S&P Global
Market Intelligence

Arch Capital Group Ltd. NasdaqGS:ACGL

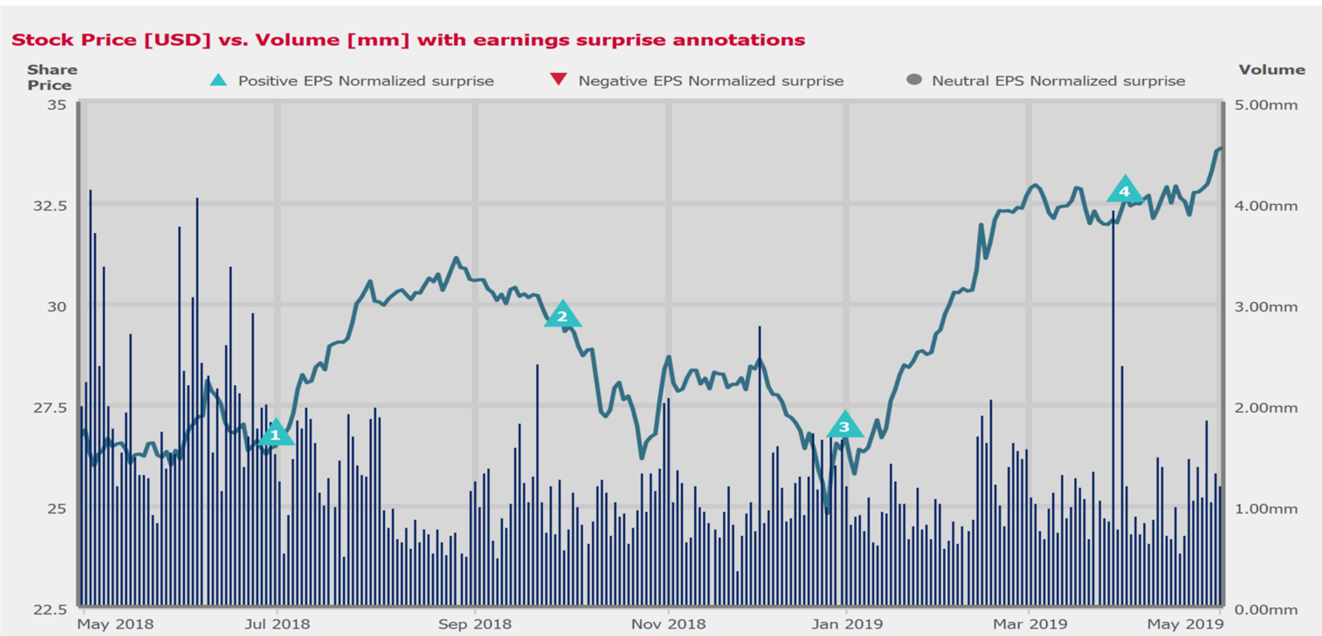
FQ1 2019 Earnings Call Transcripts

Wednesday, May 01, 2019 3:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ1 2019-			-FQ2 2019-	-FY 2019-	-FY 2020-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.61	0.67	▲9.84	0.66	2.63	2.77
Revenue (mm)	1279.75	1222.77	▼(4.45 %)	1220.40	5078.90	5135.94

Currency: USD
Consensus as of May-01-2019 10:34 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ2 2018	0.53	0.59	▲11.32 %
FQ3 2018	0.52	0.59	▲13.46 %
FQ4 2018	0.38	0.46	▲21.05 %
FQ1 2019	0.61	0.67	▲9.84 %

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Call Participants

EXECUTIVES

François Morin
Executive VP, CFO & Treasurer

Marc Grandisson
President, CEO & Director

ANALYSTS

Amit Kumar
The Buckingham Research Group Incorporated

Amit Kumar
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Elyse Beth Greenspan
Wells Fargo Securities, LLC, Research Division

Joshua David Shanker
Deutsche Bank AG, Research Division

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

Michael David Zaremski
Crédit Suisse AG, Research Division

Yaron Joseph Kinar
Goldman Sachs Group Inc., Research Division

Presentation

Operator

Good day, ladies and gentlemen, and welcome to the First Quarter 2019 Arch Capital Group Earnings Conference Call. [Operator Instructions] As a reminder, this conference call may be recorded.

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

Additionally, certain statements contained in the call that are not based on historical facts are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. The company intends the forward-looking statements in the call to be subject to the safe harbor created thereby.

