S&P Global
Market Intelligence

Arch Capital Group Ltd. NasdaqGS:ACGL

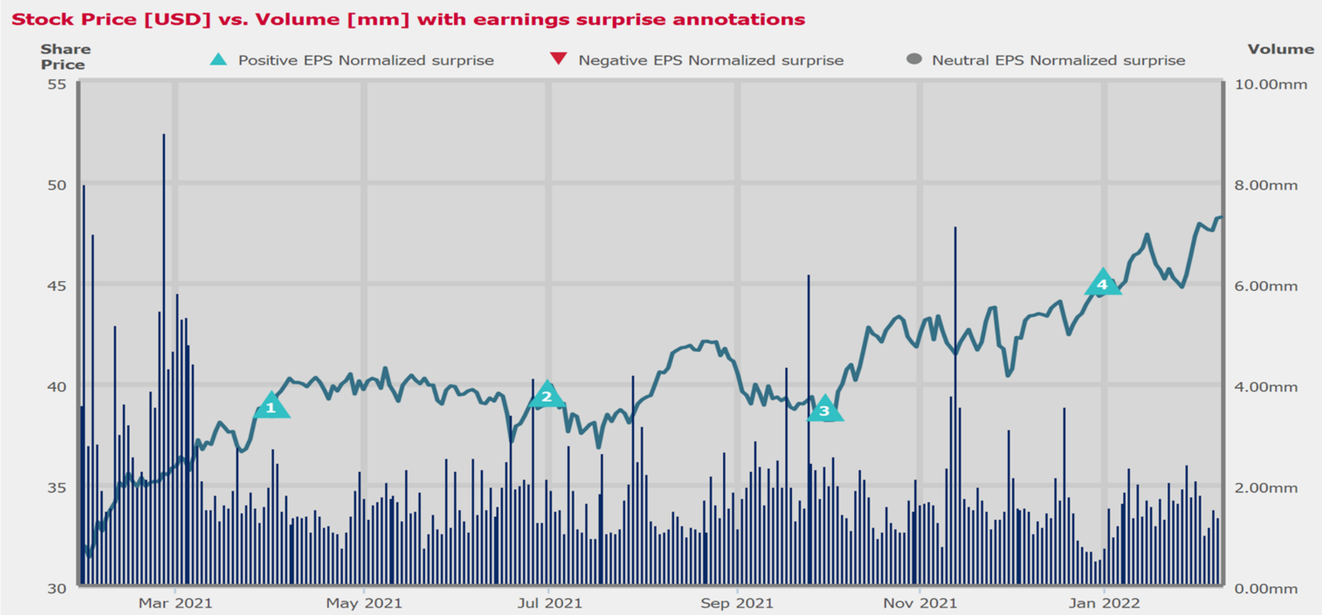
FQ4 2021 Earnings Call Transcripts

Thursday, February 10, 2022 4:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ4 2021-			-FQ1 2022-	-FY 2021-			-FY 2022-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS
EPS Normalized	1.00	1.27	▲27.00	1.20	3.32	3.58	▲7.83	4.47
Revenue (mm)	2036.50	NA	NA	3037.50	8888.17	NA	NA	11132.10

Currency: USD
Consensus as of Feb-10-2022 10:35 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ1 2021	0.45	0.59	▲1 31.11 %
FQ2 2021	0.84	1.00	▲2 19.05 %
FQ3 2021	0.35	0.74	▲3 111.43 %
FQ4 2021	1.00	1.27	▲4 27.00 %

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Call Participants

EXECUTIVES

Francois Morin
Executive VP, CFO & Treasurer

Marc Grandisson
CEO & Director

ANALYSTS

Brian Robert Meredith
UBS Investment Bank, Research Division

Elyse Beth Greenspan
Wells Fargo Securities, LLC, Research Division

Joshua David Shanker
BofA Securities, Research Division

Mark Alan Dwelle
RBC Capital Markets, Research Division

Meyer Shields
Keefe, Bruyette, & Woods, Inc., Research Division

Michael David Zaremski
Wolfe Research, LLC

Tracy Dolin-Benguigui
Barclays Bank PLC, Research Division

Presentation

Operator

Good day, ladies and gentlemen, and welcome to Arch Capital Group's Fourth Quarter 2021 Earnings Conference Call. [Operator Instructions] As a reminder, this conference call is being recorded.

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

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

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

I would now like to introduce your host for today's conference, Mr. Marc Grandisson and Mr. Francois Morin. Sirs, you may begin.

Marc Grandisson
CEO & Director

Thanks, Atif. Good morning, and welcome to our fourth quarter earnings call.

