Q3 2014 Earnings Call

Company Participants

- Jeffrey D. Kelly
- Kevin J. O'Donnell
- Peter Hill

Other Participants

- Amit Kumar
- Ian J. Gutterman
- Jay A. Cohen
- Josh C. Stirling
- Joshua D. Shanker
- Kai Pan
- Mark A. Dwelle
- Michael S. Nannizzi
- Ryan Byrnes
- Vinay Misquith

MANAGEMENT DISCUSSION SECTION

Operator

Good morning. My name is Tiffany. And I will be your conference operator today. At this time, I would like to welcome everyone to the RenaissanceRe Third Quarter 2014 Financial Results Conference Call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session.

Thank you. Peter Hill, you may begin your conference.

Peter Hill {BIO 1828241 <GO>}

Good morning and thank you for joining our third quarter 2014 financial results conference call. Yesterday, after the market closed, we issued our quarterly release. If you didn't get a copy, please call me at 212-521-4800 and we'll make sure to provide you with one.

There will be an audio replay of the call available from about noon Eastern Time today through midnight on November 25. The replay can be accessed by dialing 855-859-2056 or 404-537-3406. The pass code you will need for both numbers is 17974977. Today's call is also available through the Investor Information section of www.renre.com and will be archived on RenaissanceRe's website through midnight on January 14, 2015.

Before we begin, I'm obliged to caution that today's discussion may contain forward-looking statements. And actual results may differ materially from those discussed. Additional information regarding the factors shaping these outcomes can be found in RenaissanceRe's SEC filings, to which we direct you.

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

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

Kevin J. O'Donnell

Thanks, Peter, and good morning, everyone. For today's call, I'll start with some general comments, then I'll turn it over to Jeff to go over the financial results, and then I'll come back on to discuss the business in more detail.

Yesterday, we reported annualized operating return on equity of 11.7% for the third quarter. Growth in tangible book value per share plus accumulated dividends was 1.5%. Our results reflect our actions to reduce risk and optimize risk-adjusted returns in a difficult and competitive environment.

We benefited from another relatively light wind season but were impacted by weaker investment returns, as Jeff will explain in more detail. This quarter, we continued to shrink our Catastrophe Reinsurance book, although this was offset by strong growth in our Specialty and Lloyd's businesses. The broad themes we have talked about on the last couple of calls persisted.

In property cat, so far this year, we have leveraged our industry-leading market position, relationships and technology to access the best business. We continued to pull back where price declines resulted in business not meeting our return hurdle rates. But our focus remains the same, to construct an attractive and efficient portfolio. We believe, as we always have, that discipline is imperative in this market.

Our Specialty team was also able to leverage the strong relationships we have built over the years. We've been welcomed in targeted classes. And we're able to grow that book in the challenging market by working with partners we have known for many years.

Our Lloyd's unit also continued to grow, principally in its property lines of business. In the third quarter, our focus transitions from our in-force book to our strategy for renewals. Absent a major event or catalyst, we don't see macro trends changing much, as the year plays out. This will likely put additional pressure on pricing for property cat and ceding commissions and casualty in Specialty classes.

An area that we're monitoring carefully is terms and conditions. Weakening of terms can be a dangerous trend in our view. It can involve not only a reduction in deal economics, but also an introduction of unmodeled risks to the portfolio. This has been a good year for us in capital management, which is something we think about holistically. We seek to optimize our capital position and reduce our cost of capital to match underwriting opportunities.

We were opportunistic with share buybacks this quarter. We will continue to return capital to our shareholders and third-party investors, when we cannot find opportunities to deploy it at adequate rates of return. In that same vein, we will utilize ceded purchases to optimize the return profile of our book of business.

At this point, let me turn the call over to Jeff.

Jeffrey D. Kelly {BIO 1390834 <GO>}

Thanks, Kevin, and good morning, everyone. I'll cover our financial results for the third quarter and year-to-date and then finish by giving you our top line forecast for 2015.

We had a profitable third quarter, again benefiting from solid underwriting results and relatively low catastrophe losses. At the same time, rising interest rates and widening credit spreads hurt the total investment return during the quarter. A continued decline in the managed cat top line was more than offset by growth in our Specialty Reinsurance and Lloyd's platforms.

We were again active with share repurchases and continued to return capital that we are not able to deploy. Earlier this year, we made the decision to improve our risk-adjusted returns by reducing the size of our net cap portfolio, which we believe is the prudent strategy in the current competitive marketplace.

We reported net income of $68 million or $1.70 per diluted share and operating income of $99 million or $2.49 per diluted share for the third quarter. The annualized operating ROE was 11.7% for the third quarter. And our tangible book value per share, including change in accumulated dividends, increased by 1.5% during the quarter. For the first nine months of the year, we reported an annualized operating ROE of 12.9% and growth in tangible book value per share plus dividends of 8%.

Let me shift to the segment results, beginning with our Cat segment and followed by Specialty Reinsurance and then Lloyd's. The vast majority of our cat book is written in the first two quarters of the year, so the third quarter tends to be pretty light in terms of managed cat premiums written.

Managed cat gross premiums written declined 14% with a year ago during the third quarter. Adjusting for prior year reinstatement premiums of $10 million and a $27 million multi-year contract written and booked in the year ago period, managed cat premiums declined approximately 16% for the first nine months of 2014.

As we had highlighted on the second quarter call, the year-to-date top line decline for cat premiums was largely driven by increased pricing competition, exposure reduction and repositioning of our portfolio relative to a year ago. Net premiums written in our Cat segment increased 29% in the third quarter, due to timing differences related to ceded reinsurance transactions booked in the year ago period.

Net premiums written are down 31% for the first nine months of the year, reflecting a reduction in gross premiums written as well as increased ceded retro purchases. The third quarter combined ratio for the cat unit of 23.9% benefited from overall benign catastrophe loss experience and favorable reserve development. There were no major catastrophe loss events in the quarter. Net favorable reserve development totaled $10 million for the cat unit in the quarter.

