Q3 2018 Earnings Call

Company Participants

- François Morin, Executive Vice President, Chief Financial Officer & Treasurer
- Marc Grandisson, President, Chief Executive Officer & Director

Other Participants

- Elyse B. Greenspan, Analyst
- Geoffrey Murray Dunn, Analyst
- Joshua Shanker, Analyst
- Kai Pan, Analyst
- Meyer Shields, Analyst
- Michael Zaremski, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good day, ladies and gentlemen, and welcome to the Q3 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. As a reminder, this conference call is being recorded.

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

Additionally, certain statements contained in the call that are not based on historical facts are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. The company intends the forward-looking statements in the call to be subject to the Safe Harbor created thereby. Management also will make reference to some non-GAAP measures of financial performance. The reconciliation to GAAP and definition of operating income can be found in the company's current report on Form 8-K furnished to the SEC yesterday, which contains the company's earnings press release and is available on the company's website.

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

Marc Grandisson {BIO 4369887 <GO>}

Thank you, operator, and good morning to you all. Happy Halloween to all and best wishes to your little ghosts, goblins and princesses. While the stock market has been providing some scares this past week, here at Arch, we had another good quarter despite higher cat activity around the world as our operating strategy of diversification, cycle management and focus on risk adjusted returns produced an annualized operating return equity of 11.4% and a 2.3% increase in book value per share at September 30, 2018. François will provide more commentary on our financial results in a moment.

But it's worth noting that our modest exposure to property losses this quarter is not just the result of our good risk selection. It also reflects our ability to remain disciplined in a market where risk adjusted returns do not meet our return hurdles. The 2017 and 2018 catastrophes are a reminder that margins in cat exposed property lines remains thin and in many cases, are inadequate relative to the severity and frequency of catastrophe events. With respect to market conditions in our property, casualty operations, outside of property, there are just a few specialty areas such as travel accidents and European motor where current market conditions provide opportunities to deploy additional capital.

In most of our insurance lines, rate changes are positive and appear to be outpacing claim trends. But as we have discussed in prior quarters, the spread between rate changes and loss trend, claims inflation, if you will, is small and we remain cautious in establishing our loss picks. In addition, specialty lines such as those that we write are volatile by their nature and it is necessary to use a longer assessment period in order to evaluate the ultimate margins.

In summary, overall market conditions in our P&C businesses to evaluate the ultimate margins. In summary, overall market conditions in our P&C businesses seem relatively unchanged from last quarter and we continue to believe that additional rate increases are needed to provide a more adequate margin of safety and broader growth opportunities.

Turning now to MI where the operating environment remains attractive. I will focus my comments on our U.S. primary business, which represents over 80% of that segment. MI pricing appears to have stabilized in the third quarter as to the rate changes announced in the first half of this year. The credit quality of loans insured remains strong and our key risk barometers are still at benign levels relative to historical norms. If you have a chance, visit our Arch MI website for our full housing and mortgage market report, and called it Hammer Report. It will give you a good idea of why we remain confident of the health of the U.S. housing market. In short, due to the factors I just discussed, we like the visibility in the future performance of our U.S. mortgage insurance business.

Our U.S. MI new insurance written or NIW was strong again at $21.4 billion, a 21% increase over the same quarter last year. In the third quarter, higher loan to value or LTV mortgages with greater than 95 LTVs grew slightly as a percentage of our NIW to about

15%. Credit quality as indicated by FICO remains high across our risk-in-force with an average score of 743.

We remain underweight relative to the market in the greater than 95 LTV and the higher DTI products. Our single premium policies remain low at 7% of NIW this quarter versus the industry average of roughly 15%. In the current rising interest rate environment, monthly premium products should continue to produce better risk adjusted returns over time. The persistency of our monthly policy has increased to 82% in the third quarter and support the allocation of more capital to the monthly products.

In addition to maintain the credit quality of our in-force book, we increased our protection for mortgage tail risk by completing our second and third Bellemeade risk transfers to the capital market this year where we have become a regular issuer. Insurance linked notes enhance the level and the predictability of our expected returns. As far as the new MRT programs with the GSEs, the IMAGIN and EPMI facilities, they have begun to generate business. Momentum is building slowly as banks develop new systems to handle the programs. More on that later.

