S&P Capital IQ

CONTENTS

Universal Insurance Holdings, Inc. NYSE:UVE

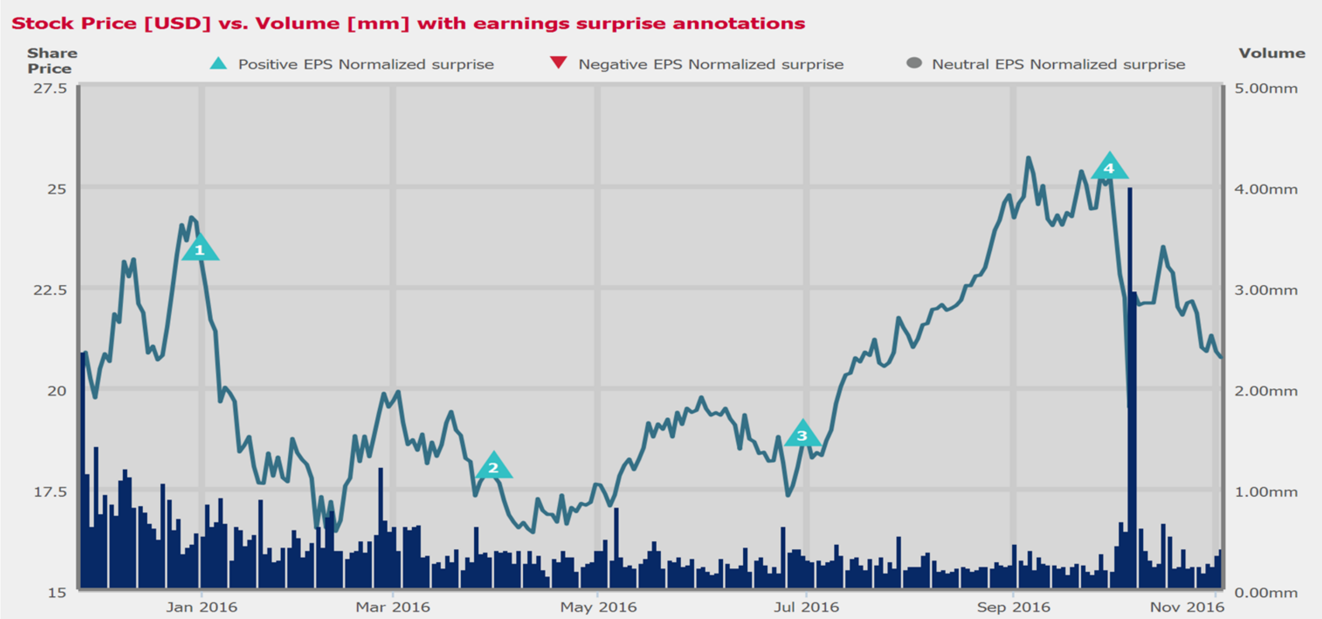
FQ4 2016 Earnings Call Transcripts

Wednesday, February 22, 2017 3:00 PM GMT

S&P Capital IQ Estimates

	-FQ4 2016-			-FQ1 2017-	-FY 2016-	
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	ACTUAL
EPS Normalized	0.20	0.38	▲90.00	0.81	2.58	2.79
Revenue (mm)	-	-	-	177.72	-	-

Currency: USD
Consensus as of Feb-22-2017 8:02 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ4 2015	0.72	0.82	▲1 13.89 %
FQ1 2016	0.63	0.71	▲2 12.70 %
FQ2 2016	0.81	0.94	▲3 16.05 %
FQ3 2016	0.60	0.75	▲4 25.00 %

Call Participants

EXECUTIVES

Dean Evans
Vice President of Investor Relations

Frank C. Wilcox
Chief Financial Officer and Principal Accounting Officer

Jon W. Springer
President, Chief Risk Officer and Director

Sean P. Downes
Chairman and Chief Executive Officer

ANALYSTS

Arash Soleimani
Keefe, Bruyette, & Woods, Inc., Research Division

Ronald David Bobman
Capital Returns Management, LLC

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Capital Returns Management, LLC

ATTENDEES

Unknown Attendee

Presentation

Operator

Good day, ladies and gentlemen , and welcome to the Universal Insurance Holdings Q4 2016 Earnings Conference Call. [Operator Instructions] As a reminder, this conference call is being recorded.

I would now like to turn the conference over to Mr. Dean Evans, Vice President of Investor Relations. Please go ahead, sir.

Dean Evans
Vice President of Investor Relations

Thank you, Andrew, and good morning, everyone. Welcome to the Fourth Quarter 2016 Earnings Conference Call for Universal Insurance Holdings, Inc. My name is Dean Evans, and I'm the Vice President of Investor Relations here at Universal.

With me in the room today are Chairman and Chief Executive Officer, Sean Downs; President and Chief Risk Officer, Jon Springer; and Chief Financial Officer, Frank Wilcox. Following Sean's opening remarks, Jon will provide an update on several important current topics, and Frank will review financial results. The call will then be reopened for questions.

Yesterday afternoon, we issued our earnings release, which is available under the Press Releases section of our website at www.universalinsuranceholdings.com. A replay of this presentation will be available on the homepage of our website until March 9, 2017.

Before we begin, please note that this presentation may contain forward-looking statements about our business and financial results. Forward-looking statements reflect our current view of future events and are typically associated with words such as believe, expect and anticipate or similar expressions. We caution those listening, including investors, not to rely solely on forward-looking statements as they imply risks and uncertainties, some of which cannot be predicted or quantified, and future results can differ materially from our expectations. We encourage you to carefully consider the risks described in our filings with the Securities and Exchange Commission, which are available on the SEC's website or the SEC Filings section of our website. We do not undertake any obligation to update or correct any forward-looking statements.

