Q2 2016 Earnings Call

Company Participants

- Craig W. Howie
- Dominic James Addesso
- Elizabeth B. Farrell
- John P. Doucette
- Jonathan M. Zaffino

Other Participants

- Amit Kumar
- Elyse B. Greenspan
- Jay Gelb
- Josh D. Shanker
- Kai Pan
- Michael Nannizzi
- Quentin McMillan
- Sarah E. DeWitt

MANAGEMENT DISCUSSION SECTION

Operator

Good day, everyone, and welcome to the Second Quarter 2016 Earnings Call of Everest Re Group Limited. Today's conference is being recorded. At this time, for opening remarks and introductions, I would like to turn the conference over to Ms. Beth Farrell, Vice President of Investor Relations. Please go ahead.

Elizabeth B. Farrell {BIO 1986541 <GO>}

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

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

Now, let me turn the call over to Dom.

Dominic James Addesso {BIO 1428096 <GO>}

Thanks, Beth. Good morning. We're pleased to report this morning another favorable quarter, particularly during a period where there has been a number of global cat events for the industry. Despite these events, we posted $3.67 of net income per share for the quarter. On an operating income basis, earnings were $3.17 per share compared to $5.03 for last year's second quarter.

This difference is primarily due to cat losses with a net impact of $105 million after reinstatement premiums and taxes. Also impacting the quarter were foreign exchange losses of $27 million or $0.44 per share after tax. Excluding cats, the underlying attritional combined ratio is virtually the same at 86% in this year's second quarter versus last.

Furthermore, the attritional loss ratio has actually improved year-over-year. This highlights the changes to business and product mix that have been achieved. You will hear later from the business leaders describing some of those changes, but it is worth emphasizing, as we have in the past, that the flexibility and nimbleness of our business model continues to yield good outcomes.

Of course, offsetting the decreased loss ratio is an increased expense ratio, as we invest in our insurance build-out. As I mentioned in the first quarter, this will moderate through time, thereby allowing the improved loss ratio to work its way into the overall combined ratio.

This moderation is already occurring as you note the decrease in the expense ratio from the first quarter to the second quarter. Notable, however, is that the total expense ratio for the insurance segment, coming in at 28.3% for the quarter, remains several points lower than our competitors. And we intend to maintain this advantage as we expand the operation. That expansion is well underway.

Growth in the insurance book is beginning to take hold as gross premiums increased by 32% in the quarter. On the other hand, somewhat offsetting this is the decline in the reinsurance segment. Rate levels and foreign exchange continue to affect this sector. Nevertheless, as John Doucette will later detail, we continue to move our capacity to the better risk-adjusted business and new product areas, particularly credit-related. I am always encouraged by our ability to remain bottom-line focused.

Another item of interest in the quarter was the recovery of investment income in the lower than expected first quarter due to improvements in our limited partnership investments.

On a year-to-date basis, we are still slightly off of last year but given the continued interest rate levels, this is completely within our expectation. The impact of lower rates will diminish over time as older maturities come in.

While overall returns on capital continued to face pressure, we remained as one of the top performing companies in the industry. In an environment where the so-called risk-free rate is low-single-digits, our returns are quite strong with a 9.4% ROE and growth in book value per share of 7% in the first six months.

Our book value per share growth also benefited slightly from our continued share repurchases during the quarter. However, this was less than anticipated due to a pause in buying when cat events began to emerge during the quarter. This was not a concern over the amount, but just the fact that we had knowledge of events affecting the quarter.

Finally, I would like to address our other announcement regarding our crop insurance business. As you may have seen, we have received the letter of intent for the purchase of Heartland, our crop MFA from CGB Diversified Services.

This transaction creates an opportunity for us to more quickly expand and diversify our exposure to this business on a more efficient basis. In the short-term, there will be no appreciable premium impact. However, it will now be recorded as reinsurance rather than insurance.

In addition, we will see an expected improvement in margin due to the benefit of a lower expense structure. Buyers' scale creates a more efficient deal for us and given their growing presence in the market, we should continue to benefit as a result of our strategic alliance.

In summary, we believe there're many great initiatives underway at Everest. Yes, there're many challenges, but we continue to work through many of them successfully. My colleagues will next (06:18) some further details on the progress we are making. I look forward to your questions after that.

Thank you and now with Craig for the financial details.

Craig W. Howie {BIO 17579923 <GO>}

Thank you, Dom, and good morning, everyone. Everest had a solid quarter of earnings with net income of $156 million. This compares the net income of $209 million for the second quarter of 2015. Net income includes realized capital gains and losses. On year-to-date basis, net income was $327 million compared to $532 million for the first half of 2015. The primary differences were catastrophe losses and foreign exchange.

After tax operating income for the second quarter was $134 million compared to $225 million in 2015. Operating income year-to-date was $357 million compared to $554 million for the first six months of 2015. The overall underwriting gain for the group was $234 million for the first half compared to an underwriting gain of $307 million in the same period last year.

In the second quarter of 2016, the group sold $149 million of current year catastrophe losses net of reinsurance. Of that total, $90 million is related to losses from the Canadian wildfires, $36 million related to Texas hailstorms, and $23 million related to the earthquake in Ecuador.

