Q1 2018 Earnings Call

Company Participants

- Marc Grandisson, President and Chief Operating Officer
- Mark D. Lyons, Chief Financial Officer and Treasurer

Other Participants

- Amit Kumar, Analyst
- Analyst
- Elyse Greenspan, Analyst
- Geoffrey Dunn, Analyst
- Ian Gutterman, Analyst
- Jay Cohen, Analyst
- Josh Shanker, Analyst
- Kai Pan, Analyst
- Meyer Shields, Analyst
- Michael Zaremski, Analyst
- Ryan Tunis, Analyst

Presentation

Operator

Good day, ladies and gentlemen, and welcome to the First Quarter 2018 Arch Capital Group Earnings Conference Call. At this time all participants are in a listen-only mode. (Operator Instructions) As a reminder, this conference call is being recorded.

Before the company gets started with its update, management wants to first remind everyone that certain statements in today's press release and discussed on this call may constitute forward-looking statements under the Federal Securities laws. These statements are based upon management's current assessments and assumptions, and are subject to a number of risks and uncertainties. Consequently, actual results may differ materially from those expressed or implied. For more information on the risks and other factors that may affect future performance, investors should review periodic reports that are filed by the company with the SEC from time to time.

Additionally, certain statements contained in the call that are not based on the historical facts are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. The company intends the forward-looking statements in the call to be subject to the safe harbor created thereby.

Management also will make reference to some non-GAAP measures of financial performance. The reconciliation to GAAP and definition of operating income can be found in the company's current report on Form 8-K, furnished to the SEC yesterday, which contains the company's earnings press release and is available on the company's website.

I would now like to introduce your hosts for today's conference, Mr. Marc Grandisson, and Mr. Mark Lyons. Sir, you may begin.

Marc Grandisson {BIO 4369887 <GO>}

Thank you, Crystal, and good morning to you all. Overall, our first quarter results were excellent and demonstrate the value of our diversified specialty insurance platforms. Before commenting on market conditions, I would like to review the core tenets that successfully guide us at Arch. Our primary goal is to produce superior risk-adjusted returns in order to drive long-term growth in book value per share, while providing customers with quality insurance products.

To support this goal, we hold dear a few core principles such as cycle and capital management, as well as being intellectually honest about the probability of achieving the risk-adjusted returns offered by the marketplace. Our shareholders, policyholders and employees all gain from this approach.

Currently, market conditions are stable to slightly improving in the P&C arena. Operating margins expanded slightly in insurance in the first quarter, while the interest rate environment has lifted expected returns. Despite growth in some niche areas, we remain cautious and do not see a broad-based market turn in the near term given abundant capital across the market.

It's important to keep in mind that loss trend is picking up and is at best a guess. We will not know for another five years what the recent changes in trend will mean for our P&C businesses. Even though there may appear to be an increase in ROEs, the uncertainty of the impact of inflation, as well as some of the negative effects of changes in terms and conditions of late, tempers our enthusiasm.

In our Insurance group, underlying the growth in our gross written premium, we continue to de-emphasize some lines such as casualty, excess D&O and some London market business, all owing to an overly competitive marketplace.

Our insurance growth is coming from travel and small to medium enterprise professional lines. In addition, premiums increased in loss impacted property line where rates and returns are improving. In reinsurance, our growth in our European auto quota share and excess of loss, as well as property is balanced out by decreases in casualty and D&O. As you can see, our insurance and reinsurance operations are in sync as to where capital needs not to be deployed.

Lastly, keep in mind that the reported growth in premium was magnified by foreign exchange impacts this quarter to the tune of one-third of growth in both insurance and reinsurance.

Turning briefly to capital management, we entered into a loss portfolio transfer on certain discontinued liability lines and program businesses predominantly from years prior to 2012. We are no stranger to the run-off market and we value what this product can offer. The transaction also included reserve development protection above the carried reserves.

We did that transaction with two main objectives in mind. First, it will reduce the volatility of future reserve development, narrowing the ultimate payments around the level currently expected. And second, it will enable Nicolas Papadopoulo, who is our new Insurance Group CEO and his team to focus on ongoing projects without being distracted from running off a business no longer core to Arch. Mark will further address this and additional capital management actions in his own comments.

Turning now to our other specialty segment, mortgage insurance. It was an active quarter in the press to say the least. We had a great quarter and we are even more convinced that our risk-based pricing framework, RateStar, is the best way to approach this marketplace. Our new insurance written for the first quarter was 11.4 billion, of which, 82% was through our RateStar platform.

The pricing outlook was looking fairly stable until recently when competitors announced a cut to their rate cards. You will remember our comment on last quarter's call that we expected this reaction. However, like you, we did not think it would occur this quickly, especially in light of the uncertainty surrounding PMIERs 2.0. We are, as is everyone, currently evaluating the competitions' rate cards and we will decide whether to take action soon.

Bear in mind, that our production from rate card is less than 20% of our NIW and we believe that RateStar will still attract the better risks even after the rate cuts announced by some in the industry are put into effect.

As I mentioned a minute ago, RateStar has proven to be a great way for Arch to enhance risk selection. One example of this is that RateStar steered Arch away from originations in high-LTV, high-DTI products over the last few quarters. Along with single premium products, we purposely remain underweight in these higher risk areas. Our expected returns on all US MI business are still in excess of 15%.

Of note, we closed another Bellemeade transaction for the second half of 2017 production at tighter spreads than the one we did in last year's third quarter. Bellemeade structures provide capital market protection for Arch for deterioration in the mortgage market. Think of it as an aggregate excess of loss covering -- cover attaching excess of a 23% loss ratio.

Turning now to IMAGIN, the Freddie Mac product announced last month, we believe that this product was an evolution of GSE credit risk transfer and not a revolution. This pilot is still very much in its infancy and we believe it has the potential to do two positive things for us. First, it establishes Arch as a go to innovator in mortgage insurance; and second, it leverages our underwriting expertise to managing interest platforms and third-party capital.

IMAGIN targets the discounted singles LPMI product and it is capped at $2.5 billion of NIW, which is projected to be less than 1% of the expected MI industry production in 2018. In addition, this new structure fits our core principle of cycle management and allows us to be a low cost provider in a highly commoditized business environment. Once you factor in the fees and the expense savings, the expected returns are appropriate relative to the risks that we're assuming.

Last, but not least, the new CRT advisory relationship that we have agreed to with Munich Re is yet another example of our ability to leverage our experience and expertise in executing various types of MI risk transfer. On the investment side, we continue to position our portfolio to be flexible and poised to recover quickly from an increase in rates, and yet, remain liquid enough to allow additional longer term alternative investments.

Our property cat exposures are substantially the same as last quarter, with our 1-in-250 year peak zone, the Northeast PML the largest at 6.2% of tangible common equity.

Our RDS for our mortgages insurance, driven largely by the US primary exposure, is stable at 16.4% of tangible common equity as a result of a growth in insurance in force and the increase in persistency in US primary MI, largely offset by the new Bellemeade transaction. We are continuing to refine the RDS for our non-US business and we will report any changes to the current view as they evolve.

In closing, book value per share rose to $61.24 at March 31st as strong operating results were partially offset by the effects of volatility in the financial markets. In summary, a good quarter, with some very early positive signs in our P&C operations and a continuing well-performing MI, on the back of conservative, proactive capital and investment management.

And now, I will turn the Mark.

Mark D. Lyons {BIO 6494178 <GO>}

Great. Thank you, Marc, and good morning to all. I will make some summary comments for the first quarter of 2018, all on a core basis. And as I say, every quarter, the term core corresponds to Arch's financial results excluding Watford Re, whereas the term consolidated includes Watford Re.

