S&P Capital IQ

CONTENTS

AXIS Capital Holdings Limited NYSE:AXS

FQ1 2017 Earnings Call Transcripts

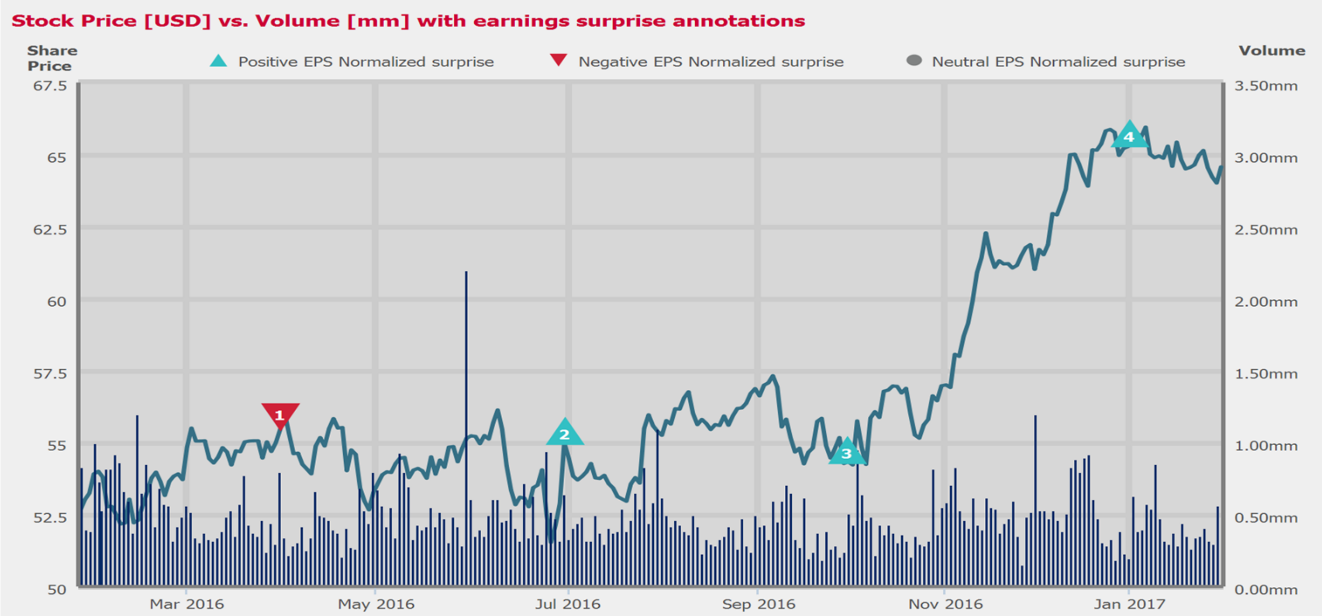
Thursday, April 27, 2017 1:00 PM GMT

S&P Capital IQ Estimates

	-FQ1 2017-			-FQ2 2017-	-FY 2017-	-FY 2018-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.84	0.59	(29.76 %)	1.19	4.08	4.93
Revenue (mm)	1689.70	1508.96	(10.70 %)	990.60	3713.35	3795.05

Currency: USD

Consensus as of Apr-27-2017 1:03 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ1 2016	1.08	1.07	1 (0.93 %)
FQ2 2016	0.32	0.51	2 59.38 %
FQ3 2016	1.04	1.78	3 71.15 %
FQ4 2016	0.94	1.14	4 21.28 %

Call Participants

EXECUTIVES

Albert A. Benchimol
President, Chief Executive Officer & Director

James O'Shaughnessy
Chief Accounting Officer, Executive Vice President and Corporate Controller

Linda A. Ventresca
Corporate Development Officer

ANALYSTS

Amit Kumar
Macquarie Research

Brian Robert Meredith
UBS Investment Bank, Research Division

Christopher Campbell
Keefe, Bruyette, & Woods, Inc., Research Division

Elyse Beth Greenspan
Wells Fargo Securities, LLC, Research Division

Ian Gutterman
Balyasny Asset Management L.P.

Presentation

Operator

Good morning, and welcome to the AXIS Capital First Quarter 2017 Earnings Conference Call. [Operator Instructions] Please note, this event is being recorded. I would now like to turn the conference over to Linda Ventresca of Investor Relations. Please go ahead.

Linda A. Ventresca
Corporate Development Officer

Thank you, Alison, and good morning, ladies and gentlemen. I'm happy to welcome you to our conference call to discuss the financial results for AXIS Capital for the first quarter ended March 31, 2017. Our earnings press release and financial supplement were issued yesterday evening after the market closed. If you would like copies, please visit the Investor Information section of our website, www.axiscapital.com. We set aside an hour for today's call, which is also available as an audio webcast through the Investor Information section of our website. A replay of the teleconference will be available by dialing (877) 344-7529 in the United States, and through the international number (412) 317-0088. The conference code for both replay dial-in numbers is 1010952. With me on today's call are Albert Benchimol, our President and CEO; and James O'Shaughnessy, our Group Controller and Chief Accounting Officer.

