Q1 2014 Earnings Call

Company Participants

- Jeff Kelly, EVP and CFO
- Kevin O'Donnell, President and CEO
- Peter Hill, IR, Kekst and Company

Other Participants

- Amit Kumar, Analyst
- Brian Meredith, Analyst
- Cliff Gallant, Analyst
- Ian Gutterman, Analyst
- Jay Cohen, Analyst
- Josh Shanker, Analyst
- Kai Pan, Analyst
- Michael Nannizzi, Analyst
- Sarah DeWitt, Analyst
- Vinay Misquith, Analyst

Presentation

Operator

Good morning. My name is Kyle, and I will be your conference operator today. At this time, I would like to welcome everyone to the RenaissanceRe First Quarter 2014 financial results conference call. (Operator Instructions)

Thank you. Mr. Hill, you may begin your conference.

Peter Hill {BIO 16538750 <GO>}

Good morning, and thank you for joining our First Quarter 2014 financial results conference call. Yesterday after the market close, we issued our quarterly release. If you didn't get 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 about noon Eastern Time today through midnight on May 21. The replay can be accessed by dialing 855-859-2056 or 404-537-3406. The passcode you will need for both numbers is 21861512.

Today's call is also available through the investor information section of www.renre.com and will be archived on RenaissanceRe's website through midnight on July 18, 2014.

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. This morning I will stick with the same format we've used on the last few calls, where I will give some high-level opening remarks; then I will turn it over to Jeff to talk about the financial results; and then I will come on to discuss the outlook of business in more detail.

The First Quarter was fairly quiet as the string of relatively low loss periods continued. Each of our segments produced solid results, generating an operating return on equity of 15.9% and growth in tangible book value per share, plus accumulated dividends of 2.8%.

Our team balanced our commitment to underwriting discipline with a commitment to market leadership, and I am pleased with the portfolio we have constructed. We were active in managing capital through share buybacks, repurchasing more shares in the First Quarter than through the whole of last year.

The fear of large losses can fade in the minds of some market participants after quiet stretches, but the recent earthquakes from Mexico to Canada along the Pacific Coast serve as reminders of the potential volatility that always exists in our business. We never waver in our focus on managing the risk of large losses over time while working to build an attractive book of business.

The themes we discussed during our last call still resonate, with supply of reinsurance capacity remaining abundant. Traditional markets are competing hard to maintain their shares, and alternative capital markets continue to look for opportunities to grow. Despite the inevitable pressure on price resulting from such dynamics, during our April renewals -- which are largely Japan -- we were able to retain attractive business.

As we head towards the midyear renewals, during which a significant portion of our book renews, we anticipate a continuation of those trends. In this environment I believe our strategy, our market position in the cat reinsurance business, and our long-standing relationships with brokers and clients will serve us well.

In the context of adding value for clients and partners, I'd just like to mention some management changes which I believe will perpetuate the high-touch, high-value relationship building for which we are well known. Ross Curtis, who has done a great job growing our Lloyd's Syndicate, is returning to Bermuda this summer to oversee global underwriting as Group Chief Underwriting Officer. He has been with the Company for over 15 years and has been instrumental in developing our strategy and our relationships.

The position of active underwriter in London will be taken over by Bryan Dalton, who most recently was responsible for international and worldwide retrocessional markets. David Marra will relocate to our Connecticut office, where he will continue to lead our specialty reinsurance business. And Justin O'Keefe remains responsible for property underwriting at a Group-wide level. Each of these gentlemen has extensive and long-standing relationships in the industry as well as a deep understanding of the RenRe culture.

I'd like to go on to discuss market conditions in more detail, but before I do, I'm going to turn the call over to Jeff to go over the results. Jeff?

Jeff Kelly {BIO 20911735 <GO>}

Thanks, Kevin. Good morning, everyone. I will cover our results for the First Quarter and then give you an update to our 2014 top-line forecast.

We had a profitable First Quarter, again benefiting from solid underwriting, low cat losses, and healthy income from our portfolio of other investments. Our managed cat top-line decline in the First Quarter mostly reflected the competitive market dynamics that we have highlighted on recent calls and that we have pointed to in our previous guidance.

We stepped up the pace of share repurchases in the quarter, which was driven by a few factors: the buildup in our excess capital position, strong corporate liquidity, as well as what we believe were attractive valuations for our stock in the quarter. We reported net income of $151 million or $3.56 per diluted share, and operating income of $136 million or $3.20 per diluted share for the First Quarter. The combined ratio was 47.2% in the First Quarter, and underwriting income totaled $151 million.

The annualized operating ROE was 15.9% for the First Quarter, and our tangible book value per share, including change in accumulated dividends, increased by 2.8% during the period. Book value growth was driven by strong earnings in the quarter, although the sizable share repurchases executed at a premium to book value were a slight offset.

Let me shift to the segment results, beginning with cat and specialty reinsurance and then followed by our Lloyd's segment. Managed cat gross premiums written declined $34 million or 6.4% compared with a year ago. There were no reinstatement premium adjustments in either period.

Managed cat premiums included $89 million of gross premiums written by our Upsilon sidecar in the current-year period compared with $54 million written by its predecessor in the First Quarter of 2013. Recall that Upsilon targets opportunities primarily in the structured retrocessional reinsurance marketplace.