So from a big picture perspective, after-tax operating earnings for the quarter were 235 plus million, which translates to an annualized 11.3% operating return on average common equity and $1.69 per share.

Book value per share was -- as Marc just said, was $61.24 at the end of the quarter, which represents a 0.5% increase from last quarter and 6.2% increase from one year ago despite a negative total investment return for the quarter.

The diversification of our operating platform and within our investment portfolio proved invaluable towards increase in book value per share in a very challenging economic and insurance environment.

Moving onto operations, core losses recorded in the first quarter from 2018 catastrophic events, net of reinsurance recoverables and reinstatement premiums, were 2 million, or 0.2 loss ratio points compared to 1.2 percentage points in the first quarter of 2017 on the same basis, approximately evenly split between our Insurance and reinsurance segments.

As for prior period pure net loss reserve development, approximately 52 million, a favorable development of 4.7 loss ratio points was reported in the first quarter compared to 8.3 loss ratio points in the corresponding quarter of 2017. This was led by the reinsurance segment, with approximately 37 million favorable, the mortgage segment adding approximately 30 million favorable and the insurance segment contributing 2 million favorable.

The reduction in net favorable pure loss development relative to a year ago was driven by a lower level of reinsurance casualty releases and a lesser amount of US mortgage second lien subrogation recoveries and fewer accident years contributing to US mortgages first lien releases. Net favorable development associated with prior year catastrophic events totaled approximately 12 million this quarter, predominantly driven by releases on Hurricane Harvey.

Before I comment on our individual segment results, I'd like to update you on capital management actions we've taken through the first quarter of 2018. As you recall, in the fourth quarter of 2017, we executed roughly 1.4 billion of internal loss portfolio transactions between our US property casualty insurance subsidiaries and our Bermuda operating company.

Additionally, effective January 1st of 2018, we canceled all internal property casualty insurance and reinsurance in force quota share treaty on a cut-off basis. The net effect of which was to improve the risk-based capital ratios of our relevant US subsidiaries. In future quarters, we will provide updates on any further actions taken, and I will comment on share repurchases later in these comments.

On a related topic, as Marc just referenced, it was announced in latter part of April that Arch Re Limited entered into a transaction with Catalina General Insurance Limited. At inception, approximately 400 million of subject reserves were transferred accompanied by an approximate 200 million adverse development cover. Catalina will assume all claims handling responsibilities and the transaction is heavily collateralized to secure Catalina's obligations, with a meaningful margin above 100% of all transferred reserves throughout the life of the contract.

It should be noted that although this was a transaction between our Bermuda operating company and Catalina, the underlying exposures emanated from the US Insurance group.

Moving now to more so into operations, the calendar quarter combined ratio on a core basis was 78.8%, identical with the first quarter of 2017, and lower compared to the 82.5% (inaudible) for the fourth quarter of 2017. The core accident quarter combined ratio, excluding cats, improved to 83.2% compared to 86.1% for 2017 first quarter.

The reinsurance segment accident quarter combined ratio, excluding cats, of 93.4%, showed 420 basis points of improvement compared to the first quarter of 2017 of 97.6% combined ratio. This was driven by expense ratio reductions with a corresponding flat accident quarter loss ratio quarter-over-quarter.

The reinsurance segment expense ratio benefited from reductions of operating expenses in the dollar sense combined with larger net earned premium base. In addition, a reduction in federal excise taxes of 2.5 million, or 90 basis points, due to a reduction from the cancellation of certain inter-company property casualty quota share agreements that I referenced earlier. This benefit will continue to improve for the remainder of 2018.

The insurance segment's accident quarter combined ratio, excluding cats, was 98.7%, up slightly from the 97.8 in the first quarter of 2017 due to higher acquisition expenses resulting from mix of business changes with also a corresponding flat accident quarter loss ratio. However, on a sequential basis, this quarter's accident quarter combined ratio improved 100 basis points over the fourth quarter of 2017, largely due to a lower level of reported large attritional losses relative to recent quarters.

Moving to the mortgage segment, their accident quarter combined ratio improved to 43.4% from 50.4% in the first quarter of last year as net earned premiums remains relatively flat as a percentage of total, being approximately 25% to 26% in both quarters. The accident quarter loss ratio of 20.1% in the first quarter of 2018 compares favorably against both the 21% ratio in the same second quarter of 2017 and the 25% ratio in the fourth quarter of 2017.

The expense ratio also improved from the 28.9% in the first quarter of 2017 to 23.3% this quarter, reflecting the benefit of a full year of integration efforts, following the acquisition of United Guaranty Corp. However, on a sequential basis, the expense ratio increased to 120 basis points from 22.1%. As we have previously discussed, this is driven by an increase in the amortization of deferred acquisition costs. Remember, at the closing of UGC transaction at prior year-end all deferred acquisition expenses were written off to zero and they are now rebuilding themselves being amortized into income.

Total investment return for the quarter was a negative 32 basis points on a US dollar basis and a negative 40 basis points on a local currency basis. These returns were impacted by the effects of higher interest rates on investment-grade fixed income securities and the overall equity market decline, partially offset by positive returns on alternative investments and non-investment-grade fixed income.

The investment duration was 2.6 years at the end of the quarter, down sequentially from 2.83 years at December 31st, and down from 3.36 years a year ago in anticipation of rising interest rates. Also during the quarter, fixed income investments, which represent approximately 76% of investable assets, saw a tactical shift away from municipal bonds, which were reduced by 28% in the quarter and into corporates and AAA backed asset securities -- asset-backed securities due to improved relative valuations.

During the quarter, the company incurred 111 million of pre-tax net realized losses, primarily as a result of the already referenced index mix shift and included within net realized loss was 18.4 million of unrealized losses in equities under the new accounting principles that requires recognition in net income of changes in the market value of equities, rather than in other comprehensive income.

As you know , our investment portfolio continues to be managed on a total return basis and not by component of total returns.

The corporate effective tax rate in the quarter on pretax operating income was 9.9% and reflects the benefit of the lower US tax rates, the geographic mix of our pretax income and a 0.5% benefit from discrete items in the quarter, mostly stock related. As a result, the pure effective tax rate on pretax operating income, excluding these discrete items, is 10.4%. As always, the actual full year effective tax rate could vary depending on the level and location of income or loss, the level and location of catastrophic activity and varying tax rates in each jurisdiction.

On a GAAP basis, at March, 31st, our total debt to total capital ratio was 18.7%, and total debt plus preferred to total capital was 25.7%, down 70 basis points from year-end 2017, and down a nice even 300 basis points from year-end 2016 when we acquired United Guarantee. This leverage reduction was due to our growth in the common equity and the redemption of the remaining 92.6 million of Series C 6.75% preferred shares that took place.

Associated with this redemption was a $2.7 million non-operating charge to expense and the original issue costs of the remaining Series C, which had been held as additional paid-in capital.

As for share repurchases, at the end of the first quarter under Rule 10b5 plan we implemented our share repurchase program during our closed window period and repurchased nearly 40,000 shares at an aggregated cost of 3.3 million. Additional share repurchases have continued into the second quarter and cumulatively total $80 million, with an average price to March 31st book value of 1.33x. Our remaining authorization, which expires in December 2019, at the end of March, was 443 million and considering the share repurchases made through April 30th, now stands at 366.5 million.

