Q3 2017 Earnings Call

Company Participants

- Constantine Iordanou, Chairman and Chief Executive Officer
- Marc Grandisson, President and Chief Operating Officer
- Mark Lyons, Executive Vice President and Chief Financial Officer

Other Participants

- Amit Kumar, Analyst
- Brian Meredith, Analyst
- Elyse Greenspan, Analyst
- Ian Gutterman, Analyst
- Jay Cohen, Analyst
- Josh Shanker, Analyst
- Kai Pan, Analyst
- Meyer Shields, Analyst

Presentation

Operator

Good day, ladies and gentlemen, and welcome to the Q3 2017 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 hosts for today's conference, Mr. Dinos Iordanou, Mr. Marc Grandisson and Mr. Mark Lyons. You may begin.

Constantine Iordanou {BIO 2397727 <GO>}

Thank you, Kristoff. Good morning, everyone, and thank you for joining us today. This past quarter, a natural catastrophe significantly impacted the industry with three major hurricanes, large earthquakes in Mexico, and other ongoing events that are likely to make 2017 one of the costliest, if not the costliest for the insurers in history. Although, we were impacted by these losses, our diversified platform and good investment performance make this quarter an earnings event for us, and I'm pleased to note that our book value per share increased by a penny in the quarter to $59.61.

Based on expected industry catastrophe losses in the range of 80 billion to 100 billion, Arch estimates after-tax net losses of 320 million from all events in the third quarter. We have arrived at this estimate through a combination of top-down model industrial loss estimates, and a bottom-up review of reported losses from our insurance.

I am sure many of you are puzzled as I am that by aggregating all the reported losses so far and adding an estimate for those companies and markets that have not yet reported, we cannot get anywhere close to the bottom end of the model range. While those losses are significant, this quarter again demonstrated core principle of Arch risk management philosophy.

As expected, returns from property and property cat risk have declined over the past several years. Our underwriters who are focused on risk-adjusted returns, and accordingly, significantly reduced their writings. Implementing this approach is not easy as competitors in both the traditional and alternative markets have accepted business at margins we deem inadequate. However, the witness of these margins are only exposed in a volatile catastrophe year like 2017.

As a result of these catastrophe losses in the third quarter, we are reporting a net loss of 52 million for $0.39 per share; and on an operating basis, a net loss of 107 million or $0.79 per share. Arch remains in positive territory for the nine months with net income of 363 million and operating income of 260 million for the nine months ending September 30, 2017. And we expect a positive year by year-end.

Now turning to third quarter results, our reported combined ratio was 110% in the quarter on a core basis. Mark Lyons usually defines that and in a moment will give you the definition, and includes 30.7 points of catastrophe losses, partially offset by 5 points of favorable prior year development from all three segments in the quarter.

Catastrophe losses push our reinsurance segment combined ratio to 127.4 combined ratio in the third quarter, although excluding, catastrophe activity and prior year development, the combined ratio improved to 96.9 sequentially in the third quarter of 2017, as large attritional loss activity in a property fac unit moderated. Catastrophe losses also increase our insurance group's combined ratio in the quarter, which rose to 138.7% combined ratio. Excluding catastrophes and prior year development, the combined ratio was 98.9% in the third quarter, compared to 99.4% in the second quarter of 2017.

This quarter's catastrophe events also demonstrates one benefit of diversification into a mortgage insurance business with earnings from mortgage substantially offsetting losses in our other two segments. While we expect a temporary increase in delinquency notices to occur from these natural catastrophes, we believe the language of our master policies generally preclude liability for the mortgage insurer, when a home has suffered extensive physical damage, and historically actual losses from catastrophic events such as Hurricane Katrina have been minor -- had minor effect in the MI industry.

Mortgage segment excluding prior year development improved its combined ratio slightly to 42.2% from last quarter. Integration of the US primarily mortgage operations continue to progress very well, and it remains on or slightly ahead of our target. Marc Grandisson and Lyons will be give you more flavor on that.

Net investment income for the third quarter of 2017 was 94.1 million or $0.70 a share, and increased marginally from the second quarter. As you know, we manage our investment portfolio on a total return basis which on a US dollar basis was a positive 160 basis points for the quarter, and a 126 basis points on a local currency basis. Our equity and alternative portfolios were the principal drivers of the quarter's returns.

Before I turn the call over to Marc Grandisson, I would like to discuss our PMLs. As we mentioned last quarter, we are also reporting to you our exposure to mortgage risk from a systemic stressed event or what we call a realistic disaster scenario for RDS, which at the end of the quarter is stood at 15.7% of tangible common equity. We have begun using tangible rather than stated equity as a result of the United Guaranty Corporation acquisition, as we believe that this is a more prudent risk management base.

Our property cat exposures are substantially the same as last quarter with our 1-in-250 year peak zone, which is continues to be the Northeast PML, which is at 6.6% of tangible common equity. You will see additional PML numbers in our 10-K which is being filed.

I will now turn over the call to Marc Grandisson to comment on our operating units and market conditions, before we go to Mark Lyons for financial reporting, and then we will take your questions. Marc?

Marc Grandisson {BIO 4369887 <GO>}

Thank you, Dinos, and good morning to you all. This was an eventful quarter for the millions of people directly affected by catastrophes, as well as the insurance industry and for those of us at Arch. Before discussing the events of the quarter, it's worth commenting on some of the recent management changes that have occurred here.

One of our senior executives and an important member of our management team, David McElroy decided to retire. Fortunately, our deep bench included our highly regarded colleague Nicolas Papadopoulo, who agreed to take on the insurance leaders role. In turn, this allowed Maamoun Rajeh to step up to lead the Reinsurance Group. Both had been with us since 2001 and are terrific executives with a proven track record. We thank Dave for his leadership and are pleased that he has agreed to continue making his contributions to Arch as a respected Senior Advisor to the company. I'm also looking forward to Nicolas and Maamoun flourishing in their new roles.

Turning now to the third quarter cat events, I would like to add my thanks to our underwriting teams who have a demonstrated discipline as reflected by the decrease in our property writings over the last five years in response to declining premium rates. In cat exposed business lines on a gross basis Arch rolled over 800 million of property and marine premiums in 2017, and at the right risk adjusted price we have available capacity for additional property risk.

To put again our capacity in perspective, our 1-in-250 single event PML is still very low at 6.6% of tangible common equity, which allows us to increase property writings should pricing improved materially. We believe that the third quarter cat events will approve difficult to assess, especially on the insurance side. The potential issues with flood and business interruption coverages as well as the assignment of benefits issue in Florida create uncertainty in the estimation process. As a result, we estimate a greater share of our aggregate loss will come from the Insurance Group.

Turning to current property market conditions, we are still evaluating our tactics as the market remains in flux. If 2005 is any guide, and we have some reason to believe that it could be, it will take several months for the market to find an equilibrium. However, for cat exposed business we believe that substantial rate increases are required to achieve an acceptable risk adjusted return.

Focusing on the P&C insurance market conditions, they remain challenging although we have seen some rates stabilize towards the end of the third quarter, particularly in the property sector. Most other areas has continuing rate adequacy erosion. After factoring in rate changes of a positive 190 bps and an overall loss trend year-on-year over approximately 200 bps, we had small margin erosion of 10 basis points for all lines in the third quarter in our US P&C insurance operations.

