S&P Capital IQ

CONTENTS

Arch Capital Group Ltd. NasdaqGS:ACGL

FQ1 2014 Earnings Call Transcripts

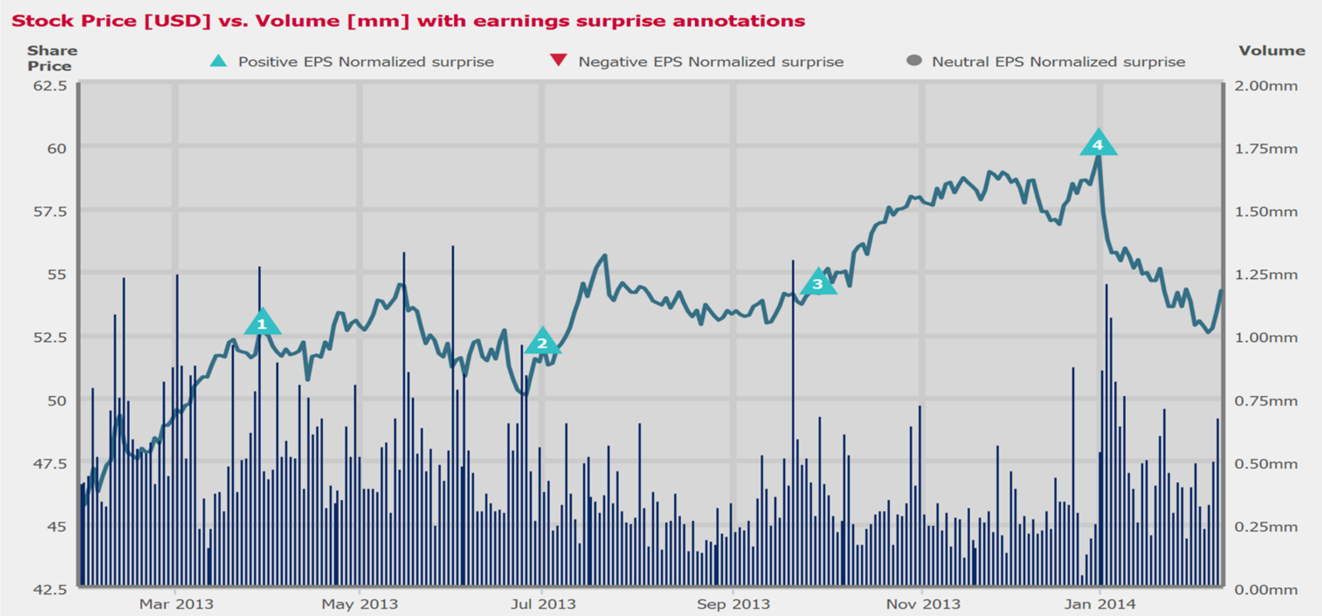
Friday, May 02, 2014 3:00 PM GMT

S&P Capital IQ Estimates

	-FQ1 2014-			-FQ2 2014-	-FY 2014-	-FY 2015-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	1.06	1.20	13.21	0.90	3.71	3.60
Revenue (mm)	1005.04	1064.99	5.96	930.23	3795.59	3827.43

Currency: USD

Consensus as of May-02-2014 10:36 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ1 2013	0.96	1.17	1 21.88 %
FQ2 2013	0.82	0.99	2 20.73 %
FQ3 2013	0.91	1.10	3 20.88 %
FQ4 2013	0.96	1.12	4 16.67 %

Call Participants

EXECUTIVES

Constantine P. Iordanou
Chairman and Chief Executive Officer

Mark D. Lyons
Chief Financial Officer, Executive Vice President and Treasurer

ANALYSTS

Amit Kumar
Macquarie Research

Brian Robert Meredith
UBS Investment Bank, Research Division

Ian Gutterman
Balyasny Asset Management L.P.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

John Arthur Hall
Wells Fargo Securities, LLC, Research Division

Kai Pan
Morgan Stanley, Research Division

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

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Ryan J. Byrnes
Janney Montgomery Scott LLC, Research Division

Vinay Gerard Misquith
Evercore ISI, Research Division

Presentation

Operator

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

Additionally, certain statements contained in the call that are not based on historic facts are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. The company intends the forward-looking statements in the call to be subject to the Safe Harbor created thereby. Management also will make reference to some non-GAAP measures of financial performance. The reconciliation to GAAP and definition of operating income can be found in the company's current report on Form 8-K furnished to the SEC yesterday, which contains the company's earnings press release and is available on the company's website.

I would now like to turn the presentation over to your host for today, Mr. Dinos Iordanou and Mr. Mark Lyons. Please proceed.

Constantine P. Iordanou
Chairman and Chief Executive Officer

Well, thanks, Glenn. Good morning, everyone, and thank you for joining us today. We had an excellent first quarter from an underwriting perspective and we're also successful in launching 2 strategic initiatives this past quarter. We entered the U.S. direct mortgage insurance marketplace and also became a reinsurance manager for Watford Re. I will comment further on these initiatives shortly. But first, let me share a few observations on the quarter.

Earnings were solid and were driven by excellent reported underwriting results, aided by low catastrophe activity. On a consolidated basis, our premium revenue grew by approximately 11% on a gross written basis and nearly 12% on a net written basis, although there were a few noteworthy items, which I will get to in a minute. On an operating basis, we earned $1.20 per share for the quarter, which produced an annualized return on equity of 12.1% for the first quarter 2014 compared to 12.9% for the same quarter in 2013. On a net income basis, Arch earned $1.30 per share this quarter, which corresponds to an annualized rate of 13% return on equity. Our reported underwriting results in the first quarter were excellent as reflected by a combined ratio of 84.7% and were aided by low level of catastrophe losses and favorable loss reserve development. We also benefited from improved accident year performance in our U.S. reinsurance groups, which was more than offset by an increase in the accident year combined ratio in the reinsurance group.

It is worth noting that there were 3 components to the increase in the reinsurance group's accident year combined ratio. In the first plays, the mix of business changed with the group writing less property cat business, which has a lower expected loss ratio. And secondly, our reinsurance group over the past 12 months found more casualty and professional liability business both in the U.S. and internationally, which met our return thresholds. And third, because some of these casualty business we underwrote has a longer duration, which should produce excellent economic returns, we follow our historical practice for reserving very long-tailed business at a more conservative level. The longer the tail, the more conservative is our loss take. And historically, this approach has worked very well for us. So no need for us to change that methodology, and we chose not to.

Net investment income per share on a sequential basis was flat in the quarter at $0.49 per share. Our operating cash flow for the quarter was approximately $200 million, a bit less than the $205 million from the same period last year. The total return on the investment portfolio was 100 basis points for the quarter, inclusive of fluctuations in foreign exchange rates. Our book value per common share at March 31, 2014, rose to $41.53, increasing by 4.3% sequentially and 10.3% relative to first quarter of a year ago.

Now let me return to the strategic initiatives I mentioned earlier. As you know, we, along with Highbridge Principal Strategies, a subsidiary of JPMorgan Chase & Co., launched a newly-formed multiline reinsurer, Watford Re, in late March with $1.1 billion of initial capital. Arch invested approximately 11% of the common equity and will serve as Watford Re's reinsurance manager. Mark will go into more detail on the accounting for Watford when he gets to his prepared remarks. Despite the late start in the first quarter, Watford Re was only formed in the last few days of the quarter, Arch ceded $32.2 million of premiums to Watford Re. We believe that this new venture will benefit shareholders of both Arch and Watford Re.

Our mortgage segment includes primary mortgage insurance written through Arch MI in the U.S. and internationally, reinsurance treaties covering mortgage risk, which is written globally as well as other risk-sharing and structural mortgage business. Our mortgage insurance business in the U.S. serves 2 major markets: credit unions and banks and other mortgage lenders. Arch U.S. MI represents about 40% of the $43.3 million of net written premium in the first quarter of 2014, most of which is attributed to the credit union sector.