Before I turn the call over to Albert, I will remind everyone that the statements made during this call, including the question-and-answer session, which are not historical facts may be forward-looking statements. Forward-looking statements involve risks, uncertainties and assumptions. Actual events or results may differ materially from those projected in the forward-looking statements due to a variety of factors, including the risk factors set forth in AXIS's most recent report on Form 10-K filed with the SEC on February 27, 2017. We undertake no obligation to update or revise publicly any forward-looking statements. In addition, this presentation may contain non-GAAP financial measures. Reconciliations are included in our earnings press release and financial supplement, which can be found on the Investor Information section of our website. With that, I'd like to turn the call over to Albert.

Albert A. Benchimol
President, Chief Executive Officer & Director

Thank you, Linda, and good morning, ladies and gentlemen. Thank you for joining us today. Let me start by communicating Joe Henry's regrets at not joining us today. He is recovering from knee replacement surgery and didn't think it was a good idea to respond to questions while under the influence of pain medication. We do have James O'Shaughnessy, our Group Controller and Chief Accounting Officer standing in for Joe today. Let's start.

Last night, AXIS reported first quarter operating income of $51 million or $0.59 per diluted share. Adjusted for dividends, diluted book value per share -- per common share increased by $1 or 2% for the quarter and 8% over the last 12 months. Our results for the quarter were under pressure from a number of unusual and onetime items, which have been previously disclosed, including the impact of the Ogden rate change in the U.K. and executive severance costs as well as an impairment of an equity invested investment and higher catastrophe and weather losses in line with higher industry experience. Notwithstanding these items, which reflect the inherent volatility of our industry, our longer-term performance remained strong. In the key metric of growth intangible book value per share adjusted for dividends, AXIS is in the top quintile of performance against a broad group of peers in the property and casualty marketplace, both for the 5- and 10-year periods. We remain pleased with the ongoing progress to enhance our franchise and deliver consistent superior value creation well into the future. Indeed, our focus on risk selection and portfolio construction is delivering improved core results, even against the backdrop of a challenging global P&C marketplace. We are continuing to increase our relevance and penetration in attractive markets and sectors. For example, dedicating more resources to the U.S. wholesale E&S market and also recently closing our acquisition of AVIABEL, a premier

European insurer and reinsurer of aviation risks in the smaller general aviation arena, which supports better balance in that line. We are sustaining positive momentum in our strategic capital partnering activities, allowing us to expand solutions for clients, reduce our cost of capital and attractively rebalance the risk-reward equation for our shareholders. Our third-party capital fees are growing healthily, and we're on track to have fees associated with these activities contribute over 0.5 point to ROE in 2017 and more in the future. Our brand continues to improve, and our ratings on various service evaluations keep rising. We are seeing very good deal flow. Unfortunately, not all business presented to us is adequately priced. So we continue to sift through these opportunities to allocate our capital where risk-adjusted returns continue to be at our standards. I'll report more on market conditions and our outlook for April 1 renewals after James covers the highlights of our financial performance. James?

James O'Shaughnessy
Chief Accounting Officer, Executive Vice President and Corporate Controller

Thank you, Albert, and good morning, everyone. During the quarter, we generated net income of $5 million. Our operating income for the quarter was $51 million and annualized operating return on equity was 4%. Our operating income this quarter was adversely impacted by a number of items, including $59 million related to the impact of the recent Ogden rate change, including the previously announced increase in prior year reserves of $50 million and also an increase in estimated current accident year losses of $9 million in the quarter. $9 million of negative other insurance income associated with our weather and commodities market business due to exceptionally warm weather in both Europe and United States. $7 million attributable to an impairment loss on an investment accounted for using the equity method. And finally, $8 million of onetime general and administrative expenses related to executive severance. Absent these factors, underwriting income would have been in line with last year, even with higher catastrophe and weather-related losses incurred this quarter. In addition, we had strong performance from our investment portfolio. The growth in book value per share in the quarter to $58.89 was driven by an increase in unrealized gains on our available-for-sale investment portfolio, which primarily reflected a tightening of credit spreads and the strengthening of the pound sterling and euro against the U.S. dollar.

