Q1 2019 Earnings Call

Company Participants

- Craig William Howie, Executive VP, Treasurer & CFO
- Dominic J. Addesso, President and Chief Executive Officer
- John Paul Doucett, Executive VP, President of the Reinsurance Division & CEO of the Reinsurance Division
- Jon Levenson, Head of Investor Relations
- Jonathan Zaffino, Executive VP, CEO of the Everest Insurance & President of the Everest Insurance
- Unidentified Speaker

Other Participants

- Amit Kumar, Analyst
- Brian Meredith, Analyst
- Elyse Greenspan, Analyst
- Joshua Shanker, Analyst
- Meyer Shields, Anlayst
- Ryan Tunis, Analyst
- Yaron Kinar, Analyst

Presentation

Operator

Good day and welcome to the Everest Re Group Limited First Quarter 2019 Earnings Call. Today's conference is being recorded. Please be aware that each of your lines is in a listen-only mode. At the conclusion of today's presentation, we will open the floor for questions. At that time. Instructions will be given as to the procedure to follow, if you would like to ask a question.

I would now like to turn the conference over to Jon Levenson , you may begin.

Jon Levenson {BIO 18636999 <GO>}

Thank you and welcome to the Everest Re Group Ltd 2019 first quarter conference call. The Everest executives leading today's call are Dom Addesso, President and Chief Executive Officer; Craig Howie, EVP and Chief Financial Officer; John Doucette, EVP and President and CEO of the Reinsurance Division; and Jonathan Zaffino, EVP and President and CEO of the Everest Insurance Division.

Before we begin, I need to preface the comments on today's call by noting that our SEC filings include extensive disclosures with respect to forward-looking statements. Management comments regarding estimates, projections and similar are subject to the risks, uncertainties and assumptions as noted in Everest's SEC filings. Management may also refer to certain non-GAAP financial measures. These items are reconciled in our earnings release and financial supplement.

With that, I'll turn the call over to Dom Addesso.

Dominic J. Addesso {BIO 1428096 <GO>}

Thanks, Jon. Good morning and welcome to the call. It was a very strong financial quarter for Everest with contributions to profit from reinsurance, insurance and investments. We also continue to increase our market profile with top line growth in both our reinsurance and insurance businesses.

My colleagues will provide - will provide the details on our results. But before they do, I want to point out a few important insights. The first relates to top line growth, within the overall increases in gross written premium there are classes of business being reduced where rates are inadequate, terms and conditions are challenged or in some cases, the customers, no longer desire to cover in whole or part.

Nevertheless,, given current market conditions, along with our meaningful capacity and experienced underwriting teams, Everest is seeing an increasing number of profitable opportunities with the resulting increase in business overall.

We are proud of the market position that we have built and appreciate the deferred status we have in the market with customers and intermediates.

Second is the underlying performance of our business. We have detailed the change in business mix over the past few years and the impact on the loss and acquisition cost ratios. I know that this quarter the attritional accident your loss ratio of 59.2% is very consistent with the results for the full year 2018.

This is noteworthy for two reasons. First is that our loss selection did not yet reflect any underwriting actions taken, which is typically recognized as improvements are realized.

And second, the earned premium in this quarter still reflects a good portion of business at 2018 rates. Rate increases achieved January 1 and April 1, reinsurance renewals and any further rate increases will be earned throughout the year, providing additional improvement to the attritional results.

Current year rates although it is by no means a traditional hard market, I am encouraged by how the industry is responding to loss activity and trends. While capacity is available there is a discipline emerging from both balance sheet and third party capital or cat related business. In addition to pricing, improving terms and conditions which are essentially equivalent to rate improvement are also gaining traction.

Property pricing has been the most responsive, although it has taken 2 years of losses to bring change to the underwriting and pricing of the most challenging areas, notably wildfire and the AOB and LAE issues in Florida.

Beyond property, the pricing momentum is mixed, classes of business where profitability is challenged are getting some much needed rate. There is also a renewed discipline around other classes, including commercial auto and professional liability, also reflective of four results. Other sectors including energy and excess casualty are affirming, in line with the recognition of advancing lost cost trends and a market that is tightening.

And finally, the discipline in London precipitated by tightening capacity at Lloyd's and the increasing migration of business from the admitted markets to the E&S space is adding momentum to an improving market. I am not declaring victory by any stretch, but it is encouraging to see both the primary and reinsurance markets demonstrating a rational response to the issues at hand.

Everest is in a fantastic position to capitalize on this improving market due to our fundamental strengths. Our focus on balance sheet strength and financial security is the starting point. The bedrock of our business is a promise to pay, and to that end we have kept ample levels of capital, low financial leverage and strong ratings.

Over the long-term. I am confident that shareholders have benefited from this conservatism, as it has allowed Everest to access the best business even during times of market stress that otherwise could have gone elsewhere.

Everest also has tremendous experience and long standing relationships with the most important trading partners around the world. We have worked with some customers for over 40 years and as a result of a difficult to replicate highly diversified book of profitable business.

And finally, Everest has and will continue to have a strategic focus on long-term performance with a willingness to absorb volatility over the short term. In an improving market, our capacity, relationships and long-term focus are a very powerful combination.

One final thought worth highlighting is that Everest is increasingly known as a market leader within the Specialty Insurance segment. The RIMS conference this year's certainly spoke to that dynamic. Last year Everest Insurance achieved excellent growth and underwriting results and here in the first quarter accident year results are likely better than market expectations and many of our Specialty Insurance peers.

