Q2 2013 Earnings Call

Company Participants

- Evan Greenberg, Chairman & CEO
- Helen Wilson, Director, IR
- John Lupica, Chairman, Insurance, North America
- Phil Bancroft, CFO
- Sean Ringsted, Chief Risk Officer & Chief Actuary

Other Participants

- Amit Kumar, Analyst
- Brian Meredith, Analyst
- Greg Locraft, Analyst
- Jay Cohen, Analyst
- Jay Gelb, Analyst
- Josh Shanker, Analyst
- Meyer Shields, Analyst
- Michael Nannizzi, Analyst
- Mike Zaremski, Analyst
- Paul Newsome, Analyst
- Thomas Mitchell, Analyst
- Vinay Misquith, Analyst

Presentation

Operator

Good day and welcome to the ACE Limited Second Quarter 2013 earnings conference call. Today's call is being recorded. (Operator Instructions)

For opening remarks and introductions I would like to turn the call over to Helen Wilson, Investor Relations. Please go ahead, ma'am.

Helen Wilson {BIO 2078659 <GO>}

Thank you. Welcome to the ACE Limited June 30, 2013, Second Quarter earnings conference call.

Our report today will contain forward-looking statements. These include statements relating to company and investment performance, guidance, premium growth, product mix, pricing and insurance market conditions, and integration and performance of our acquisitions -- all of which are subject to risks and uncertainties. Actual results may differ materially.

Please refer to our most recent SEC filings, as well as our earnings press release and financial supplement, which are available on our website for more information on factors that could affect these matters.

This call is being webcast live and the webcast replay will be available for one month. Remarks made during the call are current at the time of the call and will not be updated to reflect subsequent material developments.

Now I would like to introduce our speakers. First, we have Evan Greenberg, Chairman and Chief Executive Officer, followed by Phil Bancroft, our Chief Financial Officer. Then we will take your questions. Also with us to assist with your questions are several members of our management team.

Now it is my pleasure to turn the call over to Evan.

Evan Greenberg {BIO 1444445 <GO>}

Good morning, everyone. ACE produced record quarterly earnings that were driven by excellent underwriting and investment results. P&C premium revenue growth was particularly strong and all divisions of the Company contributed to the good financial performance.

After-tax operating income for the quarter was $790 million, up 6.3%, or $2.29 per share, both records for the Company. Our operating return on equity was 12.3%, and in the first six months of the year we have produced over $1.5 billion in after-tax operating income with an ROE that is north of 12%.

Book value in the quarter declined 2.3% due to the rise in interest rates which reduced the unrealized gains in our investment portfolio. Given we are fundamentally buy-and-hold fixed income investors, this is in essence an accelerated recognition of a loss that would have amortized in over time anyway as our bonds mature. The flipside, of course, is that our reinvestment rate has improved by about 60 basis points for a portfolio of similar distribution, and this will benefit our income over years to come.

Tangible book value was additionally impacted by our two Mexican acquisitions which closed during the quarter. We are excited about our prospects in Mexico and our teams are actively engaged in bringing our vision to reality. Phil will have more to say about our book and tangible book value and the impact of rates on our investment portfolio.

Our underwriting results in the quarter were again simply excellent. We produced $434 million of P&C underwriting income, up nearly 16%, with a combined ratio of 87.9%.

The end of the quarter was active in terms of natural catastrophes with the tornadoes in the US and the floods in Europe and Canada. Total pre; and after-tax cat losses this quarter were $81 million and $66 million, respectively. Though following the end of the quarter, we have had preliminary indications of additional losses that could add about $10 million pretax of development on these cats and this will show up in our Third Quarter results.

Positive prior-period reserve development was up modestly from last year and, again, Phil will provide more details on these items.

Similar to the First Quarter, current accident year underwriting was a substantial contributor to our overall calendar year underwriting results. Current accident year underwriting income, excluding catastrophes, was up 21% over prior year with a combined ratio of 89.2%. This was a 1.2 points better than the Second Quarter last year.

In fact, on a current accident year ex-cat basis operating income was $2.17 per share versus $2.01 per share last year. The current accident year results reflect the excellent underlying health of our current business, including global growth in earned premium with continued margin improvement in North America as a result of better pricing and mix of business and margin improvement internationally as a result of product and geographic mix.

P&C net premiums in the quarter grew over 8.5% on a constant dollar basis with foreign exchange negatively impacting that number by 1.5 points on a published basis. Growth came broadly from all regions of the world, but with particularly strong results from North America, Asia, and Latin America.

In North America, retail, commercial, and specialty P&C net premiums were up nearly 12% while our wholesale specialty business was up over 6%. Net premiums for our agriculture business were down, in line with our expectations, due primarily to an increase in the amount of crop reinsurance we purchased. We estimate full-year crop insurance net premiums to be down about $315 million from prior year and again in line with our expectations.

Internationally, commercial P&C premiums in ACE International, our retail business, were up 9%. We saw growth in commercial P&C in every territory except the continent of Europe, which was flat. Latin America led with net premium growth of 25% followed by the UK at 10% and Asia at 6%.

Premiums in our London-based excess and surplus lines business were down 4% where competition has increased steadily in the last few quarters, particularly in property and professional lines related businesses.

In our global A&H business net premiums were up over 6% in the quarter in constant dollars, reflecting improved growth as we predicted. Growth was driven by our ACE International business, which was up 11%, led by Latin America, Asia, and Europe.

Strong growth in our global personal lines business continued in the quarter. In the US premiums in ACE Private Risk Services, our high net worth personal lines business, were up over 10%, whereas internationally personal lines premiums were up 70%, reflecting the contributions from our acquisitions in Mexico. Excluding these, we had growth of over 20%.

