S&P Capital IQ

CONTENTS

AXIS Capital Holdings Limited NYSE:AXS

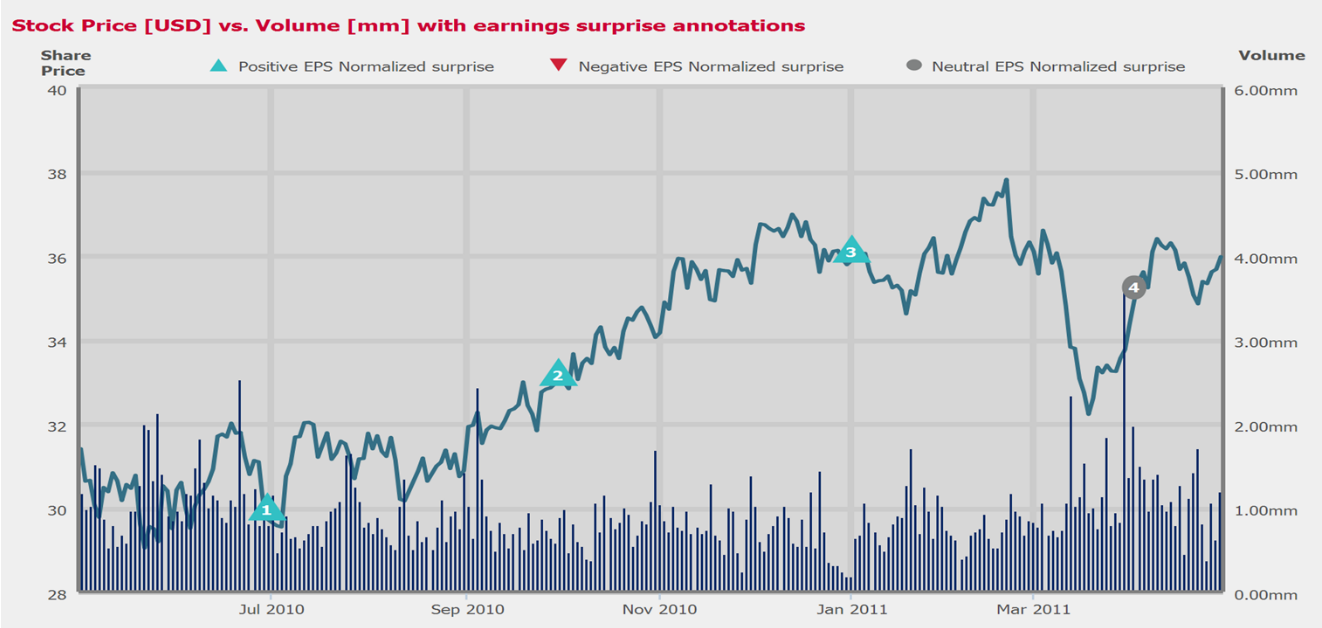
FQ2 2011 Earnings Call Transcripts

Thursday, August 04, 2011 12:00 PM GMT

S&P Capital IQ Estimates

	-FQ2 2011-			-FQ3 2011-	-FY 2011-	-FY 2012-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.48	0.65	▲35.42	0.86	(0.71)	4.03
Revenue (mm)	844.73	850.14	▲0.64	701.67	3401.80	3478.00

Currency: USD
Consensus as of Aug-04-2011 12:24 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ2 2010	1.19	1.33	▲1 11.76 %
FQ3 2010	1.10	1.22	▲2 10.91 %
FQ4 2010	1.20	1.41	▲3 17.50 %
FQ1 2011	(3.19)	(3.65)	NM

Call Participants

EXECUTIVES

Albert A. Benchimol
President, Chief Executive Officer & Director

John R. Charman
Former Director, Chairman of Axis Re and Chairman of Axis Specialty Europe

Linda Ventresca

ANALYSTS

Brian Robert Meredith
UBS Investment Bank, Research Division

Clifford Henry Gallant
Keefe, Bruyette, & Woods, Inc., Research Division

Elizabeth C. Malone
Wunderlich Securities Inc., Research Division

Gregory Locraft
Morgan Stanley, Research Division

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Matthew G. Heimermann
JP Morgan Chase & Co, Research Division

Unknown Analyst

Presentation

Operator

.

Good morning, and welcome to the AXIS Capital Second Quarter 2011 Earnings Conference Call. [Operator Instructions] Please note this event is being recorded. I would now like to turn the conference over to Linda Ventresca. Please go ahead.

Linda Ventresca

Thank you, Denise, and good morning, ladies and gentlemen. I'm happy to welcome you to our conference call to discuss the financial results for AXIS Capital for the second quarter ended June 30, 2011. Our earnings press release, our financial supplement and a new supplementary disclosure entitled Overview of AXIS Natural Perils Catastrophe Risk Measurement and Management were issued yesterday evening after the market closed. If you would like copies, please visit the Investor Information section of our website, www.axiscapital.com. We set aside one hour for today's call, which is also available as an audio webcast through the Investor Information section of our website. A replay of the teleconference will be available by dialing (877) 344-7529 in the U.S. The international number is (412) 317-0088. The conference code for both replay dial-in numbers is 10001569. With me on today's call are John Charman, our CEO and President; and Albert Benchimol, our CFO

Before I turn the call over to John, I will remind everyone that statements made during this call, including the question-and-answer session, which are not historical facts may be forward-looking statements within the meaning of U.S. federal securities laws. Forward-looking statements contained in this presentation include, but are not necessarily limited to, information regarding our estimate of losses related to catastrophes, policies and other loss events, general economic capital and credit market conditions; future growth prospects, financial results and capital management initiatives; evaluation of losses and loss reserves; investment strategies, investment portfolio and market performance; impact to the marketplace with respect to changes in pricing models; and our expectations regarding pricing and other market condition. These statements involve risks, uncertainties and assumptions, which could cause actual results to differ materially from our expectations. For a discussion of these matters, please refer to the Risk Factors section in our most recent Form 10-K on file with the Securities and Exchange Commission. We undertake no obligation to update or revise publicly any forward-looking statements, whether as a result of new information, future events or otherwise. In addition, this presentation contains information regarding operating income, which is a non-GAAP financial measure within the meaning of the U.S. federal securities laws. For a reconciliation of this item to the most directly comparable GAAP financial measure, please refer to our press release, which can be found on the website. With that, I'll now turn the call over to John.

John R. Charman
Former Director, Chairman of Axis Re and Chairman of Axis Specialty Europe

Thank you, Linda, and a very good morning to you, all. So far this year, catastrophe losses have cost the industry over $70 billion. And the industry is experiencing the worst first half year on record. We estimate AXIS' share of the cat activity for the year-to-date to be approximately $706 million, about 1% of our estimate of current industry losses for the year-to-date.