The 2016 cat losses were partially offset by $25 million of favorable development on prior-year cat losses primarily from the 2011 Japan earthquake. The net impact of these losses after reinstatement premiums and taxes was $105 million. This compares with $23 million of catastrophes during the same period in 2015.

The overall current year attritional combined ratio for the first six months was 85.7%, up from 84.5% for the first half of 2015. This is primarily due to the one point increase in the expense ratio. Our year-to-date expense ratio rose to 5.7% as we anticipated with the build-out of the insurance platform and our Lloyd's Syndicate, but it was below first quarter 2016 expense ratio of 5.9%.

Foreign exchange is reported in other income. For the first half of 2016, foreign exchange losses were $31 million compared to $44 million of foreign exchange gains in the first six months of 2015. Both of these results are unusual and represent a $75 million pre-tax swing year-over-year. The 2016 foreign exchange losses primarily reflect the weakening of the British pound during 2016 related to the Brexit vote.

The foreign exchange impact is effectively an accounting mismatch, since it's offset in shareholders' equity for translation adjustments and unrealized gains due to the positive impact of holding foreign investments that are available for sale.

Overall, we maintain an economic neutral position with respect to foreign exchange matching assets with liabilities in most major world currencies. Other income also included $3 million of earnings and fees from Mt. Logan Re in the first six months of 2016 compared to $7 million of income in the first half of last year. That decline essentially represents the impact of catastrophe losses during the first half of 2016.

On income taxes, the 11.9% year-to-date effective tax rate on operating income was lower than the 13.9% tax rate at this time last year. This was primarily due to the foreign exchange losses and the higher level of catastrophe losses in 2016.

Stable cash flow continues, with operating cash flows of $674 million for the first half of 2016 compared to $532 million in 2015 which, in part, is reflective of our strong reserve position compared to actual paid losses.

As for loss reserves, last week we released our sixth annual global loss development triangles for 2015. There were no major changes since the 2014 release. Our overall quarterly internal reserving metrics continue to be favorable.

Shareholders' equity for the group was $8 billion at the end of the second quarter, up $377 million or 5% over year-end 2015. This is after taking into account capital return for $186 million of share buybacks and the $97 million of dividends paid in the first half of 2016, which combined, represent a return of 87% of net income. Our strong capital position leaves us with capacity to maximize our business opportunities, as well as continued share repurchases. Thank you.

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

John P. Doucette {BIO 7178336 <GO>}

Thank you, Craig. Good morning. Despite a very active quarter for the industry with property catastrophe losses around the world, our reinsurance book performed well with $97 million of underwriting profit. This outcome highlights both strong underwriting by our experienced underwriting teams and the benefit of a mature, well-diversified book of business. We maintain a highly diversified portfolio by line and geography around the globe, which allows underwriting profits in one part of our book to offset losses that might arise in another part of the book.

Our sub-90% combined ratio for reinsurance for the quarter demonstrates the value and robustness of this strategy despite all the cat events. For our total reinsurance segment, net premiums were $771 million, down 8%. On a constant currency basis, they are down approximately 6% as we carefully manage our net reinsurance book with hedges, higher attachment points and reduced exposures on deal with less attractive risk-adjusted returns.

Our reinsurance underwriting profit was $80 million lower than the underwriting profit in Q2 2015. The difference driven predominantly by the $85 million in cat loss in this quarter in the reinsurance segment compared to $27 million of cat losses in Q2 last year. Underwriting profits were also impacted by lower net earned premium and exchange rate fluctuation. Drivers of lower net premium this quarter were non-renewables and reductions on some property pro rata treaties, which did not meet our risk adjusted return requirements. The attritional loss ratio this quarter is 53%; two points below Q2 last year and in line with Q1 as well as the full year of 2015.

Business mix and deployment and capacity in profitable areas such as mortgage and credit, helped us maintain strong loss ratios despite tough reinsurance market conditions. The Q2 attritional combined ratio of 82.1% is up slightly from the 2015 full year 81.8%, but down one point when compared to Q2 2015.

The improvement was largely driven by a four point year-over-year improvement in U.S. reinsurance which had been impacted by higher level of attritional losses for weather and large risk events last year.

The International segment also improved with lower commissions in the quarter. The Bermuda segment though experienced a higher attritional combined ratio, primarily due to commissions and changes in business mix.

Now some color on our June 1 and July 1 reinsurance renewals, which reflect approximately 10% and 15% respectively of our full-year reinsurance premium. June 1 renewals are mainly quartile (15:54). Changes in programs varied, but the renewal process was orderly. Some of the largest programs shrank, as we expected and we reallocated capacity to larger and new layers per preferred client. Rates were up by low-single digits.

The Florida renewal market felt like it had found the floor with more treaties not fully placed and more shortfall covers coming to Everest. We are pleased with the overall results of our June 1 renewal. And with the reunderwriting of some underperforming treaties, we head into the wind season with somewhat reduced net PML for southeast wind compared to last wind season. At July 1, the U.S. property market also felt as though it had bottomed out and the rates were closer to flat. This provides a good start to the upcoming 1/1 renewal discussions.