So now let's move into the details of our income statement. Our first quarter gross premiums written decreased by 2% with an increase in our Insurance segment, offset by a decrease in our Reinsurance segment. Our Insurance segment reported an increase in gross premiums written of $41 million or 6% in the first quarter compared to the same period in 2016. This increase was largely driven by our accident and health and professional lines. The increase in accident and health was principally due to new business from our recently established Middle East reinsurance operations and growth in the limited benefits market in the United States. The increase in professional lines came from specialty areas, in which we have invested in recent years for growth and diversification. Our Reinsurance segment reported a decrease of $88 million or 7% in gross premiums written in the first quarter of 2017 compared to the same period in 2016. Adjusting for the impact of a significant decrease in multiyear contracts and foreign exchange movements, reinsurance gross premiums written increased by $97 million or 7%. This increase was primarily driven by our agriculture lines due to an increased treaty line size. However, it is worth noting that we expect to nonrenew a significant treaty in the second quarter. Therefore, we expect growth for the year in our ag lines to be much more moderate than the growth experienced in the first quarter. Consolidated net premiums written decreased by 10% in the first quarter of 2017 compared to the same period in 2016. Insurance net premiums written were up 7%, driven by the increase in premiums written in the quarter. Reinsurance net premiums written were down 17%, reflecting the decrease in gross premiums written and an increase in premiums ceded to our strategic capital partners in the quarter. As we have previously discussed with you, we have been ceding more of our reinsurance premiums to our strategic capital partners in recent periods. This has been the case in our liability and professional lines since the launch of Harrington Re in the third quarter of 2016. We've also increased retrocessions of our catastrophe and credit and surety lines of business. Consolidated net premiums earned increased by 4% in the first quarter of 2017 compared to the same period in 2016. The increase in net premiums earned reported by our Reinsurance segment was largely driven by premium growth in our agriculture and motor lines in recent period. The growth was partially offset by the impact of the retrocession to Harrington Re, which increased premiums ceded in professional lines. The increase in net premiums earned reported by our Insurance segment was largely driven by strong premium growth in our accident and health and our property lines in recent periods, partially offset by an increase in premiums ceded in our professional lines.

Our first quarter consolidated current accident year loss ratio increased by 4.2 points to 67.3 points compared to the same period in 2016, including $35 million or 2.1 points attributable to catastrophe and weather-related losses and 2.1 points due to a combination of factors, including 1.4 points related to the adverse impact of rate and trend, 0.9 points related to the impact of the recent Ogden rate change on our motor lines, offset by improvements elsewhere. Our progress in our Insurance segment continues, with the current accident year loss ratio ex cat and weather decreasing by 0.7 points, principally due to the recognition of better-than-expected experience in our professional lines of business as a result of our portfolio optimization actions over the past few years, partially offset by the ongoing impact of rate and trend, given market conditions.

Our Reinsurance segment, current accident year loss ratio, ex cat, and weather, increased by 4.7 points, principally due to 1.8 points related to the impact of the recent Ogden rate change on our motor lines, 1.2 points due to the ongoing adverse impact of rate and trend, with the balance due to mix and experience.

Now turning to loss reserves established in prior years. Our results benefited from net favorable loss reserve development of $25 million compared to $70 million recognized during the first 3 months of 2016. Net favorable loss reserve development included $23 million of favorable development reported by professional insurance and reinsurance reserve classes and $23 million contributed by our reinsurance liability reserve class, partially offset by adverse development in our motor reserve class of $22 million. The motor reserve class adverse development included $50 million of adverse development on prior years due to the impact of the recent Ogden rate change offset by continued favorable actual versus expected claims experience for the motor reserve class. In addition to the prior year reserve adjustment, the Ogden rate change affected the profitability of the unearned premium on business we wrote prior to the rate change announcement. As we are in this business, we are booking it at a much higher loss ratio, and this had a negative impact of $9 million in the first quarter, contributing close to 2 points to the reinsurance current accident year loss ratio. We expect the Ogden rate change to continue to adversely impact current accident year losses by approximately $5 million per quarter for the remainder of 2017, as the unearned premium associated with business written prior to the rate change earns out. We expect this impact to continue into 2018, but this should not be significant. During the 3 months ended March 31, 2017, our acquisition cost ratio increased slightly by 0.2 points compared to the same period in 2016, including a decrease in our Reinsurance segment ratio of 0.4 points and an increase in our Insurance segment ratio of 0.9 points. The increase in our insurance acquisition expense ratio was due to business mix change in our accident and health lines.

Our G&A expense ratio in the first quarter was 17.2% compared to 16.6%, an increase of 0.6 points compared to the same period in 2016. The Insurance segment's ratio increased slightly in the current quarter due to higher personnel expenses offset by an increase in net premiums earned. The Reinsurance segment ratio decreased in the current quarter to 6.6% from 8.2%, reflecting the benefits of fees from strategic capital partner arrangements. In addition, corporate expenses increased significantly in the first quarter, primarily driven by higher personal expenses, including $8 million related to executive severance costs. Net investment income was $99 million for the quarter, an increase of $50 million from the first quarter of 2016. The increase is attributable to our alternatives investment portfolio. In aggregate, the total return on our cash and investment portfolio for the quarter was 1%.