As we discussed on prior calls, in the banking sector, we continue to build our client base. As of last week, we have received over 100 master policy applications from banks, of which 98 have been approved. 13 of these approvals represented national accounts and the rest are regional or local banks. The number of master policies is increasing each month with March approvals double February's rate and April is running at 2.5x the March rate. Of course, approvals are the first step in this process. It takes time to integrate systems, and then get into the bank's rotation in order to receive new mortgage insurance policies. Our sales force is working hard on this. And they are incented to achieve their sales targets all the time.

In the primary markets, in which our insurance group participates, we continue to obtain rate increases above most trends, slightly above the levels that we observed last quarter. In our U.S. insurance operations, we achieved rate increases in the quarter that provided 120 basis points of expected margin improvement we do as better than the last quarter. We continue to see best opportunities in some sectors of the E&S market and in our binding authority and program businesses. In these areas, we have been steady -- we have seen steady improvements in pricing and steady gain in exposure units, which contributed to a solid growth in the first quarter, although we did observe the large account casualty and professional liability guaranty core segments coming under more pricing pressure in this first quarter of 2014. We currently remain a minor player in these sectors.

On the reinsurance side of the business, we have seen a continuation of softening in terms and conditions that we noted in our prior quarter's remarks. As you have heard on other calls, the property cat area remains under pressure primarily due to the alternative capacity that has entered the market. For the first quarter, we experienced approximately a 15% reduction in property cat rates on a gross basis. Also as we reported on the last quarter's call, cedents are aggressively requesting additional ceding commission on quota share contracts of between 2% and 4%. And reinsurance buyers continue to shift business to excess of loss treaties. Let me remind you again since we are both an insurance and reinsurance enterprise, should we experience pain in our insurance segment, we stand to benefit from the improvement in terms of -- on our insurance operations as we are significant buyers of reinsurance.

From a production point of view, gross written premium in the reinsurance segment grew by 14.8% over the same period last year due to 2 significant treaties written in 2013 on a risk-attaching basis as well as some new international casualty treaties. Net written premium increased just 5% over the same period due to additional retro purchases in our cessions to Watford Re. The insurance segment grew premium by 6% on a gross basis and 8% on a net basis. Most of our growth is coming from loan lending accounts and our loss-sensitive business, which is national accounts and constructions, mostly written on large deductible loss-sensitive basis. Group-wide on an expected basis, we continue to believe the ROE on the business we underwrote this quarter will produce an underwriting year ROE in the range of 11% to 13% with our improvements in the insurance group results offset by the deterioration in the reinsurance group, primarily due to lower cat rates. The higher reserving rates for the casualty business in the current accident year will not affect the underwriting ROE at ultimate in our reinsurance business.

Before I turn it over to Mark, I would like to discuss our PMLs. As usual, I would like to point out that our cat PML aggregates reflect business bound through April 1 while the premium numbers included in our financial statements are through March 31 and that the PMLs are reflected net of reinsurance purchases and retrocessions.

As of April 1, 2014, our 250-year PMLs for a single event decreased to $705 million in the Northeast or 11% of common shareholders' equity. This is the late -- this is the lowest level, I think, I believe, in our history while Gulf PMLs also decreased to $624 million. Our Florida Tri-County PML now stands at $488 million. We note that these reductions reflect a change in catastrophe models from RMS version 11 to version 13 as well as opportunistic retrocession purchases that we chose to buy.

I will now turn it over to Mark to comment further on our financial returns and results. And after his prepared comments, we will entertain your questions. Mark?

Mark D. Lyons
Chief Financial Officer, Executive Vice President and Treasurer

Great. Thank you, Dinos, and good morning. As you've noticed by now, we've made some changes to our reporting format. We added 2 new segments in addition to our prior insurance and reinsurance segments as well as modified some line of business definitions. The new segments are mortgage business and the colorfully named other segments.

The mortgage business segment encompasses both insurance and reinsurance across U.S. and international operations. And additionally, any risk-sharing transactions with the GSEs or banks would be contained here. Previously, mortgage insurance, reinsurance and risk-sharing transaction results were reported within the reinsurance segment. But that is no longer the case. And we have provided apples-to-apples comparatives, so you can properly reference prior periods.

The second new segment, called other, currently reflects the Watford Re results, which is a new Bermudian Class 4 reinsurer with an A- A.M. Best rating and, as Dinos said, a $1.13 billion in total capital. Arch acts as Watford's underwriting manager while Highbridge, as a subsidiary of JPMorgan, manages Watford's investments. Even though Arch only holds an 11% minority interest in the common shares of Watford Re, along with some warrants, we have consolidated 100% of their results in Arch's financial statements with a requisite offset reported as noncontrolling interest. We

have consolidated Watford, not due to our percentage ownership but due to the accounting rules of variable interest entity or VIE. Therefore, Arch's consolidated statements now reflects Watford's assets, liabilities, cash flows, revenues and other income statement items at a gross 100% level with the corresponding approximate 89% noncontrolling interest removed as a single-line offset, where appropriate. Unlike other segments, Watford has its own operations and accordingly, has its own assets, investment strategy and management. We will present Watford's results inclusive of its invested performance.

The other change we made within our financial presentation is our definitional grouping of products within the insurance segment. Some lines are broken out more finely than before, whereas others are combined with previously provided lines. In both cases, groupings were made with an eye towards our line of management accountability in conjunction with materiality levels.

Now I'll proceed to report on our financial results for the quarter. At this point, the financial results of ACGL with or without Watford Re are not materially different from each other since Watford only had $2.2 million of net earned premium. Over time, however, as Watford Re grows, they will become more significant, and I will make some comments that include or exclude their results as appropriate in those future quarters. The only comment of significance this quarter is to point out that ACGL's cash increased approximately $1.1 billion. This is predominantly due to the capital raised for Watford Re in late March and that Arch is consolidating Watford. For this quarter, I will make financial comments that include Watford since they don't move the needle at this time.

The consolidated combined ratio for this quarter was 84.7% with 0.6% of current accident year cat events net of reinsurance and reinstatement premiums compared to the 2013 first quarter combined ratio of 84.6%, which reflected 1.5% of cat-related events. Cat losses occurring in the 2014 first quarter represented $5.5 million net of reinsurance recoverable and reinstatement premiums, emanating from various events. The 2014 first quarter consolidated combined ratio also reflected 9.5 points of prior year net favorable development compared to 7.1 points of prior period favorable development in the 2013 first quarter.

86% of this net favorable development was from the reinsurance segment with nearly 75% of that due to net favorable development on short-tailed lines primarily associated with the more recent underwriting years. Approximately 20% of the reinsurance segment's favorable development was attributable to longer-tailed lines mostly emanating from the older 2003 to 2005 underwriting years. The remaining 5% of the reinsurance segment's net favorable development was attributable to medium-tailed lines throughout many underwriting years. The insurance group accounted for 14% of the aggregate net favorable development, which was almost entirely driven by short-tailed lines in recent accident years.

Similar to prior periods, approximately 68% of our total net reserves for loss and loss adjustment expenses of $7.2 billion are IBNR or additional case reserves, which is a fairly consistent ratio across both the reinsurance and insurance segments over time. Therefore, the current accident quarter consolidated combined ratio excluding cats for the first quarter was 93.6% compared to 92 point -- 90.2% accident quarter combined ratio in the first quarter of 2003 (sic) [2013]. In the reinsurance segment, as Dinos has already commented on, the 2014 accident quarter combined ratio excluding cats was 92.6% compared to 79.7% in the corresponding quarter of 2013 and 85% in the 2013 fourth quarter serially.

