S&P Global
Market Intelligence

Arch Capital Group Ltd. NasdaqGS:ACGL

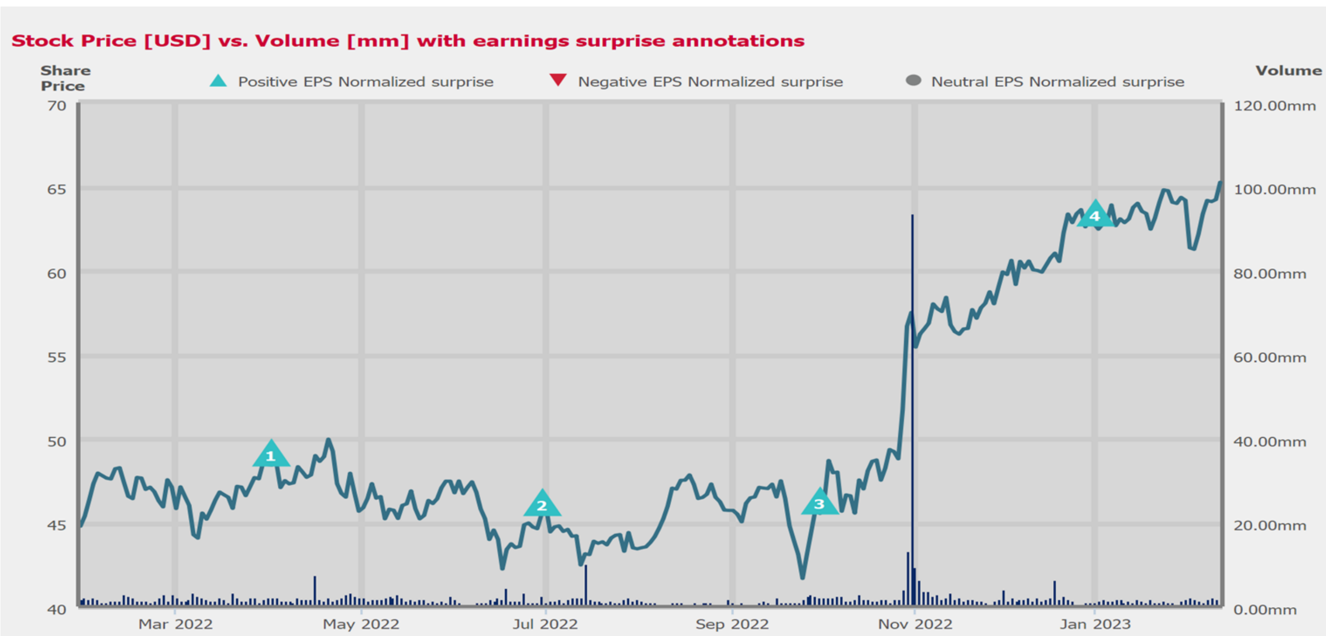
FQ4 2022 Earnings Call Transcripts

Tuesday, February 14, 2023 4:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ4 2022-			-FQ1 2023-	-FY 2022-			-FY 2023-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS
EPS Normalized	1.34	2.14	▲59.70	1.40	4.06	4.87	▲19.95	5.59
Revenue (mm)	2398.07	3034.64	▲26.55	3016.61	10415.71	11077.19	▲6.35	11827.63

Currency: USD
Consensus as of Feb-14-2023 10:53 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ1 2022	1.07	1.10	▲1 2.80 %
FQ2 2022	1.07	1.34	▲2 25.23 %
FQ3 2022	0.18	0.28	▲3 55.56 %
FQ4 2022	1.34	2.14	▲4 59.70 %

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Call Participants

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Francois Morin
Executive VP, CFO & Treasurer

Marc Grandisson
CEO & Director

ANALYSTS

Brian Robert Meredith
UBS Investment Bank, Research Division

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Jefferies LLC, Research Division

Presentation

Operator

Good day, ladies and gentlemen, and welcome to Arch Capital Group Fourth Quarter 2022 Earnings 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 in 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 this 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 or 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 introduce your host for today's conference, Mr. Marc Grandisson and Mr. Francois Morin. Sir, you may begin.

Marc Grandisson
CEO & Director

Thank you, Towanda. Good morning, and welcome to the fourth quarter earnings call for Arch Capital Group. Happy Valentine's Day to all. I'm pleased to share that for the fourth quarter of 2022, each of our 3 underwriting segments produced exceptional results. Our quarter's results were buoyed by a lower than average cat loss experience a significant favorable development in mortgage reserves and a higher level of profitable earned premiums from our recent growth.

This quarter demonstrates the power of our strategy, namely our management of the underwriting cycle across the diversified specialty portfolio with a prudent reserving and underwriting stance. Our P&C insurance underwriting teams continue to lean into hard market conditions, and our mortgage team delivered record underwriting income, which is again a direct result of our years as the established market leader there.

For the full year of 2022, Arch generated over $1.8 billion of operating income with an operating return on equity of 14.8%. 2022 was our third consecutive year of sustained premium and revenue growth, supporting stronger and more stable earnings power for the near term. The net premium written growth from our P&C units was exceptional. Reinsurance segment NPW grew 51% for 2022 as the team seized on market dislocations while our insurance segment grew a robust 21% on the year. We continue to see a broad array of opportunities to allocate capital where rates and terms and conditions allow for growth in attractive returns.

