Q2 2013 Earnings Call

Company Participants

- Jeff Kelly, SVP and CFO
- Kevin O'Donnell, President and CEO
- Peter Hill, IR

Other Participants

- Amit Kumar, Analyst
- Greg Locraft, Analyst
- Josh Shanker, Analyst
- Josh Stirling, Analyst
- Michael Nannizzi, Analyst
- Mike Zaremski, Analyst
- Ryan Byrnes, Analyst
- Vinay Misquith, Analyst

Presentation

Operator

Good morning, my name is Jodie and I will be your conference operator today. At this time, I would like to welcome everyone to the RenaissanceRe Second Quarter 2013 financial results conference call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks there will be a question-and-answer session. (Operator Instructions)

I would now like to turn the conference over to Mr. Peter Hill. Please go ahead.

Peter Hill {BIO 3135705 <GO>}

Good morning, and thank you for joining our Second Quarter 2013 financial results conference call. Yesterday after the market close, we issued our quarterly release. If you didn't receive a copy, please call me at 212-521-4800 and we will make sure to provide you with one.

There will be an audio replay of the call available from approximately noon Eastern time today through midnight on August 21. The replay can be accessed by dialing 855-859-2056 or 404-537-3406. The passcode you will need for both numbers is 14199934.

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Today's call will also be available through the Investor Information section of www.renre.com and will be archived on RenaissanceRe's website through midnight on October 10, 2013.

Before we begin, I am obliged to caution that today's discussion may contain forward-looking statements and actual results may differ materially from those discussed. Additional information regarding the factors shaping these outcomes can be found in RenaissanceRe's SEC filings, to which we direct you.

With us to discuss today's results are Kevin O'Donnell, President and Chief Executive Officer, and Jeff Kelly, Executive Vice President and Chief Financial Officer. I would now like to turn the call over to Kevin. Kevin?

Kevin O'Donnell

Thanks, Peter. Good morning, everyone. For today's call I will start by giving some high-level comments; then I will turn the call over to Jeff to discuss the financial results, and then I will come back on to give more details about the market.

This is the first call without Neill for many years. Now I am in the fortunate position of assuming the leadership of a company that is in great shape. That is in no small part thanks to the tremendous job he has done. We will miss Neill and wish him the very best through his retirement.

I have been with RenaissanceRe for 17 years, and during my career here, I have held different positions of responsibility, including Chief Underwriting Officer. Over that time I have played a significant role in the development of our strategy and have a high degree of ownership in it. So I have great confidence in our continuing approach, in our team and our position going forward.

I believe our job as a reinsurer is quite simply to match desirable risk with efficient capital. For 20 years we have focused on what we call our three superiors. Superior risk selection, superior customer relationships and superior capital management. We will continue to invest in our technology, hire the best people and put our customers first, knowing this will lead to the best results.

So let's turn now to the results and look at how the quarter unfolded.

Last night, RenaissanceRe reported operating income of (technical difficulty) $96.4 million, an annualized operating ROE of just over 12%, and growth in tangible book value per share plus accumulated dividends of just under 1%. I am pleased with these results, which include the impact of losses from European flooding and US tornadoes. They also reflected the impact of rising interest rates and volatility in the financial markets on our investment performance. Maintaining a low duration investment portfolio served us well during the quarter, and Jeff will provide more details on that in a minute.

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As we have been saying on our last few calls, we continue to see the impact of ample capacity in the market, but broadly we have done a good job of seeing the market early and adjusting our portfolio to build an attractive book of business. We worked closely with our customers to meet their needs. And we exercised good discipline in a competitive market by choosing not to write or not to renew certain deals.

That said, there is still a sufficient flow of attractive business for us to find high-quality risk and build a great portfolio.

During the Second Quarter, much of the focus is, of course, on Florida renewals. And I will give you more color on how that looked along with comments on key dynamics in the markets in a moment. But first let me turn the call over to Jeff to go over our results.

Jeff Kelly {BIO 20911735 <GO>}

Thanks, Kevin. Good morning, everyone. I will cover our Second Quarter and year-to-date financial results and then give you an update to our 2013 topline forecast.

The Second Quarter was a profitable one for RenaissanceRe despite an uptick in the level of cat losses and a rising interest rate environment. The two main catastrophic events during the Second Quarter were the European Floods and the US Tornadoes, which had a total net negative impact on our financial results of $39 million. We have included a table in our press release with details relating to our expected claims for each of these events.

Our topline held relatively steady in what was a challenging renewal season for catastrophe reinsurance while, at the same time, our Specialty and Lloyd's unit reported strong growth. We also had some one-time expenses in the quarter, and I will go into each of these in a bit more detail later.

We reported net income of $27 million or $0.60 per share, and operating income of $96 million or $2.17 per diluted share for the Second Quarter. An increase in interest rates and credit spreads led to $69 million of realized and unrealized losses in our investment portfolio. The combined ratio was 61.2% in the Second Quarter and underwriting income totaled $113 million.

The annualized operating ROE was 12.2% for the Second Quarter, and our tangible book value per share including change in accumulated dividends increased by 0.8% during the quarter. For the first six months of 2013, the annualized operating ROE was 17.3% and tangible book value per share plus change in accumulated dividends was up 5.7%.

Let me shift to those segment results, beginning with our Reinsurance segment, which includes cat and specialty, and then followed by our Lloyd's segment.

In the Reinsurance segment, managed cat gross premiums written declined $10 million or 1.6% compared with a year ago during the Second Quarter. Reinstatement premiums earned totaled $10 million in the current quarter compared with a negative reinstatement

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premium adjustment of $31 million in the prior year period. While the vast majority of our cat book consists of traditional excess of loss contracts, we did write some quota share business in the Second Quarter that accounted for approximately $38 million of premiums.