Outside the U.S., the July 1 market conditions for short tail were less rosy and still very competitive in Europe and Latin America. However, Asia and Australia renewals were better, as we found more attractive places to deploy our capacity. In Canada, the Fort McMurray wildfire loss is the largest insured loss in Canadian history and reinsurance rates were up substantially. We seized the opportunity to deploy more capacity at higher pricing, particularly with the demand for backup covers in this region. The other loss affected areas around the globe also had increased rates at July 1.

The market for 7/1 casualty business also felt as though it was finding a floor with several programs renewing as expiring, more resistance by reinsurers to broaden terms and conditions. And some high profile treaties with low take-up were either pulled from the market or repriced with more favorable terms.

Anecdotally, we have heard some broker conversation is now shifting to managing client expectations on renewal pricing, terms and conditions. We continue to find pockets of attractive long-tail reinsurance, including auto liability business. And we also continue to provide meaningful capacity in the mortgage space where there remains a robust pipeline of attractive business.

In recent months, we continue to add strong talent to our reinsurance underwriting bench. In Europe, U.S., Latin America, Singapore, Canada and Bermuda, as well as further expanding our footprint into one-off structured risk solution. These deals are complex, difficult to source and require a broad set of underwriting, accounting, actuarial, legal, tax, contract, awarding and structuring capabilities to execute them successfully. These opportunities are diversifying and much more shielded from the broader market pressures and therefore provide meaningful margins and strong risk adjusted returns adding to Everest bottom line.

We are also seeing several reinsurance opportunities driven by macro issues including capital and solvency requirements created by the market turmoil including Brexit, Solvency II, Dodd-Frank and related regulatory changes around the globe; profit and expense pressures at large clients who are now motivated to buy more reinsurance; Florida and other clients looking to expand geographically and the additional reinsurance capacity to support their growth; and some global clients are buying down retentions for individual risks or territories. Even in the midst of a tough market, these and other demand drivers provide accretive opportunities for Everest to capture as the leading global reinsurer.

In Mt. Logan, we increased the number of investors, opened new fund and raised additional capital from existing investors. Overall, AUM is about flat compared to last quarter given some redemptions. We expect long-term growth and interest by investors to continue given the unique Logan Everest value proposition which has resulted in best-in-class returns every year since Logan's launch.

As we have reached Logan's third anniversary, new types of investors, which we have been engaging with for some time, opened up to potentially invest in the platform. Through Logan, and additionally Kilimanjaro cap-ons, traditional reinsurance and ILWs, we continue to optimize our net book which remains well within our long-standing group risk appetite.

We are pleased with the outcome of both our quarters' underwriting results in the phase of several cat losses and large risk losses and the outcome of our June and July renewals despite the current market conditions. And we are well-poised for a solid finish in the back half of 2016.

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

Jonathan M. Zaffino {BIO 16652236 <GO>}

Thanks, John and good morning. Everest Insurance continued its expansion in the second quarter as we've made steady progress on our core strategic initiatives. We experienced another quarter of solid growth across our global operation, marking the sixth consecutive quarter of underlying growth with contributions from each insurance business unit.

Echoing earlier commentary, our North American division results, our largest insurance division were impacted by cat activity within the quarter. Despite this, our underlying attritional performance was solid and in line with our expectations. As announced yesterday and discussed on this call given the sale of Heartland, I will share 2016 numbers with you excluding this operation. All results including Heartland are outlined in the financial supplement release yesterday.

Our global insurance operations inclusive of the North American division and Lloyd's, gross written premium increased 23% quarter-over-quarter to $405 million, while net written premiums grew to $343 million, an increase of 19% over the prior year quarter. Looking at the first half, again, excluding Heartland, we produced gross written premium of $764 million, an increase of 17%; and net written premium of $652 million, an increase of 12%.

As mentioned in previous call, net written premium growth slightly lags gross written premium growth primarily due to a marginally more conservative reinsurance strategy in our U.S. operations as we add new businesses. The insurance segment GAAP combined ratio for the quarter ex-Heartland was 109 impacted by 13 points of cat activity or $38 million. This was attributable to exposure with our U.S. and Canadian property portfolios from the Texas tail events in April in the Fort McMurray wildfire.

On an attritional basis, the calendar year combined for the quarter improved to 95.7%, while the attritional loss and loss expense ratio for the quarter improved 130 basis points over the comparable prior year period to 66.9%.

I'll now turn to the performance of our major insurance segments, provide an update on market conditions and also briefly comment on the strategic expansion of the Everest Insurance platform. Although the quarter was impacted by cat activity in the U.S. and Canada, we remain very encouraged regarding our progress in the buildout of our global insurance operation, a result of the underlying portfolio and the opportunities ahead.

Within our P&C operations, both our U.S. and Canadian units demonstrated solid growth in the quarter. Gross written premium was up nearly 18% in the U.S. and up 22% in Canada. Further our Lloyds Insurance operation contributed nearly $11 million in gross written premium in the quarter to this segment which we expect to accelerate in the months ahead. Nearly, every underwriting unit contributed to these results. Although similar to the first quarter, the growth varied across units in line with the business.

Of note in the second quarter, we were pleased to see a meaningful contribution of 5% of premiums from our various new North American underwriting units launched principally over the past six months. Again, it is early in the growth base for these businesses and we've remained optimistic about their trajectory.