Taking stock of where we are in the current market cycle, it's important to note that we have recorded premium growth significantly above the long-term industry average. Over the last 4 years, we've grown property and casualty net premium written threefold to nearly $10 billion from less than $3.6 billion in 2018, while overall rates increased cumulatively by over 40%. As we have stated previously, our cycle management strategy dictates that we maximize premium volume when rates are rising, which is precisely what we've done.

While we expect to continue to allocate more capital to the P&C segments for the next several years, I wish to remind our shareholders that we capitalize on the attractive return opportunities in our MI segment to the tune of $5.4 billion of underwriting income since 2017. These profits allowed us to redeploy capital into more accretive uses, including $2 billion worth of share repurchases since 2018, and the substantial growth in profitable P&C premium. MI has been vital to our ability to propel our P&C underwriting growth.

Underwriting cycle management is core to our culture, and I want to take a brief detour into how we think about the underwriting cycle here at Arch. Given the simplification of falling grades insurance clock split into 4 stages. Stage 1, at the onset of the hard market, we see rates increase dramatically and capacity withdrawn. Results on the previous soft market results only begin to show up in claims activity. Stage 2. This is the beginning of the restoration phase, which is indicated by second and sometimes third round of rate increases along with some improvements for the insurers in the terms and conditions as the industry adjusts its appetite and underwriting policies. Much of the focus during this stage is also geared to filling guests in and replenishing reserve shortfalls from the soft years while showing rapid improvements.

Stage 3. That next period is where rates gradually decrease often as a result of overreactions in Stage 2. Underwriting profits from the hard market years gradually show up in the results. This period can be lengthy and it usually allows for still profitable growth, especially for the disciplined underwriters. And finally, Stage 4. Famous Stage 4 is where the industry forsakes underwriting discipline and overly focuses on topline growth even as rate decreases accelerate. This is where Arch's culture of underwriting discipline is most apparent as we cut exposure and prepare for the return of Stage 1.

Right now, we are at Stage 2 in most lines. Some, for instance property, are back to Stage 1 since the fourth quarter. Understanding where you are at each point of the cycle for every product line and the nuances within each stage is critical to the timely allocation of capital to the areas of greatest opportunity. One of Arch's key sustainable advantages is the breadth of its capabilities across many specialty insurance lines, enhancing greatly our cycle management capabilities. A core strategic tenant of Arch is that underwriting acumen and discipline through the cycle drive superior risk-adjusted returns.

Now I'd like to share some highlights from our underwriting units. We'll kick it off with reinsurance. For the fourth quarter, net premium written in the reinsurance segment was $1.5 billion. That's more than double the same quarter 1 year ago. Francois will cover the details, but much of this growth is because we were well positioned to capitalize on broad market opportunities as well as several one-off opportunities resulting from market dislocations emerging in the fourth quarter. It is worth noting that the fourth quarter growth does not include the January 1 property and property cat renewals, which will be reflected in our next quarter's results.

As you've heard, pricing for the January 1 renewals were strong. Cat pricing and terms both improved, leading to effective rate changes in the plus 30% to plus 50% range. We anticipate these trends will continue as the midyear property cat renewal and should translate to strong property cat premium growth in 2023 for Arch.

Moving now to our insurance segment, where we continue to reap the benefits of the investments we've made in enhancing our specialty businesses in the U.K. and in the U.S. On the year, we wrote over $5 billion of NPW, net premium written, compared to $4.1 billion in '21, with growth coming from a diverse mix of business. Underwriting performance continues to be excellent with an ex-cat accident year combined ratio of 89.6%. Rate increases with a few exceptions remain above loss cost trend, and we expect this strong momentum to continue for 2023. The insurance market remains rational and disciplined.

We expect also continued opportunities due to the ongoing global uncertainties and remain optimistic that this disciplined behavior that we saw in the P&C industry for the last 3 years will persist as we move through Stage 2 of the cycles.

Next, our mortgage team. Again, had an exceptional quarter, capping off an excellent year. As we benefited from earnings from our embedded book as well as from favorable reserve development as cures on delinquencies exceeded our expectations. The mortgage segment delivered $374 million of underwriting income in the quarter and $1.3 billion for the year, an excellent contribution in a year where higher mortgage interest rates slowed new originations.

Our insurance in force, the earnings foundation of the mortgage segment, grew to $513 billion at year-end '22, as persistency increased due to higher mortgage rates. As expected, higher mortgage rates led to reduce NRW as mortgage rates touched 7%, the highest rates in 20 years. Looking broadly at the MI industry's health, we have borrower credit quality which is outstanding and excess housing demand above supply, the U.S. unemployment rate is at historic lows and the borrowers' equity in their homes remain at very healthy levels. One thing worthy of mention is that the MI industry is acting in a disciplined and responsible manner. In the face of these economic uncertainties, premium rates are increasing while underwriting quality remains strong.

Finally, the interest rate increases we've seen in the last 12-plus months should help fuel our net investment income through 2023. We are poised to benefit from a higher reinvestment rates coupled with the growth in invested assets. I've got auto racing on my mind lately, and when I look at our industry, I can't help but think that Arch is one of the best cars on the track. We know that winning the race comes down to more than having a great driver or the fastest car. There is much preparation, analysis and looking at the conditions on the track as well as monitoring the other drivers.

