S&P Capital IQ

CONTENTS

Everest Re Group, Ltd. NYSE:RE

FQ2 2015 Earnings Call Transcripts

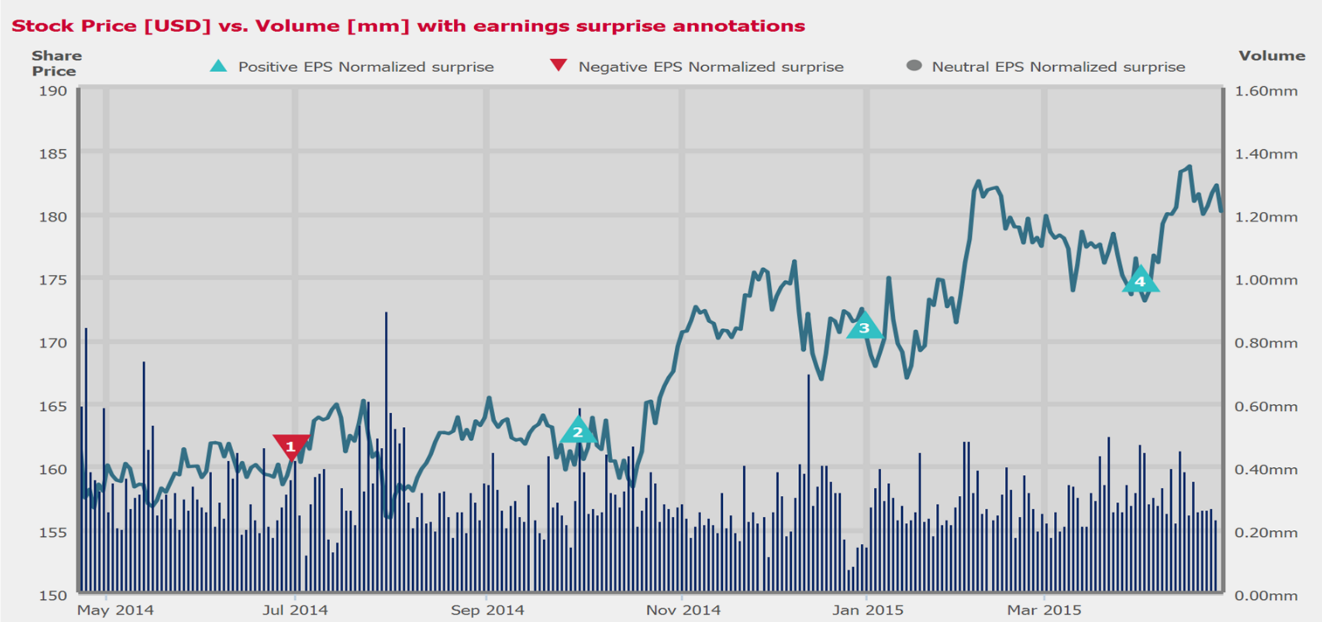
Tuesday, July 28, 2015 2:30 PM GMT

S&P Capital IQ Estimates

	-FQ2 2015-			-FQ3 2015-	-FY 2015-	-FY 2016-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	5.65	5.03	(10.97 %)	3.20	21.00	19.07
Revenue (mm)	1303.00	-	(10.32 %)	1584.20	5465.00	5733.75

Currency: USD

Consensus as of Jul-28-2015 12:14 PM GMT



- EPS NORMALIZED -	CONSENSUS	ACTUAL	SURPRISE
FQ2 2014	5.89	5.41	(8.15 %)
FQ3 2014	4.99	6.12	22.65 %
FQ4 2014	5.76	7.28	26.39 %
FQ1 2015	5.86	7.34	25.26 %

Call Participants

EXECUTIVES

Craig W. Howie
Chief Financial Officer and Executive Vice President

Dominic James Addesso
Chief Executive Officer, President and Non-Independent Director

Elizabeth B. Farrell
Vice President of Investor Relations

John P. Doucette
CEO & President of the Reinsurance Division

ANALYSTS

Amit Kumar
Macquarie Research

Brian Robert Meredith
UBS Investment Bank, Research Division

Joshua David Shanker
Deutsche Bank AG, Research Division

Kai Pan
Morgan Stanley, Research Division

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Sarah Elizabeth DeWitt
JP Morgan Chase & Co, Research Division

Presentation

Operator

Good day, everyone. Welcome to the Second Quarter 2015 Earnings Call of Everest Re Group. Today's conference is being recorded.

At this time, for opening remarks and introductions, I would like to turn the conference over to Ms. Beth Farrell, Vice President of Investor Relations. Please go ahead.

Elizabeth B. Farrell
Vice President of Investor Relations

Thank you, Stephanie. Good morning, and welcome to Everest Re Group's Second Quarter 2015 Earnings Conference Call.

On the call with me today are Dom Addesso, the company's President and Chief Executive Officer; John Doucette, our Chief Underwriting Officer; and Craig Howie, our Chief Financial Officer.

Before we begin, I will preface our comments by noting that our SEC filings include extensive disclosures with respect to forward-looking statements.

In that regard, I note that statements made during today's call, which are forward-looking in nature, such as statements about projections, estimates, expectations and the like, are subject to various risks. As you know, actual results could differ materially from current projections or expectations. Our SEC filings have a full listing of the risks that investors should consider in connection with such statements.

Now let me turn the call over to Dom.

Dominic James Addesso
Chief Executive Officer, President and Non-Independent Director

Thanks, Beth. Good morning. We're pleased to report that operating earnings for the quarter were $225 million, which was primarily driven by pretax underwriting income of $183 million and net investment income of $125 million.