International life insurance revenue was up 29% on a constant dollar basis with the strong growth coming mainly from our operations in Asia.

Finally, our Global Re business was down about 5%. As you know, the reinsurance market is quite competitive with an abundance of capacity, particularly in cat, and cat pricing is down about 5% internationally and 10% to 15% in the US. We expect these trends to continue for the foreseeable future.

I want to say a few words about the current market environment. Our commercial P&C business in the US continued to benefit from an improved pricing environment with another quarter of rate-on-rate increases. Overall, North American pricing was up about 4%. While the rate of increase for property-related pricing is moderating, casualty-related pricing, in fact, accelerated modestly in the quarter with many lines experiencing their strongest level of rate increase yet.

In ACE USA, our retail business, property rates were up 4% while casualty-related pricing was up over 4.5%. New business writings grew 5% year on year and that is after growing new business 44% in the Second Quarter last year. Exposure growth added just over 3% to our premium growth rate due to increased economic activity and our renewal retention rate, as measured by premium, was a very good 90% in the quarter.

On the US Wholesale side of our business, rates were up over 4.5% overall with property rates up about 3% and casualty-related lines up over 7.5%.

Internationally, the retail commercial P&C rate environment remains competitive but stable with rate growth flat in the quarter overall. Competition constrains our growth as we strive to maintain portfolio pricing. Rates internationally varied by class and by territory, but were mostly up or down 1% to 2%.

My colleagues and I can provide further color on market conditions and pricing trends.

As I said earlier in the quarter, we completed our acquisition of ABA Seguros, Mexico's fourth-largest personal lines company, and as we announced on last quarter's call, we also completed Mexican surety company Fianzas Monterrey. Both acquisitions are on track, and as I already noted, are beginning to contribute to premium growth. An example, in the quarter about half of ACE International's 18% net premium growth came from these acquisitions.

In summary, we had a great quarter and a strong six month's performance. We fired on all cylinders and as things stand now we expect a continued strong result for the balance of the year. With that, I will turn the call over to Phil and we will come back and take your questions.

Phil Bancroft {BIO 4621336 <GO>}

Thank you, Evan. As Evan mentioned, we had an excellent quarter with record operating results. Cash flow was strong at $895 million. Based on our strong sustained financial performance, S&P and A.M. Best recently affirmed all of our core ratings and changed their outlook on ACE to positive. Fitch upgraded us from AA; to AA.

Investment income was $534 million for the quarter, higher than our expected run rate, primarily due to higher-than-expected private equity distributions. Net realized and unrealized losses were $1.4 billion pretax and [ph] after-tax for the quarter, resulting primarily from the effect of higher yields on our fixed income portfolio.

As the fed signaled a potential end in sight to their quantitative easing program, high grade bonds that benefited from the program were the most significantly impacted by this shift in rates. Our blended market yield rose 60 basis points during the quarter and our portfolio movements were in line with market conditions. We remain at an unrealized gain position of $1.3 billion after-tax.

Future net investment income will be positively impacted as new cash flow and portfolio turnover will be invested at these higher rates. Current new money rates are 2.9% if we invested in a similar distribution to our existing portfolio and our current book yield is 3.7%. We estimate that the current quarterly investment income run rate will be approximately $525 million, which is subject to variability in portfolio rates, private equity distributions, and FX.

Our book value per share and our tangible book value per share declined 2.3% and 4.9%, respectively. Tangible book value was also affected by the impact of goodwill and intangibles arising from our Mexican acquisitions. Tangible book value per share would have declined 2.7% excluding these transactions.

The net impact of the mark-to-market change for the variable annuity reinsurance book was a realized gain of $35 million. This comprised a gross realized gain of about $200 million, primarily related to rising interest rates and increasing equity values, offset by hedge losses, falling credit spreads, and rising equity market volatilities -- all of which reduced the gain by approximately $135 million.

An additional $30 million of the gain was reduced by the timing effect, which we describe in our disclosures as the increase in fair value liability when the VA book continues to run off as we collect premiums and get closer to annuitization claims. The VA result was in line with our expectations and with our published sensitivities.

During the quarter we had positive prior-period development of $128 million pretax and $109 million after-tax, with about one-third coming from long-tail and two-thirds from short-tail lines. Our net loss reserves are up $350 million for the quarter and our paid-to-incurred ratio was 83%. Our cat losses were $81 million pretax for the quarter, approximately half related to the Canadian floods and the remainder related principally to severe weather events in the US and the European floods.

Our effective tax rate fluctuates based on where our earnings emerge. In this quarter the effective tax rate is low relative to other quarters, primarily because a greater percentage of our income was produced in lower tax jurisdictions. In addition, we had a one-off adjustment to prior-year tax accruals that lowered the rate by 1.5 points.

The Company is issuing updated guidance for full-year 2013 to account for the first-half positive prior-period reserve development, lower-than-planned catastrophe losses realized in the first half, better first half current accident year results excluding catastrophe losses, and higher net investment income in the Second Quarter and expected for the second half of the year. The range is $7.65 to $8.05 per share in after-tax operating income for the year. This includes estimated catastrophe losses of $260 million after tax for the second half of the year. Guidance for the balance of the year is for the current accident year only.

I will turn the call back to Helen.

Helen Wilson {BIO 2078659 <GO>}

Thank you. At this point we will be happy to take your questions.

Questions And Answers

Operator

(Operator Instructions) Amit Kumar, Macquarie.

Q - Amit Kumar {BIO 15025799 <GO>}

Thanks and good morning and thanks for taking my questions. My first question relates to pricing; that color was very helpful.