While our insurance operations may get overlooked by investors sitting alongside, one of the largest in premier and reinsurance franchises in the world, the reality is that our insurance group is trending to end the year at record profits and will likely end the year ahead of many of its peers, that is both the size and profit coming. Urge you to run the comps and include its fair share of investment income. Although Everest is clearly one entity, we have two distinct complementary businesses and I encourage you to look at the value of each individually and the result in sum of the parts.

While both reinsurance and insurance benefit from being part of a larger group and the many synergies they create, they each have a great potential and value on their own and into the future.

With that, I turn the call over to Craig.

Craig William Howie {BIO 17579923 <GO>}

Thank you, Dom. And good morning, everyone. Everest had a solid quarter of earnings with net income of $349 million for the first quarter of 2019, this compares to net income of $210 million for the first quarter of 2018. The 2019 result represents an annualized net income return on equity of 17%.

Net income included $74 million of net after-tax realized capital gains compared to $19 million of capital losses in the first quarter last year. The 2019 capital gains were primarily attributable to fair value adjustments on the public equity portfolio.

After-tax operating income for the first quarter was $282 million compared to $220 million in 2018. This represents an annualized operating return on equity of 14%. These results were driven by strong underwriting results across the group, stable investment income and lower catastrophe losses compared to the first quarter last year.

The overall underwriting gain for the group was $196 million for the quarter compared to an underwriting gain of $108 million in the same period last year. In the first quarter of 2019 Everest saw $25 million of catastrophe losses related to flooding in Australia compared to $100 million of catastrophe losses reported during the first quarter of 2018.

Overall, our prior year catastrophe loss estimates continue to hold. We revised the ultimate loss estimates by event and by segment with no change in the overall loss estimates. Estimated net favorable prior year catastrophe development was offset by $24 million of adverse catastrophe development on the third quarter 2018 Japan loss events. No other events reached our $10 million catastrophe threshold in the first quarter of 2019. Therefore any losses arising from these events were covered in our attritional loss estimates, which include a load for estimates less than $10 million.

The overall current year attritional combined ratio was 87.4%, up slightly from 87.1% in the first quarter of 2018. The attritional loss ratio remained relatively flat at 59.2% in line with Dom's earlier comments, while the commission ratio of 22.5% was up slightly compared to the same period last year, primarily due to changes in business mix and contingent commission adjustments in the reinsurance segment.

The group expense ratio remains low at 5.7% and was lower than prior year due to the increase in earned premium. Our reported combined ratio of 88.7% was lower than first quarter last year, primarily due to the lower reported catastrophe losses in 2019 .

For investments, pretax investment income was $141 million for the quarter, this was based on our $19 billion investment portfolio, a new record for Everest. Investment income was 2% above the first quarter of last year. This result was primarily driven by the increase from the investment grade fixed income portfolio, which had a higher asset base this year. This was partially offset by lower limited partnership income and some partnerships report income on a quarter lag, this quarter's results reflected the poor equity market performance of the 2018 fourth quarter. We would expect there to be improvement in the limited partnership income going forward if the public equity market trading conditions continue to improve in 2019.

The pre-tax yield on the overall portfolio was 3% flat compared to one year ago. However, both investment grade and alternative fixed income yields were up year-over-year.On income taxes, the 12.5% effective tax rate on operating income was close to the 13% tax rate we expect for the full year.

Positive cash flow continues with operating cash flows of $460 million for the first quarter of 2019, compared to $196 million in 2018. The increase reflects a lower level of paid catastrophe losses in 2019 compared to 2018.

Shareholders' equity for the group was $8.4 billion at the end of the first quarter, up $523 million or 7% compared to year-end 2018. The increase in shareholders' equity since year-end 2018 is primarily attributable to $349 million of net income and the sharp recovery in the fair value of the investment portfolio, partially offset by capital return from $57 million of dividends paid and $16 million of share buybacks in the first quarter of 2019. Additionally, we purchased another $9 million of shares after the close of the quarter for a total of $25 million year-to-date.

Everest continues to maintain a very strong capital position with low debt leverage and high liquidity in our investment portfolio in addition to our robust cash flow. As Dom mentioned, the strength of our balance sheet is critical to the success of our business and contestation to this is, the affirmation of our AM Best, A+ Superior rating announced last week.

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

John Paul Doucett

Thank you, Craig. Good morning. We are pleased to report a robust underwriting profit and solid premium growth for the Everest Reinsurance division during the first quarter of 2019. Our business remains well positioned for the current market and for what we see as the evolving trends over the near term. While the improving market that is emerging today is not an across the board rate lift as we may have seen in years gone by. It nevertheless has the potential to be meaningful and sustainable.

In this environment favors companies such as Everest who have the breadth, depth, flexibility, size and innovation to capture evolving opportunities across all classes of business and territories.

Everest success in the current market is based on these fundamental strengths, a global brand and platform, long standing broad relationships with clients and brokers built up over the last four decades by deeply experienced underwriting teams around the world, meaningful capacity, diversified capital sources and a strong balance sheet.

This quarter we continue to see the value of partnership with clients where the reinsurance relationship is strategic for all involved. As our clients have seen pockets of capacity in certain areas reduced, they increasingly turn to Everett to solve their risk and capital needs. Our ability to withstand market stress and continue to provide meaningful, stable capacity over 45 years is of great value to our customers and their intermediaries.

Reflecting on the latest two major renewals, January 1st and April 1st, we are encouraged with the rate change trend in the market, while not a hard market by historical standards, increasing evidence of stabilization on both underlying business and reinsurance business continues.