With that, I would like to turn the presentation over to Sean Downs.

Sean P. Downes
Chairman and Chief Executive Officer

Thank you, Dean, and thank you, everyone, for joining us today. As you may be aware, Dean joined Universal earlier this month as our new Vice President of Investor Relations. His extensive insurance industry Investor Relations and financial analysis background make him an excellent addition to the Universal team as we work to expand our IR efforts and enhance relationships with the investment community. We're excited to have Dean on board, and I know he's looking forward to speaking with all of you in the weeks and months ahead.

We also recently announced the addition of Kimberly Cooper, our Chief Information Officer and Chief Administrative Officer, to the Board of Directors effective January 19, 2017. Since joining the company in 2007, Kim has been a tremendous asset to Universal and has worked closely with senior management developing and implementing many risk management practices and key IT systems and processes. I look forward to continuing to work with her, and I'm pleased to have her insight, dedication and expertise on our Board of Directors going forward.

With that, let's turn to our results for the quarter and year. As usual, I will begin by providing some highlights from the quarter, and we'll then review our strategy and growth initiatives. Jon will cover several important current topics, and Frank will conclude by discussing financial results.

We are pleased to report another profitable quarter, with strong top line growth despite the significant impact from Hurricane Matthew in early October, which caused substantial damage in Florida and the Southeast. For the fourth quarter, we reported a 10.2% increase in total revenue and an 8.9% increase in net earned premiums, with each of these 2 items higher than any other quarter in the our history. Our profitable underwriting result in the quarter, which included a sizable industry loss event, is a testament to our underwriting acumen and substantial reinsurance program, which Jon will discuss in further detail shortly.

We reported net income of $13.7 million and diluted EPS of $0.38, which equates to return on average common equity of 14.4%. For the full year, we generated $999.4 million (sic) [$99.4 million] of net income, diluted EPS of $2.79 and a very impressive 29.4% ROE despite the catastrophes we experienced this year, including the worst first quarter in Florida history and Hurricanes Hermine and Matthew, which occurred in the second half of the year. Our ability to deliver a profitable quarter and year in the face of significant weather-related losses highlights the resilience and strength of our business model.

We continue to focus on maintaining high underwriting standards to ensure a high-quality and rate-adequate book of business, maintaining appropriate levels of reinsurance coverage and building a best-in-class internal claims infrastructure, a catastrophe response team. Notably, as expected, our rigorously reviewed and frequently stress tested response plan performed extremely well during Hurricane Matthew, which allowed us to efficiently provide support and assistance to our affected policyholders while quickly assessing and processing claims. Our outstanding response to Hurricane Matthew reflects our commitment to providing high-quality service to our policyholders and independent agency force through our vertically integrated structure. The investments we have made in our claims handling operations, including our Fast Track team, are paying tribute both to our ability to quickly close claims and to ensure our customers' needs are being met effectively and efficiently.

We are proud to say that 2016 marked a year of strong strategic and operational execution across all aspects of our business. We have actively positioned Universal for the future by pursuing various organic growth avenues. These include further growth at our home state of Florida, expanding our footprint into new states, strategic initiatives such as Universal Direct and new business lines such as the Commercial Residential product. These initiatives have resulted in a more stable, diversified and nimble business that is well positioned to drive growth and long-term shareholder value. For example, our core Florida market continues to produce solid top line growth, with policies in force, premium and total insured value, each increasing by approximately 5% in 2016. Importantly, our growth both inside and outside of Florida is entirely organically driven.

Geographic expansion remains a core element of our growth strategy, and we made great strides in 2016. Our subsidiary, UPCIC, is now licensed and operating in 14 states, and we continue to see an increase in policy count and total insured value for states outside of Florida. For the full year '16, total insured value for states outside of Florida was 21% as compared to 16% in 2015 and 12% in 2014.

A key milestone for Universal in 2016 was the launch of our direct-to-consumer online platform for homeowners insurance, Universal Direct. Introduced in April of 2016, we steadily expanded Universal Direct's availability throughout the year, and it is now available in all of our active states. Since launch, we have written over 1,800 policies in force for more than $2 million in premium. We continue to receive positive feedback from customers who appreciate the flexibility and convenience of purchasing homeowners insurance online. We will seek to prudently expand this unique offering in the year ahead, including pursuing strategic partnership opportunities where appropriate such as our most recent partnership with Liberty Mutual, under which we are now offering Liberty Mutual's extensive auto products on Universal Direct.

We discussed our entry into the Commercial Residential business during last quarter's conference call, and we're happy to report that American Platinum Property and Casualty Insurance Company wrote our first Commercial Residential policy during the quarter, fourth quarter.

We believe this business allows us to tap into a large complementary market, leverage our vast agency force and expand the depth of our operations, providing an additional avenue for further organic growth.

Overall, we are pleased with the progress we have made in 2016, and we remain focused on executing on the 4 key pillars of our strategy to drive profitable growth.

First, we will continue to provide high-quality service through our vertically integrated structure. Second, we will continue to increase our policies in force in Florida by seeking profitable, rate-adequate and 100% organic growth. Third, we will continue to diversify our revenue base and risk by increasing our policies in force in states outside of Florida through our geographic expansion strategy, adding complementary product lines and implementing unique offerings such as Universal Direct. And fourth, we will continue to optimize our reinsurance program as our risk profile changes. We are confident that leveraging these pillars and our commitment to providing best-in-class offerings and service to our policyholders positions Universal for profitable growth in 2017 and beyond.

With that, I will turn the call over to Jon Springer.

