Arch Capital Group Ltd.

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Earnings Call

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Call Participants

EXECUTIVES

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Marc Grandisson
CEO & Director

ANALYSTS

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JPMorgan Chase & Co, Research Division

Jian Huang
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Presentation

Operator

Good day, ladies and gentlemen, and welcome to the Q1 2024 Arch Capital Earnings Conference Call. [Operator Instructions]

As a reminder, this conference call is being recorded. Before the company gets started with its update, management wants to first remind everyone that certain statements in today's press release and discussed on this call may constitute forward-looking statements under the federal securities laws. These statements are based upon management's current assessments and assumptions and are subject to a number of risks and uncertainties.

Consequently, actual results may differ materially from those expressed or implied. For more information on the risks and other factors that may affect future performance, investors should review periodic reports that are filed by the company with the SEC from time to time.

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

Management will also make reference to certain non-GAAP measures of financial performance. The reconciliations to GAAP for each non-GAAP financial measure can be found in the company's current report on Form 8-K, furnished to the SEC yesterday, which contains the company's earnings press release and is available on the company's website at www.archgroup.com and on the SEC's website at www.sec.gov.

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

Thank you. Good morning, and welcome to Arch's First Quarter Earnings Call. We are pleased to report a terrific start to the year. In the first quarter, we posted $736 million in underwriting income and a 5.2% increase in book value per share as we realized the benefits from several years of strong and profitable premium growth.

Underwriters in our P&C units continued to lean into hard market conditions, writing $5.6 billion of gross premium in the quarter, a 26% increase from the same quarter last year. Overall, rate changes are exceeding loss trends, and absolute returns remain above our long-term targets, positive indicators in our continued efforts to deliver superior results to our shareholders.

Broadly, we are seeing incremental signs of increased underwriting appetite in the market, but this is not surprising, given the favorable conditions that exist. It is still an underwriter's market where Arch can thrive.

At the beginning of this hard market, as other providers pull back, Arch sought to establish itself as a key trading partner, aiming to solidify relationships and remain top of mind when it comes to addressing our clients' increased needs. Our success in establishing deeper client connections continues to pay dividends in this extended, yet increasingly competitive hard market.

The first quarter served as a reminder of our risky world when an active catastrophe quarter concluded with a major industry loss, as the Dali cargo ship collided with the Francis Scott Key Bridge in Baltimore. Although we recognized a loss related to this event, the virtue of having multiple lines of business with improved and positive expected margins, made this event manageable for Arch.

Incidents like this reinforce the importance of our core tenants. One, we practice disciplined underwriting that builds a meaningful margin of safety into our pricing. Two, we take a long-term view of risk and a conservative approach to reserving. And three, we operate a diversified global business that we believe maximizes our total return by mitigating volatility in any one line of business.

Capital management has been a key differentiator for Arch and is integral to how we operate our company. Effective capital management requires that we allocate resources to the most profitable underwriting opportunities, while retaining the flexibility to invest in our platform when we find attractive opportunities.

One of those prospects came to fruition earlier this month, when we announced our intent to acquire Allianz's U.S. middle market and entertainment businesses. We see this as a unique opportunity to quickly build scale in the $100 billion-plus U.S. middle market, a long-term strategic area of underwriting interest for us. Increasing our middle market presence will further diversify our North American insurance platform by adding stable businesses with recurring premiums that can generate attractive returns over the cycle.

As a cycle manager, we like having [indiscernible], and this acquisition will significantly expand our opportunities in the middle market [indiscernible] for years to come. I'll now share a few highlights from our segments. As you know, The Property and Casualty market cycle is evolving, but still offers attractive growth opportunities at good returns, particularly for our skilled specialty underwriters, who can use their expertise and experience to differentiate Arch.

The first quarter results from our Reinsurance segment were outstanding. Underwriting income for the segment was $379 million, while gross premium written grew by 41% over the same quarter last year. While there is some developing competition, we're observing an increased flight to quality and fully expect to capitalize on that trend as the cycle ages.

Our Reinsurance segment is in an enviable position. [indiscernible] constructed over the last several years is strong and allows us to exercise our underwriting acumen. When opportunities emerge, whether from dislocation in the casualty market or by offering value that others cannot, Arch is there to provide solutions and financial strength to its clients.

In our Insurance segment, growth tapered from the highs of the past few years as rate increases slowed and some of the dislocations were met by additional capacity. Overall, conditions remained strong and the market is behaving rationally, two important factors that continue to support growth and strong profit.