Our low volatility businesses continue to achieve rate increases, while the more complex high capacity, more commodity-driven lines of business continue to see rate decreases. Our third quarter view consistent with the last several quarters was that most areas of the P&C insurance had expected returns that are below or our threshold to grow our writings in these lines.

Turning now to reinsurance. We continue to focus on the opportunities that have relative rate strength. We are hopeful that more favorable returns will be available in property, but as always, we will have to see how the January 1st renewal will settle before we have a clearer view of the opportunity.

Our reinsurance net written premium increased by 35%, largely due to a specific loss portfolio transfer transaction, as well as some reinstatement premiums from the cat events. Excluding the effect of these distortions, our growth was more modest at 8%. This growth is due to our seizing niche opportunities such as motor and some specialty reinsurance. Our property writing decrease due to market conditions as our Reinsurance Group continued to focus on margins.

Now, switching gears to mortgage insurance or MI, as stated in prior quarters, the earnings contribution from our MI segment is again proving to be a diversifying offset to difficult conditions in our P&C operations. Our MI segment expense ratio improved to 20.6% at the end of the third quarter, while our new insurance written and NIW in the US was 17.7 billion for the third quarter, a slight increase of 2% over the second quarter, largely due to our targeted decrease in single premium business.

Although not all MI companies have reported yet, we estimate that Arch U.S. MI's market share may have dipped slightly below 24% in the third quarter of 2017. This is consistent with our expectations as we focus on improving the risk adjusted returns of our mortgage portfolio. I n the third quarter, 80% of our US NIW came through our risk-based pricing platform, which as of last week, is fully integrated into a single rate star module. We are writing primary US MI business with an expected ROE still above our long-term target of 15%.

The overall quality of the risks written remained very strong and we continue to experience favorable development in our US MI reserves, consistent with what you may have heard from others. Arch wrote five new US GSE credit risk sharing transactions or CRTs, bringing our total risk-in-force from them to approximately $2.5 billion at the end of the third quarter of 2017. Average yields in the CRTs remain healthy and ROEs are above our long-term targets. However, competition in this space is heating up and this could affect our risk appetite for new writings in coming quarters.

We executed our first mortgage capital markets transaction this week, Bellameade Re, which is a risk management tool in helping manage our capital. We view the market's growing acceptance of the security confirmation that the mortgage market is originating products of very high credit quality with low risk of default.

In summary, we will be preparing for opportunities that the market allows, but as always we will be disciplined and opportunistic.

Now, here's Mark with the more detailed financial analysis. Mark?

Mark Lyons {BIO 6494178 <GO>}

Great. Thank you, Marc, and good morning, all. First, I'll make some summary comments for the third quarter all on a core basis and as a refresher the term core corresponds Arch's financial results excluding Watford Re, or the other segment, whereas the term consolidated includes Watford Re.

I did notice that a lot of the analyst reports, the preliminary analyst reports were pulling combined ratios that are -- the consolidated combined ratios which is really not accurate, that's a 180 basis points more than core, if you take the 11% rather than 100% of Watford, it only moves up 20 basis points to 110.2 and that's the proper way to look at it.

It's worth noting that our operating earnings per share for the quarter reflect in accordance with GAAP, the use of basic shares, rather than fully-diluted shares, since the company incurred an operating loss. This translated to nearly a $0.03 increase to the operating loss per share, approximately 4.4 million fewer shares were utilized in the operating EPS calculation. However, on a year-to-date nine-month basis, fully diluted shares are utilized since the Company has positive operating income also per cat.

Claims estimates recorded in the third quarter from 2017 catastrophic events, net of reinsurance recoverable and reinstatement premiums as Dinos mentioned, were 30.7 loss ratio points compared to 1.3 loss ratio points in the third quarter of last year on the same basis. Approximately, 348 million of pre-tax losses and nearly 320 million of after-tax losses emanated from hurricanes Harvey, Irma and Maria along with the Mexican earthquakes with the balance reflecting minor adjustments to estimates by catastrophic events that occurred in the first half of the year.

Approximately 62% of the quarter's catastrophic loss estimates stem from the insurance segment and 38% from the reinsurance segment. In total, hurricane Harvey accounted for 37% of the quarter's cat losses, hurricane Irma accounted for 45% and hurricane Maria 16% and 2% in total for the balance. As for the California wildfires that occurred during the fourth quarter, our early read is that, it will be about $25 million to $30 million, which is roughly equal to our quarterly cat load.

As for prior period, pure net loss reserve favorable development, 5.4 loss ratio points was reported in the quarter led by the reinsurance segment with approximately 60% of the total, the mortgage segment accounting for approximately 35% of that favorable development and the insurance segment with about 5%. Approximately 70% of the mortgage segment favorable development emanated from the US primary first lien portfolio and about 22% stem from net favorable development, resulting mostly from subrogation recoveries by the second lien portfolio that came over as part of the UGC acquisition, and that is a one-off operation. The reinsurance segment net favorable development was across short, medium and long-tail lines and was scattered throughout the 2002 to 2014 underwriting years.

The overall calendar quarter combined ratio on a core basis was a 110% and when adjusting for cats in prior period development, the core accident quarter combined ratio was 84.4% compared to 93.4 in the third quarter of 2016, driven mostly by the mortgage segment's accident quarter combined ratio of 41.2%. The reinsurance segment actually quarter combined ratio, excluding cats at 96.9% compares to the third quarter of 2016, 96.4%, while the insurance segment's accident quarter combined ratio, excluding cats was 98.9 as Dinos mentioned, compared to 97.7 in the third quarter of 2016.

The reinsurance segment also participated in a $45 million premium size retroactive reinsurance transaction as Mark Grandisson noted, that contains sufficient risk transfer under GAAP for insurance accounting treatment. The reinsurance segment calendar combined ratio is 4.5 points lower this quarter due to the inclusion of this transaction. Without this transaction, the reinsurance segment calendar quarter loss ratio would be 40 bps higher and the expense ratio would be 4.1 points higher.

And this should be considered when examining the quarter's combined ratio. Now, this transaction also created distortions on a current accident quarter basis. When adjusted, the reported current accident quarter loss ratio and combined ratio of 63.5% and 96.9% respectively becomes a lower 58% accident quarter loss ratio and 96.4% combined ratio there, but thereby revealing stronger underlying fundamentals.

The reported Insurance Group accident quarter excluding cat, the loss ratio increased approximately 30 basis points quarter-over-quarter and after controlling for large attritional losses actually increased by approximately 80 basis points due to the lower level of such losses this quarter versus the third quarter of 2016. As a result of the ongoing competitive conditions in the P&C markets, we continue our conservative approach towards current accident year loss picks.

However, the difficult conditions in the insurance and reinsurance markets were more than offset by the continued improving profitability of the mortgage segment, amplified with their net earned premiums being a larger proportion of the total. The mortgage segments accident quarter combined ratio as stated earlier improved to 41.2% from 55.8% in the third quarter of last year and the net earned premiums represented similar to last few quarters about 25% of the core net earned premium, compared to only 9.1% in the third quarter of 2016.

