Q2 2014 Earnings Call

Company Participants

- Craig W. Howie, Chief Financial Officer & Executive Vice President
- Dominic James Addesso, President, Chief Executive Officer and Director
- Elizabeth B. Farrell, Vice President-Investor Relations
- John P. Doucette, Chief Underwriting Officer & Executive VP

Other Participants

- Amit Kumar, Analyst
- Brian R. Meredith, Analyst
- Ian J. Gutterman, Financial Portfolio Manager
- Jay H. Gelb, Analyst
- Josh D. Shanker, Analyst
- Kai Pan, Analyst
- Meyer Shields, Analyst
- Michael S. Nannizzi, Analyst
- Vinay Misquith, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good day, everyone and welcome to the Second Quarter 2014 Earnings Call for Everest Re Group. Today's conference is being recorded. At this time, for opening remarks and introductions, I would like to turn the conference to Ms. Beth Farrell, Vice President of Investor Relations. Please go ahead.

Elizabeth B. Farrell {BIO 1986541 <GO>}

Thank you, Jessica. Good morning, and welcome to Everest Re Group's second quarter 2014 earnings call. On the call with me today are Dom Addesso, the company's President and Chief Executive Officer, John Doucette, our Chief Underwriting Officer, and Craig Howie, our Chief Financial Officer.

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 like are subject to various risks. As you know, actual results could differ materially from current projections or expectations. Our SEC filings have the 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 and good morning. We are pleased to report on favorable second quarter results this morning. Our operating income per share has improved for both the quarter and the year over the comparable period – comparable prior-year period. Net income per share for the quarter was up over the prior-year, but the six-month number is lower for 2014, due to lower realized gains on investments in 2014.

The improvements in operating results are clearly driven by continuing and growing underwriting gains, (0:01:47) investment income results. The underwriting results did benefit from lower cats this year, but do reflect $45 million of losses in the second quarter, half of that reported last year.

Nevertheless, our underwriting gain in the first half remained strong at $423 million, which was up slightly over the prior year due to growth in premium earned. The growth in premium was achieved while maintaining margins, which is a reflection of our ability to navigate through this market. Yes, rates are down in many of the cat exposed regions. However, by changing attachment points and reallocating capacity to different product types and new products, we have been able to secure additional business at rates that meet or exceed our hurdle rates.

In addition, our Mt. Logan facility and other similar arrangements permit us to present more meaningful capacity to clients, which enables us to secure placements at terms which are acceptable. This trend will continue into the third quarter, as we have secured capacity from the cat on placement we sponsored as well as some purchases of ILW capacity.

We are a significant market with over $7 billion of capital. And these strategies allow us to lever that up even further. Combined with our A-plus rating and team of innovative and responsive underwriters, we are increasingly becoming a market of choice. Nevertheless, we must continue our disciplined approach. And in some segments, you will note that we were forced to retreat due to pricing. John will cover this further in his report, but of particular note is the fact that essentially all of our net premium growth was in our U.S. Reinsurance segment.

The insurance operation continues to perform well, with an underwriting profit in both the first and second quarters of this year. Growth has been constrained due to the crop book, which has actually declined year-over-year by $75 million due to lower commodity prices. That means, of course, that all of our other targeted growth areas are doing well.

Primary pricing is still increasing, although at lower rates, and as such, our insurance result excluding crop is running in the mid-90s (0:04:34) which is an improvement over the prior year. The crop portfolio was expected to improve (0:04:45) this year as we're making significant technology investments there this year.

We were active this first quarter on capital management and Craig will get into the details. Given the financial flexibility gain from our sponsored cat bond (0:05:04), the Mt. Logan facility, ILW purchases and our new debt offering, we continue to have the ability to maintain share repurchases within our earnings stream, while at the same time expanding the franchise.

All in all, we feel that with an increase in shareholder value per share of over 10% in the first half, we have done an excellent job in a challenging underwriting and investment market. We have the talent, resources, capital, and most importantly discipline, to continue (0:05:42).

Thank you. And now I will turn it over to Craig for the financial highlights.

Craig W. Howie {BIO 17579923 <GO>}

Thank you, Dom and good morning everyone. We're pleased to report that Everest had another strong quarter of earnings with net income of $290 million or $6.26 per diluted common share. This compares to net income of $276 million or $5.56 per share for the second quarter of 2013. Net income includes realized capital gains and losses. On a year-to-date basis, net income was $584 million or $12.46 per share compared to $660 million or $13.09 per share in 2013. The 2014 result represents an annualized return on equity of 17%.

Operating income year-to-date was $532 million or $11.35 per share. This represents a 3% increase over operating income of $10.99 per share last year. These overall results were driven by a solid underwriting result, offset by lower net investment income compared to the first half of 2013. The results reflect a stable overall current year attritional combined ratio of 80.9% on a year-to-date basis, down from 81.0% at year-end 2013. This measure excludes the impact of catastrophes, reinstatement premiums and prior-period loss development.

All segments reported underwriting gains for the quarter and for the first half of 2014. Total reinsurance reported an underwriting gain of $181 million for the quarter, compared to $134 million underwriting gain last year. For the first half of 2014, total reinsurance reported an underwriting gain of $396 million, compared to a $344 million gain last year.