The top-line decline for cat premiums in the quarter was largely driven by increased pricing competition at January 1 and compares with our full-year guidance for a decline of 15%. 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, Top Layer Re, and Upsilon.

The First Quarter combined ratio for the cat unit of 20.7% benefited from low catastrophe loss experience. The only notable events during the First Quarter were a series of winter storms in the US, for which we booked $11 million of reserves.

Net favorable reserve development totaled $6 million for the cat unit in the quarter, reflecting small adjustments to a number of events.

In specialty reinsurance, gross premiums written increased $72 million or 87% in the First Quarter compared with the year-ago period. Growth was primarily driven by the inception of a small number of large financial lines' quota share transactions, primarily in mortgage reinsurance. As we have often stated in the past, percentage growth rates in this segment can be pretty uneven on a quarterly basis, given the size and nature of the transactions as well as the size of the premium base. The growth rate in the quarter compares with our full-year 2014 guidance of up 15%.

The specialty reinsurance combined ratio for the First Quarter came in at 75.7%, as loss activity was generally benign. Favorable reserve development totaled $16 million in the quarter.

In our Lloyd's segment we generated $83 million of premiums in the First Quarter, an increase of 12% compared with the year-ago period. This compares with our full-year guidance for premiums to be up over 20%. The Lloyd's unit came in at a combined ratio of 93.5% for the First Quarter, also benefiting from generally low loss activity.

The adverse reserve development of $5 million was principally driven by the application of the Company's formulaic reserving methodologies for establishing IBNR reserves and did not relate to any particular set of large events. The expense ratio remained high at 43.2% but has continued to trend down as the unit grows its premium base.

Turning to investments, we reported net investment income of $39 million in the First Quarter. Our alternative investments generated a gain of $17 million in the First Quarter, driven by continued solid results in our private equity portfolio.

Recurring investment income from fixed maturity investments remained under pressure due to low yields on our bond portfolio and totaled $24 million for the First Quarter. The total return on the overall investment portfolio was 0.8% for the First Quarter, benefiting from strong returns on the alternative investments and some realized and unrealized gains in the value of fixed-income securities due to a decline in interest rates and credit spreads.

Our investment portfolio remains conservatively positioned, primarily in fixed-maturity investments with a high degree of liquidity and modest credit exposure. The duration on our investment portfolio remained short at 2.2 years and has remained roughly flat over the course of the last year or so. The yield to maturity on fixed income and short-term investments remained flat at 1.6%.

Turning to capital, similar to what we have stated on recent calls, we continue to believe we have capital in excess of our requirements, given the current portfolio structure and our outlook for business growth. During the quarter we took advantage of what we believed were attractive valuations for our stock to address some of the access capital through share repurchases.

As of March 31, we have repurchased 3 million shares for an aggregate cost of $277 million. Subsequent to the end of the quarter we repurchased an additional 329,000 shares for a total of $32 million.

We remain committed to returning excess capital to our investors with an emphasis on share repurchases. But the timing on a quarterly basis will depend on a number of factors, including the shape of our underwriting portfolio, our projected liquidity needs, and the valuation of our stock.

Let me turn to update our top-line forecast for 2014. For managed cat, we are at this point maintaining our full-year guidance of premiums to be down 15%, excluding the impact of reinstatement premiums. In specialty reinsurance, we are raising our top-line guidance to be up over 20%, reflecting the strong growth in the First Quarter. Timing differences could continue to result in premium volatility here on a quarterly basis. In our Lloyd's unit we continue to expect premiums to be up over 20%.

Finally, I would remind everyone again that premium estimates of this nature are subject to considerable risk and uncertainty. Our goal in providing them to you is 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. As I mentioned in my opening remarks, our April renewals primarily constitute Japanese business. Despite pricing being down between 10% and 15% on average, with a spread either side of this depending on the buyer, we achieved good signings and generally maintained our share on programs.

We have begun discussions with our clients about the mid-year renewals. We anticipate a slight uptick in aggregate demand in Florida for both traditional reinsurance and cat loss.

In general, state facilities in Florida have done a good job of moving more exposure to the private market, which results in more opportunities for insurers and reinsurers.

At the same time, we are seeing capacity from both traditional and nontraditional markets continuing to target US peak zone risk, even as pricing has declined. Given the abundant supply for Florida risk, we expect another competitive renewal season.

We anticipate continued emphasis from buyers on core reinsurance partners. This could, however, lead to further pricing pressure from those non-core reinsurers looking to increase their participation in Florida, as their only means to obtain business is to be aggressive on price and conditions.

The catastrophe product continues to evolve with more aggregate and multi-year deals in the market. In addition, we have seen the broadening of hours clauses and the inclusion of commercial terror in many policies. Expansion of coverage is just another form of price reduction and an area that we will watch closely to the renewals.

At a macro level, we are starting to see undisciplined behavior, with some risk being priced below an acceptable level of return for any form of capital. This behavior cannot persist permanently in financial markets.

On the other hand, it can exist for long time, and pricing decisions by suppliers are often only revisited after an event. With 20 years of operation behind us, we have the benefit of having experienced many soft markets. We have the tools to understand our customers' risk, along with the best technology to price that risk. Additionally, we have more balance sheets and more access to capital, which provides us greater flexibility to construct our portfolios.