The reinsurance segment's results this quarter reflect a reduction of property cat writings on a gross basis with additional retrocessional support as well, along with an increase of casualty business, driven by a large U.S. professional liability treaty and some European excess of loss contracts. In the insurance segment, the 2014 accident quarter combined ratio excluding cats improved to 94.8% compared to 97.9% a year ago, showing continued improvement in margin expansion that has been aided by the lesser volatile smaller account strategy implemented over the last half dozen years.

Also on a consolidated basis, the ratio of net premium to gross premium in the quarter was 82.2% versus 81.9% a year ago. In the reinsurance segment, the net-to-gross ratio was 85.9% in this quarter compared to 93.8% a year ago, primarily due to the changing mix of business on a written basis and the increased use of the retrocessional coverage as previously mentioned. The insurance segment had a 74.7% net-to-gross ratio compared to 73.2% a year ago as a function of the lesser volatility businesses that they continue to expand upon.

The consolidated expense ratio of 34.0% this quarter is 2.5 points higher than the 31.5% expense ratio reported in the first quarter of 2013. This is largely driven by increased acquisition expenses in the reinsurance segment along with operating expenses related to our U.S. primary mortgage insurance operation. The insurance segment's expense ratios was flat with the first quarter of 2013.

As respect to pricing levels, the U.S. insurance operation, as Dinos mentioned, achieved a net 120 basis point margin expansion in the quarter over the corresponding quarter of 2013. Margin expansion, as a reminder as we report it, represents the excess of written effective rate increases over estimated loss trends. Margin expansion continued in our program, casualty and construction and national account businesses while contracting slightly in health care and property. We are continuing to see a lower level of loss cost inflations but are approaching these trends cautiously.

Our new mortgage business segment posted an 81.3% calendar combined ratio for the quarter. The expense ratio of 59.4% is largely driven by front-ended operating expenses assumed during the CMG and PMI acquisitions, such as staff and infrastructure to support the acquisition of premium for the bank channel of our new U.S. primary mortgage operation. The increase in net written premiums of $17.5 million this quarter is driven by premium gains from our new U.S. primary operation, mostly the credit union channel, as Dinos mentioned, and by assumed premium emanating from the 100% quota share of PMI's 2009 to 2011 underwriting years as part of the aggregate acquisition of those platforms. Other reinsurance business added nearly $5 million of net written premium, offset by an approximate $11 million in reduction from one reinsurance treaty.

At March 31, 2014, we held $5.3 billion of risk in force from our primary U.S. operations, an additional $5.5 billion through our mortgage reinsurance and risk-sharing operations. Risk in force is a standard measure of exposure in the mortgage insurance industry that generally represents approximately 25% of the total aggregate loan values. It is this risk in force figure that forms the basis for capital ratios used by the GSEs, regulators and rating agencies. This segment also experienced $1.2 million of net favorable development this quarter, which represents approximately 3 combined ratio points. This net favorable development mostly emanated from older report years that had better-than-expected emergence.

The other segment currently contains the results of Watford Re. As I've discussed previously, Watford Re was consolidated into Arch's financial statements at a 100% level. Therefore, the $32.2 million of net written premiums written by Watford this quarter represents 100% of all the business they assumed and not just Arch's 11% common share interest. Adjustments for the noncontrolling interest are made in the single adjustment lines in net income rather than each line on the income statement, balance sheet or cash flow statement. Watford Re reported a 151.8% calendar combined ratio on a small net earned premium base of $2.2 million. Certain start-up expenses associated with the formation of Watford were also reflected, and these should be viewed as nonrecurring.

Reported net investment income in the quarter was $0.49 per share, substantially unchanged from the 2013 first quarter of $0.48 a share. Our embedded pretax book yield before expenses was 2.27% as of March 31 compared to 2.38% at prior year end. The duration of the portfolio increased this quarter to 3.24 years from 2.62 years as of year end. The total return on the portfolio was 100 basis points in the quarter with noninvestment grade, fixed income, equities and alternatives augmenting returns on our core investment-grade income portfolio. Excluding foreign exchange, total return was marginally different at 102 basis points in the quarter. The effective tax rate on pretax operating income for the first quarter of 2014 was an expense of 1.7% versus an identical expense of 1.7% in the first quarter of 2013. As always, fluctuation in the effective tax rate can result from variability in the relative mix of income or loss reported by jurisdiction.

Arch's total capital was $6.8 billion at the end of this quarter compared to $5.7 billion at the end of 2013's first quarter and $6.5 billion at year-end 2013. The $1.1 billion increase in total capital from a year ago is primarily driven by the $500 million debt raised in December of 2013 plus approximately $600 million of retained earnings over the last 4 quarters. Our capital structure now at March 31 is comprised of 13.2% debt, 4.8% preferred and 82% even of common equity. At the end of this quarter, we continue to estimate having capital in excess of our targeted capital position. And as Dinos has just mentioned, book value per share, as a reminder, increased 4.3% in the first quarter, up to $41.53, which is also 10% -- 10.3% higher than a year ago. The growth in book value this quarter is driven by the company's continued strong underwriting results.

With these introductory comments, we are now pleased to take your questions.

Constantine P. Iordanou
Chairman and Chief Executive Officer
So Glenn, we're ready for the questions.

Question and Answer

Operator

[Operator Instructions] And our first question comes from the line of Amit Kumar, Macquarie.

Amit Kumar
Macquarie Research

Just 2 quick questions. The first question goes back to your comment on capital and, I guess, declining PMLs and your 2 new initiatives. I was just wondering, how should we -- maybe can you update your views on potential acquisition opportunities in the marketplace versus what you're building out right now? Does your view change if something presents itself? Or are you more focused on MI and Watford Re right now?

Constantine P. Iordanou
Chairman and Chief Executive Officer

Multiple questions. Let me start with we're always focused intensely on everything that we run. I don't care if it's insurance, reinsurance, the MI or Watford. So that focus is always going to be there. But it doesn't preclude us from also looking forward for another opportunity. Your question about M&A activity, yes, we are willing to look at opportunities presented in the marketplace. But still our preferred way is to build versus buy. We find that from a lot of different perspectives to be more attractive, culturally with better selection or at least the selection of people that we believe culturally fit with us, et cetera. And there are some of those opportunities that we are pursuing now globally that will fit into that category. And of course, we will not say no to a potential acquisition if it fits our characteristics. Is it specialty business? Does it fit with our DNA? Is the underwriting pasture past and going forward, a good fit with us because -- and maybe I'm very biased to culture within a company. And one thing that I'm extremely careful is not to change the culture that we have within Arch. I'm not saying it's better or worse than anybody else. But it is what it is. And since we have had very good performance over 12 years following that philosophy, I'm kind of the guardian of it. So we're more of a difficult company to come to an agreement on an M&A opportunity because of all these issues.

Amit Kumar
Macquarie Research

Got it. That's actually very helpful. The only other question I have is on your MI platform. First of all -- and maybe this is a numbers question. But some other MI players -- and again I'm new to this give sales metrics in terms of new insurance written, et cetera. Would that be in the Q? Or how should we sort of think about the sales metrics?

Constantine P. Iordanou
Chairman and Chief Executive Officer

Well, we're going to be reporting that in our Q. And eventually, don't forget, this is our first attempt on the MI disclosure. And as I said in last quarter, we're looking also from input as to what is going to help you as analysts viewing our business. So any suggestions you have or what kind of information it would be helpful for you to see, get with Don Watson, who is the head of our Investor Relations. And then if we find it appropriate, we'll improve disclosure in our press releases and supplemental data.

Mark D. Lyons
Chief Financial Officer, Executive Vice President and Treasurer

But the overall approach, Amit, is that we'll provide by at least as much as what's standard in the industry for that.