Management 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. François Morin. Sirs, you may begin.

Marc Grandisson
President, CEO & Director

Thank you, Crystal, and good morning to you all. We have had a good start to the year, as Arch grew book value per share by 7.4% to $23.12 at March 31 and generated operating earnings of $0.67 per share, due to strong underwriting and investment results in the first quarter of 2019.

As mentioned on our call last quarter, we continued to see modest upward rate movement in property and select casualty lines, along with reductions in ceding commissions paid by our reinsurance units.

Our mortgage insurance, or MI, group continues to operate in a market characterized by historically strong credit conditions and conservative lending standards. For Arch, this is an underwriting market where selection and segmentation remain key to generating favorable results. It is not a one-size-fits-all market by any means.

On the one hand, we believe that the modest improvements in the property casualty markets reflect broader economic growth, particularly in the United States. While on the other hand, we see inconsistent evidence of increased discipline by underwriters.

We can sum up our review of current market conditions with 2 key virtues that describes how we operate at Arch: prudence and patience. Prudence has been a good adviser to us. In our P&C segments, rate changes in the quarter for our insurance group has been positive, but ranging in any one line from minus 5% to plus 8%, averaging about plus 2.3%. Considering that insurance loss trend or claim inflation typically runs about 200 bps above the CPI, we remain prudent in setting our elastics and allocating additional capital in any single line, given the uncertainty of future loss cost.

Prudence in our reserving process dictates that we maintain an appropriate margin for error, because reserving errors can lead to pricing errors. We saw modest growth in the first quarter of 2019 in our insurance group, as net written premium increased 8% due in part to the U.K. acquisition we mentioned last quarter. The balance of the growth was from a combination of rate and new opportunities in short and medium tail lines.

In typical Arch fashion, we remain focused on risk-adjusted returns, and patience means that we seek evidence of acceptable margin improvement even as the market experiences some pull-back in capacity, such as in the larger commoditized lines and also within some E&S markets that you have heard about on other calls.

Within our reinsurance group, property cat exposed rates are moving up after absorbing severe industry-wide catastrophe losses these past 2 years. These losses have caused some dislocation in capacity across the industry and have paved the way for new opportunities which our underwriting teams were able to participate in. However, we remain focused on the absolute level of risk-adjusted rates and selective in our approach to cat exposed business.

Now turning to our MI segment. Overall, the underwriting environment remains very attractive. Growth in our insurance in force is producing increases in earned premium and contributing to a future stream of earnings that is strong and predictable.

In MI, the key underwriting characteristics that drive earnings are credit quality and the economy, which, more than pricing, drive ultimate performance. Therefore, even as pricing has become more competitive, credit quality remains excellent and key macroeconomic factors are very good, which has resulted in very strong risk-adjusted returns. As you may know, in MI, from an accounting standpoint, these returns will be reflected in earnings over several years.

For the first quarter of 2019, our U.S. MI new insurance written, or NIW, was $11.2 billion, down about 2% from the same quarter a year ago. While NIW reflect business written in a quarter, the more relevant indicator of insurance earnings is insurance in force, in which parts of MI U has grew to $277 billion at the end of March of 2019.

As with all our business units in MI, we are focused on returns rather than market share, and we intend to remain disciplined and agile. We believe that our long experience with RateStar and our insurance linked notes known as Bellemeade securities provide Arch a competitive advantage with respect to risk management, our interface with lenders and our upfront risk selection.

As I alluded to earlier, our key risk barometers are at very healthy levels. Credit quality as indicated by FICO scores remained strong across our in-force book with a weighted average score of 743. Our combined ratio in our MI segment remains exceptional at 25.6% in the first quarter, which is substantially better than the long-term industry average of the mid- to high 40s. With respect to our investment operations, higher yields available in the financial markets produced excellent results on both a yield and total return basis.

Turning briefly now to risk management. For the past few years and continuing into 2019, our property cat exposures remain at historically low levels, with our 1-in-250-year peak zone at about 4% of tangible common equity at April 1. In our MI segment, our issuance of Bellemeade securities continue apace with our second issue this year that closed yesterday, and provides $620 million of reinsurance indemnity on more than $35 billion of insurance in force. We have issued $3.5 billion of Bellemeade securities over the past 4 years, which remains an important part of our risk management capability. As of today, Bellemeade securities provide protection on more than 90% of our existing insurance in force.