Our A&H group experienced another strong quarter of growth, registering a nearly 42% increase quarter-over-quarter. Our efforts to enhance our platform via expanded product and distribution capabilities are proving successful and opportunities in certain Medical Stop Loss markets headlined this quarter's growth.

Turning to the rate picture, the second quarter evidenced many of the same dynamics and challenges as those in the first quarter. While we did experience marginally more rate pressure in the second quarter, actual results were mixed by line of business. As noted earlier, our attritional loss ratio continues to improve despite this pressure due to changes in our mix of business and various underwriting actions taken on select portfolios and the achievement of positive rate in various areas mainly commercial auto.

Further, we continue to believe that for the majority of lines, we are operating within a relatively tight range, plus the magnitude of rate volatility is limited. In the U.S., the property market overall continues to see low double-digit rate decreases on average. However, there are signs of moderation as the market seeks a bottom. Clearly, pressure from recent cat activity in the quarter is having an impact, but it's too soon to quantify this.

Additionally, we are also noticing some select tightening in terms, particularly in states prone to convective storm activity. Third-party casualty lines are mixed with slight pressure or even flattening for both general liability and excess casualty line, once again offset by positive rate movement in commercial auto. As in the prior quarter, management of professional lines continued to experience mid-single-digit decreases overall. There remains more intense pressure on excess layers with the rate reductions moderating on the primary.

The work comp market also experienced moderately more pressure in the second quarter with low to mid-single-digit decreases being common. The remaining pockets of opportunity across classes, segments and geographies, although we continue to note new and expanded competition in this market, and we'll watch this closely in the month ahead. And within the A&H market, the Medical Stop Loss segment remains competitive other than for accounts with challenged and loss experience.

Turning to Canada, the liability market mimics that of the U.S., slight rate adjustments are noted, yet remained essentially flat year-over-year. The property market likewise remains relatively flat. Coast of Fort McMurray loss, there had been some pockets of increased rate adjustments within various territories and class of the business.

Although early, we are not seeing any wholesale forming across lines, we will keep a close eye on the market to see the tone changes as we near the 1/1 reinsurance renewals. So again, a mixed market landscape depending on the many factors influencing the various lines of business. That stated, due to our increased product depth across geographies, we are able to seize profitable growth opportunities despite challenging market conditions.

Final plot regarding the strategic expansion of our global insurance operations. We continue to capitalize on the dislocation within the commercial market to build out our global specialty insurance capabilities with the new and enhanced products, additional leadership and underwriting debt and expanded geographic reach. Each of our operations are making excellent progress on their 2016 goals, and we anticipate increased momentum from actions executed over the past year.

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

Elizabeth B. Farrell {BIO 1986541 <GO>}

Operator, we're ready to take questions now.

Q&A

Operator

Thank you. Our first question is from the line of Michael Nannizzi with Goldman Sachs. Please go ahead.

Q - Michael Nannizzi {BIO 15198493 <GO>}

Thanks so much. Maybe to start a bit on the insurance book and the growth there; clearly, a very nice growth. Are the dynamics in the markets that you're growing in, is there a shortage of capital that is allowing for you to pursue growth and continue to see profitability improve or what other dynamics are at play just because I haven't seen a lot of growth in insurance from some of our other companies so far? So I'm just wanting to get an understanding of the dynamics there. Thanks.

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

Michael, I don't think it's a case of capital. We all know that this industry is awash in capital. I think it's really taking the opportunity to – there's certain markets in particular (30:12). Companies are changing and the marketplace is always in flux, and I think brokers are in particular always looking for highly rated carriers to come into the space to either replace markets that are reshaping their own portfolios or their distribution for one reason or another or changes in their own teams. In addition, perhaps upgrading some of the credit quality of markets that they offer to their customers. So, it's not about capital, it's more about taking advantage of opportunities from what I would describe as dislocation and the offering that we can make to brokers of top quality paper.

Q - Michael Nannizzi {BIO 15198493 <GO>}

Got it. Okay. So these are opportunities that you're not winning on price. Specifically, you're able to come into the market to help fill the gap based on the profile of reinsurance counterparties, your – the brokers are the insured ones. Is that (31:21)?

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

Good, good. I thought, what I was answering was an insurance question, I thought that's what you were referencing, correct?

Q - Michael Nannizzi {BIO 15198493 <GO>}

Yeah. You're insured. So, either brokers that you're placing – you said that brokers like your rating and profile. And so, I would think that either the brokers wants you there, and that's part of the reason why you can write the business at attractive profitability or the insured themselves want you there? Was that...

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

What I was specifically addressing, that was the insurance segment, not the reinsurance segment, although some of the same qualities are there as well. And also, remember that on the insurance side, we've hired some notable talent in the industry, and with that comes relationships and business flows that way as well.

Q - Michael Nannizzi {BIO 15198493 <GO>}

Got it. I mean, I was saying, insured, not insurance. But okay, that's fair. And then, I guess is it possible to give us a little bit more color on the impact of the sale of the Crop business? How much premium should come out of the insurance segment? How much should we expect to come into one of the reinsurance segment, I guess, in U.S. reinsurance? Just any context on – and was there a dollar amount for the sale or was it all kind of part and parcel of an exchange of the franchise for a reinsurance agreement on the back of that?

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

Okay. Well, we're not at this point, since it's just really a letter of intent, we're not disclosing...

