S&P Global
Market Intelligence

Arch Capital Group Ltd.

NasdaqGS:ACGL

Earnings Call

Thursday, February 15, 2024 4:00 PM GMT

CALL PARTICIPANTS 2

PRESENTATION 3

QUESTION AND ANSWER 6

Call Participants

EXECUTIVES

Francois Morin
Executive VP, CFO & Treasurer

Marc Grandisson
Former CEO & Director

ANALYSTS

Andrew Scott Kligerman
TD Cowen, Research Division

Cave Mohaghegh Montazeri
Deutsche Bank AG, Research Division

David Kenneth Motemaden
Evercore ISI Institutional Equities, Research Division

Elyse Beth Greenspan
Wells Fargo Securities, LLC, Research Division

Jamminder Singh Bhullar
JPMorgan Chase & Co, Research Division

Jian Huang
Morgan Stanley, Research Division

Joshua David Shanker
BofA Securities, Research Division

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

Michael David Zaremski
BMO Capital Markets Equity Research

Yaron Joseph Kinar
Jefferies LLC, Research Division

Presentation

Operator

Good day, ladies and gentlemen, and welcome to the Q4 2023 Arch Capital Earnings Conference Call. [Operator Instructions] As a reminder, this conference call is being recorded.

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

Additionally, certain statements contained in the call that are not based on historical facts are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. The company intends the forward-looking statements in the call to be subject to the safe harbor created thereby. Management will also make reference to certain non-GAAP measures of financial performance.

The reconciliation 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
Former CEO & Director

Thank you, Gigi. Good morning, and thank you for joining our earnings call. Our fourth quarter results conclude another record year as we continued to lean into broadly favorable underwriting conditions in the property and casualty sectors. Our full year financial performance was excellent with an annual operating return on average common equity of 21.6% and an exceptional 43.9% increase in book value per share, which remains an impressive 34.2% if we exclude the onetime benefit from the deferred tax asset we booked in the fourth quarter.

The $3.2 billion of operating income reported in 2023 made it Arch's most profitable year-to-date. Growth was strong all year as we allocated capital to our property and casualty teams, we showed over $17 billion of gross premium and over $12.4 billion of net premium. And while most current growth opportunities are in the P&C sector, it's important to recognize a steady quality underwriting performance of our mortgage group. Although mortgage market conditions meant fewer opportunities for top line MI growth, the business unit continues to generate significant profits totaling nearly [$1.1 billion] of underwriting income for the year. As we have mentioned on previous calls, those earnings have helped on growth opportunities in the segments with the best risk-adjusted returns, demonstrating that the disciplined underwriting approach and active capital allocation are essential throughout the cycle.

Our ability to deploy capital early in the hard market cycle is paying dividends as we own the renewals, a phrase I learned from Paul Ingrey, a personal mentor and foundational leader of Arch. What Paul meant was quite simple. When markets turn hard, you should aggressively write business early in the cycle. This puts your underwriters in a strong position to fully capitalize on the market opportunity. By making decisive early moves you won become [indiscernible] who then want to do more business with you. In some ways, the growth becomes self-sustaining, which explains part of our success throughout this hard market.

At Arch, our primary focus has always been on rate adequacy regardless of market conditions. Our underwriting culture dictates that we include a meaningful margin of safety in our pricing, especially in softer conditions. And we also take a longer view of inflation and rates. For these reasons, Arch was underweight in casualty premium from 2016 to 2019 when cumulative rates were cut by as much as 50%. I thought I'd borrow a soccer analogy to help explain the current casualty market.

In soccer, players who commit a deliberate foul are often given a yellow card. 2 yellow card mean the player is ejected from the remainder of the match and their team continues with a one-player disadvantage. Today's casualty market feels as though some market participants took to the field with a yellow card on a prior game. They're playing in match, but cautiously not wanting to make an error that will put their entire team at a disadvantage. So whilst parts sometimes plays aggressively, we've remain disciplined and avoided drawing a yellow card.

At a high level, we must remember that casualty lines take longer to remediate than property. So if insurers are being cautious and adding to their margin of safety, we could experience profitable underwriting opportunities in an improving casualty market for the next several years.

Now I'll provide some additional color about the performance of our operating units, starting with reinsurance. The performance of our reinsurance segment last year was nothing short of stellar. For the year, reinsurance net premium written were $6.6 billion, an increase of over $1.6 billion from 2022. Underwriting income of nearly $1.1 billion is a record for the segment and a significant improvement from the cat heavy 2022. Reinsurance underwriting results remained excellent as we ended the year with an 81.4% combined ratio overall and a 77.4% combined ratio ex cat and prior year development, both significant improvements over 2022.

Turning now to our Insurance segment, which continued its growth trajectory by writing nearly $5.9 billion of net premium in 2023, a 17% increase from the prior year. While the business model for primary insurance means that shifts may not appear as dramatic as our reinsurance group, a look at where we've allocated capital year-over-year provides a meaningful insight into our view of the market opportunities.

In 2023, the most notable gains came in from property, marine, construction and national accounts. The $450 million of underwriting income generated by the insurance segment in 2023, doubled our 2022 output as we continue to earn in premium from our deliberate growth during the early years of this hard market. Underwriting results remained solid on the year as the insurance segment delivered a combined ratio of 91.7% and a healthy 89.6%, excluding cat and prior year development.