With regards to PMIERs, as of March 31, 2019, Arch MI's U.S. sufficiency ratio was 146% of the GSE capital requirements known as the PMIERs, as I mentioned.

With that in mind and with that, I will turn it over to François now to provide you more specifics on our quarterly results. François?

François Morin
Executive VP, CFO & Treasurer

Thank you, Marc, and good morning to all. Before I give you some comments and observations on our results for the first quarter, I wanted to remind you that, consistent with prior practice, these comments are on a core basis, which corresponds to Arch's financial results, excluding the other segment, i.e., the operations of Watford Holdings Ltd. In our filings, the term consolidated includes Watford.

As you know, Watford's common shares began trading on the NASDAQ Global Select Market on March 28, 2019. While this event now provides a market price on the value of our ownership in Watford, it does not impact the presentation of our financial statements or any of our disclosures, which have remained unchanged since Watford's formation in 2014.

After-tax operating income for the quarter was $275.9 million, which translates to an annualized 12.3% operating return on average common equity and $0.67 per share. Book value per share was $23.12 at March 31, a 7.4% increase from last quarter and a 13.3% increase from 1 year ago. This result reflects the effective strong contributions from both our underwriting operations and our investment portfolio.

Moving on to underwriting results. Losses from 2019 catastrophic events in the first quarter net of reinsurance recoverables and reinstatement premiums stood at $7.9 million or 0.6 combined ratio points. These losses were nearly all observed in the results of our reinsurance segment, which were impacted by a handful of minor events across the globe.

As for prior period net loss reserve development, we recognized approximately $36.7 million of favorable development in the first quarter net of related adjustments, or 3.0 combined ratio points compared to 4.6 combined ratio points in the first quarter of 2018. Both the insurance and the mortgage segments experienced favorable developments at $1.7 million and $36.6 million, respectively.

The reinsurance segment experienced a minor amount of approximately $1.6 million of adverse development, including $16 million related to Typhoon Jebi. The increase with this event reflects updated loss information received from scenes and additional industry data.

The mortgage segment benefited from significant favorable development in our first lien portfolio, where cure rates observed in recent quarters continued to be materially better than long-term averages and expectations.

The insurance segment's accident quarter combined ratio, excluding cats, was 100.2%, 150 basis points higher than for the same period 1 year ago. The year-over-year comparison for the insurance segment is affected by 2 notable items. First, as we mentioned on our previous call, our operating expense ratio was impacted by the shift in the timing of share-based compensation from the second quarter to the first quarter. This shift increased the first quarter expense ratio for the segment by approximately 94 basis points relative to 1 year ago.

Second, we continue to invest in our insurance operations, including the integration of recent acquisitions in the U.S. and the U.K. The most notable impact to our expense ratio this quarter relates to our U.K. regional book, whose operating expenses added 110 basis points to our overall expense ratio for this segment. As mentioned in the earnings release, we did not acquire an unearned premium portfolio with this acquisition and as a result, the expense ratio will remain higher than the long-term run rate until the associated earned premium reaches a steady-state. Overall, the underlying performance of our insurance segment showed improvements in the quarter, mostly due to lower levels of attritional losses and acquisition expenses.

The reinsurance segment accident quarter combined ratio, excluding cats, stood at 92.4% compared to 93.4% on the same basis 1 year ago. As we mentioned on prior calls, we tend to look at trailing 12-month analyses in order to assess the ongoing performance of our segments, given the inherent volatility in the business that can emerge from quarter-to-quarter.

The year-over-year comparison for the reinsurance segment is affected by the presence of a $10.2 million premium retroactive reinsurance transaction we entered into this quarter, which contains sufficient risk transfer for insurance accounting treatment under GAAP. While the overall combined ratio for this segment was basically unaffected, the impact of the transaction to each of the loss and expense ratio components was more observable, with the resulting increase of 90 basis points to the loss ratio and a decrease of 80 basis points to the expense ratio. Overall, we were able to reduce our expense ratio by approximately 400 basis points, mostly as a result of the growth in earned premium since the same quarter 1 year ago, the retroactive reinsurance transaction just mentioned and the shift in business mix. Once we adjust for these variations, the underlying performance of our reinsurance segment remained stable this quarter.

