FINAL

Bloomberg Transcript

# Investor Day

## Company Participants

- David Gansberg, Chief Executive Officer of the Global Mortgage Group
- Donald S. Watson, Executive Vice President at Financial Services
- Francois Morin, Chief Financial Officer
- Maamoun Rajeh, Chief Executive Officer of Arch Worldwide Reinsurance Group
- Marc Grandisson, Cheif executive officer
- Nicolas Papadopoulo, Chief Executive Officer of Arch Worldwide Insurance Group and Chief Underwriting Officer of Property
- Unidentified Speaker

## Other Participants

- Brian Robert Meredith, Analyst
- Elyse Greenspan, Analyst
- Jimmy Bhullar, Analyst
- Joshua David Shanker, Analyst
- Meyer Shields, Analyst
- Michael David Zaremski, Analyst
- Philip Michael Stefano, Analyst

## Presentation

### Donald S. Watson {BIO 19175196 <GO>}

Greetings and welcome to Arch Capital Group's first virtual Investor Day. While we've all had to live through numerous challenges in this Coronavirus pandemic, for better and worse, virtual meetings have become an essential tool in our communications. Before we get started, I have just a few quick housekeeping notes. I would like to see if I can handle the technology here. One of the features of this webcast platform is that you're able to adjust the size of each of the windows, such as making a video or slide content larger as needed. Simply drag the corner of any of the windows to change the size, and you can try this now if you like because it won't affect what everyone else is seeing.

You will note that there is a restore button located at the bottom of the page. That will restore your window back to this default size simply by clicking on the blue icon with the circular arrow. There is also a Q&A box located at the bottom of the screen. Please feel free to submit questions at any time during the meeting, and we'll do our best to address. Finally, we need to note our informational statements, which I'm sure you've all seen a few times. It will come as no surprise to you that there may be a few forward-looking statements today.

If I've done my job well, none of them will cast to guidance. Actual events and results will almost certainly differ. The format for today's call is modeled on the fireside chats, where I'll throw out a few softball questions to each of our speakers, and I think you know the guys. I'd like to go, there we go, to get the discussion moving. We've also posted a loose agenda here. And while we won't match the informality of our barbecue cocktail discussions virtually, we invite you to sip your coffee, Mimosas, and Virgin Marys while we'll make our case for investing in Arch today.

As one of my first forward-looking statements, I'm guessing that we'll spend about an hour reviewing current market conditions and opportunities in our business units. And then we'll take a five-minute pause before continuing with a combination of live and submitted questions from you for another hour. One of the things that I've learned in my career is the importance of competitive advantage, and how Management teams build their culture around those competitive strengths. Successful companies have a clear focus of their relative strengths, and then they execute really well. Arch's competitive advantage is our focus on cycle management. You've heard us talk about this for a long time now. The concept is straightforward. When margins are thicker, we write more business. And when margins become thinner, we write less. It's not dissimilar to how investors periodically reallocate investments to those sectors that they think have the best expected returns.

And if you allow me to stretch the analogy a bit, as one of our investors noted in a Barron's article a couple of weeks ago, Arch is like a mini Berkshire with a focus on Specialty Insurance. We invest for the long-term. And when the markets are soft, we protect our capital. And then to paraphrase Mr. Buffett; when conditions turn and it rains gold, we put all our buckets out there.

But as we all know too well, it isn't easy to stay the course and build a sustainable model over long periods of time. And that is where building a corporate culture to sustain those strengths is essential. Since inception, Arch's history of value creation has been exceptional. And we believe the key ingredient to our success is our commitment to managing across the underwriting cycle.

So with that preamble, I'm pleased to begin our Investor Day chat with Arch Executives by introducing our Chief Executive Officer; Marc Grandisson.

## Marc Grandisson {BIO 4369887 <GO>}

Hello, Don, how are you today?

## Donald S. Watson {BIO 19175196 <GO>}

Hey, there. All right, it's worked. So Marc joined Arch in 2011 to build our Reinsurance team with industry leaders Paul Alan Gray and (inaudible). Marc, you're looking pretty good. It's been a long time since I've seen you with a jacket.

## Marc Grandisson {BIO 4369887 <GO>}

Yeah, I've got to -- yeah, it's true.

## Donald S. Watson {BIO 19175196 <GO>}

(Multiple Speakers). All of us know the way to dress up here. So you've got financer pajamas on. What have you got?

## Marc Grandisson {BIO 4369887 <GO>}

I do, I do. I will not get up. I will not stand up, but I do. I'm wearing -- just one thing I wanted to say before we -- before we started, Don, is that you said, you know, it's raining gold out there. I want to say that it's not quite raining gold yet, but I like the color of the clouds. They are deep Amber. So they're on the horizon gathering, and I think it's going to be -- going to make up for a very interesting several quarters, if not several years. So it's pretty exciting. Well, buckets are ready to go.

## Donald S. Watson {BIO 19175196 <GO>}

Little bit of artistic license here, but all right. It's Amber, not quite as valuable, but it's turning the right color. All right.

## Marc Grandisson {BIO 4369887 <GO>}

That's right.

## Donald S. Watson {BIO 19175196 <GO>}

Let's follow up our theme on creating value. And can you describe for our investors here Arch's culture around cycle management, how it was developed and more important, how are you sustaining that?

## Marc Grandisson {BIO 4369887 <GO>}

Yeah, well, first -- first, it's great to be here. I wish we could see everybody face-to-face. We certainly would -- could do with some, you know, face time with everyone, talk about the business and what's happening.

I think that today you will hear from our team that a reaffirmation that the market is giving us fair amount of opportunities, and we will confirm what you already know. It's a great time to be an Arch employee. It's a great time, I believe, to be in our shareholders. So the common -- the word that always comes back to my mind right now, Don, as I'm thinking about those questions is yes. We spent so much time saying no to things, and saying no to deals, and no to conditions and terms, and now, we're able to say yes so many more -- more times, and really, the ability to flex into that market.

It's yes to many questions, right; are the price acceptable, can we make a decent return, do we have the capital, do we have the human capital to deliver on those bits -- on those promises, and is the market sustainable? And we believe that all the answer to all of those is yes.

So it's a pretty -- it's pretty nice time to be doing this Investor Day. So I'm glad everybody could join us today. Now, I want to tell you it's very flattering to be compared to Berkshire. We have a lot of respect for them as you know. Dino [ph] has worked there. I worked there. Paul Alan Gray [ph] was also an astute student of whatever Mr. Buffett would share. So, if I may start though to just level set the table as to what it is that, and you mentioned that in your opening remarks, Don, is what is it that creates the ingredients for success.

I'll just go to Slide 7, if we can, and there we go. And this is a short list of the things that we believe are key ingredients for success in insurance. And I think that a lot of it will not be so surprising for many of you guys out there who have followed us for a while, but I thought it would be a good place to start just to -- let me set the table a little bit. Just reaffirm, and we repeat to ourselves, what is it that you're partnering up with when you partner with Arch Capital.

So number one is underwriting discipline. Like I said, by far the number one ingredient, and I mentioned, we talked about this, it is key [ph]. So it's a number one. Volume is vanity, profit is sanity; things I've heard from Paul historically. And it goes hand in hand with capital allocation, which I believe we're doing a really good job at into the cycle.

And point number two, which is really, really important and very hard for most investors to really get a sense of, I hope that today, by having the presentation by our key executives, that you get a feel that it's really shared and lived, and breathed by everyone, every day. It's all about accountability. You tell about aligning -- alignment of interest in compensation and rewards, and it's also about attracting a special type of underwriter. It takes a very special type of person to be an underwriter for a long time at Arch, where you have to be willing to let go of business, willing to go against the grain, it's a really lonely place at times. So you go against the herd, and you should be fine with this. And in addition to this, we're always going to look out to make sure that we still maintain that engagement with the marketplace, making sure our famed factory is still ready to go. Right, we've been the time over the last four, or five years, Don, as you know, where a couple of production lines were shut down. We shut down one or two shifts because we didn't just have the opportunity to really deliver the demand. The demand for our product was there, but not at the price that we were willing to offer it at. But I think we're ready to maintain a little bit of an excess investment and expenses to make sure that we can, as we are seeing right now, being take -- being able to take advantage of the market when it flexes up the other way.

Speaking to point number three, something you've heard talk about it all the time, we're all about Specialty. We believe that people matter a whole lot, but if you go to the Culture and really following the playbook that we've set up for ourselves, we need the right people. And, you know, also we believe that we need people who can think, and really make decisions, and where expertise and knowledge really matter. This is what we really -- this is where we were able to flex and really expand, and really work our craft, if you will, through the cycle.

Now, point number four and five are a little bit more boilerplate, I guess, although point four is really, really important. I think it's becoming a trademark, tongue in cheek. We've got to be careful, though, the way we talk about the reserving conservatively and certainly managing a downside. We're known to be able to, you know, even if we like something a whole lot, we do not overextend ourselves in any market. We want to be able to again, get maximum optionality when things turn around. On the reserving side, which is a very important place, I think we're going to go through a couple of the years where reserves are going to be question and ask, and re-evaluate somehow. I think we have a lot of things ahead of us.

We do believe we showed, and it's in one of the exhibits that we have in the presentation, where we are showing that we think that the results for the prior four, five years to today are not going to be probably as good as it is declared. But on the reserving side, what's also important is if you have the right amount of reserve, I think the way you've always said to me, who has controlling -- control over their reserve, control their destiny. And it's extremely important because it feeds in the pricing, number one. And second, it allows you to have a clear view of how solid and how great your capital base is, and it's especially important in this time in the marketplace.

Point number six is about diversification, and why does it matter. I gave a lot of thought to this. Why we've been diversified from day one? We're always about, Don, as you know, diversifying as best as we can. And I think it's all about the allocation of capital. So if you look at what we provide in terms of special, something that's special and sustainable for the market is that it's our ability to step back, and look at all the various ponds we can fish from, all the various areas where we could deploy capital. And the more we have -- we have many already on the insurance and reinsurance, and we're able to add MI, and some things that you'll always [ph], that you'll hear from our folks just now, and even want it for that matter.

So the more we have this access to a wide variety of places where we can deploy capital, it allows us just to use the lead levers through a cycle that much more effectively, which I believe in turn generate higher returns with a much less volatility at the bottom line. So we know we can have volatility to the top line, but I think we will forego that to get more stability at the bottom line.

I think what I've observed in -- we have -- I've grown as well as everybody else in this Company. I got into different lines of business and different areas, and I've learned one thing, and it's a bit too simple, but great ideas don't need to be complicated, right. It's that ability to flex in the allocated capital. Once you understand the one or two key levers meaning rate level, and the supply and demand in one area, one product line, I think you just allow that ability to go in and out, and know the signs that allow you to decide are just portable. You can do it in many, many lines of business. And the more we have again, the better balanced we are, and the better our results are going to be from a -- from the volatility perspective.

So those are all the ingredients that we've talked about for years, brought them from Berkshire, brought them from F&G Re. I can't pretend that we're a mini Berkshire. I think it's way too lofty. Maybe down the road, but I would be -- I would be very certain that Mr.

Buffett will be quite at ease and quite at home, feeling quite at home with our strategy, and that we were thinking about this.

So from that perspective, we have some overtones to what has been in all the key ingredients for success. Yeah.

## Donald S. Watson {BIO 19175196 <GO>}

Well, thanks for that. Marc, I like the analogy with the factory shift because I think that explains a lot during the soft market about Arch is not rising as much. So you're running one shift, maybe two shifts depending on the line a bit, if you will. And now, as we get into an improving or hardening market, you've put more shifts on. I like that analogy.

There is -- there is always a but here, and one of the things that I thought it was worth pursuing, Mortgage Insurance runs on an entirely different cycle. Help our investors understand how can we exercise cycle management in a scale business like Mortgage Insurance, where size, market share matters.

How do you exercise cycle management?

## Marc Grandisson {BIO 4369887 <GO>}

Well, that's a great question. I think first and foremost, MI has been incredibly profitable for us. And I think that you'll hear from David that we clearly have an ability to cycle management. In fact, I would argue that we already have demonstrated, but I'll let -- I don't want to take away David's time under the sun -- in the sunlight. So I'll let him speak to it. But essentially, we were already doing this, right. I mean, COVID came obviously very unexpectedly, and it created some kind of, some stomachaches, and I guess some headaches for some of us, certainly. But I think that we -- but we never steered away from having a very strong credit, and very strong underwriting focus, and we had also, as you know, the Bellemeade were there to protect us from really going sideways. And I think for now, I believe that you'll hear that our MI story is largely a good one.

I think that I would look at the housing market right now, Don, and look at the Mortgage Insurance conditions, and they're extremely strong. We actually expect this segment to continue to give us good returns for -- and for several years to come. I would even argue and I've thought there's always a silver lining to some things that the COVID-19 provided us with a bit more (inaudible) for several more quarters of really good return.

I think that the market actually took it hard that the fact that there's probably more risk. You need to be careful. And let's make sure we price rate accordingly. So that actually is giving us a little bit more momentum from that perspective. So -- but it doesn't mean that we won't be cycle managing it, we will be. I'll let David speak to it. David was also, as you know, one of the originals back in 2001. So I've seen it done very well.

So, the one thing that I want to say, I did provide that slide before, and the slide is this one, right. It's the slide about how when we bring it altogether, where -- it just gets us higher return and lower volatility, and also provides us cover. We're able to be more -- that much more prudent and careful on the P&C side, obviously, as a result of having good returns from the MI letting our 7 foot 7 [ph] center, as I talked about on the call, dunking, you know, almost effortlessly all -- even though David is quick to tell me, it was a lot of work.

I think right now, what we're seeing is for the future, it's a better story in the sense that we're going to have a more balanced earnings generation from the three units, which actually is a great place to be. And you'll hear that our guys are somewhat, you know, we're fighting for capital, which is a good place for them to be. There is a lot of returns, expectations and opportunities across-the-board.

So I think now going from not solely depending on debt -- depending heavily on MI, I think will make us, you know, with the P&C now in a rising in terms of return opportunity, I think it's going to make us that much more balanced. And again, getting us ready to do any cycle management if we see it -- that it needs to be done on the MI segment. So we should be able to move Northwest and that's a good place to be.