Over the past few days investor focus has been on the sustainability of pricing improvement in US commercial lines. Evan, what would be very helpful is your view on the pricing momentum going forward from here.

A - Evan Greenberg {BIO 1444445 <GO>}

I don't hold a crystal ball that can predict the future. I can tell you that July pricing was similar to the Second Quarter pricing. That we have seen the same strong trend we have been seeing in casualty, which is flood based, continue in July.

That is encouraging to us. Beyond that, I simply can't produce -- can't predict the market, but I am very comfortable about ACE's ability to perform and outperform in any market.

Q - Amit Kumar {BIO 15025799 <GO>}

And any sort of distinction between retail and wholesale going forward?

A - Evan Greenberg {BIO 1444445 <GO>}

There is some distinction. Do you want more specific granularity around that?

Q - Amit Kumar {BIO 15025799 <GO>}

Yes, that would help.

A - Evan Greenberg {BIO 1444445 <GO>}

Okay. Then I'm going to turn it to John Lupica, who maybe will give you -- because I said it is broad based. So we will pick five or six lines, seven lines and give you a sense in both the retail and the wholesale so you will see a little distinction. Casualty pricing in the wholesale side is a little stronger than the retail side.

A - John Lupica {BIO 4213297 <GO>}

Sure. Thanks, Evan. I will give you just a little deeper dive into the rate that we are seeing and also a little bit of the growth that we are seeing in both US retail and the E&S market.

I would like to remind you this is our 27th month in North America that we have been able to get rate -- it's our ninth quarter and our fifth quarter of rate on rate, so it has been a healthy, healthy drive for rate in North America. It has been the best that I have seen in this cycle.

When I look at North America in our larger (inaudible) business, in the quarter we grew the business 16% with the rate that was up 5.8%. On a year-to-date basis we were able to get 4.5 points of rate. In our professional lines businesses in aggregate we saw 3 points of growth, 5.7 points of rate in the quarter, and about 5 points of rate for the full year.

If you look at our medical business and other specialty businesses, we saw the growth of 12%, our quarter was up 3%, and the year was up 1.5%. In the general casualty market, the excess casualties, we saw growth of 13%, the rate of 6.3% in the quarter, and the full-year rate of 5.3%. Environmental and other casualty specialty line was up 12% in growth, rate was up 4%, and on a full-year basis it was up 2.9%.

In our property market, where again the rate has been terrifically healthy in the past and we have currently seen our property retail growth of 26%, the quarter was 3.3% of rate and the year we have seen 3.7% of rate. In our E&S businesses, in our E&S Property we saw growth of 10%, our rate in the quarter was 3.3%, and our year-to-date rate was 4.7%. And in our general casualty portfolio we saw growth of 3% in the quarter with a rate of 8% and a year-to-date rate of 8.5%.

I would like to echo what Evan had noted about July. We are seeing generally the same trends in our retail casualty market and property market in terms of rate. Risk management early days, but we have seen it up 6.5%, excess up 5%, and the property market up 3%. But, again, it certainly is early days and early trades in July.

A - Evan Greenberg {BIO 1444445 <GO>}

So that gives you a better sense of both growth and also sort of the broadness of rate and that you can see the rate in the Second Quarter is better than the year-to-date rate.

Q - Amit Kumar {BIO 15025799 <GO>}

That is actually quite helpful. The only other quick question I have is on capital deployment. You talked about the recent acquisitions.

In the past you have spent some time talking about I guess a 1.5% drag on ROE. How should we think about the pipeline, I guess, of potential candidates versus the rate commentary which you have mentioned? Does that change in any way or is that completely independent somewhat of the strong pricing you are seeing?

A - Evan Greenberg {BIO 1444445 <GO>}

The pipeline of potential opportunities from an acquisition point of view are completely independent of anything to do with pricing, number one. Number two, remember generally the analyst community, and I mean this in a positive way, you have no visibility on what could be potential out there. There is over 50,000 insurance companies in the world and it is a big world, and there is a vast amount of opportunity.

If it meets our strategy, advances what we are doing organically in a line or a territory, and it meets our financial hurdles and return to investors, then we will pull the trigger. It is all opportunistic. Beyond that I won't really comment except that we are vigilant and we are paying attention and we are constantly looking.

Q - Amit Kumar {BIO 15025799 <GO>}

Got it, okay. That is quite helpful, thanks for the answers. I will stop here. Thanks.

Operator

Mike Zaremski, Credit Suisse.

Q - Mike Zaremski {BIO 20606248 <GO>}

Good morning. My first question is in regards to ACE's dividend philosophy. So, Evan, you have said in the past ACE is a growth company. The dividend was raised 4% this past May, which I guess according to consensus earnings estimate implies a declining payout ratio.

So should we be thinking it was raised by 4% because free cash flow growth will be subdued in the near term? Or maybe we just simply shouldn't be thinking in terms of managing to a higher payout ratio over time? Then I have a follow-up, thanks.

A - Phil Bancroft {BIO 4621336 <GO>}

If you look at the history of our dividend, we have increased it about 46% since January of 2012, so a pretty substantial increase. And we think that those increases have enhanced the returns to the shareholders in a sustained period of low interest rates and it has enabled us to keep considerable capital flexibility. So --.

A - Evan Greenberg {BIO 1444445 <GO>}

And, no, it signals nothing about cash flow. In fact, as you can see, our cash flow is quite strong. We are very liquid. And the payout ratio will bounce around a little bit, but it will average in the similar range over a period of time.

Q - Mike Zaremski {BIO 20606248 <GO>}

Okay, got it. That is helpful. A numbers question, maybe for Phil.

