Q4 2016 Earnings Call

Company Participants

- Craig W. Howie, Chief Financial Officer & Executive Vice President
- Dominic James Addesso, President, Chief Executive Officer & Director
- Elizabeth B. Farrell, Vice President-Investor Relations
- John P. Doucette, Executive Vice President, President and Chief Executive Officer of the Reinsurance Division
- Jonathan M. Zaffino, Senior Vice President & President-North American Insurance Division

Other Participants

- Brian Meredith, Analyst
- Elyse B. Greenspan, Analyst
- Jay Gelb, Analyst
- Joshua D. Shanker, Analyst
- Kai Pan, Analyst
- Quentin McMillan, Analyst
- Sarah E. DeWitt, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good day, everyone. Welcome to the Fourth Quarter 2016 Earnings Call of Everest Re Group Ltd. Today's conference is being recorded.

At this time, for opening remarks and introductions, I would like to turn the conference over to Ms. Beth Farrell, Vice President of Investor Relations. Please go ahead.

Elizabeth B. Farrell {BIO 1986541 <GO>}

Thank you, Jessica. Good morning and welcome to Everest Re Group's fourth quarter and full year earnings conference call. On the call with me today are Dom Addesso, the company's President and Chief Executive Officer; Craig Howie, our Chief Financial Officer; John Doucette, our President and CEO of Reinsurance Operations; and Jon Zaffino, President of North America Insurance Operations.

Before I begin I will preface our comments by noting that our SEC filings include extensive disclosures with respect to forward-looking statements. In that regard, I note that statements made during today's call which are forward-looking in nature, such as statements about projections, estimates, expectations and the like are subject to various risks. As you know, actual results could differ materially from current projections or expectations. Our SEC filings have a full listing of the risks that investors should consider in connection with such statements.

Now let me turn the call over to Dom.

Dominic James Addesso {BIO 1428096 <GO>}

Thank you, Beth, and good morning to all. We're pleased to provide our final report for the 2016 year where we closed the year with a record fourth quarter and an industry leading 13% ROE for the year. There are many moving pieces of those results which my colleagues will take you through, but let me highlight a few key themes.

In the quarter and a year that saw a heightened level of cat activity relative to the prior year, yet the overall impact of these events was easily absorbed into our results given the benefits of our diversified global platform that provides for premium across many geographies and lines. Notably, we reached a new high this year with over $6 billion of gross premium written. In addition, we realized the benefit of sizeable reserve redundancies this quarter, a reflection of our conservative reserving practices which we have been pointing to for some time now.

While we had sizeable reserve releases from our reinsurance portfolio, our insurance portfolio did experience some unfavorable lost reserve development, but this was largely isolated to construction defect claims arising out of run-off books of business. The size of the charge this year reflects our best effort to fully fund these liabilities and put this behind us.

We also topped up our specialist reserves. This reserve addition is not the result of any change we have experienced in the underlying claims, but rather reflects a re-allocation of reserves to a segment that is fraught with uncertainty.

Despite all of these reserve movements, the net result was a positive $209 million to the full year earnings. As a result of these reserve savings, and frankly many other important factors, our core operations have done very well as you will note in the numbers. Overall, Reinsurance generated an underwriting gain of over $900 million, bettering last year's number by almost $40 million.

While it is a challenged market from a rate perspective, as seen in the top line, we continue to expand our product set, shifting our risk appetite to achieve better risk-adjusted returns. These achievements are not one-off. There is a consistency to our performance relative to the market where our returns on capital have measurably outperformed. Albeit, while returns are creeping down as a result of market conditions, I think it is pretty clear that the overall market will reach it's breaking point before us.

On the insurance front, we remained extremely satisfied with our progress. Premium growth, excluding our crop business which was sold earlier this year, has been in excess of

20% due to new product and business launches. The benefits of these increased writings have not yet been fully captured due to the lag in earned premium. The underperformance in 2016 reflects this lag in earned premium, and its impact on the expense ratio as well as the reserve adjustments I previously mentioned. However, we remain confident of the new business that will come through earnings and the year to come to outperform the historical record.

Why this optimism in such a tough market for both reinsurance and insurance? First, the inevitable law of gravity and the race to the bottom; that is one race we don't intend to win, and already have shown we are far behind. Based on industry returns relative to cost of capital, the race is almost over. That race includes third party capital where a future of higher investment rates will cause those markets to raise their targets.

Second, the scale of our organization and scope of our relationships allows us the opportunity to selectively grow and introduce our new products and businesses.

Finally, great people and a culture that inspires smart underwriting and risk selection, with an eye towards being creative and entrepreneurial in everything we do. A lean organization that allows us to be nimble and quick to the right trade in the most expense-efficient way possible.

These are the qualities we continue to emphasize, and that will continue to generate market-leading returns.

Thank you, and now to Craig for the financial highlights.

Craig W. Howie {BIO 17579923 <GO>}

Thank you, Dom, and good morning, everyone. Everest had an excellent end to 2016 and a record quarter of earnings with net income of $374 million, helped by reserve releases that impacted both current and prior years. This compares to net income of $357 million for the fourth quarter of 2015.

Net income for the year was $996 million compared to $978 million in 2015. After-tax operating income for the fourth quarter of 2016 was $363 million compared to $353 million in 2015. For the year, operating income was $993 million compared to $1.1 billion in 2015. The primary differences were catastrophe losses and foreign exchange, partially offset by favorable reserve releases.

The overall underwriting gain for the group was $689 million for the year compared to an underwriting gain of $787 million for 2015. The results reflect a slight increase in the overall current year attritional combined ratio of 85.5%, up from 84.8% last year. This attritional measure increase of less than 1 point reflects a higher expense ratio as we anticipated with the build-out of the insurance platforms and our Lloyd's Syndicate.

In the fourth quarter Everest saw $185 million of gross current year catastrophe losses. Of the total, $150 million related to losses from Hurricane Matthew, $20 million related to earthquake activity in New Zealand, and $15 million related to the Tennessee wildfires. Net of reinsurance, the current quarter catastrophe losses amounted to $169 million.