By recognizing the soft market conditions in '17 and '18, we avoided the mistakes others made early in the race when they might have burned tires or overheated their engines. The pricing began to improve in 2019. We're able to take advantage of some of our competition. That fixed up an engine problems, and we took the opportunity to take more of a lead on the track by increasing substantially our writings. And then once we saw some clear track ahead of us, we were able to accelerate even faster. Today, we're firing on all cylinders, and I know we've got the right crew to bring it home.

Let's hand the wheel over to Francois before coming back to and answer your questions. Francois?

Francois Morin
Executive VP, CFO & Treasurer

Thank you, Marc, and good morning to all. Thanks for joining us today. I'm very pleased to share that once again, Arch had an excellent quarter on virtually every front. The year concluded with fourth quarter after-tax operating income of $2.14 per share for an annualized operating return on average common equity of 28%. Book value per share was up 9.9% in the quarter to $32.62, and down only 2.8% on the year, a great result considering the impact raising interest rates had on our fixed income portfolio with a difficult year in equity markets and the elevated catastrophe activity we experienced this year.

Turning to the operating segments. Net premium written by our reinsurance segment grew by an exceptional 118% over the same quarter last year. Although this quarter, we had a few large one-off transactions that impacted our results and contributed $407 million to our net written premium. Adjusting for these transactions, our net premium written growth was still elevated at 61% for the quarter. These transactions are yet another example of the dislocated state of the reinsurance market where our strong balance sheet provides a significant advantage as we look to deploy meaningful capital to support ceding companies at terms that meet our target return expectations.

More importantly, the underlying performance of the segment this quarter was very good with an ex-cat accident year combined ratio of 82.9% and a de minimis impact from current accident year capacity losses.

Reflecting ongoing hard market conditions, the insurance segment also closed the year on a very good note with fourth quarter net premium written growth of 17.4% over the same quarter one year ago in an accident quarter combined ratio, excluding cats of 89.6%. Most of our lines of business still benefit from excellent market conditions, both in the U.S. and internationally, and our expectations for the coming year remain very positive.

Our mortgage segment continued its run of quarters with results better than long-term averages as claim activity for the business remain low. While production volumes were down due to the lower level of originations in the market, we remain positive on the return prospects for this business. Net premiums earned were up slightly on a sequential basis as the persistency of our in-force insurance at 79.5% at the end of the quarter continued to increase. The combined ratio, excluding prior year development, was 45% for the quarter and reflects our prudent approach to loss reserving, one of our key operating principles.

Our underwriting income reflected $270 million of favorable prior year development on a pretax basis across all segments this quarter, which represents approximately $0.66 per share after tax. While most of this favorable prior development, $211 million came from the mortgage segment, mostly on claim reserves set up for COVID-related delinquencies in the 2020 and 2021 accident years at U.S. MI. It is worth pointing out that our P&C reserves also contributed to the overall results. Of note, both our insurance and reinsurance segments had another quarter of favorable reserve development, and the 2022 calendar year Phase 2 incurred ratio for our P&C operations was 58.7%, its lowest level in more than 5 years.

Both these metrics provide some insight into the adequacy of our loss reserves, which constitute an important element in the quality of our balance sheet. Quarterly income from operating affiliates stood at $36 million and was generated from good results at [indiscernible] and Somers.

Pretax net investment income was $0.48 per share, up 41% from the third quarter of 2022. Cash flow from operations, over $3.8 billion for the year, was strong and when combined with the proceeds from maturities and sales of securities in a rapidly rising yield environment, and hence, the underlying contribution from our investment portfolio. Going forward, with new money rates in our fixed income portfolio in the 4.5% to 5% range and a growing base of invested assets, we are well positioned to deliver an increasing level of investment income to help fuel our bottom line.

Total return for our investment portfolio was 2.6% on a U.S. dollar basis for the quarter with all of our strategies delivering positive returns. The contribution to the overall result was primarily led by our fixed income portfolio, which benefited from relatively stable interest rates and tightening credit spreads. The overall position of our investment portfolio remains relatively unchanged as we remain cautious relative to duration, credit and equity risk.

Turning to risk management. Our natural cat PML on a net basis stood at $970 million as of January 1 or 8% of tangible shareholders' equity. Again, well below our internal limits at the single event 1-in-250-year return level. Our peak zone PML remains at Florida Tri-County region. And as Marc mentioned, the PMLs we report represent a point-in-time estimate of the exposure from our imports portfolio and the premium associated with the January 1 renewals will get reported in our financials starting next quarter.

On the capital front, we did not repurchase any shares this quarter as our assessment of the market opportunity in 2023 remains very positive, one where we should be able to deploy meaningful capital into our business at attractive returns for the benefit of our shareholders.

Finally, as Marc mentioned in his remarks, the results we enjoyed this year across our operations were achieved through a thoughtful and deliberate execution of our cycle management strategy and a strong culture of allocating capital to the most profitable markets and opportunities, these results, which were an important contributor to us joining the S&P 500, were only made possible by the ongoing hard work and dedication of our over 5,000 employees across the globe. They deserve a tremendous amount of credit for making us who we are today, an industry leader with a stellar 20-plus year track record that is ready for the opportunities and challenges ahead of us.
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 Tracy Benguigui with Barclays.