## Donald S. Watson {BIO 19175196 <GO>}

No, no disagreement on that, and I like that. I have a suspicion we'll come back to that theme of balance later on. Let's return to this whole question of the factory shifts and some of the growth because Arch has demonstrated a lot of growth in the P&C business this year. So why is it that Arch is growing at this point in time, and what gives you the conviction that this is the right time to do that?

## Marc Grandisson {BIO 4369887 <GO>}

Well, for what it's worth, we're pushing it for more growth. So that's what I will tell you, and you'll hear that from our guys. It's a really good time to be in this market. I think like I said before, Don, we said no so much. And we were still a -- we were a very viable market participant, very, very strong, and we had also a smaller base.

When we look back at where we were for the last four, five years, we were just under-represented in a lot of lines. We had, on purpose, made a decision to de-emphasize certain lines of business. If I look back to the next slide, which has -- it has to do with the commercial lines environment, you'll see that over the last five or six years prior to about 12 months from now, 12 months ago, you know, the mark is not increasing that rapidly. And frankly, some of them were also going down. So it was not allowing us to do this. So we had a smaller base to start from. We have an excellent reputation, a good rating and we have, as you mentioned about the factory, we have capacity in our underwriting team to really take advantage of those opportunities, right.

We're able to -- so we were probably under leverage, under -- even though people worked extremely hard throughout the whole softer cycle, saying no is no easy thing to do, if you're an underwriter. And our team did extremely well. So I think right now, we just have pent-up demand and pent-up capacity in the system that really is allowing us to flex up.

I mean, I hear from all our guys, the submission count is just through the roof, like, it's improving and increasing dramatically, and it's great because we do have disruption, that's withdrawal capacity, and we're seen as a really good market for this. And the one thing I will tell you that we're also now in the process of realizing or really -- fully appreciating is as a hard market is not just a one or two quarters.

And that's what I want people to remember, right. I want people to go back to 2002, 2004 hard market for some of you guys were there. The market did not turn at 1/1/2002 and then went soft right away. It actually got traction, started to get traction in 2000, got better in 2001, and really got its momentum in 2002, and peaked in 2004. So the hardening market is not a one quarter thing. So that's also a reason from my perspective to be that much more optimistic and positive about what's ahead of us. And I think you'll hear from our team, one of our key statement is to have incumbents, right. Another thing that we have going for us in the marketplace is we're not a new startup, we exist. We have amazing underwriting teams, great people, great reputation. We want to get to the incumbency state, so game plan right now is to really get on those transactions, those deals because we going to get real [ph] on rate.

They're already really good, very profitable, as we speak right now, finally, after all these years, and it's giving us the forward-looking and say, hey, we're going to have two, maybe one or two more years. So just -- when it goes down again, because it will, it's a cycle, as you know, Don, it's going to -- it's going to take a while. It's not going to drop like a rock. That's what people tend to think of a hard market as being a very discrete point.

It's actually a longer phenomenon. It takes a while to unfold and play out. And that's good news for us. It's great news for us.

## Donald S. Watson {BIO 19175196 <GO>}

Well, I think we'll return to some of the themes that you've just brought up in the scalability. Enough of the softball questions though, Marc. I've talked to you about this more, but it's something that has come up from a few of our investors, and I thought it'd be worth your addressing. 2020 has been a challenging year for us, and for people generally, and the big thing that our investors are concerned about obviously is our share price. It's down about 20% this year.

It's like the S&P. Last time we did this Investor Day, you spoke about alpha creation, yeah, it looks like we're falling short this year.

## Marc Grandisson {BIO 4369887 <GO>}

Okay. So that's a two-for question, right? That's a two-for-one question. So you're going to jam it at the end. That's good. Let me take the stock price first. So that's the one, I think that most of you would agree with me that it has been a really frustrating year. So if -- I want everybody to rest assured, we're all frustrated, and many of you like us are still not happy with the valuation.

So what I remind myself everyday, what I remind the Board, what I remind each other is that, in the end, what has changed at Arch? Nothing has changed at Arch, right. We're still the same team with the same playbook. And in the end, these kinds of opportunities, these kinds of disruptive times, if you will, and they were not always easy, could also create opportunities to get in the stock.

And I think that's actually not a bad place for people. So it's the next one. Let me just do this here. So we still have the same DNA, the same recipe. You saw the ingredients that we want to have success. So nothing has changed there. We also came in the year, pretty hot, right, our price to book multiple was pretty high, but there is something that I want to tell you guys. In the end, stock price opinion evaluation is really all the folks are listening right now on the call. That's their job. This is what they are responsible to do. That's what they get paid for. That's the job they do. And they do a good job, obviously, and it's not easy. I can totally sympathize with them. I think it's a great time to own ACGL, as I would say all the time, but we do not control the stock price. So that leaves us, as Management, looking at a scorecard out there, not really fun at times. But really, if you believe that our core DNA is still there, and it is, you have to look through a longer-term period, and go back to what is it as a Management team that we're trying to accomplish. And that's really important. And we've said that before, what we can control is the book value growth. That is what we're solely a 100% of our time focusing on. Of course, we look at the stock price. But we have, in our heart, in our mind, a strong belief that growth in book value will lead to growth in stock price over time. And the data is clear on this one, right? If you look at the long-term strategy, if you grow the book value, the stock price will go in tandem with that one. So our team is focusing on ROE, and on return, and on producing growth in book value.

The one thing that most investors may not fully a 100% appreciate is all the guys you're going to hear talk today, and even like all the way down to about the top 100 people in the Company, their performance share, their performance and their pay, their compensation is directly linked to the growth in book value because our Board also believes that growth in book value will generate growth in stock price. So that's what we have believed from day one, and this has not changed, even though it creates for a lot of headaches and a lot of scratching of the heads at times. I would argue that now the stock is recovering a little bit nicely. We'll see how that goes. But the book values grow this year, and we're very proud of that in this year.

So now, turning to the alpha question. I had introduced that exhibit, if you guys remember, 2.5 years ago to look as to -- because we like to keep track of things done. We're pretty competitive. We'd like to look at how we're doing versus others. And this is about return on book value. I want to make sure that people know this is what we're looking at right now. And the alpha, we looked at two ways

Number one is looking at it as it relates to the volatility of earnings that we've generated, and we still -- we're way above the line. We're about 11.5% to 12% versus a 5% or 6%, or even a bit less than this, I guess, on the -- so 7% alpha from that perspective. So it's a pretty nice place to be. But not losing sight of the economic value added, like, really making sure we clear our cost of capital. That's also very, very important for us to be able -- that we're creating value in the system, and value for society.

And on that note, we're about 3.5% to 4% alpha creation above our cost of capital. And that's really led by, again, to go full circle again Don, but our MI group pulling us forward in this time when, frankly, a lot of our folks are not even clear in their cost of capital. So I think it's something we should be -- we are very proud of, and always looking at, at every Board meeting, we actually are spending a lot of time looking at. So I think again, for that graph, very much similar to the one that I showed before, if we continue to see this P&C market improving, I think the book value will grow, and I think we're going to have a move of our dot northwest, which is where you want to be.

You want higher return and you want lower volatility, and I think this is where those kinds of market really make a difference for us, and really make a statement for what is our mission. So one of my favorite quotes from Buffett, to link everything together is in the short run, as you know, the stock market is a voting machine, in the long run, it's a weighing machine. So our job is just to grow the book value.

So if I'd step back one second from everyone, and one message I will give you -- I will leave you with is with the MI environment getting better and definitely improving and the P&C rates gaining momentum, it's going to be a fun time to own shares in this Company for the next two years, three years. I'm excited, so.

## Donald S. Watson {BIO 19175196 <GO>}

Well, thank you, Marc. I guess it's a good thing it's a holiday season because I've got an excuse. So I'm weighing a bit more already. So let's turn to our segment discussion, and we're going to begin with the Reinsurance Group here. If we can pull that up, I love this.

Okay, Maamoun. We're pulling him up. There you go, all right.

Good morning. So Maamoun Rajeh is CEO of Arch's Worldwide Reinsurance Group. He's been a part of the core team with Marc and Nicolas in building out the Reinsurance Group really from day one. So the rumor has it, Maamoun, you're good at making three pointers.

## Maamoun Rajeh {BIO 16155071 <GO>}

Well, I'll tell you what, Don, at like five -- pushing 5 -- 10 here, a lot will say that -- that's the least I can bring to the game. But yes, we like taking the three pointers if they open up, but we really prefer alley-oops and slam dunks. And we hope to have a few more of those going forward.

## Donald S. Watson {BIO 19175196 <GO>}

All right. Well, it's not an exaggeration to say that the Reinsurance Group has developed one of the best track records of any reinsurance company over the past 20 years. Marc's talked about a recipe. Is there a secret recipe? How is it -- tell -- explain to our investors, how do you sustain this level of performance through the cycle? Because it is a remarkable track record.

## Maamoun Rajeh {BIO 16155071 <GO>}

Yes. Thanks, Don. I think when you talk about the track record, to try to put it in context, I'll just take it to the next slide. And this is a slide that we've shown in the past, many people will be familiar with it, but it really does show the track record over time against what I believe is a fair group of peers for comparison. And there are really three takeaways that I'd like to quickly touch on this, Don, not to get too boring, but I'd like to highlight three key things that come out of this chart.

And that is a combined ratio of 84% over the period at Arch versus 91% for the Peers. And if we think of the margin as the difference between that and a 100, we have produced 16 points of margin versus nine for the competition. So not -- so about 1.8, not quite two times. But importantly, we look at the risk and the volatility around those returns, and a quick measure of that is sort of standard deviation over a period of time. And if we look at the volatility in Arch, it's just under 10% versus just over 15% for the competition. So, not quite half. And the third measure that we'd like to think about is over this period, we haven't lost money. We've never exceeded a 100% combined, and I've always said to our team, stay tuned to that 2017 number.

But nonetheless, it is, it is a track record that we're proud of, and Marc touched on a lot of the points here. I think really this comes down to this culture of underwriting that we have in our Group. And our team is charged with finding deals that have margin to safety, and something compelling about making that bet. And in that instance, we're a lot more similar to a retail investor if you think about putting units of exposures in the market in the investment sense, we're a lot more like a retail investor than an institutional investor in the sense that we don't have to make the bet. Our team doesn't have to call it, am I going to be a long or short on Tesla. They don't even have to bet on Tesla. They don't even have to bet on the Automotive industry.

And so we are taking bets that are compelling, that makes sense to us. And then when you add a level of sophistication and rigor to a retail investor, it makes for a real tough competitor. So over time, we've worked with what we have in the market. Sometimes it is mini dislocations, sometimes it's sub segments that we're able to work through. Other times, you know, it's structuring around creating an advantage or a buffer. And there are times where the market wholesale gives you an opportunity to just, to have fun across-the-board. Those are rare, but -- and so you step back from this system, this culture that we have, this risk management, the rigor that we put around risk, and thinking about downside well before we think of upside, and the variability in allocating even within sub segments really makes for a nice combination. But nothing makes it happen, if not for a team. And we don't say it enough out publicly, but we -- the talent that is in this group, and I'm not just talking about the legacy folks that have added a lot of value for this Company, but the deepening of the bench that we've done, the recruiting over time that we've done, as this market was a quiet market for us at least in the last five years. We've done a lot of work recruiting and building our team. And the combination, if I think about sustainability and the chance for us to continue this track record, if you take the Culture and you take this team, we've got a lot of fun days ahead.

## Donald S. Watson {BIO 19175196 <GO>}

I like that element of fun. Marc mentioned it too. Does that explain what's going on with the growth? I mean, you guys have been on fire this year. What's -- is this organic acquisition? Can you help our investors understand where this growth is coming from?

## Maamoun Rajeh {BIO 16155071 <GO>}

Yes. Let me go to the next slide that really represents what you're saying here. As everyone can see, 2019 to 2020 is a roughly 50% uplift. And importantly, for the first time in a long time, it's really inflecting through all our segments at the same time, which is great. But if you think about over time, had we been growing steadily like the rest of the market, you would have seen this muted. But the fact that we've been so disciplined over the last period of time, and I'll really take us to the next slide. This might be small to see on the screen, but hopefully, the folks have had a chance to see it. You'll see that there are a number of cycles within our segments. There are a number of gyrations, some of that correlates, some of that don't.

And what we try -- what we've done in the last -- so this is like thinking about the five years before this last 18 months to a year. And what we've really been doing -- and I've talked here a little bit about building the capabilities, and I won't go through them in detail, but we've set up stalls that we didn't have in the past. And as I think about this most recent growth spurt that we've had, I really kind of -- there's a few buckets that I would highlight, right? There are -- you mentioned M&A. There are a number of small acquisitions of teams, if we think about Lloyd's, but that's not the material movement here, but it does contribute. There are many.

I mean, if anybody has been paying attention, there's been a lot of losses. There's been a lot of activity globally in the last three years. And as we see the market changing, within sub segments, many dislocations here and there. We've been able to kind of, grow through that. And then, of course, we've had compounding effective rate rises in the business, and to the extent that we write quota shares, we pick up those rate rises through the system, and those will earn out still over a period of time. So we've picked up the effective rate rises. And then finally, as we start to see the indicators on our dashboards blink green and all of our metrics that we look at picking up businesses and kind of, we start to lean into them. We start to lean into the business, and on those renewals as this market starts to improve, position ourselves in a way that gives us the advantage.

## Donald S. Watson {BIO 19175196 <GO>}

So you've seen a lot of green lights at this point, I take it.

## Maamoun Rajeh {BIO 16155071 <GO>}

We're seeing more than what we've got, yeah.

## Donald S. Watson {BIO 19175196 <GO>}

What's your -- what are your thoughts on the sustainability of these rate increases though? We've heard a lot new entrants, Dino is out there and a couple of other guys, of course, but are you concerned that it's typical, and you know, as the market turns, that new capital comes in.

Are you thinking this is going to be a shorter cycle?

## Maamoun Rajeh {BIO 16155071 <GO>}

Well, overall, my view is that we have sustainability in the cycle. And we all know -- those of us who have been around this business for a while, no cycle is the same as the one before it. And this has signs of sustainability. I think that the fact that it's underpinned by primary rate rises, and the fact that those rate rises have quietly been in their third year, and they're rising at an increasing rate, almost a doubling sequence if you really pay attention to it. And that has a -- as a reinsurer, that has a real good healthy underpinning to clients and what they can do going forward. You add to it all the elements that we're all reading about in the Press, all the topics that are out there whether it's ILS pullbacks, the trapped capital that's about to take place.