The fourth quarter of 2016 also included favorable development on prior cat losses largely from the 2015 year. Therefore, net catastrophe losses for the quarter were $150 million. Net catastrophe losses for the year were $301 million in 2016 compared to $54 million in 2015. For 2016, gross catastrophe losses were $420 million but were offset by reinsurance and $87 million of favorable development on prior year cat losses primarily from the 2015 Chile earthquake and U.S. storm events, of 2013 U.S. storms and Toronto flooding, and the 2011 Japan earthquake.

Our reported combined ratio was 87.0% for the year 2016 compared to 85.1% in 2015. The 2016 commission ratio of 22.3% was essentially flat compared to 2015. Our expense ratio of 5.7% for the year is up from 4.8% in 2015. The expense ratio for the Reinsurance segments remained low at 3.1% while the overall expense ratio was influenced by the build-out of our insurance segment. Everest maintains one of the lowest internal expense ratios in the industry; this is a strategic competitive advantage for Everest.

On reserves, we completed our annual loss reserve studies. The results of the study has indicated that overall reserves remained adequate. In the fourth quarter we booked $205 million of favorable prior year reserve development; this included prior period development in the insurance segment and for asbestos, which was more than offset by favorable reserve development in the Reinsurance segments.

The $160 million of prior year reserve development in the insurance segment during the quarter, as referenced by Dom, is largely related to construction liability and umbrella program business. These run-off programs were discontinued by the company several years ago. The $365 million of favorable prior year development in the Reinsurance segments reflected $419 million of favorable development, partially offset by a $54 million increase in asbestos and environmental reserves to replenish our position at the beginning of the year.

The $419 million of Reinsurance's favorable development during the quarter is mostly related to property and short-tail business both in the United States and internationally. These redundancies have developed over time, but we don't react until the position becomes more mature. We continue to hold our loss reserve estimates for the more recent years.

For investments, pre-tax investment income was $115 million for the quarter and $473 million for the year on our $17.5 billion investment portfolio. Investment income for the year remained flat compared to 2015, which was better than expected. We've been able to maintain investment yield without a dramatic shift in the overall investment portfolio.

The recent rise in interest rates drove bond prices down and had a negative impact to book value during the quarter related to the unrealized capital losses in our bond portfolio. However, this increase and the expected rise in interest rates during 2017 will have a positive impact on the net investment income over time. The pre-tax yield on the overall portfolio was 2.8%, and duration remained at just over three years.

Other income and expense included $21 million of foreign exchange losses for the 2016 year compared to $61 million of foreign exchange gains in 2015. Both of these results are unusual and represented $82 million of pre-tax swing year-over-year. The 2016 foreign exchange losses resulted from the relative strengthening of the U.S. dollar against other world currencies, primarily the British pound. Overall, we maintain an economic neutral position with respect to foreign exchange, matching assets and liabilities in most major world currencies.

Other income also included $11 million of earnings and fees from Mt. Logan Re for the year 2016 compared to $28 million in 2015. The decline in 2016 essentially represents the higher level of catastrophe losses in 2016 and the corresponding reduction in incentive or profit sharing fees.

On income taxes, the 2016 operating income effective tax rate was 10.3%. This effective tax rate for the year was lower than our expectations for the year. The tax rate was lower due to the amount and geographic region of the income associated with the loss reserve releases in the fourth quarter. Additionally, we closed a U.S. tax audit during the quarter that allowed the utilization of foreign tax credits from the years 2009 through 2012. These credits reduced the effective tax rate by about two points.

Strong cash flow continues with operating cash flows of $1.4 billion for the year up, $276 million compared to 2015. This is primarily due to our continued premium growth. Shareholder's equity for the group was $8.1 billion at the end of 2016, up $467 million or 6% over year end 2015; this was after taking into account capital return through $386 million of share buybacks and $195 million of dividends paid in 2016.

The company announced a 9% increase to its regular quarterly dividend and paid $1.25 per share in the fourth quarter of 2016. Book value per share increased 11% to $197.45 from $178.21 at year end 2015, generating 13% growth in shareholder value, including dividends.

Our strong capital balance leaves us well-positioned for business opportunities as well as continuing share repurchases. Thank you.

And now, John Doucette will provide a review of the reinsurance operations.

John P. Doucette {BIO 7178336 <GO>}

Thank you. Craig. Good morning. We are pleased to report an outstanding quarter and a record year with $903 million of reinsurance underwriting profit, despite catastrophe activity. Our earnings reflect our strengthening position in the global reinsurance market and are a testament to our continued disciplined efforts to build a diverse and profitable portfolio.

Globally, rates were under pressure except where material catastrophes occurred such as Canada. Our position as a large global, nimble, highly-rated, and longstanding reinsurer allows us to successfully underwrite through this tough rating environment to grow profitable business and once again to achieve market-beating results.

Before discussing renewals, here is some color on the fourth quarter and 2016 results. Total gross written premium for the fourth quarter was $1.1 billion, a decrease of 1% compared to last year, but flat on a constant dollar basis. Year-to-date, global reinsurance premiums of $4.2 billion were down 3%, but flat after eliminating the currency impacts.

For the quarter, the loss ratio increased to 36.3% from 33% in prior Q4 and included 12.5 points of cat losses and also about 5 points of asbestos strengthening, both of which were more than offset by 38 points of favorable prior year reserve releases. The impact of fourth quarter cats was $139 million, which included $158 million from Hurricane Matthew, the Q4 New Zealand earthquake, and the Tennessee fires, offset by reductions of $19 million for prior year cat events. The favorable prior year reserve development emanated across the portfolio, weighted towards our shorter-tail lines. The level of these releases demonstrates the strength and diversity of our global portfolio, the foundation for our strong balance sheet.

For the full year 2016, our reinsurance loss ratio improved from 50.6% a year ago to 50.1%. Excluding cats and prior year development, the current year attritional loss ratio was down slightly to 53.5%. Each year was impacted by a significant risk loss, with 2016 having $40 million of loss for the Jubilee oil platform, and 2015 having $60 million for the Tianjin, China explosion. Note, in 2016, our prior year reserve adjustment reflected the release of $43 million of that $60 million Tianjin loss estimate.

The 2016 reported combined ratio and the 2016 attritional combined ratio, excluding cats and prior year development, were also lower relative to the prior year, reflecting our disciplined underwriting approach and rigorous expense management.

