S&P Global
Market Intelligence

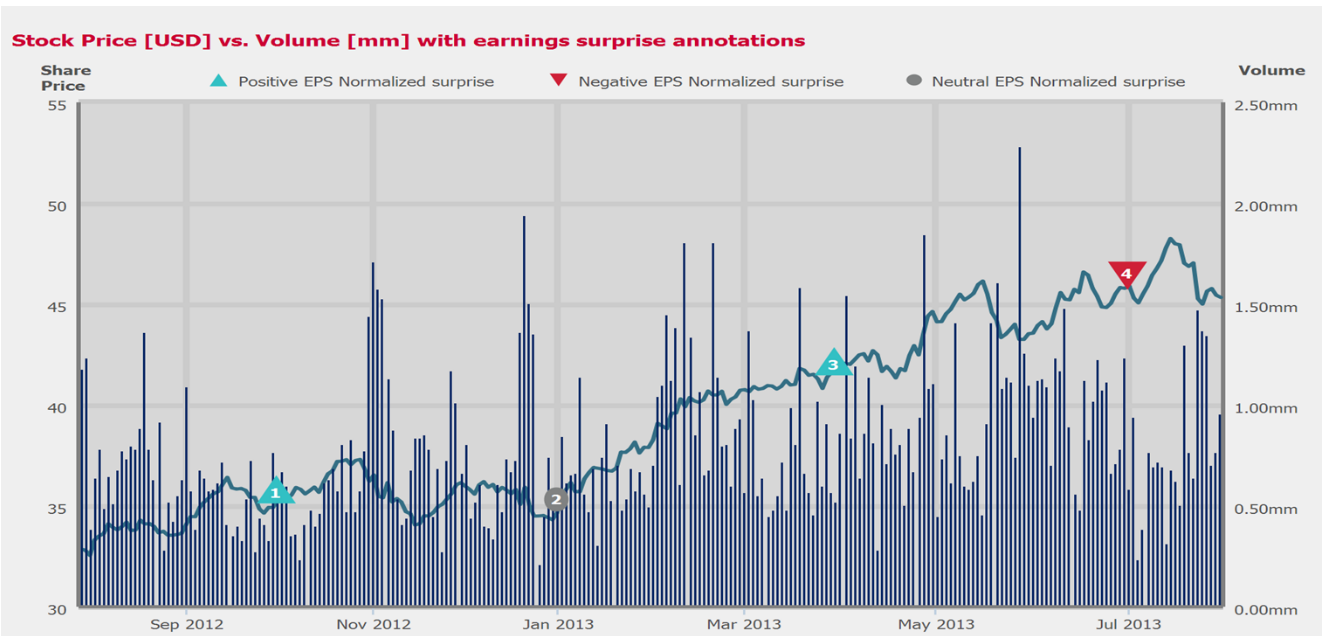
AXIS Capital Holdings Limited NYSE:AXS
FQ3 2013 Earnings Call Transcripts

Thursday, October 31, 2013 12:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ3 2013-			-FQ4 2013-	-FY 2013-	-FY 2014-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	1.21	1.74	43.80	1.29	5.03	4.71
Revenue (mm)	710.16	716.39	0.88	575.04	3861.83	4088.97

Currency: USD
Consensus as of Oct-31-2013 11:35 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ3 2012	1.04	1.63	56.73 %
FQ4 2012	(1.18)	(0.23)	NM
FQ1 2013	1.19	1.92	61.34 %
FQ2 2013	0.49	0.43	(12.24 %)

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Call Participants

EXECUTIVES

Albert A. Benchimol
President, CEO & Director

Joseph Christopher Henry
Consultant

Linda Ventresca

ANALYSTS

Brian Robert Meredith
UBS Investment Bank, Research Division

Charles Sebaski

Gregory Locraft
Morgan Stanley, Research Division

Ian Gordon

Jay Adam Cohen
BofA Merrill Lynch, Research Division

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

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Ryan J. Byrnes
Langen McAlenney

Vinay Gerard Misquith
Evercore ISI Institutional Equities, Research Division

Presentation

Operator

Good morning, and welcome to the Third Quarter 2013 AXIS Capital Earnings Conference Call. [Operator Instructions] Please note this event is being recorded.

I would now like to turn the conference over to Linda Ventresca, Director of Investor Relations.