Remember that in the mortgage segment, accident quarter has a different connotation than in the P&C world as a more similar in concept, the claims main businesses in the P&C space since the notice of default defines the assignments to the appropriate quarter. Earlier Mark Grandisson had commented on the Bellemeade Re mortgage linked note that was executed this week, the cost associated with this 10-year term cover will be approximately $11 million of ceded premium for the first year, first fiscal year and will then reduce as the underlying unpaid principal balances amortized through the securities.

So with the last quarter, there were some non-recurring costs in the third quarter, resulting from UGC acquisition. This quarter such non-recurring costs totaled $3 million even in contrast to last quarter's 2.7 million and the first quarter of 2017's 15.6 million. The sources of cost emanated from severance outplacement and trailing UGC transaction costs. During the third quarter, there were 56 mortgage employees that were noticed for an October 1st termination date in accordance with GAAP similar to last quarter, the severance costs associated with these employees were accrued.

This brings the year-to-date employee reduction totaled to 338 and additionally 28 contractors have been eliminated in the quarter, bringing that year-to-date total to 87. When combined with the actions taken in the first and second quarters of 2017, the cumulative quarterly run rate employee salary savings are 8.3 million per quarter, which will be 33.2 million on an annual basis. We will continue to comment in future quarters about any other actions that are taken and their associated financial impact.

Pure severance costs for the first 9-months of 2017 totaled 13.2 million. And given the nature of these expenses and consistent with last quarter, we have excluded this 3 million from operating income as they are not part of our true operating performance. As a respect, the effective tax rate with our changing portfolio and geographic mix,. the third quarter of 2017 tax rate on pre-tax operating income of minus 7.4% require some clarification.

The US property and casualty companies within the US tax group although incurring material underwriting losses due to the catastrophic events discussed previously, had these losses overshadowed by the gains emanating from our US mortgage unit. This put the US tax group in a tax-paying position even though the Company overall sustained operating losses. The underlying effective annual tax rate grew to 19% even from the year, for the same basic reason, which is a lower level of estimated full year operating income then was forecasted as of last quarter.

The increase in the estimated effective annual tax rate causes the first two quarters of 2017 to be re-evaluated this now at higher rate and this impact reduced earnings by $0.20 per share. Therefore, this tax adjustment is directly derivative from the catastrophic loss estimates. And as a reminder, our tax rate is affected by varying mixes of income by geographical distribution and any associated changes on local tax rate.

As for after-tax operating income, earnings per share and accretion realized in the third quarter from the UGC acquisition, we examined our results with and without the impact to the acquisition and the accretion remains consistent with past quarters and continues to move towards the initial 35% target. In a similar vein, I'd also like to clarify that in last quarter some aspects of the profitability contributions from our three underwriting segments insurance, reinsurance and mortgage.

As stated earlier, when discussing the earnings per share accretion the relative underwriting income is distorted by the catastrophic events this quarter. So if you adjust for a long-term cat load, as well as allocating intangible asset accretion and debt servicing costs and dividends and so forth by units, on a year-to-date basis, the mortgage segment accounted for 60% of pre-tax operating income and the balance being 40% split with the reinsurance segment being 23 and insurance segment, 17%.

Management however continues to evaluate performance for the operating segments, primarily by underwriting income. And views and manages the investment function as a total return basis across all three segments. This alternative view that we just provided may provide you additional insight into our sources of overall profitability.

It should also be stated that the increased efficiency of the profit streams, provided by the mortgage segment permitted our after-tax catastrophe losses to only represent less than two quarters of operating earnings, using the previous four quarters as the reference baseline. On a GAAP basis at September 30th versus year-end 2016, our debt to total capital ratio at 19.3% and total debt plus preferred to total capital ratio was 26.3%, down 240 basis points from year-end 2016. This leverage reduction was due to a combination of paying down 100 million of our revolver facility debt this quarter, and growing common equity over the last nine months, driven by retained earnings.

During the third quarter, we partially redeemed $230 million of our Series C preferred shares. These shares carried dividend rate of 6.75% and were replaced with the new Series F that achieved 5.45% annual dividend. This amounts to a $3 million annual savings. There was an associated charge of 6.7 million to net income, not to operating income or book value to recognize the original costs associated with the Series C issuance as result of the redemption.

Core operating cash flows were 440 million, up 19 million relative to the third quarter of 2016, and this increase was primarily driven by growth in net premiums collected primarily in the mortgage segment, partially offset by a higher level of net paid losses in the P&C operations.

Book value per share increased at mighty $0.01 per share and tangible book value increased 0.4% sequentially this quarter. Tangible book value growth outstripped book value per share growth due primarily to intangible asset amortization.

So with these introductory comments, we're now prepared to take your questions.

Questions And Answers

Operator

Thank you. (Operator Instructions) Our first question comes from Elyse Greenspan from Wells Fargo. Your line is open.

Q - Elyse Greenspan {BIO 17263315 <GO>}

Hi, good morning.

A - Constantine Iordanou {BIO 2397727 <GO>}

Good morning.

Q - Elyse Greenspan {BIO 17263315 <GO>}

My first question, just going back to some of your initial commentary on the conference and the market outlook, Dinos, in the past and Marc as well, you guys have mentioned you kind of told you underwriters put your pens down, let's wait for the market to turn. Are you thinking about telling them to get more excited and get ready to write more business at January 1? And then I guess or is it your expectation, if rates are more and I guess this is more a reinsurance question, more in the impacted lines, would that be something that we wouldn't really get more firmer pricing until some of the US renewals later on in the year?

A - Constantine Iordanou {BIO 2397727 <GO>}

Well, it's a good question, but it's a complicated question. Let me say this. We look for moments like this as a company by being patient in the years that pricing is not good. We get excited when prices might get much better. We don't know yet as to where this thing is going to go.

Let me share some facts with you. If you had the reported losses so far, it is 31 billion plus a number of major facilities that haven't reported, meaning the retro alternative market Liberty Mutual, Berkshire Hathaway, State Farm, et cetera. Even if you come up with some good estimates for those losses we might get to 45, maybe we get to 50, it's a long way from 80 to 100. So I believe that either the models that predicting much bigger losses which nobody seems to have that point of view because everybody's agreeing that this is an 80 billion to 100 billion aggregate event for the industry or maybe even more. So stay tuned in further development.

If we go back and we look at historically, Irma developed by 68%, Sandy developed by 70% for the industry and Katrina we got it almost right, it only developed by about 20%. So I anticipate upward developments to happen. I believe that we were very prudent in establishing our numbers because you have to do bottom-up and a top-down approach, and we actually waited more the top-down approach, which is how big is this, what is our market share, where we have exposure. And as Marc said, we were cautious with our Insurance Group and we put what we believe is reasonable numbers for us.

But depending what happens in the next quarter, and it depending what happens to pricing, I think we would be ready to do quite a bit more if the returns that will be acceptable to us. So with that I'm going to turn it over to Marc because he works with the units more day to day and he will give his comments too.