Now on to mortgage. Our industry-leading mortgage segment continued to deliver profitable results despite a significant industry-wide reduction in mortgage originations last year. The high persistency of our insurance in force portfolio, which carries its own unique version of owning the renewals, enabled the segment to consistently serve as an earnings engine for our shareholders. The credit profile of our U.S. primary MI portfolio remains excellent, and the overall MI market continues to be disciplined and return focus. These conditions should help to ensure that our mortgage segment remains a valuable source of earnings diversification for Arch.

On to investments. Net investment income grew to over $1 billion for the year due to rising interest rates that enhanced earnings from the float generated by our increasing cash flows from underwriting. The significant increases to our asset base provide a tailwind for our creative investment group to further increase its contributions to Arch's earnings. Over the past several years, Arch has leaned into both the hard market and our role as a market leader in the specialty insurance space. We have successfully deployed capital into our diversified operating segments to fuel growth while also making substantial operational enhancements to our platform, including entering new lines, expanding into new geographies and making investments into new underwriting teams, technology and data analytics.

Finally, as we bid adieu to 2023, I want to take a moment to thank our more than 6,500 employees around the world who help deliver so much value to our customers and shareholders. Our people are our competitive advantage. And without their creativity, dedication and integrity, none of this will be possible. So thank you to Team Arch. Francois?

Francois Morin
Executive VP, CFO & Treasurer

Thank you, Marc, and good morning to all. Thanks for joining us today. As Marc mentioned, we closed the year on a high note with after-tax operating income of $2.49 per share for the quarter for an annualized operating return on average common equity of 23.7%. Book value per share was $46.94 as of December 31, and up 21.5% for the quarter and 43.9% for the year, aided by the establishment of a net deferred tax asset related to the recently introduced Bermuda corporate income tax which I will expand on in a moment. Our excellent performance resulted from an outstanding quarter across our 3 business segments, highlighted by $715 million in underwriting income. .

We delivered strong net premium written growth across our insurance and reinsurance segments, a 22% increase over the fourth quarter of 2022 and after adjusting for a large nonrecurring reinsurance transactions we discussed last year and an excellent combined ratio of 78.9% for the group. Our underwriting income reflected $135 million of favorable prior year development on a pretax basis or 4.1 points on the combined ratio across our three 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 cure activity.

While there were no major catastrophe industry events this quarter, a series of smaller events that occurred across the globe throughout the year resulted in current accident year catastrophe losses of $137 million for the group in the quarter. Overall, the catastrophe losses we recognized were below our expected catastrophe load.

As of January 1, our peak zone natural cat PML offer a single event, 1-in-250-year return level on a net basis, increased 11% from October 1 but has declined relative to our capital and now stands at 9.2% of tangible shareholders' equity well below our internal limits. On the investment front, we earned $415 million combined from net investment income and income from funds accounted using the equity method, up 27% from last quarter. This amount represents $1.09 per share with an investable asset base approaching $35 billion supported by a record $5.7 billion of cash flow from operating activities in 2023 and new money rates near 5%, we should see continued positive momentum in our investment returns.

Our capital base grew to $21.1 billion with a low leverage ratio of 16.9% represented as debt plus preferred shares to total capital. Overall, our balance sheet remains extremely strong, and we retain significant financial flexibility to pursue any opportunities that arise.

Moving to the recently introduced corporate -- Bermuda corporate income tax. As mentioned in our earnings release and in connection with the law change, we recognized a net deferred tax asset of $1.18 billion this quarter, which we have excluded from operating income due to its nonrecurring nature. This asset will amortize mostly over a 10-year period in our financials, reducing our cash tax payments in those years. All things equal, we expect our effective tax rate to be in the 9% to 11% range for 2024 with a higher expected rate starting in 2025.

As regards to our income from operating affiliates, it's worth mentioning that approximately 40% of this quarter's income is attributable to nonrecurring items such as Coface adoption of IFRS 17 and the establishment of a deferred tax asset at summers in connection with the Bermuda corporate income tax. 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, I wanted to expand on some of your introductory comments, just on the casualty side, right? We've started to see some reserve additions this quarter. And I think you alluded to that last quarter as being what was going to drive the market turn. So how do you see it playing out from here? I know you said it should play out over the next several years. Could you just give us a little bit of a road map and how you think about this opportunity emerging for Arch?

Marc Grandisson
Former CEO & Director

Yes. Great question. I think that we're absorbing our own book of business. We also look at all the information on. I think from an actuaries perspective, both Francois and I have maybe dusting off our actuarial diplomas, you rely on data that's historically stable or at least have some counter predictability. And I think what we've seen over the last 2, 3 years, as a result of the pandemic, largely in the courts being closed and everything else in between all the uncertainty and then the path of inflation, there's a lot of data that's really hard to pin down and get comfortable with to make your prediction for what you should be pricing the business.

As we all know, reserving leads to the pricing, right, by virtue of reserving and having the right number for the reserving, you then feed that into your pricing. So we're in a situation where people have lesser visibility or about what the reserving will ultimately develop to. So I can totally understand our clients and our competitors having to adjust on the fly. We're having to adjust a little bit progressively incumatively. The issue with casualty, Elyse, as you know, is even if you had that information and you made some corrective actions, it still takes a while to evaluate whether what you did was enough or was what you need to do.

So I think right now, we have -- we already had a couple of rate increases in casualty starting in 2020. But I think that now we're realizing that maybe it's a little bit worse collectively as an industry than we thought. And there's a lot more uncertainty, a lot more and inflation, certainly, as we all know, is a big factor. So what I would expect right now is people will start refining their book of business. They will try to reunderwrite away from the source and inflation impacted lines.