Adjusting for the reinstatement premiums in the current and prior year periods, managed catastrophe gross premiums written would have declined approximately $8 million in the Second Quarter.

The topline decline was largely driven by increased pricing competition at the midyear renewals due to more than adequate capacity in the catastrophe reinsurance marketplace and our decision not to renew a number of contracts that did not meet our return hurdles.

For the first six months of the year, managed cat gross premiums written declined $40 million or 3.3% relative to the year-ago period. Adjusted for reinstatement premiums, managed cat gross premiums written would have declined about 7% for the first six months of the year, which was slightly better than our full-year guidance for the segment of a decline of 10%.

As a reminder, managed cat includes the business written on our wholly-owned balance sheets as well as cat premium written by joint ventures DaVinci and Top Layer Re and our sidecar Epsilon Re.

The Second Quarter combined ratio for the cat unit of 45.2% benefited from moderate cat loss experience and some reserve releases. The net impact on the underwriting results related to notable catastrophe losses for the segment totaled $41 million, with $20 million relating to the European Floods and $21 million for the US Tornadoes. Net favorable reserve development totaled $18 million for the cat unit in the quarter. This was driven primarily by reductions of $5 million for the 2011 New Zealand Earthquake, $4 million for the 2008 hurricanes and other minor reductions for a variety of smaller events.

We did not make any reserve adjustment at this point for ultimate loss estimate related to Storm Sandy. For the first six months of the year, the cat combined ratio came in at 33.4%, with favorable reserve development accounting for $37 million and lowering the combined ratio by 9.5 points.

Specialty reinsurance gross premiums written increased 57% in the Second Quarter, primarily driven by the inception of new contracts. Percentage growth rates for this segment can be uneven on a quarterly basis, given timing differences and the relatively small premium base.

For the first six months of the year, gross premiums written increased 2.2% relative to the year-ago period, which was in line with our prior guidance for slight growth for the year.

The specialty combined ratio for the Second Quarter came in at 85.6%, with favorable reserve development totaling $5 million. For the first six months of the year, the combined

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ratio for the Specialty segment was 71.7% with reserve releases of $21 million, resulting in a 21.4percentage point benefit.

In our Lloyd's segment we generated $69 million of premiums in the Second Quarter, an increase of 37% compared with the year-ago period. For the first six months of the year, Lloyd's gross premiums written increased 36% to $143 million. This compares with our annual growth rate guidance of above 30% for 2013. The split of premiums for the first six months was approximately 24% in cat and 76% across a number of specialty classes.

The Lloyd's unit came in at a combined ratio of 108.4% for the Second Quarter. Underwriting losses related to notable catastrophe events in the Second Quarter totaled $5 million, and net favorable reserve development totaled $3 million. The expense ratio remained high at 47% but has been declining sequentially as business volume has increased. For the first six months of the year, the Lloyd's combined ratio came in at 99.2%.

Turning to investments, we reported net investment income of $27 million in the Second Quarter. Our other investments portfolio generated a gain of $6.6 million in the Second Quarter as our bank loan funds had positive performance despite a rising interest rate environment.

Recurring investment income from fixed maturity investments remained under pressure due to low yields on our bond portfolio and totaled $23 million for the Second Quarter.

During the Second Quarter, we instituted a change in our classifications of gains and losses of investment-related derivatives. These gains and losses, which we previously reported as a part of investment income for fixed maturity investments, will now be reported as part of our overall net realized and unrealized investment gains or losses, and as such will not be reported as part of operating income starting this year.

We think this is a better characterization of the results as derivatives are largely put into place to offset volatility in realized and unrealized gains and losses.

For the Second Quarter, we had put in place a derivative position to lower the duration of our investment portfolio. This position, as well as some futures hedges employed by our third-party investment managers, generated a combined $21 million gain in the quarter.

Total realized and unrealized losses were $69 million in the Second Quarter and were driven by a sharp increase in interest rates and widening credit spreads. The total return on the overall investment portfolio was negative 0.7% for the Second Quarter as recurring investment income was more than offset by realized and unrealized losses.

The duration of our investment portfolio remains short at 2.4 years and has remained roughly flat over the course of the year. The yield to maturity on the fixed income portfolio and short-term investments increased slightly from the First Quarter to 1.8%, reflecting higher new money rates due to the higher interest rates in the quarter.

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Overall, while we were unhappy with the negative return in the quarter, we were pleased with the short duration of the portfolio and we remain comfortable with that duration.

As I mentioned on the call last time in response to a question, we also made a $100 million allocation to public equities during the quarter. This allocation is managed by one of our third-party investment managers and is an index-based strategy.

As we have stated on recent calls, we believe we have capital in excess of our requirements, given our current portfolio and our outlook for business growth. Share repurchases during the quarter were relatively modest, although we remain committed to returning capital to shareholders and share repurchases will remain our primary method of doing so.

During the Second Quarter, we repurchased 128,000 shares for an aggregate cost of $11 million. For the first six months of the year, we repurchased 1.5 million shares for a total of $122 million. While we don't always repurchase shares during win season, we did so last year and have a 10b5-1 plan in place to do so this year.

Whether or not we execute repurchases this year will depend on our view of excess capital and evaluation of the stock.

During the Second Quarter we issued $275 million of 5 3/8% Series E Preference Shares and used the proceeds to redeem the remaining $150 million of Series D Preference Shares and $125 million or half of our outstanding Series C Preference Shares. We were pleased with our execution here, which gave us one of the lowest cost preferred deals in our sector.