Now, briefly, with respect to our investment operations, higher yields available in the financial markets and growth in invested assets led to a 21% increase in net investment income in the third quarter. We remain underweight both credit and interest rate risk given the rising rate environment. Finally, a few words on capital and risk management. Share repurchases by Arch are typically light in the third quarter, and this quarter was no different. While we repurchased some shares this past quarter, we have been working on a few opportunities to deploy our capital into our businesses and we will let you know if and when these opportunities come to fruition.

As to risk management, for the reasons I mentioned earlier, our property cat exposures remained at historically low levels with our 1-in-250 year peak zone at 5% of tangible common equity at the end of the third quarter.

For our mortgage segment, as of September 30th, our realistic disaster scenario declined as growth in the insurance in-force was more than offset by the capital relief from the Bellemeade transaction and the continuing run-off of pre-2009 business.

With regards to PMIERs, which applies to our primary U.S. mortgage insurance business as of September 30, 2018, Arch MI was at 151% of the current GSE capital requirements. Arch required assets exceeds both the current efficiency ratio known as PMIER 1.0 and the revised GSE required assets as proposed under PMIERs 2.0 which is to be effective on March 31, 2019.

With that, I will turn it over to François.

François Morin

Thank you, Marc, and good morning to all. Let me jump right in and give you all some comments and observations on our results for the third quarter. Consistent with prior practice, these comments are on a core basis which corresponds to Arch's financial results excluding the other segment, i.e., the operations of Watford Re. In our filings, the term consolidated includes Watford Re.

After-tax operating earnings for the quarter were $242.3 million, which translates to an annualized 11.4% operating return on average common equity and $0.59 per share. On a year-to-date basis, our annualized operating ROE also stands at 11.4%, a solid result in light of challenging conditions in the P&C sector.

Book value per share was $21.15 at September 30, a 2.3% increase from last quarter and a 6.4% 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 reinstatement premiums, were $58.2 million or 5 combined ratio points. While these losses were predominantly the result of Hurricane Florence hitting the Carolinas, we were also impacted by other events across the globe including Typhoon Jebi in Japan. As for Hurricane Michael, while we are still early in the process of assessing our exposure to this event, we believe the impact to our insurance and reinsurance operations will be in the range of $40 million to $60 million on a pre-tax basis given the information available at this time.

As for prior period net loss reserves development, we recognized approximately $77.6 million of favorable development in the third quarter or 6.7 combined ratio points compared to 5.1 combined ratio points in the third quarter of 2017. All segments were favorable, led by the mortgage segment with approximately $38 million favorable, the reinsurance segment at $33 million favorable, and the insurance segment contributing $7 million. This level is higher than in recent periods, primarily as a result of the significant favorable development observed in our first-lien portfolio in the mortgage segment, where cure rates this year continue to be materially higher than long-term averages and expectations. The calendar quarter combined ratio on a core basis was 80.1%, while the core accident quarter combined ratio, excluding cats, improved to 81.8%, down 260 basis points from last year's third quarter.

The insurance segment's accident quarter combined ratio, excluding cats, was 100.2%, slightly higher than the comparable 2017 level, as a result of elevated attritional claim activity across a small number of lines, slightly offset by lower operating expenses, resulting primarily from lower compensation costs. In comparing the quarterly accident year results, it should be noted that the reported results can be subject to noise due to random occurrences that can take place in the lines of business we operate in. Just as we reported that our results last quarter were enhanced by the lower frequency of large non-cat claims, the opposite result materialized this quarter. In order to detect trends in the performance of our units, we tend to focus on trailing 12-month analyses to remove some of the noise that we see from quarter-to-quarter.

The reinsurance segment accident quarter combined ratio excluding cats stood at 92.5% compared to 96.9% on the same basis one year ago. As we discussed in the prior call, the combined ratio in the quarter one year ago was impacted by a large retroactive reinsurance contract. Given the nature of our book and the impact certain large transactions may have, fluctuations of quarterly results are not unusual and should be expected.