We ended a good year with a great quarter. On the year, Arch generated a return on net income of 16.7%. And importantly, book value per common share grew by 10.7% with net earnings per share of $5.23. We accomplished these results despite elevated cat activity and the short-term effect that substantial share repurchases have on our book value per share. Our ability to effectively allocate capital also contributed to our 2021 results, whether opportunistically investing more resources into the most profitable pockets of our business or buying back $1.2 billion worth of our common shares, fully 7.7% of the shares outstanding at the start of the year. We remain committed to a capital management strategy that creates value for shareholders.

I'd like to begin by sharing some highlights from our operating units. In our P&C insurance segment, net written premium grew 24% and earned premium grew 34% over the fourth quarter of 2020 as we earned in the rate increases of the past several quarters. Growth occurred across many lines with professional lines and travel exhibiting the strongest advances. Overall, submission activity and rate momentum remained healthy and rate increases were above loss trend.

A change in business mix led to a slightly higher acquisition expense in the quarter. However, we believe that this increase belies the underlying return potential of this segment. More accurately, it is a reflection of the Insurance group's outstanding job or -- of positioning itself to act on the better opportunities available in today's market.

Turning now to Reinsurance. Our shareholders continue to benefit from the extraordinary talents of this group, which grew gross written premium by 88% and net written premium by nearly 45% from a year ago. On whole, the Reinsurance group grew in nearly every line, a reflection of our diversified specialty mix of business and our larger participation in quota share reinsurance which allows us to participate in the improved premium rates of [Stephens] more directly.

Briefly on renewals at January 1. While property cat rates were up broadly, the increases were not enough for us to deploy more capital into our peak zones. However, we found many opportunities to grow in the other 93% of our Reinsurance business that is specialty in nature, including property ex cat.

Finally, on to the Mortgage segment, which again delivered excellent underwriting results even as written premiums declined in the quarter. Seasonally, the fourth quarter, as you know, is slower for mortgage originations and rising interest rates further depressed refinance activity, reducing new insurance written. However, our insurance in-force, the ultimate driver of earnings, still grew modestly in the quarter, mainly due to that lower refinance activity.

Credit conditions remain excellent in the U.S. with a strong housing market and demand for housing continuing to exceed supply. As most of you already know, home price appreciation remains robust across most of the country. This is a net positive for mortgage insurers as increasing borrower equity ultimately leads to a lower risk of default. Competition in this sector remains robust, but stable, and we believe that the better credit quality of our recent originations compensates for marginally lower premium yields. We continue to focus on the more stable returns available in higher credit quality business instead of broadly chasing top line growth, a luxury afforded to us by our diversified model.

Turning to the fourth leg of our stool. Investment income contributions were up materially for the year primarily due to alternative investments accounted under the equity method. These investments are primarily fixed income in nature, but because of the structure of our investments, their contributions are excluded from net investment income and our definition of operating income. Notwithstanding, these investments contributed $366 million or $0.92 per share for the full year. Over the past 5 years, below-the-line investment returns have added between 75 to 125 bps to our net ROE.

Taking a step back to get more of a big picture view, we like the way our businesses are currently positioned. Within our P&C segments, we believe that P&C pricing and returns have more room to grow in this part of the cycle and in the Mortgage segment, insurance in-force is benefiting from both solid credit conditions and good house price appreciation. Underwriting income for our P&C Insurance and Reinsurance segments expanded significantly in the fourth quarter. It's worth noting that if we were to include components of investment income that relates to the flow generation from underwriting, P&C and MI's contribution to Arch's earnings were roughly in balance. We believe that this balance improves the risk-adjusted returns for our shareholders.

Our corporate culture of being patient in submarkets, while maintaining an agile mindset is a key to our success and allows us to seize opportunity when the odds for success are more in our favor. Because different sectors have their own cycles, our disciplined, defensive underwriting during the softer part of the cycle is what has enabled us to grow faster than many of our peers in the current environment. We have begun to reap the benefits of the strong defensive posture we maintained from 2016 through 2019.

The Winter Olympics are underway, and I found an analogy to our business in a somewhat unexpected place, the most exquisite and exciting game of curling. You may or may not be aware that curling has been dubbed chess on ice and like insurance, is much more strategic than the uninformed may realize. Curling has played over 10 long ends or rounds. A defensive strategy is most common, patiently waiting for an opening to pivot to offense.

Unfortunately, defending is not exciting. It's about minimizing your opponents' scoring opportunities and avoiding mistakes. But like insurance, patience is often handsomely rewarded because when her opponent makes an error, the skip knows that now is a time to pounce and all of a sudden, patience is out the door and action is in. Most games are won in that one crucial reversal of fortune. That's how we play the insurance cycle. One year at a time, patiently waiting for the market to give us that opening. And once we see it, we're all in, just like the last 2.5 years and counting. Don't ever let anyone tell you that curling or insurance are not exciting.