Recall earlier this year we returned $150 million of capital to third-party investors in DaVinci as well as repaying a $100 million senior note issue that matured in the middle of February. Our balance sheet remains strong with considerable excess capital, and from a liquidity standpoint, over $640 million in cash and securities at our holding company. The last 18 months has been a reasonably active period for capital management, and we are happy with where we are here and with what we have accomplished.

Our ventures unit had an active Second Quarter as well. Our Medici Fund, which has in recent years managed a portfolio of catastrophe bonds on our behalf, began accepting third-party capital to manage during the quarter. We expect to increase the level of managed capital in this unit over time.

Corporate expenses were significantly higher in the Second Quarter than in either the First Quarter of this year or the same quarter last year, approximately $17 million of expenses related to the CEO transition we had recently announced.

Finally, let me turn to update our topline forecast for 2013. Given that we have written the bulk of our full year premiums during the first half of the year, we are maintaining our prior topline guidance for each of our segments. As a reminder, our forecast is down 10% for managed cat, excluding reinstatement premiums, slight growth and specialty reinsurance in growth of over 30% for our Lloyd's segment.

Finally, I would remind everyone that premium estimates of this nature are subject to considerable risk and uncertainty. Our goal in providing them to you is just to give you our best estimates at this point in time.

Thanks, and with that I will turn the call back over to Kevin.

Kevin O'Donnell

Thanks, Jeff. Looking in more detail at our business and market dynamics now, the main themes of the quarter were the recently concluded June and July renewals; the increased participation of capital markets and the cat reinsurance space and the traditional markets' reaction; and our increased focus on growing our specialty reinsurance platform in the US.

Starting with the midyear renewals, as we expected, although demand was up slightly in Florida, the overall limit purchased in the US was about flat. Supply was up, and we did see capital markets trying to gain share in Florida. Additionally, we saw increased competition from the traditional market and their sidecars.

I think we executed and performed well at this renewal. We built a great portfolio and one which I believe has separated us from the market. In addition to changing our inwards book, we restructured or ceded, changing the overall profile of our book. Once again, we are, in our vernacular, hot down low. That means we will have a declining market share of larger losses in Florida.

Another way of looking at it is that we are increasing our exposure where returns are best.

Having said that, we continue to be a significant player in the market, and it is important to note that we will have a share of all losses.

Competition was intense, and although we expected significant pricing pressure leading up to June 1, prices reduced at a more accelerated pace than we were anticipating. As major participants in the Florida market with well-established relationships, in many cases we were able to play a leading role with clients and brokers to creatively restructure reinsurance programs.

Our ventures and reinsurance teams helped our clients by providing them with innovative forms of capital. Overall, our willingness to provide cover in the most beneficial form allowed us to write the most attractive business, and we received strong allocations from the buyers.

As primary homeowners companies in Florida have increased rates, the returns have improved. Consequently, it has made quota share reinsurance a more attractive option.

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Quota share business has more associated premiums, but it also carries lower margin than traditional cat XOL reinsurance. It picks up attritional losses and less volatile risk along with the cat exposure.

We continue to look for attractive ways of ceding reinsurance risk as a means of optimizing our reinsurance portfolio. We closed our 144A deal through our Mona Lisa facility, and I am pleased with our execution there. Declining spreads in the cat bond space provided us an attractive form of risk transfer to the capital markets.

Overall, despite more competitive market conditions, we were able to build a high-quality portfolio at the midyear renewals, generating acceptable returns on an expected basis.

Moving on to the impact of the capital markets now. The dynamics affecting the cat market are changing like they have many times over our history. The supply of capacity is growing from both increased appetite from rated balance sheets and increased interest from new capital looking to enter the market through collateralized limit.

Meanwhile, we are currently seeing no increase in US demand, and this combination leads to falling prices.

I think it is worth stating though that while we have seen an increase in interest from the capital markets, when we look at the 6/1 renewal, ultimately the vast majority of business that renewed was on rated balance sheets.

One factor affecting competition was the pressure created by collateralized limit managed by existing players, where they felt they had to deploy the new capital raised. Our approach has always been to bring alternative capital to the market when it is needed by our client.

Last year our sidecar, Tim Re III, provided a significant amount of RPP limit to the market. RPP risk is among the most desirable for collateralized markets as it is a single limit. It is among the most sought-after risks, and it was aggressively priced this year. Our decision to not renew Tim Re III or much of the RPP limit was based on our belief that the clearing price would not provide adequate returns for our investors.

Turning to specialty reinsurance, we have established a new balance sheet and a US onshore presence to build stronger relationships with our clients. This provides us better access to business that typically does not come to the Bermuda market. The challenge for the specialty business has been that even though it is efficient on our balance sheet due to its diversifying nature, much of the business still generates inadequate returns on a standalone basis.

Like our Lloyd's platform, our specialty strategy is a long-term one. And we see this platform building slowly over time.

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Just a quick word on capital management. We had a relatively light quarter for share buybacks. But looking forward, our capital management strategy remains unchanged. Over the long term, we have a track record of being good stewards of our shareholders' capital, returning it as appropriate. Our capital management philosophy and strategy is a long-term one. And we will remain disciplined in returning excess capital to our owners and investors.

One final comment. Markets change, and we will remain nimble to be able to react to them. I believe there are increasing efficiencies in the market, and it will be more important to have the ability to see changes early and to interpret subtle signs.

Our systems, people, and technology are the best in the industry. And I feel more confident than ever that we are well positioned for the future.

And now, operator, we are ready to take some questions.

Questions And Answers

Operator

(Operator Instructions) Josh Shanker, Deutsche Bank.

Q - Josh Shanker {BIO 5292022 <GO>}

I am curious. Look, obviously, we know that some pricing at 6/1 was down relative to a year ago, but -- and I have tried to play with reinstatement premiums, so my numbers might not be exactly right, but it looks like net premium written in cat grew by 14% this quarter against that -- after reinstatement premiums against that backdrop. I am wondering if you can talk about -- maybe away from Florida, did you write business? I am trying to understand that growth, which is surprising.