The tax rate in the quarter jumped to 16.6%, causing some distortion relative to our first quarter numbers. Other factors affecting the first quarter comparison include: a $50 million difference in foreign currency adjustments; $30 million of catastrophes; other weather-related losses not recorded as cats per se; and finally, a marine loss from the [indiscernible] oil platform.

Adjusting for these items clearly puts our results in line with last year on a quarter and year-to-date basis. And while the returns are still quite favorable, improvement year-over-year is affected by market conditions. We believe that in an absolute sense, we're well above our cost of capital and are near the top of industry performers.

I expect that industry results will bear that out. We achieved above-market returns with strong expense controls, innovative and dynamic portfolio management, and new products.

In these last 6 months, we have continued our expansion of capital market tools to leverage our capital and achieve a net return in excess of the gross. Mt. Logan has grown to $830 million of assets under management and our purchase of ILWs has increased this year versus last year at this time. These tactics allow us to increase market capacity on attractive business without increasing net exposure, while maintaining an above-average return.

Premiums were down for the quarter and flat for the year with strong growth in the Insurance segment, offset by a reduction in our Reinsurance premiums. The factors affecting Reinsurance were less quarter share [ph] premium, the impact of foreign currency translation, shift of excess capacity to higher layers, increased corporate sessions to hedge accumulations, market pricing and nonrenewed deals due to terms and conditions.

Offsetting these trends have been initiatives on the new products side. We continue to modestly grow our credit and financial insurance business and agricultural lines in the Reinsurance segments.

In the Insurance segment, the growth has been strong at 20-plus percent as we continue to see momentum in professional lines, excess casualty, contingency, crop and property E&S. The insurance operation is on an excellent trajectory with an attritional combined ratio of 93%, excluding crop.

We continue to aggressively build out our insurance platform with the addition of underwriting talent. Market dislocation has made this a bit easier these days and a determined build is our preferred course of action here.

Despite what we all see swirling around today in the M&A space, we are generally not inclined to take on significant dilution and then still face the generally enormous integration, cultural and legacy challenges, unless, of course, it is ROE-accretive in some reasonable time frame.

We have the capital, patience and discipline to build a top-tier insurance operation consistent with our pricing and risk appetite. None of this, whether it's reinsurance or insurance will be easy. Market conditions in the reinsurance sector are challenging, but we appear to be closer to a turning point. Capital markets seem to be hitting the floor, but the traditional markets results will be a more important factor. The reality is that there is not much margin for even the small events, let alone larger inevitable catastrophes.

Based on expected second quarter industry results for reinsurers, we're likely to see that a few small cats and a large risk loss will produce returns on capital below 9%.

Along with declining bond values, this begins to feel as if the market turn must happen. Of course, markets are not always rational and a quick snap back would be atypical.

We are not waiting, however, as we continue to leverage our strengths to manage our portfolio smartly and outperform. An element of managing our portfolio will be an emphasis on insurance growth.

Furthermore, we will manage capital accordingly. In this quarter, our share repurchases were $50 million. This was below our typical pace for a number of factors, among them were longer-term capital needs driven by our insurance growth objectives. However, we have demonstrated over the long term, we're committed to returning excess capital when market conditions warrant.

As I sum up the first half of the year, despite some previously mentioned cautions, I am quite optimistic. We finished the first 6 months at $554 million of operating income, up from $532 million in the prior year and with a 15% ROE. Excellent results in such tough times, especially when compared to the industry.

We continue to be able to navigate through a difficult reinsurance market by managing risk, staying opportunistic with new products and maintaining our pricing and expense discipline.

I'm most optimistic about the trajectory of our insurance operations. Excluding crop, our year-to-date growth was 26% or $130 million and continues to produce profitable accident year underwriting results. And my expectation is that this will improve over time.

Thank you. And now I will turn it over to Craig for the financial report.

Craig W. Howie
Chief Financial Officer and Executive Vice President

Thank you, Dom, and good morning, everyone.

Everest had another solid quarter of earnings, with net income of $209 million or $4.68 per diluted common share. This compares to net income of $290 million or $6.26 per share for the second quarter of 2014.

Net income includes realized capital gains and losses. On a year-to-date basis, net income was $532 million or $11.88 per share compared to $584 million or $12.46 per share in 2014. The 2015 result represents an annualized return on equity of over 14%.

Operating income year-to-date was $554 million or $12.38 per share. This represents a 9% increase over operating income of $11.35 per share last year. These overall results were driven by a solid underwriting result and sizable foreign exchange gains compared to the first half of 2014. The results reflect an overall current year attritional combined ratio of 83.0% on a year-to-date basis, up from 82.0% at year-end 2014.

The attritional measure includes higher-than-expected current year losses in the U.S. reinsurance market, including estimated losses for the marine energy market and numerous weather-related losses that did not meet our $10 million catastrophe threshold.

All Reinsurance segments reported underwriting gains for the quarter and for the first half of 2015. Total reinsurance reported an underwriting gain of $177 million for the quarter compared to $181 million underwriting gain last year.

For the first half of 2015, total reinsurance reported an underwriting gain of $382 million [ph] compared to a $396 million gain last year.

The Mt. Logan Re segment reported a $28 million underwriting gain for the quarter compared to a $9 million underwriting gain for the second quarter of 2014.

On a year-to-date basis, Mt. Logan reported an underwriting gain of $50 million compared to a $19 million gain for the first half of 2014.

Everest retained $7 million of this income and $43 million was attributable to the noncontrolling interest of this entity.

The Insurance segment reported an underwriting loss of $23 million for the quarter compared to a gain of $4 million last year.