Tracy Dolin-Benguigui
Barclays Bank PLC, Research Division

Your 1-in-250 PML to tangible equity of 8% as of 1/1 wasn't too dissimilar to your 7.7% as of September 30. So I'm wondering what made you pause to incrementally take more exposure? Did that have anything to do with less retro capacity or your view of ROEs based on pricing for that incremental cat exposure?

Marc Grandisson
CEO & Director

Yes. I think this number -- interesting, this number is one region, one area, one peak zone. What is not seen in the numbers, and we'll have a more thorough discussion at the Q1 call is that we've increased cat exposure across a wider range of sub zones. And that doesn't really come across through that Tri-County. And I remind you, Tracy that the Tri-County renewal is going to be more important and more apparent at the June 1 renewal. So it's also one first step into it. So we have grown a European exposure because the rates were still pretty good there. Significantly, it would not show up into that one single number, right? This is sort of a -- it relies sort of the true increase in allocated capital to catastrophe. If you look at the aggregate number, which is a better reflection there is an yearly increase, that will be commensurate. It actually would -- you'll see the premium increase and the cap allocation increase or it will make sense to you.

Tracy Dolin-Benguigui
Barclays Bank PLC, Research Division

Okay. That's very helpful. So as you look through the year, even though 25% is your maximum threshold, where do you think you could realistically land based on your risk appetite?

Marc Grandisson
CEO & Director

The question -- this is a great question. Tracy, but our typical answer is, you tell me what the rate levels are like, and we'll tell you what we think we can do. We have a plan based on certain various levels of rate changes in terms of condition changes by zone, by region, and our team, as you can appreciate, is willing and able to operate on that basis. If you take a step back, I think the overall capital position of the company is, we have plenty of opportunities to deploy. It's hard for us right now to see going all the way to 25%, but certainly, we have room to grow, and we have the capital and the relationships to do so.

Tracy Dolin-Benguigui
Barclays Bank PLC, Research Division

Okay. And also really quickly on the reinsurance side, in recent times, you focused more on quota share over XOL. So with hard pricing, where do you see the best opportunities? I'm thinking about lower ceding commissions on quota shares and the higher rate online on the XOL side?

Marc Grandisson
CEO & Director

So I think it's across the board. You just mentioned that we have improved economics both on the quarter share in excess of loss. I think that the numbers you see in Q4, a lot of it has to do with our recent growth in the quota share that we've written. I think by virtue of the cat itself, as you -- as we just talked about it a few months ago, increasing. I think that we would be in a position to increase our excess of loss contribution to the bottom line.

But when the hard market is around, which we still see on the reinsurance side and the insurance and the P&C side, we have a tendency to migrate towards a quota share. There's a few reasons for that. Number one, one of the big reasons that we like to talk about is, you inherit some diversification within that portfolio that you otherwise would not necessarily get from a net excess of loss perspective. And we really, really like this, and we like to be closer to the rate change, right? When you're on a quota share basis, you're side-by-side with a client as opposed to an excess of loss, you need to be relying on your sole pricing to make it work. So over time, when the market gets harder, I think you will expect us and as part of the cycle management, to underwrite more quota share versus excess of loss. This year, they're both. This year, they're both pretty good.

Operator

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

Michael David Zaremski
BMO Capital Markets Equity Research

I'll stick with the primary insurance segment, given I feel like most of the questions will probably be on reinsurance. The growth has been decelerating there a bit. Marc, we heard your prepared remarks. Sounds like you're still excited, but maybe you can kind of talk about our -- what's driving the deceleration? What are you guys seeing? I don't know if it's worth bifurcating between kind of E&S excess surplus lines versus non-E&S. I'm just curious if the discipline there is dissipating a bit more versus reinsurance?

Marc Grandisson
CEO & Director

Yes. I think we're just experiencing in the fourth quarter. That will probably change in '23. I think opportunities are going to resurface more broadly than we even had in the fourth quarter, right? I think it took a little while to the market to digest E&S and to what it means for the overall market at another market. It's clearing the camp up making -- doing what it needs to do to improve the return on the pricing on the property, which I think also you heard in other calls, I think will impact a broader set of line of business beyond the property exposure.

But if we go back, so if you look at the 70% growth, I mean 70% growth over premium is about 3x the size 3, 4 years ago. We did have a lot of roles in the beginning of our market. So as you get into the late stages, I think 70% could be equivalent to another 50% increase in 2021 or 2020, when we started to lean into the market. So I think this is a natural phenomenon that after a while, you have -- not that you mined everything, but you really have pushed as hard as you could, and we're still pushing hard. Even 70% to me is about 3x the average growth in the premium in the industry. That tells me that we're still seeing a lot of opportunities. But again, like I said, we're later in the stage of the hard tackle.

And I think that we'll see a rejuvenation, if you will, of that growth possibly because the insurance companies are going to have to increase, as we all know, their pricing. One is the property cap and higher retention, while they have more risk retained. So -- and we're participating like the other guys on the insurance market, and we expect market to sort of getting a second bite of the apple, if you will, of a hardening market.

Michael David Zaremski
BMO Capital Markets Equity Research

And as a follow-up, sticking with the primary insurance segment. So it sounds like the opportunities might fall within the property space, if I'm interpreting your comments correctly. And when we're thinking about the segment's combined ratio, I feel like looking at my older notes, it was kind of mid-90s. Was the goal -- is that still what you're thinking? Or as time has been so good in terms of the market cycle that we should be thinking lower 90s is the more near-term goal?