Also during the quarter, AIG completed the conversion of all of their remaining convertible preferred shares issued as part of the UGC acquisition, resulting in the issuance of approximately 5.7 million common shares. You may recall that these shares were considered common stock equivalents in 2017, so the conversion in the quarter had no impact on earnings per share or book value.

Operating cash flow on a core basis increased to 370 million in the first quarter of 2018 compared to a 122 million for the same period in 2017, reflecting the growth in premiums written in 2018, a smaller level of operating expenses and UGC transaction costs, and a $52 million tax refund received.

With this introductory comments, we are now prepared to take your questions.

Questions And Answers

Operator

Thank you. (Operator Instructions) And our first question comes from Kai Pan from Morgan Stanley. Your line is open.

Q - Kai Pan {BIO 18669701 <GO>}

Thank you. Good morning. My first question is on the MI business. Given the competitive pricing cut, as well as the new pilot program, what do you think about the return of the business going forward versus your prior expectations?

A - Marc Grandisson {BIO 4369887 <GO>}

So the current returns are in excess of about 15%, which we indicated in the past and still believe it is the case. After we look at the price that -- the price cuts that were announced by one of the major competitors and they actually center around a sheet that explains how they get to -- how they factor in the tax changes, the returns are still in that area, still above 15 despite those rates. That's where we would expect it to be.

Having said all this, not everything is created equally. We are going to be looking very carefully at our RateStar framework and see whether we need to make a few changes and as well as looking at the rate card changes that took place. It's still a very, very good marketplace overall, the credit quality is still very, very high. So we are not changing fundamentally the level of return, especially risk-adjusted return as it compares to other lines of biz that we would have in our a portfolio.

A - Mark D. Lyons {BIO 6494178 <GO>}

In fact, I would just add to Marc's comments that we really look at this as a segment, not as just the US, which is what our competitors are kind of vertically focused on. So our view of CRT transactions or other businesses that we have, the fact that we lay off, we have reinsurance structures and (inaudible) structures that all are very additive towards the net ROE.

Q - Kai Pan {BIO 18669701 <GO>}

Okay. That's great. My second question is on the P&C side, what's your pricing outlook for Q1 renewals and mid-year renewals? We heard some commentary that pricing actually would not be as strong as (inaudible) and do you see the same thing and how do you position your portfolio?

A - Marc Grandisson {BIO 4369887 <GO>}

Yeah. So, we have -- we went through internationally renewal of the Japanese, for instance, at April 1st. I am sure you heard on another calls that pricing was capped at very stable to slightly down or slightly up depending on the layer or the types of risks. So, we were expecting sort of that reaction, but the most important piece, I think, you're asking is what will the US reinsurance market look like at mid-year? And the initial indications are that it's not going to be as good as the rate increases were at January 1. A lot of this is also a posturing. There is lot of early -- still pretty early. June 1st and July 1st, there is a lot of renewals taken place. So people are jousting for positioning and arguing their case as we speak. But the early signs are that the price increase is going to somewhat go down, so the second derivative is negative to the rate change. It might still a rate change, but it's not going to be as good as -- healthy as it was at 1/1.

Q - Kai Pan {BIO 18669701 <GO>}

Okay. That's great. (inaudible) is wondering what kind of lunch ordering for us -- for you guys?

A - Marc Grandisson {BIO 4369887 <GO>}

I don't know. I think we are going to have a surprise. We are going to have a special delivery after the call I'm sure.

A - Mark D. Lyons {BIO 6494178 <GO>}

I am sure we will have a French Canadian accent to it.

Q - Kai Pan {BIO 18669701 <GO>}

All right. Thank you, guys.

A - Mark D. Lyons {BIO 6494178 <GO>}

One other thing, Kai, on the underlying businesses to which the property cat attaches, we're certainly seeing some uplift in our insurance groups and we believe those uplifts are happening on the quota shares and the XOLs that Arch Re attaches on top of it.

Q - Kai Pan {BIO 18669701 <GO>}

Okay. Thanks.

Operator

Thank you. Our next question comes from Elyse Greenspan from Wells Fargo. Your line is open.

Q - Elyse Greenspan {BIO 17263315 <GO>}

Hi. Good morning. To start with couple questions on mortgage and then I do have a P&C question as well. In terms of the mortgage, did you say about how much of earnings it was in the quarter, is it still about that 60% level you had provided us with in the past?

A - Mark D. Lyons {BIO 6494178 <GO>}

I think that's -- well, yeah, that's with the allocation of our investment income that we show in the corporate segment, if you allocate that back, I think it's roughly about that, it might be a couple of points north.

Q - Elyse Greenspan {BIO 17263315 <GO>}

Okay. Perfect. And then in terms of -- a lot changed in the quarter in terms of the mortgage environment with IMAGIN, the CRT deal in relationship with Munich as well as the price cuts in the industry. I mean you guys say, you still see this business is generating about 15% ROE. But what about -- how about do you think about it in terms of the overall earnings? Because obviously some of these different components can either increase or decrease the forward earnings that you can generate from mortgage. Can you kind of help us think through the moving pieces and how the profile has changed with these new developments? Whether -- obviously, it's not just this year, but when we are more thinking about the earnings a couple years out?

A - Marc Grandisson {BIO 4369887 <GO>}

It's a very good question. I think that -- and it's speaks very well to our ability to pick and chose where we're going to allocate capital, depending on the return characteristics on a CRT, for instance, or it's an IMAGIN or that pilot program takes off and it becomes bigger even in the future, that will also allow us to participate there. We also have the US primary MI. As we've mentioned, that's also a good lever for us to utilize.

It's very -- the way we look at the MI business is very similar to the way we look at any other business. You have to tell me what the marketplace looks like as we speak and I will tell you what we -- how we will be reacting. So depending on the relative returns between the CRT, the IMAGIN or other types of structure of this sort and/or primary MI, we will be allocating capital as we see the returns get better. For instance, this quarter, a great example is, we have allocated less capital to the CRT transactions. We saw the spreads tightening to a level that we believe is not as acceptable as we would want and not meeting our threshold return, and -- but it doesn't mean that we need to deploy capital in some other areas to cannibalize the other segments. It's really just a deal by deal, area by area, looking at transactions, making sure we're maximizing the returns.

It's really hard. I guess the short answer is, I do not know until we get to what the market is going to give us in the future.

A - Mark D. Lyons {BIO 6494178 <GO>}

And Elyse, I'd just like to -- before you go onto your next question, just to also caution, this is the pilot. It's extremely early. We don't even have a lot of visibility yet into how it's going.

So -- and which we will certainly talk about in future quarters, but also just be cognizant that IMAGIN is towards US MI, whereas like here with Munich is more towards the CRT transactions. So when you picture Marc's comments about cycle management levers this creates between using working capital versus risk capital, this innovation that the mortgage guys came up with allows that cycle management to really take effect.

Q - Elyse Greenspan {BIO 17263315 <GO>}

Okay. Thank you. That's helpful. And then my last question, in terms of you guys return to buying back stock in the quarter and subsequent to the quarter, can you help us think through your excess capital position, how you would kind of balance either continuing to return capitals with your shares at this kind of one-three times book value level or if M&A, potentially a deal on the P&C side might be something that you would want to conserve capital for? How are you thinking through that decision making right now?

A - Mark D. Lyons {BIO 6494178 <GO>}

Yeah. Great question. And it is kind of an amalgam of a lot of things that you just mentioned. When we did the 10b5-1, we didn't expect certain things to happen from our competitors that kind of weighted and dampened [ph] down our stock, but what we've done historically with that wavy, not quite bright line three-year payback that we talked about. That's an ingredient into the mixture. A view of the off-balance sheet embedded value is a -- helps inform, but doesn't drive some of the decisions, but there is other things that we have going on. There's always things in the pipeline that we're entertaining, firstly.

