Q3 2021 Earnings Call

Company Participants

- Francois Morin, Chief Financial Officer and Treasurer
- Marc Grandisson, Chief Executive Officer

Other Participants

- Brian Meredith, Analyst
- Elyse Greenspan, Analyst
- Jimmy Bhullar, Analyst
- Josh Shanker, Analyst
- Matt Carletti, Analyst
- Meyer Shields, Analyst
- Mike Zaremski, Analyst
- Tracy Benguigui, Analyst

Presentation

Operator

Good day, ladies and gentlemen, and welcome to the third quarter 2021 Arch Capital Group Earnings Conference Call. At this time, all participants are in a listen-only mode. Later we will conduct a question-and-answer session and instructions will follow at that time. (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 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 companies earnings press release and is available on the companies website. I would now like to introduce your host for today's conference, Mr. Marc Grandisson and Mr. Francois Morin.

Sirs, you may begin.

Marc Grandisson {BIO 4369887 <GO>}

Thank you, Liz. Good morning and welcome to our third quarter earnings call. We are pleased to have delivered solid results this quarter as our operating units generated a 9.3% annualized operating return equity and a 12.5% annualized net income ROE despite an active catastrophic -- catastrophe quarter, sorry guys. Premium writings and rate growth remains strong in our P&C unit driving solid fundamental earnings while our mortgage insurance unit again produced excellent results.

The current market conditions allow us to demonstrate the value of our diversified platform and underwriting strength as they provide us with plenty of opportunities to deploy capital and generate an expected return on equity in the mid teens. And the broader P&C arena, we continue to see the market hardening along with ample evidence that our industry is addressing the adequacy of pricing across most sectors. The trajectory and market acceptance of rate increases reinforce why we remain optimistic that improved economics in the P&C market will be sustainable for some time. As you know, the P&C industry is facing many degrees of uncertainty, heightened cat activity and for the last five years, rising inflation, COVID ongoing influence on a global economy and enduring low interest rates.

One faced with escalating risk underwriters need both rate increases and conservative loss estimates in order to build adequate margins of safety into premium levels. With our agile underwriting established teams and strong capital position, we are well equipped to grow into this improving market.

Turning now to our operating units. We'll begin with insurance where our early focus on strengthening our underwriting capability and seizing recent market opportunities is working. Gross written premiums continued to grow substantially up 32% over the same quarter in 2020 and our accident year combined ratio ex-cats improved to 90.5%. This is another indication of the progress we have made in our specialty insurance business. We've been leaning into this hardening market for two years now as rate increases remain well above the long-term loss cost trends and have spread to more lines than last year.

Overall, 2021 rates are up around 10% compared to 2020 and we expect that the benefit of higher premium levels will be realized well into 2023 enhancing our expected returns for that period. This quarter had many bright spots including positive rate increases have accelerated the lower limits account. These lines had previously lagged the increases in larger accounts, that is no longer the case. Two, our early focus on Lloyd's and business in the UK has improved our scale and our economics in this market. Three, some of our business lines that were most impacted by COVID like travel are recapturing some of the lost volume as both business and consumer travel increases. In summary, our Specialty Insurance Group is making the most of the current opportunities.

Pivoting now to our reinsurance group. We delivered strong growth in the quarter with gross written premiums up nearly 25% over the same period in 2020. On a net basis reported growth was only a modest 3% versus the same quarter in 2020 due to a catch-up in sessions to Watford following the purchase of the company with our partners at July 1.

Francois will provide more detail during his comments, but absent this one-off transaction reinsurance net written premium growth were still very strong at 30% and our outlook remains favorable as similar to instruments. We are experiencing broad rate increases in our specialty and casualty reinsurance lines.

In the quarter, our reinsurance segment reported a combined ratio of 106% reflecting the effects of the third quarter cats primarily Ida and the Central European floods, but reinsurance's accident year combined ratio ex-cat is excellent at 83.2%. There are signs that property market rates could adjust higher due to cat fatigue as you've likely heard on other calls this quarter. The recent five-year period of elevated losses from catastrophes proves an important insurance adage, losses don't know the level of the premium.

There are also early indications that retrocessional an aggregate excess of loss protections are becoming increasingly hard to come by and we believe that this will be reflected in higher property rates broadly. As you know, we weren't remain judicious in the deployment of our cat PML, which was effectively flat in the third quarter. At less than 6% of our tangible equity, we remained underweight in net property cat exposure and we will deploy more capital to the line if expected returns improve above our target. It's too early to make a call on a January 1st renewal process, but pricing in this sector is heavily influence of the margins and if ILS or other capacity phase there is a possibility for significant rate corrections and increase engagement on our part.

In the meantime, our reinsurance teams are demonstrating their agility and like insurance are leaning hard into the markets where returns are most attractive. Thirdly, our mortgage group continues to deliver exceptional returns. It generated $234 million of underwriting profit in the third quarter and continues its impressive rebound from loss concerns associated with the pandemic.

A September 30 insurance in-force of $457 billion for the segment was up modestly. Further good news is that notices of default have declined to pre-pandemic levels at September 30, which is a good indicator of improved conditions. Additionally, loans in forbearance continue to decline as federal programs conclude and we remain cautiously optimistic that most of these loans will ultimately cure. Rising home prices have broadly increased homeowner equity and you will recall our position that equity levels are the best indication of whether a delinquency will ultimately result in a loss.

We estimate that 98% of our loans in forbearance today have at least 10% equity providing significant protection against potential losses. Overall, the MI market remains competitive but rational and our business continues to generate returns on capital in the mid-teens. Mortgage originations continue at a pace similar to last year's record origination volume and credit quality remains excellent.

