Q2 2018 Earnings Call

Company Participants

- Francois Morin, Executive Vice President, Chief Financial Officer and Treasurer
- Marc Grandisson, President and Chief Executive Officer

Other Participants

- Bob Glasspiegel, Analyst
- Brian Meredith, Analyst
- Elyse Greenspan, Analyst
- Geoff Dunn, Analyst
- Ian Gutterman, Analyst
- Josh Shanker, Analyst
- Meyer Shields, Analyst
- Michael Phillips, Analyst
- Michael Zaremski, Analyst

Presentation

Operator

Good day, ladies and gentlemen, and welcome to the Q2 2018 Arch Capital Group Earnings Conference Call. At this time, all participants are in a listen-only mode. Later we will conduct a question-and-answer session and instructions will follow at that time. (Operator Instructions) As a reminder, this conference call is being recorded.

Before the company gets started with its update, management wants to first remind everyone that certain statements in today's press release and discussed on this call may constitute forward-looking statements under the federal securities laws. These statements are based upon management's current assessment and assumptions and are subject to a number of risks and uncertainties. Consequently, actual results may differ materially from those expressed or implied. For more information on the risks and other factors that may affect future performance, investors should review periodic reports that are filed by the company with the SEC from time to time.

Additionally, certain statements contained in the call that are not based on the historical facts are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. The company intends the forward-looking statements in the call to be subject to the safe harbor created thereby.

Management also will make reference to some non-GAAP measures of financial performance. The reconciliation to GAAP and definition of operating income can be found in the company's current report on Form 8-K furnished to the SEC yesterday, which contains the company's earnings press release and is available on the company's website.

I would now like to introduce your host for today's conference, Mr. Marc Grandisson and Mr. Francois Morin. Sirs, you may begin.

Marc Grandisson {BIO 4369887 <GO>}

Thank you, Crystal, and good morning to you all. We were pleased with the results across our platform this quarter as our MI segment continued to produce outstanding returns while slightly improving conditions in our P&C operations and higher investment yields helped to produce an annualized operating ROE of 11.6%, and an increase in book value per share to $20.68.

As you may know, we believe that an opportunistic approach to underwriting and active capital and risk management will produce higher risk adjusted returns over time. As a result of this dynamic allocation of capital, we may be under weight or overweight in certain segments or areas of the market at any point in time.

Our MI focus right now is Exhibit A of the strategy, and we believe that the current level of returns available in the MI space, justifies the deployment of additional capital there. In our P&C businesses, market conditions seem to be improving modestly. In most of our insurance lines of rate increases appear to be outpacing claim trends. However, in assessing how this will ultimately impact margins, there are several issues with estimated insurance margins that temper our current market view.

First, the calculation of trend is based on past experience, while actual trend is dependent on future circumstances, which in many lines means looking several years out. Second, at the center of rate adequacy projections is an implied perfect knowledge of the current loss estimates. As we all know, loss reserving in our industry is a cumulative result of self-graded exams, and it can take several years for the truth to emerge. Third, rate changes as reported do not capture new business written or the effects of most changes in terms and conditions.

Due to these uncertainties and factoring in the record level of capacity currently in the business, we remain cautious in our underwriting posture. With that said, let me provide some color on our P&C premium volume for the second quarter. First, bear in mind, that the increase in P&C net premium written was magnified by FX movements, which represents about 30% of the increase in net written premium.

In our insurance segment, more than 60% of the growth in net written premium was due to rate increases and the balance was from exposure growth. On the line of business basis, the increase was the result of our own ongoing efforts in travel, programs, as well as from recent market opportunities in property. We decreased premium again this quarter in the more commoditized lines, such as general liability and D&O due to the highly competitive environment.

In our reinsurance segment, net premium growth was generated primarily from property, other than property cat growing slightly consistent with our view of conditions in our primary insurance. Of note, net property cat writings were down as most rate levels were below our risk-adjusted returns requirements.

With respect to our P&C underwriting results on which Francois will provide additional details in a moment. There is one topic which I think is particularly noteworthy. Large attritional losses affected the result of both insurance and reinsurance, but in the opposite directions. The Insurance Group benefited from a below average level of such losses, while our reinsurance operations were impacted by a higher than normal level, mainly in a facultative area. This demonstrate that the randomness -- that there is randomness and lumpiness of when these type of losses occur. You rarely, if ever get an even distribution of the expected losses in a given quarter or year. But over time, specialty businesses such as ourselves can generate good risk-adjusted returns if managed properly.

Turning now to MI, I'm going to focus on our US primary business, which represents over 80% of that segment. Our US MI production for the second quarter was strong at 19.9 billion, a 15% increase over the same quarter last year. About 80% of our primary MI was still written through our RateStar platform. As respect growth from a sequential basis, keep in mind that there are substantial seasonal effect between Q1 and Q2 when home purchases typically peak. Our US new insurance written or NIW increase was due to a few additional key factor.

First, it's clear to us that MI return fundamentals are excellent. House price appreciation has been broad and stronger than expected. The quality of credit remains high and our ability to price more finding for many parameters is truly an advantage. Given the strong market conditions, returns have been better than anticipated and remain very attractive.

Second, we have been successful in our efforts to expand our distribution and producer relationships with both existing and new customers. And in a few cases, we were able to close some large transactions that while attractive from a return standpoint, bring some lumpiness to our NIW in the quarter.

Third, the capital and risk management tools that we have put in place, namely the Bellamy transactions provide additional downside protection and reduce the volatility of our expected returns in MI.