A - Marc Grandisson {BIO 4369887 <GO>}

Yeah. I think more practically what's happening right now is we're in a planning process, right. We have a portfolio, which I mentioned, a substantial portfolio of property that's going to be renewed over the next 12 months, hopefully renewed in the next 12 months. And right now our -- both our insurance teams and our reinsurance teams are actually going through the portfolio and assessing which one we need to get rate, no further rate increase or higher rate increase, and sort of planning ahead as to what -- how we're going to react.

The problem that we're seeing right now is there aren't that many renewals as you pointed out for the reinsurance up until the 1st of January. So we have a lot of time and had a lot of discussion, and as you can appreciate, there is a lot of positioning by the various players in that market. So we'll probably not know realistically how the reinsurance market plays out until very late in December. But we're going to have all the things laid out in front us knowing exactly how to react.

On the insurance side, we've seen a couple of things emerge, a couple of rate changes. We've seen -- the first we started hearing is a normal rate decrease, which is a good place to be. But the rate increases are sedate for now. There are a little bit, they're coming up single to double-digit, but it's very sparse. There aren't many things renewing right now.

Again, we're very much on the reactive mode right now, evaluating on a weekly basis. Now Nicolas and Maamoun and their respective teams are talking constantly as to what's going to happen.

Yeah. One more comment about the available capacity in the marketplace is very, very hard to be estimated because some players, they have significant capacity, only because they believe that they have good support from the alternative markets and the retro markets. So the underpinning of their capacity on a gross basis is because that market was significant and it was reasonable pricing. As a matter of fact, we were buyers in that market.

We have no view yet. That's what is still in our minds. We have no view as to what's going to happen to the market and then what will be the reaction of companies that they said. I can do more on a gross basis, because I got all these protection behind me, so I can be a little more aggressive in the marketplace and maintain customer relationships, et cetera. So it's all interrelated, and as Mark said, our teams of there, we're willing and able, we have capacity, but it will depend all on expected returns based price.

Q - Elyse Greenspan {BIO 17263315 <GO>}

Okay, great. I appreciate all the color. A couple of other numbers question. In terms of the tax rate, I guess should we just expect go back to around 14% in the fourth quarter and onward?

A - Mark Lyons {BIO 6494178 <GO>}

Well, think of it this way, Elyse. The 19% contemplates a full-year view. So if the fourth quarter is more average with normal cat loans and we talk a little about California wildfires, the 19% should hold.

Q - Elyse Greenspan {BIO 17263315 <GO>}

Okay. And then in terms of the mortgage segment, can you tell us kind of what the delta in terms of some of your additional severance cost? What expenses we could expect to come out in the fourth quarter versus the third quarter in terms of your operating expenses?

A - Mark Lyons {BIO 6494178 <GO>}

Long term, I quoted salary expenses figures, so that's a run rate of 8.3 per quarter. To the extent that there is any other actions contemplated there, we only talk about that once it happen for a lot of employee morale and other aspects or reasons. There are associated additional costs with other kinds of compensation, employee benefits and so forth. But we don't, we really don't comment on that. But there is a lot of ongoing work with IT that over the next couple years when redundant system start to be peeled away all those savings and associated license costs will come to fruition.

Q - Elyse Greenspan {BIO 17263315 <GO>}

And then in terms of the acquisition cost -- cost ratio itself also came down in the quarter, how should we think about that in terms of the mortgage business going forward?

A - Mark Lyons {BIO 6494178 <GO>}

Well, first off, you should think about them in total between DAC [ph] and OpEx, because there is always -- you may think back to what we did at the end of the year, last year, because there's some -- and so like direct sales force. So some of that goes into acquisition and remember, as a result of the purchase all the DAC are really written off. So it's really varied within the intangible assets. So as one-one [ph] and subsequent as we write more business, that's on a single basis it creates a UPR, that PR grows, that grows and that has to be created over time. So it should be seeing an increase in the acquisition ratio.

Q - Elyse Greenspan {BIO 17263315 <GO>}

Okay, that's great. Thank you very much.

A - Mark Lyons {BIO 6494178 <GO>}

You're welcome.

Operator

Thank you. Our next question comes from Josh Shanker from Deutsche Bank. Your line is open.

Q - Josh Shanker {BIO 5292022 <GO>}

Yeah. Thank you. I was wondering if you guys can help me out a little bit and think about the move to getting less exposure to property cat over the last, you know, call it, five years even longer maybe, how much of that is relying on the retro market to be affordable and how much of that is in the gross premiums of the company?

A - Constantine Iordanou {BIO 2397727 <GO>}

I will give you my comments and Mark might add to it. Listen, independent of the retro market, we always look what is the pricing and what is the market accepting as expected return on that business. When that business started going to single digit expected returns, we're starting to lose a lot of interest.

And having said that, we do have a customer base that we want to maintain and continue to service. So then that's when you look around and you say, maybe at combine more protection, even that protection is available, and it will allow us to maintain, you know relationship. But the reduction, clearly the reduction in our writings, it was driven by our view that the pricing of that business was not adequate for us and for that reason. You can't go to zero and as a matter of fact, it's more difficult on the insurance side, to cut as much back than on the reinsurance side, because you got brokers, agents, relationships or customers. So in essence, sometimes you do -- had you bet by buying more protection, and we've done all of those things.

If and the market improves significantly, you might see a different approach. We might keep a lot more than that and we have capacity to do it, and also you might see us expanding our exposure base because we like the pricing. Don't forget we understand, we're in the business to deploy capital and make money for shareholders and we're not unwilling to take risk. We're just unwilling to take risk at an adequate pricing.

A - Mark Lyons {BIO 6494178 <GO>}

Josh, we look at the reinsurance purchasing on, specific on the reinsurance side. They are still partners of ours and we fully expect them to be there going forward next year and the year after as the market were to present itself. But I would say that they certainly helped us managing the net exposure because the market was indeed getting softer for last five years as you know. We actually -- I would say that between our gross, our appetite to the market and relying on our partners, probably a 50-50 split between our management and the exposure, so that probably allowed us to stay a bit longer, while -- and we're not over -- the overly reliant, if you will, on the retro placement. So, because at the end, they were nice to have. I think that our partners will still be there for the long haul. But we're not relying on this to write the business going forward.

Q - Josh Shanker {BIO 5292022 <GO>}

Thank you very much. And one other unrelated question. In terms of the amount of earnings being suppressed in the UGC transaction due to your reinsurance relationship, sort of two questions. One, I think at the Investor Day you spoke about the potential that you might think about doing that for a longer period in terms of reinsurance relationship of AIG. Just want to hear an update about that. And two, AIG provides data about how much the -- that relationship is helping their P&L but it seems to jump around a lot. Is that revenue steadier in your books or can we use AIG's numbers about UGC to understand the degree to which Arch is currently under earnings its potential?

A - Mark Lyons {BIO 6494178 <GO>}

Good questions. I think I'm going to turn it around a little, because I think you actually, your statement actually answered your question. Now they don't have exact mirror accounting, as well as they come up with their own views and estimates. But I think from an EP, earned premium, net earned premium, ceded earned premium to then assumed earned premium. I think that's a reasonable way to look at it, but clearly we're starting to downsize of the effect of the AIG quarter share diminishing each quarter.