Secondly, we still are steadfast towards reducing our financial leverage that emanated from the UGC transaction for a couple reasons: one, that then -- the more we do that, it gives us dry powder for other things in the future. We have made commitments in discussions with rating agencies, and it's also an aspect of our GSE relationship that will be helpful to us as we delever. So there is a lot of usages for cash, some of which might go towards -- depending on what gives the highest return and value that we see outside of some of the benefits that might accrue from the deleveraging.

A - Marc Grandisson {BIO 4369887 <GO>}

I would also add that this is -- there is a competition on the allocation of capital and how we deploy it. And certainly we felt when we did the 10b5-1 that this was an appropriate relative allocation of capital. And to Mark's point, there was no insight on our part as to what the markets -- how it developed. We are going to have a Board meeting next week and we're going to have all units sitting around and discussing through what projects or what is they're working on and we are going to have a more detailed discussion next week and determine what we are going to do going forward.

A - Mark D. Lyons {BIO 6494178 <GO>}

And one other thing that I could add is compared to -- just it was three years ago, with the volatility of PC and so forth, we have a lot more clear visibility down the next couple of years of mortgage earnings and the quality and strength of them, because of the way it operates with the monthlys and the persistency attached to it and so forth. So that also helps inform our decisions in a way.

Q - Elyse Greenspan {BIO 17263315 <GO>}

Okay. Thank you very much. I appreciate the color.

A - Mark D. Lyons {BIO 6494178 <GO>}

Thank you.

A - Marc Grandisson {BIO 4369887 <GO>}

Sure.

Operator

Thank you. And our next question comes from Amit Kumar from Buckingham Research Group. Your line is open.

Q - Amit Kumar {BIO 15025799 <GO>}

Thanks and good morning and congrats on the quarter. A few quick questions. So, just first of all going back to the opening remarks, I think you mentioned rate card serves 20% of the business. Is it fair to say that the competitors -- for the competitors, it's close to 100% or so, or what is probably the number?

A - Marc Grandisson {BIO 4369887 <GO>}

The competitors are not doing any RateStars. As far as rate --

Q - Amit Kumar {BIO 15025799 <GO>}

Rate cards.

A - Marc Grandisson {BIO 4369887 <GO>}

Sorry. The rate card -- 100% of revenue, we are about 18% rate card for the production in 1st quarter of 2018. Yes. That's the answer. Yes.

Q - Amit Kumar {BIO 15025799 <GO>}

Got it. No. That's what I wanted to be sure, because clearly the stock overreacted on the news last month. The second question I had was on the timelines. So you mentioned that you're looking at what to do following the pricing discussion. Do we have any idea? I mean is this going to be disclosed very shortly, or does it take a few months and then, I guess you are heading to the PMIERs capital discussion? I just wanted to clear on the timing of the decision.

A - Marc Grandisson {BIO 4369887 <GO>}

I think it's going to be like -- the way we look at the pricing and the way we deliver products to our clients, having a RateStar as a rate card, and having, I would add, different distributions, community banks and credit union, for instance, we need to be very careful and thoughtful as to how we homogenize, if you will, the way we're delivering the pricing and the product to our client. Right now, what's happening is that, our discussions as we speak -- and the discussions started two weeks ago in Greensboro about how we are going to juggle or put together in a cohesive way our reactions to the rate -- on the rate card and what it means for RateStar, if it means anything at all.

So I would -- the June 4th or thereabouts is the first date that the pricing will be in line for the MGIC and I believe Genworth as well. So we probably -- we will have to come to conclusion with rate card in shorter order. The RateStar changes may take a little bit longer to implement because as we have mentioned before, it's over 1.3 million different cells and decision-making. It's not as easy as it looks. It's a lot sturdier, but also being as granular as it is, there is probably less impetus to draw very quick conclusions to it. We can let this work itself even as we speak and even after June 4th, but we will definitely be proactive in making that determinations. I would fully expect by early June we will have full -- total, complete picture as to what we're going to do on both rate car and RateStar if any.

Q - Amit Kumar {BIO 15025799 <GO>}

Got it. That's actually very helpful. The only other question I have is, going back to the insurance segment, and if I look at page 12 of the supplement and you look at the reserve development number, it's very close to sort of 100%. And I'm trying to think is there something deeper going on in terms of the reserve movement, in terms of certain lines which might be seeing adverse and hence the net number is just modestly positive, maybe just help us better understand what's going on and why it's hovering so close to 100%? Thanks,

A - Marc Grandisson {BIO 4369887 <GO>}

Okay. So, it's really the way the reserves are developing in any one quarter, it's haphazard. It could be some negative in one area, some positive in some other area, A quarter change is very hard to pin down and sometimes you may wait one or two or three quarters before you take action. In certain lines of business you may want to do a catch up on one area. So the short answer is, the sum total is the sum total and it's really absolved of individual business units, which we have 14 of. When we go through each individual one of them, and we just look at, this one needs little bit more adverse development because some losses were reported that we didn't expect, some other goes down. So it's really just a -- what you see on our financial result is really the bottom-up approach of our reserving analysis at the individual line level. And it's really at core, where you decide as you go through it sometimes, you tend to be more proactive in certain areas because you might think that the trend is going to go against you a little bit further down the road. In some others, you are going to wait and see whether this is only a one time off thing.

I think the short answer to you, unfortunately, there is no real grand design. It's really a bottom-up approach to reserve -- to reserving. And I would say some lines showed us sort of negative or adverse redevelopments, some showed positive development depending on the quarter.

Q - Amit Kumar {BIO 15025799 <GO>}

No. I guess what I was trying to ask is, where does the combined ratio eventually settle based on the performance of this business?

A - Marc Grandisson {BIO 4369887 <GO>}

I think our accident year combined ratio that I mentioned, that Mark mentioned, 98-99 is roughly in the range of what we would expect the mix of business to be. And again, I would just caveat that by saying, there are some trends happening in marketplace, some rate changes we see, what we hear have happened, will they find their way to the bottom line over time is yet to know, it remains to be seen.

A - Mark D. Lyons {BIO 6494178 <GO>}

And I would say, Marc, I think, was pretty clear on his prepared comments on the consistency between insurance and reinsurance, is where capital is deployed and that's the function of the rates and relative to loss trend. So there is absolutely returns, and then what is market -- what are the market conditions doing, is it helping or hurting that absolute return. And that's how capital gets deployed, that's how the business mix shifts and if that's successful in the shift, you can have an even more beneficial impact.

A - Marc Grandisson {BIO 4369887 <GO>}

And I would even add, well, to add more complexities to this, if you have the same book of business this year that you renewed at a 2.75, five-year treasury versus last year 1.8, you could have a very similar accident year combined ratio but a higher return on equity. Just to add if it is not completely enough for you.

Q - Amit Kumar {BIO 15025799 <GO>}

No. Okay. Fine. I will probably get more color later today on that. I will stop here. Thanks for the answers and good luck for the future.

A - Mark D. Lyons {BIO 6494178 <GO>}

Thanks, Amit.

Operator

Thank you. Our next question comes from Josh Shanker from Deutsche Bank. Your line is open.

Q - Josh Shanker {BIO 5292022 <GO>}

Yeah. Good morning, everybody, or maybe it's already noon there. Is the travel accs and health business, is that growth based on the company getting in place the right infrastructure to be able to handle that business or is that business is seeing a difference in terms of its profitability, which makes you more hungry for it? I third on that, where is that business coming from, is the pie getting bigger, or you are taking that from competitors?