The expense ratio benefited from the reduction in Federal excise taxes of $2.3 million or 0.8 points as a result of the cancellation of certain intercompany property casualty quota share agreements effective January 1st as discussed in prior calls. This item will continue to impact comparisons of 2018 to 2017 results.

The mortgage segment's accident quarter combined ratio improved by 410 basis points from the third quarter of last year as a result of the continued strong underlying performance of the book, particularly within our U.S. primary MI operations.

The calendar quarter loss ratio of 3.2% in the third quarter of 2018 compares favorably against the 12.8% in the same quarter of 2017, due to substantially lower delinquency rates. 570 basis points of the difference or $17.1 million is attributable to increased favorable prior development, while an additional 280 basis points of the difference or $8.3 million is attributable to favorable development on 2018 delinquencies due to very strong cure activity in the period. The expense ratio was at 21.4%, slightly higher than in the same period one year ago as a result of the higher level of acquisition expenses due to increased amortization of deferred acquisition costs.

These figures highlight the contribution to our pre-tax underwriting income from the mortgage segment which remains strong this quarter. After allocating corporate items, such as investment income, interest expense and income taxes to each segment, the mortgage segment's contribution to our 2018 year-to-date net income decreases to approximately 70% of the total, after normalizing our results for catastrophic activity.

Total investment returns for the quarter was a positive 31 basis points on a U.S. dollar basis and a positive 37 basis points on a local currency basis. These returns were impacted by the effects of higher interest rates on investment-grade fixed income securities with marginally higher returns on alternative investments and non-investment-grade fixed income.

During the quarter, we continue to shift our allocations away from municipal bonds and into corporates due to relative valuations. The investment duration was substantially unchanged on a sequential basis at 2.94 years. Operating cash flow on a core basis was a strong $543 million in the quarter, reflecting the solid performance of our units. Lower levels of claim payments and higher levels of investment income received explain most of the increase over the same quarter one year ago.

The corporate effective tax rate in the quarter on pre-tax operating income was 11.8% and reflects the benefit of the lower U.S. tax rate, the geographic mix of our pre-tax income and 190 basis point expense from discrete tax items in the quarter. As a result, the effective tax rate on pre-tax operating income excluding discrete items was 9.9% this quarter, slightly lower than the 10.4% rate last quarter.

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 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 16.6% at September 30th and debt plus preferred to total capital ratio was 23.5%, down 290 basis points from year-end 2017 and 520 basis points from year-end 2016 when we closed the UGC acquisition.

As for share repurchases, we repurchased 414,000 shares during the third quarter at an average price of $26.48 per share and an aggregate cost of $11 million under Rule 10b5 plan that we implemented during our closed window period. Since the start of the fourth quarter, we have purchased an incremental 575,000 shares at a cost of $15.3 million. Our remaining authorization which expires in December 2019 now stands at $247 million after consideration of the share repurchases made through October 30th.

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

Q&A

Operator

Thank you. Our first question comes from Geoffrey Dunn from Dowling & Partners. Your line is open.

Q - Geoffrey Murray Dunn {BIO 3447798 <GO>}

Thank you. Good morning.

A - Marc Grandisson {BIO 4369887 <GO>}

Hey, Jeff.

Q - Geoffrey Murray Dunn {BIO 3447798 <GO>}

I guess, first, could you update the RDS number for the MI business and specifically can you give us what the gross RDS is and then the net RDS after all the ILN benefits?

A - François Morin

Well, I mean, we do the gross and – we focus on the net because there's a lot of movements there and there's a lot of reinsurance protection as you know that comes into play. The current number is just at about $1 billion net of all the protections we have.

A - Marc Grandisson {BIO 4369887 <GO>}

Yeah. Shy of 13%, Jeff.

Q - Geoffrey Murray Dunn {BIO 3447798 <GO>}

And is there any way for us to try to back into that gross number?

A - Marc Grandisson {BIO 4369887 <GO>}

Not really. From just talking to you, I guess at some point, we might want to talk to it through it but it's not very easily manageable I guess in a call like this.