For the second quarter, RateStar again directed our production away from lower return products, with a singles to borrower paid monthlies as singles production decline from -- to 6% from 9% in the first quarter. Higher loan to value and debt to income products represented a slightly larger share of our NIW in Q2, but we remain underweight in those areas relative to the market. This growth was opportunistic and occurred partly due to the respond by our competition to the rapid shift in mix that occurred in the first quarter.

Market pricing at this point, appears to have stabilized, after the activity in the last few months.

Before I move on from MI, I want to update you on recent developments. Regarding the pilot programs with the GSEs, IMAGIN and e-PMI, they are still in their infancy and there was no significant NIW in the second quarter. We will keep you posted as to their progress on future calls.

Briefly, with respect to our investment operations, we increased our duration slightly as we moved money out of cash equivalents to predominantly two to five year treasury instruments. In addition, the current interest rate environment has and will improve net investment income for the next several quarters.

Finally, a few words on capital and risk management. We repurchased a significant number of shares in the second quarter. Francois will give you the details, but it is worth repeating the share repurchase is yet another way for us to manage and allocate capital. At the risk management, our property cat exposures remain at historically low levels with our one in 250 year peak zone at only 5% of tangible common equity at the end of the second quarter .

For our mortgage segment, as of June 30, 2018 exposures on there are realistic disaster scenario decline last quarter as growth in insurance in force was more than offset primarily by the capital relief from the Bellamy transaction and the run-off of the pre-2009 business. Prospectively we believe that regulatory capital as defined by the PMIERs represent a more conservative capital requirement, as of June 30, 2018, Arch MI was up 134% of the current PMIERs and although we are unable to discuss the proposed changes to PMI 1 that will create PMIERs 2.0. We do not believe that the proposed changes will have immaterial impact on our capital position and that our estimated available assets will continue to exceed the required assets as proposed on the PMIERs 2.0.

With that, I will turn it over to Francois.

Francois Morin {BIO 17410715 <GO>}

Thank you, Marc, and good morning to all. I'm pleased to join the earnings call this morning and to provide more color on our second quarter earnings. As I stated during our recent investor day one of my objectives in this new role will be to key providing the same level of clarity and visibility, the investment community has come to expect from us when analyzing our financials and public disclosures. This practice will remain a key principle of ours.

On that note, I will make some summary comments for the second quarter, all on that 'core basis' [ph] which corresponds to Arch's financial results excluding the other segment, i.e. the operations of Watford Re, whereas the term consolidated includes Watford Re. As you know, we affected a three-for-one stock split on June 20, which impacts per share metrics and comparisons to prior periods. My comments will reflect the latest number of shares after the split, which currently stands at approximately 405 million outstanding shares .

After-tax operating earnings for the quarter were 242.6 million, which translates to an annualized 11.6% operating return on average common equity, and $0.59 per share. On a year-to-date basis, our annualized operating ROE increased by 200 basis points, since last year to 11.4% [ph] highlighting the improved performance of our operations.

Book value per share was $20.68 at June 30, a 1.3% increase from last quarter and a 4.1% increase from one year ago, despite the impact of higher interest rates on total returns for the quarter and on a year-to-date basis.

Moving on to operations. Losses from 2018 catastrophic events, net of reinsurance recoverables and the reinstatement premiums, were 14.9 million or 1.3 combined ratio points, evenly split between our insurance and reinsurance segments from a few small events across the globe. As for prior period net loss reserve development, we recognized approximately 60 million of favorable development in the second quarter, or 5.1 combined ratio points compared to 6.4 combined ratio points in the second quarter of 2017. This was led by the reinsurance segment with approximately 32 million favorable, the mortgage segment at about 23 million also favorable and the insurance segment contributing 5 million. This level is generally consistent with recent periods on an aggregate basis and across segments. The calendar quarter combined ratio on a core basis was down 200 basis points from the second quarter of 2017. While the core accident quarter combined ratio excluding cats improved to 84% down 230 basis points from last quarter -- last year's second quarter.

The insurance segment's accident quarter combined ratio excluding cats was 98.5%, down slightly from the comparable 2017 level, mostly due to an improvement in the current year loss ratio of 150 basis points, slightly offset by higher acquisition expenses resulting primarily from mix of business changes. We are pleased with these results, but note that a significant portion of the improvement, approximately 90 basis points is due to a lower frequency of large non-cat claims, which as Marc indicated, are by nature subject to variability from one quarter to the other .

The reinsurance segment accident quarter combined ratio excluding cats stood at 100% even slightly better than the 101.1% on a comparable basis one year ago. In a similar vein, to the corresponding period last year, our results were impacted by non-cat large property claims. This result serves as a reminder of the volatility some of our businesses can experience from time to time. The expense ratio benefited from reductions of operating expenses combined with the larger net earned premium base.

In addition, a reduction in federal excise taxes of 2.6 million, or 0.8 points resulted from the cancellation of certain intercompany property casualty quota share agreements, effective January 1st as discussed last quarter. This item will continue to recur for comparisons of 2018 to 2017 results.

The mortgage segments accident quarter combined ratio improved by 380 basis points from the second quarter of last year. Mostly as a result of improving trends in the underlying performance of the book, particularly within our US primary MI operations. The accident quarter loss ratio of 15.4% in the second quarter of 2018 compares favorably against the 19.5% in the same quarter of 2017, due to lower delinquency rates. 3.1 basis points of the difference or 9 million is attributable to favorable development on first quarter 2018 delinquencies due to very strong cure activity in 2018.

