S&P Global
Market Intelligence

Arch Capital Group Ltd. NasdaqGS:ACGL

FQ3 2021 Earnings Call Transcripts

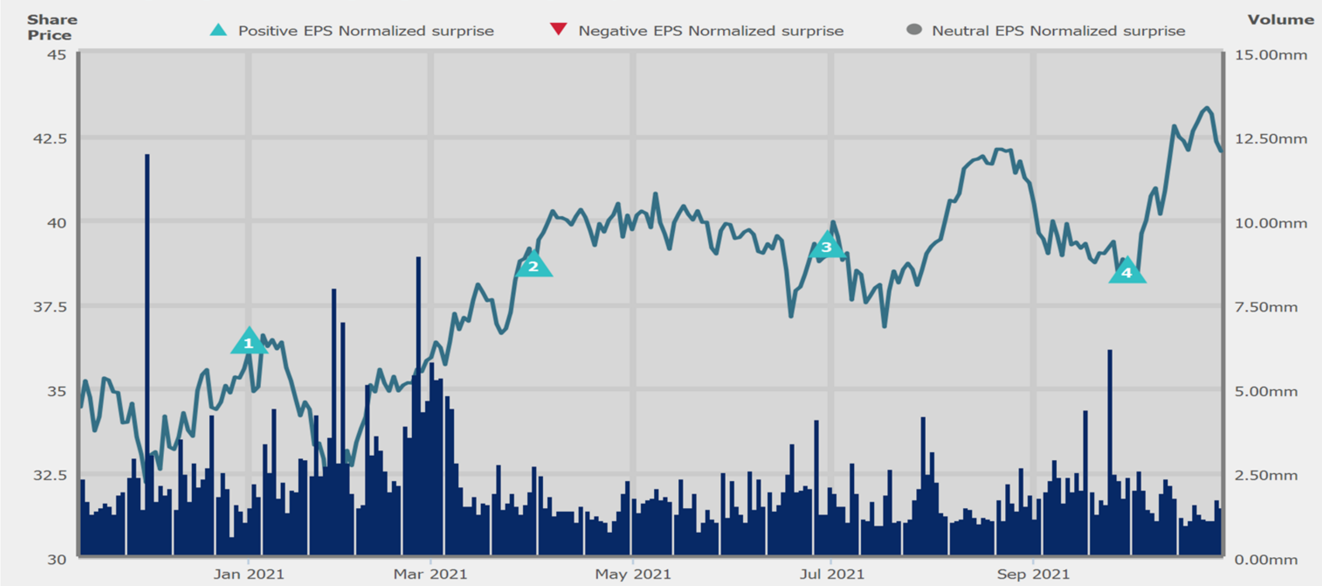
Thursday, October 28, 2021 3:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ3 2021-			-FQ4 2021-	-FY 2021-	-FY 2022-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.35	0.74	▲111.43	0.94	3.21	NA
Revenue (mm)	2221.18	2075.93	▼(6.54 %)	2217.21	NA	NA

Currency: USD
Consensus as of Oct-28-2021 10:00 PM GMT

Stock Price [USD] vs. Volume [mm] with earnings surprise annotations



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ4 2020	0.38	0.56	▲1 47.37 %
FQ1 2021	0.45	0.59	▲2 31.11 %
FQ2 2021	0.84	1.00	▲3 19.05 %
FQ3 2021	0.35	0.74	▲4 111.43 %

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Call Participants

EXECUTIVES

Francois Morin
Executive VP, CFO & Treasurer

Marc Grandisson
CEO & Director

ANALYSTS

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UBS Investment Bank, Research Division

Elyse Beth Greenspan
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JMP Securities LLC, Research Division

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

Michael David Zaremski
Wolfe Research, LLC

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Barclays Bank PLC, Research Division

Presentation

Operator

Good day, ladies and gentlemen, and welcome to the Third Quarter 2021 Arch Capital Group Earnings Conference Call. [Operator Instructions] As a reminder, this conference call is being recorded.

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

Additionally, certain statements contained in the call that are not based on historical facts are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. The company intends the forward-looking statements in the call to be subject to the safe harbor created thereby. Management 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 introduce your host for today's conference, Mr. Marc Grandisson and Mr. Francois Morin. Sirs, you may begin.

Marc Grandisson
CEO & Director

Thank you, Liz. Good morning, and welcome to our third quarter earnings call. We are pleased to have delivered solid results this quarter as our operating units generated a 9.3% annualized operating return on equity and a 12.5% (sic) [12.3%] annualized net income ROE despite an active catastrophe quarter, sorry guys. Premium writings and rate growth remained strong in our P&C unit, driving solid fundamental earnings, while our mortgage insurance unit, again produced excellent results.

The current market conditions allow us to demonstrate the value of our diversified platform and underwriting strength as they provide us with plenty of opportunities to deploy capital and generate an expected return on equity in the mid-teens. In the broader P&C arena, we continue to see the market hardening along with ample evidence that our industry is addressing the adequacy of pricing across most sectors. The trajectory and market acceptance of rate increases reinforce why we remain optimistic that improved economics in the P&C market will be sustainable for some time. As you know, the P&C industry is facing many degrees of uncertainty, heightened cat activity in 4 of the last 5 years, rising inflation, COVID's ongoing influence on a global economy and enduring low interest rates.

Once faced with escalating risk, underwriters need both rate increases and conservative loss estimates in order to build adequate margins of safety into premium levels. With our agile underwriting, established teams and strong capital position, we are well equipped to grow into this improving market.

Turning now to our operating units. We'll begin with insurance, where our early focus on strengthening our underwriting capabilities and seizing recent market opportunities is working. Gross written premiums continued to grow substantially up 32% over the same quarter in 2020, and our accident year combined ratio ex cats improved to 90.5%. This is another indication of the progress we have made in our specialty insurance business. We have been leaning into this hardening market for 2 years now as rate increases remain well above the long-term loss cost trends and have spread to more lines than last year. Overall, 2021 rates are up around 10% compared to 2020, and we expect that the benefit of higher premium levels will be realized well into 2023, enhancing our expected returns for that period.