Marc Grandisson
CEO & Director

I think we said a few things about the combined ratio. The 95% was meant as a target back in '16, '17 when interest rates were quite a bit lower. They went down further. As you know, that meant that we needed to have a lower combined ratio targets, which we targeted over last 2, 3 years, that's where you see the impact of. I think from our perspective, low 90s is still -- or high 80s is sort of what we're still pushing for because within the interest rates, they may revert back and come down after a while in a year, 1.5 years from now. So you don't want to be rushing recognize all the various interest rates, although we are currently -- we are not pricing into our business, but we tend to take a longer view like we do on the trend on our inflation. And we're thinking the rates might come back down. So I think we would still target a lower 90s to high 80s to get the returns that we think we deserve.

Operator

Our next question comes from the line of Jamminder Bhullar with JPMorgan.

Jamminder Singh Bhullar
JPMorgan Chase & Co, Research Division

First, I had a question on the reinsurance business. If you look at your premium growth, even excluding the sort of large transactions, onetime transactions, you mentioned the number is extremely strong and obviously, doesn't have the impact of 1/1 renewals in it. So what's really driving that? And do you expect some of those factors that drove the strong growth to continue into '23 as well?

Marc Grandisson
CEO & Director

Yes. I mean the one thing that right from the get go, I think, you need to appreciate -- the quota share business is something that we might have written a deal in January 1 of '22, and the premium gets written over the 4 quarters. So we're benefiting from that. That's showing up in each of the 4 quarters. If the underlying rate increases also from the ceding companies are higher than what we might have expected at the start that gets adjusted throughout the year. So a couple of factors were, basically, we're just following effectively the fortunes of the ceding companies. But still, I think our teams deserve a lot of credit for going after these opportunities, be responsive to the client needs, being -- providing good capacity with good ratings, et cetera.

Does that continue on in '23? We think so. We think the market is there and the [indiscernible] growth was not only in [Indiscernible] business, it's pretty much in [Indiscernible] business. Property and properties have gathered a lot of attention in the last few weeks, and -- but still, I mean all lines of business, other specialty, casualty, marine, aviation, remain, I think all lines are, I think, in a position to really keep growing at a good [indiscernible].

Jamminder Singh Bhullar
JPMorgan Chase & Co, Research Division

Okay. And then just shifting on to MI. Your loss ratio is obviously very good, but I think the loss pick did pick up a little bit in the fourth quarter. So is that more sort of national driven? Or is it more regional to where you're starting to see some maybe softening in the market in certain regions or states?

Francois Morin
Executive VP, CFO & Treasurer

Well, the -- we've navigated through the regional differences in our pricing. So I think we have constructed our portfolio that we're very happy with. Stayed away from what we perceive to be the more dangerous areas and underpriced areas. So I think that's kind of showing up in our performance over time.

In terms of reserving, I'd say, 2 things. One, the delinquency rates are still very low. So it's not like we're really seeing pressure at this point in terms of the higher level of delinquencies being reported. And the loss ratio pick is really more a function of us being a bit more prudent. I think there's a little bit of uncertainty with their -- home prices, are they about to come down? Does that create some potential pressure? We think we're very, very aware of that, whether there's a recession, et cetera. But we're still very, very positive on the segments. It's just a realization that this is maybe a likely riskier environment than we were in like a year or 2 years ago, and our reserves are going to reflect that.

Operator

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

Brian Robert Meredith
UBS Investment Bank, Research Division

A couple of them here for me. First, Marc, Francois, you guys typically provide in your 10-Qs the 1-in-250 for the other regions well, Northeast and Gulf of Mexico, U.K. I'm wondering if you could give -- have those statistics so we can get a better sense of what type of growth you're going to see at 1/1 renewals? And maybe focus also on Europe because I know Europe was, you guys got a good operation there and a lot of opportunities there.

Francois Morin
Executive VP, CFO & Treasurer

Yes. I mean the ones we reported really a couple more regions. We don't have -- I don't want to have those handy. I think the most -- to Marc's point, I think a lot of the growth that we saw, at least at 1/1, will come through in regions that were, I'd say, we were probably a little bit underweight in the past. So that's going to show up in Q1 premium and for the rest of the year, but in terms of P&L, it really doesn't have an impact.

Brian Robert Meredith
UBS Investment Bank, Research Division

Got you. Okay. And then second question. I'm just curious, Marc, if I take a look back -- and I'm going to date myself a little bit here. If I look back at which your underlying kind of combined ratios looks like back in 2003, 2004 after the last hard market, you're getting pretty close there in the reinsurance business. Are we getting to the point where we're kind of seeing max margins in that business? Maybe you get a little bit more in 2023, but how much more do you think you really get here?

Marc Grandisson
CEO & Director

It's a really good question, Brian. I don't know the answer to that. I like the comparison 2002, '03. I would actually like to compare probably more like a combination of '02, '03, maybe '04 in liability and maybe '06 or '07 on the property side. So I don't know what that means. We haven't blended growing the combined ratio that we had in these 2 years, but that probably would be close to what we can do.

