Q2 2020 Earnings Call

Company Participants

- Keith Alfred McCue, Senior Vice President of Finance & Investor Relations
- Kevin Joseph O'Donnell, President, Chief Executive Officer & Director
- Robert Qutub, Executive Vice President & Chief Financial Officer

Other Participants

- Elyse Greenspan, Analyst
- Jimmy S. Bhullar, Analyst
- Josh Shanker, Analyst
- Meyer Shields, Analyst
- Phil Stefano, Analyst
- Yaron Kinar, Analyst

Presentation

Operator

Ladies and gentlemen, thank you for standing by and welcome to the RenaissanceRe's Second Quarter 2020 Financial Results Conference Call. At this time, all participants are in a listen-only mode. After the speakers' presentation, there will be a question-and-answer session. (Operator Instructions) I would now like to hand the conference over to your speaker today, Keith McCue, Senior Vice President, Finance and Investor Relations.

Thank you. Please go ahead, sir.

Keith Alfred McCue {BIO 20595590 <GO>}

Good morning. Thank you for joining our second quarter financial results conference call. Yesterday, after the market closed, we issued our quarterly release. If you didn't receive a copy, please call me at 441-239-4830 and we'll make sure to provide you with one. There will be an audio replay of the call available from about 2:00 PM Eastern Time today through midnight on August 27. The replay can be accessed by dialing 855-859-2056 US toll free or 1-404-537-3406 internationally. The passcode you will need for both numbers is 3449228. Today's call is also available through the Investor Information section of www.renre.com and will be archived on RenaissanceRe's website through midnight on August 27, 2020.

Before we begin, I'm obliged to caution that today's discussion may contain forward-looking statements and actual results may differ materially from those discussed.

Additional information regarding the factors shaping these outcomes can be found in RenaissanceRe's SEC filings, to which we direct you.

With us to discuss today's results are Kevin O'Donnell, President and Chief Executive Officer; and Bob Qutub, Executive Vice President and Chief Financial Officer.

I'd now like to turn the call over to Kevin. Kevin?

Kevin Joseph O'Donnell

Thanks Keith. Good morning and thank you for joining today's call. I'm glad to report that we had strong performance both financially and operationally in the second quarter. For me three accomplishments in particular stand out. First, we raised over $1 billion of new common equity, building a fortress balance sheet in anticipation of significant future opportunities. Second, our three category approach to managing our COVID-19 exposure proved sound, with reported claims developing in line with expectations. Finally, we executed disciplined and focused renewals across property and casualty working constructively with our customers and brokers to achieve rate adequacy, and improved terms and conditions.

I will address each of these accomplishments in greater detail, and discuss the quarter more generally. As usual, Bob will also update you on our financial performance for the quarter. Beginning with our capital raise, throughout our 27 year history, we have placed a high bar to raising common equity. Post IPO, we have only issued common shares on one other occasion, not concurrent with an acquisition. To raising this equity, I believe we need to answer at least three questions; why now, why equity and why $1 billion.

First, why now? We are confident in our ability to execute into an improved market and believe the opportunity will persist for several years. Prior to the emergence of COVID-19, P&C markets were already experiencing constrained supply and elevated demand, resulting in upward pressure on rates. Numerous factors led to this supply demand imbalance. Property markets have experienced three consecutive years of elevated catastrophe activity, resulting in large losses and substantial trapped ILS capital.

Capital -- casualty markets were beset by a significant loss inflation caused by historically large jury verdicts and increasing frequency of severity. This preexisting rate trend was accelerated by COVID-19 and the deep economic recession that followed. COVID-19 will be among the largest insured losses in history. The loss will develop slowly and will add uncertainty which drives demand for reinsurance, as buyers look to reduce volatility.

At the same time the increase in demand has been mirrored by a reduction in supply, caused by increased underwriting discipline in dislocated retro markets. This confluence of factors has resulted in material rate increases that will impact almost all lines for an extended period and which we expect will create opportunities for us over the next several years. For all the reasons we concluded that this was the ideal time to raise new equity.

Second, why did we choose equity? Our strategy is to use our integrated system to match desirable risk with efficient capital. Throughout our history, we have been innovators and preferentially accessing the most efficient forms of capital depending on market conditions, flexing between common, preferred cat bonds, retro, sidecars and dedicated third party capital, as well as senior debt credit revolvers and LOCs. Each form of capital is selected to maximize its efficiency relative to the risk it is deployed against.

Given our current conditions, common equity was the best option. It is permanent. It is flexible capital, fully available for underwriting so we can deploy in order to maximize long-term shareholder value. And finally why a $1 billion? On our previous earnings call, we told you, we already had excess capital, but we chose this amount as we believe it gives us the increased scale necessary to maximize the market opportunity, we are expecting. We ran multiple proformas to determine the size of this opportunity and feel confident that we can deploy the capital, we raised while maintaining a prudent buffer.

We envisioned two main opportunities to deploy the capital we raised. Opportunity one; is growing into an improving market and opportunity two is retaining more risk. Our first and best opportunity is to grow into an improving market. We have a long-term demonstrated track record of profitable growth and believe that current conditions afford us considerable options to grow our business by deploying more equity.

With a fortress balance sheet, we can provide our customers with certainty of execution. Many insurers are concerned about their ability to purchase sufficient reinsurance and retro next year. This results in a reluctance to take new risk or renew existing business even at attractive rates. Approximately half of our business renews at January 1 and we are already having productive conversations with our customers ahead of this important renewal. Providing certainty of execution makes us a first call market for both new and large opportunities and gives us preferential access to private deals.