The expense ratio was at 22.8%, slightly higher than prior periods as a result of higher incentive compensation costs. These figures highlight the contribution to our pre-tax underwriting income from the mortgage segment, which remains strongest quarter. However, after allocating corporate items, such as investment income, interest expense, and income taxes to each segment. The mortgage segments contribution towards 2018 year-to-date net income decreases to approximately 65% of the total.

Total investment return for the quarter was a negative 19 basis points on a US dollar basis, but was a positive 33 basis points on a local currency basis. These returns were impacted by the effects of higher interest rates on investment grade fixed income securities, partially offset by positive returns on alternative investments and non-investment grade fixed income. The investment duration was 2.89 years at June 30, up sequentially from 2.6 years at March 31, as a result of the shift in our portfolio from short-term commercial paper primarily into 2-year treasuries, where we saw more attractive investment opportunities.

Also during the quarter, we continued to shift our position -- from municipal bonds into corporate due to improved relative valuations. Corporate expenses were 6.6 million lower than in the prior year, as a result of retirements and departures of Senior Executives. The corporate effective tax rate in the quarter on pretax operating income was 9.8% and reflects the benefit of the lower US tax rate. The geographic mix of our pre-tax income and a 60 basis point benefit from discrete items in the quarter .

As a result, the pure effective tax rate on pre-tax operating income excluding discrete items was 10.4% this quarter, identical to last quarter's rate. As we look ahead to -- year-end 2018, we currently believe it's reasonable to expect that the effective tax rate on operating income will be in the range of 9% to 12%.

As always, the actual full year effective tax rate could vary depending on the level and location of income or loss and varying tax rates in each jurisdiction. With respect to capital management, our debt-to-total capital ratio was 16.9% at June 30, and debt plus preferred to total capital ratio was 23.9%, down 250 basis points from year-end 2017 and 480 basis points from year-end 2016, when we closed the UGC acquisition. This leverage reduction is driven mostly by the redemption of 250 million from a revolving credit facility in the quarter.

As for share repurchases -- repurchased 6.4 million shares during the second quarter at an average price of $26.59 per share and an aggregate cost of 170.2 million, under both open-market purchases and a Rule 10b5 plan, we implemented during our closed window period. Since the start of the third quarter, we have purchased an incremental 414,000 shares at a cost of 10.9 million. Our remaining authorization, which expires in December 2019, now stands at 262 million, after consideration of their share repurchases May-June through July 30.

Operating cash flow on a core basis was 34 million in the second quarter of 2018, down on a sequential basis, primarily reflecting the Premiums ceded further reinsurance transaction with Catalina General Insurance Limited, which we discussed during last quarter's call.

With these introductory comments, we are now prepared to take your questions.

Questions And Answers

Operator

Thank you. (Operator Instructions) And our first question comes from Mike Zaremski from Credit Suisse. Your line is open. Please check that your line is not on mute.

Q - Michael Zaremski {BIO 20606248 <GO>}

Hi. Thanks.

A - Marc Grandisson {BIO 4369887 <GO>}

Hi, Mike.

Q - Michael Zaremski {BIO 20606248 <GO>}

My first question is regarding the mortgage insurance volumes. It looks like you guys took market share and you mentioned some lumpiness in the prepared remarks. So I was just kind of hoping to maybe understand you feel that the market share will be sustained or we should assume a material amount of lumpiness as you said in the comments?

A - Marc Grandisson {BIO 4369887 <GO>}

I think the question, Mike, I think we -- first and foremost, we do not look at market share as an operating principle. We're just looking at the opportunities that we see them in the marketplace. So, what I can tell you is, what we saw in the second quarter which generated those -- that production. But I think the pricing situation in the industry was different as we got into the second quarter and has changed since then and it's a lot more stable. So whatever opportunities we had to -- do what we did in the second quarter, may not keep on -- keeping being there for the remainder of the year. So it's a really hard question to answer, because I don't know the answer to that.

Q - Michael Zaremski {BIO 20606248 <GO>}

Does it imply that risk-based pricing is causing more -- is part of the reason you are winning some of these deals or it's separate?

A - Marc Grandisson {BIO 4369887 <GO>}

Yes. A large part of our wins was through the RateStar, ability to more -- again, more finely-priced for the risk and the ability that we have to shape the portfolio the way we would want. As I mentioned, we did more monthlies. So, it's clearly an advantage and we think the advantage could probably sustain itself going forward specifically in light of the loan originators, no margin being squeezed, so it represents most likely an ongoing advantage. But that advantage that we have from RateStar has been there for long time. So yes, we do believe it provides us some advantage.

Q - Michael Zaremski {BIO 20606248 <GO>}

Okay. And lastly sticking with mortgage insurance, thanks for the comments about PMIERs 2.0 not having that material of an impact. I'm curious, is that because you will get a number of quarters to let the impact -- sorry, it's a few quarters before the impact takes place? Or if it happened today it wouldn't have a material impact?

A - Marc Grandisson {BIO 4369887 <GO>}

Okay. So, we're under an NDA. We cannot really talk about the various parameters, but being at 134% and if we tell you that we think we are comfortable, that sort of gives you a rough ideas where we think it is going to land. Now things could change. They will make their final determination between now and I believe at the end of the third quarter, which will be implemented in 2019. And those comments, Mike, I would tell you are, I've been echoed by our competitors as well and I think it speaks to the health of the results and the returns that the profit that have been generated by the platforms in the MI industry.

Q - Michael Zaremski {BIO 20606248 <GO>}

Thank you.

A - Marc Grandisson {BIO 4369887 <GO>}

Sure.