And when I say pulled back, I don't mean to infer that these guys are out, but there has been an inflection in what they're doing. And it has had an impact on the business going forward. They've gotten smarter, and they're deploying more thoughtfully. And that's a good thing for the system. And so I think we've got a combination of things here. There is a bit more demand. There is a bit more risk off that we're hearing from our clients. And then we think about the new starts, Don, I mean, there have been new starts. On the one hand, it sort of validates a bit of the story. We haven't talked much about COVID, right, and we won't debate which level the industry loss is.

But let's just agree that at a minimum, it's an uncertain element that's come into the market. And the market has been hardening well before now. This is not a -- an immediate inflection due to COVID. COVID, it just added one material element to the story. And I think so far by my count, there has been about $12 billion of new capital coming into the system. And what's different about this time around is that the majority of it is on existing platforms such as ours. The new course have started to know companies that are out there, they've started -- I think my view is, if I think about one specifically, I think the impact will be fairly muted, as these companies have to build their teams and get out sort of a cogent message, and get their stalls set up. Over time, it does -- it will have an impact as that supply builds up, and these guys establish their positions, whatever they might be, competitively in the market. But I do believe that sentiment right now, whether you think about our peer group, whether you think about clients or brokers, is that the math has just gotten overwhelming. There is a need for higher margin in the business. And there's a convergence of thought that, that is where we're going.

And I don't think yet the new start-ups are of the size and scale, if I really think if COVID manifests anywhere near what it might manifest and if I think about the capital required just to pick up the rate rises in the business, that's not material capital to get in the way of this. It will have an impact. In the short term, for some folks around us, it's having an impact on recruitment, and disruption to staff, and so forth. And Don, I'd tell you what, if I take -- put a reinsurer head on and think about it this way, these guys become clients over time, and particularly, those sort of don't get lucky early -- don't get unlucky kind of early deals, and we like those.

So that's my thought on that.

## Donald S. Watson {BIO 19175196 <GO>}

I like your point on uncertainty in the market, and it's not just COVID losses. It's loss -- trend and what we're seeing there. So there's a lot of uncertainty on that. Last question before we move over to Nicolas and hear a bit more about that is I'd like you to talk a bit about the importance of managed capital in this market. And the reason I bring this up is I'm thinking of Arch increasing its investment in Watford, but also some investors have wondered if our appetite to underwrite on behalf of third-party capital has changed.

## Maamoun Rajeh {BIO 16155071 <GO>}

Yes, well, I mean, if we step back, we have been partners with third-party capital for a long, long time. We do have a legacy of it quietly with Flatiron. We had the largest sidecar in the property market at the time. And with the establishment of Watford, a multi-line effectively, a construct with third-party capital, which worked in some ways and didn't work in other ways, and we took some valuable lessons of that. And, of course, as you mentioned, we've brought it more into the tent with two partners of ours that know us well over time in Warburg and in Kelso. We sit on the Board with Kelso in the Premia affiliate, and we know these guys very, very well. So I mean, I think what was relevant then about Watford when we started the Company six years ago is even more so, as we have some tailwinds in this market, having a parallel balance sheet with Arch. But overall, I mean, third-party capital and partnerships with these third-party capitals is so important to us, and we've had opportunities in the last handful of years to do more in that space, particularly on the property side, but frankly, we didn't -- by choice, we didn't do. We didn't believe that the margins were adequate. We weren't going to represent them any differently than we saw them. We weren't going to attach our brand to it. And so we've taken a lot of passes on bringing in third-party capital. That's not the case anymore. We've built in -- again, as I talk about building capabilities, one of the big capabilities that we spend time on is our ILS platform, and we've built that out.

We have a lot of offerings [ph] coming through. And as this market really starts to inflect, it will be our time to participate more so for the sake and benefit of our clients, and for the sake and benefit of the platform and the fees that we can generate from that, and just really leveraging what we already do pretty well.

## Donald S. Watson {BIO 19175196 <GO>}

Well, thank you. I have a suspicion that we'll come back to this in some of the Q&A, but for now, keep up the work out, so we can see the results. It looks pretty good there.

## Maamoun Rajeh {BIO 16155071 <GO>}

Thanks, Don. Let's bring --

## Donald S. Watson {BIO 19175196 <GO>}

Thank you. Let's bring up Nicolas if we can, there we go. So you can see, we're all virtual, in different locations, and we're trying to figure out the Coronavirus on a day-to-day work environment. Nicolas is the Chief Executive Officer of our Insurance Group. Underwriting performance has not been at the same level as our other two segments, Nicolas, so either on a growth or a return basis.

Given that you've been an underwriter in both our primary and reinsurance operations, can you explain to our investors why growth in primary insurance lags, and whether you see any glimmers of gold that Marc was talking about on the insurance horizon for Arch?

## Nicolas Papadopoulo {BIO 4181040 <GO>}

Yes. Hello, Don, happy to do this. So I think, first, we have to iterate the fact that the Insurance Group underperformed, our Insurance Group during the soft market shares of the 2015 to 2018, and had so-so results during that period. So we -- we've been spending a lot of time to transform the Insurance Group and to build a platform that is evolved to provide profitable in any market.

And that's really a North Star. I think that's something she will get the current hardening of the market, that's really not so the insurance we'll talk to. Going back to my experience in the Reinsurance Group and well, I guess now as Don (inaudible) we're saying we are part of the Legacy team and the Insurance Group. I think the big difference between the two models is owning the infrastructure. I think in the platform, I think in the Reinsurance Group, you actually rent in the platform of somebody else's insurance. So -- and in doing so, I think you -- you're much more scalable.

If an opportunity shows up, and there is dislocation in the marketplace and somebody needs capital, I think you look for people -- for platform out there that you can support and provide capital to, and it's much faster, where in Insurance, I think you have to build a platform. So -- I mean, the -- but on the reinsurance side, I think you don't own the business, which is a big advantage of the Insurance Group, where if you build a successful platform, where you have a recognized expertise, you actually own it and can achieve their business for our own use if you think so.

## Donald S. Watson {BIO 19175196 <GO>}

Well, you guys have seen reasonable growth this year. And I guess not only with growth, we want to see some improvement in margins. Where is the growth coming from, and how are you positioned for further growth? How scalable is your platform?

## Nicolas Papadopoulo {BIO 4181040 <GO>}

Yes, let's bring up the slide. Okay, yes. So I think it's true that we've grown, both in 2019. I think we are about 19% growth, and again in 2020, about the same. Despite some of the negative effects of COVID, both in our middle market segment, small business have been very much impacted by COVID, and our travel -- our travel business, which is -- which was a significant unit, has been decimated, so. So I think that before I comment on the specific for all of that, I'd like to talk a little bit about the industry.

I think if you look at the -- and the situation there, if you look at it -- and I'll take the US, it's easier to talk about the US, but then it applies to the rest of the world. I think the US P&C industry is about $700 billion, and of the $700 billion about $300 billion is actually commercial lines. And the growth in commercial lines in 2018 and 2019 was about 5%.

So, but within that segment, if you look at the excess in surplus line business, growth in 2018 and 2019 was about double that, so about 10% to 11%. Next picture is showing that the growth in 2020 would be much higher than that. So you see it sort of two stories. And in addition to the excess in surplus lines, I think the large accounts admit the business has also seen major increase in -- outside of the workers' comp as well as the London market. So those are areas that are actually very dislocated today, and it's so -- and the reason for the dislocation is poor performance of those segments in the past. And some of our competitors are actually retrenching, cutting back capacity which drive prices up. I mean, with that cutback of capacity, price will move. So -- and I think in this dislocation, I think Arch is well-positioned because we've been disciplined in those areas, and we are able to take advantage of the current market dislocation.

So if you look at this slide in front of you, you see that the purple, which we call Wholesale/Large Capacity is actually the market share of our portfolio or the percentage of the portfolio that's actually exposed to those dislocated lines. So you've seen it grown from 2016 to today. In fact, our growth in that most particular area year-on-year 2019 to 2020 is about 40%. So we're growing much faster than the E&S market, which I think is a really, really good sign and tells the story of us managing the cycle the way we do it at Arch.

So I think the other two segments, just to describe quickly the portfolio, if you look at the blue, which is the Specialty and Small/Middle Market, I think that's the area that covers our program and our small retail, middle market, specialty middle market. So that's an area of growth for us because I think we are seeing today a rate above loss trend. And I think we like that area because it provides much more stable earnings down the road. So we want to expand.

And I think the last portion of the slide, like the green, it's really our franchise, which is really our loss sensitive business and our travel, where we have a known expertise. We are one of five markets in the US that have leaders in those fields. And -- but this particular year has been challenged because the loss sensitive business is actually heavy workers' comp, which is one of the lines of business that has really -- it's looking to bottom out, but has really been giving rates until now. And the travel, as I mentioned, has been decimated by COVID. So that's really the outlook.

## Donald S. Watson {BIO 19175196 <GO>}

And so Nicolas, if you --

## Nicolas Papadopoulo {BIO 4181040 <GO>}

Let me move you to the next slide because the next slide -- this slide I mean, it shows -- it's a nice summary of just what I said. If you look at the growth in the purple in the last two years, it's been 30%, 40%. If you look at the growth in the Middle Market, it's been high single-digit this year because of COVID in the Middle Market. But before, we were growing 20% because of the initiatives we were pushing through. And the Franchise business is actually growing very well because of the impact of the workers' comp difference [ph] rate, so --

## Donald S. Watson {BIO 19175196 <GO>}

Nicolas, just -- I want to take -- go back to Marc's analogy of the factory shifts, I'm just curious, you guys have been operating one, two shifts? Are you working all three shifts now? When you think about the opportunity for Arch to grow into '21, '22, are you going to have to build more plants, hire more people? What's the opportunity for Arch to grow in the years ahead?

## Nicolas Papadopoulo {BIO 4181040 <GO>}

So I would say we've hired a lot of people, as you know, and I think we are trying to really maximize the opportunity in the Wholesale/Large Capacity. At the same time, we've invested heavily in the Middle Market and to -- and our Franchise to really build up the platform. And my expectation for growth really in 20 -- in the short term, I think, is that we'll continue to grow. I think we'll continue to grow, and especially in the wholesale large accounts, in our E&S, again, London Market, and Large Capacity, D&O. And you see it on this slide, I think you see that on the right side, you see our market share of the excess in surplus market. I think we -- I don't know if people can see, but we bottom out at 1.1% and I think we are going to 1.4%. So I think we -- I'm really surprised that, that number is more like 1.6% next year. So again, I think there's still dislocation in the marketplace. People are still retrenching. And as long as this thing happen, we should be able to write new business. The other example I want to give is our book of Fortune 500 D&O.

I think if you look at that book and we go back to 2010, that's a chart on the left bottom, and this is indexed back to 2010. If you look at -- if we had 100 clients in 2010 -- I mean, 2017, which is closer to the bottom of the market, we were down to 66 clients. And I think this year, we'll be back to 100 clients. So -- and I think I would expect next year, because of the dislocation in the Fortune 500 Public D&O, to be above the 100 mark. So in my view, in 2021, we have more runway to grow in the Wholesale/Large Capacity.

So -- but I think -- can we leave the full slide view? In 2022, I think I expect this to kind of, come to an end. I think there will be at some point that supply will meet demand. And I think the market will come to an equilibrium and price would have peaked, but at that point, I think we will have -- we will have played the Arch playbook. I think we will own the renewals, and if you go to the next slide -- I need to move that. If you go to 23, sorry -- I needed some time -- if you go to 23, I mean, the example of our London business is a great one of the difference we've made, I think. We had a franchise in London that was about, I'd say average about $500 millions. I mean, we've transformed our franchise to be above $1 billion today, I think.

And we've gone from, you know, middle tier Lloyd's (inaudible) for the first time last year. I think we were in the top 10% -- so that's opened up possibilities beyond our market for how to become a sustainable provider of specialty capacity in the London market. That's really the model we want to follow. If you go to, just think of North America, I think for beyond 2022, I think as I mentioned earlier, we really want to pursue profitable growth for the growth of our opportunities on the specialty retail in the Middle Market Square. And we've invested heavily in the last three to five years on the differentiated solutions both on the underwriting and claims for our clients. So --

And I want to give two examples of this in the -- you know, that we have in our Middle Market space. I think we have the program professional lines book and what we call our private D&O portfolio, which are both -- books of business that are both above $100 million, which we started some time ago, and which have been profitable for the entire cycle.

So that's really the model we want to follow. And as a last example, I think I want to mention the acquisition of the other note middle market UK retail franchise in the UK, which I think we've been spending a lot of time to make it one of the first top five franchise in the UK to be able to deliver middle market products, and I think that will also be an engine of growth, profitable growth for the future. So --

## Donald S. Watson {BIO 19175196 <GO>}

So Nicolas, that's we move back to the regular sites, restore that, if you would, on the slides. Like the margin improvement that we saw this year, I'm just curious, one, further opportunities for margin improvement, but more importantly, I guess, as you said in the Insurance Group today, is it a different company today? In what way is the Company different in terms of hitting these margins?

So, I mean, you're growing in the right areas, that looks like. But is it a different Company, or is this just a function of the cycle and where we are?

## Nicolas Papadopoulo {BIO 4181040 <GO>}

Yeah, so first on the margin expansion. I think, you know, I think we -- we looked -- I mean, one of the way to look at it is look at our combined ratio. Actually not your combined ratio exact, and you've seen the combined ratio that has been in the high 90s finally this year in

2020, for the first nine months, dropping to 95. So that's a really good sign. I think we should -- we should expect more because, as I think Maamoun or Marc was saying, I think we are getting rate on rate, and the rates we are getting in most of our lines of business are both loss trend, and in a certain line of business as one mentioned in this slide there, they are double digit above loss trends.

So that should translate in the not-too-distant future. We've improved the loss ratios. I think on the expense side, I think we are, as this chart shows, I think our expenses are coming a little bit down, but I think we've invested a lot of money both in IT, both in process management, strategic analytics to really help differentiating our value proposition to our clients.