In the first quarter, we fund growth opportunities in several lines, including Property and Casualty E&S and other specialty lines. Across most of our specialty lines, pricing remains very healthy, and we are able to deploy capital in order to deliver attractive returns above our long-term target of 15%.

Like Reinsurance, our Insurance segment has made strong efforts to establish itself as a first-choice provider for its clients, and that manifests in seeing more opportunities. In life, you have to play to win, and in insurance, if you don't see the business, you can't write it.

And now let's pivot from P&C to Mortgage, which to borrow from a famous ad campaign just keeps on going and going and going. Our Mortgage segment continues to generate solid underwriting income and risk-adjusted returns from its high-quality portfolio. While Mortgage originations remain tempered by high mortgage interest rates, the persistency of our [indiscernible] remains a healthy 83.6%, while the delinquency rate is near all-time lows.

New insurance written is in line with our appetite given market conditions. When the mortgage market picks up again, we're prepared to increase our production. However, if the status quo persists, we're content with our current situation that has extended the duration over which we earn mortgage insurance premium.

Competition within the MI industry remains disciplined, which means we are in a good place. Finally, our Investments portfolio grew to $35.9 billion, generating $327 million of net investment income in the quarter. The extraordinary premium growth from our P&C segments continues to increase our float, which provides a significant tailwind to our overall earnings through the next several quarters.

In the U.S., the NFL conducted its annual draft this past weekend. Traditionally, the team that finished last season with the worst record gets the first pick, a chance to select the best college player, while the champions pick last. The player selected with the top picks are expected to be immediate difference makers, even though they are typically selected by a team with multiple deficiencies, making success far from guaranteed.

If you're a talented quarterback has nobody to throw the ball to, it can ruin the player's confidence, and the pressure can quickly sabotage a career. Compare this with teams drafting at the end of the round coming off successful seasons with talented rosters in place. They often have the luxury of selecting an excellent player who doesn't need to contribute right away. Instead, these teams select players who can fill a specific short-term role and be given time to grow into a difference maker.

Our acquisition of the Allianz MidCorp business is like adding a solid player to a winning team. We already have established all-stars, a winning talent-dense culture in a favorable schedule in the years ahead. Adding the MidCorp team to our diversified franchise makes us better today and tomorrow, and that's a winning proposition.

I'll now turn it over to Francois to provide some more color on our financial results from the quarter, and then we'll return to take your questions. Francois?

Francois Morin
Executive VP, CFO & Treasurer

Thank you, Marc, and good morning to all. As you will have seen, we started out 2024 on a very strong note, with after-tax operating income of $2.45 per share for the quarter for an annualized operating return on average common equity of 20.7%.

Book value per share was $49.36 as of March 31, up 5.2% for the quarter. Our excellent performance was again the result of outstanding results across our 3 business segments, highlighted by $736 million in underwriting income. We delivered exceptional net premium written growth across our Reinsurance segment, a 31% increase over the first quarter of 2023, driven by strong business flow in all our lines of business.

Growth was also solid for our Insurance segment, 12% after adjusting for the impact of a large nonrecurring transaction we underwrote in the first quarter last year in our warranty and lenders business unit.

Overall, the combined ratio from the group came in at an excellent 78.8%. Our underwriting income reflected $126 million of favorable prior year development on a pretax basis or 3.7 points on the combined ratio across our 3 segments. We observed favorable development across many units, but primarily in short-tail lines in our Property and Casualty segments and in Mortgage due to strong [indiscernible] activity.

The collapse of the Francis Scott Key Bridge in Baltimore last month, has the potential to become the largest insured marine event in history. Both our Insurance and Reinsurance segments were exposed to this disaster, and our current estimates represent an impact of 2.1 and 3.0 points, respectively, on the combined ratio in these segments results this quarter.

We note that the losses for this event were reported as non-catastrophe losses in our ratios. Catastrophe loss activity was relatively subdued and below our expectations across our portfolio, with a series of smaller events generating current accident year catastrophe losses of $58 million for the group in the quarter.

Overall, our underlying ex cat combined ratio remained excellent with the increase this quarter relative to the last few quarters, mostly due to the Baltimore Bridge collapse. Despite the impact of this event, our current quarter ex cat combined ratio still improved by 1.4 points from a year ago, as a result of earned rate changes above our loss trend in our P&C businesses and lower expense ratios mostly from the growth in our premium base.

These benefits were slightly offset by investments we continue to make in people, data and analytics and technology to improve the quality and resilience of our platform going forward. From a modeling perspective, I'd also like to remind everyone that our operating expense ratios are typically at their highest in the first quarter of the year due to seasonality and compensation expenses, including equity-based grants for retirement eligible employees that were made in March.