Bottom line, our reinsurance profit produced an all-time high underwriting profit of $429 million in the fourth quarter and $903 million for the full year 2016, placing us among the best performers in the reinsurance industry.

We believe we have one of the very best reinsurance teams in the industry. In addition to a very strong technical staff, we have talented, experienced, smart underwriters who know their markets and clients well and with outstanding skills to underwrite risks, build profitable books, and grow the long-term franchise, collectively enabling Everest to continue to outperform the market.

In our U.S. Reinsurance segment, 2016 gross written premium was down slightly to $2.1 billion. Changes year-over-year were caused by a decrease in our property writings as we walked away from a significant volume of underpriced pro-rata business. However, this was offset by our new strategic property insurance deal and the continued growth in alternative risk products, including credit-related business such as mortgage reinsurance.

Our alternative risk capabilities remain a differentiating bright spot in a difficult market where more sophisticated clients increasingly seek bespoke products for capital release, unique risks and, often, multiple lines of business. Everest's lean and agile operations coupled with our broad experience and expertise quickly provides solutions to both our long-term trusted partners and new clients seeking a creative solution.

The 2016 combined ratio for the U.S. Reinsurance segment was up 6.6 points, while the accident year attritional combined ratio of 78.4% was up only 2 points. The attritional increase, in large part, was caused by the increased crop reinsurance writings, which generally requires less capital to write, but produces a slightly higher combined ratio.

Our International Reinsurance segment premium was $1.2 billion, down 8% for the year, but only 5% on a constant dollar basis. Lower premium across many of our regions, Latin America, Middle East, Africa, and Asia, was due to both rate pressure and termination of underpriced business. For 2016, this segment produced $314 million of underwriting profit, up 86% over the prior year, despite increased catastrophes. This was largely due to a significant level of current and prior year reserve releases, highlighting the conservatism in our reserving process.

Excluding cats and prior year losses, the attritional combined ratio for 2016 was down 4 points to 80.4%, with the improvement due to the impact of Tianjin losses in 2015 and a lower level of attritional cat losses, catastrophes that do not breach our $10 million threshold to be classified as a cat in 2016.

Our Bermuda segment premium was $890 million, up 1% for the year, but on a constant dollar basis actually had growth of 5%, driven primarily by casualty reinsurance. The combined ratio was up about a 1 point; but excluding cats and prior-year development, the accident year attritional loss ratio was down 2.4 points to 89%. This was the result of changes in business mix and the impact of the Tianjin loss in 2015.

Moving on to the 1/1 renewals, Everest was well-positioned to withstand the market pressures. Globally, our clients are demanding solutions that address their operational breadth, the increasingly complex capital requirements, and unusual risks. We have the expertise, responsiveness, and capital to meet these demands quickly, aided by our unique and client-focused operational structure, geographic and product breadth, and diverse capital sources including Mt. Logan, Kilimanjaro, catastrophe bonds, and other hedges.

In the property market, we continue to perform well in the face of heavy competition. Facilitated by robust relationships, we re-underwrote our property portfolio substantially at 1/1, re-allocating capacity from underpriced business to more attractive layers and programs while supporting our core clients and newly marketed programs. We're also exploring our new structures that will strengthen our core client relationships well into the future.

Overall, the market property rates were down at 1/1 on average mid-single digits across most markets, unaffected by material losses. Our portfolio fared better than that, where the combined ratio of our 1/1 renewal portfolio had modest slippage of less than 1 point compared to last year's portfolio. In our casualty markets, the 1/1 pressures were mixed, with the reinsurance terms easing somewhat, but economics in certain underlying segments are still tracking in the long direction.

We achieved improvements on classes with material losses, and increasingly focused on structured and credit-related deals. Our London operations saw excess of loss rates decline from 2.5% to 5%, although some other international markets are seeing decreases of 5% to 10%. On the positive side, Solvency II is causing a demand uptick in London and European markets, specifically the pro-rata structures.

Overall, Everest reinsurance operations remain optimally diversified by product, distribution, geography, client mix, and capital sources, giving us the ability to quickly identify and move from market weaknesses to market opportunity. We recognize the markets may face continued pressure from the supply-demand imbalances; but as reflected in our results, we are well-equipped to adapt and excel in the new reinsurance world order.

Thank you, and now I will turn it over to Jon to review our insurance operations.

Jonathan M. Zaffino {BIO 16652236 <GO>}

Thanks, John, and good morning. 2016 was a transformative year for the Everest global insurance operations. The year finished on a strong note despite the impact to profitability from elevated levels of natural catastrophe losses and, as you've heard from Dom and Craig, prior year reserve development originating from one-off books of business. Nonetheless, we're pleased with the underlying performance of our portfolio, particularly so in a difficult trading environment.

Further, we continue to make significant progress on our journey to organically build a world class, specialty diversified insurance organization. I will provide further commentary on this progress later in my remarks. Similar to last quarter, due to the divestiture of Heartland in late third quarter of 2016, I will be discussing our results excluding this business. The full result of the Insurance segment, inclusive of Heartland, are covered in our financial supplement released yesterday. Additionally, for reference, we have also included a supplemental exhibit with the quarterly insurance results excluding Heartland.

For the full year 2016, the global insurance operations achieved record premium levels, registering nearly $1.6 billion in gross written premium, an increase of $274 million or 21% over 2015. It should be noted that this result exceeds 2015 gross written premium, including the results of Heartland. This strong top line performance is an acknowledgement of the value our clients, brokers, and insurers alike recognize in Everest Insurance. Further contributing to this strong top line performance were nearly a dozen new underwriting divisions that steadily contributed throughout the year.

For the full year these new divisions, which have been selectively added to the portfolio, contributed nearly 7% of total 2016 gross written premiums. This represents over a $100 million of new premium within desired segments and classes of business; a result we're certainly encouraged by as many of these divisions are not yet a year old.

From the quarter, we registered $423 million of gross written premium, an increase of $89 million or 27% over the prior year period. This represents the eighth consecutive quarter of growth for our operations. Each division within the North American segment contributed to this growth, with the U.S., Canada, and asset and health teams each growing in excess of 20%, along with meaningful contribution from our Lloyd's Syndicate. We remain encouraged by this balanced contribution across the diversity of the underwriting platform.