They'll probably push for rates. Some of them might kick some business to the E&S. Until such time as we have more stability in the reserving now the loss emerges as it relates to what your initial pricing assumptions was. And in casualty, that's why it takes several years. And if history has any indication, if you look back at the -- even the [A3] market and then the year 2000 -- '90s, '99 or 2000 to 2003, it took 3 to 4 years from the start of that, even a middle of it to really get clarity and the market got much higher, in fact, in '04-'05 than it was in 2002. So just because you have to do the action and see what the actions did what you thought. And I think that's what we're going to collectively as an industry are going through, and we're seeing it with our clients, and that's really what's happening.

Elyse Beth Greenspan
Wells Fargo Securities, LLC, Research Division

And then my second question on second quarter in a row, right, we've seen the underlying loss ratio within your reinsurance business come in sub-50. And you guys are obviously earning in right cat business within its strong wages last year. How should we think about the sustainability of a sub-50 underlying loss ratio within your reinsurance book?

Francois Morin

Executive VP, CFO & Treasurer

Well, I mean, we -- sustainability is a great question. I think you're absolutely right that we have more property premium that is more short tail and should have a lower loss ratio ex cat than not, right, compared to other lines. It's a good market. So obviously, profitability embedded in the business should be strong. But we sent you back to kind of quarterly volatility where sometimes we have a better than, call it, normal order even as a option of the book and sometimes not, there's going to be volatility. We said it before, was it again, the 12-month kind of rolling average is to us a better way to look at it. And that's how we see it. But certainly, we like the profitability in the book and it should remain strong.

Marc Grandisson
Former CEO & Director

Yes. One thing I will tell you, Elyse, probably heard on the other calls is the reinsurance market is continuing to improve somewhat into the 1/1 renewal. So it is still a very, very good marketplace. So what it means for the loss ratio, I don't know, but certainly, we're seeing improvement.

Elyse Beth Greenspan
Wells Fargo Securities, LLC, Research Division

And then just 1 last 1 on capital, right? I believe there were some pushes and pulls from the S&P capital changes on your capital, but should be positive relative to your mortgage business? Can you just help us think through your capital position and relative to just organic growth opportunities you see at hand over the next year?

Francois Morin
Executive VP, CFO & Treasurer

Well, certainly, I mean, S&P is one thing that we look at. We look at many different way -- I mean, we have different looks at capital adequacy. We have our own internal view, which drives really how we make our decisions. Rating agencies are an important factor, but I think more importantly is how we think about it. But you're right. I mean, no question that from the S&P point of view, we did -- I mean, the change in the model was a net benefit and that's reduced kind of give us, I'd say, a bit more excess capital.

But we -- and we look at it very carefully. We want to make sure that we're able to seize the opportunities that will be in front of us, and we see plenty for 2024. So right now, we're very -- our main focus is growing the business and kind of deploying that capital into what's in front of us. And then we'll see how the rest of the year plays out.

Operator

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

Andrew Scott Kligerman
TD Cowen, Research Division

First question would be around M&A. We've seen a lot in the media about other specialty players that could be acquired. Arch has been mentioned along with other companies. And I know you can't comment on specific transactions and that you've talked a lot about 15% return on capital over time. But when you do transactions, could you give us a little color and what the parameters might be. What's really important to Arch when you do deals?

Marc Grandisson
Former CEO & Director

Yes. On the M&A front, we're very prudent and careful when we do -- if we do anything. And I think historically, our historical track record is probably the best way to look at this. We'll look for something where our opportunities to earn a return is with the proper margin of safety, is fairly healthy. We're not -- there's no desire to grow for growth's sake in this company. It really has to do with the return on capital. And as Francois mentioned, the fact that we have opportunities to above 15% opportunities in this marketplace certainly makes it a little bit more hard.

Having said all this, we might be -- might mix not exceptions, but there might be some other considerations, as it relates to maybe a strategic, maybe a different counter product, maybe a geography or maybe -- and we prefer that maybe a new team that can really bring the expertise on an underwriting basis. So it's a very, very disciplined approach to M&A that we take. And we have the luxury because we're -- we have plenty of organic growth available to us.

So something has to be very compelling for us to engage in those and also other risks, as you all know, that we don't want to take on necessarily. The number one is the culture. And we are very, very adamant about keeping our culture the way it is, and that's really something that quite often times, the thing that makes the most -- is probably the one that makes the most difference in whether or not we'll entertain an M&A or not.

Andrew Scott Kligerman
TD Cowen, Research Division

That makes a lot of sense. You mentioned on the favorable developments that short tail property was a big driver. So looking at insurance at $21 million favorable, reinsurance is $7 million favorable. Just trying to understand were there any large casualty offset that might have played, and if so, what would they be?

Francois Morin
Executive VP, CFO & Treasurer

Yes. there's no, I'd say, offsets. I mean we look at each line on its own there's always going to be pluses and minuses in every single quarter. We look at the data, we react to the data. I think, as you can imagine or I mean very much a function of the type of business that we've written in the last few years. In reinsurance, in particular, we've grown a lot in property. We've taken our usual user same methodology, same approach to reserve and that generated a little bit of redundancies or releases this quarter on the short tail side.

There's always a little bit of noise on any line of business. Yes, we have a couple of sub-lines or kind of sells and casualty work, they've had. We had a little bit of adverse absolutely. But it's not -- I wouldn't call it an offset. I mean, we book every single line on its own. We reacted the data and then when number come up is what we end up with.

Marc Grandisson
Former CEO & Director

One thing I would add to this is our reserving approach at a high level is to typically recognize bad news quickly and good news over time. So again, our philosophy hasn't changed at all in all those years.

