

## Q4 2016 Earnings Call

### Company Participants

- Albert A. Benchimol, President, CEO & Executive Director
- Joseph C. Henry, Chief Financial Officer
- Linda Ventresca, Corporate Development Officer

### Other Participants

- Brian Meredith, Analyst
- Charles Joseph Sebaski, Analyst
- Elyse B. Greenspan, Analyst
- Jay Arman Cohen, Analyst
- Kai Pan, Analyst
- Meyer Shields, Analyst

## MANAGEMENT DISCUSSION SECTION

### Operator

Good morning, and welcome to the AXIS Capital Fourth Quarter and Full year 2016 Earnings Conference Call. All participants will be in listen-only mode. After today's presentation, there will be an opportunity to ask questions. Please note, this event is being recorded.

I would now like to turn the conference over to Linda Ventresca, Investor Relations. Please go ahead.

### Linda Ventresca {BIO 5930519 <GO>}

Thank you, Kate, and good morning, ladies and gentlemen. I'm happy to welcome you to our conference call to discuss the financial results for AXIS Capital for the fourth quarter and the year ended December 31, 2016. Our earnings press release and financial supplement were issued yesterday evening after the market closed. If you would like copies, please visit the Investor Information section of our website, [www.axiscapital.com](http://www.axiscapital.com).

We set aside an hour for today's call, which is also available as an audio webcast through the Investor Information section of our website. A replay of the teleconference will be available by dialing 877-344-7529 in the United States and the international number is 412-317-0088. The conference code for both replay dial-in numbers is 10098770. With me on today's call are Albert Benchimol, our President and CEO; and Joe Henry, our CFO.

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Before I turn the call over to Albert, I will remind everyone that the statements made during this call, including the question-and-answer session, which are not historical facts, may be forward-looking statements. Forward-looking statements involve risks, uncertainties and assumptions. Actual events or results may differ materially from those projected in the forward-looking statements due to a variety of factors, including the risk factors set forth in AXIS' most recent report on Form 10-K filed with the SEC on February 25, 2016. We undertake no obligation to update or revise publicly any forward-looking statements.

In addition, this presentation may contain non-GAAP financial measures. Reconciliations are included in our earnings press release and our financial supplement, which can be found on the Investor Information section of our website.

With that, I'd like to turn the call over to Albert.

### **Albert A. Benchimol** {BIO 2023727 <GO>}

Thank you, Linda, and good morning, ladies and gentlemen. Thank you for joining us today. Last night, AXIS reported fourth quarter operating income of \$101 million or \$1.14 per diluted share, bringing our full year operating income to \$4.48 per share, an 11% increase in year-over-year operating income per share and improvement in operating ROE to 7.9%. Our core operating performance strengthened in both the quarter and full year, as the improvements we've put in place allowed us to absorb both higher industry cat losses and negative market conditions, and still deliver for our customers, partners in distribution, and our shareholders. We entered the year with diluted book value per share of \$58.27.

Adjusting for dividends, diluted book value per share grew 10% over the last 12 months. This is a satisfying rate of growth, considering the significant selloff experienced in the bond markets in the weeks following the U.S. election, which impacted the value of our fixed income investments. We also continued our practice of managing our capital for the benefit of our shareholders. During the year, we increased our dividend by 9% and returned \$644 million to our shareholders through common dividends and share repurchases. Over the last five years, we returned to our shareholders in excess of 100% of aggregate operating income including the break-up fee earned from PartnerRe in 2015. We've been able to do that while we grew our overall business by optimizing our portfolio and reducing volatility for enhanced capital efficiency, as well as more strategic use of reinsurance and third-party capital.

Again, this quarter, we demonstrated our efforts to reposition our portfolio are bearing fruit. In the year with higher global catastrophe losses, our combined ratio for the full year was only up about 1 point, despite the cat loss ratio being up about 3 points over the prior year. I would also note that while observers report that 2016 was an above average year for the 10-year average, let me rephrase that, that the cat losses for 2016 were above the 10-year average, our own cat loss ratio was actually 3 points lower than our 10-year average.

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In 2016, we took bold steps forward, taking significant tangible actions to strengthen our market positioning and profitability across our businesses. We extended our geographic reach by expanding our presence in Dubai and setting up the launch of our Miami office to address the Latin American market. We increased our scale and market relevance in key sectors. This included organic growth in many of our initiatives bringing on new market leaders and teams and the recent announcement that we're acquiring Aviabel, a Premier European Specialty Aviation Insurer and Reinsurer. By acquiring Aviabel, we're absorbing a portfolio that complements our existing airline business while extending our physical presence into Brussels and Amsterdam on the continent.

We also built on our strengths. We invested in and committed to lines in markets that are consistent with our objectives of relevance, profitability and scale, and where we have the best opportunities to drive profitable growth. A recent example was our decision to redirect our U.S.-based resources and key personnel to the U.S. wholesale E&S market for property, primary casualty, and excess casualty lines, where we have historically held a very strong market position. I hasten to add that this not an exit from retail markets. We're still very successful in covering U.S.-based property and casualty lines to retail program and facilities in the U.S., as well as through our London platform. And of course, we continue to deliver a wide range of professional lines through all retail and wholesale channels.