Q - Michael Nannizzi {BIO 15198493 <GO>}

Okay.

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

... (33:06) transaction. But I can tell you that there will be no material impact of gain or loss from the sale of the company. As I mentioned in my comments, that the premium impact at least in the short-term for the group will be minimal. It would be about the same, in other words. So, right now, we have approximately $200 million of premium in insurance base, that will transition forward to and can be reflected in the reinsurance segment.

So, it'll be about the same, at least in the short-term. And then, of course, going forward, our participation with the buyer on reinsurance arrangements could – and their expansion could make that the reinsurance premium go up over time. But with other (34:00) significant premium change to the group, it's just basically shifting it from one segment to the other as of what we think has improved profitability.

Q - Michael Nannizzi {BIO 15198493 <GO>}

Got it. Okay. Great. Thanks, Dom. And then just on the prior year development of attritional cat, I just wanted to understand, was there a reason that number, the 2011 development didn't go into a prior year category and why it ended up in – anyhow, it was just accounting, but why that ended up in the current accident quarter attritional cat load?

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

Mike, this is Craig. We show cats on one line. That's the only reason we don't breakout prior year cats and current year cats. That's the only significant. That's the reason we broke it out in our discussion topic for the call.

Q - Michael Nannizzi {BIO 15198493 <GO>}

(34:50)

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

(34:52) originally. So, it flows through the same line item, if you will, on the second quarter.

Q - Michael Nannizzi {BIO 15198493 <GO>}

Got it. Okay. So, in the past, when you've had reinsurance prior development, that's been casualty development or underlying loss ratio development but not catastrophe development. Is that the difference?

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

That is correct.

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

That is correct.

Q - Michael Nannizzi {BIO 15198493 <GO>}

Okay. Great. Thanks so much.

Operator

Our next question is from the line of Jay Gelb with Barclays. Please go ahead.

Q - Jay Gelb {BIO 21247396 <GO>}

Thank you. I think there was a fair amount of concern going into the second quarter around the catastrophe loss exposure especially in Canada. When you think about the end result of roughly 10 points of earned premium and still generating around a 9% return on equity on an operating basis in the first half. How does that check out relative to what you would have thought of a catastrophe of these magnitudes in the quarter?

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

How does that translate into earnings?

Q - Jay Gelb {BIO 21247396 <GO>}

No. I mean is it – would you expect it to be this size or when you go to your risk management process, would you expect it to be a bigger impact or maybe that's just kind of jumping off point where you can talk about the risk management framework?

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

Well, I think this loss and how it impacted our results was kind of what we would have expected. We always speak to kind of writing business with the best risk adjusted return. So, as an example, in Canada, we tended not to write reinsurance bill to the (36:36) heavy personal lines exposure. So, that obviously had some benefit to it. In addition, at least for last renewal season, we tended to be in higher attaching layers. So the lower layers where – did not meet our risk adjusted return characteristics.

So, yes, it kind of translated into what we would have expected and not – given our presence in Canada, we did not experience any kind of an outside loss generally because we're directing our underwriting to those areas that we feel give us the best return. I don't know if that's frankly what you're asking about.

Q - Jay Gelb {BIO 21247396 <GO>}

It is, yes. That's helpful. Thank you. My next question was on the International Reinsurance segment, the 14% premium growth in the second quarter. Can you give us some insight in terms of what was driving that and whether we should anticipate growth at that level going forward?

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

I think that was adjustments due to some large transactions (37:49)?

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

Right. So, this is 2016, here it's more consistent with what you would expect to see going forward. There were accounting adjustments made in 2015 which is closing that comparison.

Q - Jay Gelb {BIO 21247396 <GO>}

Okay. So, just to clarify that 14% growth is normalized for international?

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

Hi, Jay, it's John. I think the way to think about it is, look at the entire six months of last year and compare it with the entire six months of this year. And that is a more appropriate comparison because it was basically kind of when we talked about it on the last quarter and it kind of washes over the first six months of the year.

Q - Jay Gelb {BIO 21247396 <GO>}

Okay. So, normalized down high-single digits, gross?

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

Right. And that's partially driven by the FX.

Q - Jay Gelb {BIO 21247396 <GO>}

Right Thank you.

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

Thank you, Jay.

Operator

Thank you. Our next question is from the line of Quentin McMillan with KBW. Please go ahead.

Q - Quentin McMillan {BIO 19411547 <GO>}

Thanks very much guys. Just a quick numbers-related question. Dom, I think you had mentioned $27 million in FX losses. I just wanted to ask about Mt. Logan. Is the remainder of the other income expense bucket, the $28.4 million, is that all just a small loss from Mt. Logan basically?

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

No. Mt. Logan actually had $3 million of income year-to-date for – the number $27 million, by the way, was after tax. Right?

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

No.

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

Pre-tax (39:29).

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

Correct.

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

But – okay. I'm sorry.

Q - Quentin McMillan {BIO 19411547 <GO>}

My apologies. So, the $28.4 million is a $3 million gain from Mt. Logan and then like a $31 million pre-tax loss in FX, is that about right?

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

$3 million of gain was for the year, Quentin.

Q - Quentin McMillan {BIO 19411547 <GO>}

Oh, for the year. I apologize. Okay. Well, just for the quarter – okay. I think the rest of the numbers are actually on 1Q, so I can break it out that way. Okay. Thanks.