Our second deployment opportunity is to retain more risk. A key component of our growth strategy is the flexibility to grow and shrink the amount of risk we share with others in order to construct the most efficient underwriting portfolio. As market conditions have evolved, our customers are increasingly seeking the stable flexible long-term capacity that our weighted balance sheet can provide.

With additional common equity on our balance sheet, we were able to offer more weighted capacity which enhances the flexibility of solutions, we are able to provide to our customers. As retro rates rise and the ILS market faces challenges, we will share less risk and sell more retro, so as more of our capital and should be able to do so in a manner that increasingly contributes to our bottom line.

Shifting to COVID-19. Last quarter, I explained our three category approach to managing our COVID-19 exposures. To-date, reported losses have developed largely as expected within this framework. If you recall, I categorized our potential COVID-19 exposure as falling into one of three distinct categories. Category one includes event like losses closely linked to the virus, such as event contingency, event-based casualty class and certain types of accident and health. We booked full limit losses for canceled events through the end of the year, and excluded COVID-19 from future renewals. In the second quarter, we began to receive claim notifications against these reserves as events have been canceled or postponed, which have been in line with expectations. To be clear however, we have not canceled events in 2021.

Category 2 covers well understood economic risks. These include losses caused by recession and our risks we are paid to take. Last quarter, we increased certain loss ratios in our Casualty and Specialty book to reflect the elevated risk related to COVID-19. We continue to monitor our credit portfolio, including mortgage for COVID-19 losses, while the likelihood of loss has risen, the current situation is fundamentally different than the Great Financial Crisis. Loans are of higher quality. Regulations are tighter and the housing market is under built. In addition, the US government has extended the largest and the most comprehensive forbearance measures in history.

For these reasons, we believe that our mortgage book is adequately reserved. And Category 3 is the known unknowns, primarily business interruption. As has been widely reported coverage of pandemic business interruption risk under property policies has been controversial, except for communicable disease coverage extensions have been provided, policyholders generally have not paid for the benefit of protection, and it follows that pandemic losses should not be covered.

Our seasons continue to advise us that they have minimal exposure to business interruption losses and intend to fight [ph] any and all attempts by the plaintiffs' bar to impose liability. We continue to stay closely connected with our teams on these exposures and are monitoring court actions in Europe and the US. Finally, before I turn it over to Bob, there's one more item I'd like to address. As we announced several weeks ago, Aditya Dutt has departed and I have assumed interim responsibility for our ventures business. I am excited to have the opportunity to work with our close -- to work closely with our talented ventures team, at a time we are seeing many opportunities to profitably deploy partner capital. We thank Aditya for his 12 years of service and wish him continued success.

Our ventures unit is one of the oldest and most respected ILS managers in the business. It has grown to play a critical role in our gross to net strategy, an integrated system, which we will continue to do so going forward. Despite third-party capital markets becoming increasingly dislocated, we successfully raised over $250 million of capital, including our line participation for Upsilon, Medici and Vermeer balance sheets in support of the mid-year renewals. Our ability to do so is a result of superior underwriting, excellent enterprise risk management, and investor confidence and our aligned approach. We greatly value the trust that our partner capital has placed in us to deliver high quality portfolios of risk, and I'm confident that we can continue to earn that trust in the future.

So with that, I'll provide an update on the renewals for our segments at the end of the call, but first, let me turn it over Bob to talk about our financial performance.

Robert Qutub {BIO 15269353 <GO>}

Thanks Kevin, and good morning everyone. We had a solid quarter with strong financial results and several strategic accomplishments. I'll begin my prepared comments with an update on our operational response to COVID-19 and then will provide an overview of the capital raise and its impact on our financials. I will then discuss our financial results, starting with our consolidated returns and then providing more detail on our three main drivers of profit underwriting income, fee income and investment income.

Beginning with an update on our operational response to COVID-19, after more than three months from working from home, we began to transition back to our offices in Bermuda and Zurich. We opened these two offices on an optional and limited basis in June, and the transition back has been smooth. Most of our employees, however, continued to work remotely and we are all operating well in this mix model. Importantly, throughout the second quarter, we continued to invest in the business through active recruiting. We hired and on boarded several new employees, remotely, to support the needs of our expanding business.

Now, moving to the capital raise, Kevin discussed we raised $1.1 billion in common equity through a public offering and a concurrent private placement with State Farm of 6.8 million common shares at a price of $166 per share. We anticipate that our largest opportunities to deploy this capital will be at and subsequent to the January 1 renewal. In the interim, this capital will have some pressure on earnings per share; this quarter that impact was minimal. And finally you will note that during the quarter, our book value per share increased $17 or 15% as a result of our capital raise, significant mark-to-market gains on our investment portfolio and strong operating income.

Now, moving to our consolidated results, we reported annualized return on average common equity of 38.5% driven by mark-to-market gains in our investment portfolio. Annualized operating return on average common equity was 12.7% influenced primarily by favorable underwriting results and fee income. Reported net income for the quarter of $576 million or $12.63 per diluted common share. Our operating income was $190 million or $4.06 per diluted common share. This excludes net realized and unrealized gains on investments, TMR transition related expenses and net foreign exchange losses.