And I really expect that should free up a lot of capacity, and at some point, I think we'll get more benefit. We will grow faster in Premia, than the expenses which would translate in a lower expense ratio. So I mean, to your second question, is the Insurance Group different compared to which what it was, I would say, we have kept the same DNA of managing the cycle. And I think we -- I think our growth in the Wholesale and the Large Capacity line of 40%, I mean, shows that we -- we're still able to do that. I think we were always able to do that. I think I want to go back to your original comment saying the Insurance Group over the last soft market has really underperformed the Reinsurance Group, and has shown some not so attractive results. I would say that's really the challenge. I think Arch didn't have enough of the differentiated value proposition to its clients to be able to sustain profitable growth because we had to compete on price. I think the work we've been doing in the background has been to really enhance our value proposition, and to come up both in underwriting and claims to be able to be seen as a brand that people come to not just for price. So that's really the -- as I was saying earlier, our North Star for the Insurance Group to be successful going forward.

## Donald S. Watson {BIO 19175196 <GO>}

All right. No. Thank you, Nicolas. I think we're all going to be watching and hoping that we continue to see some -- both margin improvement, and if we can also continue the growth in your top line, that's also fantastic. Thanks much.

I'd like to -- if you turn over now to our Mortgage Group, move off from P&C. We're running a little bit behind. I don't know how that happened. Oh, good. We got our 7-foot center up. I would like to introduce David Gansberg. Are you going to stand up, or are we going to not be able to see you on the screen here probably?

## David Gansberg {BIO 18639197 <GO>}

Well, Don, I'm not quite sure what to make of this. I was 7'7" when Marc was talking. Now, I dropped down to 7 feet. What happened? I don't know which one it is. I lost 7 inches in the last hour.

## Donald S. Watson {BIO 19175196 <GO>}

Well, at least hopefully, you're still producing the returns in the Mortgage Group, so we'll take it at 7 foot. Dave, you started in the Reinsurance Group way back when with the starting of that Group or that team. We drafted you to run Mortgage Insurance back when we acquired PMI back at the end of 2013. You probably got involved a little bit before that, I have a suspicion.

Mortgage insurance has generated a lot of shareholder value over the past few years. The Coronavirus though has created its share of potholes for the entire sector. And we've had a number of investors question whether Mortgage Insurance really fits into the Arch Specialty modeling. I'd like to -- you to begin by describing to our investors -- why do you believe Arch MI is a good place to be today?

## David Gansberg {BIO 18639197 <GO>}

Yes. Thanks, Don. I think the reality of the situation is there's no doubt that mortgage has created tremendous value over the past four years. But I think we can sum up 2020 and the impact of Coronavirus on the business with one word, and that's resiliency. And when you look at 2020 through the first nine months, we've had more than $400 million of underwriting profit. And that's in the midst of a recession, right? We're going through our stress event now, and we're still able to generate positive underwriting profit.

And even better than that, directionally, trends are going in our favor. So if you look at our reported results, third quarter was better than the second. And it's still early, but at least to-date fourth quarter is looking even better than the third, and we'll get a little bit later to some slides looking at our number of DQs to-date. So the mortgage is double-digit, mid- to mid-teen ROE business going forward. It's a good return opportunity. It's going to help us meet our hurdles. And as Marc was saying earlier, it's really providing us some great diversification, and it lowers the overall variation of the business. And then within mortgage itself, one of the big changes we've had are there are bigger guardrails that there used to be. The business is more stable, right? It's not the same business as it was a decade ago, and many of the business aspects have been altered.

So number one, the Mortgage business itself has changed significantly and for the better. Loans and underwriting standards are higher. MI Analytics is far improved. We now have risk-based pricing engines that recognize risk layering. We're able to do more active Portfolio Management, and we can recognize economic differences by region. But the MI business model itself has changed. We're no longer a buy-and-hold business. We've evolved to aggregate and distribute with catastrophe reinsurance and mortgage insurance-linked notes are now a steady part of the business, and they protect us against major recessions. And from a regulatory standpoint, we now have risk-based capital standards through our PMIERs.

And we can better, as an industry, align risk exposure. So it's a very different business than it used to be, and there's really a lot of optimism for returns going forward.

## Donald S. Watson {BIO 19175196 <GO>}

All right. We can restore and David, you sound pretty upbeat about the MI market. You're not missing your days in the Reinsurance Group? What's your outlook for the MI? Go ahead. What?

## David Gansberg {BIO 18639197 <GO>}

Don, I'm the confident team player. At 7 feet, if you need me to get down low and play in the box, I'll do that. If you want me out on the perimeter, chucking up three's with Maamoun, I'll do that too. Whatever helps the team.

## Donald S. Watson {BIO 19175196 <GO>}

I love it. All right. So what's your outlook for the Mortgage segment next year and beyond with the Coronavirus still uncertain ahead of us? And maybe if you could walk us through where we are on the DQs right now, and how you expect that to migrate through the financials next year?

## David Gansberg {BIO 18639197 <GO>}

Sure. So starting out in a special Investor Day treat, we can go ahead and look at our November DQs. So normally, we're not releasing until the 25th of the month, but as a treat for you guys, we've got early disclosure of our November NODs and you can see positive numbers there, right? Our number of NODs is down significantly from last month, continuing that downward trend, and we have another month of cures outpacing new delinquencies. So our inventory is down again, and we're down to about 4.3% delinquent inventory as of the end of November. So again, we're now two months through the three months of fourth quarter, and these are the positive trends I was alluding to.

And then aside from just the DQ trends, I want to talk for a minute about some of the economic indicators we look at. So there's a lot of different things we look at. So I just want to focus on a few here. So we've got a lot of information on this slide. So hopefully, you can see it, but I just want to move through it quickly. So we'll start out with the unemployment rate. It's continuing to come down from the peaks where it was. We just saw the November report, and we had some mixed signals there. But overall, the unemployment rate went down. It went from 6.9% to 6.7%. But we did see some people leave the job market. But definitely coming off the highest from where we were in the second quarter.

The second point is mortgage origination activity, right. That's what's going to drive our volume. It's going to drive our new business production, and as we build our insurance, it's a force that's what's going to attribute -- contribute to earnings in future years. And both the purchase and the refinance market are very high.

Nice things about the refinances; every time a loan comes up for refinance, we get a chance to re-underwrite it and re-price it. It's another way for us to continue to manage our market share, which again, we'll talk about in more detail in a few minutes. Home price appreciation has been strong. But more than just being strong, sustainable, but it's at that long-term expectation. We've been for the past number of years between that 4% and 6% range, which is where we'd like to see things on a long-term, sustainable basis. So that's also positive and then, supply and demand dynamics are in our favor.

We know there is a significant shortage of inventory and new homes, so that's going to help continue to keep prices up and keep prices strong, which ultimately, should help us in the event that some of our borrowers become delinquent. And then two, just wanted to touch on a bit, claim emergence. So we've had a few questions there. When we think about our incurred losses in any given quarter, we're getting contributions from two different things. Number one is the new NODs, right, that's kind of easy. We get a batch of new NODs in a quarter, we put up reserves against them, but then the other component is what is our view of the changing adequacy of our loss reserves we carry for prior NODs.

And in third quarter, we made an adjustment to that. We felt like it was prudent to strengthen our loss reserves. So we did that, but in the ordinary course of business, if we set our loss reserves at the proper level when we have the new NODs reported, they will wash over time and there will be no impact on incurred losses to the extent we need to strengthen our reserves. That will come through as prior-year development in a negative sense. And to the extent that we have loss reserves booked higher than they ultimately need to be, that comes through as positive prior-year development.

So our philosophy, as you guys have all come to know and love from Arch, is to be conservative in our reserve levels. We do believe we are conservative, but ultimately, the economy will dictate where we go. So all else being equal, that's what's going to drive our incurred losses. Again, I mentioned positivity in fourth quarter with respect to new NODs and with the prospect of government stimulus on hand, we sort of have renewed positivity that we're going to get some stimulus. Hopefully, that will happen before year-end, and that's going to help us out when that comes.

## **Donald S. Watson** {BIO 19175196 <GO>}

You're going to start making predictions on political changes this year. We'll probably get some of those on the Q&A in terms of what happens on the GSE front. I liked your analogy on the guardrails earlier. And one of the things that I think is both very interesting that's different about the MI sector, this era as well as what you guys have done, is the mortgage insurance linked notes.

You guys were able to issue three of those post the outbreak of the COVID-19, which is pretty remarkable, given the stress in the market. That said, Francois has mentioned that Arch does not expect to collect any payments from these securities. So has your value on -- of these mortgage insurance linked notes changed? Do you think that they're still worthwhile?

## **David Gansberg** {BIO 18639197 <GO>}

Yes. Don, I just want to start out by saying we're really proud of what we were able to accomplish in 2020 with our mortgage insurance linked notes. So the market appetite was temporarily restricted in the second quarter. But we were able to demonstrate that there was a market. We did close our first deal in the second quarter. And the terms weren't exactly where we wanted them to be, but it was a step in the right direction, and we felt like there was a lot of value there.

I would note that we did execute the first mortgage insurance linked note or a credit risk transfer transaction in the post-COVID era. So it's just another example of our leadership in the housing finance sector, right? This part of the business is here to stay. It provides us a lot of benefits by taking out the catastrophic risk, right? And when we look at loss recoveries coming from COVID, the reason that we're positive on earnings and we're optimistic about the future is this is not an extreme, extreme event, right? We talked about $400 million of underwriting profit for the first nine months. It's not an extreme event. MILNs are really there to help us on the really extreme events to eliminate the tail of volatility. What we're seeing in 2020 is not that type of event.

## Donald S. Watson {BIO 19175196 <GO>}

So thank you for that. I have a suspicion again, we'll come back. But last question because we're running a little bit behind on our time. I think it's worth getting at. Some of the model lines are reporting fairly attractive ROEs even in this current environment. So I'd like your thoughts. Is mortgage insurance better as part of a multi-line Company? Or are investors good to buy the monolines today? What do you think?

## David Gansberg {BIO 18639197 <GO>}

Yes. Don, I think the reality is the multi-line approach works much better, and I'll give you a couple of reasons; number one, cycle management and we talk about this very frequently with all lines of our business. And what you see here on this slide is an effective demonstration of cycle management. We are return focused, we're not market share focused. We're not volume focused. There is way too much emphasis on quarterly market share movements within the MI industry. This is showing that we have actively managed our portfolio.

You can see over time, rate levels have come down, and this is showing a rate index average across the year. So it does potentially obscure some micro trends, especially as we've seen movement up and down by quarter in 2019 and 2020, although the overall rate level is generally flat for the year. So it obscures some trends, but you can see as rate levels have come down, so has our market share. And we're able to create a better portfolio. And when you look at our portfolio, and you look at our mix by state, and you look at our high DTI, and you look at our high loan-to-value, and you look at the split between monthly and single premiums, and you look at our DQ rate compared to other companies that have a legacy business, you can see demonstrated cycle management and the impact that it has become.

So the benefit is we've made over $3 billion of underwriting the comp in the last four years in mortgage insurance. And now, that money is being utilized by the Insurance and

Reinsurance Group to support their growth opportunities. So you can see the benefit of having the multi-line approach.

And I would say also, lastly, as we look at the time line, again, a lot of information here, but I think the key point is multi-line and internal competition spurs innovation, right? Innovation has required us to continually improve our business, to continually get better, to continually innovate because we're always competing for capital, and we can't just sit back and only write primary MI business regardless of rate level, right? We recognize that it's a competitive situation, rate levels vary and we want to maximize the return for our shareholders.

That means we manage the cycle in MI, and we explore other opportunities, and some of those exploration are going to create great new opportunities. Some of them are not. So a big, big difference for us compared to some of the others out there, and we think it's a superior business model over time. And in 2020, it was demonstrated, right. If you look at our market share, the fact that we have come down and you look at others, right, that business has gone somewhere, it doesn't go away, right. Market share that adds up to 200. So I think we do demonstrate the value of that. So I will --

## Donald S. Watson {BIO 19175196 <GO>}

Hey, David. Thank you. You've done a nice job of teeing up Francois on our next one is this competition for capital, which I think is a pretty key theme for us. I think it's particularly appropriate, we close it with this section of the fireside chats with Francois. And Francois, I think we're talking about this literally and figuratively, you're the six man on the Arch team. I mean, finance and capital are what really propels this game.

We've heard some fairly upbeat assessments from the Group this year, and likely next year from our operating team. However, capital isn't unlimited. So for our investors, can you tell us how does Arch go about allocating capital to the units, and where are you allocating capital today?

## Francois Morin {BIO 17410715 <GO>}

Yeah. Thanks, Don. I'm happy to be the six man if I can come off the bench, and actually help us get over the finish line or make sure we win the game. That's all good. So -- yeah, and I think Marc touched on it. I think we haven't really materially changed our focus or approach over the years. I think we're -- we've always been bottom line focused, right. We look at returns. We -- that's something that is core to what we do.

And we are always re-evaluating where we deploy that capital. I think the reality, has been that in the last four or five years. We've allocated more capital to Mortgage because that's where the returns were, or at least were more attractive. And we pulled back a little bit on Insurance and Reinsurance, and Nicolas Maamoun talked on some of the strategies they employed along the way. But here we are entering 2021, and we truly feel that all three of our segments are ready to roll, and really can produce adequate results that -- adequate returns that will make us better collectively.

So the challenge for me and for the team is really how do we choose between all three alternatives. And right now, we're saying, we don't need to choose. We can actually deploy the capital in a variety of places. We truly feel we have plenty of capital to support the growth that we see coming, and the production that we think is -- will be there in front of us, and keep looking for those 15% returns, which as you know, may be a bit optimistic. Maybe, yeah, maybe high in this current interest rate environment, but still, that's the goal that we've set for ourselves. And in the meantime, we're pushing hard to make sure that all three segments can achieve those kind of returns.

## Donald S. Watson {BIO 19175196 <GO>}

So I just note that for some reason, that slide, of course, our investors have seen it before, didn't show up well on the chart in terms of the historical returns. It is up on our website correctly for those of you who want to see the numbers that further. I do want to press a little bit further, Francois, on this question.

Does Arch have enough capital to fund the growth opportunities we've been talking about? And maybe let's take it a step further. Where does Arch stand on share repurchases? There's lots of choices here.