As you know, in all of our operations, we actively manage capital to enhance shareholder returns. The strong results in our mortgage segment have enabled us to optimize our capital structure, the increased reinsurance cessions through our Bellemeade mortgage insurance linked notes as well as traditional reinsurance. Additional reinsurance purchases enable us to reallocate capital towards faster growing areas in specialty property and casualty lines while enhancing our return profile in MI by reducing required capital. MI remains a very attractive business for us. Now a point of pride and interest to us and perhaps to you all is that last Saturday, October 23, Arch celebrated its 20 year anniversary. So I want to say to our investors thank you for believing in us and to our employees past and present. Thank you for your contributions to Arch for last 20 years and our clients for showing support and conviction in our capacity to provide products to you.

Finally, the PGA tours in Bermuda this weekend. So Golf is top of mind. A golf tournament is interesting in that it takes place over several days and therefore consistency is critical. You have to be sure to pick your spots and lower your score. But if you want to make the cut, you have to limit the bogey's early, so that you can play more aggressively in the stretch. And then once you get to the weekend, you can play with a bit more freedom and really try for the birdies and Eagles. At this point in the cycle, we feel we've made the cut and now were focused on really taking advantage of our positioning to make sure we end up at the top of the leaderboard. Francois.

Francois Morin {BIO 17410715 <GO>}

Thank you, Mark, and good morning to you all on this first day of the Butterfield Bermuda Championship here in Bermuda. Thanks for joining us today. Before I provide more color on our solid third quarter results, you all have observed that while our earnings release still makes a distinction between core and consolidated for purposes of -- comparison to prior periods, there is no difference between the two presentations this quarter. As we discussed on the last call, the closing of the Watford transaction on July 1 gave rise to a reconsideration events and as a result of our updated VIE analysis we no longer consolidate the results of Watford in our financial results.

Our 40% share of Watford results is now reported in the income from operating affiliates line and there is no longer a need to make a distinction between core and consolidated results in our financials. As Marc shared earlier our after-tax operating income for the quarter was $294.7 million or $0.74 per share resulting in an annualized 9.3% operating return on average common equity, and book value per share increased to $32.43 at September 30, up 1.3% in the quarter. A very solid result in light of the catastrophe activity that was much higher than the long-term average for this quarter, which we estimate at over $45 billion in insured losses for the P&C industry apart, approximately three times the average third quarter cat losses observed over the last ten years. This quarter, I wanted to first give you some additional detail on the results of our reinsurance operations, which were impacted by the Watford acquisition, especially on the top line.

As part of the agreement signed at the beginning of the year with our co-investors in Watford, we committed to seeding varying percentages of the premium written by our Bermuda and US treaty reinsurance operations to Watford effectively enhancing the existing business model to also serve as a sidecar for Arch, while the retrocession agreements were effective as of the start of the year, their signing was contingent on the transaction closing, which delayed their recognition in our income statement until this quarter. As a result, the third quarter ceded written premium reflects a catch-up of approximately $161.2 million from the first half of the year.

The impact of the premium catch-up adjustment on underwriting income for the reinsurance segment was minimal. Growth in gross written premium remained strong at 24.6% on a quarter-over-quarter basis and growth in net written premium would have come in at 29.5% adjusting for the Watford catch up. The growth was observed across most of our lines, but especially in our casualty other specialty and property other than property catastrophe lines where strong rate increases and growth in new accounts help increase the top line. The segment's accident quarter combined ratio excluding cats stood at 83.2% compared to 83.1% on the same basis one year ago.

On a year-to-date basis, the ex-cat accident year combined ratio has improved by approximately 250 basis points over the same period last year, reflecting the improving underwriting results in most of the lines in which we write them. In the insurance segment, net written premium grew 40% over the same quarter one year ago and the segment's accident quarter combined ratio excluding cats was 90.5% lower by approximately 360 basis points from the same period one year ago.

Excellent results across the board, which demonstrate the progress our Insurance segment has made over the last three plus years and improving its performance and provide us with optimism on the underlying quality of our franchise going forward. Losses from 2021 catastrophic events in the quarter, net of reinsurance recoverables and reinstatement premiums stood at $335.9 million or 17.4 combined ratio points compared to 12.5 combined ratio points in the third quarter of 2020. As noted in our pre-release, our P&C operations were impacted by hurricane Ida, the European flooding events of July as well as a series of other events across the globe. Our mortgage segment had an excellent quarter with a combined ratio of 26.2% reflecting favorable prior year development of $48.4 million, about half of which came from USMI from better than expected cure activity in pre-pandemic delinquencies and recoveries on the second lien loans and the other half from our CRT portfolio and international MI.

The decrease in net premiums earned on a sequential basis was primarily attributable to lower levels of a single premium terminations in the quarter for USLMI business and to a lower level of call the CRT transaction than what was observed in the second quarter. Recalled the second quarter benefited from higher earned premiums due to an unusually high number of CRT transactions being called, which we highlighted as effectively being a non-recurring event.

The delinquency rate for USMI book came in at 2.67% at the end of the quarter, a material reduction from the peak we observed at the end of the second quarter, one year ago. We had another solid quarter in terms of production, mostly from the purchase market and with refinance activity coming down from prior levels, the insurance in force for our USMI book grew slightly. The increase from last quarter in the insurance in force of our international mortgage unit is mostly the result of the acquisition of Westpac Lenders Mortgage Insurance Limited in early August. Although income from operating affiliates grew significantly to $124.1 million, it is worth noting that approximately $95.7 million of the total is attributable to a one-time operating gain resulting from the acquisition of a 40% stake in Watford, which was offset in part by a realized loss upon the deconsolidation with the resulting net income gain of $62.5 million. The remainder of the operating income from affiliates represents our share of the net income generated this quarter by our operating affiliates, which consist primarily of Watford, Coface, and Premia.