The market has been reconsidering rates on some key [ph] perils and is now painfully aware of the risk embedded in historically less conspicuous perils such as wildfire. The result is a market requiring rate increases and improved terms and conditions on loss affective business, while maintaining generally stable to increasing prices in non-loss affected programs.

Overall reinsurance market capacity remains tight, as both traditional and alternative capital are recalibrating their assumptions on loss cost, exposures, risk assessment and various risk peril, particularly given the amount of catastrophe losses over the last two years.

And they are becoming more selective as to whom they will back and the terms and conditions - terms and conditions with which they deploy capacity, which is a positive step in the evolution of the overall reinsurance market.

The knock-on effect non-cap lines is also noteworthy. The market's broad recognition that cat exposed profits can no longer subsidize underperforming treaties in other lines of business, is resulting in actions on terms, conditions and underlying rates if they've been inadequate on a standalone basis. At the same time there is increased demand as our customers reinvigorate their primary books, apply rate increases and seek to manage their net exposure.

Outside of traditional P&G [ph] classes, we also find the outlook on our mortgage business robust and continue to see a long runway in the mortgage space for us to deploy capacity profitably in the current forms, as well as in new products, structures and distribution sources.

Now for a review of our quarterly results. For the reinsurance division overall, we wrote $1.5 billion of gross premium and reported an 86.5% combined ratio. Premiums were up 9% on a constant dollar basis year-on-year with casualty a strong contributor to the growth. Original casualty rates have seen pockets of improvement with reinsurance terms and pricing stable and in some cases increasing.

Lower catastrophe losses helped drive an improved reinsurance division underwriting profit of $177 million and our overall attritional loss ratio was about flat at 84.7%, despite a larger percentage of the earned premium coming from pro rata business, which typically runs to a higher attritional loss ratio.

Growth was strongest in our US operations, up 19% largely due to proportional casualty treaties, predominantly written in 2018. The overall combined ratio was stable with our attritional loss ratio down slightly and the attritional combined ratio up 3 point, mainly due to commissions increasing from the greater mix of pro rata business.

The international operations also exhibited strong growth with premiums up 13% on a constant dollar basis. Increased demand for facultative reinsurance was a large contributor to the quarter's growth and dislocation of capacity in London and other markets improve the opportunities for Everest in many international territories.

Results in the international reinsurance segment were impacted by $25 million of loss from the Townsville monsoon and flooding in Australia, as well as from increased loss estimates related to the third quarter 2018 Japanese loss event. However, our attritional loss ratio was flat at 53% and our attritional combined ratio was down 1 point to 78.6%.

The Bermuda operations had a decrease in gross premium, dropping 9% on a constant dollar basis. However, the year-over-year comparison was affected by premium recognition timing as the first quarter of 2018 premiums were bolstered by the timing of premium reported on certain large accounts.

Our London and Dublin operations included in this segment showed growth, benefiting from the dislocation in their markets. Profitability metrics are skewed due to some large shifts in prior period cap reserves to other reinsurance segments.

Our attritional loss ratio of 61.6% was up 2.5 points, due to an increase in casualty and specialty writings. However, our attritional combined ratio of 87.4% improved slightly.

In summary, the first quarter was a solid start to the year for our reinsurance operation, and we remain well positioned to capture rate improvements due to recent loss activity and overall favorable underlying market trends.

Thank you. And now I will turn it over to Jon Zaffino to review our insurance operations.

Jonathan Zaffino {BIO 16652236 <GO>}

Thanks, John. And good morning. Our insurance operations are likewise pleased to report a strong start of the year. Our first quarter performance was excellent as measured across several metrics, most importantly, the significant increase in underwriting profitability. This solid first quarter profit continued the trend we have demonstrated over the past two years, notably by delivering an underwriting profit in eight of the last nine quarters.

Underlying growth was excellent in the quarter, as some of the heavier impacts of non-renewal activity lessened,, although we have not completely diminished. The Everest Global insurance operations produced gross written premium of $595 million for the quarter, an 18% increase over the first quarter of 2018 and a 37% increase over the same period in 2017.

As we have over the past four years, we continue to pursue thoughtful and disciplined growth within our chosen product segments across the entirety of our global operations. This is the strongest first quarter production we have experienced in our history and it marks the 17th consecutive quarter of top line growth across the diversified palette of high-value product areas.

Most importantly in the quarter, the solid growth combined with outstanding execution resulted in underwriting profit of $19 million, a 50% increase over the $13 million of underwriting profit from the first quarter of 2018 and a nearly four-fold increase over the first quarter of 2017.

Further our attritional loss and LAE ratio improved 1.1 points to 65%, reflecting the continued migration towards the higher value and diversified specialty books of business and the earned premium impact of these businesses into our results.

The evidence shows that our confidence in pursuing the organic build of a world-class specialty diversified insurance organization has been justified. As we have reported on prior calls, our leadership and underwriting teams across the globe, continue to execute well on their individual and collective mandates, particularly individual and collective mandates, particular during times such as these where we are experiencing the transitioning markets. Our teams remain focused and our opportunity set, measured by our robust submission flows across lines of business continues to grow, something, I'll touch on later.

We look forward to build on this momentum throughout the year.

Turning to the financial highlights, the global insurance operations produced $595 million in gross written premium in the first quarter, an increase of $90 million or 18% over first quarter 2018, again evidence of our growing relevance in the specialty insurance market.