During the quarter, we repurchased an additional $151 million of common shares, comprised of $128 million purchase pursuant to our board authorized share repurchase program and $23 million relating to shares purchased in connection with the vesting of restricted stock awards. At April 26, 2017, the remaining authorization under the repurchase program approved by our board was $836 million. On April 17, 2017, the company redeemed the remaining $351 million of its 6.875% Series C preferred shares. Therefore, we expect preferred dividends to be $11 million per quarter for the rest of the year.

In conclusion, this quarter presents a number of significant onetime and unusual items. We are comfortable, however, that the underlying results demonstrate the power of our various underwriting and risk management actions, good progress on our targeted growth initiatives and continued momentum in our strategic capital partnering activities. With that, I'll turn the call back over to Albert.

Albert A. Benchimol
President, Chief Executive Officer & Director

Thank you, James. As usual, I'll provide a brief overview of market conditions and recent reinsurance renewals before opening up the call to questions. Generally, we're observing signs of a market that is increasingly recognizing the insufficiency of its pricing. We're seeing either small increases, flat pricing or more moderate pricing reductions than we have in the recent past. Unfortunately, this is not yet consistent across the board. I'm particularly disappointed by ongoing price reductions in the face of increasing loss trends in certain lines or to see incumbents wisely reducing their exposures, only to have new entrants jumping in to fill the void at inadequate prices. The overall trend, however, is moving in the right direction, albeit more gradually than we would like. In our insurance book, the overall rate change was minus 1% in the quarter, which has slowed from the minus 2% in the fourth quarter of last year and the minus 3% seen in the first quarter of 2016. Large accounts remain more competitive to smaller risks. Our U.S. property and casualty division achieved a price increase of 1% in the quarter, but there is still a lot of volatility around that. Property is down about 2%, while casualty is up about 4%. Both are better than last year's trend, but still not enough. For example, we believe challenging lines such as low attaching auto and heavy trucking should see meaningful increases, but there are still many offering reduced pricing in this difficult -- reducing pricing. In this difficult marketplace, risk selection and underwriting discipline becomes the only differentiator between profits and losses. We have a long track record in this space and feel we're well equipped to navigate through the challenges.

In our international insurance division, overall rate change was minus 5% in the quarter, unchanged from the prior quarter and slightly better than minus 6% in the first quarter of last year. This is by far our most competitive market, but the pace of rate reductions has slowed in recent quarters. And there was a general feeling that in aviation, property and energy classes, these must be approaching the bottom of the cycle. Onshore and offshore energy are the most challenging, and we have nonrenewed many risks that no longer represent value to AXIS. Global property rates were down about 3% for the quarter, against a prior year rate change of minus 10%. We're starting to see signs of more discipline in the market with less pressure on rates. In our professional lines division, the overall rate was essentially flat in the quarter consistent with the first quarter of last year, but up from the minus 2% we saw in the fourth quarter. Primary and lower layers are generally renewing flat or with modest positive changes, while there continues to be pressure on excess layer. That's consistent with recent loss experience. Errors & Omission lines are generally doing better than D&O. Our approach to the insurance market is to leverage our underwriting expertise and service to increase deal flow and build better portfolios. We're focused on those markets where we have the relevance, scale and high level of confidence in our runway for profitable growth. We're highly encouraged by our progress to date with both growth and improvements in core underwriting performance for our insurance business.

Moving on to reinsurance. We've just completed the April 1 renewals. Premiums renewing on or around April 1 represent about 10% of our annual total renewable premiums. The main renewal markets of this date are the U.S. and Asia, mostly Japan. In Japan, property excess of loss rates were down in the 5% to 7% range, a bit less than the previous renewals. The Japanese casualty market, however, is more constructive as it is responding to recent increases in market losses. XOL cat exposed business elsewhere in the world saw reductions of up to 5%. Brokers continue to apply pressure on profit commissions and expanded coverages. Encouragingly, however, the market is pushing back, and we are seeing more programs renewing at expiring terms. In U.S. casualty, there is continued increase in reinsurance capacity with market newcomers stepping in to replace established players when they scale back participations. U.S. regional and multiline continues to be competitive, but we are seeing some underlying primary or reinsurance rate growth on some accounts.

In the wake of the Ogden discount rate change in April, the April renewals for most XOL U.K. motor contracts were postponed to May 1. The few reinsurance XOL treaties that did renew, went for rate increases of 20% to over 100%. Our expectation is that the business that we will write will be up 40% to

50% over expiring, assuming no further changes to the Ogden rates. Overall, in the April 1 renewals, we shrank our reinsurance book by about 4% over expiring treaties.