Operator

Thank you. Our next question comes from Elyse Greenspan from Wells Fargo. Your line is open.

Q - Elyse Greenspan {BIO 17263315 <GO>}

Hi, good morning.

A - Marc Grandisson {BIO 4369887 <GO>}

Hi, Elyse.

Q - Elyse Greenspan {BIO 17263315 <GO>}

My first question, Francois, you said the tax rate was going to be 9% to 12% this year. Is that the right level that we should use in 2019 and onwards as well?

A - Francois Morin {BIO 17410715 <GO>}

It's a good question. Thank you for that. I would say, we don't have the answer right now. Certainly, as you know, we cancelled some intercompany quota share agreements at the start of 2018, were reevaluating those on an ongoing basis, certainly as we get into 2019 planning exercise which is underway now and we have more clarity on that throughout -- internally in the third and fourth quarter. So at this point, it's a bit -- we don't know. Certainly, the B tax, as you know, goes up from 5% to 10% next year, so that'll have potentially some impact. But we have certainly a couple of things we can look at that we will look at a couple of tools in our toolbox that hopefully we'll -- you know, we'll try to obviously minimize our tax liability, but we really don't really have a view at this point of what 2019 is going to look like.

Q - Elyse Greenspan {BIO 17263315 <GO>}

Okay, thank you. And then on capital return, you guys -- the share repurchase picked up in the quarter. Obviously at the start of the quarter your stock was trading at a cheaper valuation than where it sits today. And I know you guys have your metric and you look at the payback period as you think about share repurchase. So how does the higher valuation today change your philosophy around share repurchase in conjunction with the fact that we are now also approaching peak wind season?

A - Francois Morin {BIO 17410715 <GO>}

Yeah, a couple of points on that. I don't think it really changes how we think about things. Historically, as we said, we said in the past, we typically don't buy back stock in the third quarter. Although, we're not really a big cat player anymore, so that's really not something that worries us as much as it might have as a percent of equity going years back. And we've said it many times, we are always looking at opportunities that come to us in terms of potential small transactions and that's a factor and how we look at share purchases or buybacks. And there is a couple of things working on right now. So, we don't really have a definitive view on how the rest of the year is going to look for share repurchases. But to answer your main question, I think is, I don't think it really changes our view even in light of the slightly higher share price that we're currently experiencing.

Q - Elyse Greenspan {BIO 17263315 <GO>}

Okay, thank you. And then my last question, going back to mortgage -- and maybe this ties to some of the questions that Mike was asking as well. But do you think part of the reason maybe the NIW did grow so much sequentially, were you guys able to lower the pricing variables in your RateStar engine ahead of some of the other changes made by the other primary MIs and their pricing grids? And do you think maybe that led you to higher NIW that might not be sustained? Are you able to kind of pinpoint any kind of impact specifically of your RateStar engine that might have had on the NIW?

A - Francois Morin {BIO 17410715 <GO>}

I think your assessment is a very fair assessment.

Q - Elyse Greenspan {BIO 17263315 <GO>}

Okay, thank you very much.

A - Francois Morin {BIO 17410715 <GO>}

Thank you.

Operator

Thank you. And our next question comes from Michael Phillips from Morgan Stanley. Your line is open.

Q - Michael Phillips {BIO 21023048 <GO>}

Thanks. Good morning, everybody. I wanted to drill a little bit more down on the expense ratio for the two segments, insurance and reinsurance, kind of going in different directions. Higher acquisition expense in insurance from exchanges and then if you back out the excess tax thing in reinsurance, still a pretty good improvement in reinsurance. So kind of -- if you take those two separately kind of just where do you see those leveling off? Continued improvements in reinsurance from here and 25, 26 is pretty low. I don't know if that is going to continue. And then insurance, kind of where does that -- where does that peak?

A - Francois Morin {BIO 17410715 <GO>}

Yes, thanks for the question. Let me start and I am sure Marc will chime in. The way we certainly look at it in totality, so the geography of loss ratio versus expense ratio, we look at it, but it's not the primary factor we look at. We look at the totality of the combined ratio. If we focus on the insurance segment, certainly in the quarter we grew into some areas that have our expected what will have a lower loss ratios at the expense of our higher acquisition expense ratio. So there's a bit of a trade-off here where we are seeing a lower loss ratio again, and counter to that is a higher expense ratio. And it's a similar story on the reinsurance, although reinsurance is a bit more opportunistic. We have fluctuation from one quarter to the next on what kind of deals we write, what actually ends up coming through our financials. But certainly in a few instances we have some agreements some quota share agreements where there a sliding scale commission, where you will see that the loss ratio is a bit lower, it's lower right, we'll have a higher, slightly higher expense ratio. So it's a similar story that we look at it in totality and there's going to be movements within the components.

A - Marc Grandisson {BIO 4369887 <GO>}

Correct.

Q - Michael Phillips {BIO 21023048 <GO>}

Okay great. Thank you. That's helpful. I guess if I could drill a little bit further down from your commentary in the press release on the reinsurance development. You talk about short tail business in the recent accident years or recent underwriting years and then the longer tail. The longer tail piece of that, the longer tail business from early underwriting years, can you talk about kind of where that is -- not just in years but I mean the sub segments, the lines of business that were driving that longer tail business favorable development?

A - Francois Morin {BIO 17410715 <GO>}

It's mostly all in the casualty sub-segment of the reinsurance -- line of business within the reinsurance segment. As you know, we had a fairly sizable part of our business for market share proportion of our production was in casualty businesses, casualty business in the early years of Arch going back from 2002 -- all the way to 2008 and '09, let's say where we reduced our writings on that particular line. So you're still seeing some favorable development coming through from those years in casualty in particular.