I noticed the expense ratio in North America insurance, excluding agriculture, declined by over 150 basis points versus 2Q 2012 levels. Is there a lower expense run rate dynamic taking place that we should be aware of?

A - Phil Bancroft {BIO 4621336 <GO>}

I don't think -- no, I wouldn't count on a lower -- there was a couple of one-off adjustments to accruals and I wouldn't expect that to be part of the --.

A - John Lupica {BIO 4213297 <GO>}

If I could add just a little more detail, it really is -- it's the growth in our net earned premium outpacing our expense dollars so it really is historical in our premium growth. There is nothing material in the detail.

Q - Mike Zaremski {BIO 20606248 <GO>}

Okay, so more it sounds like (multiple speakers)

A - Evan Greenberg {BIO 1444445 <GO>}

Consensus is growing lower than premium.

Q - Mike Zaremski {BIO 20606248 <GO>}

(multiple speakers) operating leverage.

A - Evan Greenberg {BIO 1444445 <GO>}

And then it bounces around a little bit by mix of business because some business attracts a higher commission line than others. So when you grow your very large account business you are generally going to pay a lower commission than when you are growing your flow business, and that with the acquisition ratio will bounce around quarter to quarter a little. Underlying operating expense ratio is very comfortably under control.

Q - Mike Zaremski {BIO 20606248 <GO>}

Thank you.

A - Evan Greenberg {BIO 1444445 <GO>}

Got the mix of the two?

Q - Mike Zaremski {BIO 20606248 <GO>}

Got it.

Operator

Jay Gelb, Barclays.

Q - Jay Gelb {BIO 21247396 <GO>}

Thanks and good morning. I wanted to touch base first on the underlying combined ratio in North America P&C and overseas general. We have continued to see year-over-year improvement in the first half and the results were pretty consistent between First Quarter and Second Quarter of this year.

So I am just trying to get a read on whether you feel we are at the right baseline now and whether you feel that result can continue to improve in those two major segments as earned pricing continues to come through.

A - Evan Greenberg {BIO 1444445 <GO>}

Well, Jay, we will see how the future -- I am not going to predict the future because short-tail business can have -- it will have some variability around the mean to it. I don't know what you mean by have we hit, are we at a place where we are just comfortable.

We are constantly striving to grow the business and do it at pricing that we think achieves an adequate rate of return. And as you know, we are willing to make that trade-off in any line of business where it doesn't meet our hurdle rates or what we think is a reasonable rate of return given this environment. And that is what the combined ratios represent.

Where we see opportunity to write business at what we think is decent enough pricing to earn a reasonable underwriting margin we are going to keep doing that. The mix will change a little bit quarter to quarter and that can change the accident year combined ratio a bit. But the more you get rate and if inflation stays subdued and you keep growing the business this way then you ought to -- that is only benefits margin.

Q - Jay Gelb {BIO 21247396 <GO>}

That makes sense, okay. Then for Phil, with the run rate of investment income of $525 million we saw that favorable uptick in investment yield on the portfolio. I am wondering if we kind of roll this foreword should we expect investment income growth in the coming years as opposed to seeing a slight drag on that metric as a result of low rates.

A - Phil Bancroft {BIO 4621336 <GO>}

As you can see, our book yield still is above our market yield. So as the portfolio turns over into the yielding market rates, if market rates were to stay where they are, we think investment income would say flat on that basis because new money would offset the decline in investment income that would result as the portfolio moves into the lower rate.

Q - Jay Gelb {BIO 21247396 <GO>}

So that also --?

A - Phil Bancroft {BIO 4621336 <GO>}

I was just going to say we are predicting -- or at least internally -- interest rates will rise, but that will be seen.

Q - Jay Gelb {BIO 21247396 <GO>}

Is this also taking into account growth in the portfolio?

A - Phil Bancroft {BIO 4621336 <GO>}

Yes, that is what I mean. Growth in the portfolio through new cash flow tends to offset almost directly the degradation in investment income because the portfolio rolls into a lower yielding rate environment.

Q - Jay Gelb {BIO 21247396 <GO>}

Okay. Then one last numbers question. You gave us the impact on the net for agriculture for the full year. What would that be on a gross basis?

A - Evan Greenberg {BIO 1444445 <GO>}

It will be about flat.

Q - Jay Gelb {BIO 21247396 <GO>}

So around $1.1 billion?

A - Evan Greenberg {BIO 1444445 <GO>}

Gross, no, no. Much -- gross is much (multiple speakers) gross is roughly $2.5 billion.

Q - Jay Gelb {BIO 21247396 <GO>}

My mistake. That is clear. Thank you, very much.

A - Evan Greenberg {BIO 1444445 <GO>}

You were trying to catch me, I know.

Operator

Thomas Mitchell, Miller Tabak.

Q - Thomas Mitchell {BIO 22121384 <GO>}

I was wondering if in the United States in particular, in North America more generally, what the outlook is for growth in exposures. It looks like your premium growth exceeds your average pricing increases so that either exposures are growing in the market or you are taking market share, or maybe a little bit of both. But I am just wondering what the outlook looks like to you, let's say, today versus six months ago.

A - Evan Greenberg {BIO 1444445 <GO>}

Well, exposure growth and that is a good way to think about it. We got exposure growth two ways. As I said in the commentary, 3 points of the growth came from exposure growth on our in-force portfolio, and that is economic activity related, so that speaks to a firming economy that is reasonably broad based.

The balance came from us growing share in classes of business where we think the pricing allows us to produce a reasonable underwriting profit. And that is informed by our portfolio management that, as you know, is quite granular, quite mature, and that we just focus relentlessly on in here.