On a year-to-date basis, the Insurance segment reported an underwriting loss of $12 million compared to a gain of $8 million in 2014. The Insurance segment loss primarily related to a claim review of umbrella claims on a runoff program that was discontinued by the company several years ago. As a result of the review, we booked an additional $31 million of prior year losses rather than waiting for the reserve study that will be completed in the fourth quarter.

The Insurance segment current year attritional combined ratio was 93.4% on a year-to-date basis, excluding crop. This ratio has improved compared to 93.9%, 1 year ago.

The overall underwriting gain for the group was $183 million for the quarter compared to an underwriting gain of $195 million for the same period last year.

On a year-to-date basis, the underwriting gain was $420 million compared to a gain of $423 million in 2014. These overall results reflect $40 million of current year catastrophe losses in the first half of 2015, all recorded in the second quarter.

Of the total, $20 million related to losses from storms in Australia and $20 million came from flooding in Chile.

The 2015 cat losses were partially offset by $10 million of favorable development on prior year cat losses, primarily from the 2013 U.S. storms. This compares with $45 million of catastrophes during the first half of 2014.

Our reported combined ratio was 84.1% for the first half of 2015 compared to 82.5% in 2014. The year-to-date commission ratio of 22.1% was slightly up from 21.9% in 2014, primarily due to higher contingent commissions.

Our overall expense ratio remains low at 4.7%. This includes our industry-leading expense ratio of 2.8% for our total reinsurance segment.

As for loss reserves, in June, we released our fifth annual global loss development triangles for 2014. There were no major changes since the 2013 release. Our overall quarterly internal reserving metrics continue to be favorable.

For our investments, pretax investment income was $125 million for the quarter and $248 million year-to-date on our $18 billion investment portfolio.

Investment income for the first 6 months declined only $7 million from 1 year ago. The pretax yield on the overall portfolio was 2.9% with a duration of 3 years.

The first 6 months reflected $22 million of net after tax realized capital losses compared to $52 million of realized capital gains last year. These losses were mainly attributable to impairments on the fixed income portfolio in 2015.

Other income and expense included $44 million of foreign exchange gains in the first 6 months of 2015 compared to $15 million of foreign exchange losses in the first half of 2014.

On income taxes, the annualized effective tax rate is primarily driven by lower than planned catastrophe losses, resulting in higher-than-expected taxable income for the year. The 13.9% effective tax rate on operating income is in line with our expected rate for the year given our planned cat losses for the remainder of the year. This rate is consistent with the 14.4% tax rate at the same time last year.

Strong cash flow continues with operating cash flows of $683 million for the first half of 2015 compared to $590 million in 2014.

Shareholders' equity at the end of the quarter was $7.7 billion, up $276 million or 4% over year-end 2014. This is after taking into account over $200 million of capital returned through $125 million of share buybacks and $84 million of dividends paid in the first half of 2015.

Book value per share increased 5% to $174.84 from $166.75 at year-end 2014.

Our strong capital balance positions us well for potential business opportunities as well as continuing stock repurchases.

Thank you. And now, John Doucette will provide our operations review.

John P. Doucette
CEO & President of the Reinsurance Division

Thank you, Craig. Good morning.

As Dom highlighted, we continued our solid underwriting results into the second quarter of 2015. Our group gross written premium for Q2 was $1.3 billion, down $157 million from Q2 last year, with decreases coming from each of our Reinsurance segments, which I will get into shortly.

Our U.S. insurance operation gross written premium is up meaningfully in Q2 compared to Q2 last year, with growth coming from almost every insurance profit center.

Our group net written premium for Q2 was $1.2 billion, which was down 4% compared to Q2 last year.

Year-to-date, our group gross and net written premium are both essentially flat year-over-year.

Year-to-date, 2015 underwriting profits for the group are $420 million, virtually in line with 2014.

For our Reinsurance segments, total reinsurance gross written premium, including Logan, was $900 million for the quarter, down 17% from Q2 last year. This decrease in gross premium for the quarter was driven by several items.

First, exchange rate. The stronger U.S. dollar had a meaningful impact on our international operations and Bermuda operations. On a like-for-like exchange rate, our overall reinsurance segments would have been closer to 13% down compared to second quarter last year.

Second, declining, reducing or non-renewing business that had pricing we could not support. These occurred across all reinsurance segments of the group.

Third, in the International segment, a major deal for a strategic relationship was restructured with essentially the same economics and net premiums, but the topline is down significantly on a gross basis.

Reinsurance net written premium, including Logan, was $870 million, down 7% compared to Q2 last year. On a constant exchange ratio basis, our net written premium will be down roughly 4% due to increased retrocessional protections, including ILW purchases and other hedges to help us manage our peak zone PMLs.

Our reinsurance book, including Mt. Logan, generated $206 million of underwriting profit in Q2, an 8% increase over last Q2. These strong underwriting results, despite both an increasingly tougher market and the loss events mentioned by Craig, confirm our reinsurance strategy, leveraging our core strengths, expanding our product offering and increasing our opportunity set to achieve profitable growth.

In addition, our utilization of alternative capital structures allows us to conservatively manage our net risk position, while generating fee income and lowering our cost of capital.

Under this strategy, we have and will continue to effectively deploy our capital towards achieving some of the best risk-adjusted returns in the industry.

At July 1, Mt. Logan celebrated its 2-year anniversary. We continue to see strong investor interest with inflows of approximately $80 million of new third-party investments this quarter, raising total funds in Logan to about $830 million.

Logan remains core to our overall capital markets convergence strategy to hedge and manage risk across our overall portfolio and earned fees.