Q - Josh Shanker {BIO 5292022 <GO>}

And whether you would renew it or is there any talk about doing that?

A - Mark Lyons {BIO 6494178 <GO>}

No, there is not, there was not a renewal of that. That was 14 through 16 --

Q - Josh Shanker {BIO 5292022 <GO>}

You won't do anything on the (inaudible) with AIG or anything like that.

A - Mark Lyons {BIO 6494178 <GO>}

Well, if we did, it wouldn't be down yet and I wouldn't be speaking about it. Everything is possible, Josh.

Q - Josh Shanker {BIO 5292022 <GO>}

Thank you very much.

A - Mark Lyons {BIO 6494178 <GO>}

Okay.

Operator

Thank you. Our next question comes from Amit Kumar from Buckingham Research. Your line is open.

Q - Amit Kumar {BIO 15025799 <GO>}

Thanks and good morning, and thanks for taking my questions.

A - Constantine Iordanou {BIO 2397727 <GO>}

Amit, speak up, because we can barely hear you.

Q - Amit Kumar {BIO 15025799 <GO>}

Is it better now.

A - Constantine Iordanou {BIO 2397727 <GO>}

Yes.

A - Marc Grandisson {BIO 4369887 <GO>}

Yes.

Q - Amit Kumar {BIO 15025799 <GO>}

Thank you. So two quick follow-up questions. Number one is just going back to the discussion on industry losses. And I want to be clear that I understand this. Do you feel, based on your statements that the industry loss will eventually get to the models numbers we're hearing about? Or do you have a feeling that these models -- there was a lot of divergence between the numbers, overestimated the numbers? I guess, I want to understand if we are overestimating here, then clearly, the market does not turn and the optimism is a bit overdone?

A - Constantine Iordanou {BIO 2397727 <GO>}

Yeah. First and foremost, what I am saying is that everybody seems to congregate against the 80 billion to 100 billion, both the modeling agencies if you take average or point estimates for each of the storms, and also a lot of our competitors including us. So I think the market was probably the projecting the right number now. I don't know every company's book, I'm just making aggregate comments. But something doesn't add up, either the number is going to come down and your hypothesis is correct , if it comes down people, they're not going feel it is much on their P&L.

So in essence, they might not, the market correction might be toned down. On the other hand, if you go to historical performance, model never overestimated losses in the past and we usually are only estimates as an industry, they were below what they ended up. So I will leave you the judge of where do you think it is going to happen.

I think we are going to have an effect that is not going to be felt totally for another two or three quarters, before we know where these things are going to end up. Moving away from modeling for one second, Amit, I think if you move, if you park aside, Maria because this one has probably most uncertainty in terms of modeling in alternative projection. It's really hard for us internally, based on the modeling -- based on what we know in terms of damage?

What happened is very hard to even consider that both Harvey and Irma are less than 25 billion each. That all already takes us to the 50 billion. So before even considering Maria and the other event that's happened. So that's why we're sort of building from there to, it is not reach to get 70 billion, 80 billion, 90 billion. But I guess only time will tell, but I think it's very hard in isolation, to just look at these two losses and think that they're going to be like 15 billion each. It's very difficult for us and that the implications of the industry losses that that we've seen reported so far that these two losses will be a lot less than you've seen at this point.

Q - Amit Kumar {BIO 15025799 <GO>}

Got it. That's actually helpful. The only other question I had was I guess going back to what Elyse and maybe Josh were asking. If you look at the sub segments in the reinsurance segment, the interplay between different segments. Even based on the market opportunities, should we be rethinking about I guess the total topline and the returns differently is that premature or how should we think about I guess, the capital allocation between the different segments at this juncture?

A - Constantine Iordanou {BIO 2397727 <GO>}

It's very difficult, because I can't answer you, because I don't know myself. We -- what guide us is market pricing. At the end of the day, if you tell me what is going to be in January 1, maybe I can give you some projection, but not knowing that, I really don't know. What we gear our people to do, is to look for every opportunity available, we evaluate it and if we need to be very agile and move capacity to one area versus another, we're there to do it. And, if this is -- we get another big event and fourth quarter is another catastrophe and the whole world takes upside down for January 1. I can tell you, there is a lot of actions we're going to take, including you know, looking for additional capital and be in the business you know for our shareholders. I mean, that's what we get paid to do and we're willing to do it, Mark?

A - Marc Grandisson {BIO 4369887 <GO>}

Yeah right now we're evaluating exactly this, because back in '05, it was pretty clear that the reward -- risk reward was much more advantageous to the reinsurance team. And we at that time allocated 80% of the cat capacity to the reinsurance team. And 20 therefore, for the Insurance Group. This time around is different, right because again, we don't know when the -- where the reinsurance markets going to go, a lot of these losses are retained within the Company so it might be a different outcome on the insurance sector. Right now as we speak, the two guys leading our insurance and reinsurance are going through it, to see what kind of return they will be expecting next year. And therefore giving us a plan of action as to what they're going to do there. But they're still have to collect information as we speak.

A - Constantine Iordanou {BIO 2397727 <GO>}

The big question mark here, especially on the insurance side is, how much capacity has existed through these MGA facilities. That is somebody having the pen for somebody else and at the end of the day, their compensation is, I got to write more. I got to write more. I got to write more because they're commission-based compensation and will these facilities survive the event and get renewed and that capacity is available or, they go by their wayside or they get turns at there, they move the market upwards.

So we don't know that, because some of these facilities as is toning down what's happening in the market. They haven't expired or they might require a 6-month notice or so they're going to be used until they can be used. And they are in place now and you don't think it's going to be renewed, you're going to use it up to the last minute. So we don't know, there is a lot of things up in the air. We have our heads to the ground and we're looking at all these opportunities, but it's not a clear picture yet.

Q - Amit Kumar {BIO 15025799 <GO>}

That's correct. I'll stop here. Thanks for the answers, and good luck for the future.

A - Constantine Iordanou {BIO 2397727 <GO>}

Thank you.

Operator

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

Q - Brian Meredith {BIO 3108204 <GO>}

Yes, thanks. A couple of questions for you all. The first one, I'm just curious and maybe I missed it. Did the RDS that you provide in the mortgage include the recent Bellemeade transaction or not? And if not, what that looks like with the recent Bellemeade transaction?

A - Constantine Iordanou {BIO 2397727 <GO>}

It does include it. What will be the number without it? You have the number, Mark?

A - Mark Lyons {BIO 6494178 <GO>}

Well it's -- did you quote it what it was.

A - Marc Grandisson {BIO 4369887 <GO>}

15 --

A - Mark Lyons {BIO 6494178 <GO>}

15.7.

A - Marc Grandisson {BIO 4369887 <GO>}

15.7.

A - Mark Lyons {BIO 6494178 <GO>}

15.7, it's not much of a movement, but it benefits from that, it's a couple of hundred.

A - Marc Grandisson {BIO 4369887 <GO>}

It's 200 million.

A - Mark Lyons {BIO 6494178 <GO>}

Yeah.

A - Constantine Iordanou {BIO 2397727 <GO>}

Yeah.