As of April 1, our peak zone natural cat PML for a single event, 1-in-250-year return level on a net basis remained basically flat from January 1, but declined relative to our capital to 9.0% of tangible shareholders' equity, well below our internal limits.

On the Investment front, we earned a combined $426 million pretax from net Investment income and income from funds accounted using the equity method or $1.12 per share. Total return for the portfolio came in at 0.8% for the quarter, reflecting the unrealized losses on the company's fixed income securities, driven by higher interest rates.

Our growing Investment portfolio keeps providing meaningful tailwinds to our bottom line and remains of high quality and short duration. We have grown our investable asset base significantly over the last few years, primarily to significant cash flow from operations.

This positive result, combined with new money rates near 5%, should support further growth in our Investment income for the foreseeable future. Income from operating affiliates was strong at $55 million. Of note, approximately $14 million of this quarter's income is attributable to the true-up of the deferred tax asset at our operating affiliate Somers in connection with the Bermuda corporate income tax, a nonrecurring item.

Our effective tax rate on pretax operating income was an expense of 8.5% for the 2024 1st quarter, slightly below our current expected range of 9% to 11% for the full year, mostly as a result of the timing of tax benefits related to equity-based compensation.

As regard to our announcement to acquire the U.S. MidCorp and Entertainment insurance businesses from Allianz, we are making progress in obtaining the necessary regulatory approvals and are targeting a third quarter close for the transaction. At a high level, the agreement is structured around 2 related contracts. A loss portfolio transfer of loss reserves for years 2016 to 2023 and a new business agreement for business written in 2024 and after.

Overall, we expect to deploy approximately $1.4 billion in internal capital resources to support both contracts, in addition to the cash consideration of $450 million. The overall transaction is expected to be moderately accretive to earnings per share and return on equity, starting in 2025. It is important to note that even when reflecting the capital to be deployed for this transaction, our capital base remains strong with a leverage ratio in the mid-teen range. We maintain ample financial resources and remain committed in allocating our capital in the most optimal way for the long-term benefit of our shareholders.
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 from Wells Fargo.

Elyse Beth Greenspan
Wells Fargo Securities, LLC, Research Division

My first question is on the reinsurance market. Marc, I think in your opening comments, you mentioned something about potential dislocation in the casualty market. Are you starting to see casualty market, just opportunities emerge there? I know you've highlighted this, I think, starting in the third quarter of last year. Or is this something that you still think might take a couple of quarters to kind of fully present an opportunity to Arch?

Marc Grandisson
CEO & Director

Yes. The casualty market is going through, I wouldn't say repricing, but not reunderwriting as thorough because it has been already getting -- was hard, getting harder for the last several years. We may have some respite in terms of price increase middle of last year. But I think that the development of the prior year, as we all know, has created a little bit more uncertainties, and inflation is not ebbing.

So right now, what we're seeing is people still being very, very careful and disciplined in how they underwrite the business, which leads Arch and gives us opportunity to lean into this even more so. We have grown our casualty book of business on the insurance side quite a bit. Our casualty book is E&S, as we all know, and very specialized in specialty. But sorry, I thought there was some technical difficulties here. Elyse, are you still there? I just want to make sure you can hear me.

Elyse Beth Greenspan
Wells Fargo Securities, LLC, Research Division

Yes, we can hear you.

Marc Grandisson
CEO & Director

Okay. Thank you, you. Thank you, you're a trooper. So the casualty market on the insurance side, we're growing, but I think now we're having more opportunities to grow. I think that there's some kind of -- not repricing, but definitely a focus on that line of business on the Insurance side.

On the Reinsurance side, I think we're starting to see some of the renewals that came through [indiscernible] anecdotally it's creating a little bit more friction in terms of renewal of the casualty quota share, for instance. So what we expect right now is the early stages. We don't know how long it's going to last and where it's going to go, but there's clearly a psychological belief within the human system and the human interaction in the casualty that people need and know that we need to get more rate to make up for all the risks and potentially some of the misses that we had in the past.

Elyse Beth Greenspan
Wells Fargo Securities, LLC, Research Division

And then you guys mentioned the middle market opportunity you saw with this Allianz deal. After this transaction, are there other things on the list like when you think about Insurance, Reinsurance, now middle market and Mortgage. Are there other things that you guys think that maybe down the road, you would need or want to potentially add to the platform?

Marc Grandisson
CEO & Director

Yes. We have a long list of things we'd like to acquire or have part of our arsenal. We talk about Allianz as an acquisition, and that's an important one and a significant one and a very good one for us. We're very pleased with that one. But what we also would want to tell our shareholders is, as you know, Elyse, we've also added teams along the way.