Specialty Reinsurance gross premiums written increased by 15% in the third quarter compared with a year ago, reflecting selected growth in casualty classes as some of our recent initiatives came online. For the first nine months of the year, Specialty gross premiums written are up by $74 million, or 37%, driven primarily by the inception of some large financial lines and casualty transactions in the first and third quarters.

As we've often stated in the past, percentage growth rates for this segment can be uneven on a quarterly basis, given the size and nature of the transactions. The Specialty Reinsurance combined ratio for the third quarter came in at 91.1%, an uptick from prior quarters, due to a changing business mix and higher attritional losses. We also booked approximately $10 million of loss provisions related to various aviation related events during the quarter. Favorable reserve development totaled $15 million in the quarter.

The Specialty Reinsurance business has generated over $1 billion of income for us since its inception. We have been slowly and deliberately building up our Specialty platform in recent years to enhance our product offering to core clients and brokers. And we expect the Specialty business will continue to be an important part of our success going forward.

In our Lloyd's segment, we generated $64 million of premiums in the third quarter, an increase of 60% compared with a year ago. For the first nine months of the year, gross premiums written are up 20%. Growth in this segment was the result of select opportunity in non-cat property lines and casualty classes.

The Lloyd's unit came in at a combined ratio of 109.1% for the third quarter. Margins were lower, primarily due to a higher level of attritional losses. Results did, however, include approximately $6 million related to the U.S. crop insurance line, primarily due to hail exposure. There was no meaningful reserve development in the third quarter.

For the first nine months of the year, the Lloyd's unit generated a 101.6% combined ratio. The expense ratio remained high at over 40% for the third quarter and year-to-date, reflecting the investments we've been making in building out our infrastructure there.

Turning to investments, we reported net investment income of $25 million in the quarter. Our private equity portfolio generated a loss of $3 million in the third quarter, reflecting a volatile equity market. Recurring investment income from fixed maturity investments totaled $25 million in the third quarter, with yields remaining under pressure from low interest rates. The total return on the overall investment portfolio was negative 0.1% for the third quarter due to an uptick in interest rates and wider credit spreads.

Our investment portfolio remains conservatively positioned in our view, primarily in fixed maturity investments with a high degree of liquidity and modest credit exposure. The duration of our investment portfolio remained short at 2.2 years and has remained roughly flat over the course of the year. The yield to maturity on fixed income and short-term investments increased slightly to 1.7%.

For the third quarter, we repurchased 1.6 million shares for a total of $164 million. Since the end of the quarter, we repurchased an additional 358,000 shares for a total of $36 million. While we generally pause with share repurchases during the hurricane season, we elected to continue with them this year due to a number of factors, including the profile of our underwriting portfolio, the buildup in our capital and liquidity position, as well as the valuation of our stock.

Year-to-date we have repurchased 5.4 million shares for an aggregate cost of $514 million. This is a record year for share repurchases in dollar terms. And it reflects our commitment to return capital to our shareholders when we cannot fully deploy it in the business.

In spite of our return of capital so far this year, we continue to believe we have capital in excess of our requirements, given our current portfolio and our outlook for the business. Our goal is to optimize the size of our capital base to match business opportunities and to return excess capital to our investors when it's the most suitable option.

As we've said before, our preferred method of returning capital has historically been through share repurchases. The timing of share repurchases on a quarterly basis will depend on a number of factors, including the capital needs of our underwriting book, our projected liquidity requirements, and the valuation of our stock.

Finally, let me provide you with our initial top line forecast for 2015. For Catastrophe Reinsurance, we expect a top line decline of 10% in 2015, reflecting our expectations for a continuation of softening market conditions, and some repositioning of our book.

For Specialty Reinsurance, we expect top line growth of 10%, driven by continued expansion of our U.S. platform, where we have made select new hires. As Kevin has often said, while we seek to grow this business over time, we remain cautious, given the overall competitive market conditions.

In our Lloyd's unit, we expect premiums to be up 10%, with select growth opportunities in what we see there as a generally challenging marketplace.

Thanks. And, with that, I'll turn it back over to Kevin for his concluding comments.

Kevin J. O'Donnell

Thanks, Jeff. It's a competitive market across most classes. And let me give some color on our position in a reduced rate environment. As I said in my opening comments, the supply-demand imbalance that we've seen over the past couple of years look set to continue. One of the outcomes of this is that we're being paid less for risk.

We decided the best strategy for us during this wind season was to shrink and to de-risk. We exercised good discipline, choosing to exit business that did not meet our return requirements. And we de-risked our portfolio with additional ceded, which increased the risk-adjusted return of our portfolio. Our strategy remains consistent, to build portfolios that provide appropriate return for appropriate risk over the long-term.

We're also increasingly seeing clients looking to trade with core partners across more classes of business and across more geographies. Our leading catastrophe franchise has allowed us to build strong relationships with clients over many years. Many of those clients are pleased to see us offering more lines and products.

Some five years ago, in response to our clients' needs, we started a deliberate build-out of our specialty franchise. In 2008, we had $100 million specialty book written out of one platform in Bermuda. Today we have almost $0.5 billion in-force with platforms in Bermuda, London and the U.S. Our U.S. operation allows us to be closer to our clients and to understand their risks better. It also helps our London Syndicate to grow, by giving them an access point on the ground.

As we've said in the past, specialty business is attractive because it's diversifying to our cat-focused portfolio. And it allows us to serve our clients more broadly. To support the opportunities we expect to see over the long-term, we've steadily added talent to our team. We have also elected to increase our capital commitment to our specialty platform. And that result of growing specialty is that we lower the cost of capital and improve risk-adjusted returns.