Andrew Scott Kligerman
TD Cowen, Research Division

Got it. And maybe if I could sneak one quick one in. You mentioned during the call that one of the growth areas in insurance with national accounts, what type of limits do you write on national accounts?

Marc Grandisson
Former CEO & Director

Well, it's statutory, right? So -- and it's on an excess of loss basis. And these are -- there's a lot of sharing of experience plus or minuses with clients. They tend to be larger clients. The national accounts is 95%-plus workers' comp. It's really a self-insured sort of structure that sort. We provide the paper and the actually the document to allow people to operate in their state because you need the required thing to be able to demonstrate that you've worker's comp insurance as a protection, this is statutory. So it's unlimited. By definition, we have some reinsurance that protect some of the capping. That's really what it is.

Operator

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

Jamminder Singh Bhullar
JPMorgan Chase & Co, Research Division

So first, just a question on the casualty business. We've seen significant growth in your property exposures with the hard -- since the hardening of the market or significant hardening in the market since early last year. What are your views on just overall market trends on the casualty side? And are you comfortable enough with pricing in terms to increase volumes in that area?

Marc Grandisson
Former CEO & Director

Yes. I think a comfort -- great question on comfort on the casualty, on liability in general, or general liability, right? I exclude professional lines. I think we're -- the market is turning or has more pressure on the primary side. So I think that our focus right now is we're in the primary, as you can see on the reinsurance, what we did in reinsurance for the last year. We think the reinsurance market is a little bit delayed in reacting to what's happening as in some of the development that we see and some of the increase in inflation and of course, real point that we mentioned.

So I think that we'll probably see first an insurance market that really takes us to heart. Like I mentioned, all the remediation that they need to do. And I think the reinsurance market will probably follow suit. With their own -- possibly their own way to look at this, if the prior hard markets are any indication.

On the reinsurance side, one thing that's a little bit beneficial at this point in time. And there's a reason why reinsurers are not reacting possibly as abruptly as they probably should, as in the -- as in regards to city commission, is that we collectively understand as an industry that our clients are trying to make those changes. So we're trying to go along with them and help them and support them in their efforts. We'll see whether that's enough. Our team is a little bit waiting to see whether that develops. But I do expect this to also come around and also provide another opportunity for us to grow.

Jamminder Singh Bhullar
JPMorgan Chase & Co, Research Division

And then on mortgage insurance, I would have assumed that reserve releases would moderate over time, and they've actually become even more favorable. And I think there's a shift in what's driving that. It used to be COVID reserves last year and now it's stuff written post COVID. As you think about -- I just want to get an idea on what are you assuming in your reserves that you're putting on the book right now? Are you assuming experience commensurate with what you're seeing in the market? Or is it reasonable to assume that if the environment stays the way it is, there's more room to go in terms of reserve releases?

Francois Morin
Executive VP, CFO & Treasurer

Great question. I'd say the reserve releases this year in general were somewhat driven by our -- the views we had on the housing market at the start of the year, right? So if you roll back the tape a year, we were more concerned about home prices dropping fairly rapidly recession, no soft landing, et cetera. So the reserves we set, call it, a year ago, were very much a function of those assumptions and they just did materialize throughout the year. So throughout the year, we saw a very strong -- or very well-performing housing market. People are hearing their delinquencies much higher than we'd actually forecasted, home prices are holding up and unemployment remains relatively low. So you put it all together, I mean, it's really what transpired in '23 is very much a function of -- the reserve releases would reflect kind of how things -- how much better they played out relative to what we thought a year ago.

Where we are today at the start of '24 is certainly a bit more, I wouldn't call it, I mean, optimistic in the sense that we see good home prices and a solid housing market for '24. So on a relative basis, the reserves that we're holding today are not as high as they were a year ago. So if you extrapolate from that, is there room for as much in reserve releases going forward? Probably not, but we just don't know. I mean the data will again play out as it does and we'll react to it. But hopefully, that helps you kind of compare and understand how -- where we sit today versus a year ago.

Jamminder Singh Bhullar
JPMorgan Chase & Co, Research Division

Okay. And just lastly, your comfort with your -- the reserves in your casualty book despite all the industry-wide issues. Does that apply to the business that came over from Watford as well? Because that company obviously had a decent amount of exposure to casualty.

Marc Grandisson
Former CEO & Director

Well, just an easy one. Watford really the underwriting is managed by our team here. So the reserving and approach [indiscernible]

Operator

One moment for our next question. Our next question comes from the line of Michael Zaremski from BMO.

Michael David Zaremski
BMO Capital Markets Equity Research

Okay. First question for Francois on capital in regards to mortgage specifically. So my understanding of the mortgage reserving rules is that after a decade or so, you can start releasing a material amount of reserves, mortgage obviously isn't growing now. So it's -- I know, but you also have a Bermuda, I think some captives there, too. So just curious, is there a material amount of capital coming or expected to come from releasing from the legacy mortgage or old mortgage business?

Marc Grandisson
Former CEO & Director

Well, I'd say the short answer is yes in the sense that the contingency reserves, you're right, we'll start releasing a bit more progressively starting in '24 and '25. That will be -- and we already have some of that in the fourth quarter this year. So if you look at our PMIs ratio, why it dropped in the quarter -- in the fourth quarter was very much a function of a dividend that we were able to extract from our regulated USMI company to the group. So that we think -- the plan and it's scheduled to keep -- we should keep having dividends in '24 and beyond.