As in prior quarters contributions remain quite balanced across the diverse group of property and casualty and asset and health underwriting divisions within our global insurance operations. in fact, aside from our program operation Everest underwriting partners where we've taken underwriting actions in pursuit of improved profitability every other major business segment in the Everest Insurance portfolio delivered growth above 15% over the first quarter of 2019.

Turning to net premiums for the first quarter of 2019 net premiums written also grew by 18% to $457 million, while net earned premium grew by $32 million or 80% to $425 million. Our reported GAAP combined ratio for the quarter was 95.6%, a solid improvement of 1.2 points over first quarter of 2018 and nearly 3 points improved over first quarter 2017.

The attritional combined ratio was also 95.6% in the quarter, a 2.4. point improvement over the first quarter 2018 attritional combined of 98% and a 90 basis point improvement over the full year 2018 attritional combined of 96.5%.

The overall GAAP loss ratio for the first quarter of 2019 with 65% effectively flat as compared to last year's 64.9%. The first quarter 2019 attritional loss ratio ex-cat improved further by 1.1 points over the first quarter of 2018 and a further 3.2 point improvement over first quarter 2017 results.

As anticipated and discussed on prior calls, the downward drift in the attritional loss ratio continues. This is a result of an improved mix of business, the growing benefit from the many new businesses launched, the improving underlying rate dynamics and the strategic underwriting actions of the past four years.

Our expense ratio for the quarter was 30.6%, an improvement of 1.3 points over the prior year period. This is in line with our full year 2018 expense ratio of 3.3%. The first quarter 2019 expense ratio remains very competitive in the specialty insurance market and reflects stabilization around the 30% mark, regardless of continued significant investment in talent, new products, new geographies and new technologies.

We continue to recruit and retain the best talent in the industry and have invested in modern office locations to assist our colleagues in serving our customers in their local geographies. To support our talented employees and to enhance our client value proposition, we have committed to a robust program of IT investment in both traditional infrastructure and a variety of cutting-edge and innovative technologies. It is through the hard work of our colleagues and their tireless commitment to execution that we have been able to pair this investment and growth with an industry-leading expense ratio .

I'll turn now to the market conditions, which are clearly painting a picture of an evolving market. One of the barometers used to draw the conclusion is our submission flows in the quarter, which amounted to our third highest on record. This was particularly acute in our various wholesale dedicated businesses where submission activity is significantly increasing month -to -month.

As for underlying rates we largely experience an improving property and casualty and accident and pricing picture across the organization, a trend that has continued from last year. The exception has been worker's compensation where rates remain under pressure, however, our view of profitability within the line remains positive.

Excluding worker's compensation, overall property and casualty renewal premium change, which includes exposure change was 6.9% in the quarter. Sure, rate change on the same basis increased by 5.5% in the quarter and virtually all lines showed quarterly improvement, led by commercial auto, property and umbrella excess.

Encouragingly financial lines globally also showed strengthening, building on a trend that began in the last two quarters of 2018. This is the highest aggregate rate change we have seen in roughly five years.

Finally, and this is something that we pay close attention to, terms and conditions also point to improvement, particularly in the property and excess casualty market . The bottom line for us is that we are focused on achieving adequate technical pricing across our portfolio and are working diligently towards that objective every day.

In conclusion, the first quarter 2019 showed continued progress on our journey, along with solid results. Our vision of building a leading specialty diversified insurance company has become a reality. We have demonstrated that our strategy is sound and more importantly that we can execute on that strategy, as evidenced by our consistent underwriting profitability across eight of the last nine quarters.

More importantly, we believe we are positioned with the right capabilities, products, and of course talent to service our customers and this evolving market. We look forward to continuing our positive momentum and reporting back to you next quarter.

With that, I'll turn the call back to Jonathan for Q&A

Questions And Answers

Operator

Thank you. Ladies and gentlemen, at this time, we'll open up the floor for questions. (Operator Instructions).

Yeah. We'll take our first question from Amit Kumar with The Buckingham Research Group.

Q - Amit Kumar {BIO 15025799 <GO>}

Thanks and good morning. Just to - maybe a few questions. The first question is probably for Dom, in the opening remarks, you talked about how the 59.2 was you know, obviously does not reflect some of the things we talked about. I was curious, and maybe this ties to - ties into insurance and reinsurance, how should we think about what would be sort of a normalized fully adjusted number if all -- the if all the pluses and minuses were to influence with the numbers?

A - Dominic J. Addesso {BIO 1428096 <GO>}

Amit, we don't - we don't forecast earnings or try to give you any specific guidance on the numbers in large part, that's the job of you and many others. I think what we're trying to suggest is that our first quarter numbers not surprisingly would be consistent with our 2018 loss fix [ph] on the attrition basis and I think we were also trying to suggest is that we've got ahead of us rate increases that were already - some of which was came through in '18 with that rate increases coming from our January 1, and April renewals and then of course highly anticipated June account.

So I think what we're trying to suggest is that there should be improvement in that number and that's somewhat of course dependent upon what the level of rate increases are, which we don't try to publicly prognosticate on the specific level of rate increase. So you're on your own.

Q - Amit Kumar {BIO 15025799 <GO>}

That's a fair point. I was probably trying to come up with the Q4 comments and back into maybe two or three points of improvement. The other question I had was the discussion on reinsurance pricing and the upcoming 6/1 renewal. The 6/1 reinsurance premiums have obviously grown substantially for the Q2 2018 versus Q2 2017.