## Francois Morin {BIO 17410715 <GO>}

Sure. As you know, we've always played it very cautiously as it comes to capital. We've always wanted to have enough capital to be able to take advantage, or respond to an opportunity that was in the market and that hasn't changed. So we've always wanted to have flexibility in our capital structure in terms of leverage. And here we are in -- again, entering a market where we feel the returns will be good. And our job is to make sure we have plenty of capital or sufficient capital to deploy to take advantage of those opportunities. So how do we think about it, right? There's a lot of levers we can pull, and one of -- right off the bat, we can -- there's always reinsurance, and let's not forget that's a source of capital that we have, and we can always -- if we're really -- we see a lot of opportunities, we can always see more, whether it's on traditional P&C or on the mortgage side with the Bellemeade protections, we can always buy a bit more reinsurance. We can also reach out to third-party capital. There's a lot of -- Maamoun touched on it, there's a lot of partners out there that we have that would be more than willing to participate in some of our business, and that's always something that's available. And the last slide we have on that deck certainly talks about the leverage, and how much debt we have.

We -- again, we've got plenty of capacity there. And if the growth ends up being really, really above our expectations or what we call, we call it our baseline view of what 2021 and beyond could look like, and you and I talked about it numerous times. It's a great problem to have, and we'll find a way. And we're not overly worried at this point that this would cause us really major issues because, again, we've got lots of tools in the toolbox, and we've got a lot of levers we can pull to make it happen.

## Donald S. Watson {BIO 19175196 <GO>}

Lots of comments that I --

## Francois Morin {BIO 17410715 <GO>}

And just -- yeah, let me -- I don't want to ignore your question on share buybacks. And share buybacks is part of the picture, right? I mean, right now, we're seeing more of how '21 will look like. In a few weeks, we'll have a better idea what the 1/1 renewals were like. That will give us a good sense of what the opportunity set might be like for 2021. And while there's some pressure on our stock price in the fourth quarter, and it was a bit hard for us to not see that, and maybe think about share buybacks, so that's something that we're always looking at. But in the current environment, I think our number one focus at this point is really to put the capital to work in the business, and make sure that we can generate the adequate returns that our shareholders are expecting.

## Donald S. Watson {BIO 19175196 <GO>}

Well, clearly, I think from our view, it's Arch stock is a compelling value at this price. So that's something that I have no doubt that we'll probably hear from our investors further on later.

## Francois Morin {BIO 17410715 <GO>}

Sure.

## Donald S. Watson {BIO 19175196 <GO>}

One of the perhaps the most important questions that you can answer for investors without providing guidance, I'm putting my IR hat on, what kind of returns do you see Arch producing over the next year or two? And can you size the relative opportunity between the three segments?

## Francois Morin {BIO 17410715 <GO>}

Well, I think I touched on it a little bit. I think we see pretty much all three segments at a relatively similar place. The reality is some of the business that we've got on the books or will be coming on the books on the Insurance side, in particular, will take a little bit of time to earn out. So there's the calendar year impact that we've got to think about. So while we truly think that 2021 will see us -- should be better, I think in terms of -- and we touched on that rate on rate improvements, et cetera. It may take a bit of time, even though we're seeing the early stages of that improvement showing through our financials. I'd like to think that as we move forward in the second half of '21 and '22, that our returns on paper, on financial statement plan will be -- will keep improving.

So -- but in terms of capital deployment, as we look into what's happening now, I think pretty much all three are in the same general area, low double digits, some are approaching mid-teens depending on some subsets of the business, some specific niches that we participate in. But all in all, we think we're looking really good, and there's a lot of good opportunities out there.

## Donald S. Watson {BIO 19175196 <GO>}

All right. Thank you, Francois. I think this marks the end of our fireside chat. As I mentioned earlier, we're going to take a five-minute break here before we resume with live questions from our star research team, and we'll provide you instructions again on how to submit questions to the Arch Management team. Thank you, and we'll be back in a few minutes.

# Questions And Answers

## A - Donald S. Watson {BIO 19175196 <GO>}

All right. Welcome back, and I say we got the Arch team socially distant and are -- well, except for Maamoun. Are we going to get Maamoun up there? Or are we just going to have his smiling mugshot? All right. Hopefully, Maamoun shows up here shortly.

So we've invited Wall Street's A-team of research analysts for the live Q&A portion of the call. I'll remind our audience of the box at the bottom of your screen. There's Maamoun. This is where you are invited to submit questions and yes, I don't know. We're going to have fun getting through all these questions. We've got quite a few already queued up.

As I mentioned though, we're going to go through with the analysts first, and what I'd like to do is invite Elyse Greenspan of Wells Fargo. Hello, Elyse, are you there?

## Q - Elyse Greenspan {BIO 17263315 <GO>}

Don, can you hear me?

## A - Donald S. Watson {BIO 19175196 <GO>}

There we go. Good. All right. Yes. So what do you think, Elyse? What can we tell you?

## Q - Elyse Greenspan {BIO 17263315 <GO>}

Yes, so I think where I want to get started is probably building off where Francois ended his remarks. So you guys seem optimistic about all three businesses and pointed to low double-digit or actually even approaching mid-teens returns for the businesses, I believe, in the second half of 2021. So I'm hoping maybe to take it one step further. If you can help us understand what this means from an underlying margin perspective for Insurance, Reinsurance and Mortgage, and the level of improvement that 2021 could bring relative to 2020.

Just based -- I understand there's some unknown, so based on how you see pricing and loss trends today.

## A - Donald S. Watson {BIO 19175196 <GO>}

All right. So Francois, you've got a spreadsheet that we can just sort of populate Elyse's model here for next year, just make it nice and simple. So what do you think? Oh, we can't hear you. Testing. Do you hear? Francois, can you say something?

## A - Francois Morin {BIO 17410715 <GO>}

Is it better? Can you hear me now?

## A - Donald S. Watson {BIO 19175196 <GO>}

There we go.

## A - Francois Morin {BIO 17410715 <GO>}

Okay. Great question. Thanks, Elyse. And I'm sure others will want to chime in because it really touches on all our segments, and Marc as well, but at a high level, we've always said Mortgage, when you -- going segment by segment, Mortgage, yes -- well, 2020 will be or may be a bit depressed because of the environment we're in and the pandemic et cetera. But as we go back into 2021, we think the combined ratio will come back down to maybe not what it was in 2019, but it's on a very acceptable level. And that will generate good earnings and good returns for us.

Maybe the one area that when you look more and so if you, I think, on the combined ratio is on the Insurance Group, where it really -- for us to achieve the returns we're looking for, it really has to be in the low 90s because in an environment where interest rates are depressed and it's a challenge for us to make the overall return. So that's really -- and everybody knows it. I think the whole market knows that. We're not alone in that gap, so I think it's important to -- for everybody to appreciate that, especially in the longer tail lines of business have a lot of -- there's a lot of leverage with the interest rates, and how much we can generate there.

And on the Reinsurance side, I think it's -- and we've tried -- we've touched on it, I think, numerous times over the last few quarters is, there's a lot of volatility in our numbers. (inaudible) play a part, but there's also a large transaction sometimes that will come in and out of the picture. So we take more of a rolling 12-month or a calendar 12-month average to look at our combined ratios. But there, we think we can really outperform. We've done that in the past. And if we -- we can certainly aim to be sub-90 and that will generate adequate returns for us. So I'll let the others chime in, maybe see if anybody wants to add to the picture.

## A - Marc Grandisson {BIO 4369887 <GO>}

Yeah, what I'll add, Don, it's Marc. Quickly, a good place to start, Elyse, is looking at three, four, five years trailing return about 11% to 12%. I think it's a good place to start, recognizing that MI was overly contributing, really giving us a lot of returns. I think that we could highlight the other two units lifting up in terms of returns. As we head towards the end of 2021, we should see those kinds of returns, no double digit. But they're not going to be created equally, meaning they're not going necessarily come from the MI the way it did in the past. But I think it's not a bad place to start.

I think the one thing I will also mention is it takes a while, as Francois mentioned, for the premiums to be earned. It takes a while to get traction and get the true margin to hit the bottom line. But also, we have a depressed investment environment. So that also, it is a little bit of a headwind for that we all have collectively, so that might create a little bit more -- we may have to ask you to be a little bit more patient, I guess, over the next 12 months as we see things unfold.



## A - Donald S. Watson {BIO 19175196 <GO>}

Anyone else want to chime in or Elyse, do you have a follow up or two or three?

## Q - Elyse Greenspan {BIO 17263315 <GO>}

Yes, thanks. My second question just going on to the Mortgage business. Results continue to trend better than expected. The default rate that you guys disclosed for November is well below where you expected to finish the year, a number that you've revised down on several occasions. So as we think about 2021 for that business, you provided a good amount of disclosure on the economic backdrop today, but what do we need to pay attention to, to get a sense that we've kind of crossed the trough for that business?

Is it going through the forbearance program, having stimulus money come together? And you did -- Francois mentioned the combined ratio getting better. But what should we be paying attention to for the mortgage results, just to kind of understand that the worst is behind us?

## A - Donald S. Watson {BIO 19175196 <GO>}

David, I think you were talking about this in some of your comments earlier, but maybe take a stab at that first?

## A - David Gansberg {BIO 18639197 <GO>}

Sure. Yes, so there's a number of things to look for. Elyse, you touched on a few of them; the forbearance rate, what happens to those mortgages and forbearance. And more importantly, not only how many mortgages are in forbearance, but what happens when the forbearance periods expire? Do those borrowers become re-performing, or are they still delinquent? So that's the thing to watch. The unemployment is a thing to watch, what direction that goes. Any potential government stimulus is another thing to watch, right? The more the better, as far as we're concerned. Home prices are an important thing to watch. What happens with the direction of home prices, right?

We want to see that home price appreciation in that sustainable range going forward. So those are really all the things to look at. I would say things have generally performed better than our expectations in the fourth quarter here. We did see a bit of an increase in the number of positive COVID cases, which we expected. But those did not translate into greater mortgage delinquencies. So the economic impact we expected, didn't happen, but we'll keep our eyes out in 2021 to see if it comes up again. But generally, we're expecting positive things going forward.

## A - Donald S. Watson {BIO 19175196 <GO>}

Marc, any other comments on that or --

## A - Marc Grandisson {BIO 4369887 <GO>}

I think the only thing I said is exactly David touched upon it, the fact is the first line of defense if you're going to be defaulting on your mortgage is whether you're able to sell the house for a price above the outstanding balance of the Bank. And right now, David shortly exhibit the 4%, -- 5% increase. It's not in every area they're the same. But overall, the market is very healthy. And once you have an issue, you had a divorce, you don't have a job, you have to move, you can always sell your house. And the pent-up demand that David mentioned is clearly, clearly a huge line of defense against default.

## A - Donald S. Watson {BIO 19175196 <GO>}

David, one of the questions that was submitted that sort of relates to what we're talking about here, at least tangentially, is pricing. Once the Coronavirus caused the market to pull back a bit, pricing went up in the Mortgage Insurance sector. Can you address just generally how pricing and Mortgage Insurance is today versus shortly after, I guess, first quarter?

## A - David Gansberg {BIO 18639197 <GO>}

Yes. Don, I think the short answer is it depends on the Company. It depends, right? As we manage our cycle and we look at our market share, our prices are higher than they were pre-COVID, right? I think clearly, the entire industry as a whole, moved up in second quarter in response to COVID conditions. And I would say third quarter and into fourth is a bit of a mixed bag. So we're still well above our pre-COVID levels because that's the way we manage our business and that's the way we manage the cycle. And we want to deploy more capital into the P&C businesses.

But others out there are different. I would say some of our competitors' rate levels are back to where they were pre-COVID or maybe even a little bit lower. So it's a mixed bag and it's going to vary by Company. What we included in our rate index is our own rate levels, but I would say it's not necessarily safe to use that as an entire industry figure because there is significant variation in strategy by individual Company.

## A - Donald S. Watson {BIO 19175196 <GO>}

And perhaps, a good signal of that is who's growing and who's shrinking market share, I would guess, on that. All right. Let's go to our next questioner. Let's see who we got. Yes, Brian Meredith?

## Q - Brian Robert Meredith {BIO 3108204 <GO>}

Thanks, Don.

## A - Donald S. Watson {BIO 19175196 <GO>}

Brian, are you there?

## Q - Brian Robert Meredith {BIO 3108204 <GO>}

So -- I'm there. Can you hear me?

## A - Donald S. Watson {BIO 19175196 <GO>}

Yes. Good, thanks.

## Q - Brian Robert Meredith {BIO 3108204 <GO>}

All right, good, perfect. So two questions. So the first one, Marc, you kind of briefly kind of alluded to this in your initial comments. But I guess as I look at your valuation right now for Arch relative to peers, it clearly lags. And while the Mortgage Insurance business has clearly created a lot of earnings and growth in book value since you bought it, it definitely weighs on your valuation. I think you can absolutely agree with that.

And actually, if I look at your stock price since the close of the UGC acquisition, it's actually underperformed both your P&C insurance peers as well as MI -- interesting as well. So can you remind us on why this MI business strategically makes sense as a part of Arch as an overall kind of Company? What are the benefits you glean as a Company from having the P&C and the MI together? And then any thoughts on ever kind of separating these things at some point?

## A - Marc Grandisson {BIO 4369887 <GO>}

Yes. So the last part is easy. We always are open to anything that will unlock shareholder value. So at some point in time, we believe that this is really a better way forward for all collectively as shareholders, we would explore any avenue. So that goes without saying. We're not weathered. As you know, Brian, we're not weathered to any grandiose scheme or ambitions. We're all here to unlock value the best we can. So the one thing about the stock price, I get it, I understand that clearly, we will always have these questions inside ourselves, and we always look at some of the parts, whether we have a discount. We're not seeing a huge discount right now, if anything. What I have to remind ourselves, Brian, unfortunately, I have to, is where we were at 1.7 times clearly in this year, which was way above anybody else in the industry.

So there are times where, again, like I said, there's a lot of voting and a lot of opinions about what's happening in MI. Certainly having a crisis or the pandemic that we just went through sort of, sheds light on what could happen when the economy sort of goes a little bit -- hits a little bit of a bump. But I think overall, if you just step back in terms of growth in book value, I did mention that it did create a lot of growth in book value for us, gave us the ability to invest, brought us some air cover to not be overly aggressive on our P&C lines of business.