We continue to see strong demand from third-party capital to access our market. We're committed to managing third-party capital when it is needed by our customers. Our track record is one of interacting with clients and capital providers as partners, looking out for their best interests and aligning our capital alongside theirs. We believe this positions us well in this market.

Before I close, just one final thought. Over the 20 years plus that we've been in operation, we have seen a significant number of devastating cat events. Much of the capital that has entered the business has been particularly fortunate with the timing in taking cat risks, particularly U.S. wind risk. It has been nine years since a major hurricane, defined as a cat three or greater, has made landfall in the U.S. This is unprecedented in the historic record going all the way back to 1880.

According to our calculations, this is significantly below a 1% probability of occurring. So, said another way, investors investing in Atlantic hurricane have enjoyed a one in 100 level of return for the last nine years. However, it should not be overlooked that the annual odds for landfalling major hurricane in the U.S. remains unchanged at over 40% per year.

As we head towards the 1/1 renewals, we stand ready to serve our clients through the flexibility and capacity we offer. We have the size, scope and relationships to help match the right risk with the right capital. We will do so with the same focus and discipline that our longstanding partners have come to appreciate over the years.

Thanks. And, with that, we're ready to take questions.

Q&A

Operator

Your first question comes from the line of Vinay Misquith with Evercore ISI. Your line is open.

Q - Vinay Misquith {BIO 6989856 <GO>}

Hi. Good morning. Just a big picture question. This quarter's ROE was about 12% in a low cat quarter. Just curious as to whether – so given your capital situation, do you think you can generate a double-digit ROE on a normalized basis for a normal cat year? I mean, are you looking at it because you've purchased more retro? So are you looking at your returns more on a risk-adjusted basis thinking lower risk, lower returns versus some of your competitors who have posed higher ROEs during the last three quarters? Thanks.

A - Kevin J. O'Donnell

Sure. I think that's a great question. The last point let me focus on first, which is the risk-adjusted returns. The way we think about constructing portfolios is building what we think of as an optimal portfolio across the full set of outcomes. With that, we're looking at risk-adjusted returns not – whether there is specifically no cats or if there is a heavy cat year, but optimizing it across the full distribution of outcomes.

Being that this was a low cat quarter and the fact that we both reduced the size of our portfolio and bought the additional ceded, so de-risked the portfolio, as we discussed on the previous call as well, that lowered returns in the low cat scenario. But we believe the decisions we made across the full distribution of outcomes are the right decisions to maximize risk-adjusted returns.

Q - Vinay Misquith {BIO 6989856 <GO>}

So do you still think that you can generate a double-digit ROE in a normalized cat year?

A - Kevin J. O'Donnell

I think we'll continue to produce very attractive risk-adjusted returns. I think focusing on whether it's at a certain level or not is something that we'll monitor and we'll manage based on how well we're being paid for the risk that we're retaining. We very much look at our portfolio as a net portfolio based on the economics that are available to our third-party stakeholders and the net economics available to our shareholders. And we think that, with the current environment and with the strategy that we have, that we can still provide adequate risk-adjusted returns.

Q - Vinay Misquith {BIO 6989856 <GO>}

Okay. The second question was on the Specialty and Lloyd's businesses. Curious as to what combined ratios you're targeting in that. In the Specialty, I believe, you were thinking maybe low 80%s. I mean, is that still the case, given the softness in the market? And also wanted to get a sense for the Lloyd's business.

A - Kevin J. O'Donnell

So let me start with the Lloyd's business first. The Lloyd's business, we're still in a growth mode. It's a relatively young book, even though we started it about five years ago. And it's one in which we're consciously looking to grow. The infrastructure is built. We think we've built a world-class infrastructure. And we have room to continue to take risk out, without the same ratio of expense increase.

With regard to Specialty, we're still seeing opportunities in the Specialty business. And we look at that in twofold, one on a standalone basis to make sure that we're paid adequately for the risk that we're assuming, and then, secondly, on a marginal basis. On a marginal basis, it remains diversifying. So it's still highly accretive to the portfolio, but it's only highly accretive if we can pass the first test, which is to make sure we're paid adequately for the risk.

I'm not sure we've ever given combined ratio targets in the past. But it's something that we're keenly focused on. We do recognize that one of the moving components that of reduced economics in the Specialty book is not so much the underlying book's moving, but the increase in ceding commissions. And we're carefully monitoring that.

Q - Vinay Misquith {BIO 6989856 <GO>}

Okay. Thank you.

Operator

Your next question comes from line of Josh Shanker with Deutsche Bank. Your line is open.

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

Yes. Thank you. I listened to your comments, Kevin, at the end about responding to your clients' needs. But given the long history of RenRe, what kind of talent does RenRe have in casualty that we should think that RenRe can write it better than other people?

A - Kevin J. O'Donnell

The talent that we have, I think, is world-class, just to put that on the table. We continue to add staff to that team. We have a great track record. One of the things Jeff mentioned in his comments is that our specialty business, broadly defined, has added over $1 billion of income to the organization over time. So it's one in which, I think, we are very careful as to which lines we enter. The lines we target are lines that we believe are profitable. And then we look for the best deals in those profitable lines.

We're not looking for the one profitable deal in a market that we think is unprofitable. I think we have the same core set of underwriting tools available in the specialty side that we do on the cat side. So the technology supporting that team is very strong. But it's one that we are – the book is younger. The book is changing more than the cat book at this point in time with growth initiatives that we have. But it's one that I feel very confident will continue to outperform the industry.

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

Can you give me a few details? I mean I would argue, given my limited knowledge, that the technology at RenRe is clearly superior in the cat space to many of your competitors. How do you get a technological edge in the casualty space?

A - Kevin J. O'Donnell

So, I think there is two components of the technology that I would highlight on the cat side. One is our standalone. So do we have a better assessment of stochastic probabilities of events occurring and the other is how we allocate capital to the risks that we're taking.