We made significant progress in developing strategic capital partnerships and positioning AXIS as the company that best matches risk to the most appropriate capital. We now have over \$1 billion of additional capacity available through our strategic capital partners. An important component of our third-party capital strategy was the creation of Harrington Re, a \$600 million specialty reinsurer launched together with The Blackstone Group. These partnerships allow us to do more for our clients and partners in distribution, share risk with knowledgeable long-term investors, and earn attractive fee income.

For the full year, we reported fee income of \$22 million, and we expect that this is just the beginning as we see fee income as a steady and growing source of attractive revenue for AXIS. Through these initiatives and others and the hard work of our dedicated employees across the globe, we are reinvigorating our brand and laying the foundation for a differentiated leader in global specialty risks, achieving intelligent growth in selected markets, optimizing our portfolios, matching risk with the right capital, and delivering solid and stable profitability.

I'll report more on market conditions in our outlook for 2017 after Joe covers the highlights of our financial performance. Joe?

**Joseph C. Henry** {BIO 13390626 <GO>}

Thank you, Albert, and good morning, everyone. During the quarter, we generated strong results, featuring net income of \$131 million and an annualized ROE of 9.9%. Our net income this quarter benefited from continued good underwriting performance, including a decrease in our current accident year loss ratio, ex-cat and weather, together with continued favorable prior-year reserve development, strong investment income and foreign exchange gains.

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These positive factors were partially offset by a higher level of catastrophe and weather-related losses in the quarter primarily related to Hurricane Matthew and an increase in general and administrative expenses. Our book value declined by \$1.50 in the quarter to \$58.27, principally driven by unrealized losses on our available-for-sale investment portfolio due to higher U.S. Treasury rates.

Moving into the details of our income statement, our fourth quarter gross premiums written decreased by 9%, with decreases reported by both segments. Our insurance segment reported a decrease in gross premiums written of \$6 million or 1% in the fourth quarter compared to the same period in 2015. After adjusting for the impact of foreign exchange movements, our gross premiums written increased by 1% in the quarter.

An increase in new business written in our property and professional lines was attributable to growth in our London book including MGA in program business, and growth in our liability lines was attributable to our U.S. primary casualty book. These increases were partially offset by decreases in our credit and political risk as well as our accident and health lines. The decrease in credit and political risk was due to timing, and the decrease in accident and health was largely due to the non-renewal of a treaty in our North American reinsurance division in a low-volume quarter for that operation. I would note, however, that our A&H book grew by almost \$80 million or 22% on a year-to-date basis.

Our Reinsurance segment reported a decrease of \$64 million or 34% in gross premiums written in the fourth quarter of 2016 compared to the same period in 2015. The decrease was primarily driven by timing differences in our professional liability and liability lines of business, partially offset by an increase in our agriculture lines. After adjusting for the impact of multi-year contracts and timing differences, gross premiums written decreased by \$13 million or 7%. Further, it is worth noting that our fourth quarter is not a meaningful production period of our Reinsurance segment.

Consolidated net premiums written decreased by 22% in the fourth quarter of 2016 compared to the same period of 2015. Insurance net premiums written were down 8%, reflecting lower premiums written in the quarter and increased premiums ceded in our professional and liability lines. Reinsurance net premiums written were down 52%, reflecting the decrease in gross premiums written in the quarter, as well as the impact of retrocessions to Harrington Re on our liability and professional lines.

On a year-to-date basis, reinsurance gross premiums – gross and net premiums written were up 11% and 2%, respectively compared to 2015. As we discussed with you in previous quarters, we have been ceding more of our reinsurance premiums to our strategic capital partners in recent periods, particularly in our liability and professional lines due to the launch of Harrington Re in the third quarter, as well as increased retrocessions of our catastrophe and property business throughout the year. Consolidated net premiums earned in the fourth quarter of 2016 are comparable to the same period in 2015 in both segments.

Our fourth quarter consolidated accident year loss ratio increased by eight-tenths of a point to 66% compared to the same period in 2015. During the quarter, we incurred \$59

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million or 6.4 points in pre-tax catastrophe and weather-related losses primarily attributable to Hurricane Matthew and U.S. weather-related events. Comparatively, we incurred \$10 million or 1.1 points primarily attributable to U.S. weather-related events during the same period in 2015. With regard to Hurricane Matthew, we incurred pre-tax net losses of \$52 million, with our Insurance segment contributing \$39 million, and Reinsurance segment contributing \$13 million to these losses. After-tax net losses attributable to Hurricane Matthew are at the low-end of the range we indicated last quarter.

Our fourth quarter current accident year loss ratio, ex-cat and weather, decreased by 4.5 points to 59.6%. Our Insurance segment's quarterly current accident year loss ratio ex-cat and weather decreased by 6.4 points from 62% to 55.6%, primarily due to a decrease in midsize and attritional losses in our property, marine and liability lines partially offset by the adverse impact of rate and trend and changes in business mix. Our Reinsurance segment's quarterly current accident year loss ratio ex-cat and weather decreased by 2.5 points from 66.1% to 63.6% due to a decrease in midsize and attritional losses in our credit and surety lines, partially offset by increased loss experienced in our agriculture lines and the ongoing adverse impact of rate and trend.

Year-to-date, our consolidated current accident year loss ratio increased by 1.8 points to 67.4%, driven by a 2.9-point increase in the cat loss ratio. During the year, we incurred \$204 million of pre-tax catastrophe and weather-related losses net of reinstatement premiums compared to \$100 million in the same period in 2015. After adjusting for these events, our current accident year loss ratio decreased by 1.1 points to 61.8%.