Amit Kumar
Macquarie Research

Got it. That's very helpful. And I guess, related to that, and this is my final question, any update on your views on the MI market? It is, I guess, my understanding that there have been some players who have attributed a slowdown, I guess, to the cold weather in Q1. And there is some discussion, I guess, in that marketplace regarding the housing recovery. Any update would be helpful on the marketplace.

Constantine P. Iordanou
Chairman and Chief Executive Officer

Well, first, a little bit of a shameful plug on our people. If you go on our website, Arch Mortgage Insurance publishes a quarterly newsletter, which gets into a lot of these macro issues. And I will encourage you, instead of taking everybody's time, to get on the website, go to Arch MI and look at the quarterly views that we have on the macro issues within the mortgage insurance space. It is clear that in the first quarter, refiles have been reduced significantly on the basis that interest rates, mortgage interest rates have gone up. And I believe if you look at it from inside mortgage finance, I think the reduction in refiles were like 63% in the first quarter. Having said that, your persistency -- there is no refile goes up on the existing business. So because a mortgage that gets refiled, you're losing the premium if it was already a cover mortgage to a new one that you're going to get under the refile. We're not projecting, at least in the data that we have, a significant change in volume on our credit union business, which is -- but we expect some slowdown over the year because new originations are down and refiles that are way down. Now the more difficult question for us, one, so that's why it's going to take 3, 4 quarters for you guys to get flavor of, is our penetration in the bank channel because we're early on in the process. We're signing these master agreements. We're starting to receive business. But it's a lengthy process. You've got to go through the process of filing and getting approvals on the master agreement. Then the systems, linkage has to be there. And then you're starting to get on the rotation to start receiving that business. Mark, anything else?

Mark D. Lyons
Chief Financial Officer, Executive Vice President and Treasurer

Yes. I would just add Dinos really just had outlined a kind of a staggered approval process. And then I think what supplements that is the fact that the industry is dominated by monthly, not single premiums. So even when you get to the approvals, the business flow takes a while to build because of the monthly nature of the premium renders.

Operator

And your next question comes from the line of John Hall with Wells Fargo.

John Arthur Hall
Wells Fargo Securities, LLC, Research Division

I've got a question, Dinos, related to, I guess, the shifting business mix in the combined ratio in the reinsurance segment. Have we sort of reached a steady state, whereby the mix shift has occurred and the migrations up in the combined ratio is, variable loss experience aside, we've sort of hit where we're going to be on a go-forward basis?

Constantine P. Iordanou
Chairman and Chief Executive Officer

That's a tough question because I've got to understand the mix that we're going to have going forward. I would say probably because of a bit of a conservatism we took on some of the business we wrote that had very long duration, and I'm not talking about 4-, 5-year duration, this is business that it will have maybe 7, 10 and some of it even beyond that duration, we're always very cautious when we price the business and also when we reserve the business because you can fool yourself early on, and we try not to. If you saw where our reserve releases came from casualty in the reinsurance sector, they came from the '03, '04, '05 year. So that tells you it was the same philosophy we had then that, "Hey, let's not celebrate early on very long-term duration business." So not knowing what kind of contracts I'm going to see in the future, I would tell you that we have reached that if the mix is exactly the same next quarter. In all probability, that would be probably down 5 or 6 loss ratio points if we go back to more of our normal mix that we had in prior quarters. So it's a very difficult question to answer unless you have a scenario as to what we're going to write and what type of business going forward. But Mark, do you want to add a few points on that? Spend more time on that analyzing and...

Mark D. Lyons
Chief Financial Officer, Executive Vice President and Treasurer

Yes, I'd be happy to, Dinos. I think, first thing, I've got 2 points to make. I think the first one is that you really got to look, not as much quarter-to-quarter but perhaps what year-to-year would be like. I mean, the first quarter being at 79.7% last year, that was really an 82% for the year. And the fourth quarter ended at like 84%-ish or something. So it's a bit of an artificial movement. But I think what's more important, and I think it's telling that since I changed jobs from the insurance group over, had a chance to really dig into the reinsurance group in this position. When you look backwards, either business emanating out of a U.S. or Bermuda reinsurance operation, not only was it an outstanding job of underwriting, it was an outstanding job of reserving. And when you look now versus then, it's the same cheap actuaries. It's the same management of the segment. It's virtually the same in the holding company, which is what we're talking about here. So it's one thing for a company to say, "We haven't changed anything on the reserve methodology." It's different to say, yet, compoundedly sell, it's the same individuals involved with regard to consistency. And I think that's an important point.

Constantine P. Iordanou
Chairman and Chief Executive Officer

And John, accident year in one quarter, especially the most recent quarter, it's a self-grading exam. Self-grading exams is that something it has more than, let's say, 5-year duration. It's in fool's paradise. At the end of the day, look at me 5 years from today and you'd see how well we've done on that business. Now it makes it difficult for you guys to estimate. And I understand that. But I think the historical performance, which is where Mark is pointing you, might give you an indication of the culture and also the methodologies that we go through in making these long-term reserve decisions that you have to make.

John Arthur Hall
Wells Fargo Securities, LLC, Research Division

No, I appreciate that. And I guess, the profit characteristics, when you talk about the target ROE and the ROE you're achieving here, I guess, there's a greater portion of the most recent quarter's business attributable to investment earnings.

Constantine P. Iordanou
Chairman and Chief Executive Officer

That's correct. When you write a very long-tail line of business, there is a few of these. We have treaties that we have booked at 110% combined. We have treaties that we booked at 115% combined, depending on very long duration of liabilities. And you're going to earn the adequate return because investment income is going to come over many years. So when you take those cash flows, net present value them back, and then you look at it from that perspective -- and that's why I made that comment that the '11 to '13 on an underwriting year basis. Because that's the stage that usually will make all of our decisions. When we bring all the cash flows, we wrote something, it's going to be revenues and expenses going out and claims going out over a long period of time, we bring it all back to that underwriting year, and then we make that determination, what is the expected return. And that's what guides us. I mean, that's been the methodology, not only from a pricing point of view but also from a reserving point of view. And usually, we'll start reflecting some of that depending on the longevity of the business. Maybe 4, 5 years out, we'd take another look at it. We're not going to attach it 4, 5 years because it's too early. You've got to allow the data to come in. You get more confident and you say, "Hey, maybe my reserves a little higher than they should have been." And the beauty about reserve, nobody sticks their hands in your pocket and take some money out. It's in our bank accounts. They're running interest and dividends on our behalf. And at the end of the day, when you recognize them in your financial statements, it becomes data-driven. But data-driven from our perspective needs to have some conservatism in it.

Mark D. Lyons
Chief Financial Officer, Executive Vice President and Treasurer

And John, one of the key principles in any part of the market cycles that we've operated on is that we're driven by the economics of the dealer transaction, not the accounting of it. And I think the best example of that would be excess workers' compensation, which is more -- the green light decision on that is more a function of the interest rates, more than the underlying pricing in some cases because it's a 16- to 18-year duration business. So it's super sensitive to changes in the interest rates and is dominated by the investment return. And that will book poorly. That might be booking at 120% or 130% even in a good market, but it'd be a killer on a return basis.

John Arthur Hall
Wells Fargo Securities, LLC, Research Division

I appreciate that. I just have one point of clarification. In your prepared comments, Dinos, you mentioned that rate in primary market was above loss trend, but you didn't mention what that number was. I was wondering if you can share that.

Constantine P. Iordanou
Chairman and Chief Executive Officer

Well, we said 120 bps improvement. In the last quarter, we said, it was 80 bps. I think the rate increase, on average, I think in the last quarter was 3.8%. This quarter, I think, it was 4.0%. So 20 bps came just from that. Then, there is a little bit of a trend improvement. But when it comes to trend improvements, we are very, very, very hard bunch of guys to convince. We're always -- we look at it, we look at the improvement, but we don't factor it a lot on our published numbers until -- we're from -- what's the town?