Total investment return for our investment portfolio was de minimis on a US dollar basis for the quarter. Net investment income was $88.2 million during the quarter, down by $1.2 million on a sequential basis driven by lower coupons on fixed maturities and lower income on consolidated funds. The duration of our portfolio remains low at 2.68 years at the end of the quarter, reflecting our internal view of the risk and return tradeoffs in the fixed income markets.

Equity in net income of investment funds accounted for using the equity method produced $105.4 million during the quarter, more than half of the total income generated by our investment portfolio and a key contributor to the growth in our book value. As we discussed on prior calls, we have increased our allocation to alternative investments in the last few years, and these funds now represent -- represent approximately 12% of our total portfolio at the end of the quarter. We are also very pleased with their performance so far this year, which stands at 13% year to date.

Of note, had we included income from funds using the equity method in our definition of operating income. Our reported operating ROE would have increased by 3.2% on a year-to-date basis to 13.3%. While these funds returns are potentially more volatile and core fixed income strategies, we believe the incremental recurrence they provide more than compensate for the liquidity constraints and volatility that are usually associated with them.

The effective tax rate on pretax operating income was a benefit of 0.7% in the quarter reflecting changes in the full year estimated tax rate, the geographic mix of our pre-tax income and then 8.2% benefit from discrete tax items in the quarter. The discrete tax items in the quarter primarily related to a partial release in a valuation allowance on certain UK deferred tax assets.

Now a quick comment on the two acquisitions we closed on this quarter, Westpac and Somerset Bridge. You all have seen that in accordance with purchase GAAP we established approximately $337.4 million of intangibles and goodwill this quarter, most of which will be amortized through our income statement going forward. To help with remodeling efforts, we now expect our amortization expense to be approximately $25 million in the fourth quarter of this year and $21 million quarterly throughout 2022. On the capital front, we redeemed all of our outstanding Series E non-cumulative preferred shares for $450 million on September 30. Separately, we repurchased approximately $9.7 million common shares at an aggregate cost of $386.9 million in the third quarter. If we include the additional common shares we have purchased in the fourth quarter, the year-to-date totals are now approximately $24 million shares or 5.9% of the common shares outstanding at the beginning of the year for $917.7 million. Some of the additional share repurchases in the fourth quarter were effectuated under the new share repurchase authorization of $1.5 billion approved by our Board of Directors earlier this month.

As we have said since our formation 20 years ago, our core operating principles are anchored in active cycle and capital management. We believe this quarter results demonstrates our ability to execute on this philosophy and leads us to invest in opportunities where we believe the returns are most attractive. At recent prices and with the prospect of improving returns, we believe buying back our shares continues to represent another compelling value proposition for our shareholders without compromising our capital flexibility nor lessening the quality and strength of our balance sheet.

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

Questions And Answers

Operator

(Operator Instructions) Our first question comes from Elyse Greenspan with Wells Fargo.

Q - Elyse Greenspan {BIO 17263315 <GO>}

Hi, thanks, good morning. My first question. Marc, you're talking about the mortgage business. You talked about buying, buying more reinsurance. So it was more capital for growth on the P&C side, which I found interesting in the past you've spoken about mortgage running at around a 15 plus return and P&C at kind of 10 to 12 has the dynamics change that that caused you to kind of buy some more reinsurance to pursue more growth on the property casualty side?

A - Marc Grandisson {BIO 4369887 <GO>}

Yeah, I think our opportunities on the P&C side just have improved right over the last couple of years and I think we're even more convinced of the length and that has, that has legs for for the foreseeable future. So that makes us be more proactive, to balance, if you will, to capital allocation between more than one year, I mean we did rely heavily on a capital deployed in MI for quite a while because it returns in P&C as you know at least as attractive. But now that we have a new attractive and increase and improve returns in the P&C it behooves us to, to balance the risk profile of the portfolio and that's one of the reasons why we would do some more reinsurance and again the reinsurance also helps, helps our return on a net basis as well, which is also another benefit.

Q - Elyse Greenspan {BIO 17263315 <GO>}

But I'd return numbers I gave still kind of where you see the three businesses of 50% plus and then 10 to 12.

A - Marc Grandisson {BIO 4369887 <GO>}

Yes. I would say on the P&C side. Elyse, I would say it's getting up, is north of that now. I think we have our prospects closing, closing, the gap is closing between MI and P&C, if you will.

Q - Elyse Greenspan {BIO 17263315 <GO>}

So North, a higher than 12%?

A - Marc Grandisson {BIO 4369887 <GO>}

I would agree. Yeah, we think it's the case. Yes.

Q - Elyse Greenspan {BIO 17263315 <GO>}

And then in terms of capital you guys put in place a $1.5 billion authorization. It sounds like you bought back a little bit under that so far this quarter going through the end of next year. I know obviously what you buyback depends upon the market also will your shares and the trading over the course of the next year, but when you put that in place. Was that designed to set a mark of what you will buyback or are there other factors that could cause you to either fully buyback that level or maybe come in lower.

Just help us kind of think through that as we think about capital return through 2022.