Gross premiums written for the quarter were $1.7 billion up $225 million or 15% from the comparable quarter last year, 90% of this growth came from our property segment and 10% came from Casualty. As a reminder, we acquired Tokio Millennium Re on March 22, 2019. So, this is the first full quarter since the acquisition where results are comparable year-over-year. As we indicated before, we did not renew a significant portion of the TMR portfolio. So, our top line growth of 15% during the quarter was achieved despite downwards pressure.

You will also see the impact of the TMR acquisition in the ratio of our ceded to gross premiums. Legacy business that we acquired from TMR was covered by the ADC, so not subject to our normal ceded program, while the ratio of our ceded to gross premiums stayed flat year-over-year at 31%, this ratio has increased in the casualty segment from 25% to 28% as renewed business is incorporated into our ceded program. This was offset by a decline in property ceded from 35% to 32% reflecting our decision to cede less business this quarter.

Now, I'll dive deeper into our financial results, and to begin with, we have reorganized our financial supplement to better align it with our three primary drivers of profit; underwriting income, fee income and investment income. We have enhanced disclosure around non-controlling interests and retained investments, while also removing duplicative information. I'll begin by discussing underwriting income where we reported income of $217 million for the quarter or a combined ratio of 78.5%. Both segments performed well in the quarter with property contributing underwriting income of $201 million and casualty contributing $16 million of income. Net premiums earned were approximately $1 billion up $99 million or 11%.

Our direct expenses which are the sum of our operational and corporate expenses totaled $61 million for the quarter, which is a decrease of $23 million from the second quarter of 2019. The ratio of direct expense to net premiums earned was 6%, a decrease of more than 3 percentage points from the comparable period last year, driven by strong operating leverage as well as lower transition and operating expenses.

Transition related expenses associated with the acquisition of TMR have declined by $12 million from $14 million in the second quarter of 2019 to $2 million in 2020. We anticipate these expenses will continue to wind down over the near-term. Additionally, operating expenses were down 2 percentage points, partially driven by about $5 million in savings from reduced travel, marketing and office operational expenses related to COVID-19.

Now, moving to the Property segment, where gross written premiums were up by $203 million or 24% from the comparable quarter, driven by rate increases, growth in lines with at (inaudible) renewals in Japan, mid-year renewals, and expansion of our Lloyd's delegated authority insurance book. We reported a current accident your loss ratio of 35% and prior year favorable development of 1% in the Property segment. We did have $8 million in adverse development in the other property book, which was driven predominantly by a variety of small events in the attritional book. This was more than offset by $15 million of favorable development in the property cat from reserve releases across the last three accident years.

Underwriting expenses were down 4 percentage points, reflecting improved operating leverage and a lower acquisition expense ratio in both property cat and other property. Overall, we reported a combined ratio of 59% in the property book, both property cat and other property were favorable -- were profitable, reporting combined ratios of 33% and 86% respectively.

Moving on to our Casualty results, where we grew gross premiums by $22 million or 3% primarily related to increases in underlying rate and growth of new and existing deals. While reported gross was $22 million, excluding the impact of TMR non-renewals, we estimate that organic growth in our Casualty segment resulted in more than $100 million of premium increases in the second quarter. The current accident year loss ratio was 68%, which is in line with our expectations. And finally, we reported a combined ratio of 97% with favorable prior development up 2%.

Now, I'll shift to our second driver of profit, fee income. Total fee income for the second quarter was $46 million made up of $27 million in management fees and $18 million in performance fees. Year-to-date, fees are up 32% compared to the first half of 2019 as our partner capital business continues to grow unperformed. As I mentioned at the beginning of my prepared comments, we've made several changes and improvements to the Financial Supplement, with Page 12 providing greater insight into how the non-controlling interest from our joint ventures business, impact our financials.

We have added a new table to this page that shows the amount of partner capital that we manage on behalf of DaVinci, Medici and Vermeer. This capital is reflected as non-controlling interest on our balance sheet and for the second quarter, totaled $3.4 billion up from $2.7 billion in the comparable quarter of last year. As a reminder, this non-controlling interest does not include partner capital related to Upsilon, Top Layer or Langhorne.

DaVinci, Medici and Vermeer reported solid results in the second quarter bolstered by low catastrophes and mark-to-market gains. The non-controlling interest charge attributable to these vehicles was $119 million, which reduced our earnings accordingly. Compared to the second quarter of 2019, the non-controlling interest charge increased by $47 million. This was driven by strong underwriting performance growth at partner capital and mark-to-market gains. Regarding Upsilon, which is not highlighted in the financial supplement total managed capital at the end of the second quarter was $2.1 billion, $1.8 billion of which belongs to our partners.

All premiums associated with Upsilon flow through our financial statements as gross written premiums. However, we treat our partner's portion of Upsilon as ceded premium. Therefore, only our 14% share is included in net written premiums. Fees we earned from Upsilon serve to offset operating and acquisition expenses.

And now closing with our third driver of profit, investment income. Financial markets snapped back in the second quarter in contrast to the extreme volatility we saw in the first quarter. Our investment portfolio also recovered mark-to-market losses from the first quarter of 2020 reporting total investment results for the second quarter of $538 million with realized and unrealized gains of $448 million, predominantly in fixed maturity and equity investments.

During the quarter, we increased both the allocation to and duration of investment grade corporate credit, both of which benefited our investment results as rates decreased and spreads tightened. Our fixed maturity and short term investment income for the quarter was $76 million and overall net investment income for the quarter was $89 million. Of the $89 million in net investment income, we retained $67 million with the remainder being shared with partner capital.