But the one point I want to touch on is, and we touched on it in the past is while on a regulatory basis, yes, it's released, we would argue that capital is already somewhat being deployed in the business. So it's not that it's just sitting there not being deployed in the business. It's already been used to other sources because the regulators and the rating agencies look at the aggregate Arch Cap group kind of level of capital. So yes, on a statutory basis, the goal here is to put the capital in a better location, but overall, it's somewhat not as big an impact as you might imagine.

Michael David Zaremski
BMO Capital Markets Equity Research

Okay. That's helpful. And sticking with sticking with capital did -- when Elyse asked about you mentioned the S&P capital model, but I don't think you actually gave any quantitative or answers on the benefits. Because when we -- on paper, we see that appears to be one of, if not the most diversified. Any help there on how much of a benefit or how to think about how much of a benefit the model offers Arch?

Marc Grandisson
Former CEO & Director

Yes, you're right. I didn't quote a number, and we're not going to start putting a number, but it's a net positive. No question that, yes, mortgage charges, diversification benefit, were reductions in capital requirements. But we also -- the final rulings on debt was not as favorable, right? So the S&P and their new rules, they no longer treat $1.75 billion of our debt as being capital. So that's a significant offset. But all things considered all in it's a positive. But again, what I want to remind everyone is it's not the only thing we look at. It's just one thing among many and other rate agencies matter. And more importantly, again, is how we think about the capital we need during the business.

Michael David Zaremski
BMO Capital Markets Equity Research

Okay. And lastly, since everyone else is sneaking in a lot more questions. Based on the remarks you've made unless I'm understanding it incorrectly, it sounds like the growth might be you're more excited about the primary insurance segment. Can primary insurance potentially grow just as much in '24 as it did in '23?

Marc Grandisson
Former CEO & Director

It's a great question. I mean, again, the way we talk, we don't provide guidance because I don't know -- we don't know what the market conditions will be this year. But in terms of capabilities and capital and talent and everything else in between, absolutely, we have -- we can do win, we could do more. Yes, we could. If the opportunities are there, we'll do more, both on insurance or reinsurance for that matter.

Operator

One moment for our next question. Our next question comes from the line of Josh Shanker from Bank of America.

Joshua David Shanker
BofA Securities, Research Division

Everyone, I think there might be a problem with the phone. We heard Jimmy and Mike just fine, but we couldn't hear your answers to the questions.

I don't know if -- so -- and I hear you I don't know if anyone can hear me. Let me ask my team.

Can you guys hear me on the phone?

They hear me. So somehow it's been corrected. Okay. So I don't know what -- maybe I'm the only one maybe...

Marc Grandisson
Former CEO & Director

Yes, Josh, we can hear you. Hopefully, it's been recorded. I don't know if it's been recorded.

Joshua David Shanker
BofA Securities, Research Division

Okay. Very good. So yes, I got a couple of quick ones. So the lowest quarter of new insurance written in the mortgage insurance business since acquiring UGC. And yet it looks like the capital utilization went up, at least the risk to capital in the [premiers] capital ratio went up. Can you sort of talk about the moving pieces that are driving that?

Marc Grandisson
Former CEO & Director

Well, our PMI or -- well, very much a function of the Bellemeade transactions that we called. Josh, I think there's significant amounts of capital protection that we exercised on and no longer give us capital credit.

Joshua David Shanker
BofA Securities, Research Division

That's obviously what it is. Yes. Definitely, that makes sense. And another easy one. It looks to me from quarter end September 30 to year-end. Coface stock was about flat although it round trip through the quarter and yet you had very strong other income in the quarter. Obviously, there's some summers in that. There's other things in there. Can you talk a little about the moving pieces?

Marc Grandisson
Former CEO & Director

Coface, I mean the stock price is one thing, but obviously, for us, we booked the income, right? And they've declared pretty much a -- I don't the exact numbers, but their dividend, their annual dividend has been close to their full net income, 100% kind of payout ratio. So they -- that ends up being what we book in our financials. So yes, the stock price is going to move up and down over the year, but it -- doesn't directly I'd say, factor in or end up in their financials.

Joshua David Shanker
BofA Securities, Research Division

Okay. And just so you know, I'm getting a lot of inbound call volume or e-mails from people right now. Nobody can hear these answers that you're giving me. It may be being recorded. They hear me, but they don't hear you.

Marc Grandisson
Former CEO & Director

Hold on one second, Josh. Are we recorking?

Let us work a little bit through this quickly. Maybe we can fix it.

Francois Morin
Executive VP, CFO & Treasurer

And we can get on what's happening.

Joshua David Shanker
BofA Securities, Research Division

Okay. And so I'm just -- I don't know. Anyway, they're addressing it. People can't hear the Arch team but for people who are e-mailing right now saying we can't hear the Arch team. They're working on addressing it.

Operator

Please note everyone that this call has been recorded, and it will be available after the call is over.

Our next question comes from the line of Yaron Kinar from Jefferies.

Yaron Joseph Kinar
Jefferies LLC, Research Division

Should I ask the questions or should we wait until this issue is fixed.

Marc Grandisson
Former CEO & Director

I think we should continue on. Just ask your question, it's recorded, hopefully people can...

Francois Morin
Executive VP, CFO & Treasurer

There'll be a replay.

Marc Grandisson
Former CEO & Director

Yes, there'll be a replay for everyone, hopefully, really apologize said this, but we're trying to figure it out afterwards. Let's go forward.