A - Marc Grandisson {BIO 4369887 <GO>}

Well, I mean, two things, we bought were close to a billion dollars this year. So we don't want to go back to the Board every three months and ask for more. So we thought okay,.what may we need, could we need by the end of 2022 over the next 15, over the next 15 months effectively, $1.5 billion is just a number that nice round number. Nothing, nothing special about it. But are we committed to that number. The answer is absolutely not. If the market keeps improving and we have the ability to deploy your capital, all the capital and then some in the business, we may not end up buying anything back. So it's really again a function of the market conditions and vice versa. Right. If the market doesn't really generate give us a lot of opportunities to grow, we might be in a position where we buy back more than that. So it's really again it will be a function of what we see in front of us over the next 15 months.

And if we end up going through the $1.5billion sooner than the end of next year then we'll do something else. So again, it's very dynamic, very real time I'd say. And we'll see where things take us.

Q - Elyse Greenspan {BIO 17263315 <GO>}

Okay, thanks for the color.

A - Marc Grandisson {BIO 4369887 <GO>}

Thanks.

Operator

Our next question comes from Jimmy Bhullar with JP Morgan.

Q - Jimmy Bhullar {BIO 4278955 <GO>}

Hi, good morning. So first I've a question on just what you're seeing in terms of pricing, both on the insurance and the reinsurance side. And to what extent do you think price increases are going to hold versus may be especially on the reinsurance, market seems like things have been getting a little bit softer over through the course of the year. But how does, how do recently high catastrophes affect your view of one-one notes.

A - Marc Grandisson {BIO 4369887 <GO>}

Right Jimmy, if we bifurcate the market into property cat, you agree, I would tend to agree with you that property cat raise did not increase as much as we had hoped collectively as an industry we see not only at Arch is going to be single Arch phenomenon, therefore that's why you saw us write less property cat over the next, over the last nine months.

Assuming that reaction to those rate level, I would the -- it's still early. Like we said, like I said in my commentary, but I think we should have a repricing, definitely repricing in Europe and in the US even for the layers that have been impacted. That's for sure. And I think it would start to spill out even on to those that have not sustained a loss because I think there is a recognition of heightened cat activity and I think that the market is sort of bracing for that as we go forward. I think it's going to be a matter of degree. On the rest of the marketplace, I think that overall since if you look at the liability lines in general, overall you'll see -- you can think of in terms of the quarter share if you like quota share of casualty or liability lines, you are benefiting from the rate increases in the business and I think the ceding commissions, which were maintained, held high for in 2020 are starting to come down a little bit.

So there is a recognition that, so there's a bit of an improvement from that perspective on quarter share, on the excess of loss in general for liability. The raise are stable to somewhat, more stable, but again you apply those raise against a base that is increasing in premium level, so they are also getting some price uplift. And I think that big as soon, I mean the reinsurance market. Jimmy fees off of the insurance market right.

In a positive way I want to express a positive message. We actually, we only receiving in of a portion of what the insurance market rights, and to the extent the interest market rights premium at a higher level, we are benefiting from those -- from those rate increases.

Q - Jimmy Bhullar {BIO 4278955 <GO>}

Okay. And then can you quantify how much you've got in terms of COVID reserves especially for business interruption and I'm assuming they're mostly still IBNR as you had been quantifying last year. And just discuss what the process would be in the timeline would be for release than these given that for the most part, it seems like the courts have been fighting with the insurance companies at least thus far in the US.

A - Marc Grandisson {BIO 4369887 <GO>}

Yeah, I'd say, I mean we're still very much a lot of IBNR in our COVID reserve is more than, more than half, 60% or so. I'd say of our of -- our call it COVID reserves on the P&C side are still IBNR. So -- and how quickly well, we know, we're not know whether we'll need those reserves, time will tell. I think it's where we sit. Yes. I don't disagree that. So far, there have been a couple of positive developments from the courts, but it's going to take a while.

I truly think this is, I mean, very complicated and issue that will take years to resolve. So I wouldn't expect us to really take dramatic action on the level of COVID reserves on the P&C side for some time.

A - Francois Morin {BIO 17410715 <GO>}

And Jimmy in our industry and insurance, you could win 95 lawsuits and lose 96 and it changes everything. So there's a lot of uncertainty in our space. Even though we've been at good streak, one change could change everything so (inaudible) good.

Q - Jimmy Bhullar {BIO 4278955 <GO>}

And what is the rough number of -- what rough dollar amount of reserves.

A - Francois Morin {BIO 17410715 <GO>}

That's a good question. I don't have it in front of me. We can circle back with you, I know we booked a few hundred million dollars last year and we paid some of that I don't have that current figure, but we can give you that.

A - Marc Grandisson {BIO 4369887 <GO>}

We haven't changed ultimate Jimmy over the three quarters.

Q - Jimmy Bhullar {BIO 4278955 <GO>}

But it's not something like that's more maybe 2023-24 as opposed to 22 in terms of its potential releases on these.

A - Marc Grandisson {BIO 4369887 <GO>}

But there are releases. I will, to it will probably take another year, year and a half and we might hold a little bit more longer for the reasons I just mentioned in terms of court decisions.

Q - Jimmy Bhullar {BIO 4278955 <GO>}

Got it. Thank you.

Operator

Our next question comes from Mike Zaremski with Wolfe Research.

Q - Mike Zaremski {BIO 22348763 <GO>}

Hey, great. Good morning. I guess in some of the prepared remarks when you guys were talking about the primary insurance segment, talked about kind of seeing rate acceleration, actually in the lower limits, kind of the smaller commercial space. And any theories on what's on why that's happening, is it you don't loss cost trend, increasing because we're kind of, you're seeing a fading of rate a little bit of deceleration and in the large account space. So kind of curious, if you guys have any views, maybe broadly to on kind of loss cost trend, given all the uncertainty during the pandemic, on the primary insurance side?