Jon W. Springer
President, Chief Risk Officer and Director

Thank you, Sean. Let me start with a brief overview of UPCIC's Hurricane Matthew losses. As of year-end, we had just over 7,000 claims reported from Hurricane Matthew, and nearly 6,600 had already been successfully closed. That 94% closure rate is a real testament to our catastrophe response team and to our dedicated claims operation.

With now 225 full-time employees, our claims department continues to grow and advance in all areas. Hurricane Matthew created just another opportunity for this department to excel. From a dollar perspective, as of year-end, we had paid out $25.5 million in loss and loss adjustment expenses, had $1.8 million up in specific case reserves and set aside another $4.6 million for IBNR, making Hurricane Matthew just under an estimated $32 million gross event for UPCIC in the fourth quarter of 2016.

Importantly, as previously advised, our specific catastrophe reinsurance program covering all non-Florida states responded for those subject losses above the retention of $5 million. The reinsurers on this cover have been fantastic partners, and we were advanced the first $5 million of recovery from this program early on. We expect another $300,000 of loss recovery from this program as the payout of losses plays out in the coming days.

This $5.3 million reinsurance recovery reduces the loss for UPCIC to a pretax event of $26.6 million; after tax, approximately $16 million. This estimate is right in line with the $14 million to $18 million after-tax range we provided during our conference call last quarter. In addition to the reinsurance recovery, this program will also provide complete coverage for our $376,000 assessment from the North Carolina JUA.

From an ongoing reinsurance perspective, we're currently in the early stages of the process for the June 1, 2017, renewal of our catastrophe reinsurance coverage. The structure of the 2016 catastrophe program worked exactly as planned by providing UPCIC with some additional relief on an event impacting our exposures outside of Florida, so we will likely continue with a similar structure for the 2017 season. It is very early days in terms of pricing and coverage expectations, but all reports to date indicate that reinsurance supply continues to exceed demand, making way for the possibility of further reinsurance cost reduction.

Just to quickly touch on one other important item. Since our last conference call, we have successfully completed 2 separate actuarial reviews by Willis Towers Watson. The first was completed in mid-November, using loss data as of the end of the third quarter, and the second was completed earlier this month using loss data as of year-end.

In total, for all years 2016 and prior, we have booked a loss amount slightly higher, more conservative than their independent actuarial best estimate.

With that, I'll now turn the discussion over to Frank Wilcox for our financial highlights.

Frank C. Wilcox
Chief Financial Officer and Principal Accounting Officer

Thank you, Jon. We generated solid profitability during the fourth quarter of 2016, notwithstanding $26.6 million of pretax losses and LAE recorded for Hurricane Matthew.

Net income for the fourth quarter of 2016 totaled $13.7 million, a decrease of $15.5 million compared to 2015. Diluted EPS for the quarter was $0.38, down $0.82 for the same quarter in 2015 as a result of the decrease in net income. During this time, we continue to experience top line growth, with increases in every category of revenue for the fourth quarter of 2016 compared to 2015 while net earned premiums and total revenues were higher than any other quarter in the company's history.

Examining our results a bit closer. Direct premiums earned of $238.7 million, offset by ceded premiums earned of $74.7 million, generated $164 million of net earned premiums for the fourth quarter of 2016 compared to $150.6 million for the same period in 2015. The increase was the result of organic growth from both Florida and other state growth initiatives. Ceded premiums earned as a percentage of direct premiums earned was 31% and 32%, respectively, during the fourth quarter of 2016 and 2015.

Net investment income for the quarter of $3.5 million was $1.7 million or 96% greater than the fourth quarter of 2015. This reflects both an increase in our invested asset base as well as actions taken to maximize yields as securities mature while maintaining high credit quality.

Total invested assets reached $651.6 million as of December 31, 2016, compared to $489.4 million 1 year prior, an increase of 33%.

Commission revenue of $4.8 million for the quarter grew 16.8% compared to the same quarter in 2016, reflecting the differences in our reinsurance programs in effect during those periods, including an increase in our exposures covered by reinsurance. Policy fees of $3.8 million for the quarter grew 10.2% year-over-year from an increase in the number of policies written during the fourth quarter 2016 compared to the prior year quarter. Other revenues of $1.6 million, which is comprised primarily of financing fees and charges, grew 13.8% from the prior year's quarter, reflecting both consumer behaviors underlying the policies written and growth.

Net losses and LAE were $101.5 million for the fourth quarter of 2016 compared to $60.6 million during the prior year's quarter. A large portion of the overall increase of $40.9 million was driven by the $26.6 million in incremental losses and LAE related to Hurricane Matthew.

In addition, fourth quarter results included $16.8 million of current accident year's reserve strengthening and $4.7 million of favorable prior year reserve development.

General and administrative expenses were $54.4 million for the fourth quarter of 2016 compared to $53.6 million for the same quarter in 2015, an increase of $766,000. An increase in expenses from growth was mostly offset by a decrease in executive compensation, in part due to a decrease in performance bonuses linked to pretax income.

We generated a net combined ratio of 95.1% for the fourth quarter of 2016 compared to 75.8% for the same quarter in 2015. The net loss ratio was 61.9% in the fourth quarter of 2016 compared to 40.2% in the prior year's quarter, with the majority of the increase reflecting incremental losses in LAE related to Hurricane Matthew, which accounted for 16.2 points of losses in the current year's quarter.

In addition, the fourth quarter's loss ratio included approximately 10.2 points of current accident year reserve strengthening as well as 2.9 points of favorable prior year reserve development.