It is our decades-long effort to just get more and more insightful about -- in a more granular way about particular pockets of business that behave differently than other cohorts where we see an opportunity. And it is there that we grow exposure. So when we like the pricing to exposure, we will grow exposure. We have the capital and the balance sheet to do it, and we know our minds and we will not hesitate.

Q - Thomas Mitchell {BIO 22121384 <GO>}

That is a very good answer. Thank you, very much.

A - Evan Greenberg {BIO 1444445 <GO>}

You are welcome.

Operator

Greg Locraft, Morgan Stanley.

Q - Greg Locraft {BIO 4221265 <GO>}

Good morning. Just wanted to ask about the acquisitions and the impact in the quarter. Was any of the increase in guidance related to the acquisitions? In other words, are they accretive day one and coming through more than we had thought before?

A - Evan Greenberg {BIO 1444445 <GO>}

No, not coming through more than we thought and they are not really particularly contributing towards these revised guidance estimate. And, remember, the revised guidance we did not increase our estimate for the balance of the year current accident year. We revised our guidance based on the year-to-date results -- current accident year, cat, investment income, prior period development -- and then we rolled forward the investment income. Other than that, for the balance of the year we did not increase.

Q - Greg Locraft {BIO 4221265 <GO>}

Okay, good. So no impact to the deals and the guidance, great.

Then can you remind us about how impactful these deals will be, maybe in the out-years? I thought you talked a bit about them in previous quarters as to accretion dilution and when they will help.

A - Evan Greenberg {BIO 1444445 <GO>}

I did a little bit and so this is what -- I will make a couple of comments about them. First, I do refer you to our annual report shareholder letter that speaks to how the acquisitions we have made over the last five or seven years have performed in aggregate and how they have looked versus other means of capital deployment on a return basis. So I return analysts to that to begin with.

Number two, these acquisitions over a reasonable period of time on an ROE basis, and when I say reasonable looking out three years, will meet or exceed our hurdle rate, our ROE hurdle rate. And that is pretty good. In the early period you always have purchase accounting that weighs on ROE. And on an ROI basis, which is the underlying health of it, they are extremely accretive and doing quite well.

It is early days on Mexico, but everything we see it's on track, and if anything, it is going to perform better than we expected at this moment, from what we can tell.

Q - Greg Locraft {BIO 4221265 <GO>}

Okay. Then can you just remind us where does the amortization from the deals come through in the reported P&L? And how much is that now or how much was that in the quarter?

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A - Phil Bancroft {BIO 4621336 <GO>}

It is included in other income and the amount in the quarter, about $20 million.

Q - Greg Locraft {BIO 4221265 <GO>}

$20 million, okay. Great. Thank you, very much and congrats on another good quarter.

A - Evan Greenberg {BIO 1444445 <GO>}

Thank you, Greg.

Operator

Michael Nannizzi, Goldman Sachs.

Q - Michael Nannizzi {BIO 15198493 <GO>}

Thank you. So just wanted to follow up, Evan, if I could on you provided some growth metrics in the different businesses. Would it be possible to notionally size out wholesale retail personal lines in North America? Just obviously personal lines has been growing a bunch; I'm just trying to get an idea of what the business footprint kind of looks like today.

A - Evan Greenberg {BIO 1444445 <GO>}

Yes, we don't typically -- we don't disclose it on a quarterly basis. I believe that we put on the website we put -- at the end of last year when we did investor dinners we published a piece that we put out and it breaks down the revenue on an annual basis by division within North America. I think we have that and you can get that.

Q - Michael Nannizzi {BIO 15198493 <GO>}

Okay. I will go back in (multiple speakers)

A - Evan Greenberg {BIO 1444445 <GO>}

I don't have that in my head, but US retail is the largest. Then after that you have wholesale business and then after that you have private risk services.

Q - Michael Nannizzi {BIO 15198493 <GO>}

Great. Okay, that helps. Thank you. Then in thinking about (multiple speakers)

A - Evan Greenberg {BIO 1444445 <GO>}

You can go get it. You can go get the breakdown and it hasn't changed much between what we showed at year-end and what we run now.

Q - Michael Nannizzi {BIO 15198493 <GO>}

Got it. Great, thank you very much. Then in thinking about retail, is that an area we should assume that you're taking down the whole risk, whereas maybe in the wholesale business that is where you would write more syndicated programs? Or is that breakdown not exactly right?

A - Evan Greenberg {BIO 1444445 <GO>}

No, Mike, you are not thinking of it right.

Q - Michael Nannizzi {BIO 15198493 <GO>}

Okay.

A - Evan Greenberg {BIO 1444445 <GO>}

Syndicated -- I think of syndicated, to me, is much more of a London where there is a line slip -- there is a slip that goes around and everybody takes a share. That is a syndicated. In this case, though, of taking down whole risk, in the small and middle market commercial business one carrier will generally take down the whole risk.

In the large account in the upper middle market business -- and this varies by line of business and so it is hard to paint a broad brush. But in the upper middle market and large account it is usually a layered approach and so you will participate in certain layers. But the guy who takes the primary, puts out the paper, controls the claims and the engineering and the global servicing that is where the real action is to me.

That is where you are a real franchise versus just capital in a box. And ACE is a lead player in that regard. They come to us; not simply for the capacity, but for all those services. Then there may be others behind us who will participate in layers and that is the capital in a box.

Q - Michael Nannizzi {BIO 15198493 <GO>}

I see. Are you seeing any -- in terms of those, pardon my nomenclature, I guess syndicated is definitely more of a London term, but in terms of retail or wholesale are you seeing divergence in some of those trends that you talked about? Or whether it is in the layers of which I understand you don't participate so much in, or in the primary placements on the wholesale side, whether it is from new entrants or new capital kind of spilling out and over into these areas, are you seeing any divergence on that basis or not really?