A - Marc Grandisson {BIO 4369887 <GO>}

What I would add to what Francois just said is in the earlier years, it was mostly -- we include in the casualty segment general liability and professional lines. In the early years we wrote a lot more GL in proportion than we've written recently. So, we think that the more recent releases would come from professional lines in our treaty that we've done in the early years still giving us some release from the casualty, the traditional GL portfolio that we wrote as far back as 12 to 15 years from now. We are -- obviously we have deemphasized that line of business very heavily over the last 10 years.

Q - Michael Phillips {BIO 21023048 <GO>}

All right. Okay good. Thank you very much for the comments.

A - Marc Grandisson {BIO 4369887 <GO>}

Sure.

Operator

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

Q - Josh Shanker {BIO 5292022 <GO>}

Good morning, everybody.

A - Marc Grandisson {BIO 4369887 <GO>}

Hi, Josh.

Q - Josh Shanker {BIO 5292022 <GO>}

Can we talk about production in MI and how much capital that required on the margin from where you were a year ago? And so, when we consider the share repurchases and everything, this may be a little bit of stagnancy in P&C, how much excess capital are you guys generating per quarter given the consumption elsewhere?

A - Marc Grandisson {BIO 4369887 <GO>}

I think that we need to see our earnings coming through right. And the one thing I will tell you, I don't want to tell so much because of the couple of things moving in own production the way flows through the portfolio, the Bellamy transaction that we put together -- that we are putting together on a programmatic basis; the roll off of the capital that we are experiencing and benefiting from pre-2008 the claims that are actually rolling off even as Francois mentioned, on the curing and delinquency. And frankly, Josh, they are all pointing in the right direction, which is we are -- and that probably helped inform and still helps us inform our view about how good and how much the fundamentals, how good the fundamentals are in the business.

And I think that we have -- we made a decision in the past, we certainly have committed to embark on that Bellamy transaction. They are very, very good for us in protecting the downside. They are allowing us to deploy capital in future periods. And hopefully we get more excess capital as a result.

But we are not running out of ideas in the MI segment. So if anything we are very happy with our production and happy where we are. And if the opportunities keep on being the same as we see now we are going to keep on deploying capital there.

A - Francois Morin {BIO 17410715 <GO>}

The one thing I will add to that just as a counter to excess capital is actually persistency is actually trending up. And with higher interest rates, as you know, we would expect to have a bigger book -- the book is sticking longer on the balance sheet which does require the capital.

So it's hard for us to know and to say exactly how much excess capital we are producing on a quarterly basis. Certainly something we look at I want to say after the fact, not before the quarter starts. But that certainly an important part that we have to be aware of as we think the book will stick around for a bit longer. That just triggers capital requirements that we need to be aware of.

Q - Josh Shanker {BIO 5292022 <GO>}

Let me ask the question another way then. And I am not complaining about $170 million of share repurchase. But what tells you, okay, let's stop? Like how do you know -- how did you get your fill and decide that you had done enough? Or I mean, was it just like -- were you closed out? What was the trigger that you knew how much you wanted to purchase at what time, I guess is what I am asking?

A - Francois Morin {BIO 17410715 <GO>}

Well, some of it is the price. I mean some of it is the closed window, so we certainly bought back some stock early in the quarter. Come June 15 we had to implement a 10b5 plan. We set some guidelines in place. We passed them on to the broker and we had to just watch on the sidelines and see what they were going to execute on that.

So we gave them an authorization. They filled it; I mean they worked with the parameters of the 10b5. But I don't want to say it's a black-and-white line on when we stop and when we keep going.

And the other thing you have got to remember is we also wanted to reduce our leverage. So we paid down $250 million of the revolving credit facility, which is one of our objectives as well. We want to bring down our leverage. We want to regain the flexibility we had before the UGC acquisition. And so, those are really two things that go hand-in-hand that we want to manage through and we think we are on the right path.

Q - Josh Shanker {BIO 5292022 <GO>}

Okay. Well, thank you for the answers and I look forward to the remainder of the year.

A - Marc Grandisson {BIO 4369887 <GO>}

Thanks, Josh.

Operator

Thank you. Our next question comes from Nick Lacoviello from Dowling & Partners. Your line is open.

Q - Geoff Dunn {BIO 3447798 <GO>}

Hi, it's actually Geoff Dunn.

A - Marc Grandisson {BIO 4369887 <GO>}

Hi, Geoff.

Q - Geoff Dunn {BIO 3447798 <GO>}

I wanted to revisit the MI capital question. Your cushion is by far the biggest in the industry right now. And given your comfort with 2.0, what is the prospect for a dividend out of that platform in the back half of the year?

A - Francois Morin {BIO 17410715 <GO>}

It something we look at. No question we did declare ordinary dividends in the first half of the year, which helped us again reduce the leverage pay down the revolving credit facility. We are also -- those restrictions as you know with the state regulator is that there's only so much we can dividend out. So, if and when we get to a place where we have to -- we want to extract more capital we may have to go that down the route of extraordinary dividends and/or return of capital, which as you know, will require regulatory approval. So, it's certainly part of the equation, but you know, and the other thing I'll add to that, which is a bit influx, is we are still realigning our legal entities with the merger of UGC and Arch MI. There is a bit of more actions we need to take place that that we need to put through there just have a bit more optimal capital structure within our US regulated entities and the mortgage base. So it's all being considered. We don't have a hard number at this point, but we're actually, something we look at quarterly with the local board, the local management team, and it's part of the overall capital plan of the ACGL.