A - Marc Grandisson {BIO 4369887 <GO>}

So, okay, I am trying to get the answer. So, it's coming from -- we had a couple of programs that we won over the last 24 months, which helped us -- and we had relationships that we had developed for a long time Internationally, as well as in the US. So it's really growing with new relationships, that one of them is -- it actually growing is the large reason what we are grown in travel over the last 12 months.

The first question, yes, we have an integrated model. We have claims. We have pricing. We have portal. We also have RoamRight as you know. We have business-to-consumer (inaudible), business to business as well, which would be more wholesale or retail -- through a retail network, actually, a little bit like having a program -- not a program, but sort of relationship with a couple producers to really be there go-to-market in that segment.

In terms of returns, this is not a very super high margin business. I think you'll see other people talk about it in terms of combined ratio, but in terms of capital usage, it is very -- it's very, very effective in terms of capital usage. So we are trying to get into that segment. It's also very, very sticky as you know, as you might expect Josh. If you get a relationships with the type and work with the product development -- with the guys who sell the product, it could be beneficial for a long time. So this has been going on for at least four or five years -- our growth.

Q - Josh Shanker {BIO 5292022 <GO>}

That's very thorough. And then on the UGC 2014 to 2016 premium, I have been sort of guessing that the decay on older accident years lose about 20% of its premium annually. I don't know if that's right, but maybe how much a net premiums written growth tailwind is the UGC quarter share years going into the past given you?

A - Mark D. Lyons {BIO 6494178 <GO>}

Yeah, Josh, I'd say you're in the ballpark. I think you're a little heavy on the degree of decay in the lower --

Q - Josh Shanker {BIO 5292022 <GO>}

Okay. Thank you.

A - Mark D. Lyons {BIO 6494178 <GO>}

Yeah.

Operator

Thank you. And our next question comes from Geoffrey Dunn from Dowling & Partners. Your line is open.

Q - Geoffrey Dunn {BIO 3447798 <GO>}

Thanks. Good morning.

A - Marc Grandisson {BIO 4369887 <GO>}

Hi, Geoffrey.

Q - Geoffrey Dunn {BIO 3447798 <GO>}

Like yourselves, it seems like a number of the MIs continue to evaluate the recent BP monthly changes, but there is (Multiple Speaker).

A - Mark D. Lyons {BIO 6494178 <GO>}

Geoff, I am sorry. We can't hear you.

Q - Geoffrey Dunn {BIO 3447798 <GO>}

Is that any better?

A - Mark D. Lyons {BIO 6494178 <GO>}

Much better. Thanks.

Q - Geoffrey Dunn {BIO 3447798 <GO>}

All right. So again, like yourselves, it looks like a number of the MIs are evaluating the recent BP monthly changes, but in some of the commentary, it suggests maybe there is some evolution going on in terms of how some companies are thinking about approaching pricing. What are your thoughts on the competitive environment? If the industry started shifting to your approach, where the rate card was available for the lenders that want it, but they shift to more granular or even black box pricing for those that are looking for that?

A - Marc Grandisson {BIO 4369887 <GO>}

So, in a way for us it's music to our ears. It means that our model is the right model. And if you start having a 75 cells, and you develop now in multiple of 200, 300 cells as we see some of our guys developing, sort of refine, sort of rebuild, if you will, their risk-based pricing within the rate card phenomenon, you are going to start multiplying these cells very dramatically. It might create issues for the -- the same issues that I think the large banks for instance, who I said that, they are now really willing to entertain at this point, which is the ability to cater to all these various more permutations of pricing.

So as much as people are fighting RateStar, it seems like it's evolving into that direction. So, to us it's a little bit music to our ears, it's sort of confirmed that our model -- and a couple of our competitors made comments as such over the last week or so, that this is probably a more longer-term beneficial. There will be some disruptions in the short term. I think that probably your point that you're trying to make and I think, yes, that is possible, but we do believe that it doesn't -- the more you multiply the number of cells and more complexities you introduce into delivery and pricing the product at the originations at that level.

A - Mark D. Lyons {BIO 6494178 <GO>}

And I would just add on the boring side of it, but an important operational aspect is the response time of something this complicated to return to the lenders in the manner in which they expected and kind of shield this from that, but the response time has to be fast, so there was a major investments that the guys did in that regard. So it is just important to have the eight-ninth to (inaudible) under the water as the one-ninth that you see above the water.

Q - Geoffrey Dunn {BIO 3447798 <GO>}

Okay. And then you've always had an interesting approach on some of the innovations that are effectively introducing a capital-light model with your Bellemeade deals, with the MRT, the Munich CRT. How much -- do you view your capital allocations independently above those or do you view the return on a segment basis, where maybe those capital-light opportunities give you more leeway on the capital heavy opportunities?

A - Marc Grandisson {BIO 4369887 <GO>}

So, if you will, it's really -- I mean we -- for reasons that are -- there is a unit that's called MI, which is a global MI company, so there bonus plan and -- guidance of their performance is based on the overall segment's results. So they are -- they can fit into broader MI market, whether it's insurance, CRTs, utilizing more Bellemeade transaction if they are so sure that it's makes sense from return perspective, they could diversify in different areas around the world. And at the end, they are all internally making sure that they're optimizing the returns, so we really are looking at it, Geoff, from a total -- totality at the unit level and making sure that they -- having said all this, we have self imposed guide on to so much capital we are willing to expose for the shareholders perspective to MI, but within the confines of those, that's constrained, they have a vested interest in maximizing, optimizing the returns. We look at the whole holistically, if you will.

A - Mark D. Lyons {BIO 6494178 <GO>}

Which we don't view any differently than how the reinsurance group does it, how the insurance group does it.

A - Marc Grandisson {BIO 4369887 <GO>}

That's right.

Q - Geoffrey Dunn {BIO 3447798 <GO>}

Okay. Thanks.

A - Marc Grandisson {BIO 4369887 <GO>}

Thanks, Geoff.

Operator

Thank you. And our next question comes from Jay Cohen from Bank of America. Your line is open.

Q - Jay Cohen {BIO 1498813 <GO>}

Yeah. Just maybe small question on the MI. With the amortization of debt now being part of the expenses. Can you give us a sense of where you think the expense ratio will end up by the end of this year?

A - Mark D. Lyons {BIO 6494178 <GO>}

Well one other ingredients I didn't put in the prepared remarks was that there was some bonus cut jobs. And this is highly profitable, so the extent that bonus throughout the year was under accrued and had to be made whole with the more recent year end calculations, that's gets reflected in the first quarter and that's what happened. I mean not only the profitability of the business but the excellent execution on the integration that they've done also fits into that. So, it's going to be marginally better. And it could be lumpy on Q2, 3Q, 4Q, but I would say on the balance of the nine months, it's going to be, it's going to be marginally better.

Q - Jay Cohen {BIO 1498813 <GO>}

Got it. That's helpful. Thanks, Mark.

A - Mark D. Lyons {BIO 6494178 <GO>}

Sure.

Operator

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

Q - Meyer Shields {BIO 4281064 <GO>}

Thanks. I think we've had a couple of quarters now where you've been more cautious or sounded more cautious on loss trends. And I was hoping if you could dig a little bit more into what's driving the increased conservativeness if that's the right way to phrasing it?