Net written premiums for the year were slightly over $1.3 billion, an increase of $180 million or 16% over 2015. As discussed in prior calls, the net written premium growth slightly lags gross written premium growth due to a marginally more conservative reinsurance position we have taken to support our many new underwriting divisions. Over the quarter, net written premium increased by $50 million or 17% over the prior year quarter, reflecting a strong end to the year and solid momentum from all of our businesses.

I do want make a quick comment as respect to net earned premiums in a quarter. Net earned was down 14% due to the sale of Heartland and the accompanying of a loss portfolio transfer of this business from the Insurance segment to the Reinsurance segment. Again, excluding Heartland, earned premium was up 14%, which is directionally similar to the trend in net written premium, however, slightly lags due to the significant growth in the portfolio over the past couple of years.

Turning to the combined ratio, the GAAP combined ratio for the year, again excluding Heartland, was a 116%. As we look back on 2016, there are two notable impacts to our performance. First was the prior year development and various one-off books of business principally related to construction defect exposures that contributed 14 points to our loss ratio. Second, the Insurance results were impacted by a year of significant cat events across North America from the Fort Mc Murray wildfire, a number of Texas hail events - the worst experience over three decades - and finally Hurricane Matthew. These cat events contributed slightly more than 4 points to our loss ratio in 2016.

Taking a look at the attritional results, the ongoing global insurance operations delivered a 97.9% combined ratio for the year, in line with our expectations, however elevated from the 93.4% attritional from 2015. Let me break out some of the factors driving this increase.

First, our expense ratio was 29.9% for the year which, again, is inclusive of the expenses associated with the build-out of our U.S. and Lloyd's platforms, and is expected to moderate as we continue our expansion. It should be noted that this expense ratio remained very competitive within the specialty P&C environment. Second, for the full year, the loss and loss expense ratio was 68% compared to 67.1% in 2015.

The slight deterioration in the attritional loss ratio for the year is attributable to a number of factors, predominant among these are the adverse impacts of various non-cat weather events in 2016, a slight deterioration in our U.S. auto book, and also some additional pressure on the loss ratio due to the growth in our A&H segment, which carries a higher loss ratio than our P&C products. That stated, we are very pleased with the ultimate result of this book.

Let me now turn to offer some commentary on the performance of our major insurance portfolios, again starting with the North America P&C book which is our largest business. Year-over-year, the core P&C portfolio grew 15% or nearly a $174 million. The momentum within our P&C operations steadily increased throughout the year, again reflective of our significantly enhanced underwriting capabilities and increased market profile. In fact, the fourth quarter represented the strongest performance of the year, registering growth of 21% compared to the comparable quarter in 2015.

We experienced meaningful growth in our short-tail portfolios and our casualty lines while specialty grew more moderately. Further, our new business lines launched in the U.S., again, contributed nearly 11% to gross written premium in the quarter, a similar figure to last quarter.

Our Accident and Health group also delivered another solid quarter of growth with a 44% increase over the prior year comparable quarter. Our efforts to thoughtfully grow our Medical Stop Loss segment within key geographies and business segments proved successful. Our new A&H products also contributed to growth throughout the year, and we anticipate this to continue. We have recruited very capable distribution partners, and as a result expect to grow in the senior market segment into 2017.

Our Lloyd's operation also continued its expansion. The Syndicate contributed $10 million to insurance growth in the quarter, building on the momentum from the third quarter. While still early in its growth cycle, this platform, despite a difficult trading environment, is performing as expected. For 2016 the Syndicate has delivered $45 million of premiums to the Insurance segment, yet only $16 million of earned premium which, again, temporarily impacts the expense ratio.

Turning to the operating environment, we see a similar picture to what we experienced throughout much of 2016. With that stated, there is an early emergence of some trends within various lines of business that we are watching closely. I'll comment on the dominant lines of business starting with commercial auto which continues to be a challenging line of business. Building on the prior three quarters of 2016, we again achieved positive rate across commercial auto lines with a low double-digit mean increase for the quarter. Over 85% of our book is receiving rate increases in an attempt to address the frequency and severity trends that we have experienced across the line. That stated, our exposure to commercial auto is somewhat limited as this line of business represents less than 5% of our overall P&P premium.

The primary general liability and umbrella markets continue to remain in a tight rate range and are slightly positive for the year. As with the prior quarter and, really, all year, the professional liability market remains competitive with rate decreases in the mid-single-digit range.

Let me spend a minute on the U.S. property market. This market remains very competitive, however it is our sense that the market is trying to find the bottom on rates. The elevated frequency of natural catastrophe losses are acting as a resistance towards continued large decreases. Further, in many occupancies and geographies we believe the industry has reached the juncture that there is simply no additional rate reduction to be had. Perhaps this is driving the exit of some of capacity from the space, but we feel there's a larger story here and we'll keep an eye on as we move forward. That stated, we continue to find opportunities to deploy our capacity in a manner that meets our risk and return objectives.

Finally, worker's compensation, our largest line of business by premium size, experienced moderate rate pressure throughout the year in the mid-single-digit range, which was largely expected. The favorable underwriting results in the largest work comp market, California, were greeted with steady rate pressure throughout the year. Other markets reacted similarly, although with moderately less rate pressure. So, again, the environment trended predictably in 2016, and we expect much of the same with the exceptions noted in 2017.

Wrapping up, we're very pleased with the many efforts undertaken in 2016 to position us for future success. We enter 2017 with our leadership team in place, our market profile expanding, a portfolio aligned to our business objectives, and a significantly enhanced operating platform. We're confident we'll carry our strong top line momentum into 2017 as our many new underwriting initiatives continue to gain scale, both within North America and at Lloyd's.

Yes, it remains a challenged operating environment, yet the grown diversity of our platform, again with the top line expanding by over 20%, and a firmer handle on our existing portfolio positions us well for the future.

With that, let me turn it back over to Beth for Q&A.

Elizabeth B. Farrell {BIO 1986541 <GO>}

Thank you. That ends our prepared remarks, and we are now open for questions.

Q&A

Operator

Certainly. And we will go first to Elyse Greenspan. Please go ahead, your line is open.