A - Marc Grandisson {BIO 4369887 <GO>}

The loss cost trend as we observe it and it might change, is still roughly in the 3% to 5%. It depends on the lines of business but we have already changed our view on this at this point time we had a loss reserve review, I believe, couple of months ago.

So is it's not changing. Although we are putting in our loss ratio pick an extra level of margin safety to make sure we wouldn't be missing because it could be higher. As you know, inflation is certainly another concern that we all have collectively as underwriters. In terms of my theory about why the smaller accounts, get those rates right now, it's just that it's the market is a human psychology market and the pricing get more acutely needed in the larger capacity play, this is where the market starts focusing its first effort as the market hardens and this is not a news, this is not unusual. This is a very, very normal phenomenon in the hardening markets. So you will tend to try and fix those are more important, meaning if you put a $10 million to $15 and $25 million limit, these are the ones you're going to trying to fix right away because presumably those will have caused you a bit more pain over the last three years, we expecting more things coming from that portfolio and it's just a matter of time before people start looking sideways as to what other lines of business needed rate and then you start dipping down into your overall portfolio and seeing where the liability trends for instance might else will be impact and this is sort of a sort of a second-round sort of a rippling effect from the main capacity providing players into the ones who have a lower price. And at the same time. To be fair and to be I mean to be truthful. You also have development in ongoing happening on the smaller accounts at the same time, this is just not as acute and as glaring and as obvious early as a larger capacity play that's why.

Q - Mike Zaremski {BIO 22348763 <GO>}

That's interesting and helpful. Maybe switching gears to the mortgage segment. Just curious, I know the forbearance levels continue to decrease, if you could remind us, I believe there is some extensions to the forbearance program or maybe even new kind of enhanced programs where the P&I could be reduced, the payments can be reduced by up to 25%, is that correct.

And if so is are you seeing your borrowers utilize those options.

A - Marc Grandisson {BIO 4369887 <GO>}

Yeah. So right now the the the program is done expires of 09/30, expire in in terms of foreclosure right. So, but I don't, the forbearance, I'm sorry, the foreclosure, it's still unclear right because they could also come back and extended further if things were to change and the CFPB is also involved with the FHFA's saying that we don't want to have anymore. There is a moratorium on a foreclosure process as well.

So I think both federal entities are trying to push to go back to your last point of your question, push the, the mortgage to loan or the mortgage originator and provider of providing solutions to the borrowers who are still in forbearance or not current on their payments and to your point, a lot of it is going to be continuing the same payment. Most of it is going to be continuing the same payment at prior to the COVID forbearance program and is attaching at the end, towards the end, the lack of what wasn't paid what was accrued as unpaid at the end of the loan.

So this is roughly what it's going to look like, but it's going to be another another three quarters before we have more visibility because even though the forbearance program stopped in 09/30 and people should come now to the banks And you know the mortgage originator and trying to remediate their position from the forklift from a forbearance perspective, it's still going to take another six to nine months. And I think the agencies are watching carefully. So everything is is heading towards a happy resolution, if you will, of the overall forbearance programs like everybody is focusing on this as this point in time.

Q - Mike Zaremski {BIO 22348763 <GO>}

Okay, great. And one last one on are sticking to mortgage, and I can take this offline with but with (inaudible) but just want to the increased seeded, premium seeded as percentage of gross, is that due to Bellemeade and I guess if it, if it is. Can you guys continue to upsize the reinsurance usage in the segment if you thought opportunistically, you want to shift more growth towards other lines of business?

A - Francois Morin {BIO 17410715 <GO>}

Yeah, that's very much in that vein, I think Marc made the point earlier, we were always looking to optimize the portfolio and certainly a lot of that is focused on capital deployment, I think made the point last call that we had increased our quota share percentages on the USMI book at 7.1. So that's starting to play through basically in that, that is reflected. We also. We still very active in the Bellemeade space, so we are, we're purchasing quite a lot there as well, and I'd say, those two things combined really explain why we have more ceded premium starting this quarter.

Q - Mike Zaremski {BIO 22348763 <GO>}

Got it. There is more appetite if you decided to do more either quota or Bellemeade, both in the future. Are you kind of reaching kind of a max.

A - Marc Grandisson {BIO 4369887 <GO>}

I mean, I'd say we certainly do a lot of Bellemeade as it is. So I don't want to say we wouldn't do more, but it's, I mean we already are very active in that space and made big placement. So I wouldn't expect us necessarily increase that that vehicle of -- that mechanism to transfer risk a whole lot. And on the quota share. I mean work. Yes. Can we see more, we could, but then it's the risk return trade off and whether the economics work are reasonable or work in our favor to. So right now we're happy where we're at. But if things change in the market gives us better opportunities we could conceivably see it a bit more. Yes.

Q - Mike Zaremski {BIO 22348763 <GO>}

Thank you.

A - Francois Morin {BIO 17410715 <GO>}

Yeah. Welcome.

Operator

Our next question comes from Josh Shanker with Bank of America.

Q - Josh Shanker {BIO 5292022 <GO>}

Yeah, good morning everyone. And this may not be the best math, but it's gross, I think you guys, the inventory of COVID era mortgage claims about 120,000, you've had about 90,000 cures, I'm estimating that you guys have about $20,000 up or notice right now in the portfolio may not be exact, historically, you've had about an average of $5,000 up are noted, it seems like the reserves are stuff particularly as you tell us that 90% of -- 98% of the clientele, at least $10,000 in equity, so I mean I'm trying to rectify all this, I think, can you explain to me I feel I've asked this question before, I just don't understand what's going on there.