The mortgage segment's accident quarter combined ratio improved by 650 basis points on the first quarter of last year as a result of continued strong underlying performance of the book, particularly within our U.S. primary MI operations. The calendar quarter loss ratio of 3.5% compares favorably to the 15.5% in the same quarter of 2018 due to substantially lower delinquency rates. However, the difference is also attributable to increased favorable prior year development, which was approximately 670 basis points higher than last year. The expense ratio was 22.1% lower by 120 basis points than in the same period 1 year ago as a result of the higher level of earned premiums.

Total investment return for the quarter was a positive 270 basis points on a U.S. dollar basis and a positive 348 basis points on a local currency basis. Contributing to this result was our decision to extend our portfolio duration slightly during the second half of 2018, combined with the defensive, high-quality position of our fixed-income portfolio and the solid performance of our equity portfolio consistent with the recovery in global financial markets. The repositioning of our portfolio during 2018, combined with the reinvestment of shorter maturity bonds at higher yields, generated higher investment income year-over-year. We also benefited from higher-than-usual investment income from investment funds in the quarter.

The corporate effective tax rate in the quarter on pretax operating income was 13.1%, and reflects the geographic mix of our pretax income and a 50 basis point benefit from discrete tax items in the quarter. As a result, the effects of tax rate on pretax operating income, excluding discrete items, was 13.6% this quarter, higher than the 10.4% rate from the same quarter last year.

At this time, we believe it's still reasonable to expect that the effective tax rate on operating income will be in the range of 11% to 14% for the full year. As always, the effective tax rate could vary depending on the level and location of income or loss and varying tax rates in each jurisdiction.

With respect to capital management, we repurchased approximately 111,000 shares at an average price of $25.96 per share, and an aggregate cost of $2.9 million under our Rule 10b-5 plan that we implemented during this quarter's closed window period. Our remaining authorization, which expires in December 2019, stood at $161 million at March 31. Our debt-to-capital ratio stood at 14.6% at quarter end, and debt plus preferred to total capital ratio was 21.2%, down 130 basis points from year-end 2018.
With these introductory comments, we are now prepared to take your questions.

Question and Answer

Operator

[Operator Instructions] Our first question comes from Josh Shanker from Deutsche Bank.

Joshua David Shanker
Deutsche Bank AG, Research Division

Marc, I appreciate your comments about CPI and loss cost trends. Look, I think at the very time you make a change in your outlook, it might be the wrong time. But if you look at the past few years, what has been the loss cost trend? And what year are you comfortable making that statement about? What years were too green and what years can you say, "Yes, we know where the loss cost trend was in, say, 2015?"

Marc Grandisson
President, CEO & Director

I think, yes. So you have to -- it takes about 3 to 4 years to redevelop, and then we're talking about primary business to really get a good sense of the CPI. So I think -- if you look at the CPI, I mean, we know what it is, 1.8, 1.7, 1.9, that range has been consistent for the last 2 to 3 years. The pickup in the delta that I talk about, the claim inflation spreads above that CPI, it takes 2 to 3 years. So we have some good sense for probably 2015 -- 2014, 2015, 2016, we still have things developing for more recent underwriting years. And I would add that it's even more problematic or more difficult to fully assess when you run specialty line of business and when you have, of course, excess policies.

Joshua David Shanker
Deutsche Bank AG, Research Division

Generally speaking, was '15, '16 about 200 basis points above the loss cost -- above CPI?

Marc Grandisson
President, CEO & Director

It was a bit above that, I believe. If I -- the last time I checked the numbers, about 6 months ago, we had 150 bps above the CPI in trend inflation from '09 to about 2012, and I think it since then picked up. So I'm trying to look at the long-term average. It's very hard to pin down the exact numbers.

Joshua David Shanker
Deutsche Bank AG, Research Division

I hope I can get 2.5 questions in, but they're somewhat related. I wanted to understand the structure of your -- the exposure. I don't know how much you initially picked for, but you're not a big Japan player, and you're not a huge property cat player. So I'm just trying to figure out what happened to the contract that you paid more. Obviously, the picks went up there. And two, to what extent are higher reinsurance costs, particularly on the Japan renewals that just passed, and then when you get to Florida and the Gulf in the mid-year? To what extent are the pricing increases we're seeing in property going to get somewhat swallowed by higher reinsurance costs?