Yaron Joseph Kinar
Jefferies LLC, Research Division

Okay. Yes. No problem. So I guess first question, when you set loss into a year, do you update those other than for bad news or frequency? And what I'm trying to get at here is when we look at the reinsurance loss ratios, are they already incorporating the step change in the reinsurance market that we saw in '23 or were those losses or the loss ratio is essentially a reflection of your expectations heading into '23, and we should, therefore, see another step-up in margins over the course of '24.

Marc Grandisson
Former CEO & Director

Yes. I think our tendency when we do loss ratio effects year on, especially on the long tail line. Remember, Francois mentioned earlier, we're much more of a short-tail player than we were in proportion, right? So property is a bit easier to understand, right? It is what it is. You get the loss, you don't get the loss. So you do pick loss ratio at the end of the year. For what you think the attrition will be, there's no cap, then you can't really book the cap, but there's a couple of things you need to address.

On the liability -- and then we'll see over the next 12 months how we develop and there are cadences of releasing or decreasing the IBNR on property as have a shorter tail as you can appreciate. On the liability side, our tendency as an insurance or reinsurer on both sides of the equation, the aisle is to actually pick a loss ratio that has a little bit of a margin of safety at the beginning, not 100% recognizing all the potential benefits that we've seen, and we let it season for a while before we go in and make a change to them.

And what we look at is, obviously, how the emergence, which I mentioned about -- you may not have heard this one, but I mentioned about the emergence of the losses, how they are emerging versus what we expected. And you do this throughout the life cycle of the deal, but that's a longer-term phenomenon.

Yaron Joseph Kinar
Jefferies LLC, Research Division

Got it. And then my second question, Marc, I think in your prepared comments, you said that casualty may be collectively worse than expected for the industry. And I'm curious that comment, is that really referencing kind of the soft market years of '13 through '18 or '19? Or do you think there could also be some of that emerging for the more recent accident years where market conditions were clearly good, but maybe the expectations of inflationary trends were still a bit lower than what they ended up being.

Marc Grandisson
Former CEO & Director

It's a really good question, Yaron. Our -- we look at the action, it was expected, and we see it much more in the softer years, to be honest with you. The recent ones, it's here or there, plus or minuses that Francois mentioned, but it's all well -- as far as we can tell, our portfolio is well within a range of reasonable expectations. It's nothing really that's surprising because Yaron, as you remember, starting in '19, there were improvements in the marketplace. There were price increases already. That's why I think that those years are not as soft, clearly not as soft as '16 to '19 were.

Yaron Joseph Kinar
Jefferies LLC, Research Division

Right. But I guess the question would be, even if they weren't as soft and you were getting a lot of -- the industry was getting a lot of rate at that point if the expectation was for an inflationary trend of 5 and end up being at 7 so you could still see some deterioration of very profitable years nonetheless.

Marc Grandisson
Former CEO & Director

You could. But we do reserving with the rate level in mind. So when we were right in this in 2021, we tend to look at a longer-term loss ratio and not the more recent years that before the soft market, for instance. So when you factor all that in, we will tend to take higher loss ratio -- initial loss ratio pick ourselves on the liability side. So you don't have a similar -- one of the things that happened in '16, '19, and it was mentioned before that people probably were more aggressive than they should have been on the loss ratio pick than they did in those years. I think by the time we get to 2021, I think already there was a recognition, and we saw it to the rate increases that the market was trying to get to. And I think the loss ratio is lifted up a little bit. And I don't think we have a similar kind of deviation from initial loss ratio in those years.

Yaron Joseph Kinar
Jefferies LLC, Research Division

Got it. I'll just end by saying, I think you disappoint a lot of Swiftie fans, including my daughter by referencing Rest of World Football instead of a U.S. football this quarter. Anyway, best of luck.

Operator

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

Jian Huang
Morgan Stanley, Research Division

Just two quick ones. First, I think 2 quarters ago on the earnings call, you said when we look at the insurance underwriting cycle, we were at about 11:00, that's kind of where we were implying improved rates and also loss trend stabilization. Just curious, in your view, what time is it right now? Is it 11:30 or is it 11:59, 2:00 p.m.? Just kind of curious as to where you think.

Marc Grandisson
Former CEO & Director

It's the longest 11:00 I've ever seen in my life is what I'm going to tell you. So I think we're still roughly around the 11:00, which, again, that clock is never like a 1 year after the other, right? You can stay 11:00 and fortunately, you can stay into the 3:00 and 4:00 or where you would want. So I think that it's still roughly around that level, the 11:00, 11:30 perhaps in some cases, but roughly in that range.

Jian Huang
Morgan Stanley, Research Division

Okay. That's helpful. 11:00 to 11:30. That's very helpful. My second question, regarding MGA and capacity in general, there has been some concern that MGAs have been increasingly aggressive. Is this something you're seeing? Is this concern rightfully placed? Does it have any impact on how you think about your underwriting cycle management? Are you becoming more cautious, especially within your reinsurance? Not sure if you answered that before. So apologies.

Marc Grandisson
Former CEO & Director

That's a great question. I think -- I mean, the MGAs emerge, as we all know, when there's a dislocation which is need for capacity. And I think we see it more acute in the professional lines and some of them in property. But again, between the supply and demand on the professional lines, I think now that the capacity is probably more plentiful than it's not more probably. It is more plentiful than it was -- so I think it has some impact at the margin. Of course, it does.

I think to the answer to your second part of the question, which is how do we react? Well, we do it the same way we always do it, which is if the pricing is going down and the returns are not as good, we will tend to deemphasize or pick or select the better clients that we have in our portfolio and still react the same way we would do in cycle management.