To complement this, we also secured more ILW protection heading into this hurricane season, mostly for Southeast U.S.A. and Florida wind.

With Mt. Logan, our cat bonds and ILWs, we maintained our conservative risk position with peak zone PMLs at 7 1 [ph], close to flat compared to our 1 1 [ph] PMLs as a percentage of GAAP equity on a net after-tax basis.

Here's some color on June 1 and July 1 Reinsurance renewals. Group-wide, our in force property pro rata GWP is slightly down as we nonrenewed some treaties and some clients bought less pro rata or converted their treaties to excess of loss.

Our worldwide property cat excess of loss gross written premium went up compared to prior periods but there was more churn compared to other renewals. We cut capacity or nonrenewed underpriced business, but we also added meaningful capacity on deals we like, particularly for long-standing key clients.

Our average dollar attachment on property treaties went up as we deployed less capacity lower down and more capacity on higher layers, both in Florida and internationally. This typically consumes more capital but has better margins.

The end result of the mid-year renewals was our expected combined ratio is essentially flat compared to our expiring portfolio's combined ratio.

On a risk-adjusted basis, property pricing moderated and was off mid-single digits, although there are several regions around the globe that remained extremely competitive, including China, Australia, some parts of Latin America and U.S. fac business.

Other regions, however, provided opportunity due to a meaningful increase in demand. We, therefore, continue to build an attractive portfolio overall.

On a dollar basis, the expected dollar margin in the overall property book increased slightly compared to the expiring portfolio.

Turning to our global casualty and longer tail reinsurance books. Reinsurance terms continue to be under pressure for commodity type treaties and ceding commissions on casualty pro rata treaties remains high. Therefore, we deployed capacity to new products and new opportunities through current and new distribution sources.

We continue to receive preferential signings on attractive deals across both long-tail and short-tail business and across geographies, including the U.S., Latin America, Canada, London, Europe, Singapore and Bermuda markets due to our lead market position, financial strength, ratings and long-standing trading relationships with clients and brokers.

Moving to our insurance operations. Our premium was $344 million in Q2, up 9% from Q2 last year. However, excluding Heartland, which was impacted by changes that delayed timing on premium recognition for 2015, Insurance gross written premium is up approximately 20% for the second quarter and up 26% on a year-to-date basis.

This growth is very diversified, originating from over 10 separate insurance profit centers, including newly launched product lines, resulting in a very balanced portfolio of both short and long tail lines.

Year-to-date, we are up 41% on what we describe as direct brokerage business, which is underwritten internally by Everest underwriters.

Program business is up 9% year-to-date. We expect these trends to continue as we focus on building out our retail books. Also noteworthy, the direct brokerage business has run to about 8 or 9 combined ratio points better than the program business over the last 3 years.

As Dom indicated and you've seen from our recent press releases, we've been hiring key leaders in our insurance operations to build out this platform.

We are also in the process of establishing a Lloyd's syndicate. If approved by the Lloyd's franchise board, we will target an early 2016 launch.

Lloyd's will provide access to international business in the new products, diversifying our insurance portfolio. We expect that growth in our domestic and international insurance operations will accelerate over the next several quarters as our new initiatives gain traction.

Insurance rates are mixed, with most long-tail lines of business up, except financial institutions and management liability, due to increased capacity and competition. And similar to Reinsurance, property rates are down in several segments.

Bottom line, our overall calendar quarter insurance results were disappointing in Q2 with a loss of $23 million, driven by prior year development on the terminated umbrella program mentioned by Craig. However, the underlying accident year results of our insurance book are profitable and improving, both for the quarter and year-to-date compared to the same periods last year.

Now with some detail on what we are seeing in each insurance market. For California workers comp, the gross written premium was about $80 million in Q2, relatively flat to last year, with a mid-90s combined ratio and still getting positive rate, but that has slowed down with increased competition from a few players.

Professional liability premium with financial institutions, the largest contributor, was $55 million for Q2, up 23% compared to last Q2, with some attractive new opportunities. However, we see excess capacity and rate [ph] pressure here. Other casualty business is up approximately 22%, driven by new initiatives.

In the short-tail business, including property, DIC, nonstandard auto and contingency business, written premium was $84 million for the quarter, an increase of over 26% from last Q2 as we have deployed more property insurance capacity.

We remain bullish on the property facility and contingency businesses, but we see increased competition in the DIC book with lower rates and looser terms.

Accident and health premium was up over 35% in Q2 compared to the last Q2 to approximately $30 million, benefiting from several new initiatives.

Regarding Heartland, crop conditions are favorable and commodity prices are stable. To-date, it is running at a slight underwriting loss, partly due to the delayed recognition of earned premium. However, we anticipate positive results for the year if prices and weather hold.

In summary, we believe that our market position, core strengths and sustainable competitive advantages, coupled with the new growth initiatives for the insurance book, will propel bottom line returns that are superior to most in our industry. We continue to execute successfully in this environment for both reinsurance and insurance.

Thank you, and now back to Beth for Q&A.

Elizabeth B. Farrell
Vice President of Investor Relations
Stephanie, we are open to questions at this time.

Question and Answer

Operator

[Operator Instructions] And, it looks like, we'll take our first question from Sarah DeWitt from JPMorgan.

Sarah Elizabeth DeWitt
JP Morgan Chase & Co, Research Division

On M&A that we've seen in the industry, could you just talk about what the implications are for Everest Re from a competitive standpoint as well as on the primary side, does that mean that insurers could perhaps purchase less reinsurance, and what that would mean?