The insurance segment reported an underwriting gain of $4 million for the quarter compared to a gain of $9 million last year. And on a year-to-date basis, the insurance segment reported an underwriting gain of $8 million compared to a gain of $9 million in 2013. (0:08:12) reflected a $2 million underwriting loss for crop insurance during the second quarter, primarily due to the seasonality of crop premiums.

Mt. Logan Re's financial position and operating results were consolidated into Everest Re beginning July 1, 2013. These results are shown in a separate segment and reflected a $9 million underwriting gain for the quarter and a $19 million underwriting gain year-to-date.

Everest retained $3 million of this income and $16 million was attributable to the non-controlling interests of this entity. The overall underwriting gain for the group was $195 million for the quarter compared to an underwriting gain of $143 million for the same period last year.

On a year-to-date basis, the underwriting gain was $423 million compared to a gain of $353 million in 2013. These overall results reflect $45 million of current year catastrophe losses in the first half of 2014, all reported in the second quarter. Of the total, $30 million related to late reported losses from the snowstorms in Japan and $15 million related to the earthquake in Chile. This compares with $90 million of catastrophes during the first half of 2013.

Our reported combined ratio was 82.5% for the first half of 2014 compared to 84.2% in 2013. The year-to-date commission ratio of 21.9% was slightly up from 21.2% in 2013, primarily due to higher contingent commissions. Our low expense ratio of 4.5% continues to be a competitive advantage.

As for loss reserves, in June, we released our fourth annual global loss development triangles for 2013. There were no major changes since the 2012 release. Our overall quarterly internal reserving metrics continue to be favorable.

For investments, pre-tax investment income was $131 million for the quarter and $254 million year-to-date on our $17.6 billion investment portfolio. Investment income for the first six months declined $20 million (0:10:49) from one year ago. This decrease was primarily driven by the decline in limited partnership income for the year, although low reinvestment rates and capital used to redeem stock and debt also contributed.

Limited partnership investments resulted in a gain of $6 million for the quarter, compared to a gain of $20 million last year. On a year-to-date basis, the gain was $4 million compared to a gain of $37 million in 2013. Our existing limited partnership portfolio is fairly mature, and as a result, we're seeing a decline in current gains coming from these investments.

Despite the declining rates, our investment portfolio continues to perform well. The pre-tax yield on the overall portfolio was 3.1% with the duration of three years. The first six months reflected $52 million of net after-tax realized capital gains compared to $106 million last year. These gains are mainly attributable to fair value adjustments on the equity portfolio. There were $2 million of derivative gains during the first half of 2014 compared to $27 million of gains last year. This is related to our equity put options and is a function of the change in interest rates and indices this year.

Other income and expense included $50 million of foreign exchange losses in the first six months of 2014. This was mostly offset by foreign exchange gains on bonds reflected in other comprehensive income.

On income taxes, the increase in the effective rate is primarily driven by lower-than-planned catastrophe losses, resulting in higher-than-expected taxable income for the year. The 14.4% effective tax rate on operating income is in line with our expected rate for the year, given our planned cat losses for the remainder of the year. Strong cash flow continues with operating cash flows of $590 million for the first half of 2014 compared to $439 million in 2013.

Turning to capital management; we issued $400 million, a 4.868% 30-year senior notes in June to replace our 5.4% senior notes that will mature in October. Shareholders' equity at the end of the quarter was $7.3 billion, up $355 million or 5% over year-end 2013. This is after taking into account almost $400 million of capital returned for the $325 million of share buybacks and $69 million of dividends paid in the first half of 2014.

Additionally, we repurchased another $10 million of stock after the quarter close. These purchases will be reflected in the third quarter financial statements. Book value per share increased 9% to $160.27 from $146.57 at year-end 2013. Our continued strong capital balance positions us well for potential business opportunities as well as continuing stock repurchases.

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

John P. Doucette {BIO 7178336 <GO>}

Thank you, Craig. Good morning. As Dom highlighted, we continued our strong results into the second quarter of 2014. Our group gross written premium was $1.42 billion, up $155 million from Q2 of last year, with growth coming from each of our reinsurance segment. Net written premium was $1.22 billion, which was closer to flat given the various hedges. For our reinsurance segment, total reinsurance GWP including Logan was $1.1 billion for the quarter, up 16% from Q2 last year.

We remain optimistic on our reinsurance operations despite several market headwinds. We are successfully navigating this market and growing profitably by utilizing our many competitive advantages, including our leading global market position, franchise and reputation; our strong ratings and well capitalized balance sheet; our expense ratio advantage over our competitors and our culture of bottom line execution; our best-in-class analytics which allows us to make informed and accretive portfolio management decisions; our state-of-the-art enterprise risk management framework which recently got upgraded to strong by S&P; our utilization of the capital markets convergence, both offensively and defensively across a variety of strategies to maximize efficiencies for our clients and maximize value to our shareholders; and our long-term trading relationships with our clients as one of the longest-standing and largest reinsurers. These all – these are all advantages that provide Everest with the edge in this competitive space.