In terms of ceding opportunities, we will continue to look for ways to improve our underwriting portfolio in much the same way as we did in 2013. We will remain innovative and evaluate all options, such as cat funds, traditional sources, and other forms of ILS. We expect we will see more opportunities as we get closer to wind season, as capital that cannot be deployed in the reinsurance market may look to become deployed in the retro market.

Looking outside of property reinsurance now, in specialty we have continued to build our franchise in a deliberate manner, leveraging key relationships to grow our business. We are pleased with the growth that we have achieved, and the underlying underwriting fundamentals have been strong. We are watching this market closely as we continue to see pricing pressure for excess of loss and increased pressure on ceding commissions for quota share contracts.

Casualty and specialty business is attractive from a portfolio standpoint because of its diversifying nature to us. Ultimately, we look at stand-alone returns from these classes. Relying on the benefits of diversification alone may result in underpricing the risk over the long term.

Our Lloyd's unit continues to make good progress in building out its business. Over the past few years we have developed our underwriting capabilities and infrastructure to compete effectively in the market. The Lloyd's operation had a profitable quarter, and we expect continued improvement in this business as we see greater benefits of scale.

As we head towards the June 1 and July 1 renewals, we are ready to support our clients and partners. And we are uniquely positioned to offer capacity through many forms of capital and will look to match risk with the most efficient capital to optimize our returns on our book. We believe we are well positioned to manage the challenges and opportunities we see in this market and to continue to build attractive portfolios.

With that, I will turn it over for questions.

Questions And Answers

Operator

(Operator Instructions) Amit Kumar, Macquarie.

Q - Amit Kumar {BIO 15025799 <GO>}

Two quick questions. The first question is, going back to the discussion on the upcoming renewals, you talked about undisciplined players competitive. Can you maybe broadly put some ranges around what the expectations might be? We've heard 10% to 15%. And we have also heard of challenging Citizens' rate online placement. Maybe just give some numbers around some of those ranges. That would be very helpful.

A - Kevin O'Donnell

We are kind of in the thick of renewals right now, and having lots of discussion with our clients, and figuring out how they are structuring their programs and what they are buying. In addition to price, one of the things I mentioned is we are seeing changes in structures, which always makes it difficult to compare exactly one year to the next.

And I think thinking about it in terms only of a price reduction doesn't necessarily capture the changes that are likely to take place in the market. But I also think that it is not -- what happens to the market may be different to what happens to people who have a long commitment to Florida market, as they are the opportunities to participate either privately or in an advantaged manner in some way across different programs.

With that, I think there will be significant pressure on pricing. But it's not one in which I think it is appropriate at this time to talk about the exact levels of reductions. But it certainly will be down.

Q - Amit Kumar {BIO 15025799 <GO>}

I guess what I am trying to ask is: is it closer to just being at the edge of the return hurdles already? Or you think there's still some gap to that point?

A - Kevin O'Donnell

I think as with most markets, there is going to be deals that are better than others and layers that are better than others. I believe that there will be a lot of low returning business in Florida.

I think there's probably going to be a little bit of negative returning business, thinking about the way we divide the world up. But we certainly are targeting the attractive business and are continuing to build a portfolio predominantly based on that book.

Q - Amit Kumar {BIO 15025799 <GO>}

Got it. The only other question I have, and I will re-queue: just based on that comment and based on your guidance, how should we think about the incremental freeing up of capital, if you will? And the majority of that be used for capital management, or do you have to keep some powder dry?

And maybe also if you can touch upon the discussion on consolidation in the marketplace, and especially how it relates to Aspen and Endurance? That would be very helpful. Thanks.

A - Kevin O'Donnell

Okay. Let me break it up a little bit. You asked about capital. I think we, over the long term, have been good stewards of capital. We have great technology to measure how much economic capital is being deployed and then matching that up against our actual capital.

I believe without -- you know, as Jeff had mentioned in his comments, we will continue to look for opportunities, predominantly through share buybacks, to manage excess capital and deploy as much business as we profitably can into the markets. So really, no change in the way we are thinking about our capital going into wind season.

The other question you raised is an M&A question. And I think it's a natural point in the cycle for M&A to be part of the conversation, as we are moving into a market that is more competitive with too much capacity coming from both rated and unrated players.

I think from our standpoint, we are very comfortable with the strategy that we have. We are very comfortable with our access to business and the way in which we are deploying in this market.

We also have the playbook from prior soft markets that we can reflect upon. But to the extent that there is M&A activity, or there are targets which could further the strategy that we have, we would take a look. But at this point we're very comfortable with the platforms that we have and the access that we have to business.

Q - Amit Kumar {BIO 15025799 <GO>}

Got it. That is very helpful. Thanks for the answers and good luck for the future.

Operator

Michael Nannizzi, Goldman Sachs.

Q - Michael Nannizzi {BIO 15198493 <GO>}

Would it be possible to talk a little bit more about the specialty segment? Just to understand what you are writing there. And I understand -- it sounds like there's some mortgage reinsurance. Guessing that business may be kind of lumpy, as you said.

But what should we expect from that book? And what is your area of expertise or acts in terms of segment in the specialty market that you plan to build around there? Thanks.