Our model suggests that for our portfolio, AXIS should expect to experience this level of aggregate cat losses by the end of the second quarter every 50 years or so. Nevertheless, as we enter the peak U.S. wind season, we believe that we have the capital strength to handle further potential catastrophe-related losses, fully support our underwriting plans and drive optimal shareholder returns on a risk-adjusted basis. We would discuss this in more detail during the call.

Turning to the quarter's results. It is global cat activity which has impacted AXIS results most significantly during this second quarter and for the year-to-date. During the quarter, severe weather events in the

U.S., coupled with the New Zealand aftershock, as well as increased first quarter net catastrophe losses, resulted in a $126 million in catastrophe net losses to AXIS, primarily from our Reinsurance segment.

Despite the impact of these catastrophes on underwriting profit, AXIS had a solid second quarter. Overall in the quarter, we reported operating income of $83 million and operating income per share of $0.65 per diluted share. Diluted book value per share at the end of the quarter was $36.78, up 3% in the quarter and up 1% compared to 1 year ago. Albert will review the results of the second quarter in more detail.

Our gross premiums written in the quarter increased by 11% reflecting meaningful contributions from our new Accident and Health initiative and our renewable energy insurance team, as well as continued steady build-out in our P&C operations in Canada and Australia. Our reserves continue to develop favorably, and we have made good progress in diversifying our investment portfolio away from risk associated with rising interest rates.

Finally, our posture remains circumspect with respect to cash with the insurance markets that have yet to receive some very necessary improvement. We are seeing signs of gradual cycle change in many other lines. As expected, none of the improvement is dramatic. Rather, where there is improvement, it is slow and steady for the most part. In the catastrophe exposed lines of business we write, we are navigating the market on the basis of the new and increased view of risk introduced to the marketplace, and we have made good progress in repositioning our portfolio in catastrophe-exposed areas with a view toward deploying capital at much higher returns throughout 2012.

While we're comfortable that the share of 1% of industry catastrophe losses is in line with our global footprint in specialty short-term and catastrophe markets, we are constantly learning lessons on fine-tuning our portfolios on the basis of our experience from actual loss events. Based on the experience of the last 18 months, we have been in the midst of an intensive review of our approach to nonpeak cat zone international territories. We commenced this review following the international cat losses during the first half of last year. Our current view of what constitutes minimum rates online in a variety of territories is requiring material upward adjustment. Knowing what we now know, we believe rate change on international catastrophe-exposed business in the second quarter and that the 1st of July renewals was still at a level to make us feel fully comfortable utilizing our risk appetite for those zones.

Finally, in our view, reinsurers have not been able to achieve the fundamental restructuring of reinsurance programs in some of these markets, which would have enabled pricing and profit potential to be more appropriate relative to the known exposure and the known volatility presented by the region. To illustrate some of these points, in Australia and New Zealand, we've renewed less than 50% of expiring limits this year. The average rates online on business renewed doubled. This should give you some indication of how much further correction we believe is needed. In the recent Japanese renewals, our portfolios saw rate increases of between 30% and 70%, and we've renewed in excess of 80% of our expiring lines. There was not much change in our already conservative approach to Japan. Since our inception, we have not been willing to support uncapped proportional earthquake treaties, and we continue to avoid those. Also, we have been cautious with respect to aggregate capital commitments there with the knowledge that un-modeled loss like tsunami exists. Our limited exposure in Japan remains predominantly earthquake exposure, as wind exposure there remains inadequately priced in our opinion.

We concluded the 1st of July renewals in our Reinsurance segment a few weeks back. Approximately 15% of AXIS Re 2010 expiring premium was renewable on the 1st of July. We estimate our AXIS Re underwriting year premiums at the 1st of July, was stable relative to expiring amounts on a currency-adjusted basis with relatively stable premium volume across all lines. There could be other activity in the third quarter that will impact top line for the segment, but these estimates generally give off [ph] Good indication of how we are faring in the marketplace.

In the property reinsurance lines, I've already spent some time discussing what transpired through the second quarter and that the 1st of July renewal in the international property catastrophe market.

I will now focus my comments on conditions in the U.S. property reinsurance market. Rate improvement of the 1st of July renewals for property catastrophe-exposed business in the U.S. was in the order of 10% on average. This improvement was generally not sufficient to compensate for the increased view of risk the market needs to digest and certainly not enough to induce us to put more capital at risk. Therefore, we redistributed our catastrophe risk profile in the U.S. and continue to reposition our portfolio. This in turn, reducing or withdrawing capacity to accounts that were not adequately priced based on our incorporation of the most credible elements of our RMS version 11. Regardless, the market is gaining momentum in incorporating our MS11 views at risk, and we expect further positive momentum at the important 1st of January renewal date. Overall, U.S. casualty reinsurance remain relatively flat with no clear signs of hardening.

Moving to AXIS insurance. Most lines of business are trending directionally upwards, either showing positive rate movements in absolute terms or less negative movements than previously. The exception to this is professional lines where rate is down high-single digits overall. This line continues to deliver underwriting profits, albeit at lower levels than we would like. But in the absence of large losses, competition remains active.

In our international wholesale business, which includes many specialty lines, positive rate change is gaining momentum. For the second quarter, the overall rate change was positive 5%, while in the first quarter, rate change was flat. Most of these specialty classes are now indicating flat or increased rate, the exceptions being aviation, war and terrorism, where we have already substantially reduced our participations over the last few years because of margin erosion.

The momentum away from price reductions to price increases in property reinsurance is also becoming much more evident in many areas of the global primary insurance market on a global basis, particularly property and energy lines with the greatest increases arising from accounts with any wind exposure. Commercial liability remains the most competitive sector due to overcrowding and overly optimistic loss trend assumptions. But this is not a major concern for us as we have already substantially reduced our writings in the Primary Casualty area over the last 4 years.

In summary, all of our business lines continue to perform within expectations and are appropriately positioned to continue to do so in the current market environment. Given the recent significant catastrophe loss activity worldwide, we believe any significant industry losses during the remainder of this year will accelerate cycle change that is currently underway. Importantly, we have continued to build out our global diversified underwriting platform with the broadest array of business lines to benefit from the cycle term that is occurring globally. And with that, I would like to turn the call over to Albert.