The capital allocation piece, I think, applies in an equal way to our specialty business as it does to our cat business. I think on the standalone side, we're participating in the market differently. We're writing more quota share on the specialty side and partnering with some of the partners who we think are the best casualty writers on the primary side. So it's a different strategy that we're employing from a risk selection standpoint, but it's the same strategy from a capital allocation standpoint.

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

And are there implications for your investment portfolio? You've always been very short. You've been able to take market risk where others haven't, given the nature of what has been a very, very short tailed book that's been – had a lot of liquidity requirements. If things grow the way you think they are going to grow, what is RenRe's investment portfolio going to look like in two or three years?

A - Jeffrey D. Kelly {BIO 1390834 <GO>}

Josh, this is Jeff. So, I think, you've actually hit on the two components that are likely to change a bit. The first is, as the reserve book at least has a longer duration, I'd expect to see a generally longer duration in our investment portfolio over time. Without getting to specific numbers, that will depend on how the book evolves over time. But I'd expect to see generally a bit longer duration in the investment portfolio.

And, as you point out, to the extent that reserves are less cat related, there is probably a little bit lesser need for liquidity in the company. And we structure our investment portfolio to be able to generate a tremendous amount of liquidity in a very short period of time. I think that need probably lessens over time as the mix changes. So you might see over time a bit less - a couple of components in the investment portfolio that could be a little less liquid. But I wouldn't necessarily ascribe, at least at this point, any other investment components that would be terribly different than our current risk profile.

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

Okay.

A - Jeffrey D. Kelly {BIO 1390834 <GO>}

Increased credit risk or anything else.

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

That makes sense. And good luck in the new year.

A - Jeffrey D. Kelly {BIO 1390834 <GO>}

Thanks Josh.

A - Kevin J. O'Donnell

Thanks Josh.

Operator

Your next question comes from the line of Josh Stirling with Sanford. Your line is open.

Q - Josh C. Stirling {BIO 17463087 <GO>}

Hi. Good morning and thanks for fitting me in right behind Josh. So I was wondering if you could walk us through, I guess, maybe, Kevin or Jeff, how we should think about capital returns over the next two years. Big picture, is this something primarily you think will be driven by earnings? Or are you going to be looking at a lot of opportunities in retro or setting up third-party ventures basically to be able to shrink your own equity base? And the reason I ask you that it's not totally obvious to me whether you look at that as sort of a financial arbitrage or sort of accretive thing to do. Or you like being the size you are because you want to maintain flexibility and be able to respond after a storm and to keep the really high AA rating you have. Thank you.

A - Jeffrey D. Kelly {BIO 1390834 <GO>}

Okay. Josh, this is Jeff. I'll start off and then let Kevin add in. I think there is a lot of hypotheticals in terms of how we think about returning capital over the next couple of years. And those would depend on the obvious things like cat loads and specific events as well as pricing in general. But I'd say absent - other things being equal, we would expect to be returning or we'd look to return at least the level of earnings that we generate over the course of the next couple of years. We don't specifically target in any given year a level of retro purchases or ceded purchases to protect the book. That tends to be more opportunistic.

So to the extent that there are more opportunities to do that, it might free-up more capital in periods of time. And thus give us more opportunities to return capital. We could cede-off a higher level of ownership in various of the balance sheets that we manage for third-party investors, which would also allow us to free-up capital, if we wanted to do that. And we also are at a level with most of the capital vehicles that we manage that we could increase our ownership in them, if that made sense as well. So I think you have to look at – a base case might just be earnings are slightly better with a lot of potential flexibility to move in either direction, frankly.

A - Kevin J. O'Donnell

Let me just add one thing. I think, as Jeff said, is highlighting something that we think is critical, which is the flexibility we have between our partner and third-party capital. Our preference is to deploy our capital or our partner's capital into the business when we can get appropriate risk-adjusted return. Absent that, we will look to return it. I think the blended approach that we have and will continue to execute is the platform, which is going to be most resilient, as we move into 2015 and beyond, having the ability to manage our own capital, manage ceded and manage third-party capital on a very integrated and collaborative way.

Q - Josh C. Stirling {BIO 17463087 <GO>}

That's really helpful. Thank you. Kevin, I wonder if I might just follow-up. In your intro comments you mentioned, sort of, terms and conditions as an area to watch. I am wondering if you can give us a bit of an education about what, sort of, terms and conditions do you think are out there that might be most troubling. What sort of things are people doing or do you fear they might do?

And big picture, sort of, for those that's keeping track here at home. What kind of event or series of events do you think would most potentially stress the market? I'm wondering if it's something big or more of it's an aggregation thing like 2004 in Florida. Or whether you think maybe there is, sort of, more aggressive risk taking going on in, sort of, the global area where if something like 2011 happens that would be more of an issue? Thank you.

A - Kevin J. O'Donnell

Sure. Let me start with the terms and conditions. I think it's one that – it can be any number of things, frankly. We've seen an increase of terrorism coverage coming into different products. Where is cyber covered? Is it covered? Those sorts of questions are things that we're puzzling over as to different lines of business that we're writing. Extensions on – more transparent extensions on geography and things like that.

It really can be such a broad set of changes that it's hard to classify it into any one thing. It's just one that, as an underwriter, you need to be very careful to price for the risk that you're taking. We're always happy to add additional risks as long as we can quantify it and as long as we can charge for it. The danger is that things are coming into contracts in ways in which underwriters are not seeing and are not charging for.

The other one question you had is really regarding what can change the market as I would, kind of, summarize it. And I think the way we think about the world is it usually takes some catalyst for market directions to change. They often don't change without other people losing money or for some reason there could be a change in the perception of risk. That can come from anything really but normally comes from some sort of surprise.