Linda Ventresca

Thank you, Amy, and good morning ladies and gentlemen. I am happy to welcome you to our conference call to discuss the financial results for AXIS Capital for the third quarter ended September 30, 2013. Our earnings press release and financial supplement were issued yesterday evening after the market closed. If you would like copies, please visit the Investor Information section of our website, www.axiscapital.com.

We set aside an hour for today's call, which is also available as an audio webcast through the Investor Information section of our website. A replay of the teleconference will be available by dialing 877-344-7529 in the United States and the international number is 412-317-0088. The conference code for both replay dial-in numbers is 10034219.

With me on today's call are Albert Benchimol, our President and CEO; and Joseph Henry, our CFO. Before I turn the call over to Albert, I will remind everyone that statements made during this call including the question-and-answer session, which are not historical facts, may be forward-looking statements within the meaning of the U.S. Federal Securities laws.

Forward-looking statements contained in this presentation include, but are not necessarily limited to information regarding our estimate of losses related to catastrophes, policies, and other loss events, general economic, capital and credit market conditions, future growth prospects, financial results and capital management initiatives, evaluation of losses and loss reserves, investment strategies, investment portfolio and market performance, impact to the marketplace with respect to changes in pricing model, and our expectations regarding pricing and other market conditions. These statements involve risks, uncertainties, and assumptions, which could cause actual results to differ materially from our expectations.

For a discussion of these matters, please refer to the Risk Factors section in our most recent Form 10-K filed with the Securities and Exchange Commission. We undertake no obligation to update or revise publicly any forward-looking statements whether as a result of new information, future events, or otherwise.

In addition, this presentation contains information regarding operating income and our consolidated underwriting income, which are non-GAAP financial measures within the meaning of the U.S. Federal Securities laws. For a reconciliation of these items to the most directly comparable GAAP financial measures, please refer to our press release, which can be found on our website.

With that, I'd like to turn the call over to Albert.

Albert A. Benchimol
President, CEO & Director

Thank you, Linda. Good morning, everyone, thank you for joining our call. We're pleased to announce a very good quarter on all fronts. After-tax operating income for the quarter was $197 million, comparable with the prior year. Our annualized operating return on average common equity was 15.6% for the quarter and our diluted book value per share increased 4.5%.

Our results benefited from strong contributions from both underwriting and investments, continued strong premium growth globally, favorable reserve development, and a relatively light catastrophe and weather activity in the quarter.

For the nine months, we reported a combined ratio of 90.5%. Operating income of $4.08 per diluted share, as compared to $3.60 in the prior year and operating ROE of 12.1%, reflecting ongoing strong performance.

Back to the quarter, our gross premiums written were up 7% with both segments contributing. This is the result of our continued efforts on three fronts. First, we've amplified our activities and showed strong growth in improving market segments, particularly in the U.S.

Second, we're seeing ongoing returns on the substantial investments we've made in new initiatives of recent months and years. And finally, we continue to be disciplined in the selection of risk we have prepared to assume in a competitive market.

For the quarter and for the year-to-date, our accident year loss ratio excluding catastrophes was 56%. That ratio was up over the prior year quarter due to differences in mix and to a lesser extent claims activity including views on loss trends in certain lines. However, for the year-to-date, which is more relevant, the ratio improved a little over a point reflecting margin expansion in lines that have benefited from improved experience and rate increases and various actions taken to optimize our portfolio.

Over the last couple of years, we have made significant progress in growing lines of business which will help to reduce our overall portfolio volatility. Some of these lines may have higher loss ratios than our historical product mix. However, they contribute meaningfully to improvement in our overall risk-adjusted returns.

Our ongoing efforts to reshape a catastrophe portfolio have a similar positive effect. We believe our risk selection combined with our diligent attention to portfolio construction will continue to deliver significant returns to our shareholders.

And with that, I'll turn the call over to Joe.

Joseph Christopher Henry
Consultant

Thank you Albert and good morning everyone. During the quarter we generated strong results with an annualized operating ROE of 15.6%. In addition, quarterly diluted book value per common share increased by $1.93 per share or almost 5% in the quarter. Our results benefited from growth in our book of business and continued favorable prior year reserve development, which was partially offset by natural catastrophes and weather-related losses which although light compared to expectations were higher when compared to the same period of last year.

Valuation improvements on our available for sale investment portfolio due primarily to the strong results from our other investment portfolio and the positive impact of spread tightening on our high yield fixed maturity holdings, also contributed to the growth in our diluted book value per share.