Looking forward to June 1 Florida renewals, we're seeing an increase in early placements and initial signs indicate pricing close to flat on a risk-adjusted basis. In reinsurance, there is no doubt that the market is at a low point not seen in many years. We remain confident, however, in the long-term prospects for this business. And our goal remains to be a top 10 global P&C reinsurer once conditions improve. We know we have the capabilities and attributes to be a value-added long-term partner for our cedents. Under current conditions, however, we are content to pursue growth in attractive new lines such as flood and mortgage insurance, to do more for our customers while prudently managing our exposures and earning a growing stream of attractive fee income from our strategic capital partnerships.
To conclude, I'm hopeful that sanity will prevail and that we are approaching the floor. Where conditions are promising, we will be proactive and pursue growth where risks are properly priced. In the alternative, we will not be afraid to stand back. But we remain firm that no matter the pace of market corrections, we will continue to make progress in our franchise, platform, portfolio construction and risk lending.
I'm confident that the factors that affected this quarter are temporary, and our fundamental evolution continues. Thank you for your attention. And with that, we will be happy to open the floor for questions.

Question and Answer

Operator

[Operator Instructions] Our first question will come from Amit Kumar of Macquarie.

Amit Kumar
Macquarie Research

Just a couple of quick questions and I'll requeue. The first question goes back to the discussion on, I guess, the underlying AYLR ex cat. And you talked about rate and trend. Based on your commentary, is it fair to say that a mid-60s for reinsurance and a low 60s is the way to think for the full year? Or how should I think about the outlook for the segments based on your comments?

Albert A. Benchimol
President, Chief Executive Officer & Director

I think that's a fair way of looking at it. I mean, if you look at each of the areas as James pointed out, we started off with a number that absent mix improvements and changes to the underwriting would have grown, but in fact, in our Insurance division, notwithstanding close to 1.5 points of rate and trend, we still were able to reduce the overall loss ratio down to about 60. And I think, there is nothing unusual in the experience that we saw in the first quarter that would give us any reason to give different guidance. Not that we give guidance, but to give you any caution for the rest of the year. I think with regards to the reinsurance book, as James mentioned, the impact of Ogden was about $9 million this quarter. It will be a little bit less in future quarters, but in terms of the mix and rate change, I think where we are in this quarter, again, is not an unreasonable indicator of current performance. And again, I hasten to add that from my perspective, the Ogden is something that has to run through, but ignoring the Ogden, the rest of the book continues to perform.

Amit Kumar
Macquarie Research

Got it. The other question I had, and then I'll requeue. Just going back to, I guess, the broader capital management discussion, and it seemed that the buyback was more than -- relative to the net income, it was higher proportionately. Should we think about that slowing down going forward? Or am I overthinking this metric?

Albert A. Benchimol
President, Chief Executive Officer & Director

As you know, we've been committed to returning capital to our shareholders. We will continue to repurchase. We don't view this as unusually high or unusually low. We expect that -- originally, we were looking at a number that was at least our operating -- our planned operating income. Obviously, we weren't planning initially for Ogden, but we won't let that get in the way of our stock repurchase activity.

Operator

Our next question will come from Elyse Greenspan of Wells Fargo.

Elyse Beth Greenspan
Wells Fargo Securities, LLC, Research Division

I was hoping to get a little bit of color on the reserve releases in the quarter. If you back out the Ogden charge, your reserve releases actually would've been up year-over-year. Can you just give some color on what lines in accident year is favorable development stemming from the quarter?

Albert A. Benchimol
President, Chief Executive Officer & Director

As you know, there is no real predictability to the quarterly reserve releases. Our actuaries perform full ground-up reserve releases. They look at the A versus E. And they ultimately come through. Some quarters will be a little bit higher, some quarters will be a little bit lower. If you look at where we are today, I would say 2 things. One, you're seeing some growth in the reserve releases for the insurance book and fundamentally that reflects increased confidence in where we are, given the changes that we've made to our book in the last 3 years. And so that's gone up more this year. On the reinsurance side, we continue to see professional lines and liability lines driving the reserve releases. In insurance, it's mostly professional lines and a little bit of marine lines. There is always, of course, some adverse development here and there, but these were only partial offsets. I think if you look at where the lines are coming from, it's really depending on the mid-tail lines. Those would go anywhere from 2008, 2012. And the shorter-tail lines would come from more recent years than that. And my guess is that there'll be plenty more detail once we...

James O'Shaughnessy
Chief Accounting Officer, Executive Vice President and Corporate Controller

Issue the 10-Q.

Albert A. Benchimol
President, Chief Executive Officer & Director

Yes, correct.

Elyse Beth Greenspan
Wells Fargo Securities, LLC, Research Division

Okay. And then in terms of you guys pointed out some U.K. weather, the derivative marks, that went against you in Q1. Have those come back? Or what's the Q2 date there as we think about our models?