On the property side, we also have similar MGAs and MGUs right? But I think these guys, there's an acute need for property coverage and capacity. And I think this sort of feels that we need all the capacity we can get our hands on a property at this point in time. So we're not seeing that much of an impact. The property market is still not very strong.

Jian Huang
Morgan Stanley, Research Division

Okay. So property side, not enough capacity, professional line plentiful full capacity? That's the way we should think about it.

Operator

Our next question comes from the line of Meyer Shields from Keefe, Bruyette & Woods.

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

I think we're in the same situation where people can only hear the answers to their specific questions. So I'm hoping that comes to here as well.

Similar question to Bob. We've seen obviously a number of companies report some reserve problems in the fourth quarter. And I'm wondering when you look at the book of ceding that you have within reinsurance, is what we're seeing in the public company is a good representation of overall trends? Or is there something different in the nonpublic world?

Marc Grandisson
Former CEO & Director

Well, I think when you price -- my good question and for the record, this will be recorded, right? So we'll be able to-- this will be recorded so we'll be able to share, you'll be able to hear the other questions and the other answers. Sorry, is that okay? Yes.

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

Okay. No, that's perfect.

Marc Grandisson
Former CEO & Director

So I think the issue with casualty reserving and you're an [indiscernible] as well as I am, the actual number is in the high of where doing the work. So I think it's like everything else, our teams may have different views about the loss ratio pick for some of the things that we're looking at than they would have themselves. So I wouldn't say that it's a one-to-one. Some of them will not renew or some of them we may not be able to participate on because we have a different view of the ultimate loss ratio. So I think it's a really -- each individual underwriter and each individual company is seeing companies come up with their own number, and you have to make your own decision and your own opinion as to where it is.

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

A similar question, I guess. Obviously, what we've seen here is a lot of domestic concerns over liability lines. On the international casualty side, is that concern worsening as well or should we think that as just a domestic concern?

Marc Grandisson
Former CEO & Director

It's a similar issue. It's not to the same acuteness and some kind of level, but the world has similarly closed down in the courts. It's not as contiguous internationally, as you would expect. But we're still seeing some hardening in international casualty as well. We say that for the last 2, 3 years. So it's a very similar hardening of the market.

May not be as acute in terms of reserving "potential issues". And I'm not talking now to the globals that are internationally, underwriting internationally, that's a different story, right? If they're right in the U.S., they will have a similar issue. But there is similar issues all around, but it's not at the same level internationally that we see in the U.S.

Operator

Our next question comes from the line of Elyse Greenspan from Wells Fargo.

Elyse Beth Greenspan
Wells Fargo Securities, LLC, Research Division

I will say, I think you have a lot of folks wondering who's writing the E&O coverage for your conference call provider. But my follow-up is on casualty insurance. Can you give us a sense of the loss trend that you're booking your casualty insurance book to and what rate you're getting in casualty insurance as well?

Marc Grandisson
Former CEO & Director

Well, it depends on the business, Elyse, but I think the numbers you hear around 7%, 8%, 9%, 10%, sometimes it's 5. It depends on line of business, depends on the investment point. It depends on the limit that you provide depends on the size of risk. But the numbers you hear -- the numbers that are heard around the marketplace, we see the similar phenomenon.

I think we tend -- we said it historically. It's coming -- it's happening as we speak that the insurance trend in liabilities generally will outpace the CPI increase, and we're seeing this coming back. So with 200 or 300 basis points above. So we're largely consistent with those kinds of upticks.

Elyse Beth Greenspan
Wells Fargo Securities, LLC, Research Division

So loss trends, you said 7%, 8%, 9%, 10%, but can vary by line and sometimes be 5%. Where would you put the price increase?

Marc Grandisson
Former CEO & Director

Again, depending on line of business, but we're low to mid-teens, I would say, right now.

Elyse Beth Greenspan
Wells Fargo Securities, LLC, Research Division

Okay, low to mid-teens. I'm just also repeating, so folks listening can hear the answer, so low to mid-teens.

Yes, I think that's one, I guess, on your one last one, your cat. You said your PML went a little bit higher, right, but the percent of equity is lower given the equity rise in the quarter. Where would you put your cat load at the start of '24.

Marc Grandisson
Former CEO & Director

Well, it's certainly up from '23, right? I'd say for the year, we're looking at somewhere in loss ratio points, right, call it, 7% or so of like, call it, 6% to 7% of like our premium would be kind of like the cat load.

Elyse Beth Greenspan
Wells Fargo Securities, LLC, Research Division

Okay, 6% to 8% cat load.

Operator

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

Cave Mohaghegh Montazeri
Deutsche Bank AG, Research Division

It's Cave. I have a question on reinsurance terms and conditions and attachment points. Does it feel like overall the industry probably took on more high frequency, low severity risk that should have over the past couple of years? And now maybe on aggregate, reinsurers are probably more willing to negotiate on price than on attachment points or erms and conditions. Just tell me what your view is on that topic?

Marc Grandisson
Former CEO & Director

Are you talking about property CapEx?

Cave Mohaghegh Montazeri
Deutsche Bank AG, Research Division

Yes.

Marc Grandisson
Former CEO & Director

Yes. I think what we've seen is we continue to see is that a lot of lower layers historically for the last 4 or 5 years, turn out to be just swapping money, trading dollars back and forth. And there was a lot more activity perhaps of frequency, as you mentioned and the reinsurance market was willing to take on. So there was a natural tendency to try to increase the premium at those levels. But then at some point, it breaks down in the sense that the client is buying reinsurance protection.