Moving into the details of the income statement, our third quarter gross premiums written increased 7% to more than $900 million with growth emanating from both of our segments.

In our insurance segment, our top line was up $45 million or 9% reflecting a continuation of the trends noted in the first half of the year. The liability line was our strongest contributor. Growth in our professional lines of business reflects our continued global expansion. Property benefited from rate increases, as well as new business which significantly exceeded the continued reduction of cat-exposed business written through MGAs.

The accident & health lines continues to contribute to the top line growth during the quarter bringing the year-to-date increase in growth written premiums to almost $90 million. On the other hand we had minor reductions in aviation and marine lines.

In reinsurance our top line was up $12 million or 4%. Growth was driven by professional lines, mainly reflecting selected new business with agriculture continuing to contribute. These increases were partially offset by decreases in property and motor, relating to a number of factors including premium adjustments and a reduction in reinstatement premiums received. Our consolidated net premiums written were up 10%, exceeding the growth rate for gross premiums written.

Similar to prior quarters, the difference is driven by a number of factors with changes in reinsurance, purchasing and our insurance segment having the biggest impact. This included reductions in the quota share session rates for significant portions of our professional lines and liability books, a reduction in the cost of our property per risk and property cat-protections and higher retentions for both property and marine.

Our net premiums earned were up 10% for the quarter with growth in insurance and reinsurance driven by our accident and health and agriculture initiatives respectively. Our third quarter consolidated current accident year loss ratio increased 3.2 points to 61.5% compared to the same period last year, primarily due to the increase in the frequency of natural catastrophe and weather-related events and change in the mix of our business with a proportional shift towards lines that incur a higher loss ratio such as agriculture.

In insurance, the current accident year loss ratio increased 1.3 points to 55.9%. This increase in the accident year loss ratio during the third quarter of 2013 was primarily due to the change in our business mix. For the year-to-date 2013, the current accident year loss ratio for insurance is 63.8% up slightly from 62.6% for the comparable period of 2012, largely reflecting the increase in the natural catastrophe and weather-related events in the first half of the year.

The third quarter current accident year loss ratio for our reinsurance segment was up 5 points to 66.6%, primarily attributable to catastrophe and weather-related losses. We recognized $51 million of natural cat and weather-related losses net of reinstatements relating to a number of worldwide loss events, namely European hailstorms $15 million, Mexican floods $15 million, Toronto floods $15 million, and Colorado floods $3 million.

These contributed 10.5 points to the accident year loss ratio, whereas in 2012 net losses related to U.S. draught conditions and Hurricane Isaac contributed 5.9 points. An additional factor that contributed to the variance was the change in the business mix with a significant growth in our agriculture lines which again incurs a higher loss ratio.

For the first nine months of the year, the current accident year loss ratio for reinsurance increased by 0.9 points to 63.5% with the same factors contributing as described in the quarterly comment above.

During the quarter our results continue to benefit from net favorable development, prior year development which aggregated to $80 million. Short-tail classes in both segments contributed $57 million of that balance primarily reflecting better than expected loss emergence.

In addition, we continue to give weight to our actuarial methods that reflect our favorable experience for liability reinsurance business, which contributed a further $26 million of favorable development for the quarter and to our reinsurance professional lines which contributed $10 million reflecting lower ultimate loss estimates for years 2009 and prior. The favorable experience was partially offset by adverse development in our credit and surety line of $15 million which follows the recent claims activity on certain European bond exposures.

The third quarter reflected a steady acquisition cost ratio, while our G&A expense ratio decreased 0.8 point to 14.8%. While our total G&A cost increased primarily due to increased headcount, as we continue to build out our global platform. From a ratio perspective this was more than offset by the growth in our net earned premium during the quarter.

Net investment income was $103 million for the quarter up from second quarter's $83 million and very similar to the $104 million of the third quarter of last year. Once again the most significant driver of the change in net investment income quarter-to-quarter was the performance of our other investment portfolio which contributed $32 to this total versus $12 million last quarter and $34 million in the third quarter of last year.

The majority of our other investment portfolio is hedge funds which benefited from the strong equity markets during the third quarter. Income from our fixed maturity portfolios including cash and short-term investments remain steady at $75 million for the quarter, similar to last year's $76 million and $73 million in the prior year quarter.