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

Hi. Good morning. First off, if you could just spend a little bit more time just – I know throughout you guys have kind of said that you booked on some of these insurance programs following on the reserve review kind of to give you confidence that you'd fully address this. What are you booking the construction liability and umbrella programs to and what really changed this year that gives you confidence that 12 months from today we won't see another charge stemming from some of these run-off programs again?

A - Dominic James Addesso {BIO 1428096 <GO>}

Elyse, this is Dom. Thank you for your question. I think each year when we've examined these portfolios, we have been booking to what I would call the expected result from our actuarial review, and I'll ask Craig or someone else to comment on what we're actually booking it to.

And I didn't know if your question was a loss ratio question which I don't really think is relevant, but perhaps this answers it. This year, after undertaking that reserve review, frankly we asked ourselves the same question; we don't want to be sitting here next year and year after and taking another charge. Of course, what drove the higher estimate this year was just an increase of frequency and severity - an increase of frequency and severity. So hopefully to combat this, in this year we selected in the upper range of the actuarial estimate, so therefore we have some confidence that which is never an absolute, but of course therefore we have some confidence that this should be behind us.

And again keep in mind this is in the overall context of our overall reserve position. And I know I sound like a broken record, but we have over 200 different reserve buckets, and what we're most concerned about is our overall reserve adequacy at the balance sheet level because this is clearly a run-off business; this is not a concern over our existing portfolio. And as evidenced by the reserve release we had this year in addition to other years, you can see that our overall reserve position is solid and, in fact, was redundant. So that's what we're most concerned about, but to answer your more specific question, this year we were a little higher in the range to give a sense of comfort that we can hopefully put this to bed.

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

Okay. And then as we think about the margin kind of outlook for your segments, I know within the commentary you guys kind of pointed on the property reinsurance side a slippage probably about 1 point on the combined ratio. How do you see the overall kind of reinsurance margin just in context of tying it on what you see on the casualty side? And also do you - I guess we should expect some kind of slippage on the combined ratio as you bring the crop business to the reinsurance side. I'm just trying to kind of tie all your commentary together to really how you see on the margin profile of the reinsurance book in 2017.

A - Dominic James Addesso {BIO 1428096 <GO>}

Well, what we've been trying to - the message we've been trying to make sure everyone understands is that this is a book of business that is not dependent upon property cat business and, of course, what you've seen in our margins has been some shift in the attritional and that shift in the attritional (42:22) still we're getting improvement as a result of new products that we offer.

So as John Doucette highlighted in his comments, diversifying it to different product lines and geographies, more importantly product lines, so for example take credit reinsurance, and more specifically mortgage reinsurance, those obviously are carrying much lower loss ratio picks and better combined ratios. So that's helping offset some of the declines and actually a business that we let go in the more traditional areas. So we're not necessarily seeing any dramatic change in our attrition going into 2017.

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

Okay. And then in terms of just capital return, I know you guys have always said you look to return less than your earnings. Share repurchase, it seems like you guys do not buy back any stock since your last call. So how do you kind of think about, I guess, just the level of potential capital return for 2017, and anything's kind of changed on your capital return philosophy over the last three months?

A - Dominic James Addesso {BIO 1428096 <GO>}

Well, nothing's changed Elyse, and part of the reason that you didn't see us do anything last quarter, the fourth quarter, was on the fact that we had Hurricane Matthew sitting out there, and clearly we had information, more precise information, so we've become a little reluctant to be buying in shares given the fact that there's major events hanging out there that we're not clear as to what the final outcome will be. So that's what was driving that.

But certainly, there has been no change in the way we manage capital. We have a very good long-term track record of doing so. That, of course, gets balanced with what we see as the future business opportunities and the need for capital, and I think we've been - yes, we buy in less than earnings, growing our capital base, because we continue to see new opportunities and that's - and we look at this from a very long-term perspective; it's not just any one year, any one quarter for sure. And we will look out to more than just what our projections are for book value currently or the current book value; we will look out six months or so to determine what our threshold might be for buying in stock.

So essentially, it's a long way of saying no change in our philosophy in how we think about capital management.

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

Okay. Thank you very much.

A - Dominic James Addesso {BIO 1428096 <GO>}

Thank you.

Operator

And we will take our next question from Kai Pan with Morgan Stanley. Please go ahead.

Q - Kai Pan {BIO 18669701 <GO>}

Thank you and good morning. First question on reserves. So the 2016 reserve release, it was actually the largest in your history. And, Dom, you mentioned that since you came on board you're taking probably more of a conservative reserve stance. So is that – the question is really why now a suddenly big reserve release? Is it because the basic reserve cushion build up over time, now you have to release it? And also how sustainable is that reserve release is going forward?

A - Dominic James Addesso {BIO 1428096 <GO>}

Okay. Yes, Kai, I mean I have said several years now that we've taken a more conservative view of picking the current loss year in terms of pick loss ratio, and that's frankly driven out of some uncertainty as to, in the current market conditions, an increased level of uncertainty. But that, of course, has resulted in some of those older years coming in positively, and that we view as a good thing. What we tend to do is we handle the casualty and the property; we hold a couple of years on casualty studies and we hold less years on the property side, so this release reflects a release from few years ago, from accident years of few years ago. And that will – that is kind of the process that we go through and we'll continue to go down that path.

Our current – we still continue to feel that our current reserve position is very strong and adequate. And I can't sit here and give a prediction as to what the level of reserve releases are not might be into the future, but as I said we still remain very confident about our reserve position.

Q - Kai Pan {BIO 18669701 <GO>}

So the release mostly related short-tail lines in last few years and had not – sort of some of the potentially long-tail lines you have booked since like 2010?

A - Dominic James Addesso {BIO 1428096 <GO>}

I'm sorry, could you repeat that? You broke up a little bit on that question.

Q - Kai Pan {BIO 18669701 <GO>}

Yeah, I'm sorry. The question was is that reserve release is mostly related to short-tail line of business rather than some long-tail line?

A - Craig W. Howie {BIO 17579923 <GO>}

Kai, the process has not changed over the years. As Dom mentioned, what we do is we set a conservative loss pick and then over time we are slow to react to any favorable development, but we're very quick to react to any unfavorable development. So what you're seeing right now, most of what was released at this point in time are short-tail business. So more than two years ago, short-tail lines and property lines of business was what the majority of what was released.