Q - Geoff Dunn {BIO 3447798 <GO>}

Have you submitted a special dividend request to your state regulator?

A - Francois Morin {BIO 17410715 <GO>}

Earlier this year we did, and it was approved. And something -- and again there's a frequency of interactions you want to have with the regulator, we can go to them. We got to manage through that, but it's certainly something we want to have a fairly suspect systematic way of going in reaching out to them with definitive. I want to say views on how the capital requirements. What they see as capital requirements from their own -- the state regulators versus PMIERs. There's also differences in how much credit we get for the Bellamy transactions that come into play. So there's a lot of factors that we're working through, but we don't have a definitive plan of action, I'd say for the remainder of 2018 to go to them at this point.

Q - Geoff Dunn {BIO 3447798 <GO>}

Okay and then two questions on production. First your 97 mix has been coming up a little bit fourth quarter, first quarter and then more materially this quarter. Is there anything that is changing on the underwriting basis in that segment that's making you more comfortable? Or was particularly this quarter's gain more due to the unusual pricing that you highlighted before?

A - Marc Grandisson {BIO 4369887 <GO>}

So, from our perspective our belief is that we didn't change radically our view of pricing and risk -- appreciation of those risk is probably because the rest of the competition probably put some more extra layers on this and that probably mean that we won a little bit more in that segment. So we increased our share but, Geoff, as you know, we are still underweight versus the rest of the marketplace. And as you know as well I don't need to tell you that the production of LTV above 95 has grown in the industry. So we are also on the receiving of this and it's hitting and as a production increase in that segment there's probably more and more ability to charge a price to take on the risk.

Q - Geoff Dunn {BIO 3447798 <GO>}

Okay. And then lastly, you mentioned a couple large deals in the quarter. Are you referring to kind of these pool deals where you are quoting on a pool of whole loans in the aggregate?

A - Marc Grandisson {BIO 4369887 <GO>}

Yes, and pre-agreeing is a forward commitment, yes.

Q - Geoff Dunn {BIO 3447798 <GO>}

Okay. Thanks.

A - Marc Grandisson {BIO 4369887 <GO>}

Thank you.

Operator

Thank you. And our next question comes from Bob Glasspiegel from Janney Montgomery Scott. Your line is open.

Q - Bob Glasspiegel {BIO 1764160 <GO>}

Hello, Arch. I just wanted to dig into the insurance segment. You have now had three quarters where you've eked out a small underwriting profit. And if you adjust -- even if you adjust for the luck, you are hitting a tougher cat third quarter. But you talk pretty optimistically about sort of the environmental changes. Do you think the work you have done in the environment are sufficient that you can actually get to an underwriting profit looking out forward and start to approach your targeted returns in that segment?

A - Marc Grandisson {BIO 4369887 <GO>}

We're certainly working heavily towards that. Bob, I think you know us; we try to work towards that. I think we've always worked towards that level. I think that we are probably not -- I just want to put a little caveat to what you said. I think we are cautiously optimistic as to what we've seen in terms of margins improving. And I think that will take us some time, we have some improvement. I think some of it in the loss ratio, but as Francois mentioned, some of it is due to mix. In terms of return, we're seeing some improvement in returns, but we're not declaring for victory yet with global. It will take us a while to really see the results coming through.

But suffice it to say that there has been an active shift between the businesses that have been going on. And this is not of late. So what you see right now on insurance, as you know, Bob, is really the sum total of things you've done over the last year -- year and a half to two years, not that we are seeing right now in a reallocation to higher return lines of business and we are hopeful that this is the level that will continue and even improve in the future, but the future only the future will tell us what happens.

Q - Bob Glasspiegel {BIO 1764160 <GO>}

Thank you. Francois, do you have handy either new money rate for the quarter or current new money rate that you are investing at?

A - Francois Morin {BIO 17410715 <GO>}

Well, we're actually, new money rate on the corporates actually exceeded 3% in the last few weeks. So that's good news. That'll help the investment income going forward. But, yeah, we're right about like 3.1% in the last 20 days or so.

Q - Bob Glasspiegel {BIO 1764160 <GO>}

That is well above your embedded yield, so investment income, as you said, should continue to accelerate. And last question, was the tax rate guidance full-year or second half?

A - Francois Morin {BIO 17410715 <GO>}

Full year.

Q - Bob Glasspiegel {BIO 1764160 <GO>}

Thank you.

A - Francois Morin {BIO 17410715 <GO>}

You're welcome.

Operator

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

Q - Meyer Shields {BIO 4281064 <GO>}

Great, thank you. Marc, when you started your comments you mentioned that rates are a little bit above loss trends. And I was hoping to see whether that's the loss trends that you are currently observing or the longer-term loss trends that you have been baking into pricing and reserving.

A - Marc Grandisson {BIO 4369887 <GO>}

Yeah, okay. So it's a bit of both. Whatever we use in our loss trend is informed by the data obviously you're not future expectations. The delta is not significant, it's 150 or 125. But Meyer, it's been only that margin has only been, it's a quarter or two effects haven't been a consistent pickup in trend or in rate over loss trend that we would expect to really start growing the book of business.