That did create a lot of value. It may not necessarily factor itself on a stock price quite right away, but it certainly does make a difference in terms of managing and operating the businesses. So listen, we have the discussion every quarter. If at some point, we believe that -- no, again, MI part of a multi-line makes more sense. We did -- when we acquired that, we did believe it made more sense for the reasons that David just mentioned. The fact that you don't have -- to a man with a hammer, everything looks like a nail, as we've heard before. So we try not -- try to make sure that we have a diversity of opportunity to deploy capital.

But again, we have to give the business some time, Brian. We have to give it some time to do so. If it continues to underperform, I'm sure we'll have different discussions, it's always on top of mind to maximize shareholder value. And what you mentioned is definitely part of the discussion that we have all the time. All I want to say is we need to be a bit more patient too, right? We're just coming out of COVID-19. It's a huge crisis. So if we're going to be reacting, the one thing that you guys have as an advantage against -- instead of us is, we can't just be knee-jerking in and out of the marketplace. We just can't do this. We have made a commitment to the space. We're trying the best we can.

So over time, we do still believe that we'll get the price of book multiple to reflect that, and we'll probably be in a position at some point where we're overperforming -- at least, performing to market or possibly overperforming and if we're not, we're open. That's all I can tell you.

## A - Donald S. Watson {BIO 19175196 <GO>}

So Brian, before we go to you for a follow up on that, we got a question from one of our investors submitted, Marc, that I think is a good follow up. Says that it's hard -- talking about M&A, it's hard to acquire your way to wealth. Arch has been active in making the acquisitions recently, so persuade us that these are winning moves. Talk to us about that.

## A - Marc Grandisson {BIO 4369887 <GO>}

What we have just made recently are smaller acquisitions, right? They're not big in the grand scheme of things for the Company. And they're made with either because the book of business or -- it has some strategic value to the acquisitions that we've made. And they're all pretty recent. One, including -- meaning Coface is not even closing yet. So we'll see where that goes in the future. Again, we only bought 29.5% of the Company. We do believe that there's franchise value in this product line, one of the top three provider of this in the world. And I would argue it will provide us with strategic opportunities way beyond the trade credit at some point in time. Their footprint around the world is pretty wide.

If you look at -- Nicolas mentioned Ardonagh. Maamoun, and Nicolas would have talked to you about Barbican. Those acquisitions were not big, but were really timely. If - in fact, almost cycle management like. We sort of were able to get on with these companies at the right time in the market when the market was flexing. In addition, during Watford, and I (inaudible) Watford in that, its third-party capital aspect of them are extremely beneficial to us down the road, and this is something that we want to grow.

So the M&A, there's no -- again, there's no big plan for size, but it's more about, hey, can we acquire something at a good price? And I would argue that most of the pricing that we've acquired these enterprise, of these companies that were is favorable. So provided that the idea, there's nothing inherently wrong with the book of business, and we buy them at a time and in a location that allows us to be strategic about it, I think they're going to work out. But again, those that we're talking about are on-the-go, happening as we speak, or just happened a year ago. So we'll need a bit more time to demonstrate that they are truly accretive.

I think one slide that Nicolas pointed about Lloyd's is very telling, right? I mean, we already got -- getting scale as a result of the Barbican acquisition. That's a good example of something that's a bit more quick in terms of providing a benefit to us.



## A - Donald S. Watson {BIO 19175196 <GO>}

I think the timing on that was pretty good. Brian, did you have a follow up or --

## Q - Brian Robert Meredith {BIO 3108204 <GO>}

Yes. Yes, I do, definitely. So there's been a lot of talk about rate pricing, right, but there's that other part of the equation, the numerator where you've got loss cost inflation, right? And then coming into 2020, that was kind of a hot topic, social inflation, tort inflation. Just given, what are your kind of views right now on tort inflation? What are you looking forward with respect to when you're underwriting in pricing policies as far as loss trend assumptions? And what do you think happens as the economy starts to improve here in 2021. Do we see an increase in tort and social inflation and could that cause returns to not be as good as people expect, adverse reserve development, those types of things?

## A - Donald S. Watson {BIO 19175196 <GO>}

So Marc, why don't you take a high level and then maybe Nicolas could add a few points to it just because he's seen a lot of that on the primary level head on?



## A - Marc Grandisson {BIO 4369887 <GO>}

Yes. So very high level, the inflation has been stable. I would say, Brian, I think looking back at the numbers for the last four, five years, even 10 years for that matter; I think that also (technical difficulty) we had softening -- softer conditions than we should have had in those five or six years looking back. And unfortunately with trend. Brian, it's always looking back not looking forward. But I think anywhere from depending on line of business; some lines like workers' comp was actually negative because of frequency decrease and we certainly saw that as well in our portfolio all the way to 6%, 7%, this is all grow -- this is ground up. I think that to your question about what -- will we price based on history? We price based on what we think we've seen historically plus a bit more prudent going forward because we do believe that. And to sort of answer the question you've asked, we think we're going to see a pickup in inflation possibly. It's probably already there to be honest, Brian, in the books of business but people are not necessarily recognizing it quite yet.

It takes a while to recognize those loss trends. I wouldn't be surprised at the loss trend. I mentioned that before I've been studying these trends indicated by some firms over the years and they tend to be anywhere from 150 bps to 300 bps give or take above the inflation that we -- that the core CPE, CPI inflation. And as you guys know, the inflation has been around 2% for quite a while. So, that would lend itself to say that we better have pricing that comes around at 4% to 5% -- maybe 3% to 5% depending on line of business, but that's also for longer term than just one year. So, that's also something that we're very, very careful to make sure we reflect into our pricing. That's why when we look at the price increasing being 15, 20, 25, we have this margin of safety, if you will, that we think -- we don't know exactly with accuracy what the exact number is going to be on a trend, but we clearly are clearing that trend whatever that may be with those kinds of rate increases.

## A - Donald S. Watson {BIO 19175196 <GO>}

Nicolas, anything to add?

## A - Nicolas Papadopoulo {BIO 4181040 <GO>}

Yes. So I think for me like the loss trends, I mean we spend quite a lot of time in the insurance group by line of business to look what happens. So, it's clearly a severity issue not so much a frequency issue. I mean you get more large losses than we have had in the past so that sums the shape of the excess. And I think the reaction of the market in cutting back capacity has been -- used to be a $25 million first umbrella layer and then a couple of $50 million above. People want to mitigate their loss by putting shorter limits and asking for higher price. So, that's been the reaction. There's no -- who knows really where the actual loss trend would finish. Is it 7, is it 10, is it 5. But I think the market -- similar to Katrina. Remember Katrina, people were putting $50 million property limit or $100 million property limit in the excess and post Katrina, they discovered that school boards or housing authorities could have like the $400 million losses.

So, it happened. Happened the same way in commercial auto. In commercial auto people were expecting $10 million was a big loss, but suddenly we had a couple of $90 million losses. And now on the large account umbrella business, we're seeing the same. We're seeing more severity on D&O -- public D&O. So I think people -- the reaction of the market is the right one. I think if you're going to look for price, don't put all your eggs in one basket. So what people are doing instead of putting $25 million or $50 million limit, they put $5 million and $10 million. So the chance for one losses or two bad losses that you pick up I think has less of an impact on your loss ratio. But again that's what really has created in large part the dislocation in E&S and the large capacity market that we are seeing today. And I think the loss trend is visible also in the middle market, but as those are smaller accounts and ground up, I think the leverage is just less on the premium we collect.

## Q - Brian Robert Meredith {BIO 3108204 <GO>}

Great. Thank you.

## A - Donald S. Watson {BIO 19175196 <GO>}

All right. Thank you very much and thanks, Brian. With a little bit of luck, we can bring up our next questioner, Meyer Shields of KBW. Meyer, are you there?

## Q - Meyer Shields {BIO 4281064 <GO>}

I am. Am I coming through?

## A - Donald S. Watson {BIO 19175196 <GO>}

Excellent. All right, it works. So, what can we do for you?

## Q - Meyer Shields {BIO 4281064 <GO>}

So I want to talk about some of the, I don't know, smaller businesses. First, Watford, Can you talk a little bit about what's changing there besides pricing that would drive better underwriting results?

## A - Donald S. Watson {BIO 19175196 <GO>}

All right. Maamoun, I think this is a great question to start off on you in terms of maybe making a comment. Obviously we don't control all of Watford at this point in time, but maybe talk a little bit about the business mix at Watford versus Arch and then talk about what you see in the future.

## A - Maamoun Rajeh {BIO 16155071 <GO>}

Yes. Thanks for that. I think generally speaking and I'll reserve some of the comments on the whole -- on all the details that we have in mind post close. But wholesale, I mean if we step back and think about Watford. When Watford was set up, it really was a total return proposition where underwriting and investment returns kind of coupled together and when one part of the equation didn't come through, it necessarily meant the returns weren't going to be there. And so we've kind of taken some lessons from that and really thinking through it going forward. The strategic value of having a parallel balance sheet, the strategic value of helping our collective shelf space with clients, all that's still there. The difference generally speaking is going to be less reliance on the investment side of the house and really more having underwriting returns generate the larger component of the total return going forward.

And as you know, Watford has been very intertwined with Arch with respects to the servicing of the business, with respects to the client interface, with respects to just all of the underwriting that we do for the system; and that's not going to change going forward. I think with tailwinds, with the opportunity that we have in the market, with the understanding of Arch's underwriting being a bit more of the value proposition of Watford going forward; I think again that platform is going to be punching a bit heavier than it did in the past. But like I said earlier in my comments, we've taken some lessons from this and version 2.0 will -- we're optimistic and pleased. And we have partners that have been in the business before this industry, before they are sophisticated partners. They understand the plan. There's a lot of buy-in in what we think we're going to do going forward and so we're excited about that.

## A - Donald S. Watson {BIO 19175196 <GO>}

Meyer, did you have a follow-up?

## Q - Meyer Shields {BIO 4281064 <GO>}

I did. I wanted to switch gears a little bit and talk about Premia and its business focus and what the market looks like there. I know you have Liberty Mutual move today that indicates strong demand. I was hoping you could flesh that out a little.

## A - Donald S. Watson {BIO 19175196 <GO>}

Marc, maybe ask you to take this or rather than Maamoun, I don't know either one.

## A - Marc Grandisson {BIO 4369887 <GO>}

I think Maamoun is in probably front row so he should probably talk about it. Maamoun?

## A - Maamoun Rajeh {BIO 16155071 <GO>}

Yes. I'm happy to take it. Nicolas and I sit on the Board of Premia as you might know. And you know what, it's a similar dynamic that I'd say the Premia team has been patient in the last number of years. There's a difference in playing in the field of the large globals and going out and stock picking and making sure that you understand the portfolio that you're taking on. And the Premia team has done a wonderful job of kind of playing in the smaller tier in the mid-market sector where you do understand kind of the rationale for buying, you have an appreciation for the business that you're taking on, and there is a bit more of sort of a balance in the information knowledge when you take on the risk. We think that Premia is going to have increased opportunities going forward. I mean they are already seeing a bigger flow of business coming through with that team. That team has shown patience and I think that patience will be also rewarded going forward.

## Q - Meyer Shields {BIO 4281064 <GO>}

All right, thank you.

## A - Donald S. Watson {BIO 19175196 <GO>}

Thanks, Meyer. And we're going to change a little bit of the order here. Josh, our interrogator, is asking if he can jump up because he's got some other commitment here. So Josh, are you there? Josh Shanker, are you there?

## Q - Joshua David Shanker {BIO 5292022 <GO>}

Yes. There's no commitment like an Arch commitment, but thank you for taking my question. So, you guys have given us PMLs for a long time that helps us understand Arch's exposure tolerance for property cat risk based on various pricing conditions and we can see when you open and close the balance sheets at risk. However, Arch's exposure to liability risk is dramatically less than it used to be but rising. As we think about how much Arch was willing to use its balance sheet in '03 through '05 to take on liability risk, how much more exposure could Arch tolerate today? Do we have some tools that we could look at to give us an understanding about how much bigger the income statement can get for liability risk and what can we do without accessing any additional capital in the marketplace?

## A - Donald S. Watson {BIO 19175196 <GO>}

Excellent. Marc, this sounds like it's got your name all over it.

## A - Marc Grandisson {BIO 4369887 <GO>}

Yes. Francois can also definitely chime in now because he's capital -- he's a Treasurer of all the capital, all things capital. I think on the liability side, I think we have a lot of room to grow, right. There's a lot we could do because we don't play it and de-emphasize it so much over the last five or six years. In terms of what we can do, it will depend on the returns in the marketplace. So I think if you ask on the property cat side, I think now we are -- we have a lot more to deal with in terms of where we could deploy our capital. Josh, versus where we were in '02 or '03. When we were in '02, '03 the whole market was going gangbuster on the property side and we were not wanting to do this as much as the others because we didn't want to get unlucky early, That was one of the comments that was made way back when. So I think now with the knowledge, the expertise, and also the claim on the capital that we all -- have all around and the opportunities that we have; I think that could we grow the PML to 20%, 22%.

I think it's unlikely at this point in time based on what we see in terms of pricing and returns. Could we grow dramatically the property -- the casualty lines of business? The answer is yes. I think Nicolas just mentioned the growth that we're seeing on the insurance and on the reinsurance side. So, it's kind of hard to say how much more we can grow. Let's suffice it to say that you see the way we're growing and you heard from our guys today that we see no reason not to grow as much as this if not a bit more going forward in 2021.

## A - Donald S. Watson {BIO 19175196 <GO>}

Maybe Francois, if you could just jump in on it one moment first just on the casualty business and investment returns. I mean how do you bring that into the equation in terms of our appetite to grow?

## A - Francois Morin {BIO 17410715 <GO>}

Well, we grew, let's say, 20% or so in the last year or two and we assume another 20% in '21. I mean, that's not -- it's pretty -- it seems pretty reasonable I'd say based on what we see in the market today. But if you want to start speculating and say well, in the market we're going to grow by 50% or even 100%, My view on that is a, it would take a lot of pain in the system for the market to be willing to bear those kind of rate increases. So I think you have to see capacity withdraw from the marketplace, you'd have to see -- start seeing some pretty sizable reserve hits. I'm not sure we'll need to go to the level of bankruptcies, but it would take something more than what we're seeing right now to really achieve those kind of growth objectives or the movement in how much we write.