A - Kevin O'Donnell

Sure. We've had good success in the specialty team. That is because of a couple of different reasons. One is we have built a couple of new platforms. So we've got the new office in Connecticut, and we set up a new balance sheet which we can underwrite from the US. We have retooled the old plan co balance sheet to be a better vehicle to accept predominantly quota share reinsurance.

And I think one of the things that you hit on in there is that we have grown our financial lines component of our specialty with good success. The biggest component of that is the mortgage piece of it.

We have seen good opportunities in the post-crisis mortgage reinsurance business and have been able to add some structures and some deals that we think we understand the buyers' incentive for pursuing and the risk in which we are taking. It is highly coordinated across both our investment portfolio and our underwriting portfolio.

So I think we do have a lot of expertise in thinking about that. Going way back to when we originally were growing our specialty book in 2002, the credit businesses, which was predominantly surety at that time, was a big component of it. So we do have a history of thinking about financial lines, and how to bring them into RenaissanceRe, and how to structure the deals against our balance sheets.

Q - Michael Nannizzi {BIO 15198493 <GO>}

Because that book -- it has basically doubled in the last couple of years, and it's really growing nicely out of the gates again. How big do you want that book to get? Do you think about it relative to the cat book?

It looked like this quarter's -- over 40% of the premiums you wrote were specialty or Lloyd's. How should we think about the composition of your whole book and how big specialty could become on a relative basis?

A - Kevin O'Donnell

Sure. First, within specialty, I think it's important to think about the mix of business that we have, where we are more quota share. So the margin expectations in that are different than excess of loss, as are the premium numbers.

Q - Michael Nannizzi {BIO 15198493 <GO>}

Sure.

A - Kevin O'Donnell

I think the question -- there's a couple of components. The other piece of the question, which is: how big can it be relative to cat?

The component of that is -- the way in which we are building the specialty book right now is it -- on an economic capital basis, it is accretive, highly accretive, because it remains diversifying into our large cat position. So we have significant scope to continue to add that sort of diversification.

I do want to emphasize that we are not taking business solely because it is diversifying. The first analysis we do, and really the gating analysis to adding risk to our portfolio is the stand-alone profitability for the risk that we are assuming.

If we can get over the stand-alone profitability hurdles that we have set for ourselves, we know on a marginal basis it will look good. But skipping the first step, we think, is problematic over the long term for any reinsurer, relying solely on the benefit of diversification.

I think with all that, property cat will dominate our results for the foreseeable future, even if we continue with strong specialty and casualty growth for the foreseeable future, just because of the way the books are being constructed.

Q - Michael Nannizzi {BIO 15198493 <GO>}

Got it. Then is there other -- so besides the mortgage, do you anticipate maybe breaking that out a little bit, just so we can get some flavor for what is actually in there? Or is it primarily just a few large mortgage reinsurance transactions?

A - Kevin O'Donnell

That book has always been somewhat concentrated. It isn't a single dealer; it's more than a handful of deals. But we are not writing the index on US mortgages or international mortgages.

It is -- but I wouldn't expect that we would put out a lot of detail as to the playbook, as to how we're trying to write into where we're seeing different opportunities in different lines.

Q - Michael Nannizzi {BIO 15198493 <GO>}

Got it. Great. Then one last one. Sorry for all the questions.

But I think last quarter you talked about the stabilizing market. And I think you were very careful to say: I'm not saying that there is a floor, or we are approaching a floor, but we definitely feel some stabilization. Does it feel like the irrational components that are potentially in the market now, or that they are changing their behavior, has that reaccelerated? Or is that different than what you expected last quarter?

A - Kevin O'Donnell

It is different than what we expected last quarter. I think the reason we were believing it might be still reductions, but hopefully what we said; it was reductions, but at a decelerating rate, was because last July and June renewals, so July/June 2013, there was more price softening than there was at January of 2013. So the fact that we had the softening in January of 2014, we hoped that there would be -- we were coming into what was already a somewhat price-corrected environment.

I would say that the deceleration hasn't occurred. And what we're seeing is largely the same type of competition that we saw at the 1/1 renewal. The types of buyers are different. Their needs are different. So I'm not sure exactly how that will play out throughout the full renewal, but there is definitely more capacity and more price competition than what we thought when we talked to you back in February.

Q - Michael Nannizzi {BIO 15198493 <GO>}

Got it. Great. Thank you, so much.

Operator

Sarah DeWitt, Barclays.

Q - Sarah DeWitt {BIO 18946247 <GO>}

Your net cat premium was down 6% this quarter, which was better than your guidance and probably better than what we are hearing in terms of price declines at Jan 1. So what drove this? And why are you maintaining the guidance given the Q1 result?

A - Kevin O'Donnell

Sure. There's a lot of things that are embedded in the way that we come with our guidance. But it is a ground-up process, where we're going through it deal by deal.

In the First Quarter there's some multi-year deals; there are some other things that naturally come through. So I think probably the simplest way to answer the question: if we look at the 6% and where we are today, it's not surprising as to where our expectations were.

So when we look forward, thinking about what the renewal is going to look like, we feel comfortable sticking with the 15%. But it's not that we were -- we don't -- when we look back at our ground-up pro forma analysis, this is pretty close to where we anticipated we would be.