Marc Grandisson
President, CEO & Director

Okay. So that's about 3.5 questions, but I'll start and take them one at a time. So first one on Jebi. You're quite right, our exposure has been on the wait for quite a while. We had actually increased our exposure to quake after the Tohoku earthquake but on the wind side, you're right, we have been more careful. And this one is, I think, a small amount of limits out there, mostly on the excess of loss basis. I mean, as you know, Japan also buys somewhat on a combined basis, but most of our exposure is on the wind and flood only still to this day. And really, the initial numbers came in at $3 billion, as you know. Developed to about $12.5 billion to $13 billion, we believe, as we speak. What was missed by our ceding company, not only by the reinsurance community, was the business interruption and contingent BI loss exposures that were in there and in exactly the location where Jebi hit, and a lot of it had to do with semiconductor. That created a lot of issues, a lot more issues from the BI and CBI perspective, which was not properly reflected when you went through the path of the storm and modeled it through the new or existing portfolio exposure. And the ceding company had done the same thing, did not see it happen, did not see this developing and it just so happen that it created -- it was not fully appreciated by most people, by the whole market, frankly. So this is sort of where we are right now with Jebi.

So you talked about price increase. We've had -- we've seen some price increase in April 1, as you know, in Japan, but we -- with the price increase that we saw brought us back to about 20 -- the rate level in 2014. So it was a lot more subdued and a lot more tame than we would have hoped for. Based on those -- that indicator, Josh, knowing us, that we have increased somewhat but did not go significant increase, we are still trying to be patient in seeing further rate changes.

As we talk about Florida, the initial discussions are that the demands are going to be stable, but the supply of reinsurance is taking a pause. We don't know yet where it's going to go, but the initial signs is that it's taking a pause, which should mean an interesting renewal from a reinsurance provider perspective. Did I answer the 3.5?

Joshua David Shanker
Deutsche Bank AG, Research Division

Yes. But I was more interested in your outwards costs more than your inwards opportunity. As you pay more for reinsurance, does that limit the extent of these rate increases we're seeing in property lines?

Marc Grandisson
President, CEO & Director

Well, no, because the big reinsurance purchase that we would do would be on the insurance side. And we don't -- we do not have a significant Florida or these kinds of exposures that would have created the loss into a layer. So we have a very different exposure from our cat perspective. So it doesn't really factor itself into our pricing. It's not a significant change.

Operator

Our next question comes from Amit Kumar from Buckingham Research.

Amit Kumar
The Buckingham Research Group Incorporated

Maybe 2 questions. The first one is a follow-up on the Jedi question. Can you also talk about, I guess, what's your Trami exposure? And also talk about if there were any aviation losses in the attrition loss ratio.

Marc Grandisson
President, CEO & Director

Well, first of all, our Trami exposure is de minimis, we have basically none. And the question in aviation is not something we're a big participant in, so it's also de minimis in terms of aviation loss as part of the attritional loss.

Amit Kumar
The Buckingham Research Group Incorporated

Got it. That's helpful. The other question -- I guess, the only other question I have is going back to Josh's question. There is this sort of debate emerging between E&S pricing and commercial pricing, and Evan talked about this a lot earlier today. Can you maybe just spend some time? You gave us a range of a minus 5% to plus 8%, and then that came out to plus 2.3%. Can you just talk about how you're feeling about pricing versus loss cost trends in some of those lines? And what would be the lines where we are still trying to get rate increases? And how should we think about 2019? Is it time sort of sharpen our pencils and think about margin expansion from here, or would that be premature?

Marc Grandisson

President, CEO & Director

I think the best answer I can give you of what we think of where the margins are is if you look at where we grew premium in this quarter. That will give you a great indication as to what our teams think in terms of -- as with margin. Margin expansion is one thing, but it doesn't mean it's necessarily enough to get the returns. So we've seen enough margin expansion in a few lines that we grew our exposure. What was the second part of your question again?

Amit Kumar
Macquarie Research

In terms of either some of those lines and the rate adequacy in those lines versus loss cost trends?

Marc Grandisson
President, CEO & Director

Yes. The ones that we grew are on a shorter-tail sign, mostly -- most of the growth has been on the shorter-tail lines. And the reason it's a little bit more -- it's a bit easier to do so is because the loss costs are a little bit easier to pin down. You have a loss -- less uncertainty about ultimate loss cost on the shorter-tail lines. So that means that if you think you are perceived -- you're perceiving a margin of safety of rate above loss trend of x, you more certain you're going to get this. In other lines of business such as E&S casualty, we, like others, have seen some pickup in pricing there, but there's a lot more uncertainty there in terms of what the gap between loss cost and rate increase is. And I would argue, some of them in some lines of business, even though would look to have like a 300 pickup, let's say, in margin, they probably need a bit more than that to really make a big allocation of capital from our perspective. So it's really a transition and really an incremental marketplace.