So I think it can come from an aggregation of losses, small losses like we had in 2004. It can come from a large event, which we haven't seen in a long time like a Katrina or something like that. It can come from a financial crisis. More important though for us is not to plan for any one of those things but to have a plan in case any one of those things happens.

So we have a strategy, which we'll execute against the most probable outcome but we're always prepared to react quickly to any change in the environment in which we're trading. I believe, going forward, we'll need to react more quickly, probably with less information, in order to continue to execute against opportunities that jump into our market for whatever reason.

Q - Josh C. Stirling {BIO 17463087 <GO>}

That's great and helpful. Thanks and good luck.

A - Kevin J. O'Donnell

Thanks.

Operator

Your next question comes from the line of Michael Nannizzi with Goldman Sachs. Your line is open.

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

I guess, Kevin, one thing I was trying to understand a little bit is thinking about conditions in the Lloyd's and specialty business, sort of, relative to the opportunities you see on the cat side. Because, clearly, on the cat side, you're shrinking because you feel like the risk isn't worth the return. But just trying to understand what you're seeing in specialty and Lloyd's that allows you the comfort to continue to posture toward growth there. Thanks.

A - Kevin J. O'Donnell

Sure. One way we've talked about the cat market before is a negative return, low return, and adequate return. The return on that is really based on how much capital it's requiring to support the business. If it's a negative return no matter how – just on a standalone basis not profitable. We're not seeing much business still in the cat market, particularly in the U.S. in the negative return. It's mostly low returns. So, the reason we're exiting is not because of standalone economics on some of the deals is negative. It's because it doesn't support the amount of capital that the deal requires.

On the specialty side, because of the construct of our portfolio, we're seeing deals that we believe are profitable on a standalone basis and on a marginal basis are still accretive to our portfolio because we're not adding any real capital because it's diversifying to our otherwise cat-dominated portfolio. So, it's kind of apples and oranges as to why we're seeing greater opportunity in specialty and seeing fewer opportunities in cat. Does that answer your question?

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

It does. I guess sort of thinking – I mean I realize, and appropriately you guys look at the world from a risk-adjusted return perspective and that makes a lot of sense. But looking at it from the outside, from a pure GAAP perspective, it would seem that the notional returns in specialty, in Lloyd's specialty during the ramp up would probably be below where you are in the cat business. And so it would seem that as you mix towards these lines, potentially, and away from cat, that your volatility of returns will go down. But that the overall level of returns will likely have to move down as well. Is that – or I guess the other side of that is, unless you can deploy capital fast enough to keep the denominator moving down at a fast enough pace to offset the numerator decline. How should we think about that sort of movement and math?

A - Kevin J. O'Donnell

I think you've got all the pieces there, to be honest. I think if you take the cat, the cat book should have higher volatility, higher returns, all things equal. And the specialty book we're writing should have lower volatility and lower returns. On a risk-adjusted basis, you can argue which one you're better paid for. In order for us to continue to have quality returns across the portfolio, we're either bringing specialty up against the rate reduction and holding capital flat or you can reduce capital against the reduction in cat and continue to manage returns on that basis. But it's kind of all of those three things working in collaboration, trying to come up with what's the right mix on the gross portfolio. Obviously, on the net portfolio, we're doing some other things to manage that as well.

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

Got it. Great. Thanks. And then just one, if I could, for Jeff. You mentioned sort of guidance on premiums next year. Could you talk a little bit about how you think about that in terms of exposures or just impact from pricing? And should we think about cessions, the ceded levels, similarly to the way that we've seen 2014 develop, if you can? Thank you so much.

A - Jeffrey D. Kelly {BIO 1390834 <GO>}

Well, I think I'll let Kevin talk about the mix of expected exposure changes and pricing. I'd say it's mostly consistent with changes in price that we're seeing. But on your other question, I think – I think I just forgot what your -

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

I was saying like net versus - so, in terms of ceded premiums versus in 2015 and we talked about kind of managed cat down 10%, just trying to think about the other part of that that gets you to the net number.

A - Jeffrey D. Kelly {BIO 1390834 <GO>}

Yeah. Thanks, Mike.

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

Sure.

A - Jeffrey D. Kelly {BIO 1390834 <GO>}

We don't have budgets for ceded purchases. So there is some volatility in that, both on a quarterly basis and an annual basis. And it will just be a matter of how attractive we think ceded purchases are next year. So we don't really have any budget at all for them at this point.

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

Got it. Great. Thank you so much.

A - Kevin J. O'Donnell

Great. Thanks.

Operator

Your next question comes from the line of Amit Kumar with Macquarie. Your line is open.

Q - Amit Kumar {BIO 19777341 <GO>}

Thanks and good morning. Two quick follow-up questions. The first question relates to the discussion, I guess, in the opening remarks. You were talking about a higher level, I guess, of attritional losses. And I think what would be helpful is if you could break out those numbers, so that we could compute the normalized ROE.

A - Jeffrey D. Kelly {BIO 1390834 <GO>}

Okay. Hang on just a sec. I had a couple of - okay. At Lloyd's, we had our losses, there were about $6 million - I think, as I said about $6 million in crop hail losses. And we had a few million dollars related to a couple of wind storm events during the quarter, which were not particularly large. So those were kind of, I think, the major components of the increase in losses at Lloyd's. And specialty, the biggest singling group related to, I think it was three aviation events, which all-in-all totaled a little over $10 million. And then we had some additional crop losses there as well, of about $3 million, I think. $3 million, yeah.

Q - Amit Kumar {BIO 19777341 <GO>}

Okay. That's helpful. The other question I had – I guess this goes back to Josh and Michael's questions regarding 2015. Recently, there has been some discussion in the market press that RenRe is either looking to or thinking about some sort of an agreement with one of the largest reinsurance brokers, if you will, to find outgrowth opportunities in the U.S. casualty reinsurance market. And I was trying to reconcile that fairly detailed discussion in the market press versus your comments. Could you sort of help us reconcile those comments versus your outlook for 2015? Because net-net, it does seem like a meaningful departure as you start talking about casualty and longer tail businesses.