A - Marc Grandisson {BIO 4369887 <GO>}

Yeah, I think the answer is going to be very similar. So, very good question. Hopefully you're not taken by the police, back there. If you look at the average case reserve per annual these are, it's actually 23,500 I believe is in the supplement, you can look at and to it and you're right, it was, it went up from last year, the run rate pre COVID was roughly 10,000,11,000,12,000, so it did increase and about was about 110,000 claims that we've got as well a COVID in the forbearance and about 78% of them by cured so far, so we're about 20,500. So better than that we have about 31,707 I think is a number in terms of NODs outstanding when you multiple by through, you're right, it would look on the high side.

A couple of things I will say here. Number one is, the average face, the average severity of the policies that we are facing the COVID 19 are starting from 18-19 We have a higher face than the one we had as NODs back in 2019 why those in 2019 were largely pre 2008. So yes, adjust for the level of coverage that has increased over the last 10-12 years. So that explains one why 23 would be higher than the 11-13 historically.

The second part of your question which where should it go and this is where it's more art than science, Josh. We hear you. We are up cautiously optimistic that it may not come to pass in terms of meeting the reserves and hopefully some of it will cure better than we anticipated, but I just want to remind everyone at call and as we remind ourselves all the time, it's that this is a political positioning right things could change very quickly from the FHFA, the GSEs or the housing department. So we need to be really careful and we've never been through that kind of event. So we are Arch, as you know and we will take a cautious prudent approach to reserving. And if we happen not to meet those reserves as we do, typically will be taking them by the hands from the liability side down to the capital side.

Were not going to then stranded for a long time, but again so much, so many uncertainties, Josh, we understand you're puzzling. And this is a very unusual situation for the industry. Therefore, we have to, and that's why we appear probably to be a little bit unusual in that reserving it.

Q - Josh Shanker {BIO 5292022 <GO>}

And my second question, unrelated, can you talk about the differential. I guess, the new business NLC between new business you're putting on the books and legacy customers. So you have a deep sense of their, of their -- the risk factors on those accounts, is there a gap is the business that you're renewing at better margins, what you're booking at new business given that you know more about the business you already have.

A - Marc Grandisson {BIO 4369887 <GO>}

I believe, Josh, you're talking about P&C Right?

Q - Josh Shanker {BIO 5292022 <GO>}

Yeah, this is totally primary P&C not more of.

A - Marc Grandisson {BIO 4369887 <GO>}

It can make sense to me. So it's a really a very astute question Josh because we're keeping track of the renewal rate versus a new business rate level and symptomatic or as a representation of the hardening market, the pricing of the new business is coming higher than the renewal business, and that's sort of speaks to the fact that they need a new home and need to be repriced and people sort of get, you get tired of that relationship. And it goes back thrown back into either the E&S or the admitted market. So right now, we're still seeing on average the new business, price better the renewal business.

Q - Josh Shanker {BIO 5292022 <GO>}

Okay. Thank you.

A - Marc Grandisson {BIO 4369887 <GO>}

Thank you, Josh.

Operator

Our next question comes from Tracy Benguigui with Barclays.

Q - Tracy Benguigui {BIO 21808177 <GO>}

Thank you. Just a big picture question a seamless quarter with you and your closer peer group, is that the insurance growth is outpacing the more primary market focus players without reinsurance arm. Are you seeing a lot of market dislocation where you feel like you just do a better job assuming displace rest that still meet risk adjusted return hurdles.

A - Marc Grandisson {BIO 4369887 <GO>}

Would like to think we're better than the average guy out there, but -- but Tracy I think overall the dislocation was much larger in 2020. I think you were still seeing some dislocation right now and certainly not, there's still some repositioning of limit provided the market by a lot of players still as we speak. And I think what, what explains our ability to grow is first We have a really well established presence and we were really on the weight, Tracy, historically. We're really, really good market for people that want a good security for products such as D&O, for instance, right. We are really good home for someone to take on new as an insurer, and we're sort of, sort of, we're definitely benefiting from that as an incumbent in a good, with a good quality, good reputation as we do.

Also I think, the other thing that I want to mention, we had said that last year we were suffering a little bit from some of the travel and travel -- lack of traveling that impacted our travel portfolio. So that's certainly helps by treating the fact that economies reopening and people are traveling a bit more that also helps explain why we're able to, to grow a bit more than probably and meet the average -- within the average would. Lastly, I would say that beyond just new business funding new homes. I think the programs, we also growing in programs, as you see, this is very specialty smaller risk. I think that again another, another example of programs finding a new home, going away from the existing incumbent possibly because of better results and finding a new home and we definitely are receiving end of that relationship.

A - Francois Morin {BIO 17410715 <GO>}

Yeah. And one thing I'll add quickly, I think both depending on the mix of business of what you call the more established in the traditional insurers, I mean workers' comp and commercial auto typically will make up a bigger shares of their, of their portfolio. Auto is moving up nicely, but I would say that certainly comp as and had a really good period of excellent results so rate increases on the comp side has been pretty flattish.

So again that's probably worth adjusting for comp because it's such a big line for some of these carriers.

Q - Tracy Benguigui {BIO 21808177 <GO>}

And I'm wondering how much of that is structural in nature, like other is raising attachment points and you're lowering attachment points are offering lower deductible?

A - Marc Grandisson {BIO 4369887 <GO>}

No. We don't, we don't do that. No, we don't play that game. I think we would just be replacing most of our play typically on specialty lines Tracy is mid excess versus second, this is sort of what we play a lot of times and high excess of course in certain areas. So I know we put a record. We're not seeing any of the deductible being played out in the marketplace and that's in fact there are deductible increases if anything else and we just see a lot of shortening of limit toward on in the stacking. We saw that in 2020 is ongoing as we speak instead of having stretch of 25, talking about the larger placements you have stretches of ten or five or five or ten really in 15 perhaps still staying, but there's a lot more players needed to to fill up the towers, that's definitely happening more. So it's still continuing to some extent lesser than 2020.