So acquisition, a pure acquisition of a company is not the only thing that we're able to do. We've acquired some teams to do [indiscernible] and everything in between. So we're always on the lookout. Again, as a cycle manager, Elyse, what you want is as many areas to deploy your capital, depending on the market conditions, creates a much more stable enterprise, much less volatility to the bottom line.

And again, the more -- the market cycles are not monolithic, they are in multi phases and multi places. So we also have a little bit of an inside baseball. We -- our executive team is always -- almost every other month -- we have a list, a wish list that I will not share with you on this call, but it's a wish list of things that we know for a fact would be accretive and additive to our diversification of our portfolio, and we're always on the lookout for those. Mid market was on the list. And this is what -- so opportunities [indiscernible] the willingness to do it, and this is where we are.

Operator

Our next question comes from the line of Jimmy Bhullar from JPMorgan Securities, LLC.

Jamminder Singh Bhullar
JPMorgan Chase & Co, Research Division

Just a question on the Baltimore bridge loss that you reported in Insurance and Reinsurance. And I recognize your results were pretty strong overall. But the number seems fairly high that you reported relative to what some of your peers have talked about and also what the industry losses seem to be? So I'm just wondering, I'm assuming most of this is IBNR, but just wondering sort of -- is this because of how much conservatism there was baked into the number? Or maybe the market is underestimating what the losses from the event are eventually going to end up being?

Marc Grandisson
CEO & Director

Well, Jimmy, just at a high level, I'll let Francois talk about the reserving level. But we have been a participant in marine liability for quite a while. I used to underwrite the IGA in the Reinsurance group, way back in '02 or '03.

This is nothing new to us. We also acquired Barbican in 2019. So we have -- and we have a stronger presence than we ever had in the [indiscernible] market, which, again, is another marine market positioning. So we do also, we do Insurance, Reinsurance and some retro actually. So it's nothing new to us. We like that business quite a bit, made money over the years. The rates and the returns were and are still acceptable.

I mean but sometimes a loss occurs. I'm not sure about what the other ones are thinking about. But we definitely think that this is pretty much in line with what we would have expected the market share to be or what we think our presence in the marketplace would be.

I'll let Francois talk about...

Francois Morin
Executive VP, CFO & Treasurer

Yes. I mean again, we can't speculate or comment on how others may or may not be reserving for this event. For us, it's not unusual. And I'd say that we've taken a very conservative view of the loss and still a lot to be determined, obviously, in terms of who's going to end up paying for it.

But -- and the last point you asked last question is, yes, for us right now, it's all IBNR, I mean we don't really have all the specifics to establish case reserves. So we booked it as IBNR and we'll see how things develop.

Jamminder Singh Bhullar
JPMorgan Chase & Co, Research Division

And then on casualty reserves, your overall development was favorable, but was there any pockets of unfavorable within the overall number? And then if you could talk specifically about how your casualty reserves trended for pre-COVID and post-COVID years?

Francois Morin
Executive VP, CFO & Treasurer

Well, part one of your question, there was really no material development on long-tail casualty lines of business across all years. So both pre-2015 to '19 years and '21 to '23. So we're very comfortable with that. I think our reserves are holding up nicely. And I know there's been some concerns around the more recent years where there's been some signs of adverse in the industry. We're not seeing that. Actually, our metrics or our actuaries are commenting that our actual development is coming in more favorable than expected.

Again, very early to declare victory, but that's certainly for us a positive sign, and we'll keep monitoring and see how things develop for the rest of the year.

Operator

Our next question comes from the line of Andrew Kligerman from TD Cowen.

Andrew Scott Kligerman
TD Cowen, Research Division

Marc, you mentioned that the MI market is going and going and going. How do you think about the favorable prior year developments? I mean last year in the first quarter, it was 25 points this year. In the first quarter, it's another 25 points. I mean does that still continue going forward as well?

Marc Grandisson
CEO & Director

Well, I don't have a crystal ball for the future. But we're -- like everybody else, we're just on the receiving end of a market that's curing better. The borrower is in good conditions. There are programs on the GSEs that help the borrower staying in their homes.

Most of those that even would have a delinquency, as we speak, would have a much lower mortgage rate. So they have a lot of incentive to stay in the home and not having to do anything with it, plus there's a lot of equity being built up in the home. So people have -- are sitting on because, as you know, there's been a significant increase in property valuation over 3 to 4 years.