Our insurance segment's year-to-date current accident year loss ratio, ex-cat and weather, decreased by 1.9 points from 62.5% to 60.6% due to a decrease in mid-sized and attritional losses in our marine and property lines, partially offset by the adverse impact of rate and trend, changes in business mix, and increased losses in our insurance, credit and political risk lines. Our Reinsurance segment's year-to-date current accident year loss ratio, ex-cat and weather, decreased by three-tenths of a point from 63.3% to 63.0%, due to a decrease in mid-size and attritional credit and surety lines and partially offset by the adverse impact of rate and trend.

Turning to loss reserves established in prior years, our results continue to benefit from net favorable loss reserve development, which amounted to \$68 million during the fourth quarter. Short-tail classes in both segments contributed \$31 million of this balance. In addition, our professional, insurance and reinsurance reserve classes recorded \$16 million. Our motor reinsurance reserve class contributed \$15 million and our liability reinsurance reserve class contributed \$12 million of the net favorable prior-year development during the quarter. Our year-to-date favorable prior-year development was \$292 million compared to \$243 million in 2015.

During the fourth quarter, our acquisition cost ratio increased modestly by 0.7% compared to the same period in 2015. Our Reinsurance segment's ratio increased by 0.3% of a point to 25.9% due to the impact of retrocessional contracts. The impact was partially offset by changes in the business mix and a decrease in adjustments related to loss-sensitive features.

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In 2015, the ratio included the benefits of fees from strategic capital partners, which are now included in other income or offset against general and administrative expenses. Our insurance segment's ratio increased by 1.1 points to 14.5% driven by an increase in variable acquisition costs, primarily related to our MGA and broker portfolio business and the absence of a favorable federal excise tax adjustment, which benefited 2015, partially offset by increased ceding commissions on our professional lines' ceded reinsurance programs.

Our G&A ratio increased by 2.6% in the quarter compared to the same period in 2015. Focusing solely on dollars, expenses in the quarter have increased by \$23 million. We did, however, have some unusual expenses in Q4 2016, including severance and transition costs related to the closure of four U.S. retail business units, cost associated with the introduction of a new retirement provision in our equity plan and stock compensation expenses, which reflected the higher company share price on cash-settled awards.

In addition, incentive compensation expenses increased in the quarter compared to 2015, reflecting our stronger 2016 performance. Adjusting for unusual items and timing, we believe that our run rate in the quarter is consistent with the full year adjusted ratio in the mid-15s. Overall, we reported underwriting income of \$66 million and a combined ratio of 96.7% for the fourth quarter. On a year-to-date basis, our underwriting income was \$279 million with a combined ratio of 95.9%.

Net investment income was \$96 million for the quarter, driven by the strong performance from our fixed income portfolio attributable to an emphasis on longer spread duration assets and our alternative investment portfolio driven by hedge funds. Overall for the year, net investment income met our expectations as strong performance in the last three quarters offset negative volatility in our hedge funds reported earlier in the year. In the aggregate, the total return on our cash and investment portfolio for the quarter was negative 1.1%, including foreign exchange movements or 0.8% - negative 0.8% excluding foreign exchange.

The total return in the current quarter was primarily driven by unrealized losses on fixed income securities as a result of the increase in the U.S. Treasury rates and the strengthening of the U.S. dollar against the pound, sterling and the euro. For the year, our total return on investments was 2.5%, including foreign exchange movements or 3% excluding foreign exchange. The total return for the full year was primarily driven by contributions from net investment income and unrealized gains as a result of the tightening of credit spreads particularly in high yield and strong equity markets.

During the quarter, we issued \$550 million of 5.5% Series E preferred shares and repurchased \$49 million of our 6.875% Series C preferred shares using a portion of the net proceeds from the Series E issuance. We intend on using a portion of the remaining net proceeds from the Series E preferred share offering to redeem the remaining \$351 million of our Series C preferred shares outstanding. Until the redemption of our Series C preferred shares in April, our preferred dividend expense will be temporarily elevated.

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During the quarter, we repurchased an additional \$123 million worth of common shares pursuant to our 2016 board authorized share repurchase program. In addition, we announced the share repurchase authorization program of \$1 billion of the company's common shares effective January 1, 2017 through December 31, 2017. At February 1, 2017, the remaining authorization under the repurchase program approved by our board of directors was \$975 million.

In conclusion, I'd like to reiterate our strong underwriting performance this quarter and to note that we continue to make progress towards achieving and realizing the benefits of the strategic goals we have discussed with you in prior quarters. Finally, I'd like to remind you of the additional disclosure we introduced in our financial supplement last quarter, relating to our activities with our strategic capital partners, which includes details of premium ceded by our reinsurance segment to our strategic capital partners, as well as details of fee income generated as a result of these arrangements.

With that, I'll turn the call back over to Albert.

### **Albert A. Benchimol** {BIO 2023727 <GO>}

Thank you, Joe. Before opening up the call to questions, let me provide an update on market pricing and our January 1 reinsurance renewals. As with the rest of the market, we've observed continued pricing pressures in most lines and markets in the fourth quarter. Although we are seeing both pockets of stabilizations, and increases were warranted. The overall average price change for our insurance book was minus 2% in the fourth quarter. This is a lesser decline than the negative 3% experienced in the third quarter of 2016, and the fourth quarter of 2015. Consistent with prior quarters. The greatest pressure is on catastrophe-exposed property and London-based global specialty lines. Large accounts continue to be more competitive than smaller risks.