Our net expense ratio, which is G&A as a percentage of net earned premiums, for the fourth quarter of 2016 was 33.2% compared to 35.6% for the same period in 2015. The primary factor behind the decrease in the expense ratio was the reduction in executive compensation and economies of scale.

Our full year net combined ratio for 2016 was 82.6% compared to 73.7% for 2015 and included $46.1 million or 7.3 percentage points related to weather events beyond expected during the year.

The effective income tax rate was 39.9% in the fourth quarter of 2016 compared to 39.1% for the same period in 2015. Our full year effective tax rate for 2016 was 39%, which is slightly lower than 39.2% for '15 and in line with expectations. Our underlying effective tax rate has been trending down from historical rates primarily from reductions in the amount of nondeductible executive compensation, lower state income taxes as we diversify outside of Florida and increasing use of tax-exempt securities.

Our balance sheet remains strong, with stockholders' equity and book value per common share of $371.2 million and $10.59 per share, respectively, as of December 31, 2016. Consolidated unrestricted cash and cash equivalents were $105.7 million and combined surplus for our insurance subsidiaries was $331 million as of December 31, 2016, respectively.

Elaborating on full year results. We generated net income and diluted earnings per share of $99.4 million and $2.79, respectively. Weather activity beyond expectations in 2016 reduced net income by approximately $28.5 million after tax or $0.80 per share on a diluted basis. There were no significant impacts to earnings from storm activity during 2015. Return on equity was 29.4% in 2016 compared to 41.8% in 2015. We remain committed to providing value to our shareholders, and we believe this 29.4% return on equity is an excellent result in light of the increased frequency of weather events experienced during 2016.
At this point, I'd like to turn the call back to the operator.

Question and Answer

Operator

[Operator Instructions] Our first question comes from Arash Soleimani with KBW.

Arash Soleimani
Keefe, Bruyette, & Woods, Inc., Research Division

So just to start off, what are your plans for primary insurance rates in Florida in 2017? It sounds like last time you mentioned you were expecting to raise rates. Wanted to know if you could provide some magnitude around that.

Sean P. Downes
Chairman and Chief Executive Officer

We are currently in the process right now of creating -- gathering the data to create our rate indication. We don't have that information yet. Obviously, you've seen some of our competitors have filed for some rate increases. I think with the representative issue and the AOB issue being as prevalent as it is, I think it's safe to say that we'll probably be looking at some sort of rate increase. But it is a little too early yet right now to make that decision based upon us being in the early stages of creating that rate indication.

Arash Soleimani
Keefe, Bruyette, & Woods, Inc., Research Division

And can you talk about how your combined ratios in states outside Florida compared to the combined ratios in Florida, both on a gross and net basis?

Jon W. Springer
President, Chief Risk Officer and Director

Sure. Arash, this is Jon Springer. The combined ratios on -- from a growth standpoint would be very similar. Obviously, the makeup would be a little bit different, with the loss ratio being lower in Florida, higher in the other states. But of course, the corresponding reinsurance spend is higher for Florida, lower in the other states. Expense ratio, fairly consistent. So from a growth standpoint, you tend to get to a very similar number. When you look at it from a net combined ratio standpoint, the way the math works in terms of Florida having a lower loss ratio and higher reinsurance spend, Florida ends up being just ever so slightly better than the other states, but really within 4 or 5 points at the outset.

Arash Soleimani
Keefe, Bruyette, & Woods, Inc., Research Division

So on a non-cat basis, if we exclude the tornado losses we had in the first quarter of 2016 and the impact of Hurricane Hermine and Hurricane Matthew, how should we expect the 2017 gross loss ratio to compare to 2016? Do you expect it to increase given the environment in Florida?

Sean P. Downes
Chairman and Chief Executive Officer

Yes. Well, I'm sure as you saw, we bolstered our reserves in quarter 4, and that really had to do with basically our non-cat performance. We've seen a little bit more aggressiveness from some of the plaintiffs' law firms, contractors, et cetera, as it relates to this represented AOB issue. So I think, Arash, the easy answer to that question would be that we are probably going to increase that, and I think looking at somewhere between 29% and 30% is a safe bet for us. Obviously, there's a lot of unknowns. As you're aware, we me-too to Citizens language. We've only had 25 claims that have really been affected by that me-too language, and that's been a positive, I will tell you. But obviously, there's a lot of things that are going on with some bills. Senator Hukill's bill that he's proposing, I think, would obviously be something that would definitely impact this industry positively as it relates to AOB. So without knowing what's going to be on the horizon for us, I think, if everything remained constant, we probably expect to be in that 29% to 30% range going forward.

Arash Soleimani
Keefe, Bruyette, & Woods, Inc., Research Division

And moving on to the gross expense ratio. How should we think about that in '17? Will your expansion efforts cause that to go up in the short term? Or do you expect to get the benefits of scale right away in '17?

Frank C. Wilcox
Chief Financial Officer and Principal Accounting Officer

Well, Arash, our gross expense ratio for -- this is Frank, by the way. Our gross expense ratio for 2016 was 24%. Looking to 2017, I don't see a drastic change in that. I'd give you a range from 23% to 26%. We are enjoying economies of scale. We don't need to replicate the infrastructure in other states that we have in Florida as we expand. That being said, as you know, we are a brick-and-mortar business. We're vertically integrated, and we handle all aspects of our business. So we invest in ourselves from time to time. Those investments -- the benefits from those investments, however, don't necessarily manifest themselves in the expense ratio. They could be reflected elsewhere. When you look at our combined ratio and you see that we're 9%, 10% below the average of our peers for the past 7 or 8 quarters, you can clearly see the benefit that Sean talks about, which is paying out claims. And Jon actually shared a very nice statistic. 94% of Matthew was paid out, and the industry average was well below that. So we believe our model is unique. We believe that we are paid dividends when we invest in our infrastructure, and that investment is in the underwriting area, it's in the claims area, it's in the finance area. So we are enjoying economies of scale, but there's also investment going on.