A - Kevin J. O'Donnell

Okay. Firstly, I think we have a great relationship with all our brokers and we look at them as all strategically important to us. The agreement that's been discussed in the press is one that is not something that's exclusive. There is no incentive payments for business or anything else. It's really much more around helping us to understand some different markets. It's around helping us understand how those markets are placed into the reinsurance business and where they are placed. So, from that perspective, I think it's an agreement that we would gladly engage with any of our brokers.

With regard to it being a departure from what we've done on the specialty side, we've been in the specialty business for a long time. We are continuing to build out what we think is a world-class platform between Bermuda, London, and the U.S. We have a great team. And we're applying the same discipline in the lines that we're writing to the cat market that we've executed into for a long time. So, I don't feel as if it's as different when I'm sitting in this seat as potentially you're suggesting it is. It feels very organic and very much natural to what we've always done. Does that – any other -

Q - Amit Kumar {BIO 19777341 <GO>}

Yeah. That answers my question. Thank you for that clarification. Thanks and good luck for the future.

A - Kevin J. O'Donnell

I appreciate it. Thanks.

Operator

Your next question comes from the line of Jay Cohen with Bank of America Merrill Lynch. Your line is open.

Q - Jay A. Cohen {BIO 1498813 <GO>}

Yes. Thank you. A couple questions. I guess, first, in the specialty business, the acquisition expense ratio went up quite a bit. And you talked about the change of business mix and the higher ceding commissions. My question is if the business mix doesn't change, is that the kind of number we should assume going forward? Or was anything in that number that might have inflated it this quarter?

A - Kevin J. O'Donnell

Yeah. I think the growth in that book was – we opened the U.S. platform earlier this year. We achieved good growth in the U.S. platform and a lot of that is quota share based, which has a higher ceding commission. I think the ceding commissions we're paying are largely in line with where the market is. So I wouldn't say that there's any one thing in the business mix or in the ceding commission that I would highlight. Just simply what percent of the book is XOL and what percent of the book is quota share is probably the more natural thing to look at?

Q - Jay A. Cohen {BIO 1498813 <GO>}

So, not a bad number to use going forward all else being equal?

A - Kevin J. O'Donnell

That's probably a reasonable guess. Yes.

Q - Jay A. Cohen {BIO 1498813 <GO>}

Okay. Second question. I guess on the cat book, so your guidance is for down 10% and again it does suggest discipline. By showing that discipline and, again, assuming your market conditions shall be getting a bit worse, do you think you can maintain expected returns in your cat book in 2015 versus 2014?

A - Kevin J. O'Donnell

So our process to come up with the cat guidance is really a ground up process, where we're looking at each deal and then we're taking some assumptions of pricing both at a macro level and a deal level. I believe we will be paid less for risk in 2015 than we are paid in 2014. But I also believe we'll have at least as many tools to manage the risk-adjusted return that we're keeping on a net basis for both ourselves and our partners. So it's a difficult question to answer, because there is a lot of levers that we have to pull between our gross book, our net book and then the options for how we construct the two.

Q - Jay A. Cohen {BIO 1498813 <GO>}

Now that's fair. If I could sneak one just really quick numbers question. The amount of capital you have at Lloyd's?

A - Kevin J. O'Donnell

Yeah. Why don't we -

A - Jeffrey D. Kelly {BIO 1390834 <GO>}

Yeah. Why don't we come back to that one? Let's – give us just a minute to check on it. We'll come back to you.

Q - Jay A. Cohen {BIO 1498813 <GO>}

Perfect. Thanks, Jeff.

Operator

Your next question comes from the line of Ryan Byrnes with Janney Capital. Your line is open.

Q - Ryan Byrnes {BIO 16902592 <GO>}

Thanks. Good morning, everybody.

A - Kevin J. O'Donnell

Good morning.

Q - Ryan Byrnes {BIO 16902592 <GO>}

I was just wondering if we could get a little better breakdown of what's actually in the specialty book. I know you guys kind of note there is some casualty in there and some specialty in there. And, obviously, we know there has been some mortgage insurance stuff in there. Just wondering if you guys could just give a better color or breakdown as to what's specialty and what's casualty in that segment?

A - Jeffrey D. Kelly {BIO 1390834 <GO>}

Well, I think, let me just start with perhaps where the change came kind of year-over-year. So in the specialty book, I would say probably most of the growth came in various casualty lines, so professional lines, casualty clash, things like that. In terms of where they have been over the course of the year or where it is on an in-force basis, Kevin, you may have a better idea than I do.

A - Kevin J. O'Donnell

Yeah. The business mix really hasn't changed. I think we saw some good opportunities in some of the professional line stuff. We have an excess casualty book that we write here in Bermuda, good sized professional lines book written both out of Bermuda and out of London. You mentioned the mortgage book that we've been successful writing. And we also have a trade credit book that we – or financial credit book that we've been able to grow really since the financial crisis. So the mix is reasonably consistent. I'd say the one thing – we probably have a bigger percentage of quota share now than we did two years ago. And I'd anticipate that the quota share element of the book may continue to rise a little faster than the XOL.

Q - Ryan Byrnes {BIO 16902592 <GO>}

And then just the region of – where is the U.S. as a percentage of that book to? Just trying to figure out, I guess, for some sort of tax purposes as well.

A - Kevin J. O'Donnell

You mean the amount of casualty risk we have that's exposed to the U.S. or the amount of premium written by our U.S. platform?

Q - Ryan Byrnes {BIO 16902592 <GO>}

The amount that you're writing on your U.S. platform.

A - Kevin J. O'Donnell

Yeah. Let me just – I'm not sure if that's a number that we've given out previously. But it's a new platform, I would put it in. It's still less than $50 million. It's about $40 million or so.