Our managed investment portfolio reported yield to maturity of 1.1% and duration of 2.9 years on assets of $18.1 billion, while our retained investment portfolio reported yield to maturity of 1.4% and duration of 3.7 years on assets of $12.7 billion. We're comfortable with our asset allocation and duration and we'll continue to monitor economic developments and the impact on our investment portfolio.

And with that, I'll turn it back over to Kevin.

Kevin Joseph O'Donnell

Thanks Bob. I'll start with comments on our Property segment, then move on to Casualty. Across the board however, the common denominator for the quarter from an underwriting perspective was that we achieved higher rates and better terms and conditions, in both our segments in almost all lines of business.

Starting with property cat, we had a disciplined renewal in Florida mid-year, executing a proactive plan to prudently manage our net risk and renew on our preferred core accounts. Our strategy going into the renewal was to push rate, as well as terms and conditions. Rates were up 30% to 40% on average. We were the first call for a number of purchases and were able to obtain private market rates, well in excess of firm order terms on a preponderance of our deals.

We consolidated our participation to a smaller number of more meaningful relationships in Florida, reducing the number of clients we support by about a third. For our Florida book, we've reduced our limit, while holding premiums flat and increasing expected profit. Overall, we reduced our southeast P&Ls both as a percentage of equity and on an absolute basis. There were several reasons we reduced in Florida at the June 1 renewal, affected claims handling has been a challenge for some Florida companies, especially those relying on independent claims adjusters.

We believe that claims adjusting and subsequent repair will be made more difficult, and therefore costly by the impact of COVID-19 and the restrictions it places on movement. Cat models do not reflect this shift. In addition, the environment of pervasive claims fraud remains unchanged, consequently, we chose to maintain relationships with our best partners in Florida, those who we believe will most effectively handle post-storm claims adjusting.

Ultimately it was our willingness to meaningfully cutback on Florida exposure that allowed us to aggressively and successfully push for higher rates. Outside of Florida, rates across our property segment were increasing prior to COVID-19. The crisis has accelerated these increases. For peak zone exposure, we saw rate increases of 10% to 20%, for non-peak exposure rates were up 5% to 10%. Even with increased rates, capacity was tied and we fully expect this momentum to carry through the January 1 renewal.

With the new capital that we have raised, we are in an excellent position to grow into the dislocated market. The widespread positive reaction to our capital raise and drilling strong recognition of our fortress balance sheet have further enhanced our reputation as a first-to-all market, which can bring certainty to the renewals of even the largest and most complicated reinsurance programs. In fact, during the quarter, we are able to provide bespoke solutions to a number of very large cedents seeking to reduce their volatility by utilizing our full suite of cat focused balance sheets. Renaissance Reinsurance Limited, DaVinci, Upsilon, Vermeer, Top layer and Syndicate 1458.

As I discussed last quarter, we've been monitoring the performance of our other property book closely and have been increasing on cat exposed risk where we believe we are being paid appropriately. We continue to optimize our other property portfolio with the renewal focus for this quarter being on proportional and per risk contracts, specifically with global clients. In the second quarter, we chose not to renew several large deals that did not meet our return hurdles; in our risk book, we increased on good programs and cut back where rates wasn't adequate. We continue to see ample opportunity in the US, primary E&S insurance market, where risk adjusted rates are up 20% to 30% as capacity tightens. Terms and conditions also improved with ceding commissions down materially especially on the most challenged programs.

Shifting now to ceded retro. June 1 is the second largest renewal date for the retrosessional protection that we purchased. As I have already mentioned, retro markets remain dislocated. We went to market early, engaged fully with brokers and had a successful renewal despite these challenging market conditions. Prices were up at mid-year as expected, but we were in a strong position due to the $400 million Mona Lisa cat bond issued in January. On average, the price we paid for retro increased about 20% over 2019's mid-year program. And as expected, we purchased less limit than last year and have higher attachment points. That said, we were happy with our portfolio and believe that we are in a strong competitive position.

Moving now to Casualty, the second quarter is a significant renewal period for our casualty business and we were able to execute our renewals in a precise and coordinated way. Like Property, rates were increasing across many casualty lines, prior to COVID-19, driven in-part by loss cost inflation trends. The increased uncertainty from COVID-19 is accelerating these pre-existing rate increases and rate continues to surpass trend in most lines, including general liability, umbrella, D&O, professional liability and cyber. The market has not experienced corrections of this magnitude in almost 20 years, with rate increase in the double-digit territory for many classes and well above what was anticipated at the beginning of the year.

In addition, ceding commission are reducing on many programs, amplifying the impact of rate increases. Over the year, we have focused on building strong positions on high-quality casualty programs. We believe this puts us in an excellent position to benefit from underlying rate increases as the market improves, as well as to grow on the best programs as others got back. With respect to COVID-19, we clearly articulated our risk appetite and our approach to exclusions. We were able to attain COVID-19 exclusion on many deals and we're only comfortable renewing business without one.

The underlying policy contained the COVID-19 exclusion, the product was intended to cover losses from economic recession and was appropriately priced, given the elevated uncertainty or where exposure was minimal. In several instances where we were not able to exclude COVID-19, we chose to walk away from business. Overall, however, we renewed our Casualty portfolio, largely intact and with an improved margin. There has been some speculation in the market that COVID-19 will suppress loss cost inflation in

2020, while this is possible, we believe that the underlying dynamic that led to this problem continue to exist and to the extent, it is currently muted loss inflation will resurface as the pandemic subside.