Arash Soleimani
Keefe, Bruyette, & Woods, Inc., Research Division

And moving on to gross written premium growth, should we expect that to kind of remain steady in the upper single-digit range? And going forward, what states are you particularly excited about?

Jon W. Springer
President, Chief Risk Officer and Director

I think that the upper single-digits growth rate is a very good assumption going forward. That's where we've been for the last few years, and that's where we would expect to be going forward. In terms of which states we like, the short answer is we like all of them. We feel like we're priced correctly in each of the states that we're in. Obviously, in the short term, especially when we're growing new states, a loss here, a loss there can skew the numbers. But overall, we like all of our states. Of course, we like Florida. We feel like we're positioned extremely well in Florida, both from a rate structure as well as we talk about regularly the structure of our claims department and our ability to combat some of the challenging situations. Outside of Florida, some of our states are much more established than others. When you look at our expansion, we started expanding all the way back in 2008 and then, of course, played that all the way up to adding states just this past year. So some are much more established. We're more recognized in those markets. We feel we're doing particularly well in both North and South Carolina, even despite of Hurricane Matthew, as well as Massachusetts. So we plan to continue writing business and growing in all 14 of our states, but I touched on a few that we particularly like.

Arash Soleimani
Keefe, Bruyette, & Woods, Inc., Research Division

And since you mentioned in the prepared remarks, can you just expand a little bit about Commercial Residential and your plans there?

Sean P. Downes
Chairman and Chief Executive Officer

Yes. Obviously, the key thing there, Arash, is that we're leveraging our agency force. We're doing this on a very slow, methodical, diligent pace. We've written, I think, 2 or 3 policies to date, average premium around $35,000. But it's something that we're getting our feet wet, making sure we're doing it the right way. And I think, over time, we'll see some good growth from it. But I wouldn't expect anything too big in the next 2 quarters just because of the way we're going about it, making sure we're doing it right.

Arash Soleimani
Keefe, Bruyette, & Woods, Inc., Research Division

That makes sense. And you kind of talked about this earlier with the reserves, but I guess, how did you experience -- how has your experience with AOB changed in 4Q '16 and, I guess, even year-to-date 2017 versus the prior year and prior quarters? Would you say it's looking stable? Do you think it's getting worse? Are you potentially seeing some signs of light?

Sean P. Downes
Chairman and Chief Executive Officer

Yes. We saw a little bit of an uptick in frequency, nothing major, but the severity is down. I'll just give you a couple of numbers. In 2014, on average, HO3 with AOB connected to it, we had a severity of about 21,000. In '15, it was around 19,400. '16, right now, as of this date, it's not fully cooked. It's right around 17,590. So I think we're kind of -- I think once that's fully cooked, I'm sure you're going to be right around that 19,000. So from a severity perspective, I believe that it's relatively flat. From a pure represented issue, we are seeing much more aggressive law firms out there right now in taking shots at claims. So we've had -- we've been working on that specifically and trying to battle that situation. I think that's something that obviously is affecting the industry as a whole, and we're not immune to that. But I think our ability to get out to these claims quicker with our Fast Track team in the day of the claim and the next day is mitigating the potential for plaintiffs' law firms, public adjusters, contractors, et cetera, to intervene, to create that separation from us to our insured. So I think that's -- it's an issue that I think we're battling as good as we can. And I think, obviously, we just have to see what happens here with the me-too that we did to Citizens as we get more frequency in and then also see what happens from a legislative perspective. And obviously, as you're fully aware, this company hasn't participated in take-out in 18 years. So I think there's different starting points when you talk about some companies to others. Not all companies have participated in take-outs. But I think if you take the companies that have participated in take-outs, their starting point, the type of risk or the type of insurer in that risk, et cetera, may be not as favorable as a policy that we were able to organically grow ourselves in our pipeline. And then also, obviously, rate structure has something to do with it. And then, most importantly, I think, is the way in which your legal department, claims division is set up and what your methodology is in handling those claims. We have over 60 folks in our legal liability and subrogation division. We're extensively pushing all 3 of those, and I believe that those are helping us make this problem less severe. It is a problem. It's a problem for everybody. Everybody wants to have some sort of legislative changes positively affect what's going on. It's no different than the sinkhole issue or the Mierswa [ph] issue in a previous life. But we're doing everything we can that we believe is in the best interest of the company and our policyholders to try to mitigate fraud as best we can.

Arash Soleimani
Keefe, Bruyette, & Woods, Inc., Research Division

And I know part of this you answered in terms of the me-too language from Citizens. But how are you combating the claims that are reported after repairs have already been made? What can you do to protect your loss ratio from that phenomenon?

Sean P. Downes
Chairman and Chief Executive Officer

Yes. Well, 2 things. One, I think -- I don't think we're seeing as much of that as a lot of the others just because we're getting to the loss quicker. A lot of those claims fester over 4, 5, 6, 7 days. People talk to relatives, talk to neighbors. They then put them on to an attorney, on to a public adjuster, on to a contractor. And then that starts -- the actual loss begin the process of adversely going the wrong way.

When we do have a situation where we get to a loss early and there are contractors on who are already performing and fixing whatever issues occurred, we just have to use our experience. We have a claims department here with folks that are -- have been in this business well over 25, 30 years. So I think our expertise in that helps us. But there's still fraud being committed even in that situation. And it's just -- it's our duty to try to handle it as best we can, and that's what we've been trying to do.