For 20 years, we've been committed to taking the long-term view of the insurance cycle, being thoughtful and balanced with our capital management strategy and differentiating ourselves by being committed to a specialty model, all with the aim of enhancing shareholder value over the long term. Although every year is different and markets aren't always predictable, we've demonstrated that we can succeed in any market. So we're looking forward to what 2022 has in stall for us.

Francois?

Francois Morin
Executive VP, CFO & Treasurer

Thank you, Marc, and good morning to all. Thanks for joining us today.

As Mark shared earlier, our after-tax operating income for the quarter was $493.3 million or $1.27 per share, resulting in an annualized 15.6% operating return on average common equity. Book value per share increased to $33.56 at December 31, up 3.5% in the quarter. For the year, our operating return on equity stood at 11.5% while our net return on equity was 16.7%, excellent results indeed.

In the Insurance segment, net written premium grew 23.7% over the same quarter 1 year ago and the accident quarter combined ratio excluding cats was 91.2%, lower by approximately 240 basis points from the same period 1 year ago. The growth was particularly strong in North America where a combination of new business opportunities and rate increases supported this profitable growth.

One item to note this quarter for the Insurance segment relates to the acquisition expense ratio, which was higher than in both the prior quarter and the same quarter 1 year ago. As we mentioned in the earnings release, some of this increase is related to premium growth in lines of business with higher acquisition costs, such as travel, but it also reflects increased contingent commission accruals on profitable business as well as lower ceded premiums in lines with higher ceding commission offsets. As we have said before, our focus remains on the returns we are able to generate from all our businesses and we remain positive on the current pricing environment and the opportunities that should be available to us in 2022.

For the Reinsurance segment, growth in net written premium remained strong at 44.5% on a quarter-over-quarter basis. The growth was driven by increases in our casualty, property other than property catastrophe and other specialty lines where new business opportunities, strong rate increases and growth in new accounts helped increase the top line.

For the full 2021 year, the ex cat accident year combined ratio was 84.4% and improving by approximately 160 basis points over the 2020 year, a reflection of the underwriting conditions we have seen in most of the lines we write. Losses from 2021 catastrophic events in the quarter, net of reinsurance recoverables and reinstatement premiums, stood at $72.3 million or 3.5 combined ratio points compared to 9.4 combined ratio points in the fourth quarter of 2020. The losses came from a combination of fourth quarter events, including the December U.S. tornadoes and other minor global events, as well as some development on events that occurred earlier in the year.

Our estimate of our ultimate exposure to COVID-related claims decreased by approximately $3 million during the quarter. We currently hold approximately $195 million in reserves for this exposure, 2/3 of which are recorded either as ACRs or IBNR.

Our Mortgage segment had an excellent quarter with combined ratio of 11.7%, due in part to favorable prior year development of $72.9 million. The decrease in net premiums earned on a sequential basis was attributable to a combination of higher levels of premium ceded, a lower level of earnings from single premium policy terminations, and lower U.S. primary mortgage insurance monthly premiums due to lower premium yields from recent originations, which were of excellent credit quality.

While approximately 2/3 of the favorable claim development came from U.S. MI related to better-than-expected cure activity and recoveries on second lien loans, we also saw favorable prior year development across our other mortgage units, including our CRT portfolio and our international MI operations. Consistent with historical practice, we maintained a prudent approach in setting loss reserves, especially in light of the uncertainty we are facing with borrowers exiting forbearance programs and moratoriums on foreclosures.

The delinquency rate for our U.S. MI book came in at 2.36% at the end of the quarter, more than 50% lower than the peak we observed at the end of the second quarter of 2020. Production levels were down from last quarter, certainly a typical outcome given the seasonality in new purchases and also partially as a result of the lower level of refinance activity due to higher interest rates.

Offsetting lower origination activity in the quarter is the improving persistency rate now at 62.4%. We expect persistency to keep improving throughout 2022 on the heels of lower refinance activity. This bodes well for our insurance in-force portfolio and accordingly, the returns we can generate on our Mortgage business.

Income from operating affiliates stood at $40.6 million, again, an excellent result, primarily as a result of contributions from Coface and Somers Re. We are pleased with the returns these investments have generated for us so far.
Total investment return for our investment portfolio was 39 basis points on a U.S. dollar basis for the quarter. And net investment income was $90.5 million this quarter, up slightly, in part due to slightly higher dividends on equity investments. The duration of our portfolio remains low at 2.7 years at the end of the quarter, basically unchanged from last quarter and reflecting our internal view of the risk and return trade-offs in the fixed income markets.

Alternative investments representing just under 15% of our total portfolio performed well this year, returning 12.6%. The portfolio we have constructed has a slightly heavier bent towards debt strategies and should produce, we believe, returns that are relatively less volatile over time given the level of diversification across sectors and geographies.