In closing, we overcame a number of challenges to outperform both financially and operationally in the second quarter. We exercised discipline at the June 1 property renewal and continued to build a market leading casualty book. Our COVID-19 risk remains manageable and we experienced strong gains in our investment portfolio.

Finally, we've begun the process of reopening our office which we'll begin to execute slowly but deliberately, and with that I'll turn it over for questions.

Thank you.

Questions And Answers

Operator

Thank you. (Operator Instructions) And our first question comes from the line of Elyse Greenspan from Wells Fargo. Your line is open.

Q - Elyse Greenspan {BIO 17263315 <GO>}

Thanks. Good morning. My first question I guess kind of goes back Kevin to some of your introductory remarks on you pointed to that you're seeing an improving market that could last a couple of years before what I believe you said. So, I'm just trying to tie that together to the timeframe that you guys -- with this over $1 billion of equity capital that you raised; over what time period do you think that you can put that to work? Would that be 2020, 2021 -- sorry are you thinking 2021 and beyond?

A - Kevin Joseph O'Donnell

I think that's a great question. We will look to deploy in 2021. We might find some opportunities that come up, but I should note most of the business in reinsurance is placed in the first half of the year. So, our capital raise was really targeting and deploying in 2021 obviously January being a very important date for that. As I mentioned that we have kind of two levers we're going to pull; one is we're going to restructure our portfolio and the other is we're going to grow into the opportunity. The restructuring is something that is 100% in our control. So, as we think about what the book looks like, we can absolutely deploy a bit on the target performance we had in 2021, and we feel confident that where the markets are and our observations -- the rate that we're seeing that we can deploy this in 2021 from an organic perspective, based on our performance as well.

Q - Elyse Greenspan {BIO 17263315 <GO>}

Okay. And then my follow-up there, we're obviously in the middle of wind season right now, right and it seems like it could be an active storm season, but obviously the flipside is, it could be an inactive storm season. So, if there's not a high level of hurricane losses, just based off of your view of one-one right now, do you think that there is enough momentum, can you just give us your initial thoughts on pricing there, to put the capital to use, if there is not an active storm season?

A - Kevin Joseph O'Donnell

Yes. So, I think there's enough uncertainty in the market and I feel confident about where rates are headed that even if there is relatively light number of land falling hurricanes or no land falling hurricanes that we're still going to have strong momentum moving into 2021. I think there could be substantial further dislocation if there's additional large losses from hurricanes in 2020.

Q - Elyse Greenspan {BIO 17263315 <GO>}

Okay, thank you. I appreciate the color.

A - Kevin Joseph O'Donnell

Yes, thanks.

Operator

Our next question comes from the line of Yaron Kinar from Goldman Sachs. Your line is open.

Q - Yaron Kinar {BIO 17146197 <GO>}

Hi good morning everybody. I guess, following up on Elyse's last question, I think we're also starting to see some capital raises and even from -- I think incumbents that are looking to get into E&S markets, how much does that impact the longer term opportunity? I think, in 2005 we kind of saw -- I think the raised capital kind of slowed down the rate story. Is there a chance, if that happens this time too?

A - Robert Qutub {BIO 15269353 <GO>}

So obviously, we're watching closely what's going on with both the capital raises into existing companies and new formations. That doesn't affect anything that we're trying to do other than it may change -- exactly as you're saying the environment in which we're conducting our own. We were executing a strategy. The way we look at it is, we build our strategy. We build our performance and we engage with our customers. We're not competing with that capital necessarily that capital is not informing our strategy. So, as we look at what we're trying to do -- I remain confident that regardless of the capital that's being raised by both by existing companies and by new formations, it shouldn't dislocate our plans for growth.

Q - Yaron Kinar {BIO 17146197 <GO>}

Okay. Longer term too, I can see how they wouldn't be ready necessarily to compete in the market in one-one, but maybe beyond that you could see a little more of a competitive environment?

FINAL

Bloomberg Transcript

A - Robert Qutub {BIO 15269353 <GO>}

I think that's a good point. You know, our goal is to deploy the capital we raised in 2021. The benefit of incumbency in this business is quite high, so as we see more demand for reinsurance we'll look to meet it with this capital and also as others look to recalibrate their books against the risk they want to take, we'll look to grow into that. So, as this other capital comes online, I think we're just in a stronger position and it will be up to us to execute our strategy to make sure we're not dislocated by it.

Q - Yaron Kinar {BIO 17146197 <GO>}

Got it. My second question and Bob I apologize if I missed it in your comments, but what was the source for the large realized gain this quarter? I just wouldn't have expected this large of a number considering the relatively short duration of the portfolio?

A - Robert Qutub {BIO 15269353 <GO>}

There is two sources, and you'll see in the supplemental, probably three quarters of it came from our fixed income and that was a result generally of our positioning -- we started late in the first quarter repositioning into some investment grade credit and we saw some opportunities in the spread we continued that in April and that gave us some benefit on that aspect of it coupled with the rebound of fixed income came back, actually stronger than it did when it gave back in the first quarter. Equities made a significant rebound, as we saw a significant resurgence in that over $100 million so that's the other quarter of it, you'll see that's how we get there.

Q - Yaron Kinar {BIO 17146197 <GO>}

Got it. Thank you.