Secondly, just, John, thanks very much for – sorry, I was just talking about the cat-related losses in the quarter, just wanted to sort of understand a little bit more. It sounds like you are saying they came from Canada and then from the Texas hailstorms, but the $38 million is a lot higher than we've ever seen out of that portfolio. Can you just talk to us about sort of why there might have been elevated property losses in the cat line this quarter? Should we expect to sort of a higher cat load in the insurance segment going forward?

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

Yeah. Quentin, I don't think it's really out of line from our perspective. You remember, we've been steadily growing our E&S Property Book over the last several years. It's been incredibly profitable for us. We do manage all of our accumulations at the group level. So, in relation to a number of different benchmarks we looked at, first and foremost, group accumulation of our cat model. But secondly, also, our representative market share, and any given market. The nature of the underlying event, both obviously to extreme events here with Fort McMurray and the Texas hail. So, the number might seem bigger than you've seen in the past. But in relation to the depth of these books of business we think it's very much in line.

Q - Quentin McMillan {BIO 19411547 <GO>}

Okay. So, if I could just say that slightly different way is, sometimes the wind doesn't blow your way, this might have just been a little bit of an outsized quarter correct?

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

I think that's fair.

Q - Quentin McMillan {BIO 19411547 <GO>}

Okay. And then just last question, Dom, you had mentioned in the first quarter the 11% growth rate in the insurance segment was a little bit below what we should expect for the full year, but the 20% you had previously mentioned may be not quite in that level. Given the strong growth in the second quarter, is it safe to assume that you guys are targeting more of a 20%-plus-type growth rate or still sort of no real change?

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

Our growth rate in the insurance sector will certainly be in the high teens. I don't know if we'd readily admit to over 20%. But again, that's going to be based on what the market opportunity presents to us. If pricing continues deteriorating to any great degree, then perhaps we pull back in certain areas. But we've got a number of new initiatives that we're just getting off the ground. So, I think the growth rate should be solid teens.

Q - Quentin McMillan {BIO 19411547 <GO>}

Okay. Great. Thanks very much, guys.

Operator

Next question is from the line of Amit Kumar with Macquarie. Please go ahead.

Q - Amit Kumar {BIO 19777341 <GO>}

Thanks, and good morning, and congrats on the bid. Just a few follow ups. The first question is on the Canadian wildfire. Can you tell us what industry loss you had used to compute that number?

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

Amit, we did not – we really don't go around really that way. That certainly can be one methodology. But we obviously had people on the ground assessing what was going on there as well as report from our clients. And it's a little difficult with this type of event, that the models (43:21) aren't necessarily built for wildfires. So, basing an estimate off of an industry loss is in our view very difficult and frankly not really appropriate. You can use that as a benchmark. But at the end of the day, it really is about being on – within the site as well as talking frequently to our clients and getting reports in from our clients.

Q - Amit Kumar {BIO 19777341 <GO>}

Got it. That's a fair comment. And was Mt. Logan impacted by these cats?

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

A little bit. Yeah, sure.

Q - Amit Kumar {BIO 19777341 <GO>}

And the reception, I know that you're talking about the reception from investors. Did that change? Because as you mentioned this is not a modeled peril.

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

Yeah, not to my knowledge. We have not heard any negative feedback from investors about these kind of events.

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

Hi, Amit. This is John.

Q - Amit Kumar {BIO 19777341 <GO>}

Okay.

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

I think, we communicate a lot with them on a regular basis (44:29) and talks about the types of losses and exposures that they have. And the Logan investors get access to a global portfolio and frankly expect to get losses all over the world, not just from hurricane, not just from earthquake.

And but again, from given the returns that Logan had seen, Logan investors have seen, it's really our best in class. I think it just highlights the strength of the diversification and the value of the mouse trap – the value proposition of the mouse trap that we built between Logan and Everest. And I think that the investors, there was nothing out of line for the investors tied to the Canadian wildfires.

Q - Amit Kumar {BIO 19777341 <GO>}

That's very helpful. And just moving on to capital management, I know you talked about I think buybacks were blacked out for maybe a period. How many days were you sort of blacked out? Because I'm looking at the buyback number, it's higher than Q1. And just trying to reconcile that and asking myself, is dilution still attractive to ramp the buyback during the wind season or should we think differently about that?

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

Well, first of all, it's not technically a blackout period. What I mentioned was that because we possessed material non-public information about cat events and the fact that those reports of what those losses might be were streaming in. It became frankly a little difficult for us to be in the market. Not because of the size of the events, but more because we were in the possession of material non-public information. But I don't know if that would technically be called a black out period.

As Craig pointed out earlier, we returned almost 90% between dividends and share repurchases, 90% of income. So, frankly, that's not out of line with what we've said we would do in the past. So...

Q - Amit Kumar {BIO 19777341 <GO>}

Got it. That's helpful. And then just finally wrapping up, I know there was this question on Heartland, and I appreciate it's difficult to share all the mechanics, I'm curious what led to the decision, was it a function of scale or was it A&O payments? What prompted it and was it sort of chopped around (47:05)? Maybe just some background on that would be very helpful, because we've seen other companies also do these kind of things. I'm just curious as the background. Thank you.