Q - Sarah DeWitt {BIO 18946247 <GO>}

Okay, so that just means given the math, that the rest of the year would be down more than 15%, right?

A - Kevin O'Donnell

But there's some timing things in there, as well. But yes, to get to the 15%, you are going to have some -- there's some timing differences, but the way we built it up, I think it's just important to focus on the fact that it is not a different scenario than what we anticipated, even though there is a little bit more price competition.

A - Jeff Kelly {BIO 20911735 <GO>}

And the only thing to add to that -- in the Second Quarter of last year, we did have a couple of multi-year contracts where we booked all that premium in the Second Quarter of last year. So those policies are still in force this year. So some of it is timing from that perspective, as well.

Q - Sarah DeWitt {BIO 18946247 <GO>}

Got it. Are you able to quantify that?

A - Jeff Kelly {BIO 20911735 <GO>}

We could. I can't right off the top of my head, Sarah.

Q - Sarah DeWitt {BIO 18946247 <GO>}

Okay, that's fine. I will follow up on that.

Then just finally, as we approach the midyear renewals, how much business would you still say is in your adequately priced bucket? And if we go through another year with no cats and there is abundant capacity, how much would be left in that bucket?

A - Kevin O'Donnell

That is work that we will do, actually, throughout the renewal season and try to figure out exactly where things place. When we talk about the different types of buckets, we're looking at it in relation to our portfolio. So some of it will depend on how we construct the portfolio.

In Florida, going back over the last several years, this has a very strong population of deals within the attractive bucket. Obviously, as I mentioned, that is moving to the lower return bucket. But it's that one that I would put out exactly which percent is in which bucket.

The other thing I would mention is: we have ability to grow our portfolio for Atlantic wind in lots of different ways. Not just by writing the Florida market, by writing the 1-1 book, and also the way we manage our both our inwards and outwards retro.

Q - Sarah DeWitt {BIO 18946247 <GO>}

Okay. Great. Thanks for the answers.

Operator

Kai Pan, Morgan Stanley.

Q - Kai Pan {BIO 18669701 <GO>}

First is on the -- sorry, I just want to follow up Mike's question on specialty business. You mentioned that the return -- you basically write business on the stand-alone basis. I just wonder if the underwriting return -- how does that compare with your property cat business?

A - Kevin O'Donnell

That is a more difficult question than thinking of that -- just what is the loss ratio, because you want to think about how much capital is required to support the deals. So I think if you'd look at -- you know, a lot of what we are writing in the specialty business is quota share business. So we are going to replicate more closely to what the primary volatility curve is and return curve.

When it is put into our portfolio, obviously, it can look a lot better. But it's not one that I would look at from strictly property cat to specialty without taking into account the amount of capital required to support the deals. As a portfolio, by adding the specialty business, we are improving the overall return on the portfolio, though.

Q - Kai Pan {BIO 18669701 <GO>}

So by adding, basically, you grow this business faster than your property cat business. The overall return, like, profile will improve, but not being, like, business mix shift change and you're dragging it down.

A - Kevin O'Donnell

Yes, until from the point where you have to begin to add actual capital, where your economic capital from adding the specialty is in excess of your actual, you should be in the situation where you are improving the ROE of the portfolio.

Q - Kai Pan {BIO 18669701 <GO>}

Okay.

A - Kevin O'Donnell

As long as the stand-alone economics are profitable.

Q - Kai Pan {BIO 18669701 <GO>}

Okay. Then on the reserve on the Lloyd's business, just wondering -- you mentioned about these formulaic reserving methodology. I wonder, could you elaborate a little bit? And is that the same as what you applied to this book of business before? Or was this just change in the quarter?

A - Jeff Kelly {BIO 20911735 <GO>}

Kai, It was really just a change in the quarter. There weren't any changes to our ultimate expected loss ratio picks or our overall reserving assumptions. And as I said, no larger unusual reported losses. It was really driven by a small tweak in our processes that resulted in a change in allocated IBNR between accident years. There is really no underlying change in trend of our prior-period loss development.

Q - Kai Pan {BIO 18669701 <GO>}

So this is a sort of one-time true-up, and we would not expect going forward, or --?

A - Jeff Kelly {BIO 20911735 <GO>}

I would not expect it, no.

Q - Kai Pan {BIO 18669701 <GO>}

Okay. Lastly, Kevin, if you look back and see, like in the alternative capital market right now, you have been a pioneer in the space, but you have always been participating alongside with third-party capital providers. And now there is a new type of so-called asset managers that -- basically, they don't provide capital, but they provide the services.

And generally, because -- the return on those businesses are lower because they don't provide down capital. Just wonder what is your view to see these types of asset managers in the property cat business? And do you see yourself participating as part of it?

A - Kevin O'Donnell

I think you are absolutely right. When we have brought third-party capital to our customers, we have also put our capital in the vehicles alongside our third-party capital. DaVinci is an example of that; Upsilon is an example of that; and several of the other different vehicles that we have done.

We do that because we want to make sure that we have a high degree of alignment with our customers and with our capital partners there. And I think we have had tremendous success because of that alignment. We are -- the model where there's basically MGAs representing capital and writing on their behalf, I think, is one that if it is risk that is particularly suited to a counterparty -- and let me focus on Upsilon for a second.