I was curious, based on how you're thinking about capital deployment is it going to be more about risk selection at six - at the upcoming renewal and net-net, your size of the book remains mostly unchanged or how should we think about that?

A - Dominic J. Addesso {BIO 1428096 <GO>}

Well, that of course, that is somewhat dependent upon what's presented to us at 6/1. As we said, the, we certainly would anticipate some meaningful rate activity and terms and conditions, which are improving, which essentially is is rate, but naturally that will vary by client. So in some cases the level of rate activity will vary by client I guess is, where I would like to leave that.

Now our activity at 1/1 reflected some reduction in our exposure, you could see from our PML's disclosures and that was of course due to the fact that we did not achieve the level of rate increase that we thought was necessary and on a risk adjusted basis, some of the accounts were not renewed. Whether or not that presents itself in the same way at 6/1 not very likely.

We certainly would anticipate 6/ will be much stronger than what we saw at 1/1 and what we saw at 4/1 by the way were meaningful rate increases and in fact Japan was an area for example where we had pulled back in more recent times do risk adjusted pricing going down, but we actually increased slightly our participation in Japan at 4/1. So it's, it's a mixed bag, it will be dependent upon what the market opportunities present to us. But I don't know that you necessarily see us meaningfully increase our exposure.

Q - Amit Kumar {BIO 15025799 <GO>}

That's a fair point. The final question might before Craig or John , is that the $37 million positive movement in the catastrophes in the US reinsurance, where's that from ?

A - Craig William Howie {BIO 17579923 <GO>}

So on that we go through a comprehensive approach, this is Craig to review our cat reserves on a current-year basis, but also prior years as well. And we go through and we look at each of them. However, we reserve on a group level basis, not a segment level basis.

These events, do not always fit neatly into a segment because the exposure can be written from multiple segments. We tend to react quickly to any adverse development, as you saw from the Japan loss events from 2018 that we - that we took a charge for. But we take our time to react to any favorable development until that position becomes more mature. So you may see movements between segments, but it's really done at an overall level.

Q - Amit Kumar {BIO 15025799 <GO>}

Okay. So the $37 million is from several pluses and minuses, I think is what you're saying versus one single event?

A - Craig William Howie {BIO 17579923 <GO>}

Correct.

Q - Amit Kumar {BIO 15025799 <GO>}

Got it. Okay. I will stop here. Thanks for the answers and good luck for the future.

A - Craig William Howie {BIO 17579923 <GO>}

Thank you, Amit.

Operator

Thank you. We'll take our next question from Elyse Greenspan with Wells Fargo.

Q - Elyse Greenspan {BIO 17263315 <GO>}

Hi, good morning.,My first question. I was hoping to spend a little bit more time on the forward pricing environment, I recognize, we're still in discussions for the midyear renewals. But given what we've seen in the industry with Irma and the development with Irma, I mean can you get us set up a sense, what do you, what kind of price increases would you need to see for this to be a successful renewal versus if prices - if we get closer to 6/1 and prices fall short of expectations. Is there a certain bar where Everest is going to walk away after not able to recoup price increases after two successive years of losses?

A - Dominic J. Addesso {BIO 1428096 <GO>}

So Elyse, I'm going to ask John to comment on -- so to comment. Well, but let me just say that consistent with what I said before is that we try not to prognosticate where the rate increases will be going, and frankly where it even need to be.

It varies by client, as I mentioned a few minutes ago, depending upon client experience of the relationships, risk adjusted returns, et cider, et cider, et cider. And frankly, it doesn't really do us any service to be you know , trying to put a specific number or bar on it.

I think it probably telegraphs an inconsistent message or an incorrect message to the Street and frankly it perhaps depending on the client relationship it could be the inappropriate target for a specific client, so it doesn't really serve our purpose to be putting up - putting a benchmark or look drawing a line in the sand so to speak as you describe. But John, do you have any further...

A - John Paul Doucett

Yeah. Thanks, Dom. Good morning, Elyse, and thanks for the question. First, I do want to highlight that there's actually been three years of hurricanes hitting Florida not two with Matthew armour and Michael and I think there's been a lot of movement there and I think there's been you know, as Dom said, as we look at this, we need to achieve the rates that we expect that and that will vary by client, that will vary by product, that will vary by attachment. But we fully intend to differentiate the clients in terms of how they performed with their losses, with their LAE, with AOB, with their loss creep et cider, et cider. So that will all factor in.

We clearly see capacity hike as we head into the market, both as I touched on in my earlier comments, both on the traditional and in the alternative space for a variety of reasons due to some of the aforementioned reasons, but also just the reload, the alternative capital and the lack of reload.

So a couple of other points, that we continue to look to where we want to allocate capacity and that's not just property, that's not just client in Florida and we are allocating more capacity to global clients. We're obviously as Jon Zaffino articulated deploying more capital and capacity on the insurance space. We're seeing increasing opportunities on the casualty reinsurance space, and as I said on the mortgage space. So all that factors into a higher required return threshold or for where we are headed into our Florida business.

We don't predict rates, but we think it's going to be a very late renewal, potentially messy and ultimately we think it will be profitable for us.

A - Jonathan Zaffino {BIO 16652236 <GO>}

In other thing I'll add to that, again, Elyse is that, while it's not maybe precisely on point to your question, hopefully this helps. I did describe earlier that we've increased our participation in the Japan market and there we were seeing rate increases of 20% to 30%. So maybe that gives you some notion of our appetite and maybe perhaps what's needed generally.