Mark D. Lyons
Chief Financial Officer, Executive Vice President and Treasurer

Missouri.

Constantine P. Iordanou
Chairman and Chief Executive Officer

We're from Missouri. We -- it's got to prove itself. But I can tell you, I look at a lot of these indications. I think they actually see a -- they see a lot of me, and I don't know if they like it or hate it, but I'm the only actuary in the room usually, and they're all around me. But a lot of our indications, the positives, the trend indications better than expected and, more importantly, we do an analysis on actual versus expected. We got these curves, and then we try to see what expected losses we expect from all the underwriting years for the quarter and how much has come in, and those have been extremely good, especially this quarter. But one quarter can always fool you, but we have consistency in looking at actual versus expected and being very, very positive.

Operator

Your next question from the lines of Michael Nannizzi, Goldman Sachs.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Let me just ask, if I can, on the reinsurance book. Is there -- was there anything unusual, I mean, in this quarter about the profitability of that book? Or I realized that year-over-year is a little different because of mix because but just standalone this quarter, anything unusual about where that -- where the profitability came in?

Constantine P. Iordanou
Chairman and Chief Executive Officer

Yes. The only thing unusual is that we expect less from the property cat from 2 points of view. One is less volume because -- and second, probably a little less ROE because of the rate reduction. We're not happy about it. But listen, even the best management teams can't fight Mr. Market. And Mr. Market is going against us in that particular segment. So that's the only thing unusual. Everything else is as normal as anything We look at transactions, we look at a potential profitability and, long term, we don't care if it's short tail, medium tail, very long tail. As long it makes the return characteristics, we do it. And as Mark said, we don't really pay too much attention on the accounting.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Got it...

Mark D. Lyons
Chief Financial Officer, Executive Vice President and Treasurer

Just to add one thing there, I think, to one of the intents to your question. No, there was no underlying influx of paid claims, reported incurred claims, frequency or severity that would have caused this and cause movements, no. There was nothing of that kind.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Great. And I guess, I mean, if we were to isolate the cat reinsurance book, what impact, would the pricing that we've seen, have on the attritional loss ratio? And with all else equal, would you expect that the attritional loss ratio in that book, given pricing, is now higher?

Constantine P. Iordanou
Chairman and Chief Executive Officer

Well, listen. Putting volume aside, because there is a reduction in volume, because it forces us to buy more retro, we felt it was advantageous for us to buy retro. The cost of capital of some of our retro providers is lower than ours. So in essence, they allowed us to buy that in what we think. On an expected basis, a good price. So putting aside volume, we also believe that, based on our own calculations, the ROE projections, expectations, on our cat book has gone down by 2 to 3 points. So if we thought on a net basis, we had, let's say, 15% to 16% ROE last year. This year, it would be more like 12% to 13% ROE.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Got it. So just overall, I mean, your book aside, I mean, is probably why you're shrinking and then your expectation would be is if pricing continues to recede in property cat business that margin should fall, attritional loss ratio should rise. That would be the logical outcome.

Constantine P. Iordanou
Chairman and Chief Executive Officer

Well, in the cat business, it's feast or famine. You don't have the event, it's not going to show up. Let me remind you guys. We had very little exposure in Japan. We saw Japanese rates that were ridiculously low. We didn't participate. Our PML in Japan before the quake was $75 million. And it was from international programs that we couldn't even avoid. We didn't have much of Japanese only quake. But that served us extremely well when that event happened. Because at the end of the day, even though we looked foolish for 10 years, if there was no quake, there is no losses. So any premium you wrote, it became profit. We were proven right 10 years later. So I have a lot of confidence in our cat teams. I think we have great analytical team there from -- and great underwriting team. And I don't -- one area that I don't put my 2 cents in, and usually I like to in a lot of areas, is in the cat area because I think those guys are better than me. I wish I can get as good as they are.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

It's great. And then -- and I guess, metrics on the MI book. I mean, risk to cap, maybe different from other carriers, just given the way you run that business, a breakout of primary to risk sharing in reinsurance that -- and then some demographic data on the profile of the book. Vintage, for example, would be helpful. And then, just last one on -- numbers question. Where -- what were the startup costs in the quarter just so we can try to think about what the business should run at excluding those costs that hit the first quarter?

Mark D. Lyons
Chief Financial Officer, Executive Vice President and Treasurer

Yes. It was roughly $2.6 million, plus there was some unusual ones and you can see it in our presentation, and we have a line called other expense -- oh, I'm sorry, that was...

Constantine P. Iordanou
Chairman and Chief Executive Officer

That was MI.

Mark D. Lyons
Chief Financial Officer, Executive Vice President and Treasurer

You're talking -- oh, I'm sorry, I'm sorry, called MI startup cost.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

The MI, yes. Sorry about that. Yes.

Constantine P. Iordanou
Chairman and Chief Executive Officer

Well, the -- we have the MI startup costs. And we have a sales force that came on board ahead of the transaction and we'd been expensing that. So we have a lot of expenses in the first quarter from the sales force which has no corresponding revenue attributed to it. Because, don't forget, we got 2 sales forces. One, which is the existing business, which is CUNA Mutual employees working on our behalf, that they distribute to the credit union channel. And then, our own sales force who is trying to penetrate the bank channel and other mortgage originators, and so all that. And we can get you a number. I haven't added either all up, but I'll get Mark Lyons, and then we'll try to figure that number out. We haven't...

Mark D. Lyons
Chief Financial Officer, Executive Vice President and Treasurer

So one thing you need to understand about this, the totality of how this works is that there's a -- like a shared services agreement that goes on that varies by quarter on what services were performed. So we have everybody on the old PMI on to our payroll system now. But there's offsets associated with various classes of work, accounting work, IT work, claim-handling work and so forth that is measured and there's metrics that determine what that percentage allocation is. So over time, there will be a shift where it's going to be more resident in Arch. Right now, a lot of that is still pushed off as a credit against it, but it really varies by quarter. So understandably, it's going to be a little bit hard for you to see through that. That's a little opaque. But that's the dominant driver of the OpEx from quarter-to-quarter.

Constantine P. Iordanou
Chairman and Chief Executive Officer

But the one area you can focus eventually is I think we got about 40 people in the sales force, all that is going to be our cost. I mean, we're not going to share that because we're building, right? We're building. We have the sales force, the sales force is our expense. We don't -- we're expensing it as we go with salaries and benefits, et cetera. And the revenue is going to come down the line. There is loyally insignificant amount of revenue coming from the bank channel in the first quarter. It will be starting to show up in the second, third and fourth quarter. I don't know to what magnitude. It depends how effective we are. But we're going to build out the stage.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Got it. Maybe a better way to ask you. Once you reach scale and once you kind of reach critical mass, where do you think those -- the acquisition and/or operating expenses should kind of run to?

Mark D. Lyons
Chief Financial Officer, Executive Vice President and Treasurer

Again, it's hard to ask -- hard to answer. But if it's 3 years or more out, now, for the entire segment now, it should be 20 -- or in the 20 area. That doesn't mean every unit within the mortgage business run through that.

Operator

Your next question comes from the line of Vinay Misquith, Evercore.

Vinay Gerard Misquith
Evercore ISI, Research Division

Well, the first question. Just wanted to clarify on the reinsurance operations. So about a 93 sort of accident year x cats, that's the normalized -- I mean, that's the new norm, correct? I mean is that the way to think about it?

Constantine P. Iordanou
Chairman and Chief Executive Officer

No, no. That's not the new norm. I said you might be 5 or 6 points off.

Vinay Gerard Misquith
Evercore ISI, Research Division

So this quarter was 5 or 6 points higher than the normal, you were saying?