Dominic James Addesso
Chief Executive Officer, President and Non-Independent Director

Well, Sarah, this is Dom. Look, to answer to that question basically 2 sectors. First of all, on the reinsurance side, we don't necessarily see any major impacts from the M&A activity that are occurring today in that space. But to us, as I've mentioned in previous calls, we certainly feel we're of sufficient scale and size to maintain our relevance in the market and we -- with approximately $8 billion of capital, we feel like we're operating in this market with $10 billion of capital, and we managed to get the signings and operate in with our clients in the areas that we would prefer to do so. So no meaningful impact that we can see from that. On the primary side, the trend of acquisitions there and what that means to the reinsurance purchase, I think that's just a continuing trend of as capital grows, the larger players in the marketplace have purchased less reinsurance over time. But frankly, many other participants in the market that certainly need reinsurance. And in addition to that, as these entities get larger, they generally look to larger partners and by partners, I mean reinsurance partners. They will still continue to buy reinsurance, but they're more likely to look to partner up with larger and stable and meaningful companies. So that's kind of how we view the impact of all that, if that answers your question.

Sarah Elizabeth DeWitt
JP Morgan Chase & Co, Research Division

Okay, great. And then if you were to look at acquisitions, what lines of businesses or geographies would you be interested in? Would it be more on the insurance side or in Lloyd's to accelerate your growth strategy there?

Dominic James Addesso
Chief Executive Officer, President and Non-Independent Director

The only thing that we intend to pay more attention to in the M&A space when presented with a variety of opportunities tends to be on the insurance side. But again, as I've mentioned in my comments, our natural preference is to build our own organization that matches our risk appetite, avoiding the cultural and any legacy issues that could arise from an acquisition. We don't ignore them, but frankly, given some of the premiums that are involved in some of these transactions relative to building our own platform, we don't see the value in acquisition at this point. It doesn't mean that won't exist in the future, but currently, that's not our focus. And we can't rely on that strategy, we can't rely on acquisition strategy to further our insurance objective or strategic objective in that space, I should say.

Operator

And we'll take our next question from Kai Pan of Morgan Stanley.

Kai Pan
Morgan Stanley, Research Division

Just first one a follow up on Sarah's question on the industry consolidation. You start up like a greenfield in Lloyd's. And there's some news that the large syndicate waiting to open to merger partners. Just -- can you talk a little bit more about build versus acquire? And if you build out, would we expect at least initially higher expense as the teams ramp up [ph]?

Dominic James Addesso
Chief Executive Officer, President and Non-Independent Director

Well, certainly, there would be higher expense but even in an acquisition with any amortizations of intangibles that you have to bear, we tend to feel that the expenses, frankly -- it would be more economical to build. And as we build and as we've been adding resources, we have been growing the top line as well, so I don't think you will see any meaningful degradation in our expense ratio, if that's really where you were going.

Kai Pan
Morgan Stanley, Research Division

Okay. Would it be -- would you just follow up, or would you be interested in the sort of large-scale acquisition in the Lloyd's syndicate? Or you would prefer to go through like a...

Dominic James Addesso
Chief Executive Officer, President and Non-Independent Director

Not at some of the prices that certainly have been bantered around in the press, no.

Kai Pan
Morgan Stanley, Research Division

Okay, that's great. Then on the sort of large non-cat losses. Could you quantify what's the impact for this quarter?

Craig W. Howie
Chief Financial Officer and Executive Vice President

Overall, Kai, this is Craig Howie, the overall losses are coming for our attritional loss back [ph] and what we've had were losses that took place in April, May and June through Texas and the Midwest, also what's coming through for the first half of the year are winter storms that took place in the Northeast. None of those storms rose to our $10 million cat threshold, but we have totaled those numbers to be almost $90 million to $100 million of losses.

Kai Pan
Morgan Stanley, Research Division

Is that including the Pemex, what were the offshore energy losses as well?

Craig W. Howie
Chief Financial Officer and Executive Vice President

That's correct.

Kai Pan
Morgan Stanley, Research Division

Okay, that's great. And lastly, if I may ask on the capital management, it looks like the pace of buyback have been relatively slow compared with your earnings stream, is your total payout ratio is less than 50%. Given that, I mean, reinsurance space is slowing down in terms of capital needs. I just wonder, are you saving like capital for potential acquisitions? Or is it over the long run, we're expecting like 50%, like payout ratio?

Dominic James Addesso
Chief Executive Officer, President and Non-Independent Director

Well, Kai, as you know, we don't give guidance on our share repurchase program. I think what we tend to do is look at this over the very long term, and we have returned a substantial amount of capital over the last 10 years to shareholders through dividends and share repurchases. We look at certainly our long-term objectives in terms of growth. And over the long term, we think clearly insurance and frankly, for that matter, reinsurance, again, over the very long-term, we feel that we can succeed in this space. So we have to balance that up against our objectives in terms of what we'd like to bring stock in at, and it's a long-term game. So this past quarter, based on what we saw as our future growth objectives balanced up against what the opportunities were to bring additional shares in, we opted to do $50 million this quarter. And clearly over the long term, we remain committed to buy our own shares consistent with whatever growth objectives that we might have.

Operator

And we'll take our next question from Michael Nannizzi of Goldman Sachs.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

A quick question on just the reinsurance premiums maybe ex Mt. Logan, just the stuff that's purely on your balance sheet. Do you have the constant dollar year-over-year change in net written premiums there?

Dominic James Addesso
Chief Executive Officer, President and Non-Independent Director

Just give us a second here. Year-to-date, right, you're asking?

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Just in the second quarter, if that's okay.