Q - Tracy Benguigui {BIO 21808177 <GO>}

Okay and then just shifting to reinsurance, where are seeing your favorable reserve development coming from.

A - Marc Grandisson {BIO 4369887 <GO>}

Yeah, I mean the vast majority and we'll talk to it and obviously in the queue at vast majority is in short-tail lines. I mean, I'd say probably 80% in short tail lines, mostly property, other than cat where we've grown a lot in the last couple of years and while the tail is always a bit longer we think it should be. It's still, we have a pretty good idea, two, three years out after writing the policy or the account and we're seeing a lot of that coming through in this quarter, a bit of favorable development on prior year cats as well and a bit on trade credit and surety from a few years ago where we had some reserves that proved out to be a bit work required. So we released those this quarter.

Q - Tracy Benguigui {BIO 21808177 <GO>}

Thank you.

A - Marc Grandisson {BIO 4369887 <GO>}

Sure. You're welcome.

Operator

Our next question comes from Meyer Shields with KBW.

Q - Meyer Shields {BIO 4281064 <GO>}

Thanks. This is, cycle management question I guess for Marc, when if ever do we decide that there is never going to be an appropriate hard market and property cat just get out of the line.

A - Marc Grandisson {BIO 4369887 <GO>}

I think that by virtue of, well, first, I'm an optimist, right. I've always been an optimist, I've heard so many times over the last 27 years from some of our own underwriters that they will never be a hard market again. And when I hear this, it's music to my ears. Because that means we're cruising for bruising. So I think that things will -- things will get better and cat at some point, it may not be this quarter, Meyer, at some point numbers speak for themselves. If you lose money every year people just get get the some chanted then just walk away from it. It happened after storms in Europe 92 Andrew's, earthquake in California 94, terrorist attack, Katrina, Rita, and Wilma and there is always changes and it's not I rattled by five or six of them and you got to believe that the world is a dangerous place, Meyer. So I think something will happen and again losses don't necessarily change the market, the market pricing, but perception of risk will and would, so maybe we're in this place where people said, you know what, why bother and if that's the case, and that in the demand for cat, as you know, protection is inelastic, so if supply shrinks then demand will stay as is and pricing will therefore increase.

So I'm an optimist, so I'm not sure when it's going to happen, but I believe it will happen at some point.

Q - Meyer Shields {BIO 4281064 <GO>}

Okay. Now understood. I think that's what I was looking for. Thank you.

A - Marc Grandisson {BIO 4369887 <GO>}

Sure.

Operator

Our next question comes from Brian Meredith with UBS.

Q - Brian Meredith {BIO 3108204 <GO>}

Yes, thanks. Couple of quick questions here for you. First, I just want to follow up on the comment about new business pricing better than renewal pricing. And I have heard that from other curious. I'm just curious when you actually go to book the margin on that new piece of business are you booking a better margin than perhaps that renewal piece of business or do you have to build in some level of cushion because it is new.

A - Marc Grandisson {BIO 4369887 <GO>}

Well, it's a very good, but I think the latter part is what we would do, but even we would also take a higher level of cushion on margin safety, if you will not reserving even in our, in our renewal business. I think that we are, as you know, reserving wise and loss ratio pick wise at Arch, we tend to be more conservative and hope for the best and hopefully good news come down later. We are trying to figure out, but we need to have as much cushion as we can early on, so that we're not surprised down the road. That's not changing. I would say, it's the same approach renewal or new business. Right. How much of the change.

Q - Brian Meredith {BIO 3108204 <GO>}

Not much of a change. Got you. Okay. Second, just quick question here. Are we still seeing admitted market shed business to the E&S market or is that slow.

A - Marc Grandisson {BIO 4369887 <GO>}

Slowed down little bit, but it still happening. We're not seeing a return back to the end of the market quite yet. It's going to take a little bit longer, we think.

Q - Brian Meredith {BIO 3108204 <GO>}

Got you. And then one kind of bigger I guess philosophical question for you. I think with the MI business, clearly, you've demonstrated that it is not a big of a volatility business, it maybe some of the perceived just given the results we've seen through this recent crisis, if that is indeed the case in the amount of cash that business throws off because it's not a growth business, I guess I see you guys using share buyback as your means of capital management and I completely get that where your stock is trading now, but what about a dividend and maybe remind us about your philosophy with respect to to a dividend.

A - Marc Grandisson {BIO 4369887 <GO>}

Well, I mean, I'll take that. Brian, I think it's something we talk about with the Board and between ourselves all the time, we had a pretty long discussion at our last board meeting on that, it's always on the table. I'd say right now. I mean I think it's, it. I mean the share buyback that we went through this quarter were very attractive to towards the economics were very much. I think they are easy to justify -- justify sorry, but could we ever introduce a dividend. Certainly that's on the table, not saying it's imminent. But it's something that we evaluate pretty much, definitely regularity and we'll keep looking at it.

Q - Brian Meredith {BIO 3108204 <GO>}

Great, thank you.

A - Marc Grandisson {BIO 4369887 <GO>}

Thanks, Mike.

Operator

Our next question comes from Elyse Greenspan with Wells Fargo.

Q - Elyse Greenspan {BIO 17263315 <GO>}

Hi, thanks. Just one additional question on you guys spend time highlighting that session to Watford in the quarter, given that that transaction closed. So my sense is there going to become more Arch like in terms of the business that you're seeding to them versus prior to this transaction. So as you think about your 40% stake, can you just help us think about the earning stream there because I would think that as we go through next year that that could become a meaningful contributor to your earnings as the underwriting income of Watford for pick up from what we're used to.