We are also benefiting from strategic relationships we've been building and the new products we've been rolling out across the entire reinsurance division. All of this has enabled Everest to continue to profitably deploy its capital. This July 1 marks the one-year anniversary of Mt. Logan, representing the successful partnering between Everest and third-party investors to opportunistically grow and deploy capacity in the catastrophe risk market.

We believe this strategic initiative has been successful for all involved and our unique Logan structure was validated by new investors again coming into Logan (0:17:34) resulting in increased AUM, even after paying out profits to our investors. We continue to believe that the Logan structure adds value to both our clients and our shareholders. Our clients and brokers benefit from Everest being able to deploy more capacity on deals and layers which are attractively priced. Having access to both rated and unrated balance sheet allows us to deploy capacity to our clients in a more efficient manner than either one by itself. And our shareholders benefit from Everest's ability to deepen client relationships, better manage our overall capital and our PMLs, while achieving higher risk-adjusted returns and improving our cost of capital.

As we mentioned last quarter, in addition of Logan, we've initiated other PML and capital management strategies. We recently obtained fully collateralized reinsurance coverage funded by the Kilimanjaro Re (0:18:41) and we were active buyers in the ILW space. Executing these strategies helped us trend some of our peak PMLs.

Currently, the price of risk around the world has decreased in many areas. But with our core advantages and deployment of several capital market strategies, we can compete, win, grow and build significant shareholder value in any market condition. Here's some color on June 1 and July 1 reinsurance renewals. For our overall global property reinsurance book at June 1 and July 1, we continue to grow our gross written premium aided by the additional capacity provided by Mt. Logan.

While the expected combined ratio was up about one to two points year-over-year, the gross and the net dollar margin continued to expand in the overall book compared to the same period last year. This demonstrates the significant benefit of our long-standing diversified global portfolio across many clients, products and territories.

Across our book, Florida Cat XOL rates were down approximately 10% to 15% compared to last year. Despite that, we were pleased with our (0:20:04) renewal by growing our gross and net premium as well as our gross dollar margin and our net dollar margin across the Florida book. This was achieved by deploying meaningful capacity on cat XOL deals which we liked with key strategic clients, while reducing shares or declining deals, which we did not find attractive, and in some cases, moving up attachments on our programs where we found rates were more attractive. In Florida and other USA regions, there were some quota share treaties on which we were unable to come to mutually acceptable terms, so we came off. However, we also build new pro-rata relationships, as well as increased some existing relationships, where we like the clients, the pricing, terms and conditions.

We are continuously rebalancing both our cat XOL and pro rata books in Florida and elsewhere around the globe, as we seek the optimal position on the programs, which we believe provides us with the best risk adjusted returns, while maintaining our relationships with longstanding clients. Our overall net-net Florida PMLs are flat, from (0:21:24) as a percentage of GAAP equity, against increased dollar margins, given our portfolio management and hedging.

Internationally, we (0:21:35), with some areas (0:21:40), particularly China and Australia, and correspondingly premiums were down in those areas. But in those and other areas, we had better than market results, due to our lead (0:21:54) market position and the strength of our relationships with long-term clients and brokers.

Turning to our overall casualty and longer-tail reinsurance book globally, primary terms and conditions remain attractive. But reinsurance terms continue to be under pressure for commodity type treaties and seeding commissions on casualty quota share treaties are generally moving up. Therefore, we continue to execute new products and new opportunities, and we saw some nice growth overall in our long-tail book. These one-off, highly-customized solutions more than offset the GWP on the traditional casualty treaties, which we declined due to pricing.

Total reinsurance including Logan, bottom line, we continued the strong underwriting results with underwriting profits in the second quarter of $190 million, up 42% compared to Q2 last year underwriting profits.

Now, with respect to our insurance operations; our premium was $316 million in Q2, essentially flat from Q2 last year. As mentioned, this is due to a decrease in crop premium in Heartland from lower commodity prices. Stripping out Heartland premium, our Q2 insurance GWP is up 12% this year compared to Q2 last year. Rates are generally up in the insurance operation, including casualty and workers comp. Property insurance rates were mixed, depending on the type of risk in the territory.

We continue to see profitable growth opportunities in many areas in our insurance book, including areas that we have targeted, such as non-program workers comp, casualty, specialty and contingency lines, property, E&S and DIC, accident and health and our Canadian insurance operations. However, we remain cautious in the professional lines with more capacity coming into that space.

Bottom line, our insurance results were profitable year-to-date and for the quarter. With the year-to-date results coming in at a 98.1% attritional combined ratio and a 93.9% attritional combined ratio excluding crop, which is better than the same result last year.

We continue to be pleased with the underlying trends in our insurance book. We are seeing encouraging results of our insurance growth initiatives over the last several years, with noted improvements in both loss ratios and expense ratios, as well as premium growth in all areas of our insurance book, except for Heartland this year. We expect these trends to continue with both top line and bottom line growth in our insurance book.

In summary, the world of insurance and reinsurance is a rapidly changing world and while there may ultimately be a structural shift in the market, we are as well positioned as anyone to benefit from these changes. We remain confident in our ability to achieve profitable growth for our shareholders and we remain bullish on our future.