A - Jeff Kelly {BIO 20911735 <GO>}

Well let me maybe touch on the dynamics and the numbers. There's really three things going on here in addition. So the first one is the reinstatement premiums. So recall that we had the negative reinstatement premium adjustment last year of $31 million and then $10 million in the current period. So that is a swing of $40 million in the period. Then we also purchased less ceded during the quarter. And happy to discuss some of our thoughts around that later.

Then there was also, at least as it related -- not necessarily in cat, but for the whole -- if you look at the whole book, higher gross premiums. So I think the combination of gross premium, less ceded and the reinstatement swings is really what is driving the net earned premium increase.

A - Kevin O'Donnell

And just --

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Q - Josh Shanker {BIO 5292022 <GO>}

(multiple speakers). I am actually talking written here, though. Like, I am looking at the cat line this quarter -- (437) of net written premium, less 10 for the reinstatements a year ago, (344 less 31). I think I am doing the math right there, but maybe I am not. That is on the written side.

A - Jeff Kelly {BIO 20911735 <GO>}

Yes. So it's -- I think you are just looking at a reduction in the ceded there, Josh.

Q - Josh Shanker {BIO 5292022 <GO>}

Just on the net side -- I don't know. Maybe I will go off-line and ask some more questions about it. And I might be wrong about this, but it looks like there was actually growth in your cat book during the quarter, at least on the dollar basis.

A - Kevin O'Donnell

The gross cat book did not grow after adjusting for reinstatement premiums, just to be clear.

Q - Josh Shanker {BIO 5292022 <GO>}

Yes. That seems correct. I think I am looking at the net written book after reinstatement premiums, which shows about 14% growth.

A - Jeff Kelly {BIO 20911735 <GO>}

Yes. And I think the difference there is just a reduction in ceded premiums purchased in the quarter.

A - Kevin O'Donnell

And there's a couple of pieces of that which -- I think Tim Re III flowed through there. So now renewing the sidecar was a big piece of that. Then there were some other changes. But I think if you look at our ceded over more than just a quarter, you will see that the impact of the reduction in ceded is less over a longer period than it is just quarter to quarter. Which is timing differences.

Q - Josh Shanker {BIO 5292022 <GO>}

Okay. I will follow up a little more. And the other question was I am a little surprised about Oklahoma tornado losses. Maybe I need to know a little bit about that market. It didn't seem like a major insurance loss that would hit the reinsurance layers.

And so can you talk a little bit about what you do in the Midwest and how we should think about that?

A - Kevin O'Donnell

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Sure. From a tornado perspective, that was, I think it was about $1.2 billion from a PCS perspective. So it was a large loss for that region. I think there are -- the accounts that were largely affected there are more regional accounts. And we have good penetration to that.

If you go back to the Joplin tornadoes (technical difficulty) tornadoes, we had exposure in those as well. So it's not that it is a shift in the way we are writing the book there; it is just we have decent penetration to some of those accounts, and there was some particular ones that were relatively more exposed to where these tornadoes hit, similar to what we saw in Joplin.

Q - Josh Shanker {BIO 5292022 <GO>}

And these were principally personal lines companies ceding the risk, I assume?

A - Kevin O'Donnell

Yes.

Q - Josh Shanker {BIO 5292022 <GO>}

Thank you for the answers.

A - Kevin O'Donnell

Yes. Smallish regional companies (multiple speakers).

Q - Josh Shanker {BIO 5292022 <GO>}

Smallish â€”.

A - Kevin O'Donnell

Yes.

Q - Josh Shanker {BIO 5292022 <GO>}

Thank you for the answers. Much appreciated.

Operator

Mike Zaremski, Credit Suisse.

Q - Mike Zaremski {BIO 20606248 <GO>}

Good morning. First question. So on third-party capital, so it is my understanding, and maybe I am wrong, that third-party ILS funds took some pretty meaningful market share in Florida during 2Q.

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So I was curious is it fair to say that those third-party investors who took the market share have different return expectations versus investors who participate in DaVinci or RenRe's other joint ventures? And I guess just related to that, I was hoping to better understand the portfolio differences in decision-making process between business placing DaVinci versus the wholly-owned business in the Renaissance segments.

A - Kevin O'Donnell

Sure. So the third-party capital, we did see the presence of third-party capital in the Florida renewal. I think their penetration was something that I think we need to think about the market in a little bit more of a segmented way in order to have a discussion around how they played. So I mentioned a little bit on RPPs, where we did see pressure. Obviously to the extent that that went to other -- the RPPs went to other third-party capital, it would be fair to say they had different return expectations or different underwriting guidelines. Because we didn't think it was adequate returns for any of our capital.

The other thing I would point to within Florida is the market is talked about as a single block. But when you dive more deeply into it, there are different sections that behave quite differently. So if you look above the hurricane cat fund, we saw some efficient transfer to the capital markets. They are increasing efficient -- increasingly efficient transfers to the capital markets through cat bonds at that level. And if you look at the lower end of the capital structure within Florida or below the hurricane cat fund is, I think -- the bigger influence there was rated balance sheets, and some of those felt better protected because of some third-party capital retro that they were able to purchase.

The final segmentation I would draw your attention to is just the different credit qualities within Florida. And we saw the largest rate reduction for the lowest credit qualities. So the spread between the best credits and the low -- worst credits reduced. And I believe that was another area that there was more movement among different players. Some of that may have been third-party capital.

For what we look to do in Florida, we tend to be more concentrated towards the high credits, and we move our book around to where we can find the best returns. So from our perspective the majority of the competition we faced came from rated balance sheets. But there was certainly the overture of the third-party capital in the market.