The U.S. property and casualty marketplace closed 2016 on a positive note for us. The overall rate change for our U.S. division was up 3% in the fourth quarter. Casualty lines continued on the path of positive rate movement, while property lines witnessed the slowing of rate declines as compared to previous quarters. In property, we are seeing glimpses of carriers taking corrective underwriting actions, which we hope will translate to improving rates in 2017.

In our international division, we saw an overall rate change of minus 5% for the quarter, which although disappointing, is a deceleration of market pressures. In London, too, we are seeing the very first tentative signs of result to improve market rates. Energy, property and aviation represented the most competitive conditions. But we are managing our book carefully, reducing our business volume where necessary and increasing our writings of smaller, less volatile risks. The aviation market, in particular, has shown some encouraging signs of late, and many feel, we may be approaching a bottom.

In our professional lines division, overall rates declined 2% in line with the rate change experience in the third quarter. Aggregate E&O rates were flat for the quarter, although

with some softening seen in excess cyber coverages. D&O lines declined 4% with primary layers slightly down while excess and Side A experienced more significant declines.

As I mentioned at the beginning of the call, our resources and efforts are focused on businesses where we have competitive strengths and feel the market offers us opportunities for profitable growth. We continue to make great strides in our accident and health business, growing strongly again, and reaching underwriting profitability in 2016. And we are committed to building on that milestone in 2017. We continue to build our resources to better serve our clients and partners in distribution, and are excited about new opportunities to expand our footprint including our new office in Miami, which will allow us to reach further into the Latin American market.

Moving on to Reinsurance. Our client-centric efforts at positioning AXIS Re as a more relevant core reinsurer continue to bear fruit. Clients are increasingly consolidating panels and differentiating between core reinsurers and secondary carriers from whom they are prepared to opportunistically purchase coverage. And we are pleased with our enhanced positioning. At January 1 renewals, we saw good submission flows across many lines and markets. Although pricing continues to soften year-on-year, we were encouraged by increased discipline from some competitors in certain lines and regions. The magnitudes of price declines were generally lower across the reinsurance portfolio at January 1.

Government and non-governmental agencies are increasingly concluding that private industry is the right partner for the transfer of risk which is a very positive trend for our business. We also saw growth opportunities in motor, where clients are addressing pressures from Solvency II. There was increased interest in combined programs consolidating across similar lines of business and geographies, and we proactively work with clients to find solutions in many cases. The January 1 period represents approximately 55% of our global reinsurance book excluding agriculture. We grew gross premiums by approximately 10% on expiring business, although we expect that this will be somewhat offset by increased sessions to our strategic capital partners in 2017.

We maintained our core discipline and focus on key relationships, looking for the best deals with clients where we add value. We made some changes to our overall mix of business to protect our profitability, including getting off certain programs. As we look further into 2017, we will conservatively expand our reinsurance product and geographic scope into areas like mortgage, floods, regional multiline, and using our Lloyd's Syndicate to better serve our clients. Throughout our company, both insurance and reinsurance, new initiatives and existing business alike will be approached with discipline, but we feel there are still good profitable opportunities to pursue.

Our relationships with key partners and distributions are stronger than ever. And we are increasingly confident of our ability to build well-balanced, profitable portfolios. We will continue to expand our ability to match the right risk with the right capital and generate a growing stream of attractive fee income to enhance our overall returns. In closing, I'm very pleased with our progress across the organization in 2016. While our results do not yet reflect the full benefits of the actions we have taken, and there is more work to do, our team did a great job of driving our company forward, and I am excited about our company's trajectory into 2017 and beyond.



With that, I would like to open up the call for questions. Operator?

## Q&A

### Operator

We will now begin the question-and-answer session. The first question comes from Elyse Greenspan of Wells Fargo. Please go ahead.

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

Hi. Good morning. First question, in terms of looking at the margins within the insurance book, you saw a pretty strong improvement in the fourth quarter and also for the full year. And you mentioned a couple of times kind of the benefit of mid-sized losses. Was it a relatively low year in 2016 or a high year in 2015, and how do we kind of neutralize, I guess, for the benefit that you might not expect going forward in 2017? I'm just trying to get at - what kind of margin profile do you see on the underlying, just on the loss side for the insurance book in 2017?

#### A - Albert A. Benchimol {BIO 2023727 <GO>}

That's a fair question, Elyse. What I would say is that yes, 2015 did have, as we discussed in that year, a higher frequency of energy losses, in particular, and certainly less so in 2016. But although there were less events that affected us in 2016, I would say that it's more than just luck. Part of the reasons that we have a lower number of large losses is that we have changed the construction of our portfolios. We've reduced our limits available, we've changed our reinsurance programs. And so, although we've had some losses, they have affected us less in 2016 than they did in 2015. Our business will always have volatility of large losses, but we believe that we've constructed our portfolios to be less vulnerable than they were in the past.

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

Okay. And then on the reinsurance side, you mentioned in your commentary some areas that you're looking to expand in in 2017 like mortgage, flood, and a few other areas. What does that do to the margin profile, as you go in that business, the margin profile of your reinsurance book?

#### A - Albert A. Benchimol {BIO 2023727 <GO>}

Well, it depends on each one of them. So if you look at the mortgage business, the flood business, those tend to have generally lower technical ratios. And the regional multiline business would tend to have more of an average technical ratio. Expanding by offering our products into Lloyd's should have no impact.