Thank you and now back to Beth for Q&A.

Elizabeth B. Farrell {BIO 1986541 <GO>}

Jessica, we're open for questions now.

Q&A

Operator

Thank you. And we'll go first to Amit Kumar with Macquarie.

Q - Amit Kumar {BIO 16979665 <GO>}

Thanks and good morning. Just two quick questions. The first question relates to your underlying loss ratio ex cats for reinsurance. I'm looking at the numbers and I'm wondering you're talking about pricing declines, why wouldn't that number go up? Is that more a business mix shift issue or is there more to it?

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

Amit, this is Dom.

Q - Amit Kumar {BIO 16979665 <GO>}

Hey.

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

There are number of factors. One is mix of business. Another would be - some of it's pro rata, and to the extent that primary pricing is increasing, that impacts it, and usually - and I think your question was just related to the reinsurance book.

Q - Amit Kumar {BIO 16979665 <GO>}

Yes.

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

And then new products, in particular, is what would be driving that in different lines of business that we are getting into.

Q - Amit Kumar {BIO 16979665 <GO>}

So that is nearly offsetting the double-digit declines in pricing.

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

Correct.

Q - Amit Kumar {BIO 16979665 <GO>}

Got it. The other question I had is just going back to your discussion on the crop, how should we think about the future with the prices being down, but the yields being up? How do you feel – how does this play out? I know it's a bit early, but we just love to get your thoughts for the future on the crop.

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

You've already given part of my answer, which is, it is a bit early. And for now, weather is looking favorable. So we're anticipating decent yields. Certainly commodity prices are down for now, but there's still a lot of room to go on where that market settles out. So – then you've got the issue of retentions by the – or deductibles (0:27:37) retaining portion of the risk. So we're not anticipating at this point that the downward turn in commodity prices would (0:27:49). But there's still quite plenty of room (0:27:53).

Q - Amit Kumar {BIO 16979665 <GO>}

What percent of your...

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

(0:27:55).

Q - Amit Kumar {BIO 16979665 <GO>}

I'm sorry.

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

You have a follow up?

Q - Amit Kumar {BIO 16979665 <GO>}

Yeah, yeah. What percent of your book is revenue based?

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

Amit, this is John.

Q - Amit Kumar {BIO 16979665 <GO>}

Hey.

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

Most of it. A vast majority of it is revenue based.

Q - Amit Kumar {BIO 16979665 <GO>}

Okay. Got it. I'll stop here and re-queue. Thanks for all the answers.

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

Amit, I want to come back also to your first question, which is the declining property cat rates and you have to also remember that property cat premium only represents about 25% of our total premium. So you can have a decline in pricing there, but other new products and other things can – it's highly levered – the impact of that is highly levered.

Q - Amit Kumar {BIO 16979665 <GO>}

Got it. Fair enough.

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

Okay.

Operator

We'll go next to Josh Shanker with Deutsche Bank.

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

Hi, good morning, everyone.

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

Good morning, Josh.

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

Good morning. I want to talk a little bit about the premium (0:29:00) in the international segment as it relates to pricing and as it relates to Mt. Logan's participation?

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

Well, some of the premium in the international is a result of some strategic relationships that we have with some large global clients, so that's dominating that. It's heavily reinsured as well. So that's dominating the session there. And then of course, you do have the Mt. Logan impact as well.

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

So, the Mt. Logan portion of that would be the minority of the (0:29:37)?

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

That's correct.

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

Correct.

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

Yes.

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

And these relationships, I guess, you did not have them one year ago?

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

That is correct. (0:29:49 - 0:29:55) clarify that. These were clients we had one year ago, but the particular transactions were not in place one year ago.

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

Yes.

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

And just what lines of business is this in order to get it, you have to have (0:30:08) it's a fairly high (0:30:12) what lines or I don't know what you're willing to say about it?

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

It's across all lines of business. It's a multi-line approach quota share.

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

Okay. You want to say as much you want to say about it, I guess. That was my only question.

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

Well, I mean it's essentially the ability for these clients that need Everest in that marketplace with our rating and our capital, and it enables them to increase their participation in the markets that they operate in by partnering up with Everest on these particular transactions (0:30:55).

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

Okay. So these - see, these are reinsurance company who probably couldn't get the business on their own.

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

No, no, no, no, no, they are primary companies. They are primary companies.

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

And so I guess, I mean you're retroceding back to the client (0:31:11) I guess.

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

That is correct.

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

Okay. And then – okay. Fairly good (0:31:18). Thank you.

Operator

We'll go next to Jay Gelb with Barclays.

Q - Jay H. Gelb {BIO 21247396 <GO>}

Thank you. On the international reinsurance segment, with the retention, the net to gross going down to 70%, do you feel that's just something we should see this quarter or will that affect the sessions going forward, which is typically much closer to or the net to gross is typically much closer to 100% in international reinsurance.

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

Jay, this is Craig. I think this is something that we would expect to see going forward as well.