A - Dominic James Addesso {BIO 1428096 <GO>}

But there was some casualty in there.

A - Craig W. Howie {BIO 17579923 <GO>}

There was.

A - Dominic James Addesso {BIO 1428096 <GO>}

And I should also mention, because I know there's been a lot of focus on the insurance adds we have to make, but it should be noted that we did have some – the current book of business within insurance actually did produce redundancy coming through the results in 2016. Net-net, it was a reserve add because of the construction defect and umbrella that we highlighted earlier, but it should be pointed out that the current book of business is beginning to produce some releases.

Q - Kai Pan {BIO 18669701 <GO>}

Great. Then second question on the insurance side. The 2016 attritional combined ratio is 97.9%. I just wonder, given your gross like projection, you're still growing the business, expense ratio probably is still a little bit elevated and then there is a business mix shift, some potential to your higher combined ratio. So do you see 2017, 2018, these attrition loss ratio – combined ratio going to improve or going to deteriorate before it become improving?

A - Dominic James Addesso {BIO 1428096 <GO>}

Our expectation is that it would improve. Again, just to highlight again the things that – why I came in at that level, we had – some of it was A&H, the growth rate in A&H relative to some of the other lines; we had some non-cat – heightened level of non-cat events in 2016 which drove that; and we had a little bit of auto frequency and severity that drove that, which as Jonathan highlighted we've got lots of rate increase coming on that line of business; and the earned premium catch-up to the written should begin to benefit the results.

The expense ratio hasn't improved yet because we've actually accelerated some of our business development efforts later in 2016, more so that we anticipated that we would do. All are good things, but I would have expected the expense ratio to improve by now, but it hasn't because of kind of an up level of investment relative to our initial plans.

Q - Kai Pan {BIO 18669701 <GO>}

Great. Well thank you so much for all the answers.

A - Dominic James Addesso {BIO 1428096 <GO>}

Thank you, Kai.

Operator

And we will take our next question from Sarah DeWitt with JPMorgan. Please go ahead.

Q - Sarah E. DeWitt {BIO 18946247 <GO>}

Hi. Good morning, and congrats on a good quarter. Just following-up on the insurance business. What do you view as the underlying run rate combined ratio in the quarter ex some of these one-time items that you outlined?

A - Dominic James Addesso {BIO 1428096 <GO>}

For 2016 it would've been in the mid-90s.

Q - Sarah E. DeWitt {BIO 18946247 <GO>}

And is that in line with your target combined ratios in the segment or do you target something lower?

A - Dominic James Addesso {BIO 1428096 <GO>}

We will be continuing to target something lower than that. We would expect improvement in that over time.

Q - Sarah E. DeWitt {BIO 18946247 <GO>}

Okay. And then separately, just wanted to talk or get your thoughts on some of the macro issues following the U.S. elections. If we got U.S. corporate tax reform, how much would Everest Re benefit and are there implications from border adjustment for Everest Re?

A - Dominic James Addesso {BIO 1428096 <GO>}

I know this is a question that's hot on everybody's mind, but it is a little difficult not knowing what the final outcome would be to give you any view. But let me just say this: for the last two years the – they really wouldn't – if you take in the tax, lower tax rate plus of course border tax adjustment, it would've been very minimal impact, if any, on our overall effective tax rate in the last two years. The bigger question comes in a year where cat losses are – we do not expect that they're maybe even higher than expected; that's the great unknown. But we have got different platforms globally that we could trigger and different ways in which we could really underwrite business.

So it's not – I can't give you a clear answer on that, other than the fact that we don't think that would have any meaningful impact at this point.

Q - Sarah E. DeWitt {BIO 18946247 <GO>}

Okay, great. Thank you.

A - Dominic James Addesso {BIO 1428096 <GO>}

Thank you.

Operator

And we will take our next question from Josh Shanker with Deutsche Bank. Please go ahead.

Q - Joshua D. Shanker {BIO 5292022 <GO>}

Yeah. So good morning, everyone. I wonder if we can talk in numbers about bridging the expense to build-out the insurance practice in Lloyd's and what not, and a timeline for what we think that should be in 2017 and should it even be there at all in 2018?

A - Dominic James Addesso {BIO 1428096 <GO>}

And what would be there at all in 2018?

Q - Joshua D. Shanker {BIO 5292022 <GO>}

This – the increased expense spend associated with the build-out?

A - Dominic James Addesso {BIO 1428096 <GO>}

Are you – is that a Lloyd's question or an overall insurance question?

Q - Joshua D. Shanker {BIO 5292022 <GO>}

It's the 300 basis point gap between the 2016 expense ratio and the 2015 expense ratio, and I take – I understand your reasons behind that. I'm wondering how long I should model that to persist?

A - Dominic James Addesso {BIO 1428096 <GO>}

Okay. I would expect that to drift down slightly in 2017, and then frankly level out maybe and slightly again in 2018, but then level out from there. I don't believe that we will get back to our historical expense ratio because you have to remember that we now have a different distribution model. So previously we were primarily an MGA-focused insurance operation; today we're more of a direct brokerage operation which, by definition – forgetting even the commission element of it, just a general expense ratio element of it – requires different types of resources and different systems. So – and we'll not get back to maybe what you would have seen historically from us.

Having said that, I think if you could – our expectation would be as we, even today, we have a much better expense ratio than the industry. We expect that gap to remain.

Q - Joshua D. Shanker {BIO 5292022 <GO>}

Okay. And I'm going to go through the 4Q 2015 transfers again, read about the insurance reserve charge there. I can't remember exactly where the overlap is between where the charge for this quarter than were charged for one year ago. Is there some whack-a-mole sort of situation that while you've taken care of you think what's problematic that you saw in 2016? Can there be other things that come out in 2017? Do we have some limits in place that give us specific comfort? Or are you surprised one year later from the 2015 charges that you have these charges today?

A - Dominic James Addesso {BIO 1428096 <GO>}

We are always surprised because if I said we want to surprise then we would have put out a higher number back in 2015.

Q - Joshua D. Shanker {BIO 5292022 <GO>}

Yeah. Of course.