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

Okay. Did you guys have any losses from the New Zealand earthquake in the quarter?

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**A - Joseph C. Henry** {BIO 13390626 <GO>}

De minimis.

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

Okay. And then one last question, in terms of the reserve development, what accident years did the favorable development come from in the quarter?

**A - Joseph C. Henry** {BIO 13390626 <GO>}

Elyse, it's Joe. It really came from all accident years. If you want to characterize the reinsurance development, prior year development, it came from all lines of business and all accident years. And on the insurance side, it was almost all lines of business and most accident years. So really across the whole spectrum. I can give you more specifics if you want, but basically it's all accident years and all lines of business.

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

Okay. Thank you very much.

**Operator**

The next question is from Jay Cohen of Bank of America Merrill Lynch. Please go ahead.

**Q - Jay Arman Cohen** {BIO 1498813 <GO>}

Yes. Thank you. A couple of questions. You had mentioned on the reinsurance side that you did have some increase in agriculture-related losses. I guess, I'm wondering where that happened, because it seems like the U.S. crop business was particularly good this year?

**A - Joseph C. Henry** {BIO 13390626 <GO>}

Right. Jay, we actually had some adverse experience in our European book. We had one large claim due to the French floods and droughts that occurred in that country. So for the most part, our U.S. business was good as was the rest of the industry's, but we had a large loss in Europe.

**Q - Jay Arman Cohen** {BIO 1498813 <GO>}

Got it. That's helpful. And then on the G&A expense, where that did go up partly due to some severance expense, those charges that you took, will that result in savings going forward? And if so, I don't know if you can quantify it or not?

**A - Joseph C. Henry** {BIO 13390626 <GO>}

Yeah. So let me give you some specifics here, Jay, on G&A because we thought we were going to get that question. First, and let me say, that we will deliver by the end of 2017 on the promise we made two years ago to eliminate \$50 million worth of expenses, which has and will help offset increases in other areas.

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So, we had \$25 million in what we call one-time or timing-related items in the fourth quarter, and there were three major components. Severance, as Albert mentioned, most of which related to the decision to redeploy capital to the E&S wholesale market. We reduced staff in the fourth quarter, as a result. And that was about \$9 million of the \$25 million. I'd say that's more one-time. Share-based compensation, as we explained, part of our restricted stock awards are paid out in cash; with a significant increase in our stock price in Q4 that increased our expenses. That was \$7 million and frankly, it was a catch-up in the fourth quarter for the whole year. And then, third, we had performance-based compensation. Our fourth quarter results caused us to increase our year-to-date performance, which resulted in higher compensation there as well. So, that was a catch-up adjustment as well. So, I'd say, severance was more one-time and the share-based compensation and performance-based compensation were more catch-ups, and that was about \$4 million, if I didn't mention that.

**Q - Jay Arman Cohen** {BIO 1498813 <GO>}

Great. That's really helpful. Thanks.

**A - Joseph C. Henry** {BIO 13390626 <GO>}

Okay.

**Operator**

The next question is from Kai Pan of Morgan Stanley. Please go ahead.

**Q - Kai Pan** {BIO 18669701 <GO>}

Thank you, and good morning. First question, Albert, on the ROE profile for the business. If you're looking back for the last three years, you made great progress basically shaping the business portfolio and that's showing up in low volatilities. But on the other hand, the underlying margin is actually - combined ratio shifted higher. And your ROE was like 12% in 2013 and now down to close to 8% in 2016. I just wonder is that business portfolio sort of like at a steady state and what are the drivers for ROE improvement going forward?

**A - Albert A. Benchimol** {BIO 2023727 <GO>}

Thank you, Kai. I think that there are a couple of factors, one of which is the entire industry suffered from lower investment income, so that's just part of the contributor. But focusing on the portfolio, we're actually confident that the portfolio, although it might deliver higher technical ratios with the mix that it has, it's a more capital-efficient portfolio and, therefore, positive on the ROE. And certainly, when we look at our economic analysis, we see that the portfolio in 2016 had a better RORAC than in 2015 and we certainly are expecting that in 2017, it will have a better RORAC, return on risk adjusted capital than 2016.

So as far we're concerned, what matters is making the most efficient use of capital. We believe that the changes that we have made are going to deliver improved RORAC. And then separately, the quality of the underwriting has improved. And as I indicated in my comments, we do not believe yet that our results fully reflect some of the changes that

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we have made. As you know, part of our reserving policy is to ensure that we give positive indications time to mature before we reflect them in our reported loss ratios. And so, we believe that further progress will be achieved in the loss ratios, which ultimately will reflect in better ROEs going forward.

**Q - Kai Pan** {BIO 18669701 <GO>}

Okay. And then, on the share repurchase, 2016 actually you returned more than you earned, including some breakout fees for the PartnerRe deal. I just wonder, given that your risk profile now is significantly reduced, what's your excess capital position? Can you sustain a share buyback that's above your annual earnings?

**A - Joseph C. Henry** {BIO 13390626 <GO>}

Kai, as you know, we start our year assuming that we're going to give back to our shareholders all of our operating income in the form of share repurchase and dividends, and then we adjust up or down based on how the year develops and that continues to be our expectation.

**Q - Kai Pan** {BIO 18669701 <GO>}

Do you have estimates of your current excess capital position?

**A - Joseph C. Henry** {BIO 13390626 <GO>}

We would not disclose our estimates of excess capital position.