The yield to maturity for our fixed maturity portfolio declined modestly from 2.4% to 2.2% during the quarter due primarily to some spread tightening and a reduction in the duration of our portfolio from 3.5 years to 3.2 years. In the aggregate, the total return of our cash and investment portfolio for the quarter was 1.4% inclusive of foreign exchange impact. The primary drivers of return were spread tightening on some of our fixed maturity holdings and strong returns from our equity and hedge fund holdings.

We continue to hold a high-quality, well diversified portfolio with cash and investment assets totaling $14.8 billion at September 30, up approximately $0.5 billion from June 30 and a year ago. Our fixed maturity weighted average credit rating remains unchanged at AA-.

Our total capital at September 30, 2013 was $6.8 billion, consistent with our capital position at year-end. Net income generated during the year and a net increase in our preferred share capital from transactions during the first half of the year were offset by common share repurchases and dividends and the decrease in unrealized gains in investments due to an upward shift in sovereign yield curves during 2013.

During the quarter, as we discussed with you on the last call, we halted the repurchase of our shares under the authorized share repurchase plan as we went through the Atlantic wind season. We currently have $409 million of remaining authorization for future repurchases and expect to resume repurchasing shares this quarter.

During September 2013 A.M. Best upgraded the financial strength rating of each of our principal operating insurance and reinsurance subsidiaries to a financial strength rating of A+ (Superior). As you know, this is the second highest rating that this agency awards and we are very excited about the potential opportunity that the increased rating brings to our franchise.

Our strategic expansion opportunities continue to progress and we remain optimistic about our prospects. We believe that our diversified global franchise and strong balance sheet will continue to allow us to take advantage of market opportunities as they emerge.

And with that, I'll turn the call back over to Albert.

Albert A. Benchimol
President, CEO & Director

Thank you, Joe. Looking forward, the overall insurance markets continue to improve on average, but with increasing variations by accounts, lines of business and geographies. The U.S. continues to see the strongest improvements.

For our insurance business, average price increases are coming in at a slower pace than that observed in the second quarter of this year. For our international division, rate activity as a whole was flat, similar to last quarter. The specialty lines which comprise [sic compose] this division were typically mixed. We anticipate continuous flat rate change for this division with decreases in some specialty lines in particular aviation, terrorism and offshore energy offsetting positive rate change and others.

Offshore energy is gradually and modestly coming off historical high pricing following a two-year period of benign losses. Meanwhile, onshore energy rates saw continued modest improvement after a number of large losses in recent quarters. As with the second quarter, property rates have stabilized in this division.

In our professional lines division rate change was flat overall, but again with wide variations. For the U.S. pricing across all units was positive. On the other hand, the Bermuda excess lines are seeing pressure, especially on Side A coverages. Classes which have seen higher than expected claims activity in recent years are also seeing much higher rate increases. For example, primary public D&O is seeing rate change in the order of 7%. International professional lines faced significant pressure. While professional lines overall have not improved as much as we may have hoped for at the beginning of the year, we expect continued slow improvements with rate increases on primary layers continuing to be more robust and international professional lines under more pressure.

In our U.S. division, all lines remain in positive rate territory with a 6% rate change for the division overall. While pricing momentum has slowed on property lines, our casualty business continued with double-digit rate improvement. This division is thriving in the current environment with new submissions up over 20% and good retentions. The abundance of capacity addressed in property business has taken the edge off a bit after two years of rate improvement, but we are still seeing many attractive opportunities.

Within our reinsurance segment, underlying primary market conditions are a positive but increasing competition amongst reinsurers is such that some or in certain cases all of the improvements are staying with the cedants, leaving reinsurers with a generally stable level of overall profitability on renewed business.

The combination of new capital and the advertised reduction in reinsurance purchasing from several large cedants should make market conditions a bit more challenging as we enter 2014. The unprecedented influx of capacity into the U.S. property catastrophe market forced rates down 10% to 20% in some cases, pressure on rate extend to property and catastrophe lines outside of Florida and the U.S. although not with similar severity.

Signs of competitive pressures abound, reinsurers have been more willing to offer expanded coverage’s including multi-year terms private layers and aggregate covers.

Outside of property lines the competitive landscape is also intensifying as reinsurers seek to expand their product offering. Pressures on commissions exist across the board and as historically low loss trends continue, cedants are reviewing their buying strategies and generally retaining more. Consolidation in reinsurance buying is resulting in more multi-line programs.