Albert A. Benchimol
President, Chief Executive Officer & Director

Thank you, John, and good morning to everyone. Before I comment on the results of the quarter, I'd like to expand on our press release comments about operating income. We amended our definition of operating income this quarter to exclude after-tax foreign exchange gains and losses in our income statement. These amounts primarily relate to the impact of FX rate movements on our net insurance related liabilities. However, this is only one component of the overall impact of currency fluctuations on our financial position. FX rates also affect the unrealized gain losses on our investment portfolio, which impact is recognized in other comprehensive income, and also our net realized investment gains and losses. These investment-related movements generally offset a large portion of the foreign exchange gains and losses reported separately in our P&L, thereby minimizing the impact of currency movements on book value. As such, excluding the P&L FX line item from operating income more fairly represent the performance of our business. Accordingly, we've restated the results of our prior periods on a consistent basis.

Now to the results of the quarter. As John noted, most of our lines of business are performing as well as could be expected given current market conditions. But the unusually high level of natural catastrophe activity continued to negatively impact our results this quarter. Indeed, on an x-cat basis, excluding the impact of cats in both quarters, earnings per share would've been higher than last year's second quarter. Our operating income of $83 million, or $0.65 per diluted share, includes net catastrophe losses after reinstatement from taxes of $180 million or $0.91 per share. In contrast, second quarter 2010 operating income of $153 million, or $1.13 per share, included $25 million, or $0.18 per share, of net impact from named catastrophes. The April and May U.S storms and tornadoes have the largest impact on our second quarter results. We currently estimate that total insured losses for these events will be $16 billion, and we recognized associated pretax net losses, net of related reinstatement premiums, of $75 million. This amount was approximately evenly split between our 2 segments.

We currently expect that industry losses for the June 13th aftershock in Christchurch, New Zealand will be $3 billion, although we note that there will be some difficulty allocating individual losses either to this event or to the February event. During the quarter, we recognized estimated pretax net losses for the June event, net of reinstatement, of $31 million with the full amount emanating from our Reinsurance segment.

Turning to the events of the first quarter. We've been in regular communication with our clients and intermediaries, and continue to actively monitor available market information. Our view of the ultimate cost of these major events developed significantly since our last call. While we recognized a net increase of $20 million to our estimates for the first quarter catastrophes to a revised total of $597 million, there was significant change to individual estimates [indiscernible] To discussion.

You may recall that in the first quarter, we had a very conservative view of the Japanese earthquake and tsunami. And given the very limited amount of actual loss reports and data from cedents, assumed total losses to many of the programs in which we participate.

We also had some nonspecific IBNR allocated to the Japan quake to cover unexpected claims activity. Since then, we received loss data from our clients and have confirmed their lower loss estimate. The nature of much of the earthquake coverage provided by our cedents, who provide a lump sum indemnity payments rather than repair or replacement expense and the percentage of claims that have already been paid and closed, give us strong comfort that some of the upper layers of coverage in which we participate will not incur losses, and we have released those reserves. As to the insurance side, claims are coming in within our early estimates. Given these developments, we have reduced our estimate of industry losses to $25 billion to $30 billion range, from our original estimate of $30 billion to $35 billion range. For AXIS, we have reduced our estimates for the Japanese earthquake and tsunami by $86 million to $201 million in the aggregate. We are comfortable with this new level, as we still hold 44% of this amount in IBNR and continue to have reinsurance protection to cover additional claims if they should emerge in our Insurance business.

Separately, a bit of advice with respect to the first quarter Australian loss events, including the heavy rainfall and flooding in January and Cyclone Yasi, led us to reduce our associated estimate of pretax losses net of reinstatement premiums by $13 million to $72 million. Our estimate of industry losses for these events remain in the region of $6 billion. Unfortunately, these favorable developments were more than offset by significant deterioration in our estimates for the February New Zealand earthquake. Movement for us really came from 2 significant cedents, who changed their estimates and losses by multiples of their initial advices. This, combined with our significant share of these reinsurance programs, drove the increase in our estimates for the New Zealand aftershock. One significant cedent's more than doubled its estimate of ground-up losses from $1 billion to over $2 billion. Our share of their coverage layers alone led to a $70 million increase in our estimates. Another significant pro-risk [ph] contract presented an increase in reported losses by a multiple of their initial advice, leading to another $30 million in addition to our reserves. And we booked additional IBNR for this New Zealand event in February to cover other potential claims. All-in, our estimate of pretax losses for the February Christchurch aftershock net of reinstatements was increased by $119 million to $323 million. While we initially believed industry losses for this event would range from $8 billion to $12 billion, we now expect an amount closer to $15 billion. Our current estimates represent our best view of first and second quarter catastrophe events, but I must still caution you that there remain significant uncertainties with respect to loss estimates for all catastrophe events and especially in the case of the Christchurch earthquakes given the limited and preliminary nature of the information received to date from cedents. The number of aftershocks, which make allocation to losses for individual events more difficult, and the New Zealand Government's determination to red zone portions of Christchurch due to the extensive damage and ground liquefaction. We will, as always, keep you apprised of development.

Let's move on to the income statement. Consolidated second quarter gross written premiums were up 11% to $1 billion. Net premiums written were up 8% in the quarter, a shift in the mix of business toward lines with higher session [ph] rates, as well as increased facultative reinsurance purchasing in our Insurance segment led to a lower growth rate than that reported for gross written premiums. Consolidated net premiums earned grew 14%, continuing to benefit from the reductions in our ceded reinsurance purchasing effective in the second quarter of 2010.

Our consolidated combined ratio for the quarter was 98.9%. The consolidated loss ratio of 67.3% includes 14.9 points of catastrophes and 6.1 points of favorable development. By contrast, we reported a combined ratio of 86.2% in the second quarter of 2010 and a loss ratio of 54.9%, including 3.6 points of named cats and 10.7 points of favorable development.

Within our Insurance segment, gross premiums written were up $69 million led by our new Accident and Health unit and reflective of -- reflect of our investments in that platform in the past several quarters. Excluding A&H, gross premiums written for the segment were up a healthy 6% for the quarter, largely attributable to the fruits of our geographic expansion and our renewable energy initiative. Geographic expansion, including our Australian and Canadian operations, contributed to increases for Property and Professional lines. As you know, we have around 20 different products in our Professional lines of business, addressing many industry segments and geographies and, thus, have the ability to access the most profitable areas of this business. Our renewable energy business relates to both onshore and offshore exposures, contributing to increases in both property and marine lines. These increases were partially offset by a reduction in terrorism, due mostly to positive one-time items booked in the second quarter of 2010.

Net premiums written were up 6%, reflective of the change in mix of business and increased facultative purchases I noted earlier. While net premiums earned increased 19% as a result of the changes in reinsurance purchases enacted in the second quarter of 2010. Our Insurance segment reported second quarter combined ratio of 94.4 and a loss ratio of 60.6, including 10.5 points of named cat losses and 7.5 points of favorable development. This compares to a combined ratio of 86.2% and a loss ratio of 51.6% with no named cats and 10.1 points of favorable development.