Amortization of intangibles was $33.1 million, up sequentially as a result of the acquisition of Westpac LMI and Somerset Bridge Group Ltd., which were completed in the third quarter. For your modeling purposes, we are currently forecasting an amortization expense of $110 million for the full 2022 year, which is expected to be recognized evenly throughout the year.

The effective tax rate on pretax operating income was 4.7% in the quarter, reflecting the geographic mix of our pretax income and a 2% benefit from discrete tax items in the quarter. The discrete tax items in the quarter primarily relate to a partial release in a valuation allowance on certain international deferred tax assets. For 2022, we would expect our tax rate on pretax operating income to be in the 8% to 10% range based on current tax laws.

Turning briefly to risk management. Our natural cat PML on a net basis stood at $748 million as of January 1 or 5.9% of tangible common equity, which remains well below our internal limits at the single event 1 in 250-year return level. Our peak zone PML is currently in the Northeast U.S.

On the capital front, we repurchased approximately 8.7 million common shares at an aggregate cost of $362.1 million in the fourth quarter. And as Marc mentioned, we repurchased almost 31.5 million shares at an average price of $39.20 in 2021. Our remaining share repurchase authorization currently stands at $1.18 billion.

Finally, I wanted to take a quick moment to thank over -- our over 5,000 colleagues around the globe in what has certainly been a challenging period. Without their ongoing commitment to Arch and its constituents, we certainly wouldn't have been able to generate and report record earnings today as we close the books on our 20th year. Your efforts and dedication are truly appreciated.
With these introductory comments, we are now prepared to take your questions.

Question and Answer

Operator

[Operator Instructions] Our first question comes from the line of Elyse Greenspan of Wells Fargo.

Elyse Beth Greenspan
Wells Fargo Securities, LLC, Research Division

My first question follows up on just some of Francois' concluding comments going to capital management. Recognizing where your stock is today, can we just get some updated thoughts on how you guys think about share repurchase at these levels? And if at some point, if the valuation continues to expand, would you consider the use of a dividend to return capital to shareholders?

Francois Morin
Executive VP, CFO & Treasurer

Well, as you know, the top of mind and top priority for us is to put the capital to work in the business, and we're seeing plenty of opportunities to continue on our growth trajectory. So I'd say that remains the key focus. But as you saw last year, yes, no question that we've accumulated a bit of capital that we didn't have the options to deploy and put to work. So yes, we did return a fair amount to our shareholders last year.

What ends up happening in 2022 is a bit of a -- is an unknown. We'll keep looking for opportunities. Certainly, yes, the 1.3x book multiple is something that we've kind of looked at we talk about a 3-year payback and how we look at share repurchases. But the business is doing very well. So I'd say that the current prices are maybe a little bit above where the 3-year payback might come into play. But there's also other things or other factors we consider. And I'd say that to your final question, like, would we think about a dividend? That's something we discuss with the Board regularly. And right now, as you know, we haven't declared a dividend, but things could change down the road.

Elyse Beth Greenspan
Wells Fargo Securities, LLC, Research Division

And then, Marc, I think you said that the earnings mix, if you allocate investment income between the segments is around -- was around 50-50, sorry. If you think about the at-hand for 2022, would that sway more in the direction of P&C or Mortgage? Or how do you see that earnings mix playing out over the coming year?

Marc Grandisson
CEO & Director

Yes, I think it will slightly go towards P&C, I mean, absent cats and everything else, obviously, Elyse, as you know. But overall, I would expect it to be in the 50s, maybe a bit more towards the P&C as we go forward.

Elyse Beth Greenspan
Wells Fargo Securities, LLC, Research Division

Okay. And then one last one. S&P is in the process of rolling out some capital changes. And I know we're in the middle of the comment period, but I wasn't sure if you guys can just share with us just some high-level thoughts just on what they've put out there and how does it potentially impact Arch.

Marc Grandisson
CEO & Director

Sure.

Francois Morin
Executive VP, CFO & Treasurer

Yes. Listen, it's comprehensive. We obviously are studying it pretty deeply. We've got a pretty large team internally that's focused on -- because it touches everything, right? It touches mortgage, it touches cat losses, touches reserve risk. So all the risk charges investments. There's a lot of things that are being suggested by S&P as how they want to move forward.

And we'll be ready and we'll certainly most likely respond to their RFC in the coming weeks, and we'll see how that plays out.

But big picture, yes, I'd say it's -- there's pluses and minuses. As you'd expect, there are things that we think are -- we've been working with them over the last few years in trying to address and it looks like there are some changes coming through potentially and some that we, I'd say, didn't expect and maybe a bit more punitive and we'll adjust as time goes on. But still a bit of a ways to go before we have finality and have the clear picture on what this all will mean for everybody.

Operator

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

Joshua David Shanker
BofA Securities, Research Division

I was hoping you might help us think about other going forward. We have Somers, we have Coface. What sort of a thought can you give us about: a, the run rate goals for that unusual line item in the P&L? And what sort of volatility should we expect from it?