This quarter had many bright spots, including positive rate increases have accelerated in lower limits account. These lines have previously lagged the increases in larger accounts. That is no longer the case. Two, our early focus on Lloyd's and business in the U.K. has improved our scale and our economics in this market; three, some of our business lines that were most impacted by COVID, like travel are recapturing some of the lost volume as both business and consumer travel increases. In summary, our specialty insurance group is making the most of the current opportunities.

Pivoting now to our reinsurance group. It delivered strong growth in the quarter with gross written premiums up nearly 25% over the same period in 2020. On a net basis, reported growth was only a modest 3% versus the same quarter in 2020 due to a catch-up in sessions to Watford following the purchase of the company with our partners at July 1. Francois will provide more detail during his comments. But absent this one-off transaction, reinsurance net written premium growth was still very strong at 30%. And our outlook remains favorable as similar to instruments, we're experiencing broad rate increases in our specialty and casualty reinsurance lines.

In the quarter, our reinsurance segment reported a combined ratio of 106%, reflecting the effects of the third quarter cats, primarily Ida and the Central European floods. But reinsurance's accident year combined ratio ex cat is excellent at 83.2%. There are signs that property market rates could adjust higher due to cat fatigue, as you've likely heard on other calls this quarter. The recent 5-year period of elevated losses from catastrophes proves an important insurance outage. Losses don't move the level of the premium. There are also early indications that retrocessional and aggregate excess of loss protections are becoming increasingly hard to come by, and we believe that this will be reflected in higher property rates broadly.

As you know, we were and remain judicious in the deployment of our cat PML, which was effectively flat in the third quarter. At less than 6% of our tangible equity, we remained underweight in net property cat exposure, and we will deploy more capital to the line if expected returns improve above our target. It's too early to make a call on a January 1 renewal process, but pricing in this sector is heavily influenced at the margins. And if ILS or other capacity fails, there is a possibility for significant rate corrections and increased engagement on our part. In the meantime, our reinsurance teams are demonstrating their agility and like insurance are leaning hard into the markets where returns are most attractive.

Thirdly, our mortgage group continues to deliver exceptional returns. It generated $234 million of underwriting profit in the third quarter and continues its impressive rebound from loss concerns associated with the pandemic. At September 30, insurance in-force of $457 billion for the segment was up modestly. Further good news is that notices of default have declined to pre-pandemic levels at September 30, which is a good indicator of improved conditions. Additionally, loans in forbearance continue to decline as federal programs conclude, and we remain cautiously optimistic that most of these loans will ultimately cure. Rising home prices have broadly increased homeowner equity. And you'll recall our position that equity levels are the best indication of whether a delinquency will ultimately result in a loss. We estimate that 98% of our loans in forbearance today have at least 10% equity providing significant protection against potential losses.

Overall, the MI market remains competitive, but rational, and our business continues to generate returns on capital in the mid-teens. Mortgage originations continue at a pace similar to last year's record origination volume and credit quality remains excellent. As you know, in all of our operations, we actively manage capital to enhance shareholder returns. The strong results in our mortgage segment have enabled us to optimize our capital structure via increased reinsurance sessions through our Bellemeade mortgage insurance-linked notes as well as traditional reinsurance. Additional reinsurance purchases enable us to reallocate capital towards faster-growing areas in specialty property and casualty lines, while enhancing our return profile in MI by reducing required capital. MI remains a very attractive business for us.

Now a point of pride and interest to us and perhaps to you all is that last Saturday, October 23, Arch celebrated its 20-year anniversary. So I want to say to our investors, thank you for believing in us and to our employees, past and present, thank you for your contributions to Arch for the last 20 years and our clients for showing support and conviction in our capacity to provide products to you.

Finally, the PGA Tour is in Bermuda this weekend. So golf is top of mind. A golf tournament is interesting in that it takes place over several days, and therefore, consistency is critical. You have to be sure to pick your spot and lower your score. But if you want to make the cut, you have to limit the bogeys early so that you can play more aggressively in the stretch. And then once you get to the weekend, you can play with a bit more freedom and really try for the birdies and eagles. At this point in the cycle, we feel we've made the cut and now we're focused on really taking advantage of our positioning to make sure we end up at the top of the leaderboard. Francois?

Francois Morin
Executive VP, CFO & Treasurer

Thank you, Marc, and good morning to you all on this first day of the Butterfield Bermuda Championship here in Bermuda. Thanks for joining us today. Before I provide more color on our solid third quarter results, you will have observed that while our earnings release still makes a distinction between core and consolidated for purposes of comparison to prior periods there is no difference between the 2 presentations this quarter. As we discussed on the last call, the closing of the Watford transaction on July 1 gave rise to a reconsideration event and as a result of our updated VIE analysis, we no longer consolidate the results of Watford in our financial results. Our 40% share of Watford's results is now reported in the income from operating affiliates line, and there is no longer a need to make a distinction between core and consolidated results in our financials.

As Marc shared earlier, our after-tax operating income for the quarter was $294.7 million or $0.74 per share resulting in an annualized 9.3% operating return on average common equity. And book value per share increased to $32.43 at September 30, up 1.3% in the quarter, a very solid result in light of the catastrophe activity that was much higher than the long-term average for this quarter, which we estimate at over $45 billion in insured losses for the P&C industry, approximately 3x the average third quarter cat losses observed over the last 10 years.