And so it's a very, it's an Arch more than science at this point in time. Specifically for the more recent accident year, takes a really long time to have a clear view of what's happening. And frankly we won't know until you know 5 or 10 years from now. What we're looking for more is margin of safety between the loss trend and the rate change. And this clearly is not, we don't believe it's sufficient enough at this point in time in most lines of business. In some lines like property, we are clearly getting way above trend and that helps inform our position in allocating capital and getting a more and known better assurances that our ROE expectations is going to be there. And we are going to meet it.

Q - Meyer Shields {BIO 4281064 <GO>}

Okay, thanks. Related question, on the casualty lines -- there's I guess different views from different executives right now about whether there is an uptick in claim frequency in a lot of casualty lines and I was hoping you could tell us what you are seeing?

A - Marc Grandisson {BIO 4369887 <GO>}

We are seeing frequency not increasing dramatically. But we are not seeing it decreasingly. And the problem with frequency, Meyer, that -- you're an actor, you know that as well as I do -- is that the frequency is a look back estimate. It takes a long time for the true losses to emerge.

So, we have seen some great frequency decreases. I would be of the mind and most of us at Arch would be of the mind that some of it is due to looking back to a lower economic environment and a lower activity over the last 10 years and carrying on doing that projections in the future.

I'm reminded of the Worker's Comp years of 1993, 1994, 1995 when things were being extracted, frequency being down very heavily and it's just a matter of time before it starts picking up again. And another line of business of more recent experience is auto liability. It was looking pretty good on frequency and the frequency shot up over an 18-month to 24-month period.

So I am worried about the false sense of security of ongoing frequency decreases, especially in light of an economy that has a lot of friction, a lot of pickup in it, a lot of steam in it.

Q - Meyer Shields {BIO 4281064 <GO>}

Okay. That's very helpful. Thank you.

A - Marc Grandisson {BIO 4369887 <GO>}

Thank you, Meyer.

Operator

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

Q - Brian Meredith {BIO 3108204 <GO>}

Yes, thanks. A couple of questions. First one, just curious, the pickup in property business you are seeing on your insurance side. I know you talk about some of that is rate, but then also adding some new business there. What do you see as the attraction right now in the property business? Is that the area you think that rate is well in excess of trend? What's going on there?

A - Marc Grandisson {BIO 4369887 <GO>}

So rate, yes, we believe rate is in excess of trend. There is also -- the rate on our E&S portfolio, which is mostly an E&S portfolio play, right, Brian, it's not the global property side or the small commercial that we've seen some of it in certain areas. But by and large, the ones that have -- are E&S in nature, including the (inaudible) business, we are seeing rate increases because of dislocations in the marketplace.

Some players have been hurt a little bit. There has been some question as to whether that's a viable book of business. So there are opportunities to slide in and are able to seek opportunity.

On the reinsurance side, because I want to mention that as well, Brian, it does matter. There are also opportunities that arise because of some placements not being finalized. And we are able to pick and choose some facultative placements that are just to complete the quilt of coverage that a larger risk would have to do to place.

So there is a little bit of a shrinking of capacity in the space, specifically in the E&S property. It's an 8% trend, 8% to 9% rate increase, but this is one loan area where we're seeing some terms and conditions getting better -- actually working towards us as an insurance carrier.

So, as I say in my notes, we like to see rate increase going up one way and terms and conditions following suit, meaning giving us an extra kick up. And we believe this is what is going on in property, although it's not widespread. We have to pick our spot, but it's certainly what we are seeing in the business that we write.

Q - Brian Meredith {BIO 3108204 <GO>}

And then next question. At Investor Day Nicolas talked a little bit about maybe some initiatives to try to get the combined ratio down in that insurance segment be it expenses, be it risk selection and stuff. Can you just maybe elaborate a little bit on what you are doing to try to consistently maybe improve that? Because I can't think the returns in your business are that great when you are sitting here kind of with a 100 combined ratio, 99, 100?

A - Marc Grandisson {BIO 4369887 <GO>}

Correct. So we really identify this is an area of opportunity but that will take years to develop. And the initial things that we have done and we are doing currently right now is there's a little bit more integration going on for some things such as IT, for instance, that we think we need to do and can be done even though we have multiple platforms.

So, it's a couple of things: integrating services; leveraging some of the overseas employees that we have that are in lower-cost jurisdictions. And there's some initiatives that we are talking that we'll be working on going forward to try and decrease it. But I will tell you what happens when they happen and we are going to give it to -- give ourselves some time to get there.

Q - Brian Meredith {BIO 3108204 <GO>}

Great, thank you.

A - Marc Grandisson {BIO 4369887 <GO>}

Welcome

Operator

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

Q - Ian Gutterman {BIO 3106649 <GO>}

Hi, thanks. We're early. I can't even ask you where lunch is yet. So first, Francois, thank you for doing the script in a slower cadence than we're used to; that was helpful. So my first question, just to follow up on the tax, can you talk specifically about why it's coming in lower than you expected for the year?

A - Francois Morin {BIO 17410715 <GO>}

Well, Six months have gone by. I mean, no question that when we started the year if there is a lot of uncertainty after the tax reform. I'm trying to figure out was all of based on plan. So when we gave you the estimates back in February is all related to where we saw the profitability of the units and what local jurisdiction they come from six months have gone by and now we have a bit more clarity on the actuals and that's what we are just updating. So, I hate -- I can't put pinpoint any one particular thing on why it's come down a couple of points, let's say, it's really more just the fact that we've replaced forecaster planned with actual.