John P. Doucette
CEO & President of the Reinsurance Division

Michael, it's John. It's 5% -- it's a 5% decrease quarter-over-quarter.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

5% decrease. Great. And then, I guess, I mean just about -- off of first quarter, I think we were sort of looking for a little bit more growth. Should we be thinking about this sort of is the level, just given the sort of challenges that you outlined in reinsurance. I mean, should -- is it -- is there still opportunity to grow your sort of piece of the pie here, or would you expect to continue to see areas where you'll cut as a result of not meeting your profitability standards or the like? Just trying to get an idea of how we should be thinking about premium production on the reinsurance side here.

Dominic James Addesso
Chief Executive Officer, President and Non-Independent Director

Yes to all of that. And it's interesting because some are looking for growth, others are not looking for growth, some are critical of growth, some are critical of lack of growth, so it's an interesting dynamic. And as kind of each of us kind of mentioned in our prepared comments, there's a number of things going on, so you've got FX, you've got less proportional business that met our pricing guidelines, we've got us moving up an attachment point, which lowers rate online, we've got more retrocessional protections that we purchased, which is up significantly year-over-year, all of that kind of leading to a lower net written premium growth. Interestingly, in XOL basis, we actually did have some growth in our portfolio from gross XOL premium. But again, that was offset by some of the retrocessional protections we purchased. All with an eye towards improving our net returns on capital as compared with our gross returns on capital. So we will continue -- we believe that we continue to make headway in being a larger presence in the marketplace, and winning and gaining share from other market participants. But that doesn't mean that we are also not paying attention to things that don't meet our return hurdles. And I think, I mentioned in last quarter's call that there were some things in Florida that where we backed away from, some writings, where others have put down large lines. It doesn't mean that they're right, and they're wrong and we're right. It just means that it didn't quite meet our pricing objectives. So again, we still continue to make headway in terms of growing our book, our margin, our net margin is up year-over-year. It doesn't mean there aren't some headwinds in the marketplace, but we think we're doing quite well, and we will continue to manage that way going forward. And at some point, we certainly believe that there will be a turn in this market and we'll be well positioned to even take greater advantage of that than we are right now.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

I mean, I guess, just -- Craig, you mentioned about 9 -- it sounded like about 9 points of underlying losses. So if I take that into consideration, should I -- does that mean that -- the sort of true underlying actually improved year-over-year, so profitability is improving in Reinsurance?

Craig W. Howie
Chief Financial Officer and Executive Vice President

You said...

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

The $90 million, I guess, the $90 million of non-cat large losses.

Craig W. Howie
Chief Financial Officer and Executive Vice President

On an overall basis, I would say on a net basis, we think that it's improving, and that is the reason if you back out those $90 million to $100 million of losses, yes.

Dominic James Addesso
Chief Executive Officer, President and Non-Independent Director

I mean, essentially our operating income on a year-to-date basis year-over-year was up, right? Yes, this quarter, we had a number of things happen. Some of which, frankly, were losses that we're unaware of that were winter losses, for example, that came from the first quarter that got reported to us in the second quarter. So to look at reinsurers results just on quarter-by-quarter sometimes can be a little bit misleading. And so on a year-to-date basis, we are up year-over-year. We think it's a very -- it's quite a solid year-to-date so far.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

I guess, one question would be as, I mean, if -- I mean they're great results. I mean, is there a need then for the market to change at all? I mean, because it seems like at these profitability levels that, I mean, I just -- I don't know how the conversations happen between insurers and reinsurers but it seems like this would -- these levels of profitability are pretty attractive.

Dominic James Addesso
Chief Executive Officer, President and Non-Independent Director

Well, remember that it depends on scale, it depends on your expense ratio. And we've argued for a long, long time that we have a distinct advantage in the marketplace given our -- not only our size and the signings that we can obtain, but also, our expense ratio advantage and our global diversified platform. So compared to many other market participants that don't enjoy some of those advantages, you can see -- you've seen already, I believe, and will probably continue to see those returns -- some returns dipping below, as I mentioned, again, in my comments, below 9%. That doesn't sound like a completely terribly robust market and at the same time, you see a few losses that come through and hit the industry. Here, in this quarter, have -- take a pretty good bite out of the apple. So it suggests that there isn't much margin to handle the larger catastrophe. But, notwithstanding all of that, we think, we clearly have unique advantages, which enable us to continue to expand our offerings.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Got it. And then just one number question for you, Craig. The negative ceded premium in the international segment, I'm just trying to think about should we be looking at like the net written line as sort of a good base or starting point? Should we be looking at the gross written line and then assume like normal sessions occur from here? Just trying to sort of square that. And maybe if you could just give us some context in terms of what drove that negative number.

Craig W. Howie
Chief Financial Officer and Executive Vice President

Michael, that was really driven by one large strategic deal that we have done. It's better to look at the net written premium on the international book for that reason. That deal was restructured, so going forward, it's at the same margin but the premium will be booked differently going forward. So more appropriate to look at the net written premium.

Dominic James Addesso
Chief Executive Officer, President and Non-Independent Director

The gross though is still important in the sense of how we're utilizing the capital market [indiscernible] cat bonds, Mt. Logan, ILWs. So again, gross is -- you can't ignore it because that's also indicating what our reach is into the marketplace. It's just that this particular quarter, given the adjustments we've made on some of those transactions that we talked about earlier, that distorted that historical relationship for just this quarter.

Operator

And we'll take our next question from Amit Kumar from Macquarie.

Amit Kumar
Macquarie Research

Two quick follow-up questions on the discussion on capital. Number one, one question we were getting last night as it pertains to Everest Re is how does, I guess, the forthcoming changes, the upcoming changes to the AIR model, how does that impact your view on capital PMLs? And how much of that is actually connected to the capital management pullback?