This quarter, I wanted to first give you some additional detail on the results of our reinsurance operations, which were impacted by the Watford acquisition, especially on the top line. As part of the agreement signed at the beginning of the year with our co-investors in Watford, we committed to ceding varying percentages of the premium written by our Bermuda and U.S. treaty reinsurance operations to Watford, effectively enhancing the existing business model to also serve as a sidecar for Arch. While the retrocession agreements were effective as of the start of the year, their signing was contingent on the transaction closing, which delayed the recognition in our income statement until this quarter. As a result, the third quarter ceded written premium reflects a catch-up of approximately $161.2 million from the first half of the year. The impact of the premium catch-up adjustment on underwriting income for the reinsurance segment was minimal.

Growth in gross written premium remained strong at 24.6% on a quarter-over-quarter basis, and growth in net written premium would have come in at 29.5%, adjusting for the Watford catch-up. The growth was observed across most of our lines but especially in our casualty, other specialty and property other than property catastrophe lines, where strong rate increases and growth in new accounts helped increase the top line. The segment's accident quarter combined ratio, excluding cats, stood at 83.2%, compared to 83.1% on the same basis 1 year ago. On a year-to-date basis, the ex cat accident year combined ratio has improved by approximately 250 basis points over the same period last year, reflecting the improving underwriting results in most of the lines in which we write them.

In the insurance segment, net written premium grew 40% over the same quarter 1 year ago, and the segment's accident quarter combined ratio excluding cats was 90.5%, lower by approximately 360 basis points from the same period 1 year ago. Excellent results across the board, which demonstrate the progress our insurance segment has made over the last 3-plus years and improving its performance and provide us with optimism on the underlying quality of our franchise going forward.

Losses from 2021 catastrophic events in the quarter, net of reinsurance recoverables and reinstatement premiums stood at $335.9 million or 17.4 combined ratio points compared to 12.5 combined ratio points in the third quarter of 2020. As noted in our pre-release, our P&C operations were impacted by Hurricane Ida, the European flooding events of July as well as a series of other events across the globe.

Our Mortgage segment had an excellent quarter with a combined ratio of 26.2%, reflecting favorable prior year development of $48.4 million, about half of which came from U.S. MI from better-than-expected cure activity in pre-pandemic delinquencies and recoveries on second lien loans and the other half from our CRT portfolio and international MI. The decrease in net premiums earned on a sequential basis was primarily attributable to lower levels of single premium terminations in the quarter for U.S. MI business and to a lower level of called CRT transaction than what was observed in the second quarter. Recall the second quarter benefited from higher earned premiums due to an unusually high number of CRT transactions being called, which we highlighted as effectively being a nonrecurring event. The delinquency rate for our U.S. MI book came in at 2.67% at the end of the quarter, a material reduction from the peak we observed at the end of the second quarter 1 year ago. We had another solid quarter in terms of production, mostly from the purchase market and with refinance activity coming down from prior levels, the insurance in force for our U.S. MI book grew slightly.

The increase from last quarter in the insurance in-force of our international mortgage unit is mostly the result of the acquisition of Westpac Lenders Mortgage Insurance Limited in early August. Although income from operating affiliates grew significantly to $124.1 million, it is worth noting that approximately $95.7 million of the total is attributable to a onetime operating gain resulting from the acquisition of a 40% stake in Watford, which was offset in part by a realized loss upon deconsolidation with a resulting net income gain of $62.5 million. The remainder of the operating income from affiliates represents our share of the net income generated this quarter by our operating affiliates, which consists primarily of Watford, Coface and Premia.

Total investment return for our investment portfolio was de minimis on a U.S. dollar basis for the quarter. Net investment income was $88.2 million during the quarter, down by $1.2 million on a sequential basis, driven by lower coupons on fixed maturities and lower income on consolidated funds. The duration of our portfolio remains low at 2.68 years at the end of the quarter, reflecting our internal view of the risk and return trade-offs in the fixed income markets.

Equity and net income of investment funds accounted for using the equity method produced $105.4 million during the quarter, more than half of the total income generated by our investment portfolio, and a key contributor to the growth in our book value. As we discussed on prior calls, we have increased our allocation to alternative investments in the last few years and these funds now represent approximately 12% of our total portfolio at the end of the quarter. We are also very pleased with their performance so far this year, which stands at 13% year-to-date.

Of note, had we included income from funds using the equity method in our definition of operating income, our reported operating ROE would have increased by 3.2% on a year-to-date basis to 13.3%. While these funds returns are potentially more volatile than core fixed income strategies, we believe the incremental returns they provide more than compensate for the liquidity constraints and volatility that are usually associated with them.

The effective tax rate on pretax operating income was a benefit of 0.7% in the quarter, reflecting changes in the full year estimated tax rate, the geographic mix of our pretax income and an 8.2% benefit from discrete tax items in the quarter. The discrete tax items in the quarter primarily relate to a partial release in a valuation allowance on certain U.K. deferred tax assets.

Now a quick comment on the 2 acquisitions we closed on this quarter, Westpac and Somerset Bridge. You will have seen that in accordance with purchase GAAP. We established approximately $337.4 million of intangibles and goodwill this quarter, most of which will be amortized through our income statement going forward. To help with remodeling efforts, we now expect our amortization expense to be approximately $25 million in the fourth quarter of this year and $21 million quarterly throughout 2022.

On the capital front, we redeemed all of our outstanding Series E noncumulative preferred shares for $450 million on September 30. Separately, we repurchased approximately 9.7 million common shares at an aggregate cost of $386.9 million in the third quarter. If we include the additional common shares we have purchased in the fourth quarter, the year-to-date totals are now approximately 24 million shares or 5.9% of the common shares outstanding at the beginning of the year for $917.7 million. Some of the additional share repurchases in the fourth quarter were effectuated under the new share repurchase authorization of $1.5 billion approved by our Board of Directors earlier this month.

As we have said since our formation 20 years ago, our core operating principles are anchored in active cycle and capital management. We believe this quarter results demonstrates our ability to execute on this philosophy and leads us to invest in opportunities where we believe the returns are most attractive. At recent prices, and with the prospect of improving returns, we believe buying back our shares continues to represent another compelling value proposition for our shareholders without compromising our capital flexibility nor lessening the quality and strength of our balance sheet. With these introductory comments, we are now prepared to take your questions.