François Morin
Executive VP, CFO & Treasurer

One thing I'll add to that, just quickly, on the London market, as you know, is going through a period of dislocation. We benefit from that. We're not huge players in London, but we have a meaningful participation, both on the syndicate and the company side. Who knows whether that is going to be sustainable for the rest of 2019 and into 2020. But certainly, as Marc alluded to, some of the growth we saw in the premiums we wrote in Q1 are specifically related to opportunities in London, in particular.

Operator

Our next question comes from Elyse Greenspan from Wells Fargo.

Elyse Beth Greenspan
Wells Fargo Securities, LLC, Research Division

My first question, on the reinsurance side, Marc, in response to an earlier question, you said that supply is taking a pause. So now when we think about supply of capital in Florida, is that a comment that you would make to overall capital, to alternative capital, to traditional capital? I guess, is the -- you think about the buckets of the capital sources for the upcoming part of renewals, if you could just give us a little bit more color on how you think this will play out.

Marc Grandisson
President, CEO & Director

Well, I don't know how it's going to play out. I'm just talking about the early signs. But in terms of where it's coming from, the supply -- the pause has been taken by all participants because implicitly, in some of the traditional players, some of it is relying on alternative capital and there is also an alternative capital stand-alone as well. So it's really taking a step back, a lot of moving parts in Florida, the assignment of benefits, the LAE adjustments and whatever else, the department asking for, buying more. I mean, there's a lot of moving parts right now. So if people are still -- and people are waiting to see more up-to-date Irma numbers. They've been developing, as we all know, for several quarters now. So everybody is taking a pause. I think it's a collective -- it's not obviously, a consensus that developed by talking to one another, obviously, but it seems to be this taking a pause positioning from the supply. But we've seen this before, Elyse. I want to be open. Sometimes, you see this and at the end, people sort of roll over and do -- act differently than you would've thought they would behave. But I'm just telling you, as we speak, last information that I received this morning about the current state of the overall feeling in the marketplace.

Elyse Beth Greenspan
Wells Fargo Securities, LLC, Research Division

Okay. And then back to some comments you guys have been making throughout the call in the primary insurance market. So it sounds like you guys are finding more opportunity in the shorter-tail lines as opposed to some long-tail lines, just given on some concerns about loss costs. Another company, earlier today, pointed to this being a casualty driven market upturn. Would you agree with that statement? And maybe there's just -- you guys are holding off on really pushing for growth on the casualty side, just given waiting to see how loss trend plays out?

Marc Grandisson
President, CEO & Director

Well, I don't know if it's casualty led before. We've seen in terms of where we've allocated our efforts in capital, as François mentioned, a lot of it is led by cat exposure and marine exposure and short-tail exposures. So this is where we've been more allocating capital for the last 6 quarters -- for 3 or 4 quarters and still continue on as we speak this quarter.

On the liability side, for us to have a casualty-led, we'd still need to see some pain in the marketplace. We're not seeing broad pain yet, at least, emerging on the insurance portfolios. What I would tell you and thereby probably sort of size or is in line with what you -- the comment I made earlier in some calls is that the reinsurance market is actually being a bit more disciplined, a bit more reactive to the casualty placements. And that tells us indirectly that there's probably a bit more negative perception about the ultimate results in those numbers, but I'm not sure that these results have been published yet.

Elyse Beth Greenspan
Wells Fargo Securities, LLC, Research Division

Okay. And then are you seeing -- sorry, one last question. Are you seeing more business come from the standard markets to the E&S market?

Marc Grandisson
President, CEO & Director

Yes, most of what we see is through the E&S market. Most of the growth except for U.K. regional, obviously, which is a specific focus. But yes, the Lloyd's mark -- the Lloyd's business and the E&S market is where we are seeing more opportunities. Yes.

Elyse Beth Greenspan
Wells Fargo Securities, LLC, Research Division

And then, sorry, one last question. On the intangibles, they went -- were a little bit higher than what I would have thought this quarter. I think that's due to your 2 newer acquisitions. Is the Q1 level kind of a good run rate for this year? And could you give us a sense of where the intangibles amortization expense might come in, in out years?