Q - Ryan Byrnes {BIO 16902592 <GO>}

Great. And then just one bigger picture question. Again, we think about RenRe, we think of great ROEs, but, again, potentially volatile going anywhere from negative 5% to 25% ROEs. But now, I guess, with the business mix shift and obviously rates coming in, but also you guys are obviously buying more retro purchases, should that volatility of ROE contract some? I mean should it be, again, a 5% to 15% range? Or just trying to figure out if the actual volatility of the ROE is also kind of compressing as well as the business changes.

A - Kevin J. O'Donnell

Yeah. I think that's – let me explain what we're doing and then you can figure out what it means to the returns. If the cat market was significantly better, we have ample capacity to write and make the book look like it did before, is between a percentage of cat and specialty if we chose to.

So I think that it's really – where we are now is a statement as to the opportunity set that we're seeing. It's not that we have an objective to change the risk profile of the book or change the return profile of the book. We're simply executing the same strategy, which is trying to design the best risk-adjusted return portfolio that we can on a net basis.

So I think, thinking into the future, if the world were in a different state and cat rates were where they were in 2007, you would see a much bigger cat book. And we'd still have all the initiatives going on the specialty side. It would just be a smaller percentage.

Q - Ryan Byrnes {BIO 16902592 <GO>}

Okay. Great. Thanks for the answers, guys.

Operator

Your next question comes from the line of Mark Dwelle with RBC Capital Markets. Your line is open.

Q - Mark A. Dwelle {BIO 4211726 <GO>}

Yeah. Good morning. I guess my question is actually somewhat similar to the last one, but oriented towards the Lloyd's book. I mean now that's about 25% of net premiums and continues to be the biggest growth driver. What are the main lines of business that you're pursuing there? I know there's been some teams added. What are the main lines of business that are being pursued there? And how do you see that developing? Just an update.

A - Jeffrey D. Kelly {BIO 1390834 <GO>}

Yeah. I'll comment, again, on where we saw growth particularly in the third quarter. But I think this is pretty consistent with where it has occurred over the course of the year. So part of the growth - the largest part of the growth has been in various casualty lines, so professional indemnity, D&O, general liability, lines like that. And as well some property businesses, property D&F, quota share businesses and property per risk have been areas of growth in the last quarter.

A - Kevin J. O'Donnell

Yeah. Generally, in Lloyd's, your capital requirements benefit from greater diversification. The lines Jeff mentioned are the lines in which we're currently in and looking to continue to build out into and to develop. To the extent we can add one or two new lines in 2015, we're certainly open to that.

The business we're writing in Lloyd's is highly coordinated with the business that we're writing elsewhere in the organization. So that if we have a piece of business, we are indifferent as to which platform it goes on. On every deal, we have exactly the same standalone economics, so that there is no arbitrage between platforms. But we may apply different capital rules, depending on whether it's in Lloyd's or any one of our other balance sheets.

So, in general, it looks reasonably similar to the other specialty that we're writing. There is a small component of insurance in it and it's one in which we'll continue to seek some diversification there, because it provides an advantage for your funding at Lloyd's.

Q - Mark A. Dwelle {BIO 4211726 <GO>}

Thank you. That's a good update. And then one other question, just within the - the hedge portfolio took a loss during the quarter which isn't unprecedented, but it is unusual. Is there any more detail you could provide related to that? Maybe what type of strategies are or whether it's a particular portfolio or more than one?

A - Jeffrey D. Kelly {BIO 1390834 <GO>}

You're talking about the private equity portfolio in particular?

Q - Mark A. Dwelle {BIO 4211726 <GO>}

Correct. Yes.

A - Jeffrey D. Kelly {BIO 1390834 <GO>}

No. I don't think there is anything - I think the broader equity markets were pretty flat with some volatility in the quarter. I don't think there was anything in particular to point to with that.

Q - Mark A. Dwelle {BIO 4211726 <GO>}

Okay.

A - Jeffrey D. Kelly {BIO 1390834 <GO>}

The returns in the book were just generally lower, flat to slightly down.

Q - Mark A. Dwelle {BIO 4211726 <GO>}

Okay. That's all my questions. Thanks.

A - Jeffrey D. Kelly {BIO 1390834 <GO>}

And just returning to a question, I think, Jay, asked about capital at Lloyd's. I think, as a general proxy, Jay, the number we'd probably point you to is about $370 million.

Operator

Your next question comes from the line of Kai Pan with Morgan Stanley. Your line is open.

Q - Kai Pan {BIO 18669701 <GO>}

Thank you. Good morning. So, first question is on the expense ratio side. If you look at the property cat expense ratio drifting high from low 20%s to the mid-20%s, this is understandable given the premiums decline. So just wonder in this current environment, how do balance that – managing expense ratio at the same time reinvesting in the platform you have.

A - Kevin J. O'Donnell

I think it's something that we're keenly focused on. There's not that many levers as a reinsurer that you can pull to manage the bottom line. I think managing expenses is a balance between making sure we're continuing to invest in the businesses that we have, but also being cognizant of where the ratios are. We are continuing to hire people and to add staff. So we had a couple of great hires in the quarter. We're continuing to invest in our systems but we're also being very mindful as to kind of how and where we're spending money to make sure that it's managed appropriately, but there's not much more than that I would say at this point regarding expenses.

Q - Kai Pan {BIO 18669701 <GO>}

Okay. It's great. Then, in your opening remark, you talk about your active return to both shareholders as well as third-party investors. That's kind of in contrast to as many of the peers actually growing their sidecar, third-party capital management business. You have velocity that you want to sort of write along your third-party investors with the risk you're taking and speaking for same kind of returns. But some of these third-party investors might not have the same cap or return expectation as your own balance sheet. How do you think about that? Is that possible you have separate vehicles that are targeting different type of investors?