Q - Brian Meredith {BIO 3108204 <GO>}

Okay, great. And then I'm just curious, you guys have Watford Re out there which is more kind of a liability facility. Are there any thoughts of creating a facility that's more dedicated to severity or cat. If indeed, the market doesn't rise enough to maybe be acceptable to you on a kind of a net basis, putting a lot more cat risk on your balance sheet where there are opportunities, potentially to do something more from a gross perspective and gets [ph] income?

A - Constantine Iordanou {BIO 2397727 <GO>}

Well we have two considerations there, one is, if the market improves significantly, we'll use a lot of our own capacity, but also we'll be very much interested in managing third-party capital because, we don't want to risk -- we don't want to change our risk profile. We've done that after Katrina with Flatiron. On the other hand you know, if the market doesn't move and there is people that they will be willing to get our underwriting skills and they're willing to accept, maybe a little less return that we will. We're not opposed to managing money in the fashion either, but that's not our preferred outcome. We like the market to get hard so we can write more on our balance sheet and maybe write for our partners also.

A - Marc Grandisson {BIO 4369887 <GO>}

And Brian, I mean I'll just appreciate you allow me to put the plug up there in the marketplace. If anybody is looking to deploy capital in the space we'd love to talk to them, yeah. Thank you for that.

Q - Brian Meredith {BIO 3108204 <GO>}

Okay. And then I just -- just a question and if you, I guess you kind of alluded, kind of was asking. Maybe you can put specifics on, how much more rate do you kind of need in property cat to kind of take more on a net basis do you think?

A - Marc Grandisson {BIO 4369887 <GO>}

Well you know, if the rates -- no, right now the returns on the space are in the mid to high-single digits. So it's not --

A - Constantine Iordanou {BIO 2397727 <GO>}

Expected return.

A - Marc Grandisson {BIO 4369887 <GO>}

Expected return. They're not extraordinary. So we've actually ask our team and as what we're going through right now. We think that to get to a 15 plus return, we would need roughly 30% to 35% rate increase. So we need a substantial increase in rate. What people forget is, we have to be careful with looking at a rate that change in isolation, I think it's been mentioned on other call is that, we are at a pretty low level compared to history for the last five or six years.

So this is why in '05 when rates went up 10%, 15%, 20%, we were in a very different market pricing with a lot better where it comes from. Now, it's not as good by any stretch of the imagination. So we will need substantial rate increase to really fully deployed and even then, Brian as you know, we're very careful with our capital management. We we'll have to see it and have a good clarity of it before we commit fully to this.

And I think it's going to take a gradual price increase. It will take time, it's going to be a dynamic process for us to evaluate as we go forward. But if you close your eyes and you roll the tape and you say the rates have gone up 50%, 60% and I think we would have a lot more appetite to take on a net basis, but we'll sort of have to work -- towards this as we see, if the market allows us.

A - Mark Lyons {BIO 6494178 <GO>}

And Brian that will be a composite, because you have to take into account the underlying ceding company rate changes as well. It might be on the company itself.

A - Marc Grandisson {BIO 4369887 <GO>}

Yeah, it's true.

Q - Brian Meredith {BIO 3108204 <GO>}

Right, right. And when -- and I guess -- adding on to that. I mean, what do you think the possibility is something like that happening given, it doesn't seem like there's been a change in the perception of risk with these events. I mean last time we had that type of rate increase, you had massive changes in the models.

A - Constantine Iordanou {BIO 2397727 <GO>}

Well I'm not -- I won't be too quick to make that judgment yet, if there is. I think smart people, they're going to step back and look at the events and say, should we change our mind about how risky this business is and what kind of returns we should expect.

A - Marc Grandisson {BIO 4369887 <GO>}

I think there is a recognition right now, Brian as we speak when we hear from our producers and from even the buyers of insurance or reinsurance for that matter, that the recognition of rates need to go up. So I think that is a -- that this consensus is building slowly but surely, but the question is how much, if it does -- if it does go up. I think to answer your question, I would need to know who and will there be some creep -- some increase in loss reserve -- in loss estimation and a few players? Will there be some change to the rating agency perception of risk? Will there be some change of the modeling?

There are lot of things, unfortunately, Brian that need to happen before everything to converge to one area which was more the case in '05, if you remember, we had a two or three things converging at the same time, which really helped it. And also frankly, we might be sitting on the next call talking to you guys about it, and still not know fully where it's going. In '05 it took another four, no, it took really between June -- May or June -- March to June of 2006 to really see the market take hold and really find its footing. So it takes a little while longer than we would expect, unfortunately.

Q - Brian Meredith {BIO 3108204 <GO>}

Right, right. Yeah, yeah it was also the release of the new -- the models came out right at that time, right?

A - Marc Grandisson {BIO 4369887 <GO>}

Exactly. You got it. Yeah.

Q - Brian Meredith {BIO 3108204 <GO>}

Great. Thanks.

A - Marc Grandisson {BIO 4369887 <GO>}

Sure.

Operator

Thank you. Our next question comes from Jay Cohen from Bank of America. Your line is open.

Q - Jay Cohen {BIO 1498813 <GO>}

Yeah, most my questions were answered. Just I guess one follow-up on the Bellemeade transaction, do you see this is as the first of others, given that this is a unique thing and you had it through the other -- and next one might be a little easier?

A - Mark Lyons {BIO 6494178 <GO>}

Yeah, Jay it's a good question. We do see that as an ongoing piece of our repertoire to -- risk management in the balance sheet. So, yes.

A - Constantine Iordanou {BIO 2397727 <GO>}

And it's not the first one, it's the third one. Because United Guaranty, they too before us and then we -- we've done the third one and we're going to use that as a risk management tool as we might use also a traditional reinsurance as a risk management tool.

Q - Jay Cohen {BIO 1498813 <GO>}

Got it, thanks.

A - Constantine Iordanou {BIO 2397727 <GO>}

Welcome, Jay.

Operator

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

Q - Meyer Shields {BIO 4281064 <GO>}

Thanks. Two questions on Bellemeade. Is the ceded written premium for Bellemeade is just going to play out over the --

A - Marc Grandisson {BIO 4369887 <GO>}

Meyer, we can't hear you.

A - Mark Lyons {BIO 6494178 <GO>}

Meyer, can you please speak up?

A - Constantine Iordanou {BIO 2397727 <GO>}

You're not coming through.

Q - Meyer Shields {BIO 4281064 <GO>}

Is it better?

A - Marc Grandisson {BIO 4369887 <GO>}

You're much better, much better. Yes.

Q - Meyer Shields {BIO 4281064 <GO>}

Okay, great. Sorry about that. I wanted to know whether the ceded written premium for Bellemeade is going to just impact I guess the fourth quarter, or will it endure over the life of the contract?

A - Mark Lyons {BIO 6494178 <GO>}

Now, that goes over time. You're going to see a sessions associated with that every quarter.

A - Constantine Iordanou {BIO 2397727 <GO>}

Every quarter. The first year is the 11 million --

A - Mark Lyons {BIO 6494178 <GO>}

Yeah, that's right.