So everything is really indicating that we have a lot of the alignment between starting from the borrower, all the way to the mortgage insurer and the mortgage origination of the mortgage companies to make sure that the borrowers can make the payment, you can refinance, delay or [indiscernible] a lot of things, a lot of tools and toolbox that weren't there, frankly, in '07 and '08 when the crisis happened.

So -- but what does that mean in terms of development, we'll have to see what happens. But again, it's been more favorable than we would have said probably 2, 3 years ago, and we're just -- when we see the data, we just react to it.

Andrew Scott Kligerman
TD Cowen, Research Division

Pretty amazing stuff. And then my follow-up question is around the Allianz acquisition. And I love your analogy about the NFL draft and picking the high-quality players. Some have criticized Allianz as maybe I'll say they weren't a first round draft choice. So with that, what will Arch be able to do to kind of turn them into a first round type player? I mean I know I've heard about data and analytics, but can that help overnight? So I'd like to know what you're going to do there to really enhance that operation?

Marc Grandisson
CEO & Director

Well, there's a lot of things going on. There's a thorough and very complete plan by our unit to first integrate them, making part of our company and our culture. And we'll have to look at everything that we can do to help them out [indiscernible] okay, it's okay business, very decent business, but we'll have to make it more of an Arch business, but recognizing some of the cultural differences in the distribution, it's a little bit of a different business. Data analytics is certainly one of them.

We also bring to bear. We believe Allianz is a big company and they did a lot of work on this, where we have a strong presence in the U.S. as well. We also already do some middle market business. So we already have experience in that space. And so we have a -- we have a couple of things, a couple of tricks up our sleeve, if you will, to make it better. I won't go into all the details, obviously, but I think we're pretty excited about what we can do with the asset.

And I think like I say all the time, and this is not a comparison with Allianz or us, but truthfully, it adds to the same thing to the Mortgage through UG, they're relatively a bigger piece of our overall enterprise and perhaps they would be in some other company. So that makes it a little bit more exciting and a bit more -- and the willingness from our part, obviously, to invest, right?

I'll remind everyone that some of the earnings that we make, we put aside to invest for the future. So we have a lot of things going on, and we're pretty excited.

Operator

Our next question comes from the line of Michael Zaremski from BMO.

Michael David Zaremski
BMO Capital Markets Equity Research

On the Insurance segment, the underlying loss ratio of 57.5%. I know I'm probably just nitpicking. But I heard the commentary about the impact from the Baltimore bridge. But just curious, you've grown into property, which has a lower loss ratio, attritional loss ratio, I believe. So is there anything going on in the mix, that maybe you're putting in more conservatism on the casualty growth or anything we should be thinking about there?

Francois Morin
Executive VP, CFO & Treasurer

Mike, I'd say it's just the nature of the business we're in. I think there's going to be some ebbs and flows. There are going to be some -- I wouldn't call them unusual or unexpected developments. There could be 1 or 2 claims that surfaced in the quarter. We booked them, we recognized adverse or bad news early on and see how things play out.

So there's really nothing to say that we want -- that needs to be highlighted. It's really part of the course. And yes, absolutely, this quarter, it turns out that the ex GAAP kind of underlying loss ratio was up, I'd say, 30 bps. And that's just the reality of the world we're in, and we think it's still an excellent result.

Michael David Zaremski
BMO Capital Markets Equity Research

Okay. Got it. Second question is probably a quick one, but you all are kind enough to give us guidance on the cat load in the last quarter. I think you said it was in the 6% to 7% range for -- I believe it's just the premiums ex Mortgage segment. Is that expected to change or maybe be towards the high end of that range on a base case scenario as you kind of continue to lean into the hard market conditions as we think about '24?

Francois Morin
Executive VP, CFO & Treasurer

Well, the comment I made last quarter was -- yes, for the full year on the overall ACGL premium, 6% to 8%. We don't see that changing at this point. I think that was based on our view of how the year had a chance to play out. That's why we gave you a range.

We were very happy with the 1/1 renewals. 401s went pretty much as expected and 6/1 so far are holding up nicely. I mean still a little bit of time to go before that gets finalized. But big picture, again, that's the 6% to 8% range for the year in terms of cat load is holding up nicely.

Michael David Zaremski
BMO Capital Markets Equity Research

Sorry, is that 6% to 8% on all insurance premiums ex mortgage or just with total company...

Matthew John Carletti
JMP Securities LLC, Research Division

Total company-wide, ACGL total.

Operator

Our next question comes from the line of [indiscernible] from KBW.