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

As we've said in response to questions about our crop operation for a long time that we're always looking at strategic options. Those strategic options, in the earlier days, a month ago were more about how we could build scale and how we could diversify because those were the two things that we needed to do to be successful as a primary MPCI rider.

And folks at Heartland, put – certainly they put towards (47:49) a great effort. But given the market dynamics, it was very, very difficult to, as we found out, to grow it organically and to diversify it. And when we were presented this opportunity, this option from (48:10), it was something that, as we looked at it, we said, well, this would be a way, given their scale, they're already there in the space and we can immediately get the diversification, the scale that we need. And that's what led to the decision to move in this direction. But it was always with an eye towards wanting to grow it and diversify it and recognizing that it needed to be a scale business.

Q - Amit Kumar {BIO 19777341 <GO>}

Got it. Okay. That's very helpful. Thanks for the answers and good luck for the future.

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

Thank you, Amit.

Operator

The next question is from the line of Elyse Greenspan with Wells Fargo. Please go ahead.

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

Hi. Good morning. I was just hoping to talk a little bit more about the insurance books, although it's pointed to about (48:59) a 96% kind of attritional combined ratio ex the crop business. Is that the right kind of margin to assume on that book kind of on a go-forward basis? And then just tying into that, in terms of your just expense ratio, you did mention that it came down a bit sequentially, is that something we should expect to continue to see as we go forward through the rest of this year?

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

So, the 96% I would expect overall to frankly improve a little bit more from there as we grow the Lloyd's operation. The Lloyd's premium has been slow to book it's because of the accounting that takes places in our Lloyd's operation. And frankly, if you look at the attritional without Lloyd's, it's more like a 95%. So, as Lloyd's begins to prove its economics, which it will do through the balance of the year, that attritional combined ratio we would expect to move even lower.

The improving expense ratio, as I've said in the last quarter, I would expect that to continue to moderate over time. But compared to historical levels, it will probably still be above those for certainly probably the next 12 months, at least, but trending downward towards a more normalized level.

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

Okay. And then in the reinsurance commentary, you guys mentioned some one-offs structured (50:28) solutions. Is there kind of a way to quantify kind of the impact of that on the top-line? Was that a Q2 comment, or was that more about, when you guys were looking forward towards the rest of this year?

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

That's really – those kinds of transactions generally are pretty lumpy. And so, no, there really isn't any way to quantify that frankly on the top-line basis. And I think to the value in mentioning that was more of a strategic choice and direction that we're taking relative to our bottom-line focus. These are transactions that require a lot of time. And so there really isn't any smoothness to the premium that we can outline for you.

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

Okay. Thank you. And then last on, just the capital management. You guys – last year at the Q3 was actually when you were the most active in terms of capital return. Is there any thought process behind slowing down repurchases surrounding hurricane season, or is it kind of a similar philosophy the last year where just depending upon opportunity?

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

Probably depends upon opportunity. We do tend to be more cautious going in the wind season but that obviously is relative to the opportunity as well.

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

Okay. Thank you very much.

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

Thank you, Elyse.

Operator

Next question is from the line of Sarah DeWitt with JPMorgan. Please go ahead.

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

Hi. Good morning.

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

Good morning, Sarah.

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

On the insurance business, given your new initiative there, how big do you think this segment could be over time?

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

What's the time?

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

Three years to five years?

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

Certainly it could easily double.

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

Okay. Great. And what's driving that, mostly from new hires or can you just elaborate a bit more on that?

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

Well, I think certainly new hires, you need to have a staff in place in order to garner the business but it's really more about distribution relationships and opportunities in the marketplace to fill in voids created by the disruption in the market that I mentioned earlier.

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

Okay. Great. And then on reinsurance prices. Do you think prices are bottoming and what's your outlook there going forward?

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

Well, I do think that it does appear in that certain sector that we are kind of hitting a bottom. I'm not though, here predicting that next quarter or the quarter after that we'll see some uptick. Perhaps, we'll be at this bottom point for a while. But I do think that at these levels, there really isn't any room to go lower if you want to maintain any semblance of adequate returns on your capital.

So – and I think those are the pressures that we all face and you do – you are seeing some discipline in the marketplace for now. But I'm not – I'm certainly not predicting any major uptick at this point. So, there's still opportunities. You are seeing some areas that are showing rate increase in the loss effected regions. So, those will be the opportunities to think about going forward.

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

Okay. Great. Thanks for the answers.

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

Thank you.

Operator

Next question is from the line of Kai Pan with Morgan Stanley. Please go ahead.

Q - Kai Pan {BIO 18669701 <GO>}

Thank you and good morning. The first question is a follow-up on the Heartland deal. I just wondered from the experience for the last few years buying a business (54:26), does that change your appetite, how do you think about the acquisitions?

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

Well, Kai, as you know, we have not been that acquisitive. So, I'm not – it doesn't necessarily change my appetite. You always have to be very mindful of any kind of acquisition, what it's going to do to the business, is it strategic, what are the integration concerns, et cetera.

In this particular case, the acquisition was done because it was around a skill set that we didn't have. The marketplace was changing. But then it changed again on us and we were really unable to really get the scale and the diversification we needed. But no, it doesn't necessarily change our appetite for looking at transactions that are – that can be strategically important to us. But having said that, we are not a very acquisitive company.