A - Jeff Kelly {BIO 20911735 <GO>}

Mike, just to touch on the last part of your question as it related to the business written on and re-limited versus DaVinci's balance sheet, there are some types of contracts that we will write on RenRe's balance sheet, but that we don't write for DaVinci. And the principal one was the one that I mentioned in my prepared comments, where I think I mentioned the quota share business we wrote during the quarter.

So our underwriting criteria for DaVinci and RenRe really hasn't changed. It was just during the quarter we didn't -- we wrote some quota share business that just doesn't go on DV's balance sheet.

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Q - Mike Zaremski {BIO 20606248 <GO>}

Okay. That is very helpful. My last question is regarding to the catastrophe bonds that were issued in recent months. So it is my understanding they come with an interest expense, which I need a model in the income statement. So I was trying to -- I wanted to understand how, how to -- if there is an offset in terms of -- is the offset higher premium retention levels witnessed this quarter, and that should produce potentially more earnings? Or is there another dynamic we should take into account? If that question makes sense.

A - Jeff Kelly {BIO 20911735 <GO>}

It should show up -- it will show up as ceded premium.

A - Kevin O'Donnell

And from a behavioral aspect I would not infer any difference in our strategy or behavior. When we look to cede risk, we are indifferent to the form in which we cede it. So the fact that it is a capital markets structure or sidecar or just traditional retro, it's simply just putting it against our balance sheet, and it won't change the way in which we are -- no, the form of which we bring that capital in it won't change the way in which we write our inwards book.

Q - Mike Zaremski {BIO 20606248 <GO>}

And just to be clear, is there an interest expense associated with it, or this all flows through the premiums lines?

A - Jeff Kelly {BIO 20911735 <GO>}

It will flow through ceded premium.

Q - Mike Zaremski {BIO 20606248 <GO>}

Got it. Thank you.

Operator

Michael Nannizzi, Goldman Sachs.

Q - Michael Nannizzi {BIO 15198493 <GO>}

One basic question looking at the year over year. I also was surprised to see the premium levels -- not necessarily the growth relative to the Second Quarter, but just I was expecting slightly lower levels. But I guess on top of that, the underlyings were a lot better year over year.

So I was just curious, I am sure it has to do with where you are writing business and which areas you are primarily participating in, but can you help square the premium levels, the opportunities you saw and the better margins, given the rate backdrop that you have been talking about? Thanks.

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A - Jeff Kelly {BIO 20911735 <GO>}

Yes. Just a clarification. When you said the underlyings, I am not sure what you were referring to -- (multiple speakers).

Q - Michael Nannizzi {BIO 15198493 <GO>}

I'm sorry, so like X cat, X PPD, combined ratio.

A - Jeff Kelly {BIO 20911735 <GO>}

Okay. So I think I am still a little confused on your question. I think what you are asking is did we see significant shift in opportunity this quarter to last quarter?

Q - Michael Nannizzi {BIO 15198493 <GO>}

I guess the question is --- so, and then let me know if these numbers are wrong, but action year combined ratio X cat was (49.7%) in the Second Quarter of last year. It was (44.2%) this year in the Second Quarter. And you wrote a decent amount of business, and you have talked about some rate pressure. So I would think in a period where you have rate pressure, you would see margins deteriorate, but it doesn't look like that happened. So I was trying to understand that.

A - Jeff Kelly {BIO 20911735 <GO>}

Okay. What really renewed in this quarter was largely the Florida book. So a lot of the comments around rate this time of year tend to be focused on that. And we did see rate reduction in Florida.

The rest of the book we have written some more quota share and specialty. And that is proving to continue to be beneficial for our portfolio in two ways. One is on a standalone basis we are finding it attractive, but then on a marginal basis it is very efficient for us to bring it on our portfolio.

So the growth in Lloyd's has been largely related to the specialty businesses. Then on the recent foray we have into the US and some of the other things that we are doing is also looking to expand some of those lines, which on a standalone basis are beginning to look better. Particularly some of the professional lines.

Q - Michael Nannizzi {BIO 15198493 <GO>}

Got it. Okay. And one question on DaVinci, if I could. What is the fee structure there in terms of the unrealized losses or gains? Do you get fees based on underwriting income, or does this -- do the fees that you get include the change in unrealized?

A - Jeff Kelly {BIO 20911735 <GO>}

Yes. We -- without going into the specific fee structure, we are -- our fees are generated off of underwriting income, and then we do get a percent of the overall profits of the company, which would include investment results.

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Q - Michael Nannizzi {BIO 15198493 <GO>}

Okay, so, that doesn't -- okay, thank you.

Operator

Greg Locraft, Morgan Stanley.

Q - Greg Locraft {BIO 4221265 <GO>}

Good morning. Kevin, first off, congratulations on the new role. I wanted to get a sense as to your priorities in the lead job. How will they differ from Neill and from the past?

A - Kevin O'Donnell

As I said, we are going to remain focused on the same things. I have been part of this Company for a long time and have been influential over the strategy. I think if we continue to focus on finding good business and finding efficient capital and managing our capital effectively, we will produce superior returns over the long term.

I think investing in our people, investing in our technology is something that has been an important part of our success and will continue to be. I think the market is shifting a bit. We have a track record of being able to respond to that in -- before many other sea changes and in ways that again lead the market. That will continue.

And the emphasis we have on maintaining our cat franchise will continue, along with continuing to build out our Lloyd's operation and our specialty franchise.

So large and large, it will be a very consistent story to what you have seen. But as the market changes so will our position within it. Again that is consistent, but we can look different from year to year based on the opportunities that are available.