A - Kevin J. O'Donnell

Yeah. I think we believe alignment with third-party capital is imperative to long-term success. All that said, there are times where there's business which we believe is adequately priced but based on our models and our weighted balance sheet is capital-intense and, therefore, better suited to a collateralized vehicle. What I'd point to is Upsilon which started as our worldwide kind of structured retro product which we thought on a standalone basis was profitable, but was capital-intensive.

Even in that vehicle, we believe investing alongside the capital that comes in is important to show that we're not violating the standalone returns that are required to take that risk. So although the return profile doesn't fit on a rated balance sheet, we believe the standalone returns are still appropriate for certain types of capital. I think there are instances where the capital on a standalone basis is not suited for what we believe to be any capital. And that's where the difficulties will emerge over time.

Q - Kai Pan {BIO 18669701 <GO>}

Okay. That's great. Lastly – thank you for reminding us that there are risks out there you hadn't had in nine years. But just wondering, given the sort of influx of return on capital, especially for the pension fund, the hedge funds, what's the prospects, even if we have huge events, $100 billion losses, the capital still out there could basically anticipating the rising pricing in property cat, that could eventually like compress the pricing? Basically we would not see the spike in terms of pricing in the past?

A - Kevin J. O'Donnell

So I guess your question is, is there still cycles?

Q - Kai Pan {BIO 18669701 <GO>}

Yes.

A - Kevin J. O'Donnell

And I think we believe there is a secular shift in the market, as well as a cyclical shift. I think it's impossible to know how all capital will respond after an event. I think it will be a normal distribution of some capital wanting to increase, some capital wanting to leave, and some capital potentially staying the same. We focus on having highly informed capital supporting us and they tend to have large balance sheets and understand the risks that they are taking. We believe our capital will continue to support the vehicles that we have in a post-event world.

I think one thing that you're touching on is important, is I believe that with some of the returns that capital is coming into the market is on the belief that it will get better after an event. And I think that if there is not a increase in pricing after an event, there could be additional scrutiny as to whether this is an attractive or unattractive area for that capital to participate. So it's not only a reinsurance issue. I believe it's a third-party capital issue to understand how rates will change post-event as well.

Q - Kai Pan {BIO 18669701 <GO>}

Thank you so much and good luck.

A - Kevin J. O'Donnell

I appreciate it. Thanks.

Operator

Your next question comes from the line of Ian Gutterman with Balyasny. Your line is open.

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

Hi. Thank you. Kevin, I guess one numbers question and then one question on the market. Just looking at your results this quarter and last quarter on an accident year basis, it's been about a high 60%s combined. And you mentioned obviously some attritionals. But there is attritionals every quarter to some degree, right? So is that the right way to kind of look at the business right now, is we're sort of in a high 60%s base and then add on a cat load?

A - Kevin J. O'Donnell

I think, actually, frankly, I just divide the world into different buckets. I think of what does the cat world look like, what is specialty, casualty, XOL, and quota share, and then come up with the mix and then blend it together, rather than think of a single number as to what the book is going to look like. So I think you can go back over any period of time and come up with that mix and use that to forecast forward. It's not a number that we give guidance on.

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

Fair enough. I was trying to simplify. I was doing what you suggested and then I came to a simple answer and was hoping to confirm it, but that's okay. And then on the market, I was hoping you could expand a little bit on supply and demand and maybe if I can sort of see the response a little bit. On the demand side, it certainly sounds like we continue to see this trend where the large global buyers are eliminating cat trees by centralizing their purchasing and sort of, I guess, warehousing the internal risk transfer. Just how much more of that do you see continuing? Is that kind of played out after this year or is that a multi-year thing to come still, that we're going to keep seeing demand come out from the largest buyers?

And I guess on the supply side, given, as you said, nine years and this being another no loss year, do we see another big influx of capital markets participation from maybe more naïve -- I'll call them naïve, maybe you won't, investors just seeing the returns on the asset class over time and ignoring the fact that all these non-loss years are not typical? And maybe the last part of that is it looks like there is a big pipeline of cat bonds that need to refi early next year. I don't know if that puts any incremental pressure on as well.

A - Kevin J. O'Donnell

Okay. I'll break it down as you have in talking about it. I think on the demand side, absent some increase in Florida, we haven't seen an increase in demand in the U.S. for property cat. You touched on the centralized purchasing, I think that is a trend we've seen around the world and it's one in which a lot of primary companies are becoming a lot smarter about the risk that they have, culling their data in more effective ways to determine more effective ways to protect their risk. So I think that will continue. Whether that will result in a reduction in the types of products we sell or not, I think the jury is still out.

I think from the supply side, we are continuing to see capital express interest in this business. In general, they are aware that it's a competitive rate environment and they are looking at expected returns reducing from year to year. So there is a rational view from any investors coming in, but there still is interest. So, I'm not sure how much of that capital will ultimately be deployed or if it will remain interested, but stay on the sidelines.

With regard to cat bonds (01:04:25 - 01:04:30) basically stopped participating in the cat bond market as a purchaser because we think the rates are at a level where it's no longer sufficient returns for us to participate. We look at each cat bond that comes out. And if we see one that's attractive, we'll certainly buy it. I think there is an appetite that continues for cat bonds. But looking at the returns for cat bonds and how they've shifted downward over time, I think there's a material shift in the economics there and it's one in which I'm sure investors are going to look at carefully upon new issuance.

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

Appreciate all the answers. Thanks and good luck.

A - Kevin J. O'Donnell

I appreciate it. Thanks.

Operator

I will now turn the call back over to Mr. O'Donnell.

A - Kevin J. O'Donnell

Well, thank you, all, for your attention. And we appreciate the questions. And look forward to catching up with you after year-end. Thank you very much.

Operator

This concludes today's conference call. You may now disconnect.