Unknown Analyst

My first question was on the net to gross ratio in reinsurance. I saw that it ticked down about 5 points year-over-year. I was wondering, is that a function of buying more reinsurance? Or is there anything else going on there?

Marc Grandisson
CEO & Director

No. I think if you look at the -- it's a good question. If you look at the last 4 or 5 years in the first quarter, you'll see that our net to gross ratio hovers between 65% to 70%. Last quarter last year, it was 70% because we had a larger transaction that came through [indiscernible]. So it's really just a comparison that's not -- just 1 period comparison is not reflective of what's going on. If you look at the longer term, you look at the 65% to 70%, so nothing changed there.

Unknown Analyst

Okay. And then the next thing, shifting back to the insurance business, I was a bit surprised to see solid growth within Professional lines given the rate environment there. So can you maybe talk about the market dynamics or the opportunities that you're seeing in that? And is that growth coming from D&O? Or is that within other professional lines?

Marc Grandisson
CEO & Director

Yes. So the -- it's -- the thing -- our professional liability has many things into it. It's got a large company, large public company D&O, it's got some smaller private, also has cyber in it and some professional liability like agents and stuff like this, that's more E&O based.

I think that the growth is largely attributed to the cyber. Our teams are leaning a little bit more into it, and we've also acquired a couple of more team or developing a team in Europe, there's a big need for what we realize as a need for cyber in Europe, and that's something that we're starting to grow and see more of.

And the reason it's grown in cyber is because even though some of the rates, as we all heard, went down slightly, it's still a very, very favorable, we believe, very favorable proposition for us to underwrite. Also it helps us doing other lines of business because it creates value for our clients. It's still a little bit harder to get in terms of coverage.

On the D&O, we would have decreases and increases depending on where the rates are or where we see the relative valuation or the profitability of our portfolio. On that note, the rates in D&O went down about

8% in this quarter, not as bad as it was 1.5 years ago. You heard the comments that [indiscernible] there's still -- we believe there's still a lot of favorable opportunities in that segment as well. We just have to be a little bit more circumspect when we do this.

Operator

Our next question comes from the line of David Motemaden from Evercore ISI.

David Kenneth Motemaden
Evercore ISI Institutional Equities, Research Division

Marc, you mentioned in your prepared remarks that you're seeing increased underwriting appetite and developing competition, specifically within Reinsurance. Could you just talk about where you're seeing that, elaborate on that a little bit? And what specific lines you're seeing that in and how you guys are responding to that?

Marc Grandisson
CEO & Director

Yes. I think right now, what we're seeing is more a higher appetite, cyber is one of them. That's for sure, Insurance and Reinsurance, that would also -- I mean, can run the gamut, there are many of them. Typically, right now, what we are [indiscernible] that are more short-tail in nature.

You can see a little bit more willingness to take some more risk from the competition. And how we react to it is, we have many things we do. We typically will tend to first look at the overall [indiscernible] if the rates go down or if the rates stay as is, with the new conditions, you actually price the business as if it's a new piece of business and what kind of return it will get to you. And if it's a little bit not as much -- or not too close for comfort, we might just decrease our participation.

And we also might just stay on the clients that we believe have a better chance to really maneuver through that a little bit sideways market, if you will. It's really an underwriters' market at this time.

David Kenneth Motemaden
Evercore ISI Institutional Equities, Research Division

Got it. And just within Reinsurance, the underlying margins there were strong and even better, if I exclude the bridge loss. Can you talk about if there is anything in there that would flatter the results? Or is it more just sort of the earn-in of the property, more short-tail lines and these results are fairly sustainable? I guess how should I think about the sustainability of the results on the Reinsurance side?

Francois Morin
Executive VP, CFO & Treasurer

Yes. I mean it's a great market, right? And we've been saying that for a few quarters. I think and we've said it before, I think we encourage you all to look at results on a trailing 12-month basis. I think it's a bit more reliable, I think, less prone to volatility that is sometimes hard to predict.

But yes. I mean, we -- and Marc said it. I think the quality of the book that's in force right now is excellent, and we're going to earn that in. But whether how -- was this quarter a little bit better than maybe the long-term run rate? Maybe, we don't know. But again, as you try to look ahead, I'd say more of a trailing 12 month, again, view is probably a bit more reliable.

Operator

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

Joshua David Shanker
BofA Securities, Research Division

On the other income which doesn't get enough attention, that's Somers and Coface. It was a weak quarter for Coface stock return in 4Q '23, yet the other was quite strong and maybe I'm misunderstanding how to model this, but I bring this up because Coface had an excellent quarter this past 1Q '24. And I'm wondering if that presages a very, very strong other income return for the company as we head into 2Q '24?