Dominic James Addesso
Chief Executive Officer, President and Non-Independent Director

None of that actually. We're -- we don't expect any major change to the PMLs, no question, there will be some change. There's up and downs depending on the territories that you write in. And I'll ask John if he has any additional thoughts. But -- remember that the -- our view, the risk positions that we talk about is essentially our view of risk. It is looking at all the models, whether it's AIR, RMS and frankly, our own internal models. So to the extent that AIR is changing some of their calculations, it will have some impact but we do not expect it to be a meaningful impact. I don't know if John has anything to add to that.

John P. Doucette
CEO & President of the Reinsurance Division

Yes, just to follow on that. So net-net, we view this as a positive as this will be potentially an increase in demand, a push on demand for some of our clients, and that will be because -- just follow on what Dom said. First, we create our own view of risk. We've been spending a substantial amount of time and resources over the last 6 or 7 years building out Everest's view of risk for all zones around the world, all perils, all return periods. And we use many, many things to input this, and we're continually enhancing our views of this and have a very smart capable team of people that are analyzing this around the group. And we think this is one of our core competitive advantages, and it allows us to take all the different inputs, not just AIR, but the other vendors as well as we've been trading for over 40 years in a lot of countries around the globe, and so we look at our own results, and look at the damage ability against losses, we look at external, we look at academic studies that are done around the globe and all that rolls up to our view of risk. So our view of risk is we'll try to enhance it all the time, whether it's tied to AIR changing its results or somebody else or internal studies that we do, and we're always looking to enhance that, but net-net, we think this is a positive for us and a positive upward on rating going forward.

Amit Kumar
Macquarie Research

The other question for Dom and this is sort of a follow-up to Sarah's and Kai's question. It seems that the market is more forgiving in terms of doing dilutive tangible book value deals. And I'm curious, looking at that, has that changed your view in terms of how you might look at things going forward or not?

Dominic James Addesso
Chief Executive Officer, President and Non-Independent Director

Not a bit. Market is more forgiving today. We'll see what that turns out to be 2 years from now.

Amit Kumar
Macquarie Research

Got it. And then final question...

Dominic James Addesso
Chief Executive Officer, President and Non-Independent Director

Look, I -- we have to pay attention to here is how we feel we can best and economically and also given our strategies are, how we can best build out our insurance platform. Look, it doesn't mean that we turn a blind eye to any kind of a transaction that might be presented to us, it's just that to-date, as we look at the alternatives, our alternative looks a little better.

Amit Kumar
Macquarie Research

Got it. That's actually quite helpful. The final question is on the reserve adjustment, I think it was $31 million in the runoff book. Can you sort of maybe give a bit more color. Is that -- how should we view that $31 million versus, I guess, the size of that book? Can you put some ranges around it, which sort of give us comfort that there is not going to be possibly more noise or maybe just talk a bit more about this.

Craig W. Howie
Chief Financial Officer and Executive Vice President

This is Craig. This was a claim review that was done on a runoff program book of business for umbrella. The company discontinued this book several years ago, but the program has been running hot, if you will. We've had reserve adjustments over the last 2 reserve study cycles. There were over 300 open claims reviewed, about 195 claims had adjustments, some of them are down, most of them are up. Obviously with respect to adding additional $31 million of prior year losses. We took into account some things like other cases and local and state labor laws when we're going through these claims. But relatively speaking, this is $31 million. What we wanted to do was take this charge, the company reacts very quickly to unfavorable type development like this. But keep in mind, this is $31 million on a $10 billion book of reserves, so it's a very small number. The rest of our reserves, I'm very comfortable with the overall book, and that continues to run very favorably against our internal reserving monitoring metrics.

Dominic James Addesso
Chief Executive Officer, President and Non-Independent Director

Yes, Amit, I think I would ask that everyone consider as Craig emphasized, that it's part of $10 billion of reserves and look at our track record of calendar year results or reserve development, it's quite strong. And again, as I've said many times before, we have some 200 different reserve groups that we analyze.

This happens to be one subset of one of those, and we're going to get blips in any one of those different reserve groups from time to time. What's most important is the integrity of the balance sheet, and I think we've demonstrated that our reserve position is quite strong. Our reserve triangles have been out and we've obviously released those the last couple of years. All the analysis on that indicates that it's very positive. And clearly our own internal metrics suggest that as well. So I recognize that you certainly want to understand each -- have each segment of our business to properly project, but I also ask that you consider the overall. So thank you, though, for the question.

Operator

We'll take our next question from Josh Shanker of Deutsche Bank.

Joshua David Shanker
Deutsche Bank AG, Research Division

Could we talk a little bit about fronting arrangements and changes in those, and how we should think about ceding commissions going forward? Or I should say commission ratios.

Dominic James Addesso
Chief Executive Officer, President and Non-Independent Director

Sure. What's -- we can talk about it -- what's your -- maybe a more specific question.

Joshua David Shanker
Deutsche Bank AG, Research Division

I see the big drop-off in international premium and the uptick in the acquisition expense ratio, I'm wondering if that's one time in nature, and how we should think about that going forward?

Dominic James Addesso
Chief Executive Officer, President and Non-Independent Director

I'll let Craig take that one.

Craig W. Howie
Chief Financial Officer and Executive Vice President

Well, in the international book, as we've mentioned a couple of times, what's driving that this quarter, Josh, is one strategic deal that we had done that changed this quarter for the year and going forward. So while the margin is the same, the premium is being booked differently on a gross basis. So therefore, it's probably more appropriate to look at it on a net basis for this quarter anyway. That will give you a better indication of how that is driving the current result.