Francois Morin
Executive VP, CFO & Treasurer

Well, certainly, I'd say this quarter is maybe the -- it is the first quarter where we -- let's say, there's no -- I'd call it noise, right? It's more recurring business as usual for both of them and also [indiscernible 00:36:28] and all the other smaller investments that we have in the operating affiliates. We -- as you know, on the balance sheet, we've got over, call it, $1 billion of investments or equity in those vehicles. There's a reason why we made the investments. We think they can generate good returns for us. And that's how I would think about it.

On your side, I'd say, I mean, what kind of ROE should I expect from those businesses over the last -- over the 2022 period given there's $1 billion invested. I'll let you kind of make your decisions on that or model it out, but that's how we would suggest maybe you think about it is kind of on an ROE basis, given there's $1 billion or so...

Marc Grandisson
CEO & Director

And Josh, you have one that's coming from Coface, obviously, who's a public company. That's helpful to you guys. And it's also in the rear, so you have a good sense for where we're going the next quarter.

Francois Morin
Executive VP, CFO & Treasurer

Right.

Marc Grandisson
CEO & Director

And on the Somers, which is the old Watford, I think, it's fair to say that they would track sort of a P&C kind of return, right? I would tend to stand that is looking like a P&C insurance company. So I would describe those counter retentions. It'll, like, help you give you a sense of the magnitude and the relative magnitude between the 2.

Joshua David Shanker
BofA Securities, Research Division

And then I -- there's a little bit of shrinkage on the mortgage side of things. If you can talk about your rankings, mortgage reinsurance, insurance share buyback, they're all attractive, I know. Where are the best returns right now?

Marc Grandisson
CEO & Director

I think from a top down, I would say that mortgage is still -- just currently, right, because longer term, they might have different -- that's also why I've explained a couple of quarters back that you may be positioning yourself in areas where the returns may be not as high comparatively, but there's a longer-term reason for this. But a high level right now, Josh, mortgage is #1. #2, I would say, is reinsurance and 3 is insurance.

But -- and the investment income potentials in the future improving will, again, bring up insurance and reinsurance. But they're very much different from one another. I mean, there used to be a lot wider difference between them 3 or 4 years ago, as you know. But now the market -- the hardening market on the P&C side has made them all very, very favorable and very attractive.

On the share repurchase, you heard Francois say. So I guess it's -- we're -- you know where we bought it at, you know what we think of it. So it's still always a possibility, and I would say on the capital management, as Francois mentioned, it's not only return-specific, it's also in terms of returning it if we don't -- if we can't find anything more interesting to work with at a higher return. But I think right now, we have a lot of opportunity.

Operator

Our next question comes from Tracy Benguigui of Barclays.

Tracy Dolin-Benguigui
Barclays Bank PLC, Research Division

Would like to touch on the expense ratio. Francois, you mentioned increased contingent commission accruals on profitable business and I'm assuming you mean with MGUs. Maybe you could just walk us through how that structure works. I guess, I think there's a multiyear look-back period. And I'm going with this as essentially, if there's a lot in calculating that profit-sharing component, should we expect this profit-sharing component sticking around for a while to catch up with all the good work you've done on underwriting profitability?

Francois Morin
Executive VP, CFO & Treasurer

Well, I mean, as you can imagine, there's lots of different types of agreements with all our producers, U.S., international. And so going into the specifics would take a lot of time. But I'd say at a high level, no question that if we book a lower loss ratio in business, in some situations, that does trigger a higher contingent commission and that has to go hand in hand in how we accrue it, how we book it in the quarter, right?

So as long as the business is performing well and then, yes, it gets -- the settlements take place over a period of time with true-ups, et cetera. But at a high level, no question that as long as the business performs well and the loss ratios remain at the levels they're at right now, we would expect commensurate levels of contingent commission to be there in place over time.

Tracy Dolin-Benguigui
Barclays Bank PLC, Research Division

Got it. And then on the same topic, I mean, basically, I'm just curious what are you writing that's costing more besides maybe travel business? So if I look at the changes in your business mix, basically something that pops up maybe is professional lines in insurance. And reinsurance, it bounces around more quarter-to-quarter. So if you could just provide more context about the business mix changes that were really driving that as well as the direction of ceding commission.

Marc Grandisson
CEO & Director

Yes, absolutely. It's a very good question. I think that if you look at the structure on -- starting with the Insurance group, it's really similar phenomenon but different reasons on the reinsurance side. On the insurance side, programs is also something that we're growing. We're also smaller risk in the professional lines. We do a lot of private D&O and not-for-profit D&O for instance. That comes with a much higher expense ratio than you would have normally with larger commercial enterprises. So that's one example.