A - Evan Greenberg {BIO 1444445 <GO>}

No, not really. Where I see divergence it's not in -- the trends are the same in wholesale and retail. The wholesale side of the business naturally is the more -- that is the E&S business. Though you will write E&S also, we write plenty of it on the retail side also.

And that is where it will be the more difficult to place or tougher classes and so, therefore, you might see -- as we said, we saw over 7.5% growth in casualty rate on the E&S side, whereas it was more modest on the retail side. Same trends and that reflects the nature of the risk and its need for rate. But we are not seeing -- we are seeing the same trend and we are not seeing stupid competition that is somehow breaking that trend in either.

Q - Michael Nannizzi {BIO 15198493 <GO>}

Great. Thank you, very much. Just last one quickly; could you elaborate a bit on your comments on the reinsurance markets? You talked a little bit about additional competition there in new capital.

I mean is there anything that you think could happen over the next 12 months or so that would cause you to consider really pursuing growth on the reinsurance side, or is that just kind of out of the picture for now? Thank you, very much for all your answers.

A - Evan Greenberg {BIO 1444445 <GO>}

Sure. Look, there is more capital chasing to some degree less business on the reinsurance side. You always come back in any market economy. Any industry it is that old supply/demand thing and that is what you have got going on.

And so you see, particularly -- what is a lot of visibility to investors is the cat re side, though remember of the overall reinsurance market it is a small thing that casts a big shadow. There you see alternate capital coming in, capital markets, in addition to traditional players. And so -- and you don't see exposures growing that much and so you have got that pond with more drinking out of it.

But in the broader reinsurance market of casualty, property, marine the primary players have retained more business. On one hand, there is plenty of capital in reinsurance because the results have been good so their balance sheets have grown. And reinsurers are hungry.

As many will profess underlying discipline but they chase market share, and for many of them their standards are not the same as ours. For many it is all they do for a living and so they feel compelled, and that sets the table.

Reinsurance is softening. How much will it soften, will low interest rates maintain and put a floor under discipline remains to be seen. But the way I look at it is kind of the market you have got is the market you should expect to have, and so we will continue to play it as we do. If we like the trade, we will write it. If not -- you have seen what our track record is.

We will shrink businesses and have no problem doing that. We are so well spread in so many lines and so many geographies I am not concerned about that for a moment.

Q - Michael Nannizzi {BIO 15198493 <GO>}

Great. Thank you, very, very much.

A - Evan Greenberg {BIO 1444445 <GO>}

You are welcome.

Operator

Josh Shanker, Deutsche Bank.

Q - Josh Shanker {BIO 5292022 <GO>}

Good morning, everyone. Evan, when you were running through your prepared remarks on growth you gave a lot of percentages. I am wondering if we can pin down the premium volume from the acquisitions in the overseas segment.

A - Evan Greenberg {BIO 1444445 <GO>}

No, you cannot.

Q - Josh Shanker {BIO 5292022 <GO>}

No we cannot. Okay. Then can we get a little --?

A - Evan Greenberg {BIO 1444445 <GO>}

Because they become part of the Company and we don't just start, well, Malaysia is this big or Thailand is this big on organic. And then when we make an acquisition we don't start distinguishing those in that regard.

Q - Josh Shanker {BIO 5292022 <GO>}

No, no, that wasn't my interest. I just wanted to get an organic growth number for overseas general.

A - Evan Greenberg {BIO 1444445 <GO>}

Sure. I gave you an ACE International growth number which was 18% in the quarter and half of it was from the acquisitions. So 9% organic in ACE International and 9% from the acquisitions. AOG is made up of ACE International, ACE Global Markets, and the overseas business of combined insurance.

Q - Josh Shanker {BIO 5292022 <GO>}

I will see what I can do to tease that out. Can we get some disclosure on the $38 million of other? I mean Phil said there was $20 million of negative amortization expense associated with the acquisitions. What else is in there this quarter?

A - Phil Bancroft {BIO 4621336 <GO>}

Josh, I read your note and I think you have the sine wrong. That is actually a $38 million expense.

Q - Josh Shanker {BIO 5292022 <GO>}

That is an expense, okay.

A - Phil Bancroft {BIO 4621336 <GO>}

Other expense, right, and it relates primarily to the amortization.

Q - Josh Shanker {BIO 5292022 <GO>}

That it's primarily -- okay, that is it. Thank you.

Operator

Paul Newsome, Sandler O'Neill.

Q - Paul Newsome {BIO 1541286 <GO>}

Thank you. Good morning. I would like your perspective on the linkages between the insurance markets. There is a lot of talk about the market impact of Berkshire getting into the E&S market, of the soft reinsurance market. Historically, these segments have moved first in the cycle and they drove change in the overall market.

I guess yesterday Travelers was talking about auto, which is a little bit different. But I guess my question is do you think this is still the case that some of these markets just ordinarily lead the other markets? Do you think the linkages have strengthened or weakened from past cycles?

Because I think your perspective might be quite unique in that you write a lot of these businesses, you do it globally, so you may be in a better position than others to kind of see how one market will affect another.

A - Evan Greenberg {BIO 1444445 <GO>}

In past cycles before this one, typically it's the reinsurance market that led the primary. This time around in this cycle the primary market led, and in fact, the reinsurance market stayed stable and hardly followed. And so I don't see that same linkage that way and I don't believe that the reinsurance market is a leading indicator of where the primary market is going to go.