For the 6-month period, our Insurance segment reported a 12% growth rate in net premiums written, 23% growth in net premiums earned, a combined ratio of 104.2% and a loss ratio of 70.5%, including 12.7 points of cats and 6.1 points of favorable development. The accident year loss ratio x catastrophes of 63.9% was 3 points higher than the comparable figure in the first half of 2010, and this increase is reflective of lower pricing year-over-year, as well as some mix exchange.

For our Reinsurance segment, the 11% increase in gross premiums written for the second quarter relates to increases in motor, credit and bond and liability business, offset by reductions in catastrophe and property. Our reinsurers combined ratio for the second quarter was 98.2% and the loss ratio was 72.2%, including 18.2 points of cats and 5.2 points of favorable development. This compares to a combined ratio of 81.8%, a loss ratio of 57.2%, including 6.6 points of cats and 11.1 points of favorable development, in the second quarter of 2010. For the 6-month period, our Reinsurance segment reported an 8% growth rate in net premiums written and earned, a combined ratio of 143% and a loss ratio of 116.9%. That 116.9% includes 65.6 points of cats and 6.4 points of favorable development. The accident year loss ratio x cat of 57.7% was 1.4 points lower than the comparable figure in the first half of 2010, as our underlying results and credit and bond and to a lesser extent, professional lines are reverting towards pre-financial crisis conditions, as well as some mix of business change.

On a consolidated basis, we recognized $52 million of net favorable development this quarter. Approximately 56% of the group's consolidated net favorable reserve development was generated from short-tail lines and reflected better-than-expected loss emergence. The remainder related primarily to our Professional Lines, Insurance and Reinsurance business as we continue to incorporate our own experience into our ultimate expected loss ratios. We have yet to do this in any meaningful way for our liability lines with longer development tails.

Net investment income was $100 million for the quarter, down from the first quarter's $111 million but higher than the $83 million reported in the second quarter of 2010. All components of investment income exhibited increases in the year-over-year period. Income from our fixed maturity portfolios was modestly higher than both the prior year quarter and the first quarter this year. While we continue to suffer from low rates, the larger investment asset base allowed for investment income growth. The largest contributor to growth was our alternative investment portfolio, where once again, our CLO equity portfolio continues to recover in value. The other investments portfolio generated $12 million of income this quarter versus $25 million in the first quarter of this year and a loss of $2 million in last year's second quarter. This also demonstrates that there is some volatility in the alternative investment portfolio income recognized in any one quarter. In aggregate, the total return on our cash and investment portfolio for the quarter was 1.5%, producing a positive book value impact of $200 million. This was comprised of net investment income of $100 million, an increase in the net unrealized gains of $52 million and net realized gains of $38 million. The positive return for the quarter was driven primarily by the 50 basis points downward shift in the 3- to 5-year section of the U.S. Treasury curve. Given this shift, which has continued since June 30, we expect net investment income will remain under pressure as the fixed maturity book yield of 3.3% converges toward the yielded market of 2.7%.

The other income statement items are relatively straightforward. Total general and administrative expenses this quarter were largely consistent for the first quarter of this year, although higher than the prior year quarter, largely due to headcount increases, commensurate with our growth initiatives and global expansion. As I mentioned earlier, our foreign exchange losses for the quarter relate to the revaluation of our insurance-related net liabilities. The amount was primarily driven by appreciation of the euro during the quarter. But again, this is not reflective of the total impact of currency fluctuation movements on shareholders' equity. In fact, the net impact of FX movements on our book value during the quarter was insignificant.

Our 2.1% effective tax rate was comparable to the second quarter of last year. The net of all these items and preferred dividends was net income available to common shareholders of $101 million. Moving on to the balance sheet. Our assets grew 11% in the first half of 2011 to $18.2 billion, consistent with our activities. Gross premiums written growth has resulted in increases for premiums receivable, deferred acquisition cost and other premiums, while cat losses affected gross reserves and reinsurance recoverables.

Cash and invested assets totaled $13.2 billion at quarter end, over $1 billion higher than a year ago. Our fixed maturity portfolio continues to be our largest asset class, comprising 81% of cash in invested assets. The strategy for our fixed maturity portfolio is to continue to emphasize corporate debt and other spread sectors while maintaining a higher average credit quality with a 3-year duration.

During the quarter, our largest fixed maturity portfolio changes included a modest reduction in mortgage-backed holdings and reinvestments of those proceeds in municipal bonds. Approximately 7% of our cash in investments is invested in non-U.S. Government fixed income securities. Obligations of super-nationals, Germany, the U.K., Australia and Canada are our largest exposures and account for 69% of this total. We have no direct exposure to the sovereign debt of Portugal, Italy, Ireland or Greece, and our holdings to Spain totaled $62 million. As you know, we've been adding diversification to our investment portfolio in the past few quarters to minimize or reduce our risk to rising interest rates. We've increased our weightings to equities as a percentage of cash and invested assets by a little over 1% during the quarter and also made additional allocation to hedge funds.

We are close to our target weighting for equities and will make additional hedge fund commitments over the coming quarters, but otherwise, we are approaching our current target asset allocation. Gross reserves aggregate to $8.4 billion dollars, while net unpaid loss reserves are $6.6 billion, an increase of $1.2 billion from year end as we booked approximately $700 million in catastrophe-related net losses during the first half. Our Reinsurance balances recoverables of $1.8 billion are equal to approximately 21% of gross reserves and 68% of our Reinsurance recoverable balance is IBNR. These are items we watch closely, and we remain comfortable with both the quality and collectibility of these balances.

Our total capital at June 30 was $6.3 billion, down from $6.6 billion at year end, including $1 billion of long-term debt and $500 million of preferred equity. Book value per diluted share was $36.78 at June 30, a 3% increase over the March 31 level and 1% increase from the prior June 30, 2010. We believe it is worthwhile to note that on the worst January to June period in our history, our total decline by only about 4%. While we are disappointed in the reduction in our common equity due to catastrophes in the first half, we are confident that ours remains one of the strongest balance sheets in the industry, underpinned by high-quality liquid assets and prudent reserves.

Before turning the call over to John, I'd like to address a couple of questions that have been the focus of discussions over the past few months. The first relates to the lack of comparability in the catastrophe exposures and PMLs disclosed by various companies, and the second relates to company's capital adequacy following the catastrophe activity of the first half of this year and potential additional catastrophe losses for the rest of the year.