A - Robert Qutub {BIO 15269353 <GO>}

Thank you.

Operator

And our next question comes from the line of Meyer Shields from KBW. Your line is open.

Q - Meyer Shields {BIO 4281064 <GO>}

Thanks. Can you just help me just clarify one point and that is, you have got to think being optimistic about this -- about the opportunities that will last on a multiple year basis. Am I wrong in thinking that the dislocation in the ILS market subject to this year's hurricane, but that dislocation shouldn't take more than 12 months to (inaudible) itself with the other?

A - Robert Qutub {BIO 15269353 <GO>}

So, I think I'm not sure how to answer that, but what I would say is there the ILS market has suffered from a couple of years in a row of trapped capital and in many instances what was trapped to being lost, particularly because of the developments in Michael and the Irma. So, I think there are some bruises in that market. I think the uncertainty about trapped capital and BI losses will be a awakening for many ILS capital providers as to better understanding the types of risk that they're taking. I think the retro market being heavily impacted again will weigh on appetites for ILS capital. And then finally, this has been seen as a low beta asset and you're seeing that it's suddenly correlating with losses they've taken elsewhere in their portfolios.

So, when I look at how ILS capital is allocated into this space, I think there's a lot of internal obstacles for the ILS portfolio manager to compete against other asset classes based on the uncertainty that they've realized over several years. So, when I think about ILS capital, we are a believer in ILS capital, otherwise we wouldn't have built everything that we built. But I think there are headwinds there that will certainly last through 2021 and depending on where the -- where other markets go and how losses develop, there could be some more interest over 2021 or the lack of interest will continue to persist.

Q - Meyer Shields {BIO 4281064 <GO>}

Okay. You know that's helpful. Thank you very much. Is there any useful rule of thumb that we can adopt in terms of how much net written premium, the additional billion dollars of common equity would support? I'm looking that through the lens of -- even a lot of it would be in either reduced retro purchases or additional third-party retro writings?

A - Kevin Joseph O'Donnell

Yeah. It's -- I understand your question. I think the way we look at it is, we're going to deploy -- one of the issues is, we have the money at the holding company. We will downstream it into different balance sheets based on how we can construct those to best leverage the return on the capital. So, it'll be different by the amount and business mix within each of the portfolios. So, I think, it's difficult for us to give you a 2:1, 2.5:1 or something like that ratio to think about the capital. I'd say, where we're going to focus on is maximizing return, and then down streaming the capital as appropriate to the balance sheet that optimizes the new opportunity and this capital most efficiently. So sorry, I can't be more clear, but it's not a simple answer, I was just saying what the ratio is.

Q - Meyer Shields {BIO 4281064 <GO>}

No, completely understood. Thanks so much.

A - Kevin Joseph O'Donnell

Yes.

Operator

Your next question comes from the line of Josh Shanker from Bank of America. Your line is open.

Q - Josh Shanker {BIO 5292022 <GO>}

Yeah. Good morning, everybody. I was trying to figure out (Technical Difficulty) that you're optimizing the portfolio. But in the decision to cut PML, I mean I guess do you expect that I still -- I'm not satisfied to get the answer. It seems like there would have been a opportunity to increase exposure here at this moment, right now as well as one-one. I mean, you went into a little bit but I just thought there would have been more exposure in Florida given what you're talking about rate and what not. Can you go into sort of when you raise the capital maybe timing there was an issue there, can you walk through it a little bit better?

A - Kevin Joseph O'Donnell

Sure. You broke up for a little bit, I think your question is why didn't we grow more in Florida. Why did we raise the capital now, because with the rate change, it would have been good for the portfolio?

Q - Josh Shanker {BIO 5292022 <GO>}

Or maybe, I mean maybe it was because on June 2, maybe you didn't have the capital, I don't know. I just thought that there was a great opportunities to deploy here and you went to cutting PML, I mean, yes you cut PML to more efficient portfolio. But here we have an non-cat quarter with a 12%, 13% ROE, it just seems like there was an opportunity already past that maybe wasn't taken advantage of?

A - Kevin Joseph O'Donnell

Okay. So when we looked at Florida. Firstly Florida is a much smaller part of our portfolio. Just let me outline that with a premium for Florida currently is significantly less than 5% of our overall premium. So growing and cutting in Florida means a lot less now than it did for a company like us 10 years ago. Secondly, the decision not to grow was ours. So, we had ample opportunity to put more company -- to more capital at risk and we decided that the uncertainty in the market didn't warrant the exposure of significant more capital. We did bring some more ILS capital to the market through the $250 million that we commented on as raising. So, when I think about the opportunity in Florida and the opportunity for this capital, we raised it early because we needed to have conversations with our clients early to make sure that they understood that we were coming in on positively positioned to grow at one-one. Whether we deploy it this year or not, is not going to matter over the long-term our success for having raised this money. Our success in raising money is whether we can deploy it in 2021 and keep it deployed as time passes and make sure it's accretive.

So, we didn't put an emphasis on trying to grow in Florida in the conversations we had with the investors, we were clear that, that is not what the target of this capital was, and what we were doing is looking to the future to make sure that in 2021, we take advantage of the opportunity and construct the best portfolio. So, it's nothing about our actions in Florida -- we're different than what our expectations were and Florida is a significantly smaller part of our portfolio than it used to be and it is kind of the way I would summarize it.