Q - Geoffrey Murray Dunn {BIO 3447798 <GO>}

Okay. And then with respect to managing capital in the MI platform, as you consider both regulatory limitations on dividends and just overall surplus until contingencies start releasing, is it possible to manage to an efficient cushion on a pro forma 2.0 basis as a recurring ILN (00:20:03)?

A - François Morin

I just want to make sure – I mean the question in a sense, a cushion, yes. I mean just to be clear, we certainly want to have a cushion above PMIERs 1.0 or PMIERs 2.0. We don't think it's prudent to run the business right at PMIERs whatever that is. So no question, yes. As you saw, the PMIERs ratio did go up this quarter driven by the new Bellemeade transaction we closed on in the third quarter. We're in the middle of discussions and planning around how we can extract some of that excess capital from the regulated entity, regulated mortgage entities and see what we can do with that.

A - Marc Grandisson {BIO 4369887 <GO>}

Two things to add to this. Two things to add to this, Geoff. I think that the Bellemeade transaction, as you know, are by and large so far have been backward looking. So, you really only know after you've accomplished or you've realize them. So, your question assumes that you're going to have the same level of execution in the market going forward on a guaranteed or semi-guaranteed basis which we don't know if that's the case. But having said all of this, you also have opportunities that may develop over time in a marketplace that might mean more need for capital and that also will cause sometimes delay or it's not a very immediate release of capital, as you know, with the regulatory entities in the U.S. We have to be careful and it takes a little while to go through the capital management because of all these constituencies out there.

Q - Geoffrey Murray Dunn {BIO 3447798 <GO>}

It sounds like maybe it's little too early to ask the question.

A - François Morin

Well, I mean we're working on it. The answer is it's a fact. We closed on the transactions and, as you know, it takes time to get approvals that we had done and...

Q - Geoffrey Murray Dunn {BIO 3447798 <GO>}

Yeah.

A - François Morin

...that's really were the first thing we need to do for and then we'll once – if and when we get those, then we'll have more flexibility in what we can do with it.

Q - Geoffrey Murray Dunn {BIO 3447798 <GO>}

Okay. Thanks.

A - Marc Grandisson {BIO 4369887 <GO>}

Sure.

Operator

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

Q - Kai Pan {BIO 18669701 <GO>}

Thank you. My first question just follow-up with Geoff on MI business. It looks like last two quarters, your underlying combined ratio running at high-30s given the strong credit environment, and that's compared with last year probably in the mid-40s. I just wonder if the credit environment remains stable, will that be a sort of reasonable run rate for that business or other sort of like minus pluses like could impact that core combined ratio going forward.

A - Marc Grandisson {BIO 4369887 <GO>}

So, Kai, all moving parts that are very – there's lot of things going on. If anything else change, you're quite right that we should expect to have a very similar combined ratio. That's just based on the credit quality of the borrowers. It's still extremely good out there. So yes, that we would expect everything else being equal, which is never is, right, we still need house price to go up, we still – unemployment remaining low and mortgage rates not increasing dramatically or in a significant way. So there are lot things that need to happen for this to be – because for the shorter term, yes, we would expect this to be a sustainable combined ratio.

Q - Kai Pan {BIO 18669701 <GO>}

Okay. That's great. And then switch to the reinsurance side. We have heard a lot of sort of new demand in the marketplace since the cash leery, as well as this year's cat activity is not quite, it's not like as large last year but we have some adverse development from last year's events as well. So what's your outlook for January renewals. If you can talk both on the property cat side and as well as ongoing sort of like pricing on the casualty side as well?

A - Marc Grandisson {BIO 4369887 <GO>}

So let me take the property cat. I mean it's still early, right? We're a couple of months before the renewal of the January 1s. The market is still flush with capital. So there's a couple of things going on there that brings a lot of dynamic as we get towards January 1.

Based on the results of the losses that we've seen over the last two, three years, we would expect it to be at least - should be at least some price increase to recognize the fact that the long term average - the short term average is probably not going to favor of the insurance companies and the reinsurance companies. So we would expect that to have an influence on the renewal. But, however, capacity is plentiful and there is a lot of alternative capital that could come in and change it. So we'll have to wait and see what happens. It's not a clear cut answer from that perspective.