Q - Elyse Greenspan {BIO 17263315 <GO>}

Okay, that's very helpful. And then in terms of your JV [ph] development in the quarter, so if we look at where your initial loss sat and , we've seen a lot of development across the industry. And so the development that we see from you guys smaller percentage of your initial loss, is there a difference in how you attach on treaties there or maybe the level of insured losses you use when you set up the reserve for the losses in the third quarter of last year. Just any guidance there that we should think about in terms of the development on JV?

A - Dominic J. Addesso {BIO 1428096 <GO>}

So we believe that last year we established some reserve, we were at the high - above frankly we're way above where the industry estimates were at the time. So that obviously kept us in good stead, as well as the fact that we've essentially when we look at the losses in Asia, we are looking at them as a group, but losses as with respect to that marketplace. So I think all of those factors combined enabled us to have that managed appropriately.

Q - Elyse Greenspan {BIO 17263315 <GO>}

Okay, that's helpful. And my last....

A - Dominic J. Addesso {BIO 1428096 <GO>}

Give me one second and maybe John does...

A - John Paul Doucett

Yeah, I just want to give a little bit of a frame of our market share in Japan. So if you think back since over many years, we had posted hukou substantial rate increases and we significantly increased our book of business then. And then over the last several years there had been a downward pressure on the rates and we accordingly kind of trimmed our book each here a little bit for the worst performing accounts, and we also were moving up capacity, which I think is reflective of where we find ourselves for the Japanese book overall.

Q - Elyse Greenspan {BIO 17263315 <GO>}

Okay, that's helpful. And then my last question was on the expense ratio, it was up a little bit year-over-year and then if I look within the US reinsurance segment, you saw an up tick, you know, decent amount up tick in the commission and brokerage ratio from where you've been trending, is there something going on there that we should think about in terms of modeling going forward?

A - Craig William Howie {BIO 17579923 <GO>}

So Elyse , this is Craig. Expenses year-over-year and one of the things that you saw at year end was variable pay expenses were taking down at the end of last year, predominantly due to the profitability of the book. Those are back in normal accrual [ph] ranges for this year. Overall, but what you're seeing is just a slight up tick in expense dollars, but overall the expense ratio is staying at a low level of 5.7% overall.

A - John Paul Doucett

Yeah, and Elyse, this is John, I just want a - little more color on the mix change. So we also have been talking about increasing our casualty book of business overall, increase our pro rat -- business and at 1/1 we took action based on rates tied to our property retro and aggregate retro portfolio and that decreases. The combination of those, all those do have or did have an impact on the attritional combined ratio.

A - Dominic J. Addesso {BIO 1428096 <GO>}

And the expense ratio of course is down year over year, but the commission ratio had a -- I think you referenced the US reinsurance that had a contingent commission adjustment in the first quarter, a true up if you will due to the mortgage book.

Q - Elyse Greenspan {BIO 17263315 <GO>}

And how much was that true up?

A - Dominic J. Addesso {BIO 1428096 <GO>}

Overall, it relates to a bunch of things that relates to our contingent commission in the mortgage true up, but it's also relates to the business mix that we have with more pro rat business coming on the books that John just mentioned.

A - Jonathan Zaffino {BIO 16652236 <GO>}

And different classes of business that specifically have contingent commissions on them.

A - Dominic J. Addesso {BIO 1428096 <GO>}

So we don't have one specific number for the mortgage adjustment.

Q - Elyse Greenspan {BIO 17263315 <GO>}

Okay, that's helpful. Thank you for all the color.

A - Dominic J. Addesso {BIO 1428096 <GO>}

Thank you, Ely's.

Operator

Thank you. We'll take our next question from Yaron Kinar with Goldman Sachs.

Q - Yaron Kinar {BIO 17146197 <GO>}

Thank you. Good morning, everybody. I guess the question is a mufti-part question. So first just looking at the total reinsurance underlying attritional combined ratio in 47 [ph] just seems a little bit lower than the roughly 87 number that I think we've run rated last quarter or so. Are there other than maybe contingent commissions or a couple of other minor offsets . Are there any major drivers there, that would have resulted in the significant improvement quarter-to-quarter?

A - Dominic J. Addesso {BIO 1428096 <GO>}

So I mean, we continue to deploy more capacity into the mortgage space, which we think has a robust risk reward characteristics. And as you may recall, the mortgage book are basically mufti-year deal, there over several years. So deals from three years ago, we're still getting earned premium, two years ago, et cetera, one year ago, as well as writing new premium. That certainly has the directional impact of improving the attritional combined ratio, given the potential profitability in the mortgage book.

Q - Yaron Kinar {BIO 17146197 <GO>}

Okay, that's helpful. And then Dom from your earlier comments, it sounds like between the underwriting actions that you've taken and have been implemented starting in January and the rate increases that you've been seeing, you are expecting overall improvement. So basically you are expecting that rates will be in excess of loss trends. Is that broadly true or their lines of business or geographies where you actually don't see that to be the case?

A - Dominic J. Addesso {BIO 1428096 <GO>}

No, not in any meaningful way. I think generally - and that's primarily because in any particular class of business, in any particular geography, and of course this can get pretty manute. But if that were the case then you'd be seeing us take capacity moving away from those - in that sector. I'm not sure that I could really highlight anything that's moving in the wrong direction.

Q - Yaron Kinar {BIO 17146197 <GO>}

Okay. And I guess one last quick one, I think the increase in losses from Japan is for all three industry events (inaudible) flood losses. Would you be able to break that out?