We also are increasing our footprint in the U.K., which also carries a higher acquisition cost. So I would tend to think on the Insurance side is the size of risk, the fact that we're -- absent travel; the risks that we write from cyber as well; the primary small risk, that's also carrying because it's primary and small accounts will have a higher acquisition expense ratio. So the size of the risk is what makes it on the insurance side, absent travel, which is also a small risk be fair.

On the Reinsurance side, we see, as you know, it's a lot -- quota share is a big, big difference, right? You could have an expense ratio -- an acquisition ratio in the excess of loss versus 10 to 15, it could be 30, 33 on a quarter share basis. So that really will skew in. We've been growing both on the Insurance side for the small risk and on the Reinsurance side, on our quarter share participation. So that is just the price of getting access to the business that we have to pay for.

Tracy Dolin-Benguigui
Barclays Bank PLC, Research Division

So on the ceding commission?

Marc Grandisson
CEO & Director

Say it again?

Tracy Dolin-Benguigui
Barclays Bank PLC, Research Division

And if you could comment on the ceding commission?

Marc Grandisson
CEO & Director

The ceding commissions are -- have been stable to slightly up on the reinsurance, but not significantly. They're a bit more stable for the last 1.5 years than they had been in other harder markets. That's one thing that's really intriguing. But I guess it makes sense in terms of the economic returns and the pricing that's coming through on the primary side. But the increase itself in the ceding commission is not what's driving the acquisition expense ratio. It was truly the type of business and the mix that we're writing.

Operator

Our question comes from Mike Zaremski of Wolfe Research.

Michael David Zaremski
Wolfe Research, LLC

Great. A follow-up on the -- maybe I'm reading too much into this, but on the increase in the expense ratio, specifically, I believe probably the acquisition expense ratio, but maybe also the other portion of the expense ratio in the primary Insurance segment. So I believe you said some of it was due to increased profitability or contingent commissions. But I guess if I'm looking at the overall combined ratio for that segment for the year, it was 96 and change. And for the quarter, it was 93. I guess I thought we were shooting for like overall profitability being better than that kind of on -- in outer years or maybe even this year. So I didn't think profitability was kind of much better than expected. So any thoughts there?

Francois Morin
Executive VP, CFO & Treasurer

Well, I mean, the -- obviously, you got to slice it down by the line -- by line of business. So the agreements, they're not on the overall profitability. So sometimes we have -- we do have some books of business that are doing extremely well and commissions go up with that. The other thing that I mentioned, and I think is not insignificant is the fact that we are retaining a bit more in some lines of business, and that kind of moves the economics, I'd say, right?

So you're going to get a bit less ceding commissions that are maybe higher in some places, and you retain more net than that at a better loss ratio going forward. So that's something to -- that also impacts the overall acquisition. I'd say at a high level, there's -- and no question that there's a bit of noise this quarter, but it's not something that has us extremely worried at this point.

I think it's very much a quarterly kind of a bit of noise. There's a bit of again, recovery from COVID like last year, quarter-over-quarter when we're still in the -- very deep into the COVID crisis with no travel, et cetera. So there's other reasons that impact all -- our expense ratio in total. I'd say, at a high level, we think it's a bit elevated this quarter, but not really a cost or concern.

Marc Grandisson

CEO & Director

Yes. And Mike, you're quoting numbers that include cat events, like actual cat events. If you do it ex cat, which is probably a better reflection of the underlying margins, it's really going down from 95 to 91 for the year. So we do -- we are getting improved margin. One could argue whether it should be more or less, but it's pretty much an improvement that we saw over the last 12 months. So it's -- your numbers were skewed somewhat with the cat events, I believe.

Michael David Zaremski
Wolfe Research, LLC

No, you're right. I probably should have quoted maybe ex cat, too, but although the cats matter, but -- and also a good point on the -- your net to gross is keeping up.

Marc Grandisson
CEO & Director

Yes, yes, yes.

Michael David Zaremski
Wolfe Research, LLC

Okay. So -- and that's helpful. And maybe just switching gears to capital and inorganic growth. I guess one of the MIs hit the tape that they're potentially exploring a sale. If another MI buys another mortgage insurers, is 1 plus 1 still less than 2? Or have kind of dynamics do you think maybe changed over the recent years?

Marc Grandisson
CEO & Director

It's a good question because our understanding was that the GSEs and it's really -- we have to talk to the people in Washington and Virginia to understand what they think about this, whether that there was a preference to have more -- not lesser amount of MI providers, more diversification. So we'll see what happens. There's not much gain and benefit in scale in combining 2 MI companies. I mean you still -- all the capital models and whatnot are sort of linear. So there's not really a saving of capital.

I think there will probably be some net-net loss on the market share. I think we saw ourselves some of it from the -- when we acquired UG. So it's not 1 plus 1, it's not equal to 1.5, but it was a little bit of a loss on the market share. So that's probably not 1 plus 1 equals 2 or plus.