Q - Greg Locraft {BIO 4221265 <GO>}

Great. So it sounds like more of the same, mostly. Good. So digging into the underwriting side, one of the things -- and I think we are circling it on this call -- is the net to gross.

I was surprised to see it rise year over year. I would have thought in this market that you all would have been laying more risk off. It sounds like you have moved more down low.

I am just sort of -- if you could give us some color. Do you have now more exposure to a big event in Florida this year than previous years? Or can you maybe talk a bit about how you were thinking about laying off things in the retro market, et cetera?

A - Kevin O'Donnell

Sure. I think Jeff touched on some of the more technical points as with the bond and with Tim Re III, which are affecting our ceded premium. The one thing -- I think focusing specifically on ceded premium can be a misleading metric. And thinking about ceded, at

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the very highest level you can think about whether you are protecting your balance sheet or you are protecting your income statement. So looking at the 144A deal that we did, that is clearly at a more remote level or what I would consider more of a balance sheet protection.

A lot of the trading and a lot of what has been available in the market right now are income statement protections, which tend to attach significantly lower and have more premium associated with them. The net effect can be very, very different on the risk profile of the book that you are building.

So I think thinking past just premium is important. I think the other thing is how you write your book. So what we do is look forward and look at what we think the market will present and then build our portfolio around what that opportunity set looks like. Included in that is we structure what we think is likely to be a ceded portfolio that optimizes against our inwards book.

And we did that going into the Florida renewal, which produced, I think, a very attractive portfolio, but one that is structured not only on the outwards basis, but on the inwards basis differently. We mentioned we are hot down low, so we do have a greater market share of smaller losses within Florida. But across most of Florida, we are up a small amount, but not as much as we are at the bottom end of the distribution.

A - Jeff Kelly {BIO 20911735 <GO>}

So Greg, I would just add to that. The other thing to keep in mind, although ceded premium was down about $95 million in the Second Quarter over last year, it was actually up about $27 million in the First Quarter of this year; and then as Kevin mentioned, in the cat bond we issued, that will have the effect of adding another $11 million or so in ceded premium.

I guess the message in all that is we purchased ceded protection and traded opportunistically, and that opportunity rarely occurs on an even calendar quarter basis. So I think you do have to look at it over a bit longer period of time as well.

Q - Greg Locraft {BIO 4221265 <GO>}

Okay, that's good color. I guess my takeaway is that it sounds like you are more protected than before against a very large loss, but you have got more exposure to frequency given that Kevin says he is hot down low. So is that the right takeaway?

A - Kevin O'Donnell

I think that's it. That is a reasonable way to think about it. The other thing, actually one other thing I wanted to touch on within ceded is we have a core portfolio of ceded returns or CPPs or their quota share like instruments. And that has been pretty consistent throughout the year.

Q - Greg Locraft {BIO 4221265 <GO>}

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Great. Then one other question, just on the return characteristics. All of this supply coming in that you articulated, much of it has a lower return hurdle than you guys do and historically have driven.

Will you at all alter -- you have talked and shown data in the past on the amount of business in the market that is acceptable versus low versus negative. Have you ever articulated what those thresholds are? And will those shift at all, given that more supply that is willing to accept a lower return is coming in?

A - Kevin O'Donnell

Sure. The classification we talk about are adequate returns, low returns and negative returns. And so what we saw here -- we saw some migration within adequate returns, where returns are still adequate, but they have reduced a bit. We saw some movement between adequate returns to low return, but still very little move in the Florida market through negative return.

Your question about the returns for capital, I think it's one that is a shifting environment, is a shifting market right now with regard to that. And we have traditionally built the portfolios that we like to participate in. I think that is an important part of how we manage capital and are stewards of capital for third parties.

Right now what -- if you map the clock back and look at just rated balance sheets when we started, a lot of rated balance sheets started and thought about taking risk on a single model. You won't find many rated balance sheets that rely solely on a single model.

I think what is going on in the capital markets is somewhat similar to that, but beyond relying in some instances on just a single model, they are relying on a single point, and they are taking the expected loss and then applying a multiple to it, where I think it is very important to understand the shape of the distribution, not just the mean. And over time I think the reason we do two analyses -- a standalone analysis and a marginal analysis -- is to make sure that we or our partners are paid adequately on a standalone basis for the risk that they are assuming. Then we can match it with capital.

The first part will not change because I think that is just the risk inherent in the deal. But we continue to change how much return capital needs to be able to match with that standalone return, and that is really where the pressure is coming into the market.

So I think it is good underwriting discipline. But it is also a changing market as to the types of capital and the return they need, based on the margin of returns of their portfolios.

Q - Greg Locraft {BIO 4221265 <GO>}

That's great. Very thorough. If I could sneak one more in, apologies. But I am trying to compare the alternative capital or collateralized vehicles. If they are willing to accept a 7 or an 8 return or a 9, let's say, is that -- what is the equivalent for the rated balance sheet? Is the equivalent a 12, 13, a 14? How would you compare the two?

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That is really not a RenRe question; that is more of a traditional versus alternative return question, given the leverage inherent in the rated balance sheet versus the unrated.

A - Kevin O'Donnell

Yes. That is a hard question because the -- I think different people have different measures of return. Where we have seen some of the new capital come in saying, okay, it is a BBB; it is paying 100 basis points more; therefore I will allocate. That is a very different thought process than we would engage in as to how to think what is an adequate return for the capital. So it is hard to come up with it comparatively.

The one thing I would say is we are very comfortable with the return profile of our book for our third-party investors and for our owned balance sheets. And one simple analogy I sometimes think if we can double the capital within DaVinci and cut the returns in half, but I am not sure that's serving anyone's interest. All we have done is managed more capital. What we do is we bring in what we think is the right amount of capital and produce a portfolio that provides, we think, adequate returns for the risk that they are assuming.