On the casualty side, it's a very tough place to be. The result on the casualty, we're not a big casualty reinsurance player. What you see in our casualty segment is not at all the GL, general liability, or the traditional casualty reinsurance. We still feel this is too competitive for our own taste. The fact that people want to buy more reinsurance might indicate to me that there is a willingness and a desire to share or at least to deemphasize the risk that is inherent in their portfolio. So we'll be very cautious in the way we are going about running that business. We're not as optimistic about the casualty market as people would be out there.

Q - Kai Pan {BIO 18669701 <GO>}

Okay. Last one you may on the primary insurance side. So you mentioned attrition loss is higher, could you quantify that for the quarter? And also you mentioned that these results have been close to breakeven and you have mentioned about 95% long-term outlook and how quickly we can get there?

A - Marc Grandisson {BIO 4369887 <GO>}

Not soon enough, right? I mean that will be the right answer. I think that we've seen that trailing 12-month combined ratio hovering around 99%. This quarter, yes, did have larger attritional losses. I think it's 2 to 2.5 points impact on the quarter, which would have put this quarter in line with the other ones. But on the trailing 12-month, we are pretty much at the 99% number. And this is the one that we intend to focus on. Any one quarter does not make a trend. And as you all remember, we had large losses on reinsurance last quarter. We did not have them this quarter. We are having them in insurance. So there is a lot of volatility going around those given the specialty lines that we write.

I think that we also look at this in sense of the overall market being soft, terms and conditions not strengthening any better with some rate increase. It just makes us to be that much more prudent. When there is a large loss that comes in, most of the time IBNR would be there to make up for that loss. But we tend to take a more conservative approach to this and may not take the full impact on the IBNR and leave the IBNR at the same level and take the large loss as it comes because we are not sure that the fundamentals are improving as much as we would hope they would be.

Q - Kai Pan {BIO 18669701 <GO>}

Okay. Thank you so much.

A - Marc Grandisson {BIO 4369887 <GO>}

Thank you.

A - François Morin

Thank you.

Operator

Thank you. Our next question comes from Mike Zaremski from Credit Suisse. Your line is open.

Q - Michael Zaremski {BIO 20606248 <GO>}

Hey. Thanks. Starting with mortgage insurance, in the prepared remarks, you mentioned that momentum is building for, I think, you said some of the bigger banks to handle some of the adjustable mortgage insurance pricing. Is that you think helping you maintain your market share position? Because I think your market share jumped up a lot in 2Q and I think – and still stayed higher than expectations, which is a good thing of this past quarter.

A - Marc Grandisson {BIO 4369887 <GO>}

I'm not sure what part of my remarks you mention you referred to but the thing about our ability to increase market share and being that relevant to our clients is most clients that embraced risk based pricing are actually the ones who are gaining market share in the industry and that's been – a phenomenon has been going on for several quarters. So yes, by virtue of us being – there's much more nimbleness, if you will, at the – the more in the non-bank loan originators than there are at the larger banks out there. And I think that for the recent quarters, I think there's been a recognition that the larger banks might be losing market share to those non-bank loan originators. And RateStar actually works much better for those loan originator and actually helps them win business. So that's actually helping us grow market share or maintain our market share to be released.

Q - Michael Zaremski {BIO 20606248 <GO>}

Okay. That's a good nuance to know. Sticking with mortgage insurance, I know this is probably difficult, but is there any way that we could maybe try to size up how to measure how much could be left in terms of the pace of reserve releases if the cure rates continue to be significantly lower than historically? I mean, I guess – I don't know if you're using a two-year average or three-year or a 10-year historical average. I'm assuming you're not just assuming the rates that you've seen in 2017-2018 kind of overlay on the entire portfolio. But just kind of curious if there's anything we can look at to better understand and size up how that could trend if things do stay good for the foreseeable future as you kind of mentioned in your prepared remarks in terms of your outlook for MI.