Q - Ian Gutterman {BIO 3106649 <GO>}

Okay. I guess I would've thought -- I guess comparing to my model, not your internal model, obviously. But I would have thought that the upside in earnings has come more from MI, which obviously would be more in the US. So I would have thought if anything like the geographic mix would have biased you higher if anything. So I don't know if there were other actions you were taking to try to offset that or --

A - Francois Morin {BIO 17410715 <GO>}

It's not a big difference. The 21% in the tax rate, we got a 50% quota share on the mortgage book, so that brings it down to 10.5% right there. We can do it off-line. There is a couple of other things that I think are one-offs that kind of move it in different directions. So it's really hard to give you a lot more clarity over this range at this point.

Is the primary US business in just for your benefit. In all, some of it in the US segment is also written out a bit, which would have a different tax.

Q - Ian Gutterman {BIO 3106649 <GO>}

For sure. For sure. And then can you give us some color on the fac losses? I mean the dollar amount was about similar to last year but I assume that is coincidence. Is it coming from the same parts of the book though or is it different parts of the book or different geographies? Any color you can give us on what happened there?

A - Francois Morin {BIO 17410715 <GO>}

It's different, it's one-off. it's a one class of business that we had unfortunate, what I mean one major event that came into the quarter, we don't see any trend in it, it's really, I mean it's the assets. It's coincidence that is happening in the exact same quarter, 12 months later, but other than, again as Marc said, we've been very happy with the performance of that book over the years.

A - Marc Grandisson {BIO 4369887 <GO>}

Yeah, no question that we're going to look into it, some more as we move forward and does that force us to reevaluate some underwriting decisions. But at this point, we don't see anything that's really problematic.

A - Francois Morin {BIO 17410715 <GO>}

Knowing that loss versus last year, there are different in nature. I mean we have a second -- exactly, it's very different in nature. I mean it's fire loss for different types of risk, different types of characteristics, different coverages of sort I get very different, a different occupancy, and that, it's a very lumpy book of business, we are sitting here having Q-on-Q loss we could have, five quarters with no losses.

Q - Ian Gutterman {BIO 3106649 <GO>}

Okay, was this a fire that I would've maybe read about in the press somewhere that happened call it an island near Europe?

A - Marc Grandisson {BIO 4369887 <GO>}

No, that was not that one.

Q - Ian Gutterman {BIO 3106649 <GO>}

Okay, okay. And then maybe just for -- if I think about say the full year 2017 in fac, I mean obviously there was a bad Q2. But I'm just trying to sort of think about what's normal over the course of a year. Would last year all in have been a normal year, a worse than average year, just how should I think about that?

A - Marc Grandisson {BIO 4369887 <GO>}

Last year has been a worse than average year. I am not comfortable giving you what we think the long-term pricing and returns are. We want to keep it proprietary, but it's shown a very healthy, very profitable book of business. But last year yes, in the 11 years it has been running business for us together it's the one year that sticks out. Everything has been actually below the long-term expected, all years except for that one last year.

Q - Ian Gutterman {BIO 3106649 <GO>}

Okay. I was just trying to think about volatility, like given it's two years in a row with a bad quarter, would it be normal to have a quarter like this once every -- probably not once every four quarters, once every eight quarters or once every five years? I'm just trying to get a sense of how unusual the last two Q2s are?

A - Marc Grandisson {BIO 4369887 <GO>}

It's a very good question, Ian. I don't know the answer to that.

Q - Ian Gutterman {BIO 3106649 <GO>}

Okay. Fair enough. Fair enough. Okay, and then just quickly on mortgage, you talked about the environment being healthy. And obviously I mean that seems fairly obvious. But I guess sort of the incremental news maybe over the last month feels like there's a little bit of softness emerging. I don't know if that is maybe more at the high-end which you wouldn't have MI then the broader market. But are you seeing any signs of that? It feels like that maybe prices have just gone up a little too fast in certain geographies where affordability has become an issue.

A - Francois Morin {BIO 17410715 <GO>}

I wouldn't describe the market as being softer. I would tell you though that the types of risk that find their way to the MI purchase market have a little bit -- the credit is a little bit wider than it was possibly three or four years ago. And it's just the nature of the business and the business that we are in.

The rates are increasing. There is less refinancing. There is more first-time homebuyers and there's house price appreciation, so there tends to be higher LTVs and more first-time homebuyers. But it's just the nature of what they are, but I would believe -- and I think the market and certainly from our perspective with RateStar we believe that we are pricing appropriately for those risks.

Q - Ian Gutterman {BIO 3106649 <GO>}

For sure. Yes, I was just wondering if on the margin affordability was impacting credit at all. So it doesn't sound like (multiple speakers).

A - Marc Grandisson {BIO 4369887 <GO>}

Affordability is actually 15% above the long-term trend. So affordability is still decent, It's not all created equally in all cities like San Francisco and middle of the country. But certainly affordability is still there. The DTI equivalent is about 26. So it's not that bad.

Q - Ian Gutterman {BIO 3106649 <GO>}

Perfect. Sounds good. Thank you.

A - Marc Grandisson {BIO 4369887 <GO>}

Welcome.

Operator

Thank you. And our next question comes from Yaron Kinar from Goldman Sachs. Your line is open. Please check that your lines is not on mute. Again, sir, please check that your lines not on mute. And I am showing no further questions from our phone lines. I would now like to turn the conference back over to Mr. Grandisson for any closing remarks.

A - Marc Grandisson {BIO 4369887 <GO>}

Thank you, guys. Welcome, Francois, to the call and we look forward to talk to you after the wind season. Thank you.

Operator

Ladies and gentlemen, thank you for participating on today's conference. This does conclude the program, and you may all disconnect. Everyone have a wonderful day.