Despite these pressures profitability generally remains good and where necessary underlying primary rate improvements are accruing to the benefit of our treaties. Overall though the market remains reasonable as I said and we are confident in our ability to navigate through the various issues. We have pricing systems in every line of business that are focused on return for dollar of risk. When that return for dollar of risk is adequate or attractive, we will deploy our capital to support our clients.

Underwriting excellence has been the hallmark at AXIS and it remains our key strength and differentiator in shifting markets. We are investing heavily to enhance our strong underwriting culture and provide our underwriters with the tools and with resources they need to succeed. We are also adding improved data and analytics to meet our goals of optimizing our portfolio reducing earnings volatility while still delivering top-tier returns.

Last month, the Lloyds franchise board was granted approval on principal for the new AXIS syndicate 1686. This is yet another step in expanding our global underwriting platform to deliver an efficient, globally diversified portfolio to our shareholders. This is the latest of a number of initiatives this year introducing new products and expanding geographic distribution.

Lastly, I could not conclude my prepared remarks without highlighting our recent upgrade to an A+ by A.M. Best which is not only a testament to the strong track record of Axis and of our favorable positioning, but also a key differentiator in defending and expanding our targeted business in what is a currently a mixed market.
And with that, operator, I’d like to open the lines for questions.

Question and Answer

Operator

[Operator Instructions] Our first question comes from Jay Cohen of Bank of America Merrill Lynch.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

I guess I will start with a couple of questions. First is your own reinsurance buying, obviously you made some changes in general, retaining more of the business. Can you talk about what the plan might be for going forward? Should we expect that net to gross ratio to continue to change? That is question number one. Question number two, on the investment side, can you talk about the new money yield you are seeing available in the market relative to your portfolio yields?

Albert A. Benchimol
President, CEO & Director

Sure. Joe, why don't you take that?

Joseph Christopher Henry
Consultant

Yes, the last one Jay we are attracting 2.2% in new [ph] money versus the book yield of 2.6%. So the gap is widening a little bit from where it was in the second quarter.

I think on the reinsurance buying side, excuse me Jay, I think there is a couple of factors. The first is growth in lines of business where we don’t buy reinsurance. So obviously as you see lines of business such as A&H that are predominantly kept net that is going to have on its own an impact on the ceded ratio.

The other area is in how we choose to optimize our various portfolios. So I think what you’ve seen in the past and we will continue to see is an increase on our net retention per risk on the various property related lines. But probably more buying on the catastrophe side taking advantage of the terms that are available to manage our PMLs, to manage our zonal limits and so on.

With regards to the professional lines and liability lines, we are liking the trends that we are seeing on the professional lines and we are likely going to be keeping those levels pretty much where we are right now. I think on the casualty lines, we are growing these relatively strongly right now. We generally have a high session rate on those and over time as that book develops we are likely to keep a little bit more of that business.

Albert A. Benchimol
President, CEO & Director

The only thing I will add to that is that a lot of these changes that we put in effect occurred in March and April of this year. And most of that has foamed through our ceded written. But not all of it has actually foamed through all the ceded earned yet. So you will see a little bit of that continue on into 2014.

Operator

Our next question comes from Michael Nannizzi from Goldman Sachs.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

I guess Joe, if you guys bought back any stock so far in the fourth quarter?

Joseph Christopher Henry
Consultant

No, we have not.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

So I'm just trying to understand. I mean I get was a light wind season, but you didn't and I get you didn't want to buy back stock and you've talked about that on the second quarter call. But it seems like just seems kind of unusual or and I am just trying to understand why you wouldn't have bought back even like half way through wind season some or following the end of September, when nothing occurred. I mean is there - do you have a different plan in terms of wanting to deploy the capital, maybe at one-one or you want to hold the capital back to do something else, I am just trying to understand kind of that change in posture I guess?

Albert A. Benchimol
President, CEO & Director

Well, Mike you know what happened in the last year in the fourth quarter in terms of wind season, not that we are afraid of that, but if you look at what we've done so far this year, we purchased 8.5 million shares, $360 million worth of stock.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Yes.