A - Marc Grandisson {BIO 4369887 <GO>}

I think, we were looking at trend, I mean actually by training and the recovering actuarial I would like to say. If you look back at loss trends historically -- it's a historical phenomena, right? You have not developed data and try to make an adjustments for what you think the overall CPI , and unfortunately, the insurance trend and inflation typically lags CPI pick up .

And to the extent that we've seen some inflation pick up over that two, three years, they will not find its way through the projection of loss trends for a little while. And we've had a combination of things, right, audit premium on most of our segments that are auditable, pretty much we're always up on the upside, so there is more activity in the industry. So whatever you think your pricing -- and whatever would have been happening in the industry there is always that -- been the mismatches ongoing, it's subsiding a little bit, but we've had sort of a pick up in activity in the broad economy in the US.

So the more there is activity, the more there is friction, the more I believe there is a possibility that a loss trend could go in and develop adversary against you. It's probably more of a prudent phenomenon. I think that the problem that we have in our business, mostly casualty, is that, your pricing, forward-looking, looking back at loss trend. I think we've had undue benign loss experience over the last eight or nine years. And I think it's largely as a result of the economies slowing down so much as a result of the great financial crisis.

So it just -- we're not saying it's going to go crazy, we're just saying that the likelihood of this being above what we believe and what we are coming out of our actual model, I think is -- this is a more likely than not. We tend to be more prudent when we factor in the loss trend. Mark, anything else?

A - Mark D. Lyons {BIO 6494178 <GO>}

Yeah. Just I would just kind of echo were Marc again said, were capital isn't going, where we allocate on D&O, in fact to excess casualty. There is loss trend in your actuarial arithmetic and then there's trend not explained by actuarial arithmetic. D&O for example is incredibly lumpy year-to-year, as there's no real projection about it, each and -- they will always have a primary excess. But on casualty excess, actuarial arithmetic never works, never works. It's always terms and conditions that really drive it. So when we say loss trend, we're also recognizing the slippage in terms of conditions.

Q - Meyer Shields {BIO 4281064 <GO>}

Okay. That's very helpful. And I guess a second unrelated question. I think we talked a little bit more about -- I'm trying to figure out how to phrase it, pursuing individual opportunities in the insurance segment a little bit more rapidly than in the past and I was hoping you could update us on how those opportunities are bubbling up?

A - Marc Grandisson {BIO 4369887 <GO>}

There's always possibilities around. And I'm not here to tell you what we're going to do next month. I don't think it's fair on the call of that nature, Meyer. But I think that -- I think our comments also had to do with, we're also going to be a bit more proactive in reacting to either adverse or positive reactions. For instance, property was a great example, right. Property rates increased a little bit and I think we -- Nicolas took it upon himself, when he took over in October. So, listen, even though the rates -- and I was saying in the third and fourth quarter, you need rates of 30% to 40% to really start pushing the envelope and do -- make a significant commitment in capital to property.

We still have some rate increases and Nicolas -- well, we need to be a bit more proactive in positioning ourselves in the marketplace. I think that would have been not necessarily the way -- it is not sort of way a traditional insurance company would think all the time. And I think we're trying to bring -- which is more of an opportunistic way of thinking, which I think is brought up on largely as a result of Nicolas has been, he's done so well in the reinsurance, and our insurance group is taking up to it like fish and water.

Q - Meyer Shields {BIO 4281064 <GO>}

Okay. Perfect. Thank so much.

A - Marc Grandisson {BIO 4369887 <GO>}

Thanks, Meyer.

Operator

Our next question comes from Ian Gutterman from Balyasny. Your line is open.

Q - Ian Gutterman {BIO 3106649 <GO>}

Thank you. Marc, I was thinking of going into the front this time, but some traditions are too good to change though.

A - Mark D. Lyons {BIO 6494178 <GO>}

(Multiple Speakers) You can always hang up and redial in to be last.

Q - Ian Gutterman {BIO 3106649 <GO>}

My time is a little off I guess. So, I had one, wanted to follow up question before I get to my main questions. Maybe it is much of an observation as a question. Marc, how is it that some of these lines where we are seeing adverse development, every year most of the companies seem to pick into 65 every year in mid to long tail casualty?

A - Marc Grandisson {BIO 4369887 <GO>}

Boy, asking the question is -- it's a very, very deep question. I think that, if you overlay what happened and we were on the receiving end of this and Mark (inaudible) when he was running insurance. When you were looking at results in 2012, '13, '14, and pricing of ongoing business or looking at the results of the years, you would look at the '08, '09 and 2010 and even 05 or 06, you would have lesser development than the actuaries for a decay. So we do a loss reserve analysis, pretty much everything comes down below the expectation. So -- and this has been going on for a while, actuaries or loss reserve specialist lose a little bit of their credit after a while because it's kind of hard to deviate from anchoring yourself with a long-term level, it's very hard for people reserving to think that this is really a 30% loss ratio and it's also the same way, very difficult to say, it's not running 65 it's running 80.

Since we're looking back and then you look back out to five or six years, if you are an actuary right now, if you look at the loss reserve development, you will say, well, I think it's sort of 75. These are the same people that were saying, it should be booked at 65-68, five or six years ago and things have developed to be 56, 57, 58. So there's a little bit of a mismatch. It's not easy for people to reconcile the way the reserving is made. Most people and I think we can be guilty of it ourselves as well, people tend to think of insurance as being not cycle effected. But there is such a thing as cycle effected, it's not a linear plus or minus 2 or 3 points, especially if your specialty insurance companies like ourselves. So many moving parts.

It's really hard to pin it down and you have history as a guide and the loss ratio around the long-term expected varies wildly. Unfortunately or fortunately, I think I like it because it creates opportunities for us in the future because people keep on booking 65% and 66%, when it turns out to be 85, 88, they have to recognize it. We'll be able to seize the opportunity of people deemphasizing that line of business precisely. But it's going to take while.

Q - Ian Gutterman {BIO 3106649 <GO>}

I agree and that's helpful. It's how I remember things from the early days when we were first meeting on the Island and you guys are being formed. It feels like the similar story. So, my main couple of questions, one on the mortgages. I get, obviously, the advantage of having RateStar versus the card when other people are cutting rates, but how should I think about -- and I'll try to come up with an examples, probably not the best one, but you can hopefully get the spirit of it.

If there is a cell under RateStar that maybe was priced, tended to -- because you looked at it in a better way and maybe was 20% discount to most people's rate cards and maybe you had, I don't know, a 50% hit rate or something on that cell, if everyone else is cutting rates, does that hit rate go from 50% to 25% even if you don't change anything? So even though you're not using the rate card, do you become less competitive and need to maybe reconsider some of your pricing in the RateStar cells?

A - Marc Grandisson {BIO 4369887 <GO>}

Yeah. So we've been thinking about this. And I think the best way is, let me try and make an analogy from property cat exposure. Most of our analysts are P&C people. So let's think about two types of risks, hurricane in Florida and California quake. If you think about writing a line of business, or pricing -- you price yourself at 20 online for a layer in Florida, attaching a $10 billion market loss. Hopefully, for the overall event. This 20% is the current pricing, you have an excess of $60 billion quake exposure in California and that current pricing is 10%, right. RateStar might say that the current pricing for Florida, I should be getting 22%, but the rate card is saying is 20. So I'm not necessarily get -- win a lot of that business.

At the same time, because of inefficiencies in the overall card, I can tell you that our RateStar pricing for that California risk, which is much higher, much is likely to be hit, is 10% when the rate card is 13%.