It is difficult for me to comment on each of the models of the individual capital. But there are -- going back to the BBB one, there are different ways in which people are thinking about it.

Q - Greg Locraft {BIO 4221265 <GO>}

Thanks for the answers and congratulations again on the new role.

Operator

Vinay Misquith, Evercore.

Q - Vinay Misquith {BIO 6989856 <GO>}

Good morning. Sorry for beating a dead horse, but trying to wrap my head around the net premium increase for the cat segment. So that is about $90 million roughly up this quarter versus the year-ago quarter. And I believe you mentioned about $40 million came from reinstatement premiums. And say roughly about $38 million came from the quarter share. So that is about $78 million of the $92 million.

So it seems that the net premiums were up even more (than) those two items. So was that because of buying less reinsurance on the lower layers like you mentioned? Just trying to get a sense for -- yes, sorry, go ahead.

A - Jeff Kelly {BIO 20911735 <GO>}

I think the principal variable that you are trying to identify in the two comparisons is the fact that we didn't write Tim Re III this year compared to last year, which was about $31 million.

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Q - Vinay Misquith {BIO 6989856 <GO>}

Sure, but that would have been -- right, so that would have lowered your gross premiums too, right? But your gross premiums were roughly flat. So you actually wrote more gross payments this year adjusting for Tim Re III, correct?

A - Jeff Kelly {BIO 20911735 <GO>}

No. It was in cat it was about flat.

Q - Vinay Misquith {BIO 6989856 <GO>}

Right, but the premium was $31 million and last year it was in the numbers in the gross, correct? Then you ceded it out, correct?

A - Jeff Kelly {BIO 20911735 <GO>}

Right. So Tim Re was about $40 million in last -- and the reinstatement premium swing from quarter to quarter was about $40 million as well. So those two things canceled one another out roughly.

Q - Vinay Misquith {BIO 6989856 <GO>}

Okay. Maybe I will just follow up, but it just seems that the gross number then would be higher than what it would normally be, so if you take Tim Re out. Okay.

Second question. Growth in RenaissanceRe's topline seems to be higher than DaVinci, and you mentioned because you wrote the quarter share in RenaissanceRe's balance sheet versus DaVinci's. But just curious as to, should you choose to, can you take more premiums from your other balance sheets that you use and put them on the (year on) books if you want to grow your own premiums?

A - Kevin O'Donnell

Yes. So we can cali -- we can change DaVinci in lots of different ways. We can change our ownership in DaVinci. We can change the absolute size of DaVinci, and we can change signings to DaVinci, which is something that we look at at each renewal and also on each deal to figure out what is optimal.

We try to keep the DaVinci cat portfolio to be closely correlated with the RenRe portfolio, but we have a lot of discretion as to how to do that and to make sure that each of the balance sheets are being treated fairly and appropriately.

Q - Vinay Misquith {BIO 6989856 <GO>}

Sure, but let's say that you saw less opportunities in the market. Could you take more premiums from your other balance sheet and put them on your own balance sheet, therefore generating more premiums for yourselves?

A - Kevin O'Donnell

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Yes. We can do that, but I don't want to leave you with the feeling that we would do that. We look at DaVinci as a long-term vehicle, and that capital and that vehicle are partners to us.

So thinking about changing it from quarter to quarter would not be necessarily the way we think about it. We think about constructing a portfolio that is largely very similar to the RenRe portfolio. And we are more likely to adjust capital or our ownership than to change inward lines simply to benefit the RenRe Limited balance sheet.

A - Jeff Kelly {BIO 20911735 <GO>}

Yes, just to add to that, the way we look at managing third-party capital is like most things here over a very long-term basis. And we want to provide excellent returns for our investors in all of our third-party capital vehicles over the long term. And we also want to cultivate good long-term partners in our third-party capital vehicles.

We are probably -- to the extent that we would be willing to adjust those, we would probably be more willing to do it in sidecars than in DaVinci. And such was the case with not renewing Tim Re III this year.

Q - Vinay Misquith {BIO 6989856 <GO>}

Fair enough, thanks. One last question with the buybacks. Curious as to whether you guys were blacked out this quarter, that is why the share repurchases were low?

A - Jeff Kelly {BIO 20911735 <GO>}

No. I wouldn't say that. During the quarter we did -- we had 10b5-1 plans in place -- 10b5-1 plan in place coming into the quarter. I think through the first half of the month our shares were trading above the cap that we had set on that. We instituted one after the announcement of Neill's retirement that took place in late May. And by the time that one actually became active, we were -- that took us to the last week or so in June.

So there was a period of time where we weren't in the market, but I would say that the principal factor during the quarter was just the relative valuation during the -- at least the first half of the quarter.

Q - Vinay Misquith {BIO 6989856 <GO>}

Sure. Thank you.

Operator

Ryan Byrnes, Janney Capital Markets.

Q - Ryan Byrnes {BIO 16902592 <GO>}

Good morning. Quickly, obviously there was some pressure on cat rates in Florida. And you guys rearranged or restructured your portfolio. Just wanted to figure out year over

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year how your new portfolio stacks up against last year's on a risk-adjusted basis.

A - Kevin O'Donnell

We touched on some of this earlier in the call, but we did restructure the book in Florida. Thinking about a topline rate change in Florida, let's say it is down 15%, I think is not necessarily the way to think about how we construct our portfolio. We did a very good job this quarter working closely with our brokers and clients early. We did a good job working with our ventures unit to bring capital to the market in nontraditional ways.

So although the market generally was down pretty significantly, we were largely able to play around that because of our strong relationships and our ability to bring capital in many forms.