But to your question, Don, in terms of the interest rates, they're part of the picture. I think that's factored into our pricing. So on the one hand if it gets to a place where the market is willing and we see the opportunities being that good and we can grow by let's say a sizable amount above and beyond what we're currently seeing, that will mean there's a lot of good things that will work in our favor. I think it will be again great tailwinds. And then I mean as I touched on it a bit earlier, I think it will be a challenge for us to -- it shouldn't be a challenge. I mean we'll have to pull some additional levers to get the right level of capital to support the business. But if it gets to that point, I think we'll all be more than happy to do so because it will bring back some of the good memories of the early 2000s.

## Q - Joshua David Shanker {BIO 5292022 <GO>}

Are there any...?

## A - Donald S. Watson {BIO 19175196 <GO>}

So, Josh -- yes, go ahead.

## Q - Joshua David Shanker {BIO 5292022 <GO>}

Yes. Those would be the same question, but one other way and then I'll get off. But are there any easy rule of thumb for us to think about? If we say that Arch is willing to expose 25% of its balance sheet to a property catastrophe or mortgage disaster, but right now it's only willing to allow 8% to be exposed. Is there any clever rule of thumb that we can think about when it comes to liability?

## A - Francois Morin {BIO 17410715 <GO>}

We don't think of it in those terms. Although in terms of capital, certainly one-to-one is usually bringing the surplus is -- bringing the capital is an easy rule of thumb that we think about. So if you think about adding $1 billion or $2 billion or $3 billion of premium to the balance sheet or -- that would require that much additional capital if they were to be that good. With us risking -- putting capital to work is what we're all about. I think in an environment where if we were to be able to grow at that level, I think -- and Maamoun touched on it, I think we'd have more buffer, we'd have more margin in the business. So, it's a safer bet to make. It sounds a bit crazy, but it's maybe counter-intuitive but that's really the way it were. If it gets to a place where we can grow that much more beyond what we're currently seeing, it to us would be that much more attractive and I'd say we'd be more than willing to put the capital to work because we'd like to think that the odds would be in our favor.

## Q - Joshua David Shanker {BIO 5292022 <GO>}

Thank you very much for the thoughts.

## A - Donald S. Watson {BIO 19175196 <GO>}

Thank you. All right. We'll see if we can pull up Jimmy Bhullar if he's around. Can we get Jimmy?

## Q - Jimmy Bhullar {BIO 4278955 <GO>}

I am here.

## A - Donald S. Watson {BIO 19175196 <GO>}

Excellent, all right.

## Q - Jimmy Bhullar {BIO 4278955 <GO>}

I just had a question first on your views on the sustainability of pricing. Obviously your comments have been pretty positive so have your peers. But what do you think about sort of new capital coming in, some of the capital that's trapped potentially getting released over time? So, just anything that you're watching to see whether the cycle will not sustain especially once there's better clarity on COVID related losses or on the economic environment?

## A - Marc Grandisson {BIO 4369887 <GO>}

I mean I'll ask maybe Maamoun to start -- Maamoun talked about it a little before, maybe Nicolas. Why don't you guys just go and give it a shot?

## A - Maamoun Rajeh {BIO 16155071 <GO>}

So, I'm happy to just start real quick. Look, you can't ignore supply coming into the chain, right? But I tell you I think on nuance, some of the -- I mean if you think about the capital raising so far, that could change when you think about the capital raising so far. If you're set to go out and write some retro, that's easy. You need a two person desk, a lot of capital, some rating, a phone -- a telephone, and a value proposition around a product and off you go. And if you're building a reinsurance platform and then an insurance platform, that takes time, right? That takes time to build. I think the third-party capital that's being deployed in the business right now is coming with conditionality. I mean the fact that we're hearing raises and we're hearing some of these numbers, we know because we're in the game and we're offered capital as well.

You can throw out a headline of a number, but if you don't achieve certain returns with that number, if you don't achieve certain terms and conditions that come with deploying that capital; that capital is not going to be deployed. The release part of the trapped capital also. I mean I think you got to step back as a risk -- as a manager of risk, whatever function you may be playing. If you have collateral in this uncertainty and we can't call it better and we think we've got a pretty good handle on it, it's very hard to release collateral. That's the product and the product is there to say do you think you're going to collect or you're going to hold on to the cash. So I think again that's going to take some time until COVID shakes out before any of that money wholesale, there'll be exceptions here and there, is released.

And so my point is if we think about it, it really -- personally it just doesn't speak to volumes and the sort of approach. And mind you, a lot of these companies are backed by PE funds and we all know the return requirements of PE firms. And so I think -- I really think this capital is coming in with a mindset that there is an opportunity to make returns and if that opportunity doesn't manifest, my sense is we'll see a little bit of pullback or a lack of deployment of that capital. So, it's informed thoughtful capital that's coming in and speaks to a bit more sustainability than otherwise might be.

## A - Marc Grandisson {BIO 4369887 <GO>}

Yes. I'll just add quickly, right Jim. I think if you think about it, back -- I looked at an article from 2002 when we were forming ourselves end of 2001 and it was a big CEO on the island that said we don't need that -- the capacity is not needed, it will put a damper on the hard market. And it didn't, right? It just didn't because what you have -- it's kind of hard for you guys to see on where you sit from. But there's a momentum, there's really a recognition collectively in the insurance industry that we need to get more rate and get higher returns. And as sort of that momentum builds, independently what's happening in terms of capital and it's certainly informed by the lack of returns -- historical lack of return and/or riskiness perceived in the underlying current underwriting.

That is not -- that (inaudible). Brokers are talking about rate increases. Underwriters are not being pushed back. When they ask for more rate, they're getting it. So, that human psychology system is very much at work right now. The same way it was at work where you couldn't lose money in insurance and you could just price anything and you can make return, it doesn't matter. And then you lose and then you change your mind and say no, we need more to achieve the return. Clearly there has been a shift in mentality and that's an important aspect of the marketplace that is kind of hard to see and it's not a number we can point to. But it certainly is a part of every discussion that we hear out there. So, nothing really new from that perspective.

## A - Nicolas Papadopoulo {BIO 4181040 <GO>}

Yes. I thought we can add on the (inaudible), as Maamoun said, we can see change of heart If we have a couple of years without cat. That's what happened in 2001, that's what happened post Katrina. So, we could see the totally capital coming back, being better educated. So not so much driving price down, but I think on the pricing side of the house, everyone is (technical difficulty).

## Q - Jimmy Bhullar {BIO 4278955 <GO>}

Thanks.

## A - Unidentified Speaker

Whether it's D&O, whether it's GL or commercial auto; I think we have a lot of headwinds. We have first the low interest rates, which we mentioned, which is a trial make it much more difficult to go back to double-digit ROE. And we have this social inflation that not only applying on a going forward basis, but applies to claims businesses that didn't return in '14, '15, '16 and '17 coming through the system that will make it more difficult for (inaudible). So, that is decided D&O -- public D&O is a flavor of the day, I think they will look back and see claims outsized and so there's more fear in the market on the casualty side and there is fear on the property side today. But I think the fear on the casualty side is here to stay for a little while.

## A - Donald S. Watson {BIO 19175196 <GO>}

I wanted to pickup on that before we go to Jimmy's follow-up because we had a couple submitted questions in -- about just the BI risk from the coronavirus and what you're seeing. And I wonder, Maamoun, if you could start on the reinsurance side because we've talked about it generally about the BI risk on insurance and Nicolas certainly in London, we've seen that with the different rulings there but -- and Australia, right. But could you talk about the fear factor in property today and how that BI risk is maybe also affecting third-party capital, Maamoun.

## A - Maamoun Rajeh {BIO 16155071 <GO>}

Yes, sure. And that's the ship if you guys can hear it. Yes. I think that focus has been sharpened by some of the European announcements. Some of the pan-European companies have announced some impact on their cat covers recently in the last few weeks and sure that's added a factor to it. And the way I look at it from our perspective is we charged our guys very early in this process to call it, right, to make an ultimate call on COVID not hey, this is what we're seeing at the moment. It took us a couple of quarters to get there, but I think where we sit today in our reserving, we feel good about it. We've tried to make a call of the ultimate and that call includes some of these uncertainties that we're hearing today. But there is -- I mean it's very nuanced, right. In Australia in fact we see a lot of press about Australia couple of weeks ago, but there is a big DIC between treaty covers on the property cat side and the underlying policies.

And I question whether that's going to be flown through to the reinsurance market. But then you nuance it, you get out of property cat that pegs to the 2015 Act. You get into pro rata or risk excess, well, that's a different ball game, you're going to pick it up. So I think you're going to see varying territories, varying covers coming through, and that -- that's the overhang that we're talking about. That's the uncertainty factor that's going to permeate for a little bit. No one's going to be certain. Capital -- reserve capital is going to be trapped. The cash hasn't started to flow out yet, right? The industry is about $25 billion reserved or so. That cash hasn't started to move yet and eventually it will. But we really think that overhang is going to play a role in firming and it's playing a role frankly on the ground with the team on day-to-day deliberations, on the going forward coverage, and so forth. It's just one more sticky factor in this renewal season.



## A - Donald S. Watson {BIO 19175196 <GO>}

Nicolas, would you have anything to add there or...

## A - Nicolas Papadopoulo {BIO 4181040 <GO>}

Yes. I think again, I think for us when I look at our book in London and I think the specific of London is a lot of -- some of the insurance policy in the middle market cover the civil regulatory shutdown. So when the government shut down and asked certain business to shut down, not all of them to shut down, those business clearly triggered for those policies some form of coverage. Which this cover doesn't really exist -- it didn't happen that way and it doesn't really exist in the US. So, that's a specificity there. I think in the US so far, I think the courts have been quite favorable to the policy as it's written. So, I think the uncertainty I think on the insurance side is more the indirect. The D&O losses and some of the construction loss or the surety losses that will be a consequence of a slower economy and some of the business, some of the economy not picking up. But that is still not I think fully baked in I think in the numbers in my view so.

## A - Donald S. Watson {BIO 19175196 <GO>}

Jimmy, I know we digressed a bit there. But do you have a follow-up yet or...?

## Q - Jimmy Bhullar {BIO 4278955 <GO>}

Yes. It was on business interruption actually. So, what percent of your reserves for BI type losses are IBNR overall? And then relatedly, have you made any changes and are you seeing any changes in the industry-wide language on policies related to the whole BI issue?

## A - Donald S. Watson {BIO 19175196 <GO>}

So, maybe I'd ask Francois to take that on at least first.

## A - Francois Morin {BIO 17410715 <GO>}

Yes. On the first part, we were at about 80% through third quarter and that obviously will change in the fourth. But yes, a vast majority of our reserves were IBNR for BI.

## A - Donald S. Watson {BIO 19175196 <GO>}

All right. And anything else there? Nicolas, we can't hear you. Still having trouble? Try again.

## A - Nicolas Papadopoulo {BIO 4181040 <GO>}

I think the BI question for us is really -- the business interruption question is really one in the UK and I think there, I think we -- I mean the way our book -- we pick it up mostly for the Ardonagh acquisition and that's really under control. This is like a small portion of what we do. So, it's a manageable amount.

## A - Donald S. Watson {BIO 19175196 <GO>}

All right. Well, thank you very much, Jimmy. And if we can move to Mike Zaremski, Credit Suisse. Mike, are you around? We got you?

## Q - Michael David Zaremski {BIO 20606248 <GO>}

Hey, great. Thanks. Good afternoon. I know everyone's getting hungry so I'll be fast. I guess to kind of exhaust the business interruption question. If I -- I think you mentioned, Maamoun, $25 billion or so of reserves have been taken by the industry so far. And if I look at my math on how much BI reserves Arch has taken, it seems like so far you're saying that your -- Arch's losses will be less than 1%, which would imply a lower level of market share than the industry event size so far. So I'm just -- I'm trying -- I know I'm being too high level and every event is really different. But I guess the main question we get is do -- should we expect the industry to continue to grow its reserve levels and that includes Arch?

## A - Maamoun Rajeh {BIO 16155071 <GO>}

I'm happy to jump in quickly on this. Well, so like I said, I think we try to be full, Mike, in our reserving. I kind of look at it the other way around. I look at it from a reinsurance perspective. First, some perspective, let's just step back. Where are -- why are we where we are? Because over the period of time we've talked a lot about being patient, over a period of time just the allocation to the class from a reinsurance perspective hasn't been at a peak. We've been underleveraged and that's a good thing. The second thing I would say is we've stayed away from tech lines; difficult to model, difficult to predict, difficult to price; and that's kept us as well closer to the personal lines sector more or less on the cat side by a large proportion. And so, that's just some context as to what we face when we're looking at this marketplace. But we went at it ground-up and we went at it top down as well.

I mean roughly speaking I think if we were going to consider the COVID loss that would take the industry to somewhere in the, I don't know, $75 billion threshold plus in our estimation requires something like a $35 billion property component of that loss. Again that's our math. There's nothing -- we're not doing anything more magical than you can or anybody else can do here. But in our view one of two things happens, either the property industry loss gets up closer to that $35 billion number and if it does, we feel good about it reserving or the property doesn't manifest around that number and frankly we'll probably find ourselves we've overcooked it. That's speaking on behalf of Arch. And as I look at the market shares of some of our peers, I'm left with a different feeling either that those numbers are going to go up or the industry loss has to come down.

## A - Donald S. Watson {BIO 19175196 <GO>}

So Francois, just to follow-up to one of the submitted questions is whether or not we expect COVID losses to bleed into '21. Any thoughts there?

## A - Francois Morin {BIO 17410715 <GO>}

I think Maamoun answered it perfectly. We don't think so. We think we've done -- across both insurance and reinsurance, we've done a pretty thorough of looking ahead trying to forecast some potential scenarios. Still a lot to be determined, but at this point both segments we're very comfortable with the level of reserving that we have in place and don't expect any material movements at this point.

## A - Donald S. Watson {BIO 19175196 <GO>}

All right. Mike, you got a follow-up there?

## Q - Michael David Zaremski {BIO 20606248 <GO>}

Yes, great. I guess moving to primary insurance. Not to beat up on you, Nicolas; but used the word transform, used the word kind of differentiated value proposition to compete more on value versus price. They're kind of fluffy words in my humble opinion. I guess anyway you can give us some specific examples on how you're doing that in order to kind of get returns up to the double-digit goals you have?