So right now, what I'm going to be doing is focusing more on my capital on the one that is up 10%. Two things will be evident to you is that. I'm having a lower rate than the average that personal writes I think in Florida. So that's why for us the average rate is a very, very misleading way to think about it. Now the rate card is 20 in Florida and is 13 in California. Next year, somebody cuts the rate card by 10%, that 20 goes to 18, that 13 goes through 11 and change. What am I going to be able to write next year. My RateStar hasn't changed, I'm still at 10 in California and I'm still at 23 in Florida. So what's going to happen? I'm going to get even less from the Florida business and presumably the same or if not a bit more of the business in California. So that's sort of what RateStar does for us. Does that make sense to you?

Q - Ian Gutterman {BIO 3106649 <GO>}

That's make perfect sense. I totally agree with that. I was trying if there was sort of cells in the middle where you would have gone from maybe something that was a 20 and you were -- at 19 you're getting business and now your overwriting -- writing now at 19 versus 18. (Multiple Speakers) book that is, maybe that just on the margin, it's not that big a deal.

A - Marc Grandisson {BIO 4369887 <GO>}

Yeah. To your point I made two -- I made one extreme example about two different rates. But you're right, there's a lot between a spectrum that goes and that we have David Ginsberg, Tim Allen and John Gains [ph] spending an amazing amount of time dynamically connecting with clients and looking at production on daily basis and try to figure out what will work. RateStar is sort of a floor of sort and we though it over and probably we put the pricing that we think will sell in the marketplace that give us a return obviously, but we're not trying to leave money on the table, but we're trying to be competitive and take the best risk as in the example I just mentioned. There is a lot more going on. You are quite right. I mean there is 1.03 million cells, 17ish different -- it's a very arduous process.

A - Mark D. Lyons {BIO 6494178 <GO>}

I would just say, you probably heard some of the other questions just on, talked about what if others have RateStars and have fine pricing, then I think your question is a lot more relevant. I think right now, it's like we got a old buckshot -- they have a old buckshot (inaudible) and they are trying to hit it with that, where they need a scalpel. And over time I think your question is going to have a lot more relevance.

Q - Ian Gutterman {BIO 3106649 <GO>}

Yeah. Got it. And if I can just ask quickly on the Catalina transaction? Just can you give a little color on what US lines of business we're in there? I guess I don't really think of you guys have a runoff book, so I'm a little confused of what exactly you mean, and what went into this transaction?

A - Mark D. Lyons {BIO 6494178 <GO>}

Sure. Well, actually we kind of view this as our third action because some of these programs that we talked about, which we've terminated, we talked about in past calls, past years, of terminating programs and your stuff with the runoff, we terminated because we didn't like the results or we didn't like the emergence of claims of the underlying coverage, and allowed that to happen. And similarly on the specialty casualty runoff, it's predominantly old New York labor law issues, California residential contractor business, where you get -- you think you've done in 10 years, but then they do repairs and the clock starts over again and those kinds of things.

So that's really -- and so there's no ongoing customer continuity issues, things of that nature. So, given that those decisions were made, and I think they were the correct ones, and then we still wound up -- you see it in our 10-Ks, still having some issues whether we said, let's -- looking across the board on capital management, let's just try to solve it once and for all.

Q - Ian Gutterman {BIO 3106649 <GO>}

Okay. And then even though it was back dated 1/1, any -- since the deal was written in April, is there any financial impact that is going show up in Q2 was already up and accounted for in Q1?

A - Mark D. Lyons {BIO 6494178 <GO>}

Well, what you windup happening, it's going to be in Q2. So -- but remember just that, ultimately, there's a difference between statutory and GAAP, if the adverse development cover is ever hit, we don't think it will be, but it gives us reinsurance, but to the extent that it is, statutorily you get 100% of the recoverable immediately, but on a GAAP basis it's kind of amortized. And think of it between the Berkshire/AIG and ADC, and the way that works.

A - Marc Grandisson {BIO 4369887 <GO>}

But we don't expect much change in quarters two, not much compliance.

Q - Ian Gutterman {BIO 3106649 <GO>}

Okay. Good. That's what I was curious about. Okay. Thank you.

A - Marc Grandisson {BIO 4369887 <GO>}

Thank you.

Operator

Thank you. And our next question comes from Ryan Tunis from Autonomous Research. Your line is open.

Q - Ryan Tunis {BIO 16502263 <GO>}

Hey. Thanks. I guess just following up on the ADC, can you give us some idea of the amount of adverse development, I guess, maybe you took last or you have taken in the past few years and the lines that were subject to that?

A - Mark D. Lyons {BIO 6494178 <GO>}

I do not have that on my fingertips. Programs -- I can tell you that on the programs over the last couple years I believe the majority of the adverse - is associated with these terminated program. So I think that's the best color I can --

A - Marc Grandisson {BIO 4369887 <GO>}

And this is same on the casualty, if there were any adverse developments in say, specialty casualty book of biz that Mark referred to.

Q - Ryan Tunis {BIO 16502263 <GO>}

And that's a pretty good adverse I looking at the 10-K, right, so now that's a lack of a headwind going forward/

A - Mark D. Lyons {BIO 6494178 <GO>}

Yes. That's correct.

Q - Analyst

Okay. And then I guess, just -- I had a couple of bigger picture ones I guess on the MI conversations. And I guess the first one is this whole discussion mid teens ROEs, I guess at what return level would you guys proactively start writing less?

A - Marc Grandisson {BIO 4369887 <GO>}

I think you've seen it as we speak. I think we have a threshold risk adjusted -- I mean like I said, not everything is -- else is created equally, but you saw some changes already in two quarters where we -- first we deemphasized singles for a little while because we don't think the returns are there. Is it was low-teen, unfortunately going a little below 10% which is not acceptable to us. It's also a portfolio thinking, right, you got to think about it, Ryan, in terms of portfolio, so not every transaction is -- this could be accretive, they could bring diversification even within the portfolio, your MI. But having said all of this, you heard about the singles and you can -- the two other riskier areas that we've looked at, the high LTVs and the high DTIs, we have tendency to go away because those returns went below the threshold that what we have in RateStar, better than RateStar.

So for now, we don't see any reason to start thinking about other than these two areas I mentioned in terms of risk in that. I think it's very -- and it's a very ongoing on a quarterly basis and on a weekly basis actually just reviewing what pricing is out there, what kind of risk is going on. And the other thing that I would tell you is, now it's everything else being equal, different products come at some point down the road in the future. So we'll be reacting to it when we see it. So that's the best I can tell you.

Q - Ryan Tunis {BIO 16502263 <GO>}

Okay.

A - Mark D. Lyons {BIO 6494178 <GO>}

And Ryan I would just add that the -- and Marc referenced in the C&L discussion, he talked about the property cat and he talked about the RDS, which I'll emphasize again, we're the only one with an RDS. But that is an important heavy forward focus and our executive management focus, we are at 16.4% of tangible. So it could be a combination of things. It could be a combination of front-end, which we think we've scoped pretty well through RateStar and it's a risk management tool on the front-end. But because of the -- I think the excellent way the MI group has integrated their front-end pricing, the backend, the RDS on the risk management side, they all inform each other, they are all -- in a integrated basis.

So if we Bellemeade or that programmatic session winds up becoming too expensive, where you cancel it out, what does that pay us. The outside world is having a different view of mortgage credit risk. And therefore our net could go up more, even though the front-end hasn't reacted yet. So it's a combination of all those factors that -- and team take into account.