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

This is John. We would also, as Logan – as we continue to see business from all of the segments, we would see an impact of that (0:32:07) somewhat within the international segment as well.

Q - Jay H. Gelb {BIO 21247396 <GO>}

Okay. Have you said before what portion of Everest Re's business is ceded to Logan?

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

You can see that in the segment report in terms of what the gross written premiums that were ceded to Logan in the Logan segment at the back of the Analyst Report.

Q - Jay H. Gelb {BIO 21247396 <GO>}

Okay. So that's just direct from the Everest Re book.

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

Correct.

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

Correct.

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

You're right.

Q - Jay H. Gelb {BIO 21247396 <GO>}

Okay. And then on share buybacks, the pace slowed in 2Q relative to 1Q. Why was that?

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

Basically the price of the stock kept going up and exceeding our target in terms of what we gave or instructions that we gave to our broker, and we just couldn't keep pace with it.

Q - Jay H. Gelb {BIO 21247396 <GO>}

All right. That's a – I guess that's a good problem to have. Thank you very much.

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

And thank you.

Operator

We will go next to Kai Pan with Morgan Stanley.

Q - Kai Pan {BIO 18669701 <GO>}

Good morning. Thank you for taking my call. The first question is just follow-up on Josh's question on the retro buying. I just – (0:33:23) think about strategically, do you think is a defensive move that you want to retain, maintain, and grow the relationship or it could be a arbitrage that actually can enhance your margin offensively?

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

This is John. Good morning. Lots of times around the world, we have opportunities to partner and build strategic relationships with clients, and there's a variety of reasons why they do that. And sometimes it's to get access to their business or our business or, as Dom said earlier, to give them an opportunity to enhance their writings. And as we've been saying for many quarters now, we've been building strategic relationships with this, which gives us access to what we believe is profitable business and then help to strengthen relationships with some of our long-standing clients around the globe.

Q - Kai Pan {BIO 18669701 <GO>}

Okay. Then you mentioned on the – sort of your global reinsurance book (0:34:27) pricing decline and (0:34:27) expected combined ratio to deteriorate about one to two points. (0:34:35) – could you give more color on (0:34:39) your pricing commentary that you had said about it, pricing declines, especially in Florida, pretty big, but it looks like the combined ratio deterioration relatively is moderate. So anything behind that?

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

Well, in part was what I mentioned before. I will ask John to comment as well, but again we recollect that the cat premium, particularly the cat XOL premium or total cat premium is 25% of our total premium volume. So if that pricing is down 10% to 15%, it's not going to be dollar for dollar impact of the combined ratio across the entire book, so there is that leverage impact.

Q - Kai Pan {BIO 18669701 <GO>}

Right. The 10% to 15% was the comment on Florida rates. We also talked about how we move up in programs where the rates - we move within programs, so that the impact to us may not be 10% to 15%. But then the comment on the one to two combined ratio point, that was on our global property book. And I think that just highlight the kind of the strength of a diversified portfolio trading in 80 countries around the world, where we write property reinsurance with clients that we've been trading with for very long time, and it helps insulate our portfolio and we look to grow areas around the globe, where we think we're getting paid to take the risk and that (0:36:16) our portfolio for various rate decreases that are happening in different areas.

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

And remember in the first quarter - you might remember in the first quarter that we referenced some areas of the world, rates were going up, in particular, Canada, that those were - that's something that helps offset decline that we see in other territories.

Q - Kai Pan {BIO 18669701 <GO>}

Great. And last question maybe for Craig. I saw that you mentioned the tax rate, that's going to be 14% sort of run rate or I might have missed that?

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

That's correct, Kai. So let me just explain a little bit. The taxes, operating tax specifically, operating tax is based on the geographic region where the income is earned, (0:37:01) right? And then it's also based on the tax rate in that country. What we had is an annualized rate of 14.4%; that's higher than where we were after the first quarter at 13.8%. It's primarily due to the fact that we had lower than planned cat losses. So, with a full cat load for the year, we would expect our tax rate to be somewhere between 13% and 14%. And with the remaining cat load for the rest of this year, we expect it to be at about 14.5%. If we look at this, with no more cats for the rest of the year, I would expect that rate to even rise further to about a 15% to 16% rate. So, it's really based on - currently - it's primarily based on the amount of catastrophes that we have or don't have during the year.

Q - Kai Pan {BIO 18669701 <GO>}

Okay, great. Thanks so much for all the answers.

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

Thank you.

Operator

We'll go next to Michael Nannizzi with Goldman Sachs.

Q - Michael S. Nannizzi {BIO 15198493 <GO>}

Thanks. Dom, just had a question on, I think it was to – and your answer to Amit's question about mix change, just what lines of business are you growing in, are you mixing towards where margins are kind of similar or better than the cat business?

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

Most of it would be in the credit space. John?

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

Definitely, we're seeing some. We've talked about that in the last several quarters We also are one-off (0:38:31) highly customized products that we think have better – it's not commodity, (0:38:36). They're not just (0:38:41) product that everybody can do again. You know these are – some of these are very complicated products. But we have the underwriting talent, the actuarial, the contract wording (0:38:53), tax, et cetera to bring the bear (0:38:59) and we're seeing a lot of traction in that.