A - Dominic James Addesso {BIO 1428096 <GO>}

Yeah. So there's a surprise. And, look, with reserves you never know what an increased level of frequency or severity might, in fact, do to you. But as I mentioned, our other pieces of our portfolio that are active are, in fact, running at – this past year, produced a redundancy. So we're confident that those reserves are frankly in good order. But, again, in the context of our overall balance sheet, our reserve position is quite strong, and I think that applies to the various segments as well.

Even though I know I keep emphasizing the overall balance sheet, which is important and worth emphasizing, we do go through each of our segments to make sure that we've got positive reserve or a strong reserve position in each of those segments.

Q - Joshua D. Shanker {BIO 5292022 <GO>}

And then finally I guess in terms of the Heartland premium coming in to the Reinsurance segment. Given that you sort of explained the economics of Heartland as insurance contract, how different are the economics of it as a reinsurance contract?

A - Dominic James Addesso {BIO 1428096 <GO>}

I'll let John into that. John.

A - John P. Doucette {BIO 7178336 <GO>}

Good morning. This is John. So a couple of things. The strategic relationship we entered as a reinsurance opportunity with the buyer of Heartland is – has a couple of advantages for us. First of all it runs, we believe, to a meaningful improvement in expenses, and because of just economies at scale that we were unable to achieve on our own book given the size of the premium.

And then, secondly, we also get struggled in our insurance book to develop a broad, diversified portfolio, and so individual localized weather events were causing more problems for us and cause more volatility in the book as an insurance play. What we're going to get is the benefit of a much, much larger book, a share of that book on a reinsurance quota share basis.

So we think we're going to run through a better combined ratio meaningfully, and we think there's going to be less volatility in the results.

Q - Joshua D. Shanker {BIO 5292022 <GO>}

One of your competitors in the crop business has said this is a 89%, 90% combined ratio business. Do you think that's adequate or fair?

A - John P. Doucette {BIO 7178336 <GO>}

I don't know specifically what you're talking about. And if you're talking about it as an insurance play or as a reinsurance play, we would think as a reinsurance play it's low-90s.

Q - Joshua D. Shanker {BIO 5292022 <GO>}

Okay. That's excellent. Thank you for the color.

A - Dominic James Addesso {BIO 1428096 <GO>}

Thank you, Josh.

A - John P. Doucette {BIO 7178336 <GO>}

Thank you, Josh.

Operator

And we will take our final question from Quentin McMillan with KBW. Please go ahead.

Q - Quentin McMillan {BIO 19411547 <GO>}

Hi. Thanks very much, guys. I just wanted to tie together something that you've historically said versus what we saw today. So, Dom, you mentioned that 2016 is a heightened year of cat loss activity. You had a little over $300 million in cat losses on a net basis, and then I think Craig mentioned $420 million on a gross basis when we net out prior year cat losses. But that $300 million number, it's about – it's a little under 6 points on the cat loss ratio, and historically you guys have said that you expect about 10 points of cat losses in a normal year.

So can you help sort of tie those thoughts together, of this being a heightened loss year yet you were running much better than what that cat loss would indicate?

A - Dominic James Addesso {BIO 1428096 <GO>}

I'm actually going to ask – I'm going to make a few comments and then I'll ask Jon to set a comment on it as well. But also – but keep in mind that, yes, it was a heightened year. Many of the losses though were low in the attachment point. A lot of the losses were assumed by primary. And what is consistent with what you've said is through – over the last couple of years, given risk-adjusted pricing and we want to maintain our level of risk-adjusted pricing, we've moved attachment point, gotten off from certain things that we didn't like the pricing on, and we believe that that's had an impact on our result relative to what the overall level of cats were in the industry.

So I think that's just a general comment, and maybe John Doucette may have some – something to add to that.

A - John P. Doucette {BIO 7178336 <GO>}

Yeah. Quentin, I think - a couple of things. The reinsurance strategy, we continue to look to how we can improve the book and deploy and take cat risk better and deploy and build a better and better portfolio, and taking into account market conditions but also the buying habits of local companies, regional companies, and global clients. So to the extent that we are - the global client - take the global clients, to the extent that they're looking to do more across the board and across multiple lines of business and multiple territories with companies like Everest, we're deploying more cat capacity to them and that usually means, given the retentions that they want to take in order to control the pricing of the reinsurance program, they typically are protecting against the real major losses: very big earth quakes, very big hurricanes, et cetera. And so that wouldn't necessarily impact us as much in a year like this, with the exception of the Canadian wildfires and Hurricane Matthew.

And then we also, as Dom said, we're trying to shift our book and we have been moving, not in every case, but generally we've been moving up the tower; that also means it takes larger losses to affect us. But then I would also highlight the different hedges that we have in place, including Mt. Logan, and Mt. Logan continues to be a strategic platform for Everest, and we saw some benefits from that in 2016 with recoveries that we saw from both Matthew and Fort McMurray wildfire losses in Canada as well as some other smaller losses around the group.

So we think that that helps mitigate some of the cat loss activity that Everest faces on its inward book of business through the various hedges that we have in place as well.

Q - Quentin McMillan {BIO 19411547 <GO>}

Great. That's very helpful. And just on a capital-related question. You guys paid out about 60% in the form of dividends and share purchases, and I know you don't have a specific capital plan that you're going to guide us to. But how much of the remaining 40% of the operating earnings that you produced was used to fund the strong growth in the Insurance segment this year on Jonathan's side?

A - Jonathan M. Zaffino {BIO 16652236 <GO>}

I am going to answer that as, really, an overall question as opposed to specifically to Insurance. Overall, we still have about the same level of what we call excess excess capital, and so all of the metrics that we use to measure what our economic capital needs to be remain about the same. So that capital growth basically is supporting all of the lines of business, both insurance and reinsurance, remembering that we're doing some different things on the reinsurance side that consume different levels of capital.

Q - Quentin McMillan {BIO 19411547 <GO>}

Okay. Very helpful. And then sorry to sneak a last in, in terms of the investment portfolio. Obviously there was a big move and you guys did have a mark-to-market loss as everybody did - unrealized loss as everybody did in the quarter. But the yield in the portfolio looked like it ticked up a little bit. Did you guys shift anything around and can you just talk about what the new money yield is versus where they – I believe Craig said that portfolio pre-tax yield currently is 2.8%, so maybe versus that currently?