A - Francois Morin {BIO 17410715 <GO>}

I think the 40% share would grow at an average sort of reinsurance market results because we are writing business on the balance sheet of Watford. So you would expect that. I think that what you would also see is our collecting fees or for our efforts and compensation for our efforts for Watford that would be for the 100%. So I think that the overall return would be slightly better even though at least as you could appreciate with the accounting rules it might not show as such, but I think that our results will be as good. I would hope for if not better than our overall results. So it's definitely an accretive return generator for reinsurance platform. It's going to be hard harvested

Q - Elyse Greenspan {BIO 17263315 <GO>}

That should pick up within that other income line as we move to the next year:

A - Marc Grandisson {BIO 4369887 <GO>}

Yeah. So a couple of. Yeah. The 40%. Correct. The other income line is well the fees are picked up by the reinsurance segment because they, it's for the underwriting services they provide to Watford, but you're correct in saying that the net equity pickup of the 40% that we own in Watford, if you're modeling what kind of combined ratio is it going to operate at, what kind of premium or are you going to see in terms of the volume, I would. You're right, I mean it's probably more and more over time is going to look more and more like Arch Re, the reinsurance segment, the percentages we see to Watford are not uniform across all our divisions. But directionally, I think that's a good way to think about it. And the other thing, too, which has somewhat been an issue with Watford is the performance of the investments. Right. And that has, that is being a little bit as being addressed as we speak. I think there are, there is a process underway to reduce the volatility from the investment portfolio of the investment strategy at Watford. So think of it more, yeah -- a more less volatile stream of income with more reliance on underwriting income and less so investment income and hopefully that gets you in a good place to start modeling out how offer is going to play out for us the 40% for Arch by going forward.

Q - Elyse Greenspan {BIO 17263315 <GO>}

And then maybe I'll squeeze one last. And I'm not sure if you provided an updated tax guidance, if so I missed it, if you can just let us know that and we've heard about some potential tax changes whether in the US and also abroad in relation to Bermuda, you guys are just any on any kind of prospective tax loss and just some of -- what we're hearing in the market and how that could impact Arch.

A - Francois Morin {BIO 17410715 <GO>}

Yeah, I'd say, first of all, that question, fourth quarter, we're still on the 9% to 11% kind of tax rate for for Arch in the fourth quarter for 2022 and beyond and Marc will chime in, it's way too early and fortunately we track, we look at all developments, very carefully. We're on top of things. And the reality is they change daily. So it's very hard for us at this point to give you any kind of guidance or any expectations on what we think 2022 is going to look like, we'll be more than happy to have good discussion at our, on the next call. But for now it's, we feel it's just premature because we really don't know.

A - Marc Grandisson {BIO 4369887 <GO>}

And it leases to make the point about daily literally last night our Tax Director or this morning just sent us like there's a new proposal on the hill that brings back shield and then corrects other things and then dispenses of other areas of the tax proposal in the year, we see. So again a moving target, it's politics. We'll react to it when we do, when we see it.

Q - Elyse Greenspan {BIO 17263315 <GO>}

Okay, thanks for the color.

A - Marc Grandisson {BIO 4369887 <GO>}

Thanks Elyse.

A - Francois Morin {BIO 17410715 <GO>}

You're welcome.

Operator

Our next question comes from Matt Carletti with JMP.

Q - Matt Carletti {BIO 5249827 <GO>}

Yeah, thanks, good morning. I think I just wanted to circle back on the discussion about pandemic reserves and Marc you're pretty clear on the P&C side in terms of getting 95 good outcomes with the 96 can change everything, how about MI. I mean, it kind of follow-up for Josh line of questioning like things like pretty conservative there. Can you help us with a little bit the timeline by which if things can kind of continue to unfold well, would be the timing by which we might see things on line.

A - Francois Morin {BIO 17410715 <GO>}

Well, let me start, I'd say we may see a little in the fourth quarter, but that will be, I don't think everything will be resolved. But I truly think that the first half of 22 is when you'll see most of the, of the movement or the corrections in our assumptions and cure rates and mediation right. So I'd say we're going to start seeing some some data as early as this month internally and the number of cures and people moving out a forbearance, but I think the way it's going to flow through our numbers again given some of the uncertainties that Marc talked about I think will be first half of 22.

And the reason, also, that is, has to be said and understood is that they had 18 months of forbearance, worst when you get to forbearance earlier in 2020 and some of them went into forbearance, came out of forbearance and went back in again. But they still get to get to do to benefit from 18 month worth of forbearance, that's why some of them will coming out of their 18 month in the fourth quarter. And many of them in the first and second quarter. Next, so it seems like some of them were able to get, get back current for four, five months and went back to forbearance program.

That's why we have this lengthy adjustment period.

Q - Matt Carletti {BIO 5249827 <GO>}

And thank you, that's very helpful. Thanks.

A - Francois Morin {BIO 17410715 <GO>}

Yeah, Thank you Matt.

A - Marc Grandisson {BIO 4369887 <GO>}

Thank you.

Operator

I'm not showing any further questions. I would now like to turn the conference over to Mr. Marc Grandisson for closing remarks.

A - Marc Grandisson {BIO 4369887 <GO>}

Thank you so much for being here. We're going to be going for I think some golf, Francois and I and happy 20 years and have a good weekend everyone, thank you.

Operator

Ladies and gentlemen, thank you for participating in today's conference, this concludes the program. You may all disconnect.