Q - Michael S. Nannizzi {BIO 15198493 <GO>}

Got it. And how to – and from a capital intensive perspective, how do those products sort of compare to the cat business?

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

Well, the way we think of capital is capital where we're full – areas where we're (0:39:21) fullness of volatility attracts more capital. So in a lot of cases, we're not that full and a lot of these products are a little – have more structure to themself, but they don't have the volatility (0:39:35). So in general, they attract less capital.

Q - Michael S. Nannizzi {BIO 15198493 <GO>}

Got it. So this is an area, I – it sounds like that you'll continue to move towards, there's (0:39:43) good margins. You're getting paid for technical expertise that others can't replicate, so that seems like an area that you'll look to continue to grow?

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

That's our job, to find areas like that and others.

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

And it's not just technical expertise, it's also size, (0:40:04) these are all things that they give us a unique advantage.

Q - Michael S. Nannizzi {BIO 15198493 <GO>}

Okay. Can you give an example, just like the mortgage-guarantee space or is this something different?

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

I mean, there's a whole array of deals. But, as Dom said, we've done a lot of different things in the credit space, some in the mortgage space too.

Q - Michael S. Nannizzi {BIO 15198493 <GO>}

Got it, okay. And then one question about Mt. Logan, so the cat load there was higher than the legacy business. So, is that kind of what you would expect that Mt. Logan will run at a higher cat load than the sort of on-balance sheet business or is that somewhat anomalistic, as we're trying to figure out how the relationship between that and to your on-balance sheet business moves?

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

This is John. If I understand your question correctly, it's – what is the embedded cat load as a percentage of premium? Mt. Logan is taking all and only property catastrophe excess of loss business, where Everest on the reinsurance book, and the cat load, as a percentage of premium is applied to all lines of business. So, you would see.

Q - Michael S. Nannizzi {BIO 15198493 <GO>}

More concentrated. Okay.

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

Yes.

Q - Michael S. Nannizzi {BIO 15198493 <GO>}

That makes sense. Okay. And then just last question to Dom, I think a numbers questions, you mentioned 25% cat as a percentage of premiums. Do you have any – what is that in terms of, as a percentage of underlying or underwriting profitability? Just trying to right-size those two.

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

Well, our expected underwriting profit on a cat book would be running to 50% to 60% combined ratio, that would be kind of what we would expect (0:41:56) depends on territory, depends on attachment point, a lot of variables there, but that would be kind of the expected outcome over time from the catastrophe book. Does that answer your question?

Q - Michael S. Nannizzi {BIO 15198493 <GO>}

(0:42:09) but I guess if cat premiums are 25% of total premiums, is there an equivalent percentage or could we know what the equivalent percentage is of just profitability of total, kind of average profitability represented by your cat business?

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

Well, it's a significant portion, no question, because - but you've got the cats that will earn (0:42:32) the premium, and it's - and we got commission and brokerage, (0:42:43) with a significant percentage of profits (0:42:47).

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

I mean, given the volatility, we would certainly expect it to run to a higher percentage of underwriting profits for us to assume the volatility (0:42:58). And we would all - likewise, we would assume (0:43:04) combined ratio.

Q - Michael S. Nannizzi {BIO 15198493 <GO>}

Right, got it. Okay, thank you.

Operator

We'll go next to Meyer Shields of KBW.

Q - Meyer Shields {BIO 4281064 <GO>}

Thanks. Good morning, everyone (0:43:16).

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

Good morning.

Q - Meyer Shields {BIO 4281064 <GO>}

John, one quick question, I guess, I was a little surprised that you said you're moving up in attachment points in Florida, because my understanding was that higher the attachment points, the more competitive things were, am I misreading the situation?

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

I think the situation is dynamic and I was trying to give a couple of examples and there's other examples that would be (0:43:39) to that, but one thing that I think we saw was some of the Florida companies moved up partially, because of not having had cats over the last couple of years, had moved up their retentions. And again, our view of risk maybe different than other peoples view of risk, but they were definitely cases where we thought the pressure on rates was less (0:44:03) than otherwise.

Q - Meyer Shields {BIO 4281064 <GO>}

Okay, that's helpful. Two quick numbers questions if I can, I guess for Craig, one, the tax rate specifically on net investment income also went up in the quarter, is that likely to persist?

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

That's really based on where that investment income is. And so when you say likely to persist, if it's in the U.S., it's a factor of 35% rate. That's really what it comes down to.

Q - Meyer Shields {BIO 4281064 <GO>}

Right. Is the mix shifting away or towards the U.S.?

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

For the gains that happened this period, yes.

Q - Meyer Shields {BIO 4281064 <GO>}

Okay. And we talked about higher commission expense on contingent commissions. Is that both U.S. reinsurance and the insurance segment?

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

Mostly, it's mostly the reinsurance segment. On the insurance side, most of our contingents' arrangements would've been with MGAs, and of course, as you know we've been shrinking our participation in that segment of the market. So while we still have some reserves out there for profit sharing contingent payouts, the impact of that is much smaller, it's mostly the reinsurance book.