A - Constantine Iordanou {BIO 2397727 <GO>}

And then it cascades down as --

A - Mark Lyons {BIO 6494178 <GO>}

Yeah, correct, which will be the case on every -- because there is a latter rate. We do another Bellameade its first payment will be higher and decremented, And if we do another one at in 2018, they'll be our first payment that's higher and, it will decrement.

A - Marc Grandisson {BIO 4369887 <GO>}

Yeah, Meyer, the way it works is that you have to -- it's on a -- if you look at quarterly, the amortization of the limit is amortized over time. Is -- it's 5% of risk in force and if there's persistency of 80% per year, you would expect 80% of the premium to be paid in the next year and an 8% and 64% of them were 11 million in the third year and so on and so forth. That's how the board, that's how the bond works. The 368 will amortize over time.

Q - Meyer Shields {BIO 4281064 <GO>}

Okay. Perfect. That's very helpful. And then just going retroactive reinsurance transaction, that's the second two quarters. Is there like a building market for that, that would align with probably ceding, reserve redundancies across the industry?

A - Marc Grandisson {BIO 4369887 <GO>}

You are talking about the --

A - Constantine Iordanou {BIO 2397727 <GO>}

No, no, he is talking about the reinsurance transaction market, the retroactive reinsurance --

A - Marc Grandisson {BIO 4369887 <GO>}

The loss before transfer.

A - Constantine Iordanou {BIO 2397727 <GO>}

We're seeing that market getting very active. And then we're very happy, very pleased with premium. Premium is way ahead of this initial plan, and it's testament to our team's effort and working very diligently. I think that there is a -- like we said before, I mean there is a lot of books of business, specifics -- specifically on the liability -- this is liability transaction that's why you look in the casualty unit.

This is -- there is a lot of books of business who have issues and then work. And people are trying to, and I can't blame them trying to fund a new home for to just move more away from it and just put it behind them. And this one is really meant to bring finality to that client. So I think we're going to see more of these. I think in a sense of capital management and earnings management, you can expect more companies to look at it as a very, very healthy flow of offers in the book for our Premia folks.

Q - Meyer Shields {BIO 4281064 <GO>}

Okay. That's all. Thanks so much.

A - Constantine Iordanou {BIO 2397727 <GO>}

Thank you.

Operator

Thank you. Our next question comes from Kai Pan from Morgan Stanley. Your line is open.

Q - Kai Pan {BIO 18669701 <GO>}

Thank you and good, afternoon. And so my first question is on the casualty lines. I just wonder, do you think these increasing the property lines would spread out to the casualty lines and do you see any sort of change in term underlying loss cost trends?

A - Constantine Iordanou {BIO 2397727 <GO>}

You got a multiple questions. First, we hope but we don't see it. It's -- second, it's needed but we don't see it. And your third question yes, loss cost even though we're getting slight rate increases on average. We are having difficulty in -- including us which we're pretty conservative in our underwriting maintaining the same level of profitability. As a matter of fact, we lost another 20 bps of margin between what we believe the loss cost escalation was versus what kind of rate increases we got on average. Marc, you want to?

A - Marc Grandisson {BIO 4369887 <GO>}

No, we're not seeing it right now we think it should happen but actually, it might actually be have a perverse reaction as a result of property line having losses before I look at the casualty and professional line. For us casualty got to be clear encompasses more especially in the range of more than just GL, it also encompasses -- professional line.

It could be have a perverse reaction that people use it as an excuse to get price decreases for accounts that haven't had a casualty loss in the while, because well look at the property accounts, they're giving you losses, we're not giving you accounts. So everybody will -- I shouldn't probably be using these arguments on a call to give to our clients, but I'm sure they'll be using them.

Q - Kai Pan {BIO 18669701 <GO>}

All right. Just a second question on capital management. And your cost buyback for the UGC transaction and like, do you think that you will return to buyback in 2018 in light of potentially the market pricing environment to get maybe better, you might find other place to deploy your capital.

A - Mark Lyons {BIO 6494178 <GO>}

I think if I can just start it. I think Kai, it's completely derivative to the other discussions we're having on property cat and the opportunity. If the opportunity is strong, then those are clearly a decrease likelihood of doing that on a return. So it is a totally in balance with each other, we need to see what the market is before we can really answer that.

A - Constantine Iordanou {BIO 2397727 <GO>}

If -- Kai if I have to guess. I think there is going to be price movements that it will cause us to have more opportunities in the market. So -- but we don't know, stay tuned, ask the same question in the fourth quarter.

Q - Kai Pan {BIO 18669701 <GO>}

I will, thank you.

A - Constantine Iordanou {BIO 2397727 <GO>}

Thank you.

Operator

Thank you. And our next question comes from Ian Gutterman from Balyasny. Your line is open.

Q - Ian Gutterman {BIO 3106649 <GO>}

We're not telling you, what's for lunch here.

That's okay, I actually had a question for you. Are you familiar with the game, Where's Waldo Dinos?

A - Constantine Iordanou {BIO 2397727 <GO>}

No, no, no.

A - Mark Lyons {BIO 6494178 <GO>}

My kids are.

Q - Ian Gutterman {BIO 3106649 <GO>}

Okay. That's okay, so we'll go with that. So what I found out I know where the missing losses are. Waldo took the profits from selling all those books and he wrote a bunch of reinsurance. So when you find Waldo, you're going to find $50 billion. Okay, it could be in London, it could be in Bermuda, it could be in Germany Waldo likes to hide lots of places. So keep an eye up for Waldo and you'll find the losses.

A - Constantine Iordanou {BIO 2397727 <GO>}

So when you find it, just call us, because then we might help us with our strategy going forward.

Q - Ian Gutterman {BIO 3106649 <GO>}

Yeah, you can look too, he could be anywhere. So, he might be delivering lunch today, you never know. So my first question is, what do you think -- I'm sure you listen to some of these calls and everyone's strident that they've learned from '11, they've learned from '05 and they're not going to late report this time. Where do you think the issues are, I mean, a lot of the primary companies are even saying we've closed most of our claims already.

Like it's so obvious we know what our inventory is. There is nothing that can surprise us. What are -- and you mentioned program and outside of that, are there other reasons we should see late reporting on what the primary companies are calling simple storms at least --

A - Constantine Iordanou {BIO 2397727 <GO>}

Listen. There is, I can go into a lot of directions. Flood always has been a big problem in -- look at Sandy and how long did it take, et cetera. Second, if you go to Florida, is a lot of snowbirds that haven't even gone down yet to start looking -- repairing their homes. And these assignment of benefits issue in Florida, it's going to have escalation of losses. So if they know that closing, and all that is news to me at the end of the day, I'm only going by history and history has told us that there is always been an underestimation and we have more positive escalations and negative people instead of taking reserves down, they added to over time.

So listen, if is less is less and then maybe my number is too high, but how do I know.

A - Marc Grandisson {BIO 4369887 <GO>}

I think that and you have to keep in mind, if you have a portfolio of homeowners where a straightforward plain vanilla and you had a lesser amount of risk, there is probably more likely that you'll be able to close the file that quicker. But the area where we think there's a lot more availability is on the E&S and on-occupied buildings and then that sort. And that's going to take a while for everybody to really figure out what the coverage are going to be in. You have insurers who are possibly even more sophisticated and a bit more better equipped to fight with the insurance companies. And certainly we're seeing it as with AOB phenomenon in Florida, that story doesn't help matter.