Q - Josh Shanker {BIO 5292022 <GO>}

Okay, that's good. And an unrelated question, do you have any approximate dollar number for how much expenses you saved in the quarter by not being able to travel and whatnot and how much that helped EPS?

A - Robert Qutub {BIO 15269353 <GO>}

Yeah. Josh, it's Bob. I talked about that in the prepared comments, it's about $5 million -- lower travel -- lower travel, mostly covered that. There were some marketing and reduced office expenses. We kind of expect that to hold through this quarter here, we don't expect much to open up. We'll see how that develops over time, but as offices start opening up, we'll see some of that come back, the bulk of its going to be travel until the markets open up for business travel that probably will stay down slightly.

Q - Josh Shanker {BIO 5292022 <GO>}

Thank you.

A - Kevin Joseph O'Donnell

Thank you.

Operator

Our next question comes from the line of Jimmy Bhullar from JPMorgan. Your line is open.

Q - Jimmy S. Bhullar {BIO 4278955 <GO>}

Hi, thanks. So first I had a question on just your view on COVID losses -- to what extent do you think you've got sort of clarity on ultimate claims and you have already booked most of them versus just ongoing uncertainty in some lines whether it's business interruption or something else?

A - Kevin Joseph O'Donnell

COVID-19, I think is something we'll be talking about for many quarters, as we go forward. You know firstly it's still an ongoing -- the pandemic is ongoing as we all see in the news every day. And I believe that this will result in very large losses has not changed. We think the best way to handle COVID related losses is with the framework that we have, and apply discipline to that framework. So, we think about the framework we're trying to be as transparent as possible recognizing that this loss is going to be slow to develop and very difficult to estimate.

So, if you think about the three categories, we go from pretty transparent and the most direct impact from the virus to Category 2 which have less direct tie to the virus and probably more related to the recession and the depth of the recession which is unknown and the length of the recession is unknown. It's probably the primary driver for loss into Category 2. And the third one is a bit of an unknown because of the challenges that will continue, I think for many -- a significant period of time with regard to how the BI losses are or not covered in primary policies.

So, what we're trying to do is provide a framework that's transparent and be disciplined in our approach to that framework. So, with that, it is not possible at this time to come up with what a final COVID loss related number is because we believe the event to be ongoing and it's largely dependent on the shape of the recession.

Q - Jimmy S. Bhullar {BIO 4278955 <GO>}

And as you think about losses for your balance sheet, are you comfortable deploying the capital that you've raised even with that uncertainty or is it likely that you'll keep some of it as long as there's not great visibility into what your exposure could be?

A - Kevin Joseph O'Donnell

It's a great question. I think the way we think about it is, although a number is difficult to produce we have done extensive analysis on understanding what our exposure can be, and then testing that exposure under -- under very extreme scenarios as well as more -- more likely scenarios. So, all that said and done, I feel very, very comfortable about our balance sheets and the exposure that we have.

The realization of exposure to loss maybe it temporally is difficult to predict, but none of it affects our appetite for risk and none of it changes our willingness to deploy this capital. So, when I think about the capital raise that we have, it's a 100% opportunistic looking for the future and it is not a reflective potential uncertainty with related losses potentially from COVID-19.

Q - Jimmy S. Bhullar {BIO 4278955 <GO>}

Okay. And then just lastly on expenses, you mentioned -- you gave the number out on the travel expenses, but as we look at your expense ratio overall it was fairly low. How do you see that sort of ramping up now that more people are back at the office and I'm assuming, your marketing-related activity will pick up as well? Do you think the expense ratio will stay depressed through the second half of the year or go back to more of a rate that it was at in 1Q?

A - Robert Qutub {BIO 15269353 <GO>}

Yes Jimmy, two things on that one. One, is we expect the COVID-related reductions just because we're not working in the office that will stay around for a while because we don't expect everything to get back to business as usual. But more importantly, the drivers, if you look back over our history, I talked about we leverage our operational base extremely well, relative to the gross or the net premium written, and I talked about that. So we do step investments, we expect over time as we deploy more capital out there, that volumes increase, we'll have to spend more on the infrastructure. But, if you look back over time, you'll see we've demonstrated a strong track record for leveraging our operating platform.

Q - Jimmy S. Bhullar {BIO 4278955 <GO>}

Thank you.

Operator

Our next question comes from the line of Phil Stefano from Deutsche Bank. Your line is open.

Q - Phil Stefano {BIO 18965951 <GO>}

Yeah. Thanks again good morning. It feels like messaging earlier in the year, may have been around the potential to withhold some capacity, at least into the mid-year renewals with an expectation that there might be new purchases of reinsurance, just to help manage volatility and the COVID uncertainty. Does it feel like that demand came through or is it beginning to come through or -- have the conversations you had feel like this might be more of a 2021 event, which is kind of helping to steer where the equity raise can be put into play?

A - Kevin Joseph O'Donnell

Yeah. As we said, I think, in the last call trying to empathize, we think that the COVID is -- the pandemic is ongoing and with that, we believe that the losses will emerge slowly. All that's kind of at the lens in which we're looking at the market, we think the opportunity for us to deploy this capital is in 2021. Should there be additional purchasing, we've been in good contact with our customers and if they are looking to supplement their purchases in 2020, we're having those discussions. But I don't want to leave with a false impression that we're going to deploy this in 2020, our goal is to deploy it in 2021.