Q - Meyer Shields {BIO 4281064 <GO>}

Okay. (0:45:22). Thanks very much.

Operator

Our next question comes from Brian Meredith with UBS.

Q - Brian R. Meredith {BIO 3108204 <GO>}

Yeah. Good morning. And couple of just quick questions here for you. First one, with respect to some of the (0:45:33) business you got off of in the quarter, did that impact the second quarter results or are we going to see (0:45:39) third quarter, because I know in the past, you've had some ups and downs in your North American business because of some big quota shares you've gotten them off of?

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

There was an impact to the book this period. Again, it's based on the amount of premium that was leaving and being returned, but small impact to the book this period.

Q - Brian R. Meredith {BIO 3108204 <GO>}

So (0:46:05), okay.

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

Yeah, but over time, our mix between (0:46:10) and XOL really haven't (0:46:11) changed dramatically. And in fact, the reference quota share that we're now off of, particularly in Florida, we've replaced with some other Florida quota shares as well as some quota shares in the Northeast. So...

Q - Brian R. Meredith {BIO 3108204 <GO>}

Gotcha.

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

Again the book is constantly - its fluid.

Q - Brian R. Meredith {BIO 3108204 <GO>}

Gotcha.

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

But we would not expect any significant impact. When the complete year unfolds, the year-over-year numbers will not be that dramatically different.

Q - Brian R. Meredith {BIO 3108204 <GO>}

Great (0:46:42), thanks, And then second question, I'm just curious, Dom and John, could you chat a little bit about what you're seeing with respect to demand for casualty reinsurance out there right now? Has it increased at all?

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

If you're willing to pay a high (0:46:58), yes, the demand is going up. And in our particular case, we are not playing in many of those high ceding (0:47:10) commission transactions. John, if you have anything further there?

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

Yeah, there certainly have been some cases of people coming into the market that hasn't been in the past. But yeah, I think there's been a long-term trend of kind of tepid demand on casualty business. And again that's more - it varies a lot around the globe.

Q - Brian R. Meredith {BIO 3108204 <GO>}

Okay. So you haven't really seen a change necessarily this quarter, where primaries are trying to buy more casualty?

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

Not in any strong trend that we could identify at this point in time.

Q - Brian R. Meredith {BIO 3108204 <GO>}

Great, thank you.

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

Thank you.

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

Thank you.

Operator

And we'll go next to Vinay Misquith of Evercore.

Q - Vinay Misquith {BIO 6989856 <GO>}

Hi, good morning. Just a follow-up on the international retro that was purchased, I believe you said that that should continue in the future. But this quarter, we saw about a 30% increase in gross written premiums. So should that continue into the feature, so higher gross written premiums and higher retro in the future?

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

Let me – let's maybe clarify something. It's retrocessional in absolutely in the way it's booked or what it's called, but it's not really retro in the way you're implying.

Q - Vinay Misquith {BIO 6989856 <GO>}

(0:48:41).

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

These are transactions that – where we're participating with some global clients on deals, where we're taking the premium in the front-end and they're participating to a significant degree as a reinsurer of that incoming portfolio.

So, don't think of it in the terms of, as we're out there buying retro in the retro market; it's not that. We do – we have increased our "retro buying" just from the mere fact that we have the Mt. Logan facility and various ILWs that we are buying, but it's dwarfed by the strategic transactions that we've been talking about earlier. So the – that percentage that you see – that you saw in terms of sessions is likely to persist, but it's not necessarily going to grow dramatically from here unless we find other strategic relationships and transactions to enter into with clients. So that's – that's the best I can do about telling you what's out there in the future with respect to that number.

Q - Vinay Misquith {BIO 6989856 <GO>}

Sure. But just on the gross written premium lines, (0:49:53) front end and then giving it out sort of on the back, correct? I mean that's the way to look at it?

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

Right, right. But it's part of a – it's part of a complete transaction that took a few clients.

Q - Vinay Misquith {BIO 6989856 <GO>}

(0:50:08) That's helpful. The second is with respect to the primary insurance. I see the expense ratio also going up. (0:50:15) items in that.

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

Just that was really more of a function of the fact that our Heartland crop premium was down dramatically this year as I mentioned, because of commodity prices. So – and the commission ratio in the crop book is less than our standard – the other primary lines of business.

Q - Vinay Misquith {BIO 6989856 <GO>}

Sure. Fair enough. And then the last one, the share repurchases, I think you answered that question. But if I heard you correctly, you said you can sort of give back all the capital from earnings despite growing your business. I just wanted to understand that correctly. So can you...

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

I don't know that I quite said it that way. I basically said that we certainly look – our share repurchase program looks to be contained within earnings. That does not necessarily mean that we're saying or predicting that we would buy in up to our actual earnings. It all depends on the price of the stock. It depends on what opportunities we see out in front of us and what our needs for capital are. But certainly we got a little bit behind our targets in the second quarter, again due to price movement in the stock.

Q - Vinay Misquith {BIO 6989856 <GO>}

Okay, that's helpful. Thank you.

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

Thank you.

Operator

And our last question comes from Ian Gutterman with Balyasny.