I mean, look, there's a lot of things that are different this time around. The interest rates are lower than they were before internationally. More specifically, we're an international diversified reinsurance company. Hard to tell, but it's certainly going in a way of getting above our long-term ROE targets. That's for sure, and that's really what, in the end, what really drives us, as you know.

Operator

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

Yaron Joseph Kinar
Jefferies LLC, Research Division

My first question. Just looking at the ROE profile of the company, clearly, there's upwards momentum here. Can you maybe talk about, a, what the target would be? And b, if you'd see it coming more from -- or the expansion from here on coming more from NII or more from underwriting?

Francois Morin
Executive VP, CFO & Treasurer

Yes. I'd like to think we got room to grow. But you're right, I think the biggest probably opportunity is NII, just with the leverage and the correction or the increase in interest rates we saw last year. I think that's going to take still a little bit of time to show up in the numbers. But as we look forward over the next 12 to 24 months, I'd like to think that, that will -- there's leverage there that we can show up in the numbers. In terms of the segments results, I think they can all -- mortgages, again, the reported results, I mean significant reserve releases, which certainly helped the bottom line and the ROEs that we -- that are reported. But we think the segments, the fundamentals underlying each of the 3 segments are still very good and that they can actually still deliver very healthy results.

Yaron Joseph Kinar
Jefferies LLC, Research Division

Great. And then my second question, just looking at the insurance business, it sounds like you think that there may be some inflection to accelerating growth again in '23. Can you maybe help us think about the impact of the reinsurance market, kind of available capacity, cost of reinsurance, how that plays into your -- the potential growth that you see for net premiums written in '23 in insurance?

Marc Grandisson
CEO & Director

Great question, Yaron, because I think what we're going to see through '23 is a recognition. I mean it's already there, but it's probably really coming home and the [Indiscernible] is for us as a saving company, right? I mean [Indiscernible] and our clients and ceding companies that more needs to be charged to the insured that they can in turn pay the reinsurer they need to buy. Even if they went there, right, we heard that a lot of increasing retention, there's still more volatility that's absorbed by those insurance carriers, which should lead to, again, needing a higher rate, everything else being equal.

So I think what we're seeing is -- what we'll see is gradually -- and again, on the reinsurance, I think there is a volatility around, you can just renew business 1/1 and everything changes on the time, right, on one stroke of a pen.

On the insurance side, it takes 12 month period to transition and transform and then reprice the whole business. So that's what I think we're going to be seeing. That's why I'm also fairly optimistic is because we're going to have that repricing occurring throughout 2023 and beyond. And alongside with those, between all of us here, the terms and conditions are also going to be on the table, right, on the docket for companies to present to find a way to not curtail, but find a way to have a better risk sharing with their insurers when it comes down to other policy.

So I guess for that reason, that's what underlies is that sticker shock, not sticker shock, but good increase in reinsurance at the beginning of the year that we'll have to filter through all the plans and budgeting for all the insurance companies, including ourselves as we go forward in '23. So it's going to be a slow motion but it's still going to happen. That's why I'm optimistic.

Yaron Joseph Kinar
Jefferies LLC, Research Division

Got it. And I apologize, I'm going to try and sneak one more in here. Clarification. When you talked about kind of targeting low 90s, high 80s combined ratio, was that a reported combined ratio in the insurance segment?

Marc Grandisson
CEO & Director

That's policy year target effective [indiscernible] it's expected, right? Plus or minus, as you know, in our space, is volatility around the expected numbers, but it is long-term expected.

Yaron Joseph Kinar
Jefferies LLC, Research Division

Because you've been running at kind of mid-90s. So where is that improvement coming from? Is it mostly just better rates and in risk selection?

Marc Grandisson
CEO & Director

Well, we're running -- we're running about 90 now, and I think that we still continue to see improvement in pricing. So that would -- that should help us get there somehow.

Operator

Our next question comes from the line of Ryan Tunis with Autonomous.

Ryan James Tunis
Autonomous Research US LP

First question. I guess following up on Tracy, could you give us some indication of, I guess, how you're viewing your overall cat budget this year relative to '21 based on what you saw with 1/1 renewals? Should we expect to kind of the expected cat ratio to be higher?

Francois Morin
Executive VP, CFO & Treasurer

The cat ratio or cat? I mean, in terms of...

Marc Grandisson
CEO & Director

Cat load.

Francois Morin
Executive VP, CFO & Treasurer

Cat load. Dollars of cap, yes, we think will go up. No question. We've been targeting or target -- I mean our cat load in '22 was, call it, $80 million a quarter. Now it's probably between $100 million and $120 million for the first quarter of '23 based on what we wrote, right? And we'll see how that develops for the rest of the year. I mean, depending on how the [indiscernible] renewals, how those kind of materialize. There is, I'd say, a good probability that it will keep going up throughout the year. But based on the in-force portfolio that we have currently for the first quarter, I mean that's kind of how we see the exposure to the cat losses.

Ryan James Tunis
Autonomous Research US LP

Perfect. That's helpful. And then add one for Marc, I guess, on the man-made cat side, which isn't something we've talked about too much, but I would think that's one of the better markets right now on the reinsurance side. And I guess just trying to size that, whether or not maybe some of the rate increases post-Ukraine, if that can move the needle relative to property capital. Just looking at your marine and aviation premium, it's actually pretty chunky relative to property cat. So if you could just give us some indication of can that move the needle? Is that something that we should be paying more attention to in terms of the markets you're seeing that are getting incremental firming that could help Arch?