**Q - Kai Pan** {BIO 18669701 <GO>}

Okay. Great. Lastly on the U.S. tax reform, some argue that U.S. players' tax rate going lower, and some global players tax rate could go higher. Do you think that could potentially change your competitive position in the marketplace?

**A - Joseph C. Henry** {BIO 13390626 <GO>}

Kai, let me answer your question maybe a little bit differently than you asked it. First, with respect to tax reform, it's early days, and I think it's very difficult to predict where tax reform may go. As you would expect, we monitor closely all the proposals regarding tax reform. With respect to the border adjustment proposals, which have gotten a lot of attention in the last couple of weeks, the House Republican Blueprint for tax reform does not provide much specificity as to how this adjustment would apply. So, with respect to insurance and reinsurance companies, to me, it's unclear whether a U.S. cedent would be considered to be importing a service or exporting a risk to a foreign reinsurer.

If it's viewed as an import, we support efforts to carve out financial service payments including insurance and reinsurance payments from the border adjustment provisions. I'd also note that this only applies to U.S.-sourced business, and we have a significant amount of our business, which is sourced from outside of the United States. Against the backdrop of a shifting landscape, we believe the flexibility built into our organizational structure with

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investments and platforms such as Lloyd's will allow us to react reasonably nimbly to legislative changes and to proactively optimize outcomes once we have more clarity.

**A - Albert A. Benchimol** {BIO 2023727 <GO>}

And Kai, let me add. So I think Joe gave you a good view of how we look at the situation right now and our preparedness to respond (37:51). But I also want to respond to one of your comments which is how does this affect your competitive position. And I think there is a difference between where we get our income, where we pay our taxes and our competitive position. Our competitive position has been nothing but improved over the last several years. We continue to focus on service, we continue to service to - on agility, claims payments. Those things will not change. And as I said earlier, our relationship with our producers and clients are as good as they've ever been. We will continue to do that. And then, when we get some clarity around taxes and other factors, we will do what we need to do to optimize results at that point.

**Q - Kai Pan** {BIO 18669701 <GO>}

That's great. Thank you so much.

**A - Albert A. Benchimol** {BIO 2023727 <GO>}

You're welcome.

**Operator**

The next question is from Charles Sebaski of BMO Capital Markets. Please go ahead.

**Q - Charles Joseph Sebaski** {BIO 17349221 <GO>}

Good morning.

**A - Albert A. Benchimol** {BIO 2023727 <GO>}

Good morning.

**Q - Charles Joseph Sebaski** {BIO 17349221 <GO>}

I guess the first question is kind of on capital philosophy and the new preferred issuance that you did. I know, Joe, you said you're going to retire the Series C, but I believe you'd still end up with a net increase in preferred equity and given the changes in the book to a more capital-efficient profile, why do you need more capital?

**A - Albert A. Benchimol** {BIO 2023727 <GO>}

It's not that we need more capital, it's we want to have more efficient capital Charles.

**A - Joseph C. Henry** {BIO 13390626 <GO>}

As you know, one of the factors that we look at, is ensuring that we have a strong ratings from the rating agencies because we think it's appropriate in our marketing. The rating

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agencies give full credit to a certain amount of perpetual preferred capital. So, if we're going to get the same 100% credit for perpetual preferred shares that cost us \$5.50, versus our equity which has a higher cost of equity, we think we should maximize the amount of that cheaper preferred shares. So, we will maximize the amount of preferred shares that we can, where we get full credits point from the rating agencies and then, we then manage our total capital. So it's not that we need more capital, as we've said, we've bought back a lot of stock but we think that this allows us to replace equity with lesser cost preferred equity.

**Q - Charles Joseph Sebaski {BIO 17349221 <GO>}**

Okay. And so I mean, that's what I was - maybe I didn't ask it properly is that, I thought that due to the changes in the book, the total capital need because of the new capital efficiencies of changing the portfolio and the reinsurance buying would have meant that you just needed less equity, less shareholder equity in general for the book of business. So, it wouldn't necessarily need to be replaced, but there will be a free up of capital due to the restructuring of the overall portfolio.

**A - Albert A. Benchimol {BIO 2023727 <GO>}**

I generally agree with what you're saying, which is why we've been able to return all of our operating earnings while we've been growing the book and we will continue to manage capital appropriately to balance capital efficiency on the one hand, but also, financial strength and ratings on the other, and the opportunity for profitable growth where we find it. So, it's a balancing act. We think that we have been very strong stewards of capital and we will continue to pursue down that path.

**Q - Charles Joseph Sebaski {BIO 17349221 <GO>}**

Okay. I guess then on the insurance book or insurance business overall and how you think about it going forward to generate the returns necessary. I mean, I guess if we're looking down the road, one year, two years down the road, how do you view the contribution of earnings in the insurance business relative to the reinsurance business as these changes take place regarding underwriting and other? I mean, it's still overall higher contribution from the reinsurance business. Do you expect that to maybe not parity but to get closer in the future, or do you expect the relative contributions from the business to remain at their current balance levels?

**A - Joseph C. Henry {BIO 13390626 <GO>}**

Charles, I would prefer to answer the question by saying that I have a very high level of confidence that the profit contribution from insurance will increase over time as the various actions that we have put in place start to be reflected through. Ultimately, as you know, there's a fair amount of things that affect the contribution from one area or the other, the location of cats and so on and so forth. But what I can tell you is that, the team is very committed to delivering stronger financial returns, and my expectation is that we would have stronger returns coming out of the insurance book.