A - Craig W. Howie {BIO 17579923 <GO>}

This is Craig. Quentin, we did not make much of a shift. What we did do was shift it a little bit, as I mentioned last quarter, and within the alternative capital, our alternative investment buckets. But overall, the portfolio remains very stable, very high credit quality, investment grade bonds makes up the majority of the portfolio, and then we have alternative investments.

The new money rate that you're suggesting is about the same, about 2.8% compared to what the current yield is at 2.8% as well.

A - Dominic James Addesso {BIO 1428096 <GO>}

And the return, the yield that you're referencing, essentially what happened in the fourth quarter, it all depends on timing of the limited partnership and alternative investment income; and that can get a little lumpy. So I'm real pleased that frankly year-over-year investment income was flat. We think that was a pretty terrific outcome.

Q - Quentin McMillan {BIO 19411547 <GO>}

Perfect. Thanks very much, guys.

A - Dominic James Addesso {BIO 1428096 <GO>}

We're going to expand a little bit because I know we're running over. But perhaps we've got a little worry in our opening remarks, so we'll extend beyond our usual hour. And if there's one or two more questions that perhaps we can entertain? Beth, I'm sure you won't mind?

Operator

Yes. We will go next to Jay Gelb with Barclays. Please go ahead. Your line is open.

Q - Jay Gelb {BIO 21247396 <GO>}

Thank you. I was hoping you could comment on the M&A environment broadly within insurance and reinsurance, and any update on Everest's view on consolidation. Thanks.

A - Dominic James Addesso {BIO 1428096 <GO>}

Well, I still think the same factors are at play. Scale, being one of the more relevant factors, continues to put pressure on many of our competitors to seek partners, and that's not necessarily a bad thing. And I think that will continue to be the trend going forward: scale and efficiency.

For us, as you know, our strategy remains the same. We're not a big fan of putting a ton of goodwill in the books, and frankly acquisitions are difficult to – in our view, others have –

certainly could have a different business model, but in our view acquisitions are difficult to assimilate, and with it comes perhaps elements of the portfolio that you don't wish to be engaged in. So it requires some remediation, and we think it's a lot cleaner to get the talent that we think we can secure a good talent and build up a portfolio in the manner and shape that we feel is most desirable. So that's kind of our continued strategy.

If there are things that we don't think we can build out on our own successfully, meaning elements of different lines of business, very focused areas, we'd continue to look at things, but I'm not giving it a high likelihood that you'd see something in that regard. But I wouldn't rule it out completely.

Q - Jay Gelb {BIO 21247396 <GO>}

Thank you.

A - Dominic James Addesso {BIO 1428096 <GO>}

Thank you. Jay.

Operator

And we will go take our final question from Brian Meredith with UBS. Please go ahead.

Q - Brian Meredith {BIO 3108204 <GO>}

Hey. Thanks for fitting me in. Just two questions for you. First, Dom, John, do you have any exposure to changes, potential changes in (1:07:37) rate table?

A - John P. Doucette {BIO 7178336 <GO>}

Brian, I think you said the (1:07:41) rate table...

Q - Brian Meredith {BIO 3108204 <GO>}

Yes.

A - John P. Doucette {BIO 7178336 <GO>}

...you just broke out a little bit. Yeah. So we write business all over the world, we write a very little bit of mode of business in the context of our overall over $4 billion of premium; it's not material to us. So the short answer to your question is we watch that. We look at the rates. We're probably a little less - we're probably a little more pessimistic on that over the last couple of years, so we have not deployed that much capital in that respective area. So we do not think it's material to us.

Q - Brian Meredith {BIO 3108204 <GO>}

Great. Thanks. And last question. John, I was intrigued by your comment that you said that you're exploring new structures, it'll strengthen kind of core client relationships well into the future. Are you referring to kind of multi-year kind of reinsurance agreements? Can you give us some examples of what you're talking about?

A - John P. Doucette {BIO 7178336 <GO>}

So we have – it really applies to a lot of different things. It applies to strategic relationships that we're trying to build with some of our core clients. We've added some of those in 2016. We have somewhere between a half a dozen, and a dozen of these kind of core strategic relationships. We're looking to expand that, and continue to deploy that where we really become a strategic partner to the clients and not just a large reinsurer to them. And that's worked out very well for us.

We continue to deploy and really holistically deploy capacity with the global clients, and we see that as a big opportunity for us in the future as they want to trade more with companies like Everest and less with others, either because of too much concentration with some of the big directs or they want to narrow their reinsurance panels.

We're spending more time really strategizing about how we, as one of the very largest broker market reinsurers how we can grow more with the brokers in the reinsurance area, and we think that's something that will be to the benefit of both of us, and we expect to continue to make headway on that in different products that they have, different initiatives, and different strategies with that going forward.

And then frankly just a lot of these new alternatives really building out what we call the non-traditional space where there's product, new products, new distribution, new clients, and we're making some good headway there, both hiring people, developing resources internally, and have had recently some few nice wins in that space. And we look to continue to deploy that going forward.

Q - Brian Meredith {BIO 3108204 <GO>}

Great. Thanks for the answer.

A - Dominic James Addesso {BIO 1428096 <GO>}

Thank you, Brian, and thank – thanks to all for participating in this morning's call. Apologies for going a little longer, but we had the questions in queue. We obviously were pleased with our performance this past year, and we recognize, as do you, that it's a very challenging market. But we're still quite confident that we can outperform on a relative basis and an absolute basis.

My colleagues here this morning kind of outlined some of the new things we're doing, and I've highlighted our balance sheet strength, the reserve position which certainly bodes well for the future, so we're very confident that we can continue to perform well. And that's not without taking an increased level of risk; it's continuing to do what we do. It's underwrite through the different parts of the cycle and diversifying, diversifying into new products and new areas, and continue to expand our franchise, in particular expand the insurance franchise which we think is one of the ways forward as well as product diversification on the reinsurance side.

So thank you very much for your interest and your participation this morning. We look forward to seeing you probably over the next several weeks. Thank you.

Operator

This does conclude today's program. Thank you for your participation. You may disconnect at any time.