Our integrated risk management framework considers all material risks in our business, either from investments, underwritings or on our operations around the world. As a part of this, for natural perils, we consider both the loss of capital in a year due to a single large event, as well as the loss of capital that would occur for multiple and although potentially smaller events in the aggregates. So this is a multidimensional approach as is the case with all risks across the organization. We recognize that it is difficult for an external third party to arrive at conclusions about our capacity or capital adequacy on the basis of a single dimension. At a single event level, which represents only one of the many ways we monitor catastrophe exposure at AXIS. Management imposes a probable maximum loss exposure risk tolerance by zone. At an annual aggregate level, we manage our exposure so that the financial loss from all risks in any one year is unlikely to exceed a defined percentage of our total capital at different return periods. These are self-imposed limits, reflecting what we believe, currently, is the appropriate risk-return relationship that would add the most value to our shareholders over time.

At present, we have no external limits of any concern to us. Over the past few months, we have researched ways to give investors better disclosure and context related to our PML reporting. We believe we have improved the disclosure in our financial supplement so that it relates more directly to our approach to internal risk tolerances and to make them more comparable to those of our peers. Specifically, in our financial supplement, we have discontinued disclosure of the multi-zone, single-event U.S. wind PMLs, but expanded our hurricane PML disclosure to include peak single-zone PMLs. We have also provided a separate supplementary disclosure entitled: Overview of AXIS Natural Peril Catastrophe Risk Measurement and Management, which was posted to our website along with our financial supplement last night. We believe this supplementary disclosure document should assist in putting our reported PMLs in context.

In our view, PML measurement and disclosures, to the extent they exist, remain inconsistent across companies. Therefore, we caution against making direct comparison amongst companies or judging capacity on the basis of these disclosures alone. In our new supplemental disclosure, we have tried to provide information, which we believe is useful in judging the substance of our approach. We believe we have a prudent approach to measuring and reporting our catastrophe risk, which should give shareholders comfort that we operate on the basis of a realistic view of risk.

One final point I would like to make with respect to disclosures that relate to measurement and management of risk is that our disclosures are likely to develop and change in tandem with our measurements and view of enterprise risk. Enterprise risk management is inherently dynamic and considers countless complex interactions amongst the various enterprise risks and is always updated. You will see from our new PML disclosure that under our current PML measurements, which incorporates elements of RMS 10 with views from other vendors, our 1-in-250 PML from a single event does not exceed 21% of common equity in any single zone.

We are continuing our process of validating the various components of RMS 11 and have not finalized our review. However, based on preliminary incorporation of the most credible components of RMS 11 into our proprietary modeling approach, we expect any U.S. wind PML increases to be in the range of 10% to 20% depending upon the zone. In that scenario, we would still expect to be compliant with our internal risk tolerances across all zones and able to participate fully should substantially better pricing and new opportunities present themselves.

Given the understandable focus on capital strength as we enter the peak U.S. wind season, we thought it would be useful to walk you through an acute stress scenario to demonstrate our capital adequacy. With our first half results as our base, we've considered a reasonably acute stress case during the second half of the year, namely a 1-in-100 years Southeast wind event. For context, this is likely to emanate from a $100 billion-plus industry event in the Southeast. The 1-in-100 Southeast probable maximum loss for AXIS is estimated to be about $700 million, as outlined in our financial supplement disclosures.

The year I have just described is likely to mean close to $200 billion of losses for the industry, which should be over 1.5 times the highest year on record, and we believe, likely to lead to a comprehensive market turn. In that hypothetical year, for AXIS as I have just described it, if the rest of our portfolio performs as expected, we would expect to finish the year with approximately $6 billion of total capital and financial leverage, including both debt and preferreds of about 25%. We would expect $6 billion of total capital to keep us strongly positioned as a top 10 reinsurer based on size of capital base. Our pro forma financial leverage of 25% would remain in line with acceptable leverage for our aspirational ratings, and we would not be close to leverage limits for our current ratings. Again, in that scenario, for AXIS to lose approximately 10% of its capital in the hypothetical worst year ever in the industry speaks we believe to the strong enterprise risk management at AXIS.

In the final analysis, we do not believe there is any need for us to raise capital now. To the extent the industry does not experience a significant capital erosion in the second half of this year, then we would expect only a slow and gradual improvement in market conditions. We would see no need to take on substantial new amounts of risks at less than attractive returns, and we believe our capital cushion should grow. If the industry were to experience a market-changing event, then it is likely that all of our book would immediately reprice substantially upwards without any increase in risk. At that point, we would consider whether raising capital would be appropriate to take advantage of opportunities. But we also believe that our new capital providers would be very well compensated for their investment under those conditions. At that point, I'll return the call back to John.

John R. Charman
Former Director, Chairman of Axis Re and Chairman of Axis Specialty Europe

Thank you, Albert. And to conclude, we believe that we have the capital, ratings, global footprint and diversity to succeed in whatever market develops as we enter 2012. As we review our underwriting portfolio, we are focused on remaining well capitalized, while diversified and globally nimble. All with the exception that, with our global market reach and deep underwriting expertise, we will significantly accelerate growth following any material hardening that may occur within the insurance or reinsurance markets. We are confident that we have appropriately positioned our underwriting portfolio to drive optimal shareholder returns on a risk-adjusted basis going forward.
Operator, I would now like to open the lines for questions.

Question and Answer

Operator

[Operator Instructions] And our first question will come from Vinae Mesquita [ph] of Evercore Partners.

Unknown Analyst

Just wanted to get some more -- kind of beyond the capacity for you to write more business given RMS 11. Did you pull back from the June, July renewals in the U.S. because of RMS 11? And do you think you'll have some opportunities to write more business on Jan 1?

John R. Charman
Former Director, Chairman of Axis Re and Chairman of Axis Specialty Europe

Yes, nice and simply. We still felt, as we said in our script, that the risk-reward characteristics were not sufficient for us to fully deploy our capacity. We believe that as the market continues to debate and encompass RMS 11, that prices will move much more strongly at the year end, and we want to be able to take full advantage of it, and we will do.

Unknown Analyst

Okay, fair enough. Second question is on New Zealand. Do you have any more exposure to New Zealand?