Constantine P. Iordanou
Chairman and Chief Executive Officer

Assuming no change, like I said, you heard my comments, right? Assuming no change in the mix, the mix -- if I write a lot of very long tail business because I continue to find opportunities there in buying those contracts, it might still be another quarter 92, 93. But if I go back to more of a traditional mix, it will probably be at least 5 or 6 points lower than that. And Mark just went through the evolution of it. It didn't come overnight. In the past, we were below 80. There has been some deterioration to that which we will always reflect because of additional cost in ceding commissions. And then, there is some deterioration to that because of change of mix, less short tail as a percentage of the total that has low accident year loss ratio on an expected basis. So I would say, mid-80s is more of a number. But let me caution everybody, it will depend on our mix.

Vinay Gerard Misquith
Evercore ISI, Research Division

Sure. Okay, that's helpful. The second question was on the MI business. I thought that -- I mean, you'd said that it would take about maybe 2 or 3 years to really gather steam and to contribute to the bottom line. It seems that, I mean, even the new acquisition, that's actually having a small positive impact on the bottom line this quarter. Just curious as to whether you think that impact is going to increase even in the near term?

Constantine P. Iordanou
Chairman and Chief Executive Officer

It will -- again, it will depend as we start getting more business, how do we do with these books, target transactions. So it's hard to predict, right? But don't forget, even though it's positive and it's good news, I think it's positive faster than we thought, right? We didn't expect to have a positive earnings especially with front-loaded expenses on this first quarter. The ROE associated with it is not acceptable to us. Long term, it's going to be much better. But a lot of the other indicators we're very, very pleased with, especially on the existing book that we have for credit union business. First quarter numbers was at -- the delinquency rates are coming down, and they're coming down significantly. And on new delinquency rates in the quarter, they were down by 24.7%, that's a significant number. The average course per claim in one quarter was down by almost 20% from an average of 48,000 at year end to 38,000 at March end. So there is a lot of positive on the -- and this is -- I'm only talking about the U.S. MI, and I'm only talking about what we do with the credit union business. So there's a lot of positive indications because that is an existing book, we have it, we own the old, we own the current and we're going to own the future. So those indications tell us that this is a good segment to be and it's with a very acceptable profitability.

Mark D. Lyons
Chief Financial Officer, Executive Vice President and Treasurer

And, Vinay, I would suggest simply, just think of it like this. The U.S. MI operation versus, I'll say, everything else, reinsurance operations and everything else, has comparably outstanding loss ratios. The primary business has the drag of expense that we just we talked about because of the front end load nature, where the reinsurance transactions do not.

Vinay Gerard Misquith
Evercore ISI, Research Division

Right, right. Okay, that's helpful. And the $6.7 million from the 100% quota share from PMI, so will that occur every quarter? Or is it a onetime deal?

Constantine P. Iordanou
Chairman and Chief Executive Officer

No. It's quarter-over-quarter. That's a business that's already on the books. And usually this business takes, I don't know, 6, 7 years to run off, right?. So this is business they wrote in -- right before they went into receivership, that would be '09 through '11. So I mean, it's going to -- there is declining revenue coming over time because some of the more -- the mortgages that they get off of that is those that they achieve more than 78% loan-to-value and the mortgagee decides to interrupt the insurance, refiles that they drop off, otherwise -- or a sale when the mortgage gets set aside. But usually, the tail on these is about 6, 7 years. So it will go out until '16, '17, taking 10 as the midpoint of this.

Operator

And your next question comes from the line of Kai Pan with Morgan Stanley.

Kai Pan
Morgan Stanley, Research Division

So first, on the investment side, the duration extended from 2.6 to 3.2. Is that related to now and sort of you have longer duration liability on the, particularly, on the reinsurance side?

Constantine P. Iordanou
Chairman and Chief Executive Officer

Well, it's a -- yes, a little bit of that. A combination also where we believe with -- at least our investment people believe where interest rates with the new Fed Chairman might or not might go, but we're not -- duration for us usually gets conservative. We think that there is imminent rise of interest rates. We don't see that yet, at least for the next year or so, based on statements they made. So we make that adjustment. And also, we always match duration of reserve liabilities with the assets covering those.

Kai Pan
Morgan Stanley, Research Division

And so, would we expect to add this sort of -- with the higher duration than the higher, like, investment yields?

Mark D. Lyons
Chief Financial Officer, Executive Vice President and Treasurer

Could you ask that again?

Constantine P. Iordanou
Chairman and Chief Executive Officer

Higher duration...

Kai Pan
Morgan Stanley, Research Division

Where you said your longer duration of your investment book, is that the average sort of yield?

Mark D. Lyons
Chief Financial Officer, Executive Vice President and Treasurer

I don't think it's going to move the needle. We got 14-plus billion dollars of investable assets, a few hundred million won't move the needle that much. And also, what's the thickness of the yield curve? Because they, quarter-after-quarter, flattened out in the quarter just passed that made you a little more indifferent to where you were.

Kai Pan
Morgan Stanley, Research Division

Okay. Then, second question, on Watford Re. Besides sort of your minority interest in the operation, and what other sort of economic benefits for Arch in terms of the ceding commission or the others?

Constantine P. Iordanou
Chairman and Chief Executive Officer

I mean, it's what we put in our -- we get paid for that activity upfront as managers of reinsurance, and then we have a performance fee that we get at the end on underwriting performance, total return performance. So that's the benefits that we get as an organization for that business that goes there.

Kai Pan
Morgan Stanley, Research Division

In terms of accounting, where are those sort of booked in your income statement?

Mark D. Lyons
Chief Financial Officer, Executive Vice President and Treasurer

Yes, acquisition.

Kai Pan
Morgan Stanley, Research Division

Okay, okay. Lastly is on the capital management. Now you have the MI and Watford Re behind you, and the stock is trading at 1.4x book, probably a little bit off your threshold. And at the same time, you still have excess capital. So what's your preferred way to deploy the excess capital? And have you considered, like, a dividend?

Constantine P. Iordanou
Chairman and Chief Executive Officer

Our preferred ways to deploy in our business, and there is a few opportunities that we're still looking at, so that hasn't changed. I haven't given it a lot of thought if we're going to do a dividend or share repurchases because right now we're focused on the opportunities rather than how to return capital to investors. And let's face it, they're paying us to find the opportunities. And I'm spending a lot of time and all of our people are looking at new opportunities. And there is quite a few out there in the market.

Operator

Your next question comes from the line of Ryan Byrnes, Janney Capital.

Ryan J. Byrnes
Janney Montgomery Scott LLC, Research Division

Great. Quickly on the Watford segment, how long should that take to get to scale? Because, again, thinking from a reinsurance standpoint, you'd think it should be able to get to an underwriting premium dollars in a fairly quick manner?

Constantine P. Iordanou
Chairman and Chief Executive Officer

I would think maybe 3 years or so. It's going to take at least 2, maybe 3 years to get to scale. It depends on a lot of things, market conditions, et cetera, with the opportunities. But we don't force things. We're going to go with -- our obligation to them is to be prudent underwriting managers. That's what we got hired to be. Use the techniques that we have been using for Arch, and look for the opportunities for them. And if it takes 2 years, fine; if it takes 3 years, it's fine. I don't -- and as Highbridge is going to focus on the investment returns, I think they have the same approach. They have a long-term approach to it.

Mark D. Lyons
Chief Financial Officer, Executive Vice President and Treasurer

And remember, this year is already just the 9-month year.

Ryan J. Byrnes
Janney Montgomery Scott LLC, Research Division

I'm sorry, because it was closed and...

Constantine P. Iordanou
Chairman and Chief Executive Officer

They just bought it March and...

Mark D. Lyons
Chief Financial Officer, Executive Vice President and Treasurer

Yes, March. Right.