Question and Answer

Operator

[Operator Instructions] Our first question comes from Elyse Greenspan with Wells Fargo.

Elyse Beth Greenspan
Wells Fargo Securities, LLC, Research Division

My first question, Marc, when you were talking about the mortgage business, you talked about buying more reinsurance. So there was more capital for growth on the P&C side, which I found interesting. In the past you've spoken about mortgage running at around a 15-plus return and P&C at kind of 10% to 12%. Has the dynamics changed that, that caused you to kind of buy some more reinsurance to pursue more growth on the property casualty side?

Marc Grandisson
CEO & Director

Yes. I think our opportunities on the P&C side have -- just have improved, right, over the last couple of years. And I think we're even more convinced of the length and that it has [indiscernible] for the foreseeable future. So that makes us be more proactive to balance, if you will, the capital allocation between more than 1 year. I mean we did rely heavily on a capital deployed in MI for quite a while because the returns in P&C, as you know, at least weren't as attractive. But now that we have a new attractive and increase and improved returns in the P&C, it behooves us to balance the risk profile of the portfolio. That's one of the reasons why we would do some more reinsurance. And again, the reinsurance also helps our return on a net basis as well, which is also another benefit.

Elyse Beth Greenspan
Wells Fargo Securities, LLC, Research Division

But are the return numbers I gave still kind of where you see the 3 businesses, so 15% plus and then 10% to 12%?

Marc Grandisson
CEO & Director

Yes. I would say on the P&C side, at least, I would say, it's getting up. It is north of that now. I think we have our prospects closing -- the gap is closing between MI and P&C, if you will.

Elyse Beth Greenspan
Wells Fargo Securities, LLC, Research Division

So north of -- higher than 12%?

Marc Grandisson
CEO & Director

I would agree. Yes, I would think it's the case, yes.

Elyse Beth Greenspan
Wells Fargo Securities, LLC, Research Division

And then in terms of capital, you guys put in place a $1.5 billion authorization. It sounds like you bought back a little bit under that so far this quarter. Going through the end of next year, I know, obviously, what you buy back depends upon the market, also where your shares end up trading over the course of the next year. But when you put that in place, was that designed to set a mark of what you will buy back? Or are there just other factors that could cause you to either fully buy back that level or maybe come in lower? Just help us kind of think through that as we think about capital return through 2022?

Francois Morin
Executive VP, CFO & Treasurer

Well, I mean 2 things. We bought -- we're close to $1 billion this year. So we don't want to go back to the Board every 3 months and ask for more. So we thought, okay, what may we need, could we need by the end of 2022 over the next

15 months, effectively, $1.5 billion is just a number that -- a nice round number, nothing special about it. But are we committed to that number? The answer is absolutely not. If the market keeps improving, and we have the ability to deploy our capital -- all the capital and then some in the business, we may not end up buying anything back. So it's really, again, a function of the market conditions and vice versa, right? If the market doesn't really generate -- give us a lot of opportunities to grow, we might be in a position where we buy back more than that. So it's really -- again, it will be a function of what we see in front of us over the next 15 months. And if we end up going through the $1.5 billion sooner than the end of next year, then we'll do something else. So again, it's very dynamic, very real time, I'd say, and we'll see where things take us.

Operator

Our next question comes from Jimmy Bhullar with JPMorgan.

Jamminder Singh Bhullar
JPMorgan Chase & Co, Research Division

So first, I had a question on just what you're seeing in terms of pricing, both on the insurance and the reinsurance side. And to what extent do you think price increases are going to hold versus maybe especially on the reinsurance market, it seems like things have been getting a little bit softer over through the course of the year, but how do recently high catastrophes affect your view of 1/1 renewals?

Marc Grandisson
CEO & Director

Right. Jimmy, if we bifurcate the market into property cat, you agree -- I would tend to agree with you that the property cat rate did not increase as much as we had hoped, collectively as an industry, I would say, not only at Arch, it's not a single Arch phenomenon. Therefore, that's why you saw us write less property cat over the next -- over the last 9 months. Assuming a reaction to those rate level, I would -- it's still early, like we said -- like I said in my commentary, but I think we should have a repricing, definitely repricing in Europe and in the U.S. even for the layers that have been impacted. That's for sure. And I think it would start to spill out even onto those that have not sustained a loss because I think there's a recognition of heightened cat activity.

And I think that the market is sort of bracing for that as we go forward. It's going to be a matter of degree. On the rest of the marketplace, I think that overall, since -- if you look at the liability lines in general, overall, you can think of in terms of a quota share, if you got quota share of casualty or liability lines, you are benefiting from the rate increases in the business. And I think the ceding commissions, which were maintained or held high for -- through 2020 are starting to come down a little bit. So there's a recognition that -- so there's a bit of an improvement from that perspective on a quota share. On the excess of loss in general for liability, the rates are stable to somewhat -- more stable. But again, you apply those rates against a base that is increasing in premium levels. So they are also getting some price uplift. And I think that -- I mean the reinsurance market, Jimmy feeds off of the insurance market, right, in a positive way. I want to make a positive message. We actually -- we are on the receiving end of a portion of what the insurance market writes. And to the extent the interest market writes premium at a higher level, we are benefiting from those rate increases.

Jamminder Singh Bhullar
JPMorgan Chase & Co, Research Division

Okay. And then can you quantify how much you've got in terms of COVID reserves, especially for business interruption? And I'm assuming they're mostly still IBNR as you had been quantifying last year. And just discuss what the process would be and the time line would be for releasing these given that for the most part, it seems like the courts have been siding with the insurance companies at least thus far in the U.S.