Albert A. Benchimol
President, Chief Executive Officer & Director

Yes, of course, we have a number of programs in New Zealand. They were not all exhausted. I will say that -- let me give you a general answer because I'm sure they'd be different people have questions on that. The way to look at New Zealand is really threefold. We've got some per risk exposures, we've got some international cat programs and we've got some local cat programs. The incidental per risk exposures of course are going to move in line with just how severe this event is. And as you know, we still don't have all the transparency that we would like to have, a lot of zones are closed and so on and so forth. So we've taken a probabilistic approach to those things. But as we go in, we'll find out what whether were right, wrong or where we are. With regards to the -- what I would call the international cat programs, in most of these cases, our clients don't have huge exposures locally, those are really to cover incidental exposures that they have. None of these programs have substantial limits exposed to that area, there've been some small losses here or there. And again, just to give you a sense of scale, the totality of our international programs, we have approximately $25 million worth of estimates for claims to that. So even if that were to double, we're talking about an insignificant area. I think the relevant issue is the local programs. And there, we have exhausted substantially all of our limits. We literally have only 3 contracts now with any limit to speak of, the aggregate $85 million. But the bulk of that $85 million is really $67 million in a single program. And for us, to blow that $67 million, our client would have to take their ground-up losses from $2 billion to $5.5 billion. So there's a lot of room for growth there. Again, I want to caution you all, this is a fluid situation. We got a lot of information. We've got some exposures here. We got limited exposures there. What you have today is our best estimate given the data that we know today.

Operator

And our next question will come from Beth Malone of Wunderlich Securities.

Elizabeth C. Malone
Wunderlich Securities Inc., Research Division

A couple of questions. On the pricing, you mentioned that it's still not adequate in some markets and as a consequence, you're not participating as much as you would like, I guess. My question -- with all the dynamics that have developed in the marketplace, what is the main reason that we're not seeing the kind of pricing, I mean, as you described, these cats, they're significant enough to represent some of the worst cats we've ever had, yet pricing still hasn't reacted the way you would have normally thought.

John R. Charman
Former Director, Chairman of Axis Re and Chairman of Axis Specialty Europe

Beth, you're absolutely right. And I'm very disappointed about the reaction of the global reinsurance community to pricing and conditions, as well as the structure of a lot of the contracts in these nonpeak cat-zone international zones. And, as I said earlier, we -- after the losses that we experienced in the first half of 2010. We started turning up the trains on that entire portfolio. And as we went into this year end, we fundamentally changed our view and the requirements that we had with the knowledge that we have gained from the cat losses of 2010. And that is why we actually missed a very substantial program, a $4 billion reinsurance program that was fully written in the marketplace, Australian program going into 2011. I really believe that the underwriters have fooled themselves into thinking that rate increases alone of between 30% and 50% or 30% and 60%, call it what you like, solves the problem. From my personal experience, it does not address issue at all. There's some structural issues within the programs, especially in Australia and New Zealand relating to retentions of the individual cedents, relating to free reinstatements, which have not been properly priced into the original contracts and there's a whole slew of things that I think the market should have given better thought to instead of just raising prices. But I believe that, that will be the second wave that happens because -- and that's why we aggressively took down our activity in that region because I believe that quite frankly, there was still quite some way to go to put the risk-reward factors back into a more appropriate position, but I'm very surprised by the rest of the -- a large part of the reinsurance market. So I hope that the management of some of those reinsurance companies will begin to dig deeper into some of those regions and ask more searching questions of their underwriters.

Elizabeth C. Malone
Wunderlich Securities Inc., Research Division

Okay. Two more quick questions. One, on -- what's your position on share repurchases given that you're withdrawing some of this -- do you have excess capital? And would you use that to buy back stock at this point?

Albert A. Benchimol
President, Chief Executive Officer & Director

Well, as we've mentioned to you, Beth, and we're looking forward and we've stressed test where we are. We think at this point in time, it's appropriate not to repurchase any shares until we see where the third quarter goes, and frankly what we expect in terms of conditions for January 1. I think that, at this point in time, we don't know what the loss expense [ph] will be. We've got some expectations and some hope that the market will accelerate in its pace of improvement. And if that's the case, we would expect that with our international book and diversification, we ought to find some pockets where we can use that -- utilize that capital. And certainly, that continues to be our most likely scenario. So at this point in time, we would rather hold our capital to take advantage of opportunities, but we won't do anything until we have a better view of the third quarter events and what the run up to January 1 looks like.

Elizabeth C. Malone
Wunderlich Securities Inc., Research Division

Okay. And then the last question on the reserve development, the favorable reserve development. In general in the marketplace, we've seen a lot of companies reduce or not have as much reserve development as time has gone on because of the pricing environment that the industry's experienced over the last several years. Are you anticipating or can you anticipate that you should -- why you still have favorable reserve development going forward? Is there any way to like quantify that? Or give us an idea, is that something we should anticipate?

Albert A. Benchimol
President, Chief Executive Officer & Director

Well, by fiat, our position at all times is that our current reserves are at the appropriate level, and we cannot project at any point in time that there will be future reserve releases. What I can tell you is that the bulk of our reserve release relate to 2007 and prior. And as we pointed out in our remarks, over half of that relates to short-tail lines where we know whether or not the losses have come in. We continue to monitor progress. In our professional lines, as you know, even if we see generally positive indications, we wait until we're approximately 70% developed in the line of business before we even consider whether or not we want to take any actions. And with regard to the long-tail lines, as we've discussed, at this point in time, we still have not made any meaningful changes to those estimates because, again, we are concerned that given the lengthy nature of that tail that we wouldn't want to react too quickly with regard to that. So the only comment that I would make to you is that we remain extremely comfortable with the quality of our reserves, that when we do make reserve releases, we believe we have a fair amount of substantial facts and time in our favor, so that we feel comfortable that it is appropriate to release the reserves as we do so.

Operator

And our next question will come from Matthew Heimermann of JP Morgan.

Matthew G. Heimermann
JP Morgan Chase & Co, Research Division

A couple of questions. I guess, with respect to the PMLs that you put out, I was a little surprised that Mid-Atlantic was actually bigger than the Southeast PML. So I was hoping you could give a little color there, I don't know if that's related to commercial exposure in the Northeast driving that, but just some insights there.

Albert A. Benchimol
President, Chief Executive Officer & Director

Yes, the real issue is Mid-Atlantic in some cases includes New York and others doesn't, for us it includes New York, which is a huge amount. If we were to move New York from the Mid-Atlantic to the Northeast, the Northeast would end up having that. And as you know, the issue with New York is there are substantial amounts of both personal and commercial properties, and that's the major factor. The issue with the Northeast in New York is it's not so much a low-frequency -- it's not so much a high-frequency event at low return periods, it's really for that, god for bid, Category 4, 5 crosses Long Island and so on and so forth. It's an improbable event, but if it does happen, it could be meaningful and that's captured in the PMLs.

Matthew G. Heimermann
JP Morgan Chase & Co, Research Division

With the North PML [indiscernible] in the Mid-Atlantic, is that in dollar, in kind of level of dollars as well?