Ryan J. Byrnes
Janney Montgomery Scott LLC, Research Division

Yes, sure. Certainly. And then, just my last question on the increased retro purchases for the property cat book, it clearly had -- looks like it had an impact on your 1-in-250 PMLs. But just wanted to see where in the risk curve you're trying to -- you're seeking this efficiency? It certainly seems like they're in 1-in-250 level, but I want to see how far lower that goes.

Constantine P. Iordanou
Chairman and Chief Executive Officer

Well, I'll give you the 40,000 foot view to this because it's a little more complicated than that. But we try to maintain the customer relationships that we have. There is more tendency because capacity is plentiful and available for a lot of the buyers who want you to play across the placements. So they don't want you to pick and choose layers, et cetera. Usually, we don't like to be down on the frequency area. We believe that's -- this is a high rate on line areas that also have a lot more exposure from a frequency expectation. So that's where we buy most of our overall retro. So on the front end of the curve, we buy more retro. We don't like to be at the tail end of the curve because -- so even on a direct basis, we don't bring in that business. We're not there to put a lot of PMLs or a lot of capacity on 2% or 3% rate on line business. We try to avoid that. So that's the general principle or, what, thought process. And with that, that's where our cat teams go and buy the retro sessions.

Operator

Your next question comes from the line of Meyer Shields, KBW.

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

Two quick ones, if I can. One, when we look at the other segment, I guess, I would have expected the income available to Arch to be about 11% of total. But coming a little bit less, I'm wondering what I'm missing there?

Mark D. Lyons
Chief Financial Officer, Executive Vice President and Treasurer

Well, it's not exactly 11%. It should -- it's within spitting distance of 11%. So I'm not sure exactly what you're looking at because it's there.

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

I guess, what I'm thinking, and maybe this is the accounting of it, that since you've got the 11% stake and you're collecting fees, the net impact should translate into a higher percentage.

Mark D. Lyons
Chief Financial Officer, Executive Vice President and Treasurer

Right. And part of it is geography. Because this is Watford Re, the fees that we earn don't go to Watford Re, they go to Arch.

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

Okay. Got it...

Mark D. Lyons
Chief Financial Officer, Executive Vice President and Treasurer

So it's going to be our numbers, right?

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

Right. But is it in the other segment showing above it?

Constantine P. Iordanou
Chairman and Chief Executive Officer

Well, the other segment is going to be the investment. And that will be pari passu with any other investor in Watford Re. Fees and/or profit commission because of our performance as underwriting managers or Highbridge's investment managers and all that, is not going to be on this line.

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

Okay. That's in the acquisition...

Mark D. Lyons
Chief Financial Officer, Executive Vice President and Treasurer

And we do sympathize because you're looking at the 100% numbers, and you got them on each line of account at 100%. And then, there's one line that's an amalgamation of all the impact, that's the 89% subtraction. So we don't make the rules. We got to follow them.

Constantine P. Iordanou
Chairman and Chief Executive Officer

Right.

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

Yes. That's fully understood. With regard -- just to follow up on Kai's question before. I understand that the flatter yield curve limits the benefits of the increasing duration, but then why increase duration in the quarter?

Constantine P. Iordanou
Chairman and Chief Executive Officer

For our belief, it's what a yield curve is and where it's going. We elongate it by almost half a year in duration. Our approach to duration is that with much liabilities on the reserves. This way we don't take any risk there. When we borrow funds, right, we try to have the cost of those funds on the spread. So in essence, by us borrowing $500 million that pushes us to increase duration a bit. And then, we use the shareholders' capital to vary duration up and down depending on how we view where the prospects and where the yield curve is going to go. That -- so that's the combination of all 3 principles in 1. And like I said before, that's what pushed us, our investment, people, to move duration to the level that we have.

Operator

Your next question comes from the line of Jay Cohen with Bank of America Merrill Lynch.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Yes. I guess, a question on Watford. The premiums that you ceded to Watford, is that basically a mirror image of your whole book? Or were there only particular lines that were ceded?

Constantine P. Iordanou
Chairman and Chief Executive Officer

No. It's -- to almost simplify it, it was a few transactions. Some of it mirrors what we have, some of it doesn't. But don't forget, Watford wasn't in business. And some of it, think of it as, at least for the first quarter, we will have something that they might have written direct themselves. And then, we ceded it back to them. We're the underwriting manager. So we said, "Hey, this will fit Watford." We didn't want to lose time and wait for them until they were in business. So we might have bound a piece of business, put it on Arch, and then we cede it to them when they were up and running.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

That's helpful. And then...

Constantine P. Iordanou
Chairman and Chief Executive Officer

You're not going to see 100% sessions from March to Watford in future quarters. What you're going to see is going to be some sessions from us because we still is -- we're ceding to a lot of reinsurance, Watford being one of them. And also, you want to see a lot of deals that Watford will write direct.

Mark D. Lyons
Chief Financial Officer, Executive Vice President and Treasurer

And also, Jay, back to the whole underlying theory of it. Although there's property cat that may be there as a piece of the overall portfolio, in all likelihood, it's always going to be a lesser percentage than what Arch would have. And therefore, a longer duration on the liability stream of Watford versus the average of Arch.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

And in the casualty business, you will see -- or I should say, they will write at the end of the day. Do you think that will be a lot different than the casualty business you have? Or I've seen they have some similarities to it.

Constantine P. Iordanou
Chairman and Chief Executive Officer

They're going have -- listen, it's the same underwriting standards, right? We view their advantage is that I think we can assume a bit higher investment yield. And so, that always -- and I don't know transaction by transaction, but it might push you to maybe a little longer duration in liabilities-type of business because that's where their advantage becomes greater. So -- but only time will tell. As we see the transactions, either for us and/or Watford come in, and then our underwriting people apply our standards to come up to expect that ROE and see where it fits.

Operator

Your next question comes from the line of Brian Meredith with UBS.

Brian Robert Meredith
UBS Investment Bank, Research Division

I had 2 questions here for you. First on the mortgage insurance operations, where do you guys stand on getting on the platforms of the large national banks? And then...

Constantine P. Iordanou
Chairman and Chief Executive Officer

We got 13 already out of the top 40.

Brian Robert Meredith
UBS Investment Bank, Research Division

But what about the big 3? Because that's where a lot of it comes from.

Constantine P. Iordanou
Chairman and Chief Executive Officer

Well, we're still in the process. I don't know exactly where we are. And I don't know who the top 3 in your mind are. But we're not going to comment on specific relationships that we have. But believe me, we -- our goal is to be in all top 40 all the time. And we're working hard to get approval from all of them.

Brian Robert Meredith
UBS Investment Bank, Research Division

Okay, great. And then, I guess, my second question for you, Dinos, is I'm just curious. So increasing in casualty reinsurance business, although if you listen to people in the market and they're talking about higher ceding commissions and a lot of capacity there, I just want to understand why is all of a sudden the casualty reinsurance business that much more attractive is because interest rates are up, call it, 100 basis points year-over-year. Is there something else happening?

Constantine P. Iordanou
Chairman and Chief Executive Officer

No. Listen, you got to look at transaction by transaction. There is always this displacement in places. 4 years ago, 5 years ago, it was the Moreaux XOL [ph] in France because everybody was withdrawing, et cetera. So we look at these opportunities. We don't like to talk much about it as to where, because if I found a little vein with a little goal in it, and I'm digging into it to -- I don't want every competitor to know what it is, and then they go and they mess up the market. So either you guys trust we've got the underwriting skills to do that, or you don't. And I trust our people. And when they find the opportunities, and we look at the economics if it fits, we do it. And we don't -- and as Mark said, we don't really care that much about the calendar year accounting issues because you can make a decision to buy your reinsurance underwriter on calendar year numbers. You got to understand policy year, and you got to understand their underwriting year performance, and do you trust that they will do a good job in making those determinations.