Francois Morin
Executive VP, CFO & Treasurer

Yes. I'd say -- I mean, we're still very much -- a lot of IBNR and -- our COVID reserves more than half, 60% or so, I'd say, of our of our, call it, COVID reserves on the P&C side are still IBNR. So -- and how quickly do we -- will we know or not know whether we'll need those reserves, time will tell. I think it's where we sit, yes, I don't disagree that. So far, there have been a couple of positive developments from the courts. But it's going to take a while. I truly think this is, I mean, very complicated and issue that will take years to resolve. So I wouldn't expect us to really take dramatic action on the level of COVID reserves on the P&C side for some time.

Marc Grandisson
CEO & Director

And Jimmy, in our industry, in insurance, you could win 95 lawsuits and lose 96th, and it changes everything. So there's a lot of uncertainty in our space, even though we've been -- we had a good streak, one change could change everything. So we're very...

Jamminder Singh Bhullar
JPMorgan Chase & Co, Research Division

And what is the rough number of -- rough dollar amount of reserves?

Francois Morin
Executive VP, CFO & Treasurer

That's a good question. I don't have it in front of me. We can circle back with you. I know we booked a few hundred million dollars last year. And we paid some of that. I don't have the current figure, but we can give you that.

Marc Grandisson
CEO & Director

We haven't changed ultimate, Jimmy, over the last 3 quarters.

Jamminder Singh Bhullar
JPMorgan Chase & Co, Research Division

But it's not something like it's more maybe 2023, '24 as opposed to '22 in terms of potential releases on these?

Marc Grandisson
CEO & Director

There are releases. I will say, yes, it will probably take another 1 year, 1.5 years, and we might hold a little bit more longer for the reasons I just mentioned in terms of the court decisions.

Operator

Our next question comes from Mike Zaremski with Wolfe Research.

Michael David Zaremski
Wolfe Research, LLC

I guess in some of the prepared remarks, when you guys were talking about the primary insurance segment, talked about kind of seeing rate acceleration actually in the lower limits kind of the smaller commercial space. Any theories on what's -- on why that's happening? Is it due to loss cost trend increasing because we're kind of -- we're seeing a fading of rate a little bit of a deceleration in the large account space. So kind of curious if you guys have any views maybe broadly to on kind of loss cost trend, given all the uncertainty during the pandemic on the primary insurance side.

Francois Morin
Executive VP, CFO & Treasurer

Right, the loss cost trend as we observe it and it might change is still roughly in the 3% to 5%. It depends on lines of business, but we haven't really changed our view on this at this point in time. We had a loss reserve review, I believe, a couple of months ago. So it's not changing, although we are putting in our loss ratio pick an extra level of margin safety to make sure we wouldn't be missing because it could be higher, as you know, inflation is certainly another concern that we all have collectively as underwriters.

In terms of my theory about why the smaller accounts get those rates right now, it's just the -- it's -- the market is a human psychology market and the pricing gets more acutely needed in the larger capacity play. And this is where the market starts focusing its first effort as the market hardens. And this is not unusual. This is a very, very normal phenomenon in the hardening markets. You'll tend to try and fix those or more important, meaning if you put a $10 million, $15 million, $25 million limit, these are the ones you're going to trying to fix right away because presumably, those will have caused you a bit more pain over the last 2, 3 years, you were expecting more pain coming from that portfolio. And it's just a matter of time before people start looking sideways as to what other lines of business need rate and then you start dipping down into your overall portfolio and seeing where the liability trends, for instance, might also be an impact. And this is sort of a second round, sort of a rippling effect from the main capacity providing players into the ones who have lower players. And at the same time, to be fair and to be -- I mean, to be truthful, you also have development ongoing -- happening on the smaller account at the same time. It's just not as acute and as glaring and as obvious early as the larger capacity players. That's why.

Michael David Zaremski
Wolfe Research, LLC

That's interesting. That's helpful. Maybe switching gears to the mortgage segment. Just curious, I know the forbearance levels continue to decrease. If you could remind us, I believe there is some extensions to the forbearance program or maybe even new kind of enhanced programs where the P&I could be reduced if the payment can be reduced by up to 25%. Is that correct? And if so, are you seeing your borrowers utilize those options?

Marc Grandisson
CEO & Director

Yes. So right now, the program is done, it expires at 9/30 -- expired in 9/30 in terms of foreclosure, right? So -- but the forbearance, I'm sorry. The foreclosure it's still unclear, right, because they could also come back and extend it further if things were to change. And the CFPB is also involved with the FHFA saying that we don't want to have any more -- there's a moratorium on the foreclosure process as well. So I think both federal entities are trying to push -- to go back to your last point of the question, push the mortgage -- the loan -- the mortgage originator and provider of providing solutions to the borrowers who are still in forbearance or not current on their payment. And to your point, a lot of it is going to be continuing same payment. Most of it is going to be continuing the same payment as prior to the COVID forbearance program and it's attaching at the end -- towards the end, the lack of what wasn't paid or what was accrued as unpaid at the end of the loan. So this is roughly what it's going to look like. But it's going to be another 3 quarters before we have more visibility because even though the forbearance program stopped in 9/30 and people should come now to the banks and -- to the mortgage originator and trying to remediate their position from a forbearance perspective, it's still going to take another 6 to 9 months. And I think the agencies are watching carefully. So everything is heading towards a happy resolution, if you will, of the overall forbearance programs. Like, everybody is focusing on this at this point in time.

Michael David Zaremski
Wolfe Research, LLC

Okay. Great. And one last one, sticking to mortgage, and I could take this off-line with [indiscernible] too. But just I want to -- the increased ceded -- premium ceded as a percentage of gross, is that due to Bellemeade? And I guess if it is, can you guys continue to upsize the reinsurance usage in the segment if you thought opportunistically, you wanted to shift more growth towards other lines of business?