François Morin
Executive VP, CFO & Treasurer

Yes. Well, certainly, yes, the part 1, our practice for the amortization of the intangibles is linear throughout the year. So you should expect the remainder of 2019 to be at very much close to the same level that we had in Q1. In terms of outer years, we had given direction on the -- specifically on the UGC transaction, how it was going to wind down in 2020 and beyond. So we're happy to recirculate that and give you an update on that, but that's a very much scheduled, and we know where it's going to be. I don't have the numbers in front of me for 2020, but we can certainly, yes, give you that in the 10-K.

Elyse Beth Greenspan
Wells Fargo Securities, LLC, Research Division

Okay. So the UGC numbers are unchanged and it's just up a little bit due to the 2 recent deals?

François Morin
Executive VP, CFO & Treasurer

Exactly, that's correct. Yes. You can see the numbers were locked in at the time of the closing. Yes.

Operator

Our next question comes from Mike Zaremski from Credit Suisse.

Michael David Zaremski
Crédit Suisse AG, Research Division

First question is on mortgage insurance. I believe in -- Marc, in your prepared remarks, you mentioned even as pricing has become more competitive, you used that term. Is pricing currently becoming more competitive? I know that a lot it is within these dynamic pricing models so it's not as transparent. And maybe you could comment on -- is that maybe why your market share -- I know you don't focus on market share but maybe that's why your market share seems to feels like you've fallen quarter-over-quarter?

Marc Grandisson
President, CEO & Director

Yes, I think it's true that there's -- well, it's hard to see if it's a broad competition but certainly, there's a lot of dislocation occurring in the pricing -- in the marketplace as a result of all these new risk-based pricing. It's very hard to see what it means and to even evaluate whether it's down or up or sideways. So we'll reserve ourselves some more time to evaluate and come to terms to what it means in this quarter. But certainly, we haven't changed our pricing. We held the line and stayed the course on our risk-based pricing. And at the end, we just harvest what we put out there and what's stuck to the marketplace. And -- but it's going to take a while, right. Markets are going through establishing the systems, educating the loan originators how it's used and sort of fixing some of the bugs. So it's going to take several quarters for us to really see if there is truly that much more price competition. But I think the price competition that I mentioned in my remarks has been over the several last quarters; I was not specifically talking about this quarter.

Michael David Zaremski
Crédit Suisse AG, Research Division

Okay. That's helpful. And lastly, moving to kind of leverage levels and excess capital. If you could remind us, I know leverage is down to 21%-ish. Historically for UGC it was in the teens. Can you remind us, is there a level that you have kind of soft promised to rating agencies? And then also kind of curious whether holding dry powder is more or less important today versus in the past?

François Morin
Executive VP, CFO & Treasurer

Yes. Part 1 to your question, yes. 20% was roughly the number that we were -- the leverage level, the leverage, yes, the level that we were targeting at the time of acquisition, and we are there today. So I think we're -- we've accomplished what we set out to do, and that's good news.

And yes, part B, to your question. Absolutely, dry powder is something we that we always have been firm believers in, whether it's deploying the capital in potential other opportunities, whether they're acquisitions or if this rate environment picks up steam and gives us the opportunity to put more capital at work in the business in any of our 3 segments, we want to have that ability to do so. So the answer to your question is, yes, having the flexibility is something that we've always believed in and thankfully, I think we're there right now.

Operator

Our next question comes from Yaron Kinar from Goldman Sachs.

Yaron Joseph Kinar
Goldman Sachs Group Inc., Research Division

Just wanted to circle back on the reinsurance prior year development. So even if I exclude the Jebi adverse development, I think net, you see a bit of a decrease year-over-year. Can you maybe talk about the moving pieces there?

François Morin
Executive VP, CFO & Treasurer

A couple of other things that are, I'd say, more minor. I mean, there's been some timing of some claims that came through that, yes, impacted favorable or the level of favorable development in our reinsurance segment reserves. No question that we didn't -- we've held a healthy level of reserve releases over the years that were not -- we never plan for it. We always observe the data and we always react to the data. Turns out this quarter, the level of favorable wasn't as high at it has been in prior quarters. Does it revert back to a higher level next quarter? Well, we don't know, we'll find out in 3 months. But no question that, yes, Jebi was a big part of it. There's a couple of other small moving parts that are just, I think,, a bit more noise and somewhat idiosyncratic in terms of the timing of the events that affected the aggregate level of PYD on the reinsurance segment.