A - François Morin

Yeah. I'll say a couple of things on that. First, I mean, yeah, delinquency rates are at very low levels, so we don't think they're going to go much lower than that. But the reality is the performance has been very, very good. As you know, the reserving methodology in the mortgage segment is very much a more of a mechanical prescribed exercise. There's a lot less flexibility in the mortgage segment than there might be in the P&C side. So if the delinquencies are there, yes, we can put up reserves for it; and if they are no longer there, they cure, the reserves come down. So there's no in between. Is it delinquent? It's only delinquent, yes or no. And from there, the model we built produced the estimates we carry or the reserves we have on the books.

So, to answer your question, I think maybe there is a bit more to go, but I think to be honest, the levels that we saw this quarter have been extremely high and probably higher than any of us here expected. So, if it happens again next quarter, say, well, I'd be surprised. I'm not saying it can't happen, but it would be again a continuation of a very favorable trend that the whole industry is seeing. We're not the only ones as you know that are seeing these trends. But, again, I don't think they'll be there sustainable for an extended period.

Q - Michael Zaremski {BIO 20606248 <GO>}

Okay. Great. And then, lastly, just on capital. You mentioned that looking at some new opportunities – I know you guys are always opportunistic and looking at things. Just curious if you can give us a flavor whether it's primary insurance or reinsurance or MI or all of the above that you're kind of looking at.

A - Marc Grandisson {BIO 4369887 <GO>}

It's pretty much all of the above. There are possibilities, and we'll be communicating with the market as and when we find out. If they do find out, they'll come out to fruition. So, yes, the answer is all of them.

Q - Michael Zaremski {BIO 20606248 <GO>}

Okay. Thank you.

A - Marc Grandisson {BIO 4369887 <GO>}

Thank you.

A - François Morin

Yeah.

Operator

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

Q - Elyse B. Greenspan {BIO 17263315 <GO>}

Hi. Yes. Good morning. My first question is going back to the discussion on your insurance business. So, obviously, the higher non-cat losses drove the increase in the quarter. But I'm just trying, as we think about going forward and you guys getting to kind of that 95% target, can you just give us a little bit more color on what you're seeing with inflation, anything that you guys are watching out for – you think about setting your picks as we think about the margin outlook for the business for 2019?

A - Marc Grandisson {BIO 4369887 <GO>}

Yeah. So the trend is a very interesting and important discussion. The problem is nobody will really know what it looks like until five or six years from now. Historically, trend in the insurance industry has been outpacing the core CPI increase and we've seen the CPI at about 1.7% to 1.8% over the last four or five years, which would mean to me that a trend – and if you look at the spread over that historically, it was 100 bps above that. So the inflation on claims for insurance claims is always higher than CPI. I just want to make sure it's clear here. We've seen 250 bps above this over the last four, five years. So there is a lot of uncertainty on this. We are trying to do two things, right? And one of them is portfolio construction. We try to focus on more primary policies because we think that the excess portfolios will have a lot more uncertainty in terms – if we turn out to be wrong on a trend on a pricing, the trend is going to impact the excess insurance market a lot more than the primary market. And then, second, we are pricing for those kinds of trend or give us a range around those trend and putting a cushion that we're not on the wrong side of the decimal when we actually produced the results.

There is also other things, Elyse, that help us. We could buy reinsurance to help us shape around the expect margin. But by and large, it's a give and take and working through with the marketplace, and really portfolio construction, and also focusing on a business where – you heard us talk about travel and property, right? Those two lines of business would be lines where inflation is a lot less relevant because you're going to tend to find out what inflation truly is much quicker than let's say any E&S casualty or high excess workers comp.

Q - Elyse B. Greenspan {BIO 17263315 <GO>}

Okay. Great. And then in terms of the tax rate, I know there's potential for some changes as we get closer at the end of this year. Do you still think your rate will kind of stay in that 9% to 12% range as we think about 2019?

A - François Morin

Too early to tell. We think it's not a bad place to start. We're in the middle of planning for 2019, and all I can say is we will give you more color with the year-end call. I'd say once we're into 2019, we'll have more visibility on how things are shaping up and the mix of business in what jurisdictions and how we think that'll play out.