A - Dominic J. Addesso {BIO 1428096 <GO>}

We do not break that out.

Q - Yaron Kinar {BIO 17146197 <GO>}

Okay. But if I take the three industry events together, it would seem like you're in the 80 to 90 basis point market share of those three losses based on current insights, is that roughly how you're seeing it?

A - Dominic J. Addesso {BIO 1428096 <GO>}

Roughly 1%.

Q - Yaron Kinar {BIO 17146197 <GO>}

Roughly 1%. Okay, thank you very much.

A - Dominic J. Addesso {BIO 1428096 <GO>}

Thank you.

Operator

Thank you. We'll take our next question from Ryan Tunis with Autonomous Research.

Q - Ryan Tunis {BIO 16502263 <GO>}

Thanks. Just if you had little bit more color on the texture behind the Japan book now at renewals and maybe in terms of premium size, how much of that is quoted share, what's the weighting between the wind and the quake and how much of that if it's excess of loss is aggregated occurrence?.

A - John Paul Doucett

Good morning, Ryan, this is John. So our Japan books about $60 million -- $50 million to $60 million, up slightly this year over prior years. The mix should be -- I don't have that in front of us, the mix should be mostly excess of loss business and that's mostly property, there is some other - surety, fidelity and some mother smaller programs that we write for lot of the major clients.

Q - Ryan Tunis {BIO 16502263 <GO>}

Thank you. And then a follow-up for Dom, going back to the prepared remarks about thinking about these two businesses from some of the parts context. I'm just curious like is your ROE outlook on -- where the primary insurance business is today and where the reinsurance business is?

A - Dominic J. Addesso {BIO 1428096 <GO>}

Well, first of all our - we would certainly target an ROE in the double digits. Clearly we would expect a higher ROE out of our reinsurance business in the insurance business, given the volatility there. Couple of hundred basis point difference. But that's about as specific as I think I want to get without giving a specific number which would then of course translate into an earnings projection.

Q - Ryan Tunis {BIO 16502263 <GO>}

Fair enough, thanks.

A - Dominic J. Addesso {BIO 1428096 <GO>}

Thank you.

Operator

Thank you. We'll take our next question from Joshua Shaker with Deutsche Bank.

Q - Joshua Shanker {BIO 5292022 <GO>}

Yes, good morning everybody. I wanted to talk a little bit about pricing see both sides of the markets. First of all, on the, in terms of the rate increases on the primary side, and its not just for you but others. To what extent are broadly discuss industry price increases going to get mitigated by higher outwards reinsurance costs which you guys will benefit from.

And two, in absence of up property pricing being up, I'm sure you in your non-property lines you're seeing price increases, but would it be business as usual, or is there really something palpable going on outside of the property driven pricing markets?

A - Jonathan Zaffino {BIO 16652236 <GO>}

Good morning, Josh, this is John. Let me take that from the primary side. First and foremost, I don't see this as a reinsurance driven pricing change. I think some of the underlying fundamentals dynamics are such that there are a number of areas that just simply needed corrective rate actions.

So we're seeing that across several line, some of which I mentioned in my script. We're actually seeing some of the momentum actually built, which is -- which fundamentally I think is creating a pretty interesting dynamic and outlook.

So we anticipate that to continue as the year moves on. We're seeing it outside of property, we mentioned the commercial auto, is not a new story, obviously, but as I mentioned earlier in the financial lines, you're starting to see particularly and some of the management liability areas, public company D&O, certainly primary layers, you're starting to see increased rate of change happening there in terms of rate actions.

So we just see sort of a broad based move, but a lot of it being driven by underlying fundamentals versus kind of a top down view.

Q - Joshua Shanker {BIO 5292022 <GO>}

And even though it's not being driven by the reinsurance side, are your clients going to see some of their rate driven margin expansion curtailed by higher outwards reinsurance costs?

A - Dominic J. Addesso {BIO 1428096 <GO>}

While there would be -- we would expect the industry - the primary industry to obviously realize some of the reinsurance rate increases. I'm not so sure that would translate into margin compression on their end. I think their rate levels, clearly the reinsurance spend is only a portion of their gross written premium. But I think the economics are such that I wouldn't necessarily expect any compression to the margins, because of increased reinsurance pricing.

A - Jonathan Zaffino {BIO 16652236 <GO>}

And I think, it's Jon to speak more of this, but I know everyone buy [ph] is differently. So I think it's a very difficult translation one to one. So I don't know, John if you want to comment on this demand side.

A - John Paul Doucett

Yeah, what we're clearly seeing a lot of our clients - for insurance clients looking to grow -- to buy more frankly, grow the reinsurance treaties and some of them are property driven for volatility. And interestingly, we're still seeing a lot of demand on the casualty side of the house and that is resulting in - so to your, the original question, we're still seeing, non-property rate improvement with improved terms and conditions and lower ceding commissions on the casualty, the broader casualty part. And then we're also seeing some pickup in some of the specialty reinsurance areas, Aviation, Marine, et cetera. We're seeing some lift, some that really loss driven. So we're seeing some opportunities there that we wouldn't have found attractive in prior years but at better pricing we could put more capacity to work there.

A - Unidentified Speaker

One area Josh , we may see some of what you're suggesting could be in Florida, with some of the smaller companies where they may feel a little bit of pressure from rising insurance costs, but that would be the only spot where I think that would potentially go through.

Q - Joshua Shanker {BIO 5292022 <GO>}

Thanks for the answers.