**Q - Charles Joseph Sebaski {BIO 17349221 <GO>}**

Okay. And then just finally on the strategic partners and the cede that you've done from the reinsurance side, and I believe there's also a cede from the insurance side that's not included in the disclosure in the supplement. But I guess, I'm just trying to get a better understanding of what's your thoughts or what's the full scope of what can be ceded, provided, when you think about how you use those facilities and those partnerships? It's a couple of \$100 million here, can it be a multiple of that or is it mostly there? I'm just trying to understand to what level that can get over - not even necessary 2017, over a multi-year period.

**A - Albert A. Benchimol {BIO 2023727 <GO>}**

Charles, that's an excellent question and from our perspective, strategic capital partnerships are really about funding the totality of our portfolios. It's not necessarily limited to the cat business or to liability business on the reinsurance side. It's really about getting into partnerships with investors who have an appetite and we've got a broad range of products and we're happy to share anyone of those products with them. So as we walk down this path with our capital partners, we would be very happy to continue to cede to them any kind of insurance business, A&H business, reinsurance business that fits their appetite.

From my perspective, I see nothing wrong with growing the top line of this company and having a greater proportion of our risks shared with strategic capital partners. Because I believe that that is the best way to manage an insurance and reinsurance company in this market. If we have the capital available to us, we can do more for our clients and our partners in distribution. We've got knowledgeable strategic partners who are willing to work with us and accept risk. And we have the ability to earn fees to enhance our capital efficiency and improve our ROE. So you should expect us to continue our efforts to gather and garner more third-party capital and to creatively find structures where we can share more risk with third-party capital. We think that is the right way to go.

**Q - Charles Joseph Sebaski {BIO 17349221 <GO>}**

And how should we think about the fee component of that relative to an earnings perspective. How much is expense offset versus profitability - to get a handle on what - if I think of this growing over time from a \$22 million fee in 2016 to \$40 million in 2017, how is that contribution from an earnings versus just an offset of expenses that are currently undergoing in your business? I'm just trying to get some...

**A - Albert A. Benchimol {BIO 2023727 <GO>}**

Right. That's fair. Joe, I think you could confirm that, but I believe that we've estimated that about two-thirds of the fees...

**A - Joseph C. Henry {BIO 13390626 <GO>}**

Two-thirds. Yeah.

**A - Albert A. Benchimol {BIO 2023727 <GO>}**

...go to offset G&A. There's obviously some profit in that too, but from an accounting perspective, those go to offset G&A, and then one-third of the fees will end up in other income because they reflect profit contributions and other forms of revenues that don't properly offset G&A.

**Q - Charles Joseph Sebaski** {BIO 17349221 <GO>}

Thank you very much for the answers.

**A - Albert A. Benchimol** {BIO 2023727 <GO>}

Yeah.

**Operator**

The next question is from Brian Meredith of UBS. Please go ahead.

**Q - Brian Meredith** {BIO 3108204 <GO>}

Yeah. Thanks. A couple of questions here for you. The first one, Albert, could you talk about your exposure to the potential changes in the Ogden discount rates?

**A - Albert A. Benchimol** {BIO 2023727 <GO>}

Sure. So some people in the investment community may not be familiar with them, but in the UK, there is a methodology to calculate lump sum payments for large claims and the Ogden discount rates are utilized for that. The Ogden discount rates are currently approximately 2%, and there's talk that the Chancellor will reduce those rates. Obviously, if you reduce those rates, that would make the lump sum payment higher. So it only affects one small part of our overall book of business, and that's the motor book.

What I will say is that - as I hope you already know from the discussions we've had with the way we set reserves, we prudently set reserves with conservative assumptions with regard to a number of areas, and they are set with the expectations that not every trend that we have in place will continue. And so, we set our reserves to be able to absorb unexpected changes, whether they be frequency, severity, or discount changes. We are comfortable, at this point in time, that our reserves can properly reflect the risk of lower Ogden rates.

**Q - Brian Meredith** {BIO 3108204 <GO>}

Got you. Could you give a general sense of how much of your reserves would be exposed to it? Because I completely agree that you guys set reserves very conservatively, but it could impact the magnitude of favorable development actually going forward given the discount rates.

**A - Albert A. Benchimol** {BIO 2023727 <GO>}

I appreciate that. What I would suggest is that we wait until we find out what the Ogden rates are, and then we can provide you with more specificity. At this point in time, we



would just be guessing, and I'm not sure that's helpful.

**Q - Brian Meredith** {BIO 3108204 <GO>}

Okay. Great. And then Albert, next question, could you give us some views on kind of what you're seeing with respect to loss trend? I mean, a couple of companies have purchased adverse development covers, and kind of thinking about that is that maybe some fear that loss trend is starting to pick up. Are you seeing that?

**A - Albert A. Benchimol** {BIO 2023727 <GO>}

Well, they're certainly picking up in certain lines. I mean, you've heard about motor liability trends going up. You've heard about passenger motor liability. We don't do any real motor business in the U.S., so that's not affecting us. And you've also seen in the D&O world a significant increase in D&O cases. So that's the industry. I'm pleased to say that, in our book, we've been following our book in great detail for a number of years, and we have taken action where we needed to, when we needed to. And not to necessarily repeat some of these issues, but we addressed the D&O book back in 2013, and we discussed those issues with you. And I'm pleased to say that notwithstanding the fact that class action claims are at probably the highest level they've been in a long time, our participation in those claims is as low as it's ever been.