Francois Morin
Executive VP, CFO & Treasurer

Yes. So just to be -- make sure we're on the same page, there's a lag, right? So Coface is booked on a one lag -- one quarter lag basis. So what they just reported for Q1 will show up in our Q2 numbers. Somers is on a real-time basis.

And as we know, Somers should follow relatively closely the performance of our Reinsurance book because it's effectively [indiscernible] there's some nuances to it. But big picture, that is booked on a real-time basis and should mirror fairly closely our Reinsurance book. But to your point, yes. I mean if Coface reported out a strong Q1, you should see the benefits of that to flow through in our second quarter.

Joshua David Shanker
BofA Securities, Research Division

In theory, there should be -- I guess, if you're saying some correlation between Reinsurance segment underwriting income and Somers, which appears in that other line?

Francois Morin
Executive VP, CFO & Treasurer

Correct. Yes. It's not perfectly correlated because it's not the whole segment. It's mostly the Bermuda Reinsurance unit that we -- that they follow. Not the entire business, but big picture is still -- I mean, if the market conditions are good and Reinsurance, the Somers will benefit from that on a similar basis.

Joshua David Shanker
BofA Securities, Research Division

And if one other numbers question post the S&P Model, the change from a few months ago, is there any way to think smartly about how much excess capital you think you're sitting on or the possibility if you find other interesting M&A items, the ability to quickly deploy?

Francois Morin
Executive VP, CFO & Treasurer

Yes. I mean that's always an evolving topic, right? I think we are always focused on putting the capital to work in the business where we can. I think we've done a fair amount of that, obviously, this quarter with the Reinsurance growth that we saw.

The $1.8 billion that will support the Allianz transaction is another example. We will see how the year plays out. No question that, we're generating significant earnings so that goes to the bottom line. And we'll be patient with it until we can't really find other ways to deploy it. But for the time being, it's -- we're in a really good place in terms of capital and gives us a lot of flexibility.

Operator

Our next question comes from the line of Brian Meredith from UBS.

Brian Robert Meredith
UBS Investment Bank, Research Division

A couple of quick numbers and one big-picture question for you all. The first one, just quickly, on the Allianz deal, is it possible to give us how much cash you're expecting to come in from the, I guess, [indiscernible] net cash position you're expecting...

Francois Morin
Executive VP, CFO & Treasurer

Yes, big picture, it's a $2 billion [indiscernible] with dollar for dollar, right? So we get $2 billion in cash, and we were spending $450 million that goes out back to them for the cash consideration. So net-net, it's $1.5 billion of incremental cash that we will get.

And the rest on the new business, then it's, call it, it's the premium flow with as we write that business, that's the overall -- over time, that will be the incremental investment income or invested assets that we will get.

Brian Robert Meredith
UBS Investment Bank, Research Division

That's helpful. Second quick question here. You referenced in your commentary higher contingent commissions on ceded business in your Reinsurance. What exactly is that?

Francois Morin
Executive VP, CFO & Treasurer

A lot of it is third-party capital, right? We -- last year was a very light or a good year for the performance of that book. So some of those agreements, many of them actually pay us a commission that is -- there's a base and then there's a variable aspect to it, then that was kind of a lot -- a large part of that. So that's effectively performance-based commissions on property cat or property business.

Brian Robert Meredith
UBS Investment Bank, Research Division

Makes sense. And then one bigger-picture question here. I'm just curious, on your Reinsurance business, Obviously, during the first quarter, you're getting a lot of [indiscernible] coming in from clients. What are you seeing with respect to reserve development at your clients, right? And how you kind of protect against that and not potentially seeing some of that adverse development that your clients are seeing on your cut of casualty quota share business?

Marc Grandisson
CEO & Director

Yes. So I think the -- Francois mentioned the actual is expected, which is sort of consistent in both insurance and reinsurance on the more recent policy or accident year, which having the right starting point means that you don't really have to correct frequently. So I would say that we're not surprised on the Reinsurance about what we see.

But as I said earlier, I think there is anecdotally and some heavy -- a lot of more friction, I would say, between Insurance and Reinsurance companies to make sure that people get an agreement as to what the ultimate book is going to be. So we're hearing this going in the marketplace.

Of course, we participate in that, but we're not seeing this as being a big issue for us. And the other years that would have been pre-2020 and 2021, I want to remind everyone that we were very defensive. We do not have a whole lot of those premium and those harder-in-developing areas that people are talking about.