We have less capital in Upsilon than some of our other vehicles, because the way it uses capital within our structure, we can add some efficiencies by adding more third-party capital to that vehicle. I think that is the way we would think about it going forward more than us completely disassociating our capital from our partner capital. Because we think the alignment is critical for long-term success.

Q - Kai Pan {BIO 18669701 <GO>}

Thank you, so much for the answers.

Operator

Josh Shanker, Deutsche Bank.

Q - Josh Shanker {BIO 5292022 <GO>}

I want to talk a little bit about what has happened to your gross exposure for peak zones compared to your net exposure and how that relates to capital returns and the share repurchase during the quarter.

A - Kevin O'Donnell

Obviously, we deploy a lot of capital that is both ours and for others, which is really the gross exposure that we're taking. We really manage much more to the net exposure by vehicle and then by balance sheet and by the enterprise.

I think if you look at that, we are cutting our top line for our managed cat. We have increased the amount of ceded that we have. So I think it's something that I would expect that we wouldn't have more net exposure in any material way going into this wind season than we have had last year, for sure.

Q - Josh Shanker {BIO 5292022 <GO>}

Could you take a lot more gross exposure and cede it through retro to maintain profitability? Or is that not really possible?

A - Kevin O'Donnell

I think we have always been good stewards of thinking about how to construct attractive portfolios. Going back and thinking about how we have done that in different markets, it has always been a little different. But having large sessions has been part of our strategy.

We have always broken the way in which we have ceded into a partner account and a trading account. And I anticipate that that's tools we will certainly be using in 2014, just as we did in 2013.

Q - Josh Shanker {BIO 5292022 <GO>}

And in terms of the buyback, it was quite sizable this quarter. How does that relate to exposure reduction? Or is that just -- I mean, it's not immaterial, but perhaps the size of the buyback is just coincidental?

A - Jeff Kelly {BIO 20911735 <GO>}

I wouldn't say it is completely coincidental, Josh, but it was mostly driven by the factors that I mentioned, really, earlier: the build-up in our excess capital from very strong earnings in 2013; you know, having a very strong liquidity position at the holding Company; and just the valuation of the shares during the quarter.

There was also a little bit of a technical issue in that that helped facilitate that in that typically we trade about 500,000 shares a day or so. Around the beginning of the year -- the end of last year and the beginning of this year, we had a few days where there were in some instances well over 1 million shares traded in a day. And that allowed for -- at a time when we thought our share price was particularly attractive, that allowed us to buy more shares on a daily basis than we might otherwise be able to do.

Q - Josh Shanker {BIO 5292022 <GO>}

I appreciate all the answers, and good luck at 6/1.

Operator

Cliff Gallant, Nomura.

Q - Cliff Gallant {BIO 1854853 <GO>}

Just a follow-up question on the previous. So when you think about your outlook for mid-year renewals, and then looking at your excess capital position today, is it stronger? Is your excess capital position stronger, or less than what it was four months ago at the beginning of the year?

A - Jeff Kelly {BIO 20911735 <GO>}

I would say it is marginally lower than it was at the beginning of the year. And that dynamics there, Cliff, are changing into account the outlook for business going forward, but also earnings in the First Quarter, alongside the share repurchases dollars that we committed to share repurchases year to date. So the net of that took it down a little bit.

Q - Cliff Gallant {BIO 1854853 <GO>}

But then I guess that would mean that your appetite for further buyback, then, is still healthy, I would assume?

A - Jeff Kelly {BIO 20911735 <GO>}

Yes, I think maybe -- anticipating a question in that regard, I think other things being equal, the factors driving our activity in the market, we'd anticipate being active if conditions come together through wind season on share repurchase.

Q - Cliff Gallant {BIO 1854853 <GO>}

Thank you.

Operator

Vinay Misquith, Evercore.

Q - Vinay Misquith {BIO 6989856 <GO>}

The first question is on the retro purchases. There seem to be a lot more this quarter in the cat segment versus the year-ago quarter. So the question is: do you intend on buying more retro for the rest of the year versus last year?

And as an add-on to that, also, we all know that the returns on the business have come down. But on the flip side, because the purchases are retro, would you say that the downside is also now lower than the past, making this a less risky business versus the past?

A - Kevin O'Donnell

We think about retro as just another tool to help us optimize the different portfolios that we have. And I think more commonly in the interest, people go out with a retro program and purchase it once a year. Then they think about that as part of their overall capital structure.

We are little bit more dynamic in that. We're constantly looking at our portfolios and looking to what is available in the market.

I think if you look at the change from last year to this year quarter to quarter, one of the big pieces of that is really Upsilon. So Upsilon gets reported as a ceded premium. So I think that's a big piece of the change that you are seeing in how much of a session that we have.

I think going into this year, this wind season, we are actively looking for more opportunities to share risk. And I think that will continue up to wind season and probably throughout wind season, to the extent there is capacity available.

And every time we buy ceded, we are looking at the effect that -- the entire shape of the distribution, and making sure that we, on an each-transaction basis, like the updated portfolio more than the previous portfolio without the ceded. So I think it's a constant optimization.

Q - Vinay Misquith {BIO 6989856 <GO>}

How much of the decline in rate can you recapture through cheaper reinsurance? Let's say that pricing is down 15% to 20%. Can you recapture about 5 points from that through the cheaper retro?