One of the reasons is the size of balance sheets on the primary side of the large players. There are much better data over the years than last cycle because of math and computer power, and technology has changed it that way. Given their insight, they are making different kinds of decisions about how to hold the retentions, how to think about exposure. They retain much more, many do, than they did in the past and that is what creates some of that de-linkage between the two.

And so I don't expect that somehow -- I am not spooked that somehow the reinsurance market portends the insurance market. I don't see that in front of me.

Q - Paul Newsome {BIO 1541286 <GO>}

What about the excess and surplus market? That also tended to be kind of a leading indicator of the overall market, at least historically.

A - Evan Greenberg {BIO 1444445 <GO>}

I don't think that is right either. Usually the E&S market expands or contracts with market cycles as in a softer part of a cycle the E&S market shrinks because the traditional insurers on the retail side they expand their appetite. They tend to write business that they have no business writing because all of a sudden they think, man, that price looks good relative to what I normally write. I will write a lot of habitational business.

They don't realize that that business that -- they are writing it at a loss. When they then get disciplined because the losses role in then they shrink their appetite and the E&S market expands, and so the E&S market usually follows along that way. It doesn't lead it.

Q - Paul Newsome {BIO 1541286 <GO>}

Great, thank you. Appreciate it.

Operator

Vinay Misquith, Evercore.

Q - Vinay Misquith {BIO 6989856 <GO>}

Hello. Good morning. The first question is on the international growth. I believe you mentioned that there was about a 9% organic growth. We have been hearing some rumblings about some sort of growth slowdown internationally, so if you could help us understand are you seeing that or are you not seeing that in your business?

A - Evan Greenberg {BIO 1444445 <GO>}

Well, I am confused, Vinay. Help me with the question a little more because we just published 9% growth organically and 18% without it. So do you mean the economic slowdown?

Q - Vinay Misquith {BIO 6989856 <GO>}

Yes, yes. I mean we have seen or we have heard about a slowdown in growth in the emerging markets. Have you really seen it in your numbers as yet, because it doesn't seem that you have seen that? And do you think that is going to negatively impact you in the future?

A - Evan Greenberg {BIO 1444445 <GO>}

Well, I can't really predict the future but, first of all, you do see a slowdown in major emerging markets right now. China, Brazil as two in particular. When China slows down that lead generally most natural resource-based countries will slow down.

In China, where an awful lot of assemblage for export takes place, those that are doing component manufacturing, so throughout Southeast Asia, etc., they will slow down. And as China's own consumption, if it slows down, then that will impact many other countries in Asia and to some degree in Latin America.

We see economic slowdown. It has obviously slowed down dramatically in Brazil, as an example, and our business has slowed down in that country. But we got Mexico, Colombia, Chile, the Andean countries have been doing quite well.

When I look at Asia Pacific, China, which we don't consolidate as you know because we own a minority position in Southeast Asia, I don't see that in our business and I don't see the economic slowdown. I was just in Indonesia and Malaysia and those countries are doing quite well.

Will they moderate do I believe? Will they ameliorate in terms of growth? Yes. But particularly because, as I say, China casts such a big shadow, but I think it will still be relative to the developed world. It will still be robust, relatively robust growth.

At any one time these markets are volatile and at any one time any one country or two countries can slow down and that can have some impact on us. But on the overall I don't see it yet. I don't see in front of me at this moment.

Q - Vinay Misquith {BIO 6989856 <GO>}

Okay, that is helpful. Then two quick numbers questions for Phil maybe. The first one is the amortization of intangibles. Phil, I think you mentioned it was $20 million.

What number do you see for the next sort of one year? And does that slow down after 12 months, because most of the amortization happens in the first 12 months?

A - Phil Bancroft {BIO 4621336 <GO>}

Yes, 12 to 18 months, and what we are going to do is put a schedule in the 10-K or 10-Q that will lay out our expectation for the rest of the year.

Q - Vinay Misquith {BIO 6989856 <GO>}

So that would be great. Just the next question is under normalized tax rate do you have a number for that normalized?

A - Phil Bancroft {BIO 4621336 <GO>}

Prospectively you mean? I would say if you looked at current accident year, ex cats, I would use a number in the neighborhood of 15%.

Q - Vinay Misquith {BIO 6989856 <GO>}

Okay, that is it for me. Thank you.

Operator

Jay Cohen, Bank of America Merrill Lynch.

Q - Jay Cohen {BIO 1498813 <GO>}

Thank you, a couple questions. First, on the investment income. It seemed that the good performance in the first half largely related to private equity gains, yet you upped your expectations for the second half. Did that increase represent continued positive outlook for private equity or was it the higher interest rates we are seeing?

A - Phil Bancroft {BIO 4621336 <GO>}

It is principally the positive interest rates. As we said, the portfolio market rate was up 60 basis points in the quarter and we see that having a positive impact for the next two quarters, at least.

A - Evan Greenberg {BIO 1444445 <GO>}

Jay, the other thing you have is mortgage -- things like mortgage redemptions have slowed down, so to a degree portfolio turnover has slowed down a little bit and that benefits it.

Q - Jay Cohen {BIO 1498813 <GO>}

That is helpful. Second question was on the favorable reserve development. I'm wondering if you could give us a bit more color as far as what classes you are seeing that development in and what accident years it is coming from?

A - Evan Greenberg {BIO 1444445 <GO>}

For the long tail it is predominantly, overwhelmingly, 2007 and prior, and for the short tail it is more recent years. And, Sean, do you have any more color you want to add?

A - Sean Ringsted {BIO 4168540 <GO>}

Sure. I can -- as Phil said, it is two-thirds short tail, one-third long tail. In the short tail nothing unusual there. It's just plain coming in better than expectations.