Q - Ian J. Gutterman {BIO 18249218 <GO>}

Hi. Good morning, guys.

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

Good morning, Ian.

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

Good morning.

Q - Ian J. Gutterman {BIO 18249218 <GO>}

I guess my first question is sort of big picture, I guess, I'm sort of puzzled why we are not shrinking the reinsurance book, and what I mean by that is, if we had this conversation a year ago or even in January, frankly, it seem like the pressure is mostly on cat. When you talk to people, you made the reference and others have to (0:52:17), you see, it seems that the (0:52:21) is trying to cause trouble in the other non-cat property lines, I mean why aren't we shrinking the book instead of growing the book?

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

Because our margins are expanding, and in many cases, the premium or the transactions that we're seeing exceed - and I don't mean by a slight margin, exceed our hurdle rates for business. So if we're able to put additional business on the books and still generate double-digit returns on equity to our shareholders, we're going to continue to do that. Also remember that we've increased, as we mentioned, we've had our (0:53:03), we've had ILW purchases.

Our net return on capital on transactions is higher than the gross cost. So in other words, we're improving our ROE by bringing on business and then using - taking the advantage of the capital markets to lay off significant portion of that risk, if not in some cases, all of it. So that's the reason why.

Q - Ian J. Gutterman {BIO 18249218 <GO>}

Okay. So (0:53:29) I guess the reason I ask you is there other reinsurance executive saying, we're starting to (0:53:34 - 0:53:40), you don't agree with that statement then?

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

Well, because we've got other forms of capital, we can hedge the exposure. So if we're a - if - that we didn't have in the late 90s. So if we're able to utilize the capital markets and improve our ROEs, while at the same time maintaining, and John mentioned this, but it's worth re-emphasizing, our net PMLs from the beginning of the year have not really changed materially as a percentage of capital. So we're expanding margins with basically the same PML exposure.

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

I'd like to add a different dimension response to your question. We also are seeing opportunities. There has been a lot of talk about that - the haves and have nots in the reinsurance world. And so I can't respond specifically to you say other reinsurance executives are saying these things, but our opportunity set is not the same as the opportunity set in front of a lot of other reinsurance companies. We see deals around the globe that are shown to three or four reinsurance companies. We're creating new distribution sources through these new products we've been talking about now for several quarters.

So we have significant clients that - we have global clients that want to do more business with companies like Everest and with - and less business with other people. So there's a lot of other dimensions to this – to the landscape and we think we're navigating it pretty well.

Q - Ian J. Gutterman {BIO 18249218 <GO>}

(0:55:24). So that's a very, very good point. Just to follow up – I normally wouldn't ask about a specific contract, but I think it's in the public domain, who Citizens reinsurers with. You guys took a very large line I believe on that (0:55:39) program. I don't think you're on it much (0:55:40) just maybe talk a little bit about why that was a good place to deploy capacity?

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

Yeah, we did take a larger line this year. We liked it. We liked (0:55:54) and frankly there was some improvements in the contract wording, that was one of reasons we didn't put up a bigger line last year. So we were happy with that met our returns (0:56:04). And so, therefore, as we looked and headed into our June renewals, we thought it was accretive to the portfolio that we're trying to build and it made sense particularly it fit well, and given the way we managed our net PMLs, we thought it was the right thing to do.

Q - Ian J. Gutterman {BIO 18249218 <GO>}

Got it. So, if I (0:56:32) you had a big up there, a big down on Universal. Outside of those two, would you say your cat book grew in the quarter or was it really just those were the two big (0:56:40) and the rest was maybe slightly down?

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

(0:56:44) in the quarter.

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

(0:56:46) You remember what I was saying earlier, yeah.

Q - Ian J. Gutterman {BIO 18249218 <GO>}

Right. (0:56:49) what I'm trying to get is, was Citizens all over the growth or was there other growth even if you didn't do (0:56:57)?

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

One way I would describe this renewal was very volatile. There were lots of new structures. We played at different levels of attachments. Our line size has moved up and down more than it has in the past.

Q - Ian J. Gutterman {BIO 18249218 <GO>}

Got it. Got it. And then just lastly a numbers question, in the U.S. reinsurance segment, the acquisition expense ratio historically has been around may be (0:57:24) this quarter, was that a mixing? Was that higher (0:57:27), any color on that?

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

That's the higher contingent commissions in the commission ratio.

Q - Ian J. Gutterman {BIO 18249218 <GO>}

Okay. But (0:57:36) the base (0:57:38) has gone up?

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

That's correct.

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

Correct.

Q - Ian J. Gutterman {BIO 18249218 <GO>}

Got it. Perfect. Thank you.

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

You got it.

Operator

And at this time, I would like to turn the conference back to Dom Addesso for closing remarks.

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

Thanks for all your questions this morning. In summary, I'd like to just reemphasize that despite many challenges that are out there in the marketplace that we've discussed this morning, we remain optimistic about continue to deliver double-digit ROEs, due to our size and ability to navigate through this market. So again, thank you for participating on the call this morning.

Operator

This does conclude today's conference. Thank you for your participation.