So it is one I touched earlier that the lower credits were more heavily affected by or had better -- received better benefit from the rate reduction than the best credits in Florida. And most of our larger relationships were among some of the best credits in the market.

So the rates were down. But I think this is something that we have seen before. Our relationships and then our access to clients and our ability to structure nontraditional deals is very beneficial.

Q - Ryan Byrnes {BIO 16902592 <GO>}

Great. Then, shifting over to the new US platform. Wanted to see what types of risks you are looking to write there and where you see the opportunities.

A - Kevin O'Donnell

I think the new platform is going to be a Bermuda-based balance sheet, but a US taxpaying balance sheet. And we have an office that we are opening in Connecticut. That office will really focus on certain types of risks that don't come to Bermuda. And most of that really is quota share -- specialty lines quota share. And the type of quota share that needs more contact, more ability to audit the book, more ability to understand as the book is changing over time, which can be difficult to do with an offshore balance sheet.

Q - Ryan Byrnes {BIO 16902592 <GO>}

Great. Thanks.

Operator

Josh Stirling, Bernstein.

Q - Josh Stirling {BIO 17463087 <GO>}

I will end with one big picture question. Margins are coming down, it's -- so you're seeing at the margin less acceptable business. And you guys have your three superiors, and long

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track record as a big advantage, but you have got a few different strategic choices you are playing out.

Sounds to me you are trying to synthesize, you are trying to get close to your customers with quota shares and distribution in the US. You are trying to leverage your expertise to grow into other stuff, specialty in Lloyd's; and then finally, you sort of source and use more third-party capital.

The big question I struggle with a little bit is trying to figure out how you think these things will balance out over the longer term? And should we be looking at you growing more in these businesses in a meaningful way? Or are these sort of modest pieces of the story? And in fact maybe should we be thinking about you more shrinking the topline over time and repositioning to being primarily a third-party capital manager?

I would love to get your long-range thinking on what you guys look like. Thanks.

A - Kevin O'Donnell

Let me start with Lloyd's specialty, and then I will come to the cat piece. Lloyd's is something that going back four years ago we decided to start the Lloyd's balance sheet. And it was something that very much is a long-term view, and we took the position that it was better to integrate it and grow it slowly over time rather than to acquire it. That strategy has not changed, and we are continuing to see good opportunities in Lloyd's. We are a small player in a large market. So I remain optimistic that we will continue to grow at a good clip there.

The specialty business is one that is still significantly smaller than it has been going back to 2004 and those years. But it adds the same benefit to the portfolio that it always has, which is diversifying profit.

So I think we are continuing to expand that platform. Our recent expansion into the US is nothing more than, again, trying to get closer to the customer, but also trying to access business that we otherwise wouldn't be able to access. So again that is a strategy that has been in place for a long time, and one that I see good opportunity with and will continue.

The cat business -- you asked specifically about third-party capital. And I think we believe third-party capital will be part of the market for the long term.

So and if you go back, we would not have been managing or would not have built the infrastructure that we have to manage third-party capital if we didn't believe that. But we also believe that in each of the optimizations that we run, our preferred position is to have a balance between a rated balance sheet and third-party capital, and looking forward I think that will continue.

So I think the market will go through cycles where capital is more available at certain periods of time like it is now, and it is less available at other times, like we have seen in

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the past. But our ability to play between a rated balance sheet and third-party capital I believe will be the optimal structure within the vast majority of scenarios.

Q - Josh Stirling {BIO 17463087 <GO>}

Thanks and congratulations. Good luck for the win season.

A - Kevin O'Donnell

I think we have time for one more question here.

Operator

Amit Kumar, Macquarie.

Q - Amit Kumar {BIO 15025799 <GO>}

Two quick follow-up questions. First of all, just going back to RenaissanceRe specialty US. That operation has roughly $100 million of shareholders' equity.

How are you thinking about the premiums going forward? I am not looking for a specific number, but I am thinking about how long will that take to ramp up and become a meaningful contributor.

A - Kevin O'Donnell

I think, again, we wanted to match the size of the capital to the opportunity, and we are prepared to scale up the capital as the opportunity grows. We retooled our -- another balance sheet, our old Glencoe balance sheet in a similar way to write quota share business, the quota share business here in Bermuda. And we achieved our three-year plan in two years. That isn't necessarily what we are intending to do with the US, but I think it will be a reasonably small platform for the foreseeable future. And one that will really be around opportunity-based growth.

I think there is an opportunity now, but it is not one in which we want to deploy a significant amount of capital until we have more of a foothold in the market.

Q - Amit Kumar {BIO 15025799 <GO>}

Got it. That's helpful. And the only other question, going back to the discussion on the Florida marketplace. I appreciate the discussion on retooling of the book. But let's say as we go forward in rates, rates are down let's say another 10%, 15% in 2014.

Do you still think that there are slivers of acceptable return at that time? Or do you have to meaningfully relook at the lower layers at that time?

A - Kevin O'Donnell

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As we talked a little bit about on the call, I don't think rates tend to move uniformly among all participants in the market and for all reinsurers. I don't anticipate that any realistic scenario for renewal of the Florida book in 2014 will require us to leave the market.

We will certainly need to change our strategy, think about what capital we are going to apply to the opportunity and think about it from a collaborative or from a coordinated perspective between our inwards and our outwards.

But in pretty much any scenario I see that we will have a strong presence in the Florida market. So we can be surprised by things, but I think that is extremely unlikely.

Q - Amit Kumar {BIO 15025799 <GO>}

Got it. Thanks. I will stop here. Thanks for all of the answers.

A - Kevin O'Donnell

Well thanks, everybody, and we look forward to speaking to you next quarter.

Operator

Thank you. That concludes today's conference call. You may now disconnect.

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