Albert A. Benchimol
President, Chief Executive Officer & Director

These were not simply U.K. This was -- the reason that we ended up with the loss is that we had this unusual occurrence of having exceptionally warm weather in both the U.S. and Europe. So usually, the diversification helps us, but in this case, we had a relatively tail event with not only was it exceptionally warm, but it was exceptionally warm in all places. And as I say that, I need to comment that, of course, we recognize there was global warming. That's taken into consideration in our pricing and our structuring, but the changes that we saw this quarter were well above the trend lines that were estimated. Some of those unfortunately closed out. So there isn't any reversal to be seen. There isn't any significant change to our marks so far in the quarter.

Elyse Beth Greenspan
Wells Fargo Securities, LLC, Research Division

Okay. Great. And then if I look at your G&A in the quarter, and I kind of back out the $8 million severance costs, it still was probably some corporate cost, may be a little bit higher than I was modeling. And I know there were some moving parts. Do you guys still, as you think about the expenses that you outlined to the Street, is your assumption will still see the $50 million fall out of the expense base by the end of this year just in light of some higher personnel cost that you were speaking about?

Albert A. Benchimol
President, Chief Executive Officer & Director

That's right. Look, from our perspective, we will have achieved in excess of the $50 million in cuts by end of '17. So we are confident that what we indicated to you is happening. The -- of course, a lot of these savings have now been reinvested in other parts of the business, analytics, and so on, but the progress continues. It's true that the expense in the G&A line grew up. There were a few other seasonal items. We just -- we did not believe that it was worth identifying them as exceptional. And so we're happy to give you a little bit more detail on that. But there were some seasonal items that also included the growth of G&A line.

Elyse Beth Greenspan
Wells Fargo Securities, LLC, Research Division

Okay. And then 1 last question, if I may. There was a tax benefit in the quarter. What was that?

James O'Shaughnessy
Chief Accounting Officer, Executive Vice President and Corporate Controller

Yes, Elyse. This is James here. There was a new accounting rule that came in, in Q1 2017 and was on share-based comp simplification. So the tax impacts of the share-based comp are now included in the tax line. Prior to 2017, the tax benefits were booked to the shareholders' equity line. So due to the vesting schedule, the majority of the tax impact is reflected in Q1 '17, and the amount of tax benefit was also impacted by the increase in our share price. So you would expect maybe a bit of a spike potentially in Q1 with the vesting of the shares going forward. So that was an equity item before, but it is now booked through the income statement.

Albert A. Benchimol
President, Chief Executive Officer & Director

Fundamentally, the way we would look at it, and we talked about kind of core accident year loss numbers with Amit a few minutes ago. I think we would be looking at a core G&A number that's about 150 per quarter.

Operator

Our next question will come from Christopher Campbell with KBW.

Christopher Campbell
Keefe, Bruyette, & Woods, Inc., Research Division

Just -- I was wondering if we could get a little bit of additional color on why AXIS is releasing the professional lines, the current year reserve releases. Just kind of given the long-term nature, potentially higher loss cost inflation and then some reports of an increasingly aggressive plan thus far?

Albert A. Benchimol
President, Chief Executive Officer & Director

Christopher, I'm happy you're asking the question, because I was totally confused by your report last night. What we said is that the IELR, the loss ratio that we're putting in '17 is reflecting the progress that we have achieved over a number of years. As those who followed us for a number of years know, is we've made some very significant changes to our approach to the D&O, E&O book. However, we have been reserving that book very prudently without giving any credits to the impact of those changes that we have made over the last 3, 4 years. And '14, '15, '16 are emerging much more in line with what we would have expected when we wrote that book, but of course, we did not reserve it at those levels. So we reserved those years in professional lines with a conservatism that did not fully reflect the improvements. What we are doing in 2017 is now readjusting the starting point for the '13, '14, '15, '16 years and, therefore, granting some credits for the changes in the portfolio. We, of course, have not changed our indications for 2017 which, as is our practice, continues to assume a prudent amount of rate and trends, and we will not revisit the 2017 loss number for a number of years, just as we have not revisited the professional lines' loss numbers for '14, '15 and '16. Does that help you understand the wording that we used?

Christopher Campbell
Keefe, Bruyette, & Woods, Inc., Research Division

Yes, they -- that's very helpful. And then just kind of over the broader results. Core loss ratio is up about 200 bps. How much of that is the mix shift versus just deteriorating market conditions?

Albert A. Benchimol
President, Chief Executive Officer & Director

So -- I'm sorry, could you repeat that question?

Christopher Campbell
Keefe, Bruyette, & Woods, Inc., Research Division

Yes. I'm just looking overall, like the overall core loss ratio, which is about 200 bps higher year-over-year. And I just wonder -- just kind of wondering what the breakdown would be? I know the book is shifting in certain segments like maybe accident and health in insurance. So how much is -- of that deterioration is just writing higher core loss ratio business versus overall market conditions?