Q - Ryan Tunis {BIO 16502263 <GO>}

I guess my follow up is just. I am sure you guys have thought about this, but just trying to think about the floor on pricing with MIs. I guess the analog I am bringing up is the fact that, your property cat used to be a mid-teens ROE business and you had alternative capital and capital-light models. And that just feels sort of familiar here, and all of a sudden, you've got several years, where all you are talking about is negative pricing, and all of a sudden you are back to pre-Katrina levels, and so -- that's obviously not been really much fun. So, I am hoping whether you guys can talk me off the ledge a little bit on that analog? I mean is there anything that -- I guess it's really the structure of the market or anything like that that makes this, you think, less susceptible to I guess lower-cost capital? And I know your over time competitor is accepting some 10% ROEs.

A - Marc Grandisson {BIO 4369887 <GO>}

Yeah. So, unlike property cat, right, you've written business for the last five years at a rate level that is pretty healthy and that business continues producing return and results for you as we go forward, on the basis and on the back of I would argue, very healthy increase in house prices, we have LTVs -- our current LTVs on originations currently our portfolio is way south of 80. So, it's -- and we thought south of 80 overall. So it's pretty healthy, lot of equities, lot of collateral in front of us. So we're actually in a very -- still we are still not winning our sales, if you will. So if we play to take going forward, right, the rates are probably 2 to 2.5 times what they were pre-crisis. I mean there's been a significant amount of price increase, and I'm not even talking about the kind or the types of product. So the kind of -- and a property cat is 12 month -- It's of one 12-month commitment, it's a lot easier to change price, you can change on the fly, so the whole -- a 100% of portfolio every single year.

On mortgage, you always have this portfolio as it on one through time. So if I overlay this healthy house prices index, lack of products, the bad product that took place in mid 2000 that really created a lot of the issues. I look at a borrower with a FICO that's an all-time -- as high as it has ever gotten, there is a lot of room to give over time, but the question that you're asking, which we're really asking ourselves because we're going to live it together with our units, It's going to take a while to erode that huge increase in quality and pricing that we went through after the crisis of 2009.

So we're not as -- so might of our depth are greatly exaggerated, no it's not. It's going to take a little while before we get to a threshold of being dangerous -- too dangerous for us to stick around if you will. But it will come, I just don't know when.

A - Mark D. Lyons {BIO 6494178 <GO>}

And Ryan, one other thing, back to your analogy, if it was -- this is longer duration, right. I mean our property cat capital comes in, pretty quickly you can know how to exit. it's longer-tailed liability streams or with that comfortable for alternative capital, there would be tons of casualty vehicles out there, but there's not. So has a mortgage issue, has a lot of duration outflow and duration inflows, that are very interest rate and macroeconomically sensitive. So I think that's quite a ways off, so I would open that window and get back in the room.

Q - Analyst

All right. That's helpful, Thanks guys.

Operator

Thank you. And our next question comes from Mike Zaremski from Credit Suisse. Your line is open.

Q - Michael Zaremski {BIO 20606248 <GO>}

Thanks. I'll try to be fast given it's past lunch hour. Could you elaborate on what type of economics Arch receives from running IMAGIN?

A - Marc Grandisson {BIO 4369887 <GO>}

We are not in a position to do those. I mean we have strong NDAs, and there's a lot of communications that we need to keep to ourselves. But we are -- the returns are comparable to what we would get in the general business sense as we factor in our managing and operating and risk management and bring oversight to the staff.

Q - Michael Zaremski {BIO 20606248 <GO>}

Okay. So maybe we can follow-up that in the future quarter. And can you remind me, staying on MI, have combined ratios from the rate card generated business been materially different from RateStar business?

A - Marc Grandisson {BIO 4369887 <GO>}

That is one great question and the answer is, no, as of yet right. And we believe that the risk adjusted pricing framework that RateStar gives us is going to be tremendous in a more of a stress scenario. And we haven't that really -- we've had some localized stressed scenarios, but we haven't really gone through that exercise of analyzing it. And I think if you look at the loss ratio, when the wind doesn't below or when the quake doesn't shake, everybody has a zero loss ratio. So we are in this relatively benign claims environment and it's really hard to see it and that's probably one of our biggest frustrations I guess as managers at Arch is that the fact that we are looking at the way we have done the cat pricing and the way we -- for instance, the way we've structured our portfolio.

When there are no losses, we don't look very good because we looked that we should have done more, but the way we think about this and we talk about it internally all the time is, we are very honest about analyzing the underlying economics and risk characteristics, probably recognizing that we could be wrong for a while. And MI is pretty much like a cat line of business in a lot of ways. So the short answer is, no, we haven't done it. We don't expect it to be a very much of a difference on reported loss ratio.

Q - Michael Zaremski {BIO 20606248 <GO>}

Okay. That's helpful. And lastly, a follow-up to Josh's question earlier on travel and ANH given it's a -- it continues to grow at a nice clip. So it felt like you guys were alluding to it being driven by let a few relationships. I am just kind of curious are these relationships longer -- if it's correct, is this -- are these relationships sticky, longer term in nature or would this be kind of a line that's classic Arch, which will ebb and flow over time depending on the return profile? I guess is this -- I know it's a short-tail liability, but is the distribution stickier?

A - Marc Grandisson {BIO 4369887 <GO>}

We believe it is stickier. These are small items. There's more connectivity to the pricing, claims adjustment. And because it's a lot of travel, there is claims adjustment, right. You need to be able to pay the person that cannot go to their place or repatriate some of them. There is a lot of stuff you need to be able to do. So, we believe it is stickier.

But having said this, everything is stickier, but in the long run everybody is dead, right. In the long run, everything is variable on the costs. If you remember, your microeconomics. So at some point the pricing gets too out of whack. I'm sure everything is fixable, but it's relatively sticky in the short-term -- short to medium-term.

Q - Analyst

Okay. Thank you very much.

A - Marc Grandisson {BIO 4369887 <GO>}

Thank you.

Operator

Thank you. And we do have a follow-up from Jay Cohen from Bank of America. Your line is open.

Q - Jay Cohen {BIO 1498813 <GO>}

Sorry to delay lunch further.

A - Mark D. Lyons {BIO 6494178 <GO>}

You couldn't get enough.

Q - Jay Cohen {BIO 1498813 <GO>}

I know right. On Catalina, can you talk about the assets that get transferred over? I am trying to get a sense of the impact on investment income?

A - Mark D. Lyons {BIO 6494178 <GO>}

I will tell you what, let me answer the question more broadly than you asked it, because I think you are trying to update your model, right? So let me get to it, we did an LPT at year-end, which was a bullet. I mean the quota share has quarterly cash payments, right. We report them. So this is a bullet cash payment to our Bermuda operating company. We did the cancellation of the quota shares, which brings UPR back onshore with associated cash transfer and then there's the Catalina which in scale of things is not large. So it's effectively close to a wash between the investment income that you might guess, onshore, offshore because of all those flows back and forth. For Catalina, the reason I did that, of the three, Catalina ranks third in size compared to the LPT first, the UPR cancellation second, Catalina third.

Q - Jay Cohen {BIO 1498813 <GO>}

Thanks for the clarification, Mark. I appreciate it.

A - Marc Grandisson {BIO 4369887 <GO>}

Sure. Thanks Jay.

Operator

Thank you. And I'm showing no further questions from our phone lines. I would now like to turn the conference back over to Marc Grandisson for any closing remarks.

A - Marc Grandisson {BIO 4369887 <GO>}

Thank you very much everyone. Happy quarter and on to lunch now. We will see you next quarter. Thanks.

Operator

Ladies and gentlemen, thank you for participating in today's conference. This does conclude the program. You may all disconnect. Everyone have a great day.