Francois Morin
Executive VP, CFO & Treasurer

Yes, that's very much in that vein. I think Marc made the point earlier, we're always looking to optimize the portfolio. And certainly, a lot of that is focused on capital deployment. We, I think, made the point last call that we had increased our quota share percentages on the U.S. MI book [indiscernible] So that's starting to play through, basically. And that is reflected. We also -- we're still very active in the Bellemeade space, so we're purchasing quite a lot there as well. And I'd say those 2 things combined really explain why we have more ceded premium starting this quarter.

Michael David Zaremski
Wolfe Research, LLC

Got it. And there's more appetite if you decided to do more, either quota or Bellemeade in the future? Or are you kind of reaching kind of a max?

Francois Morin
Executive VP, CFO & Treasurer

I mean, I'd say we certainly do a lot of Bellemeade, as it is. So I don't want to say we wouldn't do more, but it's -- I mean, we already are very active in that space and made big placements. So I wouldn't expect us to necessarily increase that vehicle or that mechanism to transfer risk a whole lot. And on the quota share, I mean, we're -- yes, can we see more? We could, but then it's a risk return trade-off and whether the economics work -- are reasonable or work in our favor, too. So right now, we're happy where we're at. But if things change in the market, gives us better opportunities, we could conceivably cede a bit more, yes.

Operator

Our next question comes from Josh Shanker with Bank of America.

Joshua David Shanker
BofA Securities, Research Division

This may not be the best math, but it's rough. I think you guys -- the inventory of COVID [indiscernible] mortgage claims about 120,000, you've had about 90,000 cures. I'm estimating that you guys have about $20,000 up per notice right now in the portfolio. It may not be exact. Historically, you've had about an average of $5,000 up per notice. It seems like the reserves are stuffed, particularly as you tell us that 90% of -- 98% of the claims have at least $10,000 in equity. So I mean, I'm trying to rectify all this -- like, can you explain to me, I feel -- so I've asked this question before, I just don't understand what's going on there?

Francois Morin
Executive VP, CFO & Treasurer

Yes. I think the answer is going to be very similar. So a very good question, hopefully not taken by the policemen back there. We -- if you look at the average case reserve per NODs, it's actually 23,500. I believe, it's in the supplement, you can look into it. And you're right, it was -- it went up from last year. The run rate pre-COVID was roughly 10,000, 11,000, 12,000. So it did increase. And about -- it was about 110,000 claims that we got as well of COVID in the forbearance and about 78% of them have cured so far. So we're about 20,500. So [this -- we have about 31,770] I think, is the number in terms of NODs outstanding. When you multiply by 23, you're right, it would look on the high side. A couple of things I will say here. Number one is the average -- the average severity of the policies that are facing the COVID-19 are starting from 18, 19, which have a higher face than the one we had as NODs back in 2019, right? Those in 2019 were largely pre-2008. So you have to adjust for the level of coverage that has increased over the last 10, 12 years. So that explains one, why the 23 would be higher than the 11, 13 historically.

The second part of your question was, well -- where should it go? And this is where it's more art than science, Josh. We hear you. We are cautiously optimistic that it may not come to pass in terms of needing the reserves. And hopefully, some of it will cure better than we anticipated. But I just want to remind everyone on the call and as we remind ourselves all the time, it's that this is a political positioning, right? Things could change very quickly from the FHFA, the GSEs or the housing department.

So we need to be really careful. And we've never been through that kind of event. So we are, Arch, as you know, and we will take a cautious, prudent approach to reserving. And if we happen not to meet those reserves, as we do typically, we'll be taking them by the hands on the liability side down to the capital side. We're not going to let them stranded for a long time. But again, so much, so many uncertainties, Josh. We understand your puzzling. This is a very unusual situation for the industry. Therefore, we have to -- and that's why we appear probably to be a little bit unusual and that we're reserving it.

Joshua David Shanker
BofA Securities, Research Division

And my second question, unrelated. Can you talk about the differential, I guess, the new business penalty between new business you're putting on the book and legacy customers who you have a deep sense of their -- the risk factors on those accounts. Is there a gap? Is the business that you're renewing at better margins at least the way you're booking it, the new business, given that you know more about the business you already have?

Francois Morin
Executive VP, CFO & Treasurer

I believe, Josh, you're talking about P&C, right?

Joshua David Shanker

BofA Securities, Research Division

Yes. This is only primary P&C. Not more...

Francois Morin
Executive VP, CFO & Treasurer

Right. That makes sense to me. So it's a really -- a very astute question, Josh, because we keep on track of the renewal rate versus the new business rate level. And symptomatic or as a representation of the hardening market, the pricing of the new business is coming higher than the renewal business. And that sort of speaks to the fact that they need a new home and they need to be repriced and people sort of get tired of that relationship and it goes back, throw them back into either the E&S or the admitted market. So right now, we're still seeing, on average, the new business price better than renewal business.

Operator

Our next question comes from Tracy Benguigui with Barclays.

Tracy Dolin-Benguigui
Barclays Bank PLC, Research Division

Just a big picture question. I see this quarter with you and your closer peer group, is that the insurance growth is outpacing the more primary market focused players without reinsurance arms. Are you seeing a lot of market dislocation where you feel like you just do a better job assuming displaced risk that still meet your risk-adjusted return hurdles?

Francois Morin
Executive VP, CFO & Treasurer

We'd like to think we're better than the average guy out there. But Tracy, I think overall, the dislocation was much larger in 2020. I think you are still seeing some dislocation right now. It's certainly not -- there's still some repositioning of limit provided to the market by a lot of players still as we speak. And I think what explains our ability to grow is, first, we have a really well-established presence, and we were really underweight, Tracy, historically. We are really, really good markets for people that want a good security for products such as D&O, for instance, right? We are a really good home for someone to take on new as an insurer. And we're sort of -- we're definitely benefiting from that as an incumbent good -- with a good quality, good reputation as we do. And also, I think the other thing that I want to mention, we had said that last year, we were suffering a little bit from sort of a travel -- lack of traveling that impacted our travel portfolio. So that certainly helps, right, Tracy, the fact that economy is reopening and people are traveling a bit more. That also helps explain why we're able to grow a little bit more than probably means the average -- than the average would.