Joshua David Shanker
Deutsche Bank AG, Research Division

And so if I think about it going forward, for the remainder of the year, year-over-year, is the expense ratio higher than it was a year ago?

Craig W. Howie
Chief Financial Officer and Executive Vice President

I don't think the expense ratio will be significantly higher for acquisition cost even on an international book.

Joshua David Shanker
Deutsche Bank AG, Research Division

Okay. And so -- and thinking about 2Q '16, not that I'm asking for guidance or anything, but more interested in this deal, is this onetime in nature? How was it booked this year? When we think about next year, you'll be doing that again? Or have you discontinued the relationship or how does that all play in?

Craig W. Howie
Chief Financial Officer and Executive Vice President

We have not discontinued the relationship. There have been some law changes in Latin America with respect to how to treat these transactions going forward. So over the next 5 years, we would expect these transactions to decline going forward, but that will be over a longer period of time, over 5 years.

Joshua David Shanker
Deutsche Bank AG, Research Division

This next question is very subjective, you can answer it any way you want, whether it's about Everest, whether it's about the industry. If you were prohibited from writing cat business for some reason, just hypothetically, what do you think the combined ratio is in the reinsurance market for non-cat business today?

Dominic James Addesso
Chief Executive Officer, President and Non-Independent Director

Was an option there not to answer your question or...

Joshua David Shanker
Deutsche Bank AG, Research Division

Whatever you want. I'm trying to tease out -- it's still like you had a higher loss ratio, still very attractive in a non-cat quarter always hard to adduce what the real numbers are.

Dominic James Addesso
Chief Executive Officer, President and Non-Independent Director

Look, I'm going to take a guess at it more than anything, but at this point, because part of the answer to that question, if that were the case, the whole marketplace would be in a different dynamic, right? So you've -- transactions that you might do with clients might be done on a different basis. But I think the answer to the question would be somewhere in the low-90s, would be kind of a guess. Obviously, you've got casualty business, you've got all of our Facultative writings, you've got property per risk, you've got professional alliance [ph] treaties. I mean, it's a multitude of things, but the whole mix of the business will change, but I think what you're really asking is what's the rest of the portfolio kind of running at.

John P. Doucette
CEO & President of the Reinsurance Division

Right. Josh, this is John. And just to add some more color related to Dom's answer. So it very much would depend on the book of business that we have. And I mean, one of the things that Everest has built very intentionally over the last 40-plus years is a very, very diversified book of business, and we're not a one-trick pony tied to property cat. And we keep talking about these 200-plus IBNR groups, that means we have 200 different segments of business around the group, different lines of business and different geographies. So we're always looking for profitable business and based on a combined ratio, ROE and other metrics that we look at. So I think it very much depends on what the opportunity set is. We feel very good about our opportunity set, and we have, for many, many years, been a lead reinsurer in the casualty market and we will -- are capable to deploy as much capacity there as market conditions dictate, and we desire to given the market condition. We can flip from reinsurance to insurance so we have a lot of dials as we talk about on each of the earnings calls. But we trade in many, many different classes of business that there's margin in and not just in the property cat space.

Operator

We'll take our last question from Brian Meredith of UBS.

Brian Robert Meredith
UBS Investment Bank, Research Division

Two quick questions here. First one, Craig, can you give us a sense of where new money yields are right now versus your current portfolio and your fixed income? Are we getting close to a bottom with respect to book yields?

Craig W. Howie
Chief Financial Officer and Executive Vice President

I would love to say that we are, but our new money is just over 2%. We don't see a bottoming out or until probably mid-2016, Brian.

Brian Robert Meredith
UBS Investment Bank, Research Division

Great. And then the last question, on the Lloyd's startup here, a couple of Lloyd's -- guys in Lloyd's have kind of commented that price competition with Lloyd's right now is equivalent to kind of where we were back in 1999, so pretty darn competitive. I'm curious why from a timing perspective now going into Lloyd's given the competition?

Dominic James Addesso
Chief Executive Officer, President and Non-Independent Director

Well, first of all, I think some of those comments were related to some very, very specific classes, and so that's number one. And those are not classes that we necessarily have on our radar screen, at least not in the near term. And frankly, if -- just like in our reinsurance lines if the market is not giving us the return -- that meets our pricing metrics, then we won't write the business. We don't necessarily though have the choice as to when we start these projects, literally months and at least a year in advance, you have to kind of start thinking about how to get these things running. So you don't have a choice in terms of timing sometimes. But you do have a choice in terms of what kind of business you put on the books, and we will continue to maintain our underwriting discipline and our underwriting culture, which will dictate the kind of business we write. And frankly, the business plan that we've put forth, we believe, can generate a very nice underwriting margin for us.

Operator

I'll now turn it back over to the speakers for any closing remarks.

Dominic James Addesso
Chief Executive Officer, President and Non-Independent Director

I will close it out, just to say, thanks for your interest. We went a little over today, but my apologies for that. And thank you for your interest. Clearly, within the industry, there's certainly lots of headwinds. We think Everest has demonstrated that we have the scale and the talent to manage through that as I've mentioned before, the positive underwriting result, the positive operating results for the first half of the year, and it's really -- it's a long-term business, and we think we have to look at it on a 6-month basis, and we think we've performed very, very well with a 15% return on capital.

So thank you for your interest, and we look forward to talking with you in the weeks and months ahead.

Elizabeth B. Farrell
Vice President of Investor Relations

Thank you.

Operator
And this does conclude your teleconference for today. Thank you for your participation. You may disconnect at any time.