Marc Grandisson
CEO & Director

It's a good question, Ryan. I think the one thing with an event such as Ukraine, which is a war event, there's actually a specific market for those kinds of risks. So it's not like it's included part of the overall coverages for cat or whatever else out there. There was some -- there definitely is a result of that event in attempt to exclude a lot of these war events and bring them back into the proper aviation war or marine war market, for instance. So yes, there is a lot of -- obviously, a lot of activity there, a lot of rate increases there. We're participating in there, but those markets are to begin with pretty small. So that's why I think you'll see some improvement, but it may not be necessarily enough to move the needle for the industry, even though it's a very, very healthy proposition that rates have gone through the roof as you can appreciate for the right reasons in those lines of business.

Ryan James Tunis
Autonomous Research US LP

Yes. Makes sense. And then just lastly, the acquisition expense ratio has been kind of hard to pin down in Arch over the past few years, but it's gone up. Obviously, it sounds like there were some changes in terms of ceding commission structures, things like that at 1/1. Is there anything directional you can say about maybe how the acquisition expense ratios could move in '23 versus '22? Or do we just kind of expect something relatively similar?

Francois Morin
Executive VP, CFO & Treasurer

Yes. I don't think it's going to move a whole lot from where it's been. I think there's been a lot of shifts in the mix of business over the years, right? As particularly as our insurance book in the U.K. has grown, that's a bit higher acquisition ratio, different kind of reinsurance purchasing decision. So there's a long list of reasons or explanations as to why it is where it is now. And obviously, what we focus about -- what we're focused on is the bottom line returns whether -- if we're going to pay a bit more acquisition, we certainly think we're going to get a lower loss ratio and that has been the case. So -- but for your modeling, we kind of, I think, exercise. I assume something pretty similar to '22 as a starting point, and we'll keep you updated as the year goes on.

Operator

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

Elyse Beth Greenspan
Wells Fargo Securities, LLC, Research Division

My first question, I guess, is going back to the reinsurance margin discussion that came up earlier. So do you guys have a flat PML and you guys are seeing 30% to 50% rate increases in cat? Wouldn't that triangulate into margin improvement coming through in the reinsurance book in 2023?

Marc Grandisson
CEO & Director

Well, just -- if I could just isolate. First, we wonder where you were, so good to see you there. Second, I think the -- if you look at the property cat itself, I think it's -- the returns have dramatically improved. But as you know, for us, it's going to be incrementally, of course, accretive to our bottom line, but we're not -- it's not the biggest line of business for us. So that's what allows us, we believe, the opportunity to -- and room to grow the way we think we could grow in 2023. So it's hard to say how much more, but the property cat itself, the market itself has significant margin improvement.

Elyse Beth Greenspan
Wells Fargo Securities, LLC, Research Division

Would you say -- building on that, Marc, and would you say that of all your business lines as you sit here today, the line with the best expected return in '23 would be catastrophe reinsurance?

Marc Grandisson
CEO & Director

It's up there, but there are others that we don't advertise too much that our really, really healthy and getting better as we speak. And as big, if not has been -- probably, some of them might are as big as a property cat -- property cat writing. So we have quite a few who are giving us pretty high returns, but it is up there. It's up there. It's beyond -- you heard on the calls. This is a good time to write property cat itself, a really good time.

Elyse Beth Greenspan
Wells Fargo Securities, LLC, Research Division

And then you said, right -- on the PML discussion, you had mentioned, right, that we need to kind of see how things come together at June 1 that, that could also be a good opportunity. What could derail this? Is it just alternative capital and more capital coming into the reinsurance space as you think leading up to June 1? And even when we think beyond that, what are you guys concerned about that could derail the uplift that we've seen in the catastrophe reinsurance market?

Marc Grandisson
CEO & Director

I mean it's hard to imagine, Elyse. I think the third-party capital you mentioned, you still -- we're in a wait-and-see attitude. The U.S. renewal, as we all know, is a small portion of the overall cat writing in the year. So more has to happen and as we all know -- and in line with what our Tri-County with a Florida exposure. Florida is the biggest exposure. So it's hard to tell what could derail it. I'm trying to think out loud there the third-party help coming in. I don't see it being a case. No cat in the first half of the year. While we better have -- it would be great for an industry at least take advantage of the less cat activity.

No, it's hard to see anything at least because I think that the psychology of the market is quarry of the cat of remediating what needs to be remediated in a property cat space at all levels. And from the C-suite all the way down to the underwriting system desk, I think it's clearly a recognition that we need more. I think the only thing I could say is, the one thing that I could say just to help you out here, I think that will make sense to you that we may have a bit less than perhaps some people have budgeted or maybe a bit more than budgeted price increase when we have a delta around what we see. But in terms of core capital needs and supply and demand, I don't see a major shift. That was a long question because I was thinking out loud here, so there you go.

Operator

Our next question comes from the line of Meyer Shields with KBW.

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

Great. I hope this wasn't covered. I missed about a minute of the call. But I was hoping to maybe dig into the nonrecurring transactions in reinsurance I'm assuming this was a retroactive reinsurance. I was hoping you could talk about specifically the sort of risks or the lines of business that you're assuming? And maybe give us an update on what that market looks like now.