So I will say that we see opportunities to write more of those, and we expect to see more opportunities to write more of those types of deals this year, but I wouldn't say that we are the most present in those worst years, if you will.

Operator

Our next question comes from the line of Cave Montazeri from Deutsche Bank.

Cave Mohaghegh Montazeri
Deutsche Bank AG, Research Division

I only have one question today on the Florida market. The total reform implemented over a year ago seems to have had some positive impact on the primary carriers, and Reinsurance capital seems to be coming back. This is a market that you guys know very well. Do you have any color you can share with us on the state of the market in Florida?

Marc Grandisson
CEO & Director

No, I think it's -- to your point, some of the adjustments are coming through, but inflation is also picking up. And there's also, as we all hear, there's potentially more activity in the Southeast of the U.S. in terms of activities and storms.

So I think that people are trying to sort out what they will do at this point in time. I think we have already existing relationships that we think will get us a little bit ahead of the game in terms of participating and getting a participation in the marketplace. But bottom line is we expect the Florida market to be well priced and very good from a risk-adjusted basis.

Nothing indicates anything else other than that. Even, of course, the -- everything that's been done to take care [indiscernible] and whatever else in between, I think, is helpful. But it's still the largest property cat exposure for everybody around the world. So even if you make some corrections and they have made some corrections, I think we still have a couple of years before we start thinking about having a heavy softening in the market.

There might be some here and there, but we still believe the market will be healthy as a reinsurer.

Operator

Our next question comes from the line of Bob Huang from Morgan Stanley.

Jian Huang
Morgan Stanley, Research Division

Quick question on M&A side. Obviously, you have historically generated very durable underwriting returns, mainly because of cycle management, in my view. Just curious as you move into M&A and diversify your business mix, does that impact your cycle management ability for retention levels when we think about M&A or potential M&A down the road?

Marc Grandisson
CEO & Director

No, it doesn't change. I mean cycle management is a core principle of ours. And if anything, we'd like to be able to do -- it's going to be a matter of degree perhaps. Some lines of business have more acute cycle management because they're probably more heavily commoditized. I would expect the cycle management to be much softer in the Allianz and the U.S. MidCorp business. And that's also what's attractive about it, right, because it creates more stability for the portfolio.

Jian Huang
Morgan Stanley, Research Division

Got it. No, that's very helpful. And then in that case, when we think about M&A or future M&A, is it the first preference to use the excess capital or excess cash you're generating from this business to do the M&A deals? Or is it more preferable to use some of the stocks given where the valuation is and things of that nature?

Francois Morin
Executive VP, CFO & Treasurer

I mean there's no one answer to that. I think there's always -- I mean, and we talk about M&A, but M&A doesn't happen that often. So there's a size that matters, how much could we need -- would we need to raise in terms of using our own stock?

Certainly, in terms of dilution, it's always, we think better to kind of use our cash. But there's many considerations we look at, trying to optimize as best we can all the options. We've got plenty of capacity in raising debt too, if need be. So it's very much a function of each specific circumstance, each specific opportunity. We look at it on its own and go from there.

Jian Huang
Morgan Stanley, Research Division

Sorry, if I can just have a little bit of clarification on it. Is it fair to say that in that case, cash and debt is more preferable and then equity may be a little bit less or I'm [indiscernible]? So sorry, just maybe a little bit clarification on that.

Francois Morin
Executive VP, CFO & Treasurer

I mean that's been the preference historically. But I mean, again, it's hard to speculate on what could be the next thing. So yes, historically, but things change over time, too.

Operator

Our next question comes from the line of Michael Zaremski from BMO.

Michael David Zaremski
BMO Capital Markets Equity Research

Just a quick follow-up. You mentioned fee income earlier. Arch has a lot of diversified sources of income. Is there a way you can update us on kind of what percentage of your earnings maybe last year was derived from these kind of fee income type arrangements at a high level?

Francois Morin
Executive VP, CFO & Treasurer

I mean it's grown over the years, for sure. I think that the difficulty or the reality we face is some of these fees are somewhat -- with the expense -- the revenue we get that has some expenses that go with it, and those are kind of co-mingled with our own internal expenses.

So isolating, call it, the margin on those contracts is a little bit kind of cloudy. But yes, it's grown. It's part of what we do. It's part of the leveraging our platform, leveraging our underwriting capabilities, in all our segments, right?

All 3 segments have some fee income that comes into the errors. Obviously, Somers is part of that as well. But yes, it's become a bit more sizable for us.

Operator

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

Marc Grandisson
CEO & Director

Thank you very much for hearing our earnings. Great start of the year. We look forward to seeing you all in July.

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