So I don't know what's going to happen. I mean, I don't know what people have in mind. I think to me, our core principle about MI and the way we've operated stays, which is it's always better in a multiline diversified platform. That's not going away. I would say that some of the S&P new modeling is appreciating and recognizing that. So that's my view at least. I think the more sensible thing would be put this MI to find another home somewhere else outside of the MI arena. But I'm not a predictor of this, Mike, so.

Michael David Zaremski
Wolfe Research, LLC

That's helpful. And so the -- you mentioned the S&P capital model will -- are you -- will the diversification get increased benefits, so the MI can...

Marc Grandisson
CEO & Director

Well, in general, right, it's not on MI. In general, there's better diversity in credit, the more diversified you are, which again speaks to our model, which makes sense to us.

Operator

Our next question comes from Mark Dwelle of RBC.

Mark Alan Dwelle
RBC Capital Markets, Research Division

A couple of questions related to MI. First, on the -- in the quarter, it looked like the average paid claim -- average paid cost per claim was around $51,000. It's been running more in 30s. Is there anything in particular that accounts for the uptick, maybe some large claims or something?

Francois Morin
Executive VP, CFO & Treasurer

Yes, we had -- it's a one-off, really. It's a settlement with a servicer that took place this quarter that was for precrisis kind of claims. So definitely a one-off here.

Mark Alan Dwelle
RBC Capital Markets, Research Division

And then a second question related to MI, just really a clarification. The reserve releases that you did in the quarter, are we to understand that those related to the reserve set up when COVID began? Or were these reserves related to other time periods or other classes of reserve?

Francois Morin
Executive VP, CFO & Treasurer

I mean, we made the point in the past that we have a hard time, to some extent, right, isolating COVID from non-COVID claims, but still more than half is for reserves that we had set up before COVID. So I mean, the vast majority -- or the majority is if you want to go at just the periods of when they were set up is pre-first quarter 2020.

Mark Alan Dwelle
RBC Capital Markets, Research Division

Okay. And then the last question I had was really more of a general market kind of question, maybe for Marc. Are you seeing any signs in the insurance or reinsurance businesses of competitors taking more aggressive pricing stances, I mean, basically getting at is the insurance clock getting towards 12:00 or are we still firmly at 11:00?

Marc Grandisson
CEO & Director

Well, it's probably, like, the longest 11:00 that we'll see in our lifetime. I think that if you look at the risks that are ahead of us, you have -- you still have climate to deal with. You still have inflation concerns, which, I guess, leads to reserve -- potential reserve questioning or analysis, cyber risk and COVID reopening. There's a lot of stuff going on right now that sort of leads the whole market to be a lot more careful and thoughtful.

So the market is always competitive, right? There's always competition out there. But right now, what we are -- it's a very disciplined market. And we're not seeing anything -- we haven't seen anything and we're not seeing anything percolating that would indicate that this would change for 2022.

Operator

Our next question comes from Meyer Shields of KBW.

Meyer Shields
Keefe, Bruyette, & Woods, Inc., Research Division

If I can go back to the contingent commission question, I guess it's clear that underlying profitability is getting better. Should we expect a smoother recognition of contingent commission accruals in 2022?

Marc Grandisson
CEO & Director

Not necessarily because -- no, Meyer. The release of profit commission or contingent commissions is dependent on loss picks. So we tend to take our beautiful time to make sure we have all the data available to make those contingent commissions. So they can be spotty, right? We can make a decision to look at 2 or 3 underwriting years and have that adjustment made. And we accrue for some of it, but we don't always accrue to the full extent of the ultimate. The losses actually drive these contingent commissions. So this is -- so it's really spotty. It's very hard to predict.

Meyer Shields
Keefe, Bruyette, & Woods, Inc., Research Division

Okay. No, that's fair. I just want to understand the process. Second question, I think, Francois had talked about maybe reducing the sessions on some quota share contracts in insurance, so less of an offset. Does that outpace or trail the loss ratio improvements that you should anticipate from keeping that business?

Marc Grandisson
CEO & Director

Let me -- and -- so are you saying that -- can you repeat your question differently? I'm not sure I got exactly what you're trying to get to, Meyer. I apologize.

Meyer Shields
Keefe, Bruyette, & Woods, Inc., Research Division

Okay. Yes, let me try again. So acquisition expense is going up because you're ceding less business that has high ceding commissions.

Marc Grandisson
CEO & Director

Yes.

Meyer Shields
Keefe, Bruyette, & Woods, Inc., Research Division

I'm just hoping that you can sort of frame that relative to the loss ratio improvements that we should expect because you're keeping more profitable business?

Marc Grandisson
CEO & Director

Yes. So if we're keeping more profitable business, the loss ratio would, everything else being equal, go down.

Meyer Shields
Keefe, Bruyette, & Woods, Inc., Research Division

Right, by more than the increase in acquisition expense?