And that speaks to the construct of our book. We've always been cautious about motor liability, and so we do not have a large net exposure to motor liability. Although, today, we are taking advantage of the opportunities that are coming out of motor liability. With regard to some of the casualty claims, you heard that last year, we got out of excess casualty globally, not in the U.S. but in the global facilities. So I think that we were, to-date, quite good at reacting to the early signs and have been shifting our book such that we feel very good about where our book is, and we do not have any of the concerns today that have been expressed by others.

**Q - Brian Meredith** {BIO 3108204 <GO>}

Great. Thank you very much.

**A - Albert A. Benchimol** {BIO 2023727 <GO>}

You're welcome.

**Operator**

The next question is from Meyer Shields of KBW. Please go ahead.

**Q - Meyer Shields** {BIO 4281064 <GO>}

Thanks. Two questions, if I can. First, setting aside the impact of rates and trends - the project of shifting your business mix to lower volatility and higher capital return lines, is that impact - specifically on the loss ratio, is that basically done?

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**A - Albert A. Benchimol** {BIO 2023727 <GO>}

I'm sorry. Can you expand on your question? I want to make sure that I understand and respond to what you're looking for.

**Q - Meyer Shields** {BIO 4281064 <GO>}

Yeah. So, as I understand it, one of the major projects of the past few years was to focus on lines of business with both less volatility and maybe smaller margins because the overall returns on capital were better. So that seems to have worked, but it does imply lower technical margins compared to the proceeding book and I'm wondering whether that business mix shift has basically played out.

**A - Albert A. Benchimol** {BIO 2023727 <GO>}

Right. Yeah. The answer to that is generally yes, but what I would say is that it's not simply a mix from a short tail or a catastrophe line to a longer tail or a general liability line. Certainly, we've done that. But the real hard work has actually been in shifting the way we put risks into each of these individual portfolios. So let me give you an example. We're still very strong participants in the energy world. And that is very good business, but we've changed the way that we're building our portfolios. We've grown; we're now a very large leader in the renewable energy work and doing less on the marine side.

We're taking smaller limits which, again, reduces the volatility. So none of those things affect, if you would, the gross line-by-line change in technical ratio. Same thing in property. We still write a lot of property, but we've done a lot of work in terms of our risk selection, in terms of managing micro zonal concentrations and so on. So I don't want to leave you with the impression that we've given up on low technical ratio, volatile lines and shifted the book entirely into long-tail lines. It's been a combination of that shift, yes of course, but also some significant improvement in the way that we are selecting risk and building our portfolios. And that has gone very well and will continue.

**Q - Meyer Shields** {BIO 4281064 <GO>}

Okay. That's very helpful. Second question, and this is really naive. If there is a change in U.S. tax rates - or let me ask this differently. How much global reinsurance demand reflects arbitraging difference in tax rates between, let's say, the U.S. and Bermuda?

**A - Albert A. Benchimol** {BIO 2023727 <GO>}

There are different views on that one, Meyer. I don't know how to answer it because when you're - when we're doing business in the U.S., we charge the same rates as U.S.-based reinsurers. So how do you respond to your question? I think that it's a market clearing price as you know. And so, the market clearing price is not necessarily set by people who have one tax rate or people who have a different kind of tax rate. There's a discovery process. I think as we see the tax environment changing, we're obviously going to see how different companies react and we will do whatever we need to do at that point in time to optimize our portfolio.

**Q - Meyer Shields** {BIO 4281064 <GO>}

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Okay. Understood. Thank you so much.

## Operator

The next question is a follow up from Jay Cohen of Bank of America Merrill Lynch. Please go ahead.

**Q - Jay Arman Cohen** {BIO 1498813 <GO>}

Yeah. I just have follow up for Joe. Joe, if you could talk about the new money yield you're seeing in the market relative to your portfolio yield on the fixed income side?

**A - Joseph C. Henry** {BIO 13390626 <GO>}

Yeah. The new money yield is about 2.8%, Jay. So it spiked up actually in the third and fourth quarter. We have built in frankly some rate increases into our 2017 plan. So this is not necessarily going to dramatically change what we forecast at our income to be going forward. But definitely, the increase in interest rates is having a beneficial impact on the net investment income portion of the portfolio.

**Q - Jay Arman Cohen** {BIO 1498813 <GO>}

Yeah.

**A - Joseph C. Henry** {BIO 13390626 <GO>}

Okay. Are you good? Jay?

**Q - Jay Arman Cohen** {BIO 1498813 <GO>}

Okay. Thank you.

**A - Joseph C. Henry** {BIO 13390626 <GO>}

Okay.

**A - Albert A. Benchimol** {BIO 2023727 <GO>}

Thank you.

## Operator

There are no additional questions at this time. This concludes our question-and-answer session. I would like to turn the conference back over to Albert Benchimol for closing remarks.

**A - Albert A. Benchimol** {BIO 2023727 <GO>}

Thank you, operator, and thank you all for participating in our call. As we discussed, we're confident that we're on the right path for differentiated growth and profitability. We're encouraged that we've made great progress, but we know we still have more work to do

to deliver on our goals. I can promise you that we're fully committed and focused on delivering further progress in 2017 and beyond. Have a great day. Thank you.

**A - Joseph C. Henry** {BIO 13390626 <GO>}

Thank you.

## Operator

The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.

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