Lastly, I would say that beyond just new business, funding new homes, I think there are programs. We're also growing in programs, as you see. This is a very specialty smaller risk. I think that, again, another example of programs, funding a new home going away from the existing incumbent possibly because of the results and funding a new home, and we definitely are in receiving end of that relationship.

Marc Grandisson
CEO & Director

Yes. And one thing I'll add quickly. I think both -- depending on the mix of business of what you call the more established and the traditional insurers, I mean, workers' comp and commercial auto typically will make up bigger shares of their portfolio. Auto is moving up nicely, but I would say that certainly, comp has had a really good period of excellent results. So rate increases on the comp side have been pretty flattish. So again, that's probably worth adjusting for comp because it's such a big line for some of these carriers.

Tracy Dolin-Benguigui
Barclays Bank PLC, Research Division

And I'm wondering how much of that is structural in nature. Like are others raising attachment points and you're lowering attachment points or offering lower deductibles?

Francois Morin
Executive VP, CFO & Treasurer

No. We don't do that. No, we don't play that game. I think we would just be replacing most of our play typically on specialty lines, Tracy, is mid access, first and second -- this is sort of what we play a lot of times and high access, of course, in certain areas. So we -- for the record, Tracy, we're not seeing any of the deductible being played out in the marketplace. And in fact, there are deductible increases if anything else. We just see a lot of shortening of limit towards in the stacking. We've saw that in 2020. It's ongoing as we speak, instead of having stretch of 25, I'm talking about larger placements, you'll have stretches of 10 or 5 -- 5 or 10 really and 15, perhaps still staying. But there's a lot more players needed to fill up the towers. That's definitely happening more so and still continuing on to some extent, less so than 2020.

Tracy Dolin-Benguigui
Barclays Bank PLC, Research Division

Okay. And then just shifting to reinsurance. Where are you seeing your favorable reserve development coming from?

Francois Morin
Executive VP, CFO & Treasurer

Yes. I mean the vast majority, and we'll talk to it -- vast majority is in short-tail lines. I mean, I'd say probably 80% is in short-tail lines. Mostly property other than cat, where we've grown a lot in the last couple of years. And while the tail is always a bit longer, we think it should be, it's still, we have a pretty good idea 2, 3 years out after writing the policy or the account, and we're seeing a lot of that coming through in this quarter. A bit of favorable development on prior year cat as well and a bit on trade credit and surety from a few years ago where we had some reserves that proved out to be a bit -- weren't required. So we released those this quarter.

Operator

Our next question comes from Meyer Shields with KBW.

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

This is -- it's a cycle management question, I guess, for Marc, [whenever] do we decide that there's never going to be an appropriate hard market in property cat just get out of the line?

Marc Grandisson
CEO & Director

I think that by virtue of -- well, first, I'm an optimist, right? I've always been an optimist. I've heard so many times over the last 27 years from some of our own underwriters that there will never be a hard market again. And when I hear this, it's music to my ears because that means we're cruising for bruising. So I think that things will get better in cat at some point. It may not be this quarter, Meyer, but at some point, numbers speak for themselves. If you lose money every year, people just get this enchanted and just walk away from it. It happened after the '90 storms in Europe, '92 Andrews, earthquake in California, '94, terrorist attack, Katrina, Rita, Wilma, I mean there's always changes. And it's not -- I rattled like 5 or 6 of them. And you got to believe that the world is a dangerous place, Meyer. So I think something will happen. And again, losses don't necessarily change the market pricing, but perception of risk will and would. So maybe we're in this place where people say, "You know what, why bother?" And if that's the case, and that -- and the demand for cat, as you know, protection is inelastic. So if supply shrinks, then demand will stay as is and pricing will, therefore, increase. So I'm an optimist. I'm not sure when it's going to happen, but I believe it will happen at some point.

Operator

Our next question comes from Brian Meredith with UBS.

Brian Robert Meredith
UBS Investment Bank, Research Division

A couple of quick questions here for you. First, Marc, I just want to follow up on the comment about new business pricing better than renewal pricing, and I've heard that from other carriers. But I'm just curious, when you actually go to book the margin on that new piece of business? Are you booking a better margin than perhaps that renewal piece of business? Or do you have to build in some level of cushion because it is new?

Marc Grandisson

CEO & Director

Well, it's a very good point. I think the latter part is what we would do. But even -- we would also take a higher level of cushion on margin safety, if you will, not reserving, even in our renewal business. I think that we're, as you know, reserving wise and loss ratio pick wise at Arch we tend to be more conservative and hope for the best, and hopefully, good news come down later. We're trying to figure out would have as much cushion as we can early on so that we're not surprised down the road. That's not changing. I would say it's the same approach, renewal or new business, Brian. It's not much of a change.

Brian Robert Meredith
UBS Investment Bank, Research Division

Not much of a change. Got you. Okay. Second, just a quick question here. Are we still seeing admitted market shed business to the E&S markets? Or has that slowed?

Marc Grandisson
CEO & Director

That slowed down a little bit, but it's still happening. We're not seeing a return back to the admitted market quite yet. It's going to take a little bit longer, we think.

Brian Robert Meredith
UBS Investment Bank, Research Division

Got you. Got you. And then one kind of bigger, I guess, philosophical question for you. I think with the MI business, clearly, you've demonstrated that it is not as big of a volatility business that maybe somewhat perceived just given the results we've seen through this recent crisis. If that is indeed the case and the amount of cash that business throws off because it's not a growth business, I guess I see you guys using share buyback as your means of capital management, and I completely get that where your stock's trading now. But what about a dividend? And maybe remind us about your philosophy with respect to a dividend.