John R. Charman
Former Director, Chairman of Axis Re and Chairman of Axis Specialty Europe

Would you be so kind, Matt, as to repeat that. You were breaking up. I did not hear your question.

Matthew G. Heimermann
JP Morgan Chase & Co, Research Division

I'm sorry. Is that -- would it be fair to assume that if you shifted New York to Northeast, would be around that $1 billion number?

Albert A. Benchimol
President, Chief Executive Officer & Director

I don't have the numbers in front of me. It would be a big number. But I'm loathe to guess. I don't have the numbers in front of me. But I feel comfortable that, if that were to happen, the Mid-Atlantic would be an immaterial zone, and the Northeast would take on that kind of importance.

Matthew G. Heimermann
JP Morgan Chase & Co, Research Division

Okay. That's fair. I appreciate that. The other -- I guess, related that to then -- is when we think about how the potential PMLs are likely to change based on RMS 11. Just curious how the commercial exposure is going to drive that across these zones? And so, in other words, which of these zones should we expect to be on the higher or lower end? And is commercial going to be the dividing factor there?

Albert A. Benchimol
President, Chief Executive Officer & Director

Look, at this point in time, I believe we've already reached a little bit and given you a range. I would like the benefit of finalizing our reports we're giving you -- we want to make sure that as we go forward here, we've got solid data that is reasonably comparable to that of others. And I would just beg of you one more quarter until we finalize those numbers, and then we'll give it to you exactly where it is and where it comes from. But for the moment, I'd like to stand by that 10% to 20% depending on the zone.

Matthew G. Heimermann
JP Morgan Chase & Co, Research Division

Okay. And based on the way you presented this data, would you be willing to give us a sense what the ratio of the annual aggregate is to the largest single event in PML? Because my sense is if the way you're describing your zones as being more conservative is that should be a relatively low ratio?

Albert A. Benchimol
President, Chief Executive Officer & Director

Well, I will tell you our 1-in-250 is less than double our largest exposure. Our aggregate 1-in-250 is less than double our largest single zone.

Operator

And our next question will come from Brian Meredith of UBS.

Brian Robert Meredith
UBS Investment Bank, Research Division

Two questions for you. First, I'm curious, looking at the cat exposed primary property business in the U.S. versus the property cat reinsurance business, would you see you've got a preference for either or right now based upon the rate activity? What are your expectations on those business lines as we look forward?

John R. Charman
Former Director, Chairman of Axis Re and Chairman of Axis Specialty Europe

I think the primary cat exposed property business has moved much more quickly -- reacted much more quickly, I think, to RMS 11 than the reinsurance marketplace. And so -- but the reinsurance market, we really haven't really seen where it's going to end up with, but I can tell you that the insurance market is reacting more quickly and naturally, we're seeing much better margin improvement there. We've said that we've been disappointed on the Reinsurance side so far, and that's why we've held back our capacity. But I hope that the Reinsurance side will have the same momentum as the primary side by the year end.

Brian Robert Meredith
UBS Investment Bank, Research Division

Great. And then a second question, John, I wonder if you could comment on what do you think the potential impact of the RMS 11 changes are going to be for European wind on the marketplace? And then maybe, Albert, a little bit on your thoughts on maybe what the impact on your business will be and your capital?

Albert A. Benchimol
President, Chief Executive Officer & Director

Right. Again, I think that we have to recognize that we don't have all of the details. We've got some headlines this year. I think, the thing that is likely to affect the European model is the clustering and the higher frequency at the lower layers. And so what happens here is that we expect that it'll affect a lot of the primaries. It may affect some of the lower layers. At the higher layers, its doesn't seem to be as impactful. What I am giving you again is kind of the headlines, as we understand them. And of course, once again the model and we vet it and so on, we'll give you some more insights. But at this point in time, we think it's going to effect the lower layers mostly.

Brian Robert Meredith
UBS Investment Bank, Research Division

And have your clients over there had any fully [ph] impacted them yet or is this still too early to tell?

Albert A. Benchimol
President, Chief Executive Officer & Director

The only comment I would make you is everybody in the U.S. has RMS 11, and they still haven't fully accepted it. I think you'll find that there tends to be a desire to make sure that [indiscernible] want to be the first so on and so forth. One of the things that gives me some comfort, if you would, is that over time, Solvency II is going to require substantially more transparency with regards to risk management modeling and so on and so forth. And I'm hopeful that, that will compel organizations to more quickly reflect new science in their risk management.

John R. Charman
Former Director, Chairman of Axis Re and Chairman of Axis Specialty Europe

And to be more transparent about it, Bryan.

Operator

And our next question will come from Greg Locraft of Morgan Stanley.

Gregory Locraft
Morgan Stanley, Research Division

I wanted to just -- and most of my questions have been answered. I actually just wanted to get your take on the expense line. Do you manage the business differently on the expense line given the year we've had so far? And how should we think about leverage coming through the expense ratio going forward?

Albert A. Benchimol
President, Chief Executive Officer & Director

I'll start with that. One of the things that impressed me when I joined this company is actually the fact that it takes a long-term view as to where the opportunities are and is willing to invest in new businesses. And when you look at our expense ratio and expense dollars, just to give you a sense of it, this company currently has approximately 1,000-plus employees. 7% of those employees are in A&H, which is only today starting to deliver a premium. And we've been spending money developing the A&H operation, recruiting individuals, opening up new offices, applying for new licenses and so on and so forth. And are clearly, are expenses that are not covered by the premium volume. We have exactly the same situation in Canada and Australia as it relates to AXIS Pro, which are smaller -- smaller and international professional lines. So a good chunk of our G&A really relates to the investment that this company is making in the future, both in terms of platform, in terms of volume. The other issue that you are starting to see, is that this company is also in the midst of a significant IT systems upgrade modernization. We are looking to put modern -- the most modern tools at our disposal to both analyze, access and report on our risks. And that of course, is going to be a multimillion, multiyear project. And you're starting to see that in the G&A. Again, these are investments that over time should deliver both higher volume, but more importantly, better quality volume of business.

Gregory Locraft
Morgan Stanley, Research Division

Okay. So no leverage then into next year on the expense line? I mean, you got top line growth coming through, so there's dollars coming in, but we should not be taking our expense ratios down given the top line?

Albert A. Benchimol
President, Chief Executive Officer & Director

Well, I think that this year's actually a good example. We've had a significant year-over-year increase in G&A, and yet, our operating expense ratio is about flat. And so I think that's where we are right now. I would expect lesser growth in staff next year. But as of now, again, we don't know. We haven't finished our planning process, so I can't tell you how it relates to the top line. I will make one more statement though, and that is with regards to the overall expenses recall that when we reduced our reinsurance purchases and we reduced our cedes for property and professional lines, our acquisition expense ratio went up because we got less ceding commission. That, of course, is going to be offset not so much of the expense line, but hopefully, by retaining better quality premiums. John?