Mark D. Lyons
Chief Financial Officer, Executive Vice President and Treasurer

Hey, Brian, I think you should think of it is a collection of well-thought-out transactions rather than sector events.

Constantine P. Iordanou
Chairman and Chief Executive Officer

Right. Well, said Mark. You see you're much smarter than I am.

Mark D. Lyons
Chief Financial Officer, Executive Vice President and Treasurer

More tired than you are.

Operator

And your next question comes from the line of Ian Gutterman, BAM.

Ian Gutterman
Balyasny Asset Management L.P.

I'm not as smart as Mark either, so I'm still confused on the reinsurance. I guess, I don't understand why it should be so variable quarter-to-quarter. If we're looking at written ratios, I can get that, but the earn should be a reflection of what you've written over the last year. So -- and I will think that's recently baked into this, a couple of quarters of what this mix change is given casualty has been growing a lot in the past few quarters and cat has been shrinking. I would think we kind of know for the next couple of quarters what it should be. So why might it switch a lot Q2 versus Q1?

Constantine P. Iordanou
Chairman and Chief Executive Officer

Well, don't forget, you had Q1 versus Q1 of a year ago. As Mark said, that thing was inching up along as we wrote those transactions. And some of these transactions we wrote in the third and fourth quarter. So they're inching up as the earnings are coming through. So your statement is absolutely correct. But also you got to go back and see the sequential movement that we have done. The only change to that is what we've done in the first quarter, and mostly it was European kind of business which was not as part of what it was coming from the third and fourth quarter last year. And don't forget, if you go and look at our statements and what we have reported, we talked about some of these transactions. They had a higher combined ratio on an expected basis, but a very good return characteristics over time.

Ian Gutterman
Balyasny Asset Management L.P.

Okay. So if the written patterns stay consistent with the few quarters then, if I'm understanding right, we will see the accident years increase year-over-year, but not as much as the first quarter but sequentially be reasonably similar to this quarter and the rest of it comes through from higher investment income because you're going longer tail. Is that fair?

Constantine P. Iordanou
Chairman and Chief Executive Officer

That's correct. And it might reverse itself and go the other way depending if those transactions get renewed or not as when you get to the expiration.

Mark D. Lyons
Chief Financial Officer, Executive Vice President and Treasurer

Ian, I think, one thing we proved we do, and that is we take -- try to take maximum event as to what the market gives us. And it changes from quarter-to-quarter what it allows and what it gives us.

Constantine P. Iordanou
Chairman and Chief Executive Officer

Right.

Ian Gutterman
Balyasny Asset Management L.P.

No, I agree. I get that on written. I just wanted to make sure I wasn't misunderstanding the earned.

Constantine P. Iordanou
Chairman and Chief Executive Officer

No, no, no. You're absolutely -- you're right on to it. That's why the comparison year-over-year sometimes got to be supplemented by also the sequential change quarter-over-quarter -- quarter-after-quarter, right. Yes.

Ian Gutterman
Balyasny Asset Management L.P.

Got it. And then, on the mortgage insurance business, I guess 2 questions there. One, from just the publicly available rate filings everyone has, it looks like you guys are priced lower than the market. A, is that accurate? And B, sort of what's the thought behind that? Is that just that an easy way to get established? Or something else?

Constantine P. Iordanou
Chairman and Chief Executive Officer

The statement you made is incorrect. I have the table with our competitors, and we're right on -- there is not even a -- out of the table, that is -- it has 1, 2, 3, 4, 5, 6, 7, 8, 16 cells, right? We are slightly lower in only one and not with all, right? And in everything else, I think we're right in line with everybody else.

Ian Gutterman
Balyasny Asset Management L.P.

Got it. Okay. I'll take another look at that. I'm still learning this stuff...

Constantine P. Iordanou
Chairman and Chief Executive Officer

I have Arch compared to Magee, Gradient, Genworth, Essent and NMI, and we have the grid. I mean, the grid I was referring to is the...

Mark D. Lyons
Chief Financial Officer, Executive Vice President and Treasurer

The rate card.

Constantine P. Iordanou
Chairman and Chief Executive Officer

The rate card. And when you look at the rate card, there is one, only one cell that we slightly achieve. Every other cell is exactly the same as everybody else.

Mark D. Lyons
Chief Financial Officer, Executive Vice President and Treasurer

The buyer paid cells, as opposed to the lender paid.

Constantine P. Iordanou

Chairman and Chief Executive Officer

Right.

Ian Gutterman
Balyasny Asset Management L.P.

Okay. Got it, got it. And then, just my last one. The stackers that you've written through, how does that show up? Was that -- it wasn't in the commentary of the premium. Was that in the premium this quarter? Or does that show up somewhere else because it's derivative form? Or how does that work?

Mark D. Lyons
Chief Financial Officer, Executive Vice President and Treasurer

Ian, it doesn't. We've deemed it because of the way the loss side works. It's what -- the loss severity is referential to a table. It has nothing to do within individual characteristics of the claim itself. So we view it as the derivative. So you're not going see it anywhere in premium. Instead, it's closer to a mark-to-market impact each quarter. And it finds itself into...

Constantine P. Iordanou
Chairman and Chief Executive Officer

An acquisition.

Mark D. Lyons
Chief Financial Officer, Executive Vice President and Treasurer

Okay, yes. It's an acquisition expense.

Ian Gutterman
Balyasny Asset Management L.P.

Okay. So where do we see that? So does that end up in operating income? I mean, I'm just trying to figure out how to think about where that will show up in my model. Basically, is it in operating income? Is it at the bottom line? Or where is it?

Mark D. Lyons
Chief Financial Officer, Executive Vice President and Treasurer

Yes, it's underwriting. It's an acquisition expense, so it's in underwriting.

Constantine P. Iordanou
Chairman and Chief Executive Officer

It will affect the underwriting combined ratio, but it's in acquisition expense.

Ian Gutterman
Balyasny Asset Management L.P.

Okay, okay. But it's, simply, it's in that mortgage insurance segment...

Constantine P. Iordanou
Chairman and Chief Executive Officer

It's a derivative. So at the end of the day, it's going to be income.

Mark D. Lyons
Chief Financial Officer, Executive Vice President and Treasurer

Right.

Ian Gutterman
Balyasny Asset Management L.P.

Got it, okay. And is that because it's a derivative, it might be volatile based on what's going on with interest rates and such? Or is it reasonably something else?

Constantine P. Iordanou
Chairman and Chief Executive Officer

No, no. It's a derivative because if you look at these transactions, right, a portion of the staggered transactions is done in the cash market that sold us bonds, right? And those trade on a daily basis. And then, you've got to market to that. So depends what that happens, right? How those bonds will trade it will tell you. If you -- you can write a staggered transaction that over a long period of time will give you positive returns. But maybe in the first or second or third quarter, depending where the cash transaction trades. Or you might take a loss in the first...

Ian Gutterman
Balyasny Asset Management L.P.

[indiscernible] Okay. So as that becomes material, I'm guessing, you'll call that out if we have any of that line item.

Constantine P. Iordanou
Chairman and Chief Executive Officer

Right. But it's -- we expect that to be positive. We expect it to be -- but -- and don't forget, it's going to come over 6 or 7 years, right? So you're setting it out.

Operator

At this time, we have no further questions. I will like to turn the call over to Mr. Iordanou and Mr. Lyons for closing remarks.

Constantine P. Iordanou
Chairman and Chief Executive Officer

All right. Thanks, Glenn. And thank you, everybody, for attending. We're looking forward to speaking to you next quarter. Have a wonderful day.

Operator
Ladies and gentlemen, that concludes today's conference. Thank you for your participation. You may now disconnect, and have a great weekend.