A - Kevin O'Donnell

That's a more difficult question to answer for us, I think, in that we generally don't take a deal in and then cede a deal out on more of a facultative basis. We tend to write our portfolio and then hedge the entire portfolio. Then we measure the capital advantage that we have against the pre-ceded and post-ceded portfolios. So it's more difficult to compare it exactly to what is going on in one specific renewal, because we tend to hedge more holistically against the risk that we are taking.

Q - Vinay Misquith {BIO 6989856 <GO>}

Fair enough. And just on the retro again: so would you say that your downside risk is now lower than the past? I would think -- so looking at the net exposures, are they lower than the past because of the purchase of more retro?

A - Kevin O'Donnell

That's a difficult -- our peak exposure is Atlantic hurricane. And we're kind of in the midst of building that portfolio out right now. So we are constructing what our net will look like.

So it's difficult to comment exactly what we're going to be like going into this wind season. But we are certainly going to be careful to make sure that, for the capital we are deploying, we are adequately paid for it. But it's probably not the right time for us to think about exactly what that looks like, because so much of our book is in flex.

Q - Vinay Misquith {BIO 6989856 <GO>}

Sure. And just one last question on retro again: The acquisition expenses and the operating expense in the cat segment actually went down year over year. So is that a function of the purchase of more retro? And should we see that helping the acquisition in operating expense within that segment of the rest of the year?

A - Jeff Kelly {BIO 20911735 <GO>}

Vinay, so the answer to the acquisition expense is really due to an increase in profit commissions, largely -- let me just leave it there -- profit commissions during the quarter that flow through as a reduction to acquisition expense. So that is really what you are seeing there.

I think in terms of the operating expense overall, that is more an internal allocation issue, where we allocate some of our expenses based on gross written premium; and, obviously, on a relative basis that increased in the specialty book. And so you saw specialty expenses up during the quarter and cat expenses down. I think that probably largely explains that shift.

Q - Vinay Misquith {BIO 6989856 <GO>}

That is helpful. Thank you.

Operator

Jay Cohen, Bank of America.

Q - Jay Cohen {BIO 1498813 <GO>}

Just a question on the Lloyd's business: the premium growth there decelerated quite a bit from what we had been seeing. I know you kept the full-year guidance the same, but I'm wondering what happened in the quarter to lead to that deceleration.

A - Kevin O'Donnell

I wouldn't read anything into it. The book we write in Lloyd's is a little bit less date-dependent, just because of the types of risk that we are writing there, than the reinsurance book. So I think, looking at what we're seeing in the quarter, I wouldn't read into anything, other than some seasonal differences. And our expectations for the year remain consistent.

Q - Jay Cohen {BIO 1498813 <GO>}

Got it. Then the second question on the market: Kevin, there is increasing irrationality. Are you seeing it more on the ILS side or among traditional reinsurance companies?

A - Kevin O'Donnell

I think at this point, capacity is capacity. And we are seeing strong competition coming from all sectors, to be honest.

Q - Jay Cohen {BIO 1498813 <GO>}

Got it. All right. Thanks a lot.

Operator

Brian Meredith, UBS Investment Bank.

Q - Brian Meredith {BIO 3108204 <GO>}

Kevin, two questions here for you. First one: if I take a look at Top Layer Re, you continue to see a reduction there of the income coming through. What is going on there? Is it just that the competition now in the cat bond markets taking on weigh opportunities there?

A - Kevin O'Donnell

A lot of the cat fund activity -- there has been a little bit more internationally, but the vast majority of it is still US, and Top Layer is focused outside the US. So I think it is much more around pricing. Some of it is being priced out from cat bonds, but I wouldn't say that that's a specific concern.

The thing I would say, though, is if you look at Top Layer restructure -- you know, you talk about the fact that the new capital coming in is cheaper or more efficient capital. Top Layer Re, I think, is a unique structure, and it is one of the most capital-efficient structures to write that type of risk.

So to the extent that we are not writing the risk, I think it's not because the capital that we are competing with is any cheaper than the capital that we are bringing. It is because we didn't like the stand-alone economics of the transaction.

Q - Brian Meredith {BIO 3108204 <GO>}

Okay. Then my second question, too -- I'm just curious. If I look at your other investment portfolio, the amount of cat bonds in it has increased substantially on a year-over-year basis. Do you view the cat bond market as attractive right now from an investment perspective?

A - Jeff Kelly {BIO 20911735 <GO>}

Brian, it is Jeff. I think that on a year-over-year basis, the principal increase in the cat bonds, in our cat bond holdings, result from -- in the Fourth Quarter we purchased what we lovingly refer to as some dead cats, more as investment vehicle surrogates for our short-term investments rather than investing in short-term corporates or treasuries.

So we have seen an increase in the amount of cat bonds that we manage for third-party investors. But the biggest part of that increase was due to that purchase in the Fourth Quarter.

Q - Brian Meredith {BIO 3108204 <GO>}

Great. Thank you.

Operator

Ian Gutterman, Balyasny.

Q - Ian Gutterman {BIO 3106649 <GO>}

First, Kevin, I believe the way you guys have always talked about capital in the past -- and I have probably had this discussion with you guys for a few years. But the way I remember historically is you guys focus a lot less on PML and things like others do. And you always talk more, I think, about the expected profitability being the determinant of how much capital you needed. Is that still the way you manage the book?