John R. Charman
Former Director, Chairman of Axis Re and Chairman of Axis Specialty Europe

Greg, And I think that to elaborate from what Albert said that the way I would see the next couple of years is the fact that as we begin to see those substantial investments, financial investments we've made in new businesses bear fruition, I would expect to see a flattening of our expense ratio. And we want to get it back to being industry competitive, and that's what both the investment in new businesses and new products is all about, as well as the substantial investment that Albert talked about in terms of new systems. And I want us to return to a very competitive expense line. That's what the investment is all about.

Gregory Locraft
Morgan Stanley, Research Division

Okay, great. Thanks. And then actually just shifting gears, we almost got a full call without, anything on political risk. John, just any update there in terms of that line?

John R. Charman
Former Director, Chairman of Axis Re and Chairman of Axis Specialty Europe

It's chugging along nice and steadily, and nice and slowly. The amount of competition for emerging market business is fierce. So what we're actually seeing is a slowdown in the amount of activity in the marketplace. Investment banks are really, I think, struggling to compete on a global basis and win market shares. But we're just chugging along, we're being very cautious as we always have been. There are no surprises. The guys are working very hard. It's still emerging market focused. And it's -- we won't be achieving our business plan target in that area I can assure you in terms of premium volume.

Operator

And our next question will come from Cliff Gallant of KBW.

Clifford Henry Gallant
Keefe, Bruyette, & Woods, Inc., Research Division

Just curious [indiscernible], deciding how to deploy capacity? So for example, this quarter, when you did grow in areas like A&H or marine, did you just say that, that business is just on itself more profitable than the opportunities you might have passed up in the catastrophe and property areas? Or is there a capacity component to it, where you say, look A&H because it has less impact on our PMLs, even if the expected return to business might be lower, it actually might be more attractive to you in the context of your full portfolio? I'm sorry, it took a bit of a confused way of asking the question. I'm not sure if you got it.

John R. Charman
Former Director, Chairman of Axis Re and Chairman of Axis Specialty Europe

It's a broad question. But let me just point out what I've always pointed out in the 10 years that AXIS has been operating. Because of the controls that we have within the company, we're a single coordinated business, albeit, but we're structured across insurance and reinsurance. And that allows us as the senior management of the company to essentially portfolio manage the businesses on a daily basis, and deploy activity where in consultation with our underwriters, we see best fit. And that's what we do day-in and day-out. And that is why I have constantly said to you, that there is no other company in our industry where the senior management of the company is as deeply embedded in the day to day underwriting activity of the company as we are. So that does allow us to search for margin. And there are strategic positionings that we have undertaken like A&H where we saw, 3 or 4 years ago, that there was a unique opportunity in a very mature market place occupied by a limited number of major mature companies for us to come in with new capital, new systems, better efficiency, great people, great market spread, to take a strategic position -- long-term position in that industry. There other areas of our activity where were being extremely opportunistic. And then there are other areas where we're actually watching the market move and trying to find our best spot within those market movements. So it's a combination of a number of different activities, I'm afraid. There's not one clear tactic because we don't, because the world's a big place, and it's got lots of products, and they're all changing and moving at different speeds.

Operator

And our next question will come from Jay Cohen of Bank of America Merrill Lynch.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Just a couple of quick questions, most of them had been answered. In the investment income, it looks like the income that came from equities jumped up above [indiscernible] -- not a huge number, but I'm wondering if there's anything unusual in that line item?

Albert A. Benchimol
President, Chief Executive Officer & Director

No, just normal equity dividend. These are publicly traded securities. We basically have 2 types of exposures in the equities, some are ETFs and the others are managed funds, but there's nothing unusual there.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Great. And then, I'd just get an update on underlying claims trends, excluding the weather, obviously, if you're seeing any change or what you have been seeing for the past several years?

John R. Charman
Former Director, Chairman of Axis Re and Chairman of Axis Specialty Europe

I'll ask Hurricane Albert to deal with that one.

Albert A. Benchimol
President, Chief Executive Officer & Director

Actually, we're looking at -- some of the things that we monitor, our paid to incurred, our paid loss ratios and so on and so forth. But there really isn't -- there's not anything of any substance other than, if you would the frequency of large events going through. As you know, we haven't paid anything yet for anything through 2011, and we haven't even paid much yet on 2010. As you've heard from us earlier, as you've heard from John earlier, either one of the reasons that we're seeing pricing declines on the professional lines is that here again, we don't see a lot of activity. We've all been, I think, communally concerned in the industry with regard to the credit crisis years. And there's been a lot of noise back and forth. But as you know as well as I do, a lot of these cases get thrown out, judge keep giving the plaintiffs roadmaps on how to do it right, but nothing ultimately gets done. So were watching, we continue to have -- where we believe our prudent reserves for that need to stay in place for the credit crisis and so on, but we really haven't seen anything of any substance.

Operator

And we have a follow-up question from Beth Malone of Wunderlich Securities.

Elizabeth C. Malone
Wunderlich Securities Inc., Research Division

On the renewable energy market that you all have recently entered, was that decision driven by the potential growth in that market, or was it just the attractiveness of the lack of competition? What were the factors, and do you anticipate that that's going to have an accelerated development because of demand?

John R. Charman
Former Director, Chairman of Axis Re and Chairman of Axis Specialty Europe

I think you're right to pick out renewable energy. We started about 2.5 years thinking about this particular product. But we had to wait for the right people to become available because we will not enter -- even product lines, which appear to be attractive unless we can get the right people. And it was a marketplace where there are very limited -- there's a very limited amount of skilled resource available. And then secondly, there are limited number of carriers that are trading in the marketplace, and it's a marketplace that's very tight. The clients actually want what I would consider to be good expertise, with good capital, with good consistency of approach. And so that we over the last 18 months, have been able to make a pretty substantial inroad into this rapidly growing product line. But we see it as a very complementary fit to our global energy portfolios, both onshore and both offshore. So it's a great product in itself, but it's extremely complementary to the very strong product lines that we -- and expertise we already have around it.

Operator

And ladies and gentlemen, this will conclude our question-and-answer session. I would like to turn the conference back over to Mr. John Charman, CEO, for any closing remarks.

John R. Charman
Former Director, Chairman of Axis Re and Chairman of Axis Specialty Europe

Ladies and gentlemen, farewell, thank you very much for taking the time to participate on this morning's call. And we very much look forward to getting together again at the end of the third quarter. Thank you.

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