Q - Elyse B. Greenspan {BIO 17263315 <GO>}

Okay. Great. And then one last question on mortgage. Your market share seems like it might have grown a little bit this quarter, but you – maybe slightly around 25% or a little bit higher. You had been taking that down after the deal, and then it started to come back up earlier this year. As I thought you guys kind of got ahead with RateStar and some of the other in adjusting your pricing, and so others probably kind of caught up this quarter. So I just want to get a full sense of what's really – do you see kind of that 25% or so as a share that you would expect to maintain, and how should we think about that going forward?

A - Marc Grandisson {BIO 4369887 <GO>}

So, first, we don't run the business, as you guys know, on a market share basis. We just provide our best foot forward with our rate in our approach to risk based pricing and try to give good service to our clients and provide them with good products. And at the end of the quarter, we count them, we look at where the chips fell and we just – this is what it is.

We have no design for market share. When we did the UG acquisition, we had thought about – we had indicated we might be lower 20s just by virtue Some of it was by virtue is the singles being less of a relevant product and we had delivered on this. And we like the monthlies. I guess there is no answer, Elyse. I don't know where we're going to be. I just know that what we've done this quarter generated x market share and we're happy with that. I don't know what the future holds for us.

Q - Elyse B. Greenspan {BIO 17263315 <GO>}

Okay. Thanks very much, Marc. I appreciate the color.

A - Marc Grandisson {BIO 4369887 <GO>}

You're welcome.

A - François Morin

Thank you.

Operator

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

Q - Joshua Shanker {BIO 5292022 <GO>}

Yeah. Hi there, everyone. There was earlier call from Genworth who said that they lost a major U.S. customer. I'm wondering how that shapes up in the market and whether you'll get the same share of a large customer that the rest of the group did, or is your market share in such a way that it's harder for you to take a big chunk out of that new opportunity per se.

A - Marc Grandisson {BIO 4369887 <GO>}

I think we're in the same market as Genworth from that perspective, right? I mean there are large customers and that happens all the time that might decide to reallocate between providers of mortgage insurance for various reasons. There's no grand design here. I think that it could happen to us, it's happened to them, and we might be gaining what they lost and vice versa. There's nothing magical there, Josh. I can't read much into it much more than this.

Q - Joshua Shanker {BIO 5292022 <GO>}

Okay. And I saw there is decent amount of growth in property, marine, aviation. That's a pretty big catch-all for a lot of things...

A - François Morin

Yeah.

A - Marc Grandisson {BIO 4369887 <GO>}

Yeah. It's property.

Q - Joshua Shanker {BIO 5292022 <GO>}

...in insurance. What's going on exactly?

A - Marc Grandisson {BIO 4369887 <GO>}

It's really property. A lot of it came out of the – mostly London cat exposed business that went through substantial rate changes, rate increases as a result of the 2017 cat event in the areas like Texas and the Caribbean. So this is most of where the increase came from on the insurance side. On the reinsurance side, very similar story. You'll see that the property also grew dramatically. We have some growth in marine, but it's largely driven by property. And for the record, it's not aviation. Just want to make sure, very clear. It's not aviation.

Q - Joshua Shanker {BIO 5292022 <GO>}

And does this business have a lower normalized combined ratio than the aggregate book? And what I'm getting at is is this going to cause one year from today the combined ratio all things equal to lower than it is now?

A - Marc Grandisson {BIO 4369887 <GO>}

Everything else being equal, it should. I think that the property cat exposed insurance or reinsurance business will have a combined ratio of probably 60 or 70, 75. Whereas a more or less cat exposed – this is absent any cat, right? If there's a cat, of course, it could be a lot worse. Right. So, yes, you're right. It will depend on the cat activity in the year. But all things being equal, your assumption is right.

Q - Joshua Shanker {BIO 5292022 <GO>}

Okay. Thank you. Good luck.

A - Marc Grandisson {BIO 4369887 <GO>}

Thanks, Josh.

A - François Morin

Thank you.

Operator

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

Q - Meyer Shields {BIO 4281064 <GO>}

Great. Thanks. François, you talked a little bit about lower other expenses. I guess you saw that in reinsurance, mortgage and corporate. I'm hoping you could provide a little bit more color really in terms of the sustainability of the third quarter versus prior 12 months run rate.