Arash Soleimani
Keefe, Bruyette, & Woods, Inc., Research Division

And just moving back on to the reserves. You addressed this also in the -- in your remarks. But obviously, the balance there has been declining year-over-year. Just given the environment, what gives you -- I guess, what gives you comfort with the current reserve balance worth then?

Jon W. Springer
President, Chief Risk Officer and Director

Well, I mean, a lot of things give us comfort. I mean, just to start, as I mentioned in my opening remarks, having completed 2 separate independent analyses by one of the most respected actuarial firms in the world gives us comfort that we've got some pretty smart people looking at this thing many different ways to make sure that we're ending up where we should be. I think in terms of your comment just about reserves declining, really to do a proper analysis on that, you have to take into account the number of remaining open claims and how many claims have been closed. And Sean has talked several times about the implementation of our Fast Track team, how quickly we're getting to claims, how quickly we're closing claims. Obviously, those claims that are adjusted and closed no longer need any amount in the reserve category. So to do a proper analysis, you have to take into account that. You also would have to be able to fully appreciate the partial payments on the remaining open claims because it's very common that we do get money into policyholders' hands quickly. Maybe the full claim is not adjusted and settled, but a large portion of it has already been paid. And then, of course, you would turn your attention to the reserve column and the potential need for IBNR, and that IBNR number obviously would be offset by anticipated subrogation that we expect to receive in the future. So in order to really look at it, I guess what I'm saying is you have to do a very deep dive into the data, and we've just done 2 of those, one with data as of the end of the third quarter and another with data as of year-end.

Sean P. Downes
Chairman and Chief Executive Officer

And to add on that, Arash, as well, we're trying to make our case be the be-all and end-all, if you will, of the actual claim. So if the case reserve could encompass the full benefit of what the actual incurred loss will be, that's kind of what we're shooting at and then, obviously, your traditional IBNR, the unreported piece. And then we -- like I said, our legal department, we have been focused 100% in the last 1.5 years to 2 years on our subrogation team, and we have seen amazing gains with our subrogation team and what we've been able to achieve in that department. And that's just, again, -- it's another layer that participates in IBNR force. So we feel pretty confident about where we're at as it relates to that.

Arash Soleimani
Keefe, Bruyette, & Woods, Inc., Research Division

And I just had one last question I wanted to add on just given current events. If corporate tax rates are lower, I know the current administration has been talking about that, do you expect that to drop to the bottom line? Or do you expect that, that would be passed through to consumers? And if it's the latter, how quickly do you think those, I guess, rate decreases would be passed through? Or would it result in purchasing, for example, more reinsurance? Just wanted to know how you're thinking about that.

Jon W. Springer
President, Chief Risk Officer and Director

Well, I think you're thinking about it correctly. There's a lot of unknowns there. The biggest one would be timing. What is the timing of this potential corporate tax rate change? What is the timing of our next pending rate filing to potentially be impacted? Obviously, you're aware that when we do make rate changes, then they roll on to our book of business over the course of 12 months. A lot of timing issues there to be able to just say the money goes to the bottom line or the money ultimately returns to policyholders.

Operator

And our next question comes from Ron Bobman with Capital Returns Management.

Ronald David Bobman
Capital Returns Management, LLC

And, Dean, welcome aboard. So I had a question. Sean or Jon, could you talk a little bit about the auto strategic relationship that you mentioned in the prepared remarks, the Universal Direct one?

Sean P. Downes
Chairman and Chief Executive Officer

Yes. We're in early days with that right now, but I'll tell you how it's working right now. I don't have any concrete numbers to give you as far as success rate with that because we have received that report yet. But if you bind a policy online at Universal Direct, you are then offered to go to a co-joint JV website that is -- that was created between ourselves and Liberty Mutual, and you are offered an auto policy. So we're working on it. Like I said, it's early days. But we feel that going forward, we can gain some traction with that and make that a solid reciprocal relationship.

Ronald David Bobman
Capital Returns Management, LLC

And when you mentioned in '17 or going forward, you're going to entertain and pursue other strategic relationships, how wide conceptually might that be? Or should we think of it really as extensions of the Liberty Mutual type of relationship, in effect other lines of business, other states but it's going to be sort of supplemental insurance sales? Or could it be a lot wider than that?

Sean P. Downes
Chairman and Chief Executive Officer

That's a great question. I think you think about it right now in simplistic terms, such as what we're doing with Liberty Mutual. But there are some wide-ranging thoughts and some discussions that we have had with some folks that are very interesting that we're going to continue to try to figure out how that may best fit. There's a lot of different things. I mean, you can talk about the banks, mortgage markets, et cetera. So there's a lot of different things we're looking at, Ron. But again, it's -- I think the main situation is just try to figure out how best to offer some products to people who are looking to buy insurance and then figure out what type of products people are purchasing that need homeowners insurance and try to create some sort of joint venture that makes sense for both parties.

Ronald David Bobman
Capital Returns Management, LLC

Okay. And did you provide any metrics on Universal Direct as far as recent new PIF or premium and sort of the relative rate of increase? And if not, would you?

Sean P. Downes
Chairman and Chief Executive Officer

Yes. We are in excess of 1,800 policies currently for premium in excess of $2 million. We are closing about 10% of the quoted business online right now, which is a fantastic rate. So we're pleasantly surprised with this. We really have only been in all of our states for a few months. So we are cautiously very optimistic about the potential for Universal Direct going forward and continuing that to be a positive organic pipeline for the company.