Marc Grandisson
CEO & Director

Possibly. It's hard to say, right? From the get-go, I think we made these economic decisions. It's kind of a hard one to pin down. I mean sometimes -- sometimes the -- what you cede capital will return that's different than the pure combined ratio. So there's a lot of things going on. It's more -- it's not only about the pure combined ratio. The return is improving. That's what matters to us.

Francois Morin
Executive VP, CFO & Treasurer

Directionally, I think we were -- we don't disagree with what you're saying. I think the precision or the timing at which everything happens is less -- I mean, it's less precise. I mean it's -- but yes. I would say would -- directionally, I think it's right.

Marc Grandisson
CEO & Director

Better -- for better return.

Meyer Shields
Keefe, Bruyette, & Woods, Inc., Research Division

Okay. No, completely understand. And then one big picture question, if I can. Anything and everything that you're saying, Marc, about the cycle lasting longer because of concerns on the loss trend side. So I guess why rates are going up, why do you think rates are still going up more than loss trends?

Marc Grandisson
CEO & Director

Well, that's a definitely loaded question, Meyer. That's one that we should probably have at the bar at a corner. All kidding aside, I think that it's probably a recognition that this uncertainty is what creates the need for more margin safety. I think that when you're faced with uncertain pickup in inflation, I mean, we had a 7% roughly inflation print this morning. I mean when you have a high number that comes like this, it comes as a shocker.

So I think that people are being preempting, preempting in making sure that they cover as much of the base as they can. I think the insurance industry, for what it's worth, has been very disciplined and is acting in a very, very proper way in, I think, over the last 2 years, I think it recognizes that the risk is building up and need to price better, price higher because there's more risk of a -- of sliding a bit -- slide sideways. So I think it's an appropriate and very welcome change. A very -- no, the discipline in the market is pretty good from that perspective.

Operator

Our next question comes from Brian Meredith of UBS.

Brian Robert Meredith
UBS Investment Bank, Research Division

I got 2 questions for you guys. First one, I'm just curious, I know there was a block of stock of Coface that's traded and I know you all didn't buy it. Was there any regulatory reasons you couldn't do it? Or is that just kind of a capital allocation decision that you don't want to own the whole thing?

Francois Morin
Executive VP, CFO & Treasurer

No, not at all. I think the existing shareholder wanted to sell and very much very -- much easier for them to do it the way they did it than to come to us. And at which point, yes, we would have had to go to the regulators and that would take in weeks, if not months, and the whole approval process would have probably maybe dragged on. So I think they want speed over maybe better execution, and that's what they got dealing -- doing it the way they did.

Brian Robert Meredith
UBS Investment Bank, Research Division

So is that Coface stake less strategic for you then going forward?

Francois Morin
Executive VP, CFO & Treasurer

Not at all. Not at all. I mean, it's -- to be candid, I mean, they didn't even come to us offering it up to us. I mean they just went ahead on their own instead of coming to us and saying, "Would you be interested in buying the 10% or 12%, we have to -- we want to get rid of or we don't want anymore?" They just went through their own process because, again, they knew that we'd trip the requirements, that we'd have to do a tender and all that, which would have taken, again, a long -- longer. So they -- that was their decision, and we respect it. But going forward, strategically, I mean, we still look at Coface, and it's been very good to us so far, and we keep thinking about how we -- if and when or how we do things differently going forward.

Brian Robert Meredith
UBS Investment Bank, Research Division

Great. And then first of all, let me just clarify one comment you made earlier in talking about kind of repurchasing your stock and understand that you want that 3-year payback period, but you said there's other considerations and I understand that. But does that mean that with your stock trading just a little over 1.4 book value right now that you would not be buying back stock right now? It just -- it did -- your return profile doesn't fit that?

Francois Morin

Executive VP, CFO & Treasurer

Well, it's never black and white, but I'd say that the forward-looking returns that we see for -- how we think about the business, the embedded profitability over 3 years, it's higher than 10%, right? So you could kind of stretch it to a bit more than 1.3x book. And so that it's -- I'll stop here. I'd say we could consider going above 1.3x book very much as a function of how we think about the business and what kind of profitability we see coming our way.

Marc Grandisson
CEO & Director

The other thing, Brian, I would say, I mean, you know this as well, right? I mean there are a couple of things happening, for instance, on the MI side that might change what we perceive to be the real book value of the company. So these are also considerations that could be way outside of the reserve -- the return possibility going forward. So that's one example.

Operator

I would now like to turn the conference over to Mr. Marc Grandisson for closing remarks.

Marc Grandisson
CEO & Director

Well, thank you, everyone. I want to thank our employees, as Francois mentioned as well. And Valentine's Day around the corner, so make sure you take care of your loved one this weekend. So on to the next quarter.

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