## A - Nicolas Papadopoulo {BIO 4181040 <GO>}

Yes. So, I thought I did. I gave you example of private D&O, I gave you some example of private PL, I gave you some example of the work we are doing with UK retail acquisition which is middle market acquisitions where... I think the theme here is trying to understand why people -- why insurer or broker come to you. And I think in the specialty area, I think there are two types of product. There is the E&S, the excess and surplus type, where it's driven by larger brokers and it's really price driven. I think the large insured or the type of buyers there is really driven by price. And there is this more middle market business, which we have footprints in which we had program business, we have some middle market retail example that I gave you where we can demonstrate that if we are able to be specialized a little bit like some of our competitors do.

A company like Berkley, they are in the middle market but with true specialty attached to the product to sell. And those particular products, the pricing doesn't vary as much because the client is looking for the insured to solve a solution. I mean it's in the coverage, it's in the claims, it's in the ease of doing business. So it's -- I agree. It sounds like a lot of fluff, but it's -- we've proven for the year but it's real. I mean you buy for the expertise, you need -- you don't need huge limits, but what you need is the proper coverage and the proper settlement of claims when the claims happen. So, this is -- Berkley is a good example and I think Travelers is a good example in certain other lines of business. Other companies are doing this very successfully I think and we did -- actually we did some of it, but probably not enough. So, we ended up being more in competing on the -- for large parts on price.

## A - Marc Grandisson {BIO 4369887 <GO>}

So Don, if I may add. Mike, one thing. If I may add just one quick example. Like we have a tool that was created over the last 12 months that really allows us to see through what the brokers have to offer and really be more proactive in seeking out the deals that we would want to -- that we know we'll be able to compete and win. So there's a lot more than fluff, to use your word, Mike, than meets the eye. There's a lot of technology and a lot of data analytics that's applied on a daily basis to make sure that we are, to your point and to Nicolas' point, more relevant to the clients which I'm thinking behind it -- with some thought behind the way we go about this. I mean we've tried to get away from the receiving end of submissions to actually be proactive and go up there and seek out the submissions that we want to see and that's actually a really, really powerful thing. We're rolling it out across and I think it's going to be that much better next year. But this is practical IT data analytics, very, very practical thing that we've done over the last 12 months.

## A - Donald S. Watson {BIO 19175196 <GO>}

So Michael, you definitely sound like you're a bit out of the state of Missouri, the Show-Me state. And I think it's incumbent upon Nicolas and his team to show those results. And so I think the expectations are out there that we're going to see some improvement there. With that, thank you much, Michael. And we'll move to our last questioner I think at this point, Phil. Phil Stefano from Deutsche Bank, are you there?

## Q - Philip Michael Stefano {BIO 20346322 <GO>}

Yes. Thank you. Good afternoon, Don. How are you doing?

## A - Donald S. Watson {BIO 19175196 <GO>}

All right, Phil. What can we do for you?

## Q - Philip Michael Stefano {BIO 20346322 <GO>}

So, I'm going to focus on mortgage insurance a little bit to wrap things up. As you talked about cycle management and mortgage insurance, I guess I was a bit surprised to hear the extent to which you feel like you need to be managing the cycle in MI right now. So, I was maybe hoping you can elaborate on that. And secondarily, are there any business needs in mortgage insurance when you think about the flow from originators that it makes it more difficult to be cycle managers in something like this versus the traditional P&C business that you have?

## A - Donald S. Watson {BIO 19175196 <GO>}

So David, you were talking about that competition for capital earlier and I think that is kind of a good way to start responding to Phil's questions.

## A - David Gansberg {BIO 18639197 <GO>}

Yes, you're absolutely right. And I think the reality is we are -- sorry, can you...

## A - Donald S. Watson {BIO 19175196 <GO>}

Yes, we can hear you. You're good.

## A - David Gansberg {BIO 18639197 <GO>}

Okay. Yes, I guess my mic must have been off for a second. But I think the reality is in MI, like all our business, is continual cycle management. It's we're managing it in good times, we're managing it in bad times. So I think when you look at our portfolio, we have been responsive to market conditions and there's lots of market conditions, right? I mean we talk about pricing, that's probably the most obvious one. But also remember we saw a gradual expansion of credit really from 2013 up through 2019, right? We had this gradual expansion of credit. We were seeing more high LTV business. We were seeing more high DTI business. So, we were managing our portfolio in response to that as well. So, it's probably an oversimplification just to think about price. I think we also have the issue with many of our competitors introducing black box pricing, which certainly changed the dynamics of the business as well, right?

So it was a different picture for us when we were the only one doing it, everyone else was using a rate card. So when the rest of the industry introduced that, that changed the dynamics as well and forced us to react. So, the cycle management is constant. I think it would be a wrong conclusion to think that cycle management means conditions are great, we want to reduce our business. Cycle management is an active and ongoing process that respond to all kinds of positive and negative conditions and adjust market share as appropriate. So, I think it's very timely. And the reality is in addition to what's happening within the mortgage sector and the mortgage insurance sector, we also have to overlay that what's happening within Arch Capital from an opportunity cost perspective, right? So for a long time, mortgage insurance was by far the best opportunity, right, when stacked up against insurance and reinsurance. It's not the case anymore, right?

There's a lot of attractive opportunities within insurance and reinsurance so we've got to manage it. That means a constant rebalancing and a constant internal competition and that internal competition and rebalancing is managing the cycle. As far as the external impact, I would just say so long as there are other providers happy to write the business, there's no issue, right? I think whether we choose to reduce our share as long as there's someone else who wants to step in and write it, customers are probably okay with that. I think the challenge comes in when the whole industry pulls back and that's where it's incumbent to educate your customers, make them understand what you're seeing, communicate with them about trends and conditions because there's a good chance that whatever you're seeing, they're also seeing. And you're probably pretty consistent with them with respect to credit. So, keeping lines of communication with customers open is key in those places in those periods of time when a cutback may be necessary.

## A - Donald S. Watson {BIO 19175196 <GO>}

David, one of the things I think -- we got a submitted question and I think it's worth -- you touched on this, on the black box pricing or risk-based pricing modules of our competitors. Can you talk or walk us through what's happening with returns as the other -- the rest of the industry embraces that one, from an industry-wide perspective? And I don't know if you have any insight in terms of what the impact of that is on Arch's returns.

## A - David Gansberg {BIO 18639197 <GO>}

Yes. I mean I think what the biggest effect of the risk-based pricing on a broad basis is going to be the flattening of both the peaks and the troughs. So, I think what happens is as companies are running their own form of analytics and their own view on risk return dynamics, you're going to cut out some of the peaks but equally, you're going to eliminate those troughs. So, it should contribute to a more stable return over time. You're always going to have some variance, right? We're going to have differences in opinion on credit attributes from other companies. We're going to have different views of returns. We're going to have different corporate structures. We're going to have different opportunity cost of capital as well. So, you're going to see some variation. But I think the real benefit of risk-based pricing is the moderation of the extremes that we saw because we're going to operate within I think a better band and it allows people to better understand and better control the risk that comes into our portfolio. So I think from a systemic standpoint, it creates less volatility for the industry in terms of returns over time.

## A - Donald S. Watson {BIO 19175196 <GO>}

Interesting. I think maybe a counterpoint to what some of our hedge fund investors are thinking these days as we've seen price competition. But I think generally, David, you would agree you like the return prospects in the mortgage insurance business today. Think that would be a fair statement?

## A - David Gansberg {BIO 18639197 <GO>}

For sure. Yes, for sure. I think the return prospects are good. I think as someone said earlier, we were seeing great numbers in 2019 and while we may not see some of those numbers again, there's still fantastic opportunities and we're generating very good returns still going forward.

## A - Donald S. Watson {BIO 19175196 <GO>}

We haven't touched on embedded profits here. But let me turn it back to Josh and just ask, Josh -- I'm sorry, Phil. Do you have a follow-up for us, Phil?

## Q - Philip Michael Stefano {BIO 20346322 <GO>}

Yes. Hopefully just a quick one. As you noted you were one of the first -- I think the first to market with the Bellemeade transaction post the ILS market ceasing up with COVID. It felt like sequentially as out there MIs came out with their own ILS transactions, the pricing improved. Maybe you could talk about the balance of securing the Bellemeade transaction versus waiting for pricing improvements and how that fits in the broader capital strategy? Thanks.

## A - Donald S. Watson {BIO 19175196 <GO>}

David, sounds like you again.

## A - David Gansberg {BIO 18639197 <GO>}

Well, I think it's difficult, right.

## A - Donald S. Watson {BIO 19175196 <GO>}

Yes. Go ahead, David.

## A - David Gansberg {BIO 18639197 <GO>}

Thanks. I think it's always difficult, right, Is my mic on? Can you guys hear me?

## A - Marc Grandisson {BIO 4369887 <GO>}

You're good.

## A - David Gansberg {BIO 18639197 <GO>}

Okay, great. Thanks, Marc. I mean I'm not sure, it seems like my mic keeps cutting out. But sorry. I think the reality is someone's got to be first, there has to be a leader. If everyone's sits back and says I'm going to wait for the other guy to do it, we would still be shrugging our shoulders and saying are we ever going to have another mortgage insurance linked note placed. So I think the reality is we are a demonstrated leader in this space and does that mean that we had terms that were a little worse than we could have had otherwise? May be but equally we are recognized by the investors, by those bondholders of our leadership position and we believe we get benefit for that, right? We see greater liquidity in our share, in our -- when I say share, sorry I don't mean ACGL shares.

I mean the bonds, the Bellemeade mortgage insurance linked notes, right? Greater liquidity in that. We're a more frequent issuer, right? We are doing three to four a year so we get benefit from that as well. So, we thought it was important in establishing our continued leadership and we did that. And reality is we took a higher attachment point than we ideally would have liked, but we can go back now and fill it in, right. Now that the market is returning and there's a greater appetite for the ability to place risk down to a lower level, we'll go back and we'll fill in the gap. We have the ability, the flexibility to do that, and it's something that we'll look to execute on in the near future.

## A - Donald S. Watson {BIO 19175196 <GO>}

All right. Well, thank you. And thank you, Phil. We're kind of hitting our time frame here. We do have an awful lot of other questions we could get to. I have a suspicion we can go through the lunch hour here. Marc, maybe I'd have you answer one last question for us and then make some closing remarks. Had a couple of questions about the acquisitions and I think we've talked about those. So, one of the things we've heard from investors is that they think acquisitions or potential acquisitions could complicate the investment case for Arch. And MI certainly has created some complications in understanding the business model of Arch and I think you tried to address that and say you like cycle management and we're trying to make that case. But how do you get comfortable with the addition of these businesses that they're actually adding value to shareholders and is bigger better? Talk about this if you would.

## A - Marc Grandisson {BIO 4369887 <GO>}

No. I think in general the acquisitions, a lot of them have to do with timing and acquiring business such as the case in Lloyd's. That is -- was sort of ground zero for what in terms of transforming -- what's happening in the marketplace. So, really a good timing from that perspective. Watford, we felt it was appropriate to get it a bit more of a sustainable future and provide -- still give us the flexibility to deploy as a platform going forward third-party capital being really important -- an important play there. I think the other ones, we have yet to do one. Coface for instance and I know there's some questions about it. Listen, we've done trade credit for 25 years. It is a line that can also be cycle managed. Every line can be cycle managed. I think the answer to the question is do you have the culture, do you have the fortitude and the commitment and the conviction to do so.

And I think if there's one thing that this Group has demonstrated and still demonstrating every day is that this is our DNA, this is where we come from. And it's not like overly complex these transactions, right? You can really look through at a high level the long-term bases, the average rate level that any of those businesses were in. And you see the rates are going up and rates are going down so it's not -- I don't want to say it's simple -- it's too simple, but it's pretty simple when you could cut right down to it. If you are keeping track and keeping an eye on the things that really are driving the results, which is by and large the rate level and the conditions, you can really, really outperform and create superior return while at the same time avoiding potholes along the way.

I mean not going to be perfect. Sometimes you may be a bit too early, too quick in and out of market, but there's clearly a lot of capabilities and possibilities to do that. So listen, also about acquisitions, like I said, there are other reasons that we don't really necessarily talk about all the time. But some of it has to do with strategic client base and distribution and maybe some products that we can offer in there through these acquisitions. So, there's a lot more than meets the eye. And we never -- at least haven't done except for MI, we're not on the lookout for any transformational M&A. I think that we've done pretty well on the M&A side and that's why I like the ones that we did recently. They're really additive, accretive, and help and also were done in a price that I think is very manageable from our perspective and will really help spur returns for the foreseeable future.

We really believe that at some point MI may not be as favorable as it is right now and that's quite okay and we'll just shift our capital allocation to other lines of business where we think the returns are going to be more appropriate recognizing that at some point MI will come back in favor and that's totally okay. I think one of the challenges that we talked -- just talking about MI for instance is to say listen, we're going to have some loss ratios of 100, 120 at some point in our history. Let's just to make sure that our market share is well in a lower single-digit when this happens and this is where really we'll create outperformance of returns through a cycle.

So, I think in closing comments. I think that we hear all the comments, some on the stock and the M&A. I think we're working very hard to right now take advantage of the market opportunities that are ahead of us. We're built for those opportunities. We're fairly bullish and very positive about our perspective for the next 12 months to 24 months. Again we believe that growing book value the way we have historically and the way we think we're positioning the book -- the business right now for the next 12 months, 24 months, 36 months; we are convinced that stock price will reflect that at some point. We'll need some patience. The same way we ask our underwriters to be patient, we'll have to ask some of our investors to be patient. We're in a long haul -- we're in a long game here. We're looking at this over a long period of time. And historically, growing book value at a good clip has been very, very positive and has showed us the path to greater riches for our shareholders and certainly for ourselves individually.

So, we're pretty excited. On that note, I will leave it at that. Hopefully that was informative. I want to thank everybody here on the call and you, Don, and Vinay, everybody from the back for the Wizard of Oz creating all that presentation. It was well done. But nothing beats like a barbecue so hopefully we have some barbecue next year where we can really see face-to-face and we have more good news to talk about next year.

## A - Donald S. Watson {BIO 19175196 <GO>}

All right, guys. Thank you much and I'm sure we'll be hearing from of you. Take care. Happy Holidays.

## A - Marc Grandisson {BIO 4369887 <GO>}

Thank you.