Ronald David Bobman
Capital Returns Management, LLC

Okay. I had an unrelated question. A challenge that sort of all of the Florida -- sort of the legacy Florida monolines face as they enter -- broaden their geographic footprint is sort of getting nipped and cut from hailstorms in other states, severe thunderstorms, minor snowstorms, et cetera, sort of a death by a thousand cuts. And I guess, in some respects, it's sort of a reinsurance question, but maybe it's broader than that. How do you think about trying to sort of minimize the damage, minimize the losses, minimize the averse hit to EPS on whether it's a quarterly or an annual basis from sort of smallish events in other states, new states, from the Carolinas to even newer states, as you build the business geographically and buy your reinsurance? That's it for me.

Jon W. Springer
President, Chief Risk Officer and Director

All right, Ron. We've thought about this a lot, and we've evaluated several different options. I think it really starts with getting your primary rate correct from the beginning. So you need to understand and appreciate that, as you put it, those thousand cuts are going to happen over time in these other states that we're in. So we have attempted to bake into our rate the ability to withstand those smaller cat-type events. From a reinsurance perspective, we have evaluated several different types of aggregate products. The challenge with those aggregate products, Ron, is that they can be expensive. So while it may sound good and feel good to purchase an aggregate and say, "Listen, we've capped it off here at this level," you really need to appreciate how much have you paid to do that. And we evaluated those things very deeply last year, and as you well know, it's been talked about quite a bit. We decided to purchase in other states underlying occurrence tower down to $5 million. So granted that doesn't necessarily help us for a $1 million event in Delaware, I get that, but it did give us comfort certainly as Hurricane Matthew was approaching and ultimately causing the damage that it did in Georgia, South Carolina, North Carolina that we, indeed, did get some reinsurance recovery to take the sting out of the loss in the other states' portfolio.

Ronald David Bobman
Capital Returns Management, LLC

That helps. And just so I understand, if any -- in the same quarter, if we have that nasty event in Delaware and then there was one -- another nasty event -- a different nasty event in another one of your states, is your retained under that scenario capped at $10 million, $5 million in each of the 2 states, assuming you don't go through the top of the tower?

Jon W. Springer
President, Chief Risk Officer and Director

No, under our current reinsurance program, it is an occurrence retention. So we have coverage above $5 million for any event that causes loss outside of Florida. So if we had a $1 million event in Delaware, we would retain the full $1 million net. But again, we...

Ronald David Bobman
Capital Returns Management, LLC

But if you had $6 million gross in Delaware and $6 million gross in South Carolina in the same quarter, you would retain $10 million total from those 2 unrelated events?

Jon W. Springer
President, Chief Risk Officer and Director

The only way we would get a reinsurance recovery is if a given occurrence, an event -- a single event exceeded $5 million. So it is not an aggregate program, it's an occurrence program.

Operator

And our next question comes from the Vimal Gupta [ph] as a private investor.

Unknown Attendee

I have 2 questions. One is the new states, I think you have devoted last year in implementing direct insurance, but you were granted certificate of authority in New York and New Jersey over a year ago. Do you have any plans to start writing insurance in these states?

Jon W. Springer
President, Chief Risk Officer and Director

We are current -- yes, we have plans to start in those states, and we are currently in the process of gaining approval from each of those states to our rate and form filings. As you may remember us talking about in the past, Vimal [ph], in order for us to properly create a rate structure, we need to do our homework, and that takes time. We've been in those states. We've been talking to agents. We've been evaluating a potential competition in those states to create our own rates, then we needed to file those with the Departments of Insurance in those states. And we're currently in the process of waiting for that approval before we can commence writing business.

Unknown Attendee

Okay. Regarding joint ventures, something like Liberty Mutual, can you speak a little bit more what you could expect in 2017 in terms of revenue or benefit, something as much as you can?

Sean P. Downes
Chairman and Chief Executive Officer

Yes. As I said a little bit earlier, Vimal [ph], the -- there's a lot of different avenues that we're looking at. There isn't anything right now that I can speak to definitively, because we haven't officially agreed to any terms yet. But there is a lot of things, like I said earlier, that are simplistic as it relates to offering auto, a lot of the different single, simplistic insurance products that we could put on Universal Direct. And then there are some things that we're looking at that are wide range that would be a pure JV perspective, that would be reciprocal from us and whatever the other entity may be. But we are working on it and into it pretty deep, and I think we'll have something for you by next call.

Operator

And our next question comes from Samir Khare with Capital Returns Management.

Samir Khare
Capital Returns Management, LLC

I have a few questions on different line items. On the expense -- and I apologize if this was covered. I had technical difficulties and had to redial in. But on the expense ratio, you guys said in the press release that it is lower because of incentive comp. Was there a reversal of accrued executive comp in Q4? And if so, how much?

Jon W. Springer
President, Chief Risk Officer and Director

No, there wasn't any reversal. As I've mentioned in the previous quarters, we have lowered our stock-based compensation. And the reason it's been lowered is that it's a fixed dollar amount versus a fixed share amount. When it was a fixed share amount, you had awards that would take place in the future, and as the stock price goes up, so, too, does comp expense. So now they're fixed dollar amounts, and we're experiencing less stock-based compensation as a result of that. What also happened during this quarter in particular is the reduction in pretax income from the storms reduced the basis from which we calculate management incentive bonuses. So those 2 factors drove down the expense ratio, I think, by about 2%.

Samir Khare
Capital Returns Management, LLC

Okay. And on the direct initiative, what are the aspirations for 2017? Do you guys have a target that you guys have in mind internally?