Albert A. Benchimol
President, Chief Executive Officer & Director

So if we look at the group number, and you start with the Q1 '16 number of 61.5% and you add the impact of Ogden which, as we said is, we think of as a cat, which will run through over the next few quarters, that's 0.9 points and the rate in trend on average for the book is about 1.4, 1.5. That gives you a total of approximately 63.8%, 63.9%. We actually delivered 63.6%, which means that our mix and underwriting has actually given us progress against the market conditions. I think, however, it is much more impressive when you split it up between insurance and reinsurance. On the insurance side, the accident year ex cat loss number was 60.8% last year, and we've got rate and trend of approximately 1.4, which means that if we would have done nothing to the book, the loss ratio would have been 62.2%. As a midpoint to that earlier, that number came in at 60.1%. So the ongoing improvement in our book of business, underwriting and portfolio construction actually led with 2 point -- over 2 points of improvement in the insurance book. And this is what I was referring to in my prepared remarks that no matter what's happening in the market, we will continue to make progress in our underwriting results. Reinsurance is a little bit more complicated, where, of course, we have not only the impact of Ogden and the rate change, but in that area, it has been a more difficult market, and we've been absorbing tougher conditions there and the mid-60s loss ratio that we discussed earlier really reflects more of the market conditions and less of the mix shift. The mix shift we have essentially done, as I've said before, the macro shift that we wanted to make. What we're doing today are more tactical based on the opportunities available to us.

Operator

Our next question will come from Brian Meredith of UBS.

Brian Robert Meredith
UBS Investment Bank, Research Division

Albert, could you talk just a little bit more about the growth in the catastrophe reinsurance area. What's behind that given where market conditions have been?

Albert A. Benchimol
President, Chief Executive Officer & Director

I appreciate that. You're seeing growth in the gross number. In a net number, actually it's lower. And we have, as we've discussed with you in prior quarters, we've been increasing our strategic capital partnerships, but we have strategic capital partners who have an interest in cat business, and as we've said before, this is a great opportunity for us to do more for our customers, provide risks that our strategic capital partners want and earn fees in the process. But what you're seeing is an increase in the growth, and you will be seeing a reduction in the net. And in fact, you will notice in the PMLs, there really hasn't been much change in the PMLs.

Brian Robert Meredith
UBS Investment Bank, Research Division

Got it. That makes a lot of sense. So just bigger line sizes you're getting on treaty, so...

Albert A. Benchimol
President, Chief Executive Officer & Director

Yes, what matters to us is to be a full-service, value-added partner to our customers. And we're very happy to do more for them. As I mentioned in my prepared remarks, we're unlikely to be increasing our net exposures in this market, but there is demand in the investment world for cat risk, and we're happy to work in conjunction with our strategic capital partners and satisfy both their appetites and our customers' needs.

Brian Robert Meredith
UBS Investment Bank, Research Division

Great. And then another quick question I know on the policy acquisition costs in the Insurance segment, it was mentioned a mix shift with respect to A&H. Is it there's more reinsurance? Or what's happening in that area?

Albert A. Benchimol
President, Chief Executive Officer & Director

That's exactly right. There is -- as James mentioned, there is growth in that Middle East reinsurance business and that comes with a higher acquisition expense.

Brian Robert Meredith
UBS Investment Bank, Research Division

Got you. Got you. And then just last question for you, to just curious your thoughts, lot of talk recently about intermediate comp -- intermediary compensation kind of -- what are your thoughts on that?

Albert A. Benchimol
President, Chief Executive Officer & Director

We are not a direct insurer and reinsurer. So by definition what we write is going to have commission. What I can say is that, commission changes, it depends by line. If you're writing program business or stuff like that, by definition you're going to pay more. Some lines in the large accounts are with net. So there is going to be some change around that. What I will say to you is when we look at the profitability of a proposal, whether it's a treaty or an individual risk, we look at it on a technical ratio basis, which is both the loss ratio and the commission. If we find that together the loss ratio and the commission are unattractive for whatever reason, whether it's the loss part or the commission part, we will pass on it. If we find that the technical ratio is acceptable to us and we want to write it, at that point, we're a little bit less concerned whether that comes from lower commission or lower loss ratio as long as all-in, the risk is attractive to us. So my answer to that is it's up to us as evaluators of risk and return to determine which technical ratios are attractive and which are not.

Operator

[Operator Instructions] Our next question will come from Ian Gutterman of Balyasny.

Ian Gutterman
Balyasny Asset Management L.P.

I guess, I'll start with the simple one. The credit business in the reinsurance looked like it shrunk about in half. Anything interesting going on there?

Albert A. Benchimol
President, Chief Executive Officer & Director

No. That's the -- we discussed earlier that part of a reduction in the net written premiums -- in the gross written premiums was multiyear treaties. We had a multiyear treaty last year. And obviously, we did not renew that. We're just writing less multiyear treaties now.

Ian Gutterman
Balyasny Asset Management L.P.

That makes sense. Okay. You mentioned in your earlier remarks that the strategic partners is adding about 0.5 point to ROE. If I want to track that in the income statement, is that just that $11 million of fee income from partners you report? Or is there a different way to analyze that?