And on the long-tail side reviewed North America and Tempest this quarter, and as Evan said, it's predominantly 2007 and prior. We did have some -- you will see this in the Q -- we did have some favorable release on more recent years, but this is attributable to our shorter-tail exposure on multi-claim industrial accident and our workers comp book. But the theme is 2007 and prior and better than expectations.

Q - Jay Cohen {BIO 1498813 <GO>}

Is it fair to assume, Sean, that the claims environment on the long-tail side remains fairly unchanged? Are you seeing any, on the margin, any changes in that claims environment?

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A - Sean Ringsted {BIO 4168540 <GO>}

We are not seeing what I would call any systemic changes in claim frequency or severity. We do see some frequency changes in our longer tail lines, but I would call these portfolio specific, and really driven by business mix as we take -- Evan mentioned portfolio management. And as we take underwriting actions to come in and out of lines and moderate our exposures with deductibles and SIRs and so on.

I would call these changes portfolio specific, reflective of our ability to execute on portfolio management and also monitor. So we have got a feedback loop; we are now starting to see these changes in frequencies come through. So I think that is the important aspect of this.

It's portfolio specific, you see it in the US and non-US, but nothing systemic. These portfolio changes are really in line with our expectations as we execute on underwriting.

Q - Jay Cohen {BIO 1498813 <GO>}

That is great, Sean. Thank you.

Operator

Meyer Shields, KBW.

Q - Meyer Shields {BIO 4281064 <GO>}

I just want to continue on that last thought about changes in the reserve environment. Are there any leading indicators (multiple speakers) I'm trying to get a sense, are there any leading indicators that would suggest that the current environment isn't changing but it might two or three years from now?

A - Evan Greenberg {BIO 1444445 <GO>}

Wow, Meyer, that is the Holy Grail. You know, look, no, there is no indicators. It is relatively benign. I remind you that CPI is not the indicator of insurance-related inflation.

Medical inflation, while it is down, still runs around 4%. You have legal inflation that continues. And by the way, on the short-tail side you have more inflation around construction materials and you get some hourly rate and all of that, particularly as housing starts, etc., pick up. So you always have an underlying trend and you got to know that, but it has been pretty steady.

We choose not to change long-term inflation factors for casualty, and if it turns out to be better, it shows up ultimately in our earnings in prior period. But we run a business conservatively. Anyone who has been in the casualty business for any reasonable length of time; it is not a business for optimists and you understand that the good news comes early and the bad news comes late. And so we continue to play it conservatively that way because you don't know two or three years out.

If economic activity picks up that is what will drive inflation. We know it is holding inflation down. It is demand side, not supply side.

Q - Meyer Shields {BIO 4281064 <GO>}

That is very helpful, I appreciate it. I guess I have to look for the Holy Grail. On an unrelated topic --

A - Evan Greenberg {BIO 1444445 <GO>}

Well, when you find it you send it on in here. We'll be very interested.

Q - Meyer Shields {BIO 4281064 <GO>}

Okay, look at the Court of Appeals. Are you seeing any increased submission activity reflecting sort of the discussion about the major brokers looking to consolidate their placement among fewer carriers? Is that a relevant factor at all?

A - Evan Greenberg {BIO 1444445 <GO>}

You know, that has been a slow-moving trend for a bunch of years now. That is not new. When you talk to the majors, as I know you do, they will talk to you about the thousands. The inefficiency is they see it in their own system and thousands of carriers that they deal with or many hundreds and how that is not the most efficient for both client or for themselves; it's how they do business.

And for many reasons that occurs, but it all comes down to human and their desire to over time rationalize and consolidate that. You see it show up in different activities and actions on the parts of brokers over time. That has been going on and my sense is that will continue to a degree. There is nothing -- it is not event related and it is not startling and I haven't seen anything new.

Q - Meyer Shields {BIO 4281064 <GO>}

Okay, thank you very much. I appreciate it.

A - Evan Greenberg {BIO 1444445 <GO>}

I always see a lot of old wine, new bottles constantly coming out, but that is true of kind of any business.

Q - Meyer Shields {BIO 4281064 <GO>}

Got it, thank you very much. Appreciate it.

A - Helen Wilson {BIO 2078659 <GO>}

Operator, we have time for just one more question please.

Operator

Brian Meredith, UBS.

Q - Brian Meredith {BIO 3108204 <GO>}

Thanks. Two quick questions here. First, Phil, corporate admin expenses looked elevated in the quarter. Was there any kind of one-time items related to the closed acquisitions that don't repeat themselves?

A - Phil Bancroft {BIO 4621336 <GO>}

It really wasn't related to acquisitions, but we did have some accrual changes related to some work we were doing around the stock compensation area. But nothing that I would take as an ongoing trend.

Q - Brian Meredith {BIO 3108204 <GO>}

Then, second, I wonder if you could talk about any kind of notable changes in terms and conditions. I've heard a little bit about an increase in multiyear deals all of a sudden coming back into the market. What are you seeing; anything that would be at all alarming?

A - Evan Greenberg {BIO 1444445 <GO>}

No, I am not. The only place I really see multiyear deals of any size has been in cat re.

Q - Brian Meredith {BIO 3108204 <GO>}

Great, thank you.

A - Evan Greenberg {BIO 1444445 <GO>}

That is (multiple speakers) that always occurs. Other than that, no, I'm not seeing it.

A - Helen Wilson {BIO 2078659 <GO>}

Great. Thank you, everyone, for your time and attention this morning. We look forward to speaking with you again at the end of next quarter. Thank you, and good day.

Operator

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