Sean P. Downes

Chairman and Chief Executive Officer

We do have a target. I'm not quite sure I could share that with you right now, Samir, but I would tell you that we are seeing, as I said earlier, a very positive closing rate from our quote to bind. And I think as we get a little bit more in depth with some marketing, some things that we have been lined up to start doing, we're going to see this thing gain a lot more traction than it has. I mean, we're very pleased right now that we've done $2 million in premium. A lot of people said that this couldn't be done, it was much too much of an extensive process for people to do online. But I think we're seeing a segment of millennials and then people that just -- their time is valuable to them and they want to go ahead and do this type of process online. So the best part about it is that we have built all these platforms, own all these systems ourselves, and it gives us the ability to change and manipulate it on a daily basis as we see fit to positively affect the platform. So the quick answer to your question would be, I think you're going to continue to see the growth that we have had since we've been on all these states in the last, say, 3 months, and I think that the growth will be exponentially ongoing in a positive manner.

Samir Khare
Capital Returns Management, LLC

Okay. And then the joint venture you have with Liberty Mutual, is that -- is there any exclusivity to it, whether it be geography or time?

Sean P. Downes
Chairman and Chief Executive Officer

No.

Samir Khare
Capital Returns Management, LLC

Okay. And then on Hermine and Matthew, did you guys see an elevated instance of AOB?

Sean P. Downes
Chairman and Chief Executive Officer

We have seen really no AOB as it relates to that. It's really unquantifiable. The number is so small. Really, I think we've had 47 instances on 7,000 claims, so nothing really to talk about that's of any worry to us.

Samir Khare
Capital Returns Management, LLC

Okay. And on the reserve review, you discussed booking above best estimate. How far above the best estimate are you booked?

Sean P. Downes
Chairman and Chief Executive Officer

We booked $2 million above the actuarial best.

Samir Khare
Capital Returns Management, LLC

Okay. And was there was any change to prior quarter cat in Q4?

Sean P. Downes
Chairman and Chief Executive Officer

No, not at all.

Samir Khare
Capital Returns Management, LLC

Okay. And do you guys have metrics as to what the IBNR is as a percentage of total reserves at year end 2016 versus 2015?

Jon W. Springer
President, Chief Risk Officer and Director

I don't have that handy, Samir. I'd be happy to have a conversation offline with the schedule being in front of me.

Samir Khare
Capital Returns Management, LLC

Okay. And you talked about subrogation efforts. Do you have a metric that you can give us to show the progress of these efforts, say, in 2016?

Sean P. Downes
Chairman and Chief Executive Officer

Yes. Obviously, like I said, we've been building this department since mid-'15, and we're seeing approximately around a 10% return rate to us right now on our overall incurred losses that are affected. Look, we run an insurance company that most of the claims are water related. So baked into that, obviously, there is a lot of circumstances where we are able to recover from a subrogation perspective. Since we started this in '15, the beauty of it is, due to the statute limitations, you can go back extra amount of years and work on the claims that you had in those previous years. So that's what we've been doing, working on that and trying to figure out how best to utilize our expertise in getting some of that money back from a subrogation purpose. Theoretically, we have our own internal law firm here. And inside, we use those folks as well as our other subrogation folks to participate. And when we see claims that from a Fast Track perspective all the way up to large loss, that we believe that there is some subrogation connotation attached to it, we then put it to its appropriate bucket and then those folks start working on it. So that's a huge part of our business.

Samir Khare
Capital Returns Management, LLC

Okay. And, Frank, can you talk about any changes to the investment portfolio given the current environment?

Frank C. Wilcox
Chief Financial Officer and Principal Accounting Officer

Yes. Well, I mean, when you look at the net returns year-over-year, we had about a 96% increase in net investment income, and that's a result of several things, a lot of actions that we've taken. About -- we had about a 33% increase in invested asset, so that certainly accounts for some of it. We've also -- as securities mature or we put new money into the portfolio, we've been funding munis, to take advantage of the tax benefits on that. We have been relocating our allocation from U.S. governments over to those munis. We've also extended the duration out. Our average duration is now in excess of 3 years, where it was somewhere between 2 and 3 last year. All of that has increased the yield, and we've done that without necessarily sacrificing our credit quality. We still have a very high credit quality of AA-. In addition to that, our returns have improved as a result of negotiations that we've gone through with our investment advisers to negotiating the fees down, and that certainly increases return on investments. Now the rate environment, obviously, rates went up a little bit and they may continue to go up a little bit, and we'll have the same impact as everyone else.

Samir Khare
Capital Returns Management, LLC

Okay. And just stepping back, any thoughts on the recent suspension of guidance from Demotech and what that might mean to your operation, your competitive position and your appetite for acquiring companies or books of business?

Sean P. Downes
Chairman and Chief Executive Officer

Yes. There's going to be no negative impact to any of our entities at all. And I would tell you that the only positive would be is maybe there's some additional organic business maybe that we could attain because of it. But I would be cautious about that because most of those smaller carriers were mostly take-out companies. So again, I don't think it's anything that would be a negative for us at all and may be a slight positive.

Samir Khare
Capital Returns Management, LLC

Okay. And then does it affect your appetite of acquiring companies or books of business?

Sean P. Downes
Chairman and Chief Executive Officer

Look, we're always open to the possibility of listening and looking in the M&A arena. We just haven't seen anything right now that kind of fits our portfolio or what we want to do going forward. We're very pleased with the way we're putting business on organically with our traditional agency force as well as Universal Direct. So we're always looking and listening, Samir, but there isn't anything right now that I would tell you that's increasing our appetite.

Operator

I would now like to turn the call back to Mr. Sean Downs, Chairman and CEO, for closing remarks.

Sean P. Downes
Chairman and Chief Executive Officer

As always, in closing, I would personally like to thank all of our shareholders, employees, Board of Directors, policyholders and my management team for their hard work and loyalty to Universal. This concludes today's call. Thank you.

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