A - Dominic J. Addesso {BIO 1428096 <GO>}

Thank you, Josh.

A - John Paul Doucett

Thank you .

Operator

Thank you. We'll take our next question from Meyer Shields with KBW.

Q - Meyer Shields {BIO 4281064 <GO>}

Thanks. I was hoping you could give us and your views on the sophistication of the Japanese catastrophe models compared to the ones we've got the Southeastern United States?

A - Dominic J. Addesso {BIO 1428096 <GO>}

So, let's start with first on (inaudible) and every time - and every time a loss happens you know. some of the weaknesses get again demonstrated and then there is kind of a look back and re-tool and back to cover the loss that happened. And I think that's one of the reasons why we take pretty holistic view on across the whole board and really try to think about it on a first principle basis and not just be model driven.

So our -- I think the data is getting better over time overall, but it's still not nearly as good in a lot of international areas as it is in the US ,that would include Japan. But it has gotten a lot better over the last several year and the market is therefore are also better.

Q - Meyer Shields {BIO 4281064 <GO>}

Great, thank you that's very helpful. Second question, I think it's my personal belief is that you tend to see reinsurance buyers or really all insurers get somewhat more optimistic in their loss picks during soft markets and in that reverses when rates rise, can you talk about how you sort of manage against that in the reinsurance book?

A - Dominic J. Addesso {BIO 1428096 <GO>}

Well, I mean it's an interesting observation and of course selecting in ELR and knowing your true cost of business, cost of goods sold in this business is something that you never really know for years into the future. So you never really know accurately your cost of goods sold and it's always a challenge.

so the best, the best way to deal with that is to use all the tools that are available to you, stay true to your process, be conservative and disciplined around how you establish loss reserves and just collect all the data you can.

And I think what we've shown and demonstrated in our attrition al book, we've - we have a fairly good track record over the last half a dozen years or so of reasonably reserving through various market cycles. But look at it, it's never an exact science, and it's all about being presenting a fair financial picture it, which we think we've done.

A - Craig William Howie {BIO 17579923 <GO>}

And to just add a little more color, we also benefit, and this is where I think data and experience with clients, lines business in different territories I mean, we write business for 45 years, we write in basically all P&C lines, in all territories and have traded with 70% of our clients for decades now and that's incredibly helpful because we can pull up prior year submissions, we can pull up similar clients and we can look and build .

So I think being, having a global footprint for a long period of time, gives us a very strong insight into what we think the market really is, the loss pick really is and the rating environment really is, which I think has helped us time and time again being in that favorable position to be able to execute on that and not just rely specifically on what a specific clients information tells us. But to be able to pull in across kind of our institutional knowledge on actuarial pricing and trends, the loss trends, things like that.

A - Dominic J. Addesso {BIO 1428096 <GO>}

And to be specific about our process and I know we've mentioned this from time to time. What we do and our processes that after the last reserve study, and this will was supply to every class of business, we then apply to that last reserve study, selection we apply, what's happening with rate. So if there are rate decreases going - going on in the marketplace, w will take the last reserve study pick an adjusted downwards or upwards, I'm sorry for any rate decreases in the opposite their rate increases going on. So that's how we deal with it specific to our company.

Q - Meyer Shields {BIO 4281064 <GO>}

Okay. That was very thorough and helpful. Thank you.

A - Dominic J. Addesso {BIO 1428096 <GO>}

Thank you.

Operator

Thank you. We'll take our next question from Brian Meredith with UBS.

Q - Brian Meredith {BIO 3108204 <GO>}

Yes, thanks. Most my question have been asked, but just one quick question here, John, what do you think the impact of the AOB legislation board is going to have on just the pricing environment. Maybe kind of loss cost and stuff going forward?

A - John Paul Doucett

Yes it's a great question, again, we try to absorb all the information out there. We don't really try to make specific predictions on what this is going to do ex [ph] or that going do what, I'll go back to three years of our Hurricane Florida, a lot of capacity, the loss script that we did see, I think capacity is tight as Dom alluded to, a lot of the rate -- a lot of the reinsurance clients there, their reinsurance programs our capital for them and I think they need to be reflective of the not so great experience over the last couple of years.

We certainly hope, and we think it's a positive move that the Florida Legislature is addressing this issue, so, hopefully that'll make an overall better healthier market in the long-term.

Q - Brian Meredith {BIO 3108204 <GO>}

I guess more specifically to the quota shares actually done in Florida. Do you think it will have any impact on pricing, then are you going to kind of just wait and see what happens, call it a year, year from now?

A - John Paul Doucett

I think there could be -- I think - I don't know if your question was insurance pricing there, the original pricing on reinsurance pricing. If you had to be, there's going to be directional movement up and down and all that stuff, but again I think the capacity is -- capacity is tighter this renewal.

Q - Brian Meredith {BIO 3108204 <GO>}

Great. Thank you.

Operator

Thank you. At this time there are no further questions in the queue.

A - Dominic J. Addesso {BIO 1428096 <GO>}

Good. I'll just sum up here. Thank you for joining this morning and for your questions and discussion. Certainly we're off to a good start for the year. But more important is what is likely to unfold as the year progresses. And I think as you heard from us and other market participants the rate outlook is quite positive. This along with our many business initiatives and expansion opportunities causes us to be very optimistic about our future. So I look forward to interacting with many of you in the weeks ahead and have a good day. Thanks, again.

Operator

Thank you. Ladies and gentlemen, this concludes today's teleconference. You may now disconnect.