Francois Morin
Executive VP, CFO & Treasurer

Yes. I mean to keep it at a fairly high level, those are general -- I mean, I consider them to be kind of capital relief, capital support transactions for a variety of reasons. Companies that have grown a lot under some rating agency pressure, any capital relief, the companies starting put some exposures behind them, et cetera. So -- but just to clarify that those are not retroactive. So they're all insurance-accounted transactions, all insurance or reinsurance accounting, so that flows through our premium, et cetera. They are across -- you saw it in our lines of business. They are -- they did hit multiple of our lines of business. Some were other specialties, some are casualty, some are a little bit of property so it's a spread.

But it's all in a vibrant market. I mean there's a lot of pain that some companies are experiencing right now, and they're working for solutions. And again, we're -- we think we have a strong balance sheet and capital to support them. So I think -- we don't know if they're going to happen again. There's -- those are lumpy. But if and when they are presented to us, we're happy to get consider them and we want in a while, we end up writing a few of them.

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

Okay. No, that's helpful. Second question on mortgage insurance. And I don't even know how to phrase this, but you put up very conservative reserves for mortgage insurance over the course of COVID. And I'm wondering how much of that unusual reserve is still there because clearly, speaking at least for myself, we haven't done a great job of forecasting reserve releases in that unit.

Francois Morin
Executive VP, CFO & Treasurer

Well, it's a great question, which is becoming harder and harder to answer because in the early days, no question that we had adjusted our -- because so many loan delinquencies that were in our inventory were in forbearance and trying to make the distinction between kind of forbearance and noncore bearing delinquencies and how much of that worth was -- a new concept or new kind of reality we were facing. Over time, I mean it's been 3 years now. I think the reality is like the inventory is somewhat chemical mingle. So we don't really think of loans and forbearance in a [Indiscernible] differently than we look at the other loans, even though we know there's still a few of them in the inventory.

So I mean long story to say that it's not something we can quantify directly every quarter anymore, but we still perceive that there's a bit of risk with COVID-related reserves, and that's why we've been holding on to the reserves up to the point where we think we just don't need them. Right now, this quarter was an example where I think the data kind of suggested that we were -- it is the right time to release, but they're more of the reserves that were set up in those years.

Marc Grandisson
CEO & Director

Meyer, quickly, I think what Francois is saying is true for all lines of business in historical, but we'll try to take a prudent stance on reserve to ensure we have enough and will let data speak for itself. And this one is very unusual, Meyer, right, and [indiscernible] something unlike anything else. It's when we have another one, we'll have a better playbook to use, but we just didn't know. And we still don't know. So not over on [Indiscernible] forbearance. So it's still coming back in the -- it's not totally gone yet. So that's what leads us to be that much more. From the outside and look like we're conservative, but we think will be prudent and the data speak for itself. And mostly, if it happens that we don't need it, and we'll adjust it based on the data we see.

Operator

We have a follow-up question from the line of Tracy Benguigui with Barclays.

Tracy Dolin-Benguigui
Barclays Bank PLC, Research Division

I'm wondering what your outlook is on professional lines within your insurance segment? And particularly, what stage you would classify that business in when you went through your stages?

Marc Grandisson
CEO & Director

Tracy, would you -- do you include D&O there? Or you just wanted that non -- the ex-D&O. Which lines specifically? Professional lines is a really broad market.

Tracy Dolin-Benguigui
Barclays Bank PLC, Research Division

Yes. Okay. So my focus is more on D&O.

Marc Grandisson
CEO & Director

D&O. Okay. So D&O, we expect similar trends that we see -- so in the last fourth quarter, it may change a little bit as a result of the overall thing that's happening in the marketplace. But the trend in the large commercial, for instance, have been neutral to negative, actually, for the last 3, 4 years. So I would say that even though we may hear -- you hear, I know rate decreases might be a helpful large commercial, there's rationality behind it. So we expect rationale [Indiscernible] some existence. Not -- There's a lot of data that points to -- that validates what kind of price points we're seeing on the D&O side.

On the smaller D&O side, which we do a fair amount of -- to remind you, we do fair amount of D&O, we still see a very, very stable, very good marketplace. But again, the smaller D&Os are not the big ticket items that you would expect, but a lot of them are going to be not-for-profit small policy. So minimum premium is really -- a lot of times what happens and that 5% increase might be $50, right? So the kind of thing that we do. The [Indiscernible] we have grown dramatically over the last 4 or 5 years, it's becoming a big section of what we do.

That market is healthy from a change perspective, right? To go back what I said about the large commercial, the SCAs are down 25%, 30% over the last 4 years. So it's a pretty good market to be there. The IPO market has stabilized. It was pretty hot for a while. Pricing got crazy. We took advantage of a lot of opportunity. Not crazy, but it was a very acute needing capacity. We expect this to sort of renormalize again. So I think I would say, D&O is normalizing for the large commercial, sort of a Stage 4. I meant Phase 3 were recognizing some of the overreaction, but the smaller D&O is probably early Stage 3, which is still very profitable and a little bit of decrease here and there or a slight increase.

Operator

I'm not showing any further questions in the queue. I would now like to turn the conference back over to Mr. Marc Grandisson for closing remarks.

Marc Grandisson
CEO & Director

Well, spend a good day with your loved ones, and we will see you in the next quarter. Thanks for listening, guys.

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