Q - Phil Stefano {BIO 18965951 <GO>}

Understood.. I guess my follow-up question will be, was there a reaction from the ventures capital partners in response to the equity raise, and I guess, part of the wonders whether they view the increase in pricing and maybe to an extent them being crowed out as you have the ability to do additional business yourself on the heels of the equity raise? Maybe that's an unfair correlation I'm trying to draw, but just curious has the conversations with the capital partners changed in anyway?

A - Kevin Joseph O'Donnell

Yeah, that's a great question. I've spoken to all our largest investors over the last couple of weeks, and we've spoken to all our investors over the last few weeks. So, firstly if you think we raised $250 million in the quarter and deployed it, so we are continuing to bring risk to third party capital. Going into the one-one renewal, the way I think about our partner capital is that they have a right of incumbency on the deals that they're on, just as we do.

So, when I look at how we are going to structure the portfolios, we were not going to derisk them to deploy the capital that we have. What we're going to do is, is optimize their portfolio against their rate environment and the opportunity and then build our portfolios with the new equity. The one likely area where the risk will be underwritten in a material way is in the retro market and in the aggregate market.

The vehicle which mostly takes that risk for us is Upsilon. So, I anticipate that the way Upsilon will be structured, consistent with the mandate for the risk that it targets will be less appealing to buyers than other vehicles that we have, and with that if there is a shift of risk, I think it's more likely to come from Upsilon than it is from certainly Vermeer, DaVinci, Top Layer and some of our other balance sheets.

So, we'll constantly look at how we can best match efficient capital with desirable risk. But, we will not look -- and it's not our objective to cherry pick the investors that we have. We give them right -- right to participate alongside in capital raises and they are true partners to us in the risk that we take.

Q - Phil Stefano {BIO 18965951 <GO>}

Got it. Thanks, and hope all continues to do well.

A - Kevin Joseph O'Donnell

Appreciate it, thank you.

Operator

Our next question comes from the line of Elyse Greenspan from Wells Fargo. Your line is open.

Q - Elyse Greenspan {BIO 17263315 <GO>}

Hi, thanks for taking the follow-up. My first question, I guess Kevin, goes back to something that you just answered. So, in response to the capital you said at holding company and you would downstream it depending upon where you can get the best returns on that capital. But, is the desire to use most of the equity raise on your own balance sheet or is it also depending upon opportunities, you could use some of that capital in partnership with some of your venture capital?

A - Kevin Joseph O'Donnell

Yeah. It is a good question. I think, it could to be a little of everything. So, I anticipate -- if you look at our percentage on our vehicles and you look at the size of the capital raised, most of it will be deployed on our fully owned balance sheets. That said, if there are opportunities to increase DaVinci's participation in the market or others, we'll look to deploy alongside our partners into those vehicles. So, when I think about it, I would think about it as mostly on our owned balance sheets. That said, we will also look for ways in which we can bring more risk to -- DaVinci is probably the most likely one and we can certainly continue to invest more in Upsilon should that vehicle -- should we want to right size that vehicle.

The issue is what's written on some of these will likely shift in structure where the risk appetite of the vehicle may not be as defined -- it may not be as natural a fit for the vehicle and with that when we limited it, which has the broadest appetite is a likely home for it.

Q - Elyse Greenspan {BIO 17263315 <GO>}

Okay that's helpful. And then my second question, so on the TMR side, you guys had called out right this is the first quarter we annualized the deal so the non-renewal of some of the business had an impact on the growth within specialty casualty. I know when you guys announced the deal, you had laid out some figures for what you expect it to retain of the book business, but then my sense is, is we've had conversations, you got incrementally more positive on some of the business that you would thought you might not renew. So, can you just give us a sense of how much of that business needs to not renew like, as we think about the modeling over the next three quarters within that specialty business?

A - Kevin Joseph O'Donnell

Yeah, I'll give you back an answer. We did start last year -- we looked at -- we walked you down for about a $1.2 billion in premium down to about $700 million is what we said we thought we would be able to renew. Going through the books, getting to know the terms, getting to know the understanding and the relationships gave us a much more favorable view of some of the books we were unsure of at the time.

So, we did outperform our expectations on the renewal of the TMR book. We did probably well over $800 million versus the $700 million which we felt very comfortable with. But having said that, there's a strong element that we did not renew, and I talked about our implied growth was more of $100 million than it was $20 million -- things we didn't renew Elyse was like auto, some things like that, drove it down and general liability you'll see that coming down on pieces of it. But we generally renewed a lot more of the book than we felt, got to know it better and we feel strong with what we've underwritten.

A - Robert Qutub {BIO 15269353 <GO>}

Yes. The good news about having the $700 million target and then getting [ph] $830 million [ph] is that we found more good business than we originally hoped and that was only added to our confirmation, so that was a good deal for us to engage in.

Q - Elyse Greenspan {BIO 17263315 <GO>}

Yeah that's helpful. Thank you for the additional color.

A - Robert Qutub {BIO 15269353 <GO>}

Sure.

Operator

I would now like to turn the call back over to our presenters for closing remarks.

A - Kevin Joseph O'Donnell

So I appreciate you dialing in for this quarters call. We feel great about the quarter that we just had, and we feel highly engaged and highly confident about our ability to deploy the $1 billion as we move towards the one-one renewal, and look forward to speaking to you next quarter. Thank you.

Operator

Operator: Ladies and gentlemen, this concludes today's conference call. Thank you for participating. You may now disconnect.