Marc Grandisson
President, CEO & Director

And I think our loss cost trend discussion is certainly key to our being prudent and careful in the way we set up reserves because things could be shifting. And so that's really part of the -- that's part of the informing our decisions currently. It's not recent, but it's really part of that as well.

Yaron Joseph Kinar
Goldman Sachs Group Inc., Research Division

Understood. I guess what I'm trying to get at though is the year-over-year change, excluding Jebi, coming more from shorter-tail lines or more from longer-tail lines?

François Morin
Executive VP, CFO & Treasurer

It's a mixed bag. It's a bit of both.

Yaron Joseph Kinar
Goldman Sachs Group Inc., Research Division

Okay. And then with regards to the U.K. block that you acquired, should we expect it to be fully earned in kind of within a roughly 12-month period, so January of 2020?

François Morin
Executive VP, CFO & Treasurer

Pretty much. I mean, right? So the premium, it's a ramp up, so it's effectively a start-up. And we -- it will be 50% earned by -- in 2019, but you're right, Q1 into next year, I'd like to think that the run rate of earned premiums is going to be pretty steady. And yes, there's nothing specific, nothing special about their annual policies, and the accounting should follow pretty easily from there.

Operator

And our next question comes from Meyer Shields from KBW.

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

I also wanted to ask about the U.K. acquisition. Once you get past the -- a steady run rate for earned premiums, is there any difference in its loss ratio, expense ratio breakdown and the legacy Arch insurance segment?

François Morin
Executive VP, CFO & Treasurer

Well, should -- I mean, there's a lot of moving parts in the expense ratio. We're trying to improve on that point in the U.K. in particular, and you guys all know about the realities of the London market and it's generally an expensive place to do business in. So that was always one of our objectives here is try to reduce our expense ratio, specifically from the U.K. side, and this acquisition helps us achieve that given it's a more -- it's a better business model for us and more efficient on that sense. But the counter to that, I will say, is we're very -- there's other opportunities, other investments that we're making within our insurance segment that may offset some of that. So I -- we don't have complete visibility on everything we're going to do in 2019, but if you are looking for some view on what the expense ratio may look like for the insurance segment for the remainder of the year, I would say no question that Q1 was elevated because again, the lack of a premium on the U.K. book and the timing of the share-based expenses or compensation expenses. By the end of the year, we'd like to think that we can bring it down between 100 and 200 basis points from where it was in Q1.

Marc Grandisson
President, CEO & Director

But Meyer, overall, the business that we've acquired is retail business. As you know, it's not cheap, necessarily. You still -- there's a lot of commissions that have to grow through. But the problem -- well, which means the loss ratio would hopefully be lower than a comparative E&S portfolio. Having said all this, I think by virtue of the critical mass that François just talked about, I think that it should improve the overall expense ratio, but it's -- I wouldn't expect it to go to be a significant improvement.

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

Okay. That's very thorough and very helpful. Looking at mortgage, I think, Marc, you talked earlier about the benefits of the current economy. I don't know how to ask this without being too political charged, but do you see that as being vulnerable to next year's presidential election?

Marc Grandisson
President, CEO & Director

Well, it -- politics are part and parcels of what we have deal with all the time. We're on the receiving end of what's happening out there. But one thing I'll tell you about the politics, we've been worrying about this, we've been asked that question for a long time, but the consistent answer on any administration that was in place and anybody that runs the FHFA, it's clearly a recognition that private market has a place in delivering the product to the homeowners and providing insurance and protection. So we don't see any major change there. We also don't see any change to the GSE mandate and the way that MI is one of the collateral that's used to bring the LTV down below 80%, so none of those core essence things that are really essential for -- to make sure that the market exists has been under siege or will be under siege. I mean, there might be some changes to the delivery of the product, and we certainly have been participating in some of those new innovations and we'll continue to do so for the future. But the way we think about politics and as it regards MI is we're agnostic as to what happens, we'll react and are able and willing to help in any way that we can to deliver the product to the homeowners and to the banking system.

Operator

And I'm showing no further questions from our phone lines. I'd now like to turn the conference back over to Mr. Marc Grandisson for any closing remarks.

Marc Grandisson

President, CEO & Director

So from François and I, have a good day, and then we'll talk to you next quarter. Thank you much.

Operator
Ladies and gentlemen, thank you for participating in today's conference. This does conclude the program. You may all disconnect. Everyone, have a wonderful day.