A - Kevin O'Donnell

Yes. I think when we say we don't focus on the PML, what we focus on is the full shape of the distribution, not single points along the distribution. And we still are very much focused on building portfolios with high expected return and with that you need the right profitability against the right capital.

Q - Ian Gutterman {BIO 3106649 <GO>}

Okay. I guess where I am going with that is: if prices have come down across the market, isn't that whole curve lower, if you will? The expected profitability is lower, and therefore, even if you are cutting back some business, doesn't that suggest you don't free up as much capital under that approach as someone who is of a more pure PML type writer? And let's say we got off business, so therefore we freed up PML and we freed up capital?

A - Kevin O'Donnell

Yes, I think if you are going into a market where every dollar of risk is associated with a slightly less dollar of premium, everyone's curve is going to shift down, regardless of what methodology they're using.

Q - Ian Gutterman {BIO 3106649 <GO>}

Okay. I guess what I'm getting at is -- I think this is sort of what Vinay was getting at, but maybe in a different way -- there seems to be this perception that if people get off business, it frees up a ton of capital. And obviously, that is true to some extent.

But isn't that offset to some degree by the renewal book being less profitable? So even though -- if you renew a piece of business, the PML doesn't change, but the expected profit goes down, right?

A - Kevin O'Donnell

I think generally that is true. So if you look at -- I will use our example -- our property cat premiums on expected basis being down 15%. With rate reductions, I would not expect that the capital allocated for that business is down 15%.

Q - Ian Gutterman {BIO 3106649 <GO>}

Right. Okay.

A - Kevin O'Donnell

If you then change the construction of your portfolio, you could add ceded, you could do other things. But at the end of the day, you have got to come back to the fact that every dollar of risk you are taking has a less -- some percent smaller dollar of premium associated with it.

Q - Ian Gutterman {BIO 3106649 <GO>}

Got it, thank you. Then on Upsilon, I guess I was a little surprised to see the increase be so dramatic, just given -- I mean, I can understand from a demand standpoint, there would be loss of demand. But I would have thought, just given the pricing dynamics in retro seems to be the most competitive of all, that you could find enough good business to grow that vehicle so well. Can you maybe talk a little bit more about what kind of rates they found, without, obviously, getting too specific? But just the character of where the growth came from?

A - Kevin O'Donnell

Sure. It is not a dissimilar book than what we had previously. So it's more of a structured retro book. The reason we do it in a sidecar vehicle is because it tends to be a very broad territorial scope. So within the other capital vehicles that we have, it uses a substantial amount of economic capital. So it is beneficial to bring it to market through Upsilon on a collateralized basis.

I think the way I would think about it is: it is not a large number of transactions. It's a targeted, call it a club-type deal, where we targeted a group of sessions which we think fit the Upsilon and then work very hard to structure deals that work for the buyer and work for the capital we put into the vehicle. So what is going on in the larger retro market is much broader than this very narrow segment in which we have targeted within Upsilon.

Q - Ian Gutterman {BIO 3106649 <GO>}

Okay. Because I was trying to think through the comment about some players may be being irrational. And I guess the conclusion I was taking -- and tell me if I'm going down the wrong path here. But if there is so much demand for good vehicles like Upsilon, if that demand isn't satiated, then I guess there's just so much capital that there is no choice of that capital other than to do irrational things?

I mean, obviously, they could pack up the capital and go home. But there is just such a flood of capital, that good opportunities are just so oversubscribed, that we are left with people feeling forced to do silly things? Is that the tone?

A - Kevin O'Donnell

Yes, I think if you look at -- we have a significant number of people trying to get into vehicles which we have. Part of the reason they want to get into our vehicles is because they trust that our capital is aligned with their capital.

I think, others, there is -- I think there's different models in which, when there's not as much capital alignment, there can be different incentives as to how to think about whether or not to deploy capital into certain transactions.

Q - Ian Gutterman {BIO 3106649 <GO>}

Got it. Then just my very last one is: just given the pressure we are seeing in Florida for nontraditional capacity, does that suggest that -- I guess I'm asking for a prediction here. Do you think by next year that we will see them break the code and deploying more into non-peak zones, given that they are likely to be frustrated with the results in the peak zones?

A - Kevin O'Donnell

This is -- I'd love to have more time to talk about that, I think. The discussion of this being -- the reason this has been -- to wind the clock back, one of the primary precedents for this capital coming in is because it is diversifying to the other -- against the very large portfolios in which it's coming from. So moving away from that peak to a rated balance sheet.

So if we move away from a peak and use our rated balance sheet to compete, the efficiency of that, that argument that that capital is more efficient than our capital, really diminishes. So I'm not sure that moving outside of peak zones for nontraditional capital is going to be a cure for competition within peak zones.

Q - Ian Gutterman {BIO 3106649 <GO>}

Got it. That makes a lot of sense. Thanks so much.

Operator

There are no further questions at this time.

A - Kevin O'Donnell

Thank you, everybody, for joining us for this quarter's call, and we look forward to catching up with you next quarter. Thanks again.

Operator

This concludes today's conference call. You may now disconnect.