Q - Kai Pan {BIO 18669701 <GO>}

Okay. That's fair. I was just curious because this is a rare deal you've done in the past few years. It didn't turn out as well as you had hoped for. Then for – if the (55:49) business, $200 million transfer from the insurance to reinsurance. You mentioned better combined ratio, the insurance segment I think in the past, you were targeting 95%. If you look at the reinsurance, they're running at the low 80%s. Is that a magnitude of difference in term of profitability?

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

No. I mean, the crop business doesn't run to the low 80%s on an expected basis. It's probably more high 80%s, low 90%s kind of business.

Q - Kai Pan {BIO 18669701 <GO>}

Okay. And then the – on the foreign exchange losses, I just want to make sure this is like mark-to-market, so basically if the exchange rate stays the same, you will not see big movement in the third quarter?

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

That's correct. It's quarter-to-quarter.

Q - Kai Pan {BIO 18669701 <GO>}

Okay. Great. Great. And lastly, it's just philosophically, if you look at insurance segment, you're growing pretty fast. What – is there any risk you worry about growing that business that fast? What could be the downside there? Because if you look at the history of the insurance operation, the probability of it has been like near breakeven and what gives confidence by growing at, like, high teens and at the same time you can have – actually you can improve on the combined ratio you're already having right now.

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

Well. The insurance model today is much different that it was about 10 years ago, all right? Which was mostly a program-oriented model. So, that's number one.

Number two, I think we've offered or added an awful lot of great talent to the organization that's focused on the underwriting of business. So, it's risk-by-risk, if we think gives us potential for better outcome as well as, kind of, a reengineering if you will of our program business.

So those two things, we think we'll help dramatically. In addition, keep in mind, that we're not growing at this kind of percentage in one line of business and one territory. It is a very diversified play across a wide distribution network. And so, it's that I think will also ensure that we have good outcome.

Q - Kai Pan {BIO 18669701 <GO>}

Thank you so much for all the answers.

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

Thank you Kai.

Operator

Thank you. Next question from the line of Josh Shanker with Deutsche Bank. Please go ahead.

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

Good morning everyone. Thanks for taking my question. The first question – during the prepared statement, Jon Zaffino said that the ex-Heartland combined ratio for insurance was 109%. Is it reasonable for me to think that historically Heartland has been a, maybe, 150 basis points, 200 basis points drag on your results.

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

150 basis points of what, on combined ratio?

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

The combined ratio, yeah.

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

I don't know if that's the right math or not, Josh. But...

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

That's why I'm asking.

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

I mean, generally, that business over time has been running at, just the Heartland operations, so...

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

I don't think over time. I think it's been over 100%.

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

Right.

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

We have shown losses. I don't think it would be quite that high. The current quarter, it's running at about 120%, 119% for the current quarter.

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

And the premium on that is?

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

For the current quarter, the earned premium is about $31 million.

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

Okay. And this is going to sound incredibly nitpicky, I apologize. But I've gotten a few question about it. It's a question about when did you know what – you guys were, sort of – due to material non-public information, you guys were locked out of repurchasing shares. But you could have put out a press release and sort of bought yourself back to the market. When did you know, what sort of the cats were? Why didn't you put out a press release? And I guess when did you know you had favorable development which kind of offset your need to put out a press release?

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

Yes, Josh. That is incredibly nitpicky.

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

I am sorry.

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

The challenge with Canada was that the number was moving around quite a bit. And we did have a number early on. And in fact as we got more and more information, that number frankly got a little better, but it kept changing. And we did not have – because of the question I was asked earlier, we didn't think it was appropriate. We weren't getting a right answer by using kind of an industry loss estimate times market share, given how we participated in that particular event with those particular clients.

It wasn't a simple matter of taking an industry loss estimate and a market share. We had to have reports from clients as well as on the ground investigation. We didn't know that frankly until relatively late in the game, probably two weeks ago of course (01:01:20) that we were comfortable with the number.

In the meantime, as we have said in the past, we generally look at is an event or a series of events going to be within our expected cat load, and we, kind of, thought that this was probably going to come in at the expected cat load and therefore a release on the event was not required. That's kind of what we said in the past. Had we felt that this was going to be materially above our expected cat load, then probably would've had reconsidered whether to put something out.

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

Okay. That's perfectly fair. Thank you for the answers, and good look with the hurricane season.

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

Thank you, Josh.

Operator

Ladies and gentlemen, that's all the time we have for questions. I'd like to turn the call over for closing remarks.

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

Well, thanks, everybody for participating in the call. As I mentioned, we're quite satisfied with our results given the frequency of events. Some of which didn't even reach the level of cats for us. So, that's a testament to our numbers. Our insurance initiative, as we've mentioned is going well and with crop moving to the reinsurance segment. Improved underlying performance of this book should become more apparent on a go-forward basis.

On the reinsurance side, we continue to manage through the cycle. And as noted in some areas, our PMLs are down, pricing does appear to be bottoming and we are well-positioned to shift when warranted. So again, thank you all and talk to many of you in the weeks ahead. Thanks again.

Operator

Ladies and gentlemen, that does conclude our conference for today. I'd like to thank you again for your participation. And you may now disconnect.