A - François Morin

Well, no question that we look at our expenses. I mean that's something that we watch very closely and this quarter just turned out there's always going to be movements in quarter-to-quarter. So on the corporate side, yes, a little bit lower but I wouldn't read too much into it. Sometimes there's just timing of some cash payments or what have you, some expenses that we have throughout the year. So I wouldn't read too much into that.

The reality on the reinsurance side is their lower compensation which is a direct result of the performance of the units. No question that as we accrue bonuses throughout the year, they are based on an expected ROE, which this year turns out may not be as good as it has been in prior years, and we're adjusting for that. So, certainly, you think that the operating expenses should adjust over time based on the profitability of the units. And there is a reality there's also a couple of miscellaneous payments here and there that will move the needle. But, again, the message is yes, we keep looking at it. We're trying to be as diligent and do as good a job making sure that we're spending the money in the right places and making the right investments in our people, in our technology, in our systems. But there's no question there's going to be some movements from quarter to quarter.

Q - Meyer Shields {BIO 4281064 <GO>}

Okay. In terms of mortgage, I guess would the underlying things be getting better?

A - Marc Grandisson {BIO 4369887 <GO>}

Say it again, Meyer, please, I didn't catch up, I didn't catch this.

Q - Meyer Shields {BIO 4281064 <GO>}

I'm sorry. So the other expenses in mortgage insurance declined. I don't know if it's significantly a lot, but $7 million, $7.5 million from the second quarter to the third, and I would naively maybe expect the better cure rate to drive more incentive comp better than last year.

A - Marc Grandisson {BIO 4369887 <GO>}

Well, that was – second quarter, we had accrual for a lot of...

A - François Morin

Yeah. Yeah.

A - Marc Grandisson {BIO 4369887 <GO>}

...equity-based compensation.

A - François Morin

Yeah. There's the timing of the second to third quarter. Second quarter is historically where we've done our equity grants, and there's a spike there across the board for all units. There is also depending on whether it is retirement-age people or not, there's a different way of accounting for the grants. But that's really why comparing second quarter to third quarter is something that you've got to be careful with. And just to give you a bit of a heads up as you plan ahead and maybe on a year, overall 12-month period, it doesn't make a huge difference, but we're contemplating moving the equity-based awards from the second quarter to the first quarter next year. So, again, we'll give you more color when and if we get there, but that's a possibility we're exploring right now to make those all in the first quarter.

Q - Meyer Shields {BIO 4281064 <GO>}

Okay. That's very helpful. And then bigger picture question I guess for Marc. If you were to isolate insurance segment casualty pricing, I guess, what do you see in terms of rate increase accelerating, if at all?

A - Marc Grandisson {BIO 4369887 <GO>}

Whether we do or not. Yeah. Most of the rate increases we've seen in casualty over the last two, three years were led by commercial auto and it's still very hard to get significant rate increases outside of that realm. And I think, as you know, Meyer, that is slowing down. I'm not judging whether it should or not, but I think that we're seeing that the rate increases are slowing down, because it went through two, three years of significant rate increase. (00:44:05). We still are able to push rate increase in some of the E&S casualty that have some auto exposure. But if you don't have auto exposure, it's still not clear that you can get those rate change accelerate or getting higher.

And again, I think the rates on the E&S casualty will react, will start to accelerate when and if we see losses emerging. We believe we will, but we've been wrong before. But since the downside of being wrong is too painful, would take a pause and take a step back and just wait for (00:44:44).

Q - Meyer Shields {BIO 4281064 <GO>}

Okay. Thank you very much.

A - Marc Grandisson {BIO 4369887 <GO>}

(00:44:49) Yeah.

Operator

Thank you. And I'm showing no further questions from our phone lines. I'd now like to turn the conference back over to Marc Grandisson for any closing remarks.

A - Marc Grandisson {BIO 4369887 <GO>}

Yes. We understand that there were some technical problems at the start of our webcast, and we apologize of that inconvenience. There will be a complete replay of the call available on our website within two hours by 2:00 PM Eastern. Again, Happy Halloween. Thank you very much for listening and we'll talk to you next quarter.

Operator

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