Marc Grandisson
CEO & Director

Well, I mean I'll take that, Brian. I think it's something we talk about with the Board and between ourselves all the time. We had a pretty long discussion at our last Board meeting on that. It's always on the table. I'd say right now, I mean I think -- I mean the share buybacks that we went through this quarter were very attractive to us, the economics were very much, I think, they're easy to justify, justify, sorry. But could we ever introduce a dividend. Certainly, that's on the table, not saying it's imminent, but it's something that we evaluate pretty much definitely with regularity, and we'll keep looking at it.

Operator

Our next question comes from Elyse Greenspan with Wells Fargo.

Elyse Beth Greenspan
Wells Fargo Securities, LLC, Research Division

Just one additional question. Can you guys spend time highlighting that session to Watford in the quarter, given that, that transaction closed. So my sense is they're going to become more Arch like in terms of the business that you're ceding to them versus prior to this transaction. So as you think about your 40% stake, can you just help us think about the earnings stream there? Because I would think that as we go through next year that, that could become a meaningful contributor to your earnings as the underwriting income of Watford for pickup from what we're used to.

Francois Morin
Executive VP, CFO & Treasurer

Yes. I think the 40% share would grow at an average sort of reinsurance market results, right, because we are writing business on the balance sheet of Watford. So you would expect that. I think that what you would also see is our collecting fees or -- for our efforts, compensation for our efforts for Watford that would be for the 100%. So I think that the overall return would be slightly better even though, Elyse, as you can appreciate with the accounting rules, it might not show as such. But I think that our results will be as good, I would hope for, if not better than our overall results. So it's definitely an accretive return generator for reinsurance platform.

Elyse Beth Greenspan
Wells Fargo Securities, LLC, Research Division

And that should pick up within that other income line as we move through next year?

Francois Morin
Executive VP, CFO & Treasurer

Yes. So a couple -- yes, the 40%, correct. The other income line is -- well, the fees are picked up by the reinsurance segment because they -- it's sort of the underwriting services they provide to Watford. But you're correct in saying that the net equity pickup of the 40% that we own in Watford, if you're modeling what kind of combined ratio is it going to operate at, what kind of premium, or are you going to see in terms of the volume, I would -- you're right, I mean it's probably more and more over time, it's going to look more and more like Arch Re, the Reinsurance segment. The percentages we cede to Watford are not uniform across all our divisions, but directionally, I think that's a good way to think about it. And the other thing, too, which has somewhat been an issue with Watford is the performance of the investments, right? And that has -- that's being a little bit -- is being addressed as we speak.

I think there's a process underway to reduce the volatility from the investment portfolio or the investment strategy at Watford. So think of it more as a, yes, a more less volatile stream of income with more reliance on underwriting income and less so on investment income. And hopefully, that gets you in good place to start modeling out how Watford is going to play out for us -- the 40% for Arch going forward.

Elyse Beth Greenspan
Wells Fargo Securities, LLC, Research Division

And then maybe I'll squeeze one last in. I'm not sure if you provided an updated tax guidance. If so, I missed it. If you could just let us know that. And then we've heard about some potential tax changes, whether in the U.S. and also abroad in relation to Bermuda. Do you guys have just any kind of prospective tax loss and just some of what we're hearing in the market and how that could impact Arch?

Francois Morin
Executive VP, CFO & Treasurer

Yes. I'd say, first of all, that question, fourth quarter, we're still in the 9% to 11% kind of tax rate for Arch in the fourth quarter. For 2022 and beyond, and Marc will chime in, it's way too early. Unfortunately, we track and we look at all the developments very carefully. We're on top of things. And the reality is they change daily. So it's very hard for us at this point to give you any kind of guidance or any expectations of what we think 2022 is going to look like. We'll be more than happy to have a good discussion at our -- on the next call. But for now, it's -- we feel it's just premature to -- because we really don't know.

Marc Grandisson
CEO & Director

And Elyse, just to make the point about daily, literally last night, our tax director or this morning, just sent us like there's a new proposal on the hill that brings back shield and then corrects other things and then dispenses off other areas of the tax proposal in the OECD. So again, a moving target, it's politics. We'll react to it when we do when we see it.

Operator

Our next question comes from Matt Carletti with JMP.

Matthew John Carletti
JMP Securities LLC, Research Division

I just wanted to circle back on the discussion about kind of pandemic reserves. And Marc, you're pretty clear on the P&C side in terms of you get 95 good outcomes, but the 96th can change everything. How about MI? I mean kind of a follow-up to Josh's line of questioning like things look pretty conservative there. Can you help us with a little bit of the time line by which things can kind of continue to unfold well, the timing by which we might see things unwind?

Francois Morin
Executive VP, CFO & Treasurer

Well, let me start. I'd say we may see a little in the fourth quarter, but that will be I don't think everything will be resolved. I truly think that the first half of '22 is when you'll see most of the movement or the corrections and our assumptions and the cure rates and mediation. So I'd say we're going to start seeing some data as early as this month internally and the number of cures and people moving out of forbearance, but the way it's going to flow through our numbers again, given some of the uncertainties that Marc talked about, I think, will be first half of '22.

Marc Grandisson
CEO & Director

And the reason also, Matt has to be said and understood is that they had 18 months of forbearance worth when you get into forbearance earlier in 2020. And some of them went into forbearance, came out of forbearance and went back in again, but they still get to -- get to do -- to benefit from 18 months' worth of forbearance. So that's why some of them were coming out of their 18-month and then fourth quarter and many of them in the first and second quarter next. So it seems like some of them were able to get back current for 4, 5 months and went back to forbearance program. That's why we have this lengthy adjustment period.

Operator

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

Marc Grandisson
CEO & Director

Thank you so much for being here. We're going to be going some -- watching some golf, Francois and I, and happy 20 years and have a good weekend, everyone. Thank you.

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