Spending more for things than they actually realize they should be retaining. That's why you've seen retention go up. Now in a sense, by virtue of having a higher retention, then they have to turn on and then is what we've seen, they're turning on to their own portfolio and try to manage and make it better and improving.

The aggregate loss that they have there -- I'm sorry about this. I think that what we're seeing on the CapEx set of loss right now is that people are buying more on top because they also are appreciating and evaluating the total level of exposure and capacity means in PML. So I think what people -- what we're seeing is people trading away in the bottom layers and buying more on top. And I think we're going to see that a bit more as we go into '24, which totally makes sense.

Cave Mohaghegh Montazeri
Deutsche Bank AG, Research Division

Okay. My follow-up is on mortgage insurance. Now you had been kind of pulling back even before activity came to a halt. But if the Fed rate cuts, if it do come, lead to a pickup in the U.S. activity in the housing market. Would you be happy to grow in line with the market? Or should we expect you to kind of grow maybe less fast in the market?

Marc Grandisson
Former CEO & Director

Yes, mortgage, absolutely, we would be. I think that -- yes, the answer is we would be more happy. We have capacity, capital to be able to deploy. And I think we would be very, very pleased to do more. Absolutely.

Francois Morin
Executive VP, CFO & Treasurer

And it's been -- as you know, we -- I mean it's been a very good market, very rational market. So obviously, the rates we're able to charge for the risk will matter and where we -- how we position the book. But in terms of our ability to grow, originations go up, we're absolutely capable and willing to do that.

Operator

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

David Kenneth Motemaden
Evercore ISI Institutional Equities, Research Division

Apologies, I haven't been hearing the answer. So I'm not sure if you've answered any of these already. But just Marc, you spoke a little bit at the beginning of the call about the need or the strategy to lean in at the early part of a hard market. I guess how do you manage that with potential false starts? It sounds like the casualty market on the reinsurance side hasn't hardened as quickly as you've expected. But how do you manage that just internally between writing business that might be hardening, but not totally to where you think it should go and the potential for false starts.

Marc Grandisson
Former CEO & Director

It's a very, very good question. And I think this is where the art comes in the play, right. And experience and knowing some of the marking of the hardening market. A lot of it is also has to do with things you want to hear, right, is our underwriting team sitting down with clients, potential clients and try to understand how do you think about the risk, I'll talk about reinsurance now specifically.

And we also have a very healthy database like everyone else, but we also have our own and we have our own view of claims and how we develop and we have, again, experience over 20 years of data and information. And this is what we use to hopefully get their compass in the right order. But if I -- I can't be sitting here and tell you and pretend that we're going to get everything right 100%. It's a little bit more art and science. And I would think that, as I'm getting older, the psychology of the market is becoming way more important fields to me than even the numbers. And it's probably what compelled me or what made me as the team to lean into 2019. And you don't know for a fact until it's done, but there are markings or signs in the overall market that help you and support your decision to lean into it heavily. That's all I can tell you because it's really not -- it's not a one-for-one -- there's no like one number or one spreadsheet I can point to that will get me the answer.

Francois Morin
Executive VP, CFO & Treasurer

And the only thing I'll add quickly, David, is the reverse is true as well. When the market goes soft, sometimes you pull back and you might go back too early. But that's the game we play. That's the business we're in, and we do our best -- again, we're never going to time it perfectly, but what matters more is the direction of it, and then over the cycle, we think we should come out ahead.

David Kenneth Motemaden
Evercore ISI Institutional Equities, Research Division

Yes. No, understood. That makes sense. And then, Marc, you had mentioned that at 1/1, the property market continued to improve, property cat reinsurance market. I guess as we sit here today and sort of looking forward at the sustainability of that as we move through 2024, what's your view now on that and the growth opportunities in property cat.

Marc Grandisson
Former CEO & Director

First, we have no growth constraints per se. We can grow, as you know, also mentioned that at our PML is 9.2%. So we have room to grow there. I think the question about where it's going to go is so difficult to answer because it's dependent on what happens and what kind of activity we see this year. But if I -- I would probably point to you to the 2006, turn of the market and it was '07, that's probably a better way to think about it. Probably '06 or '07, '07 was a better year than '06. And '08, '09 and '10 were really, really good years in property because the market, as we all know, goes up very, very quickly, but does not go down in one fell swoop. You've got a lot of sustainability in the returns for a little while. It takes a while before things get too close to the line or below the line of what we would want to adjust. So we have some runway in front of us.

David Kenneth Motemaden
Evercore ISI Institutional Equities, Research Division

Got it. Understood. And I know in the past, you've said alternative capital or ILS can -- has the ability to swing the market one way or the other. What exactly are you seeing there?

Marc Grandisson
Former CEO & Director

What we hear is there's still a very high demand for returns, which prevents -- high demand for returns and also still some level of skepticism that might change, but I will see where that goes. But clearly, right now as the margins some increases, but it's not the weight that we saw probably in '14, '15 and '16, nowhere near that.

Operator

Thank you. Arch Capital Group answers have been captured and will be available in the replay. I would now like to turn the conference over to Mr. Marc Grandisson for closing remarks.

Marc Grandisson
Former CEO & Director

Yes. First of all, I want to apologize thoroughly for the call quality and dropping in and out. There will be a recording available for replay. And you know to our steemed colleagues, Don and Vinay will be available to follow up, obviously.

I want to thank you for listening to our call, and I'm looking forward to speak to you again in April. Thank you very much.

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