Albert A. Benchimol
President, Chief Executive Officer & Director

That's right. Obviously, there's a little bit of expense associated with that, but by and large, that's the driver.

Ian Gutterman
Balyasny Asset Management L.P.

That’s what I was going to ask. Is -- the expense, is there a way I can pick that up or a guestimate of margins on that or...

Albert A. Benchimol
President, Chief Executive Officer & Director

They're not huge. The real margin is in our third-party capital unit, which is a small unit. But the rest of it is just normal G&A. We would be incurring the underwriting expense and the rent expense, whether we were taking $20 million a line or $25 million a line. So it's high-margin business.

Ian Gutterman
Balyasny Asset Management L.P.

Got it. And then on the professional lines, can you just remind me a little bit of, maybe both on the insurance and the reinsurance side, what -- sort of where you play? Do you just buy it by lines of D&O, E&O, EPL, et cetera, and just kind of what type of customer you're doing mostly, Fortune 5s, are you doing regionals, are you doing not-for-profit? Just a sense of the spread of your book.

Albert A. Benchimol
President, Chief Executive Officer & Director

Well, it is, in fact, a very widely spread book. But I would say that where we have changed our book over the last 4 years is the following: Number one, we are writing less D&O and more E&O than we have in the past. You'll recall 2013, we discussed the D&O market with you, and we decided at that time that we were going to write less. Where we are writing D&O, we've significantly changed the distribution by industry. We had been overly represented in the technology and healthcare world, we've significantly reduced those. We've reduced our primary exposure. We've increased our attachment points, and we've reduced our line size. And all of those have been key drivers to our improvement. And as I've mentioned in the last call, our participation in the existing class action lawsuits is the lowest that it's ever been. So we feel very positive about what we've done on the D&O side. E&O is both a more attractive market right now than D&O is and where we have been growing. And there we have a significant amount of management liability experience and expertise in multiple professional lines, architects and engineers, we do cyber, we do healthcare, we do a number of areas. We've been growing in Europe in professional lines, mostly, I would say, in the mid-market area. We do write some large accounts, but we are mostly in the middle market. And if you look at our average customer and average policy size, those have been coming down in size. So we've been moving away from the large accounts and more into the mid-market and small. And our line size has reduced over the last 3, 4 years, and we like where it is right now.

Ian Gutterman
Balyasny Asset Management L.P.

And on the reinsurance side, is it mostly quarter share?

Albert A. Benchimol
President, Chief Executive Officer & Director

Yes, it's quarter share. And there, it's really about underwriting the customer, making sure that there is a good book of business there and making sure that the ceding commission that we pay is commensurate with the profitability of the underlying book of business. And there, as you know, there has been some real pressure over the last 2, 3 years at increased ceding commissions. And frankly, we've reached a limit on that. And so we're happy to renew flat where the underlying is booked, but we have not been -- we haven't been encouraging people to speak about higher ceding commissions.

Ian Gutterman
Balyasny Asset Management L.P.

Okay. And what you're seeing is there be sort of the major players that I would get off the top of my head? Or is there a lot of regional clients? Or maybe high professional, I don't know...

Albert A. Benchimol
President, Chief Executive Officer & Director

No, it's active players, recognized players, because, of course, it's really important that our customers have expertise and relevance in that marketplace. So we want to make sure that we deal with people who've got the right book, the right distribution.

Ian Gutterman
Balyasny Asset Management L.P.

Okay. And then just last thing on the topic. Is the -- what sort of elevated losses we're seeing in the M&A and some of the other things. Are those things that are mostly still at the primary or maybe low access where it's largely a defense and sort of a modest settlement? Or are we seeing pressure on the excess layers with claims as well?

Albert A. Benchimol
President, Chief Executive Officer & Director

That's our experience. So as you know, first of all, I'll start with the fact that we're now writing a lot less of that business and writing smaller accounts. But it's true that most of what we're seeing, we're seeing elevated activity, but most of what is happening is staying in the primary layers, which is why, as I indicated earlier, we're seeing price increases in the primary layers and more pressure on the excess. Because the excess to date has been able to avoid the frequency that you had on the primary.

Operator

[Operator Instructions] Having no further questions, this will conclude our question-and-answer session. I would like to turn the conference back over to CEO, Albert Benchimol, for any closing remarks.

Albert A. Benchimol
President, Chief Executive Officer & Director

Thank you, and thank you all for participating in the quarter. And if there is a message that I hope you will take away from this, is that this was a noisy quarter. However, we do believe that the events that affected our results in this quarter are unusual in their nature, and the journey continues. And we're very pleased with our progress. And you have our commitment that we will continue down that path. Thank you, all.

Operator
The conference is now concluded. Thank you for attending today's presentation. You may now disconnect your lines.