So I guess you have to put things in perspective and it depends on who you talk about. But I would agree I would echo what Dinos just said, a lot of the insured population will not probably have any -- anything settled or finalize in terms of loss estimation and indemnity paid for another six to nine months. It takes a while.

A - Constantine Iordanou {BIO 2397727 <GO>}

You're going to see real losses, a restaurant who had no real damage to the restaurant, but the parking lot was flooded. And as customers couldn't have access to the parking lot and he was going to claim business interruption because of the flooding, et cetera. And it was in a zone 5, which is not considered a flood zone. So he had no exclusion on the policy and his deductible was pretty low. All these things are going to take a long time to get resolved. And I -- like I said, it's our view and usually not a lot of people agree with that views, but more often than not we are right.

Q - Ian Gutterman {BIO 3106649 <GO>}

I agree with you, Dinos. I think we're in the minority and I agree with you. So related to that, the one that surprises me the most so far is that most people have Maria as their lowest loss storm and that's the one where I would think the greatest risk is of DI, because in Houston like I said, there are some issues with getting back on your feet. But it's not that hard. right In Puerto Rico I mean, who knows how long, right. I mean, why isn't every DI limit on the island for loss?

A - Marc Grandisson {BIO 4369887 <GO>}

Yes. This is very uncertain. We have asked our best co-underwriters that the right in that -- in the area this week actually. And again, it's still extremely opaque, there still a lot of no information, there is a lot of areas don't have power yet and things are not just back into an order. And it's going to be a long time before we figure out. But this is where a cat -- even a cat event, Ian could be a long tail event and long tail phenomena and which is, again things that we forget as an industry sometimes.

Q - Ian Gutterman {BIO 3106649 <GO>}

Fair enough. And so the other comment you made earlier, Dinos about the gross risk net line underwriting, the companies were relying on retros. So they don't have to shrink their gross. Again, I don't know how many calls you've listened to this week, but pretty much everyone who has been doing that is stay on their calls, I'm simplifying here, we're going to keep our net lines where we are and we're going to look to grow our gross. So it feels like people want to double down on that strategy, which, if that's the case, A, I'm not sure where they think, they're getting all this extra incremental capacity. But if so, doesn't that suggest it's harder to get pricing if -- sort of to Brian's question, right. Where is the pain, no one wants to shrink?

A - Constantine Iordanou {BIO 2397727 <GO>}

Well but, it's on the premise that the net to gross can work, meaning that, there is a robust retro market or quota share market that is going to reduce their net exposure. We don't know -- we haven't heard from that market yet. We knew it was in the 20 billion range and some people they might be estimating maybe 50 or even maybe 75% of it might be gone.

A - Marc Grandisson {BIO 4369887 <GO>}

And, Ian, I think you're exactly right. I think, not only on the loss estimate from the size, what the ultimate loss is going to be at the industry, but to add matter, to add even more complexity then your quite right and we talk about all the time. If I turn it to capital, it's a relatively newer phenomenon to our segment and that brings a little bit more, a quite a bit more actually uncertainty as to what's going to happen. And would add that it might increase the volatility of what could happen which could be good for us in a way as well. So it remains to be seen.

Q - Ian Gutterman {BIO 3106649 <GO>}

Absolutely. Absolutely. All right, so a couple of Arch specific things. First the retroactive contract. Should I guess that that was, you took a share of that deal Premia wrote?

A - Marc Grandisson {BIO 4369887 <GO>}

Yeah, 25% of it.

Q - Ian Gutterman {BIO 3106649 <GO>}

Okay, got it. Looking at your recoverable on the balance sheet, should I assume most of that growth was from the hurricane so that your gross was about twice your net?

A - Mark Lyons {BIO 6494178 <GO>}

Bingo.

A - Marc Grandisson {BIO 4369887 <GO>}

Yes.

Q - Ian Gutterman {BIO 3106649 <GO>}

Okay, good.

A - Constantine Iordanou {BIO 2397727 <GO>}

And you do your homework.

A - Marc Grandisson {BIO 4369887 <GO>}

(inaudible) pretty good, Ian.

Q - Ian Gutterman {BIO 3106649 <GO>}

I try. So it was late night last night, but I try.

A - Mark Lyons {BIO 6494178 <GO>}

Ian, that's perfect. Ian, for the record I'd say, you weren't one of the guys that went to the (inaudible) combined ratio.

Q - Ian Gutterman {BIO 3106649 <GO>}

Exactly. And then what I was going to say was the -- so the one part that's surprising on your losses, which is the composition. I think I know why but I just want to hear to make sure. I was surprised that the amount of the insurance just picking up like a simple thing I looked at, right is, your insurance loss from these events were basically equal to your 2011 plus Sandy, right. So it seems that I don't know, is that just because of the geography of things as because you're in certain businesses that are more property now than you did then. Does that -- I guess I was just surprised, the reinsurance isn't surprising at all, but the insurance is a little higher than I thought.

A - Constantine Iordanou {BIO 2397727 <GO>}

We're on E&S rider, and we believe the flood losses, they're going to have all these questions that I have raised, the business interruption, et cetera. So we've been cautious of estimating a loss. And the same thing in Florida, we believe that this assignment of benefit is going to have an escalation of maybe up to 30% on the cost of repairs. So we factor all that in, and that's why you see more on our insurance.

A - Marc Grandisson {BIO 4369887 <GO>}

And, Ian just to add further if we go through that the losses that are reported. And we look on the reinsurance side, right. Is that even if there were some creep up of some factoring the AOB, the flood or the business interruption, is hard to see that more creeping up into the reinsurance layers, but it's a more it's a pro rata effect on the insurance side. So we had to do a more prudent selecting the losses, reflecting those uncertainty between the insurance and the reinsurance. I think there is a lot more uncertainty on the reinsurance -- on the insurance side at this point in time.

A - Mark Lyons {BIO 6494178 <GO>}

And Ian to marry to Marc's comment to some of the ones earlier on that proportional aspect. The extent that the market losses, the industry losses start to decrease because of the proportionality on the insurance side, that will be shared, whereas some programs on reinsurance are retro markets it -- and some companies might be well think of it as an event aggregate excesses and you're really saving for the reinsurer more than just saving for your net.

Q - Ian Gutterman {BIO 3106649 <GO>}

Yeah, that makes sense. Okay, got it. Very good, thank you. Enjoy your lunch.

A - Constantine Iordanou {BIO 2397727 <GO>}

Thank you.

A - Marc Grandisson {BIO 4369887 <GO>}

Thank you.

A - Mark Lyons {BIO 6494178 <GO>}

Take care.

Operator

Thank you. And I'm showing no further questions from our phone lines. I would now like to turn the conference back over to Dinos Iordanou for closing remarks.

A - Constantine Iordanou {BIO 2397727 <GO>}

Well, thank you all and looking forward to talking to you next quarter. Have a wonderful day.

Operator

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