Albert A. Benchimol
President, CEO & Director

Our operating income less dividends is $384 million, we are almost exactly on the plan that we have said before, we indicated to you before and we intend on following through on that in the fourth quarter of the year.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

I see, okay. So that's kind of the expectation is that maybe you pulled forwards in the buyback into the second quarter, and then you just kind of wait to replenish and adopt the same sort of pattern on the forward. Okay, that makes sense. And then I guess, we've seen a lot of folks moving into crop this year, I am just curious, I mean I'm guessing that year-over-year pricing is maybe flattish despite last year's losses. First off, kind of what's your outlook there and is that an area where you want to continue to grow, what's the competitive dynamic like on the reinsurance side, and if I could, what are your expectation, just given the decline in corn prices this year, is that potentially going to have any impact on your book?

Albert A. Benchimol
President, CEO & Director

I think starting, Mike, with the market in general, there has been more people coming into it, especially on the reinsurance side as the primary companies this year, following the severe drought last year we are looking to purchase more. Our experience is a little bit different than what you mentioned in terms of pricing. I think you're right, pricing is flattish on the primary side, but certainly on the excess of loss side, especially on the loss impacted accounts last year, we certainly saw pricing increases and I expect that will stay.

In terms of the growth as the - I think that you have very well developed markets in the U.S. and some in Canada, but there is also in my mind, real opportunity internationally and one of the things we feel really good about is the fact that the teams that we brought in to supplement the existing team that we already had in place, the team that we brought in has a real expertise and real contacts, not only in terms of the U.S. and North American market, but also internationally.

So we think that this market certainly still has opportunities both domestically and internationally and I think in terms of international positioning we feel very good about where we are right now.

With regard to the profitability of the year, it's looking in our mind and certainly reflected in the numbers, it's an average year, we don't think it's particularly highly attractive year, we certainly don't see this as a loss year for the business. So we see this as an average year in terms of profitability.

Operator

Our next question comes from Gregory Locraft at Morgan Stanley.

Gregory Locraft
Morgan Stanley, Research Division

Hi, good morning. Congrats on a nice quarter. Albert, you had mentioned the A+ and I had never thought of you guys as disadvantaged due to ratings, I am just wondering what does it open-up in terms of lines of business, how will you run the business a little differently and maybe you could also talk about the Lloyds initiative as well, because again I never thought it was something that you have to have, but now you got both Lloyds in the A+ so what are you going to do with it?

Albert A. Benchimol
President, CEO & Director

Well, it hasn't hurt us, but it's good to have both. I think the short answer is that the A+ doesn't change the strength that we had the day before or the day after, but I think it's great to have the recognition from the rating agencies for all of the hard work and accomplishment that our people have done.

And there is one area what I would say the A+ does make a difference and that's in the casualty and the long-tails reinsurance business. Buyers of long-tail reinsurance really care about the ratings of the reinsurers they use and I know for a fact that the size of -- even putting them on the panel in the 1st place and the size of the allocations really do have are really influenced by the A+. So I'd rather have it than not have it, I think it does provide some benefits and in our mind it is nice to have an external validation for all of the good work that they have done and of our market positioning.

With regards to Lloyds, we absolutely did not need Lloyds in the first phase of our life cycle. We built a great international platform, we grew the business, where we are right now as we look to the next decade, where do we take this company to the next step, this is just one more area, one more initiative in terms of diversifying our distribution channel, expanding our geographic reach and accessing new markets.

So it's the right thing for us at this stage of our life cycle and I expect that it will provide us with greater ease in access and risk in certain areas of the world where we have not been licensed previously and access to certain business that generally tends to stand the Lloyds market. We see both of these as a positive.

Gregory Locraft
Morgan Stanley, Research Division

Yes. Certainly they are, great. So just jumping back to Mike's question on the buyback front, I just want to clarify, so there is no change? You guys are going to return 100% of op income this year in dividends and buybacks.

Albert A. Benchimol
President, CEO & Director

That was exactly Joe's point. I mean we have given back through September 30 essentially 100% of our operating income through dividends and repurchases. Our goal has been and continues to be that we will return pretty much close to our 100% of our operating income in dividends and repurchases. We will be reinitiating our repurchase program as soon as our window opens. So we are right on target, we are right on plan, no change.

Gregory Locraft

Morgan Stanley, Research Division

Sounds good. Okay, great. And then last just, you guys are fortunate because you have a balanced model globally. So you can sort of access the risk that are most attractive when you wish. Did you think we could see a world next year where you are shrinking reinsurance and growing insurance? Just given your pricing commentary, it seems like reinsurance is more challenged than primary lines. How do you think about it in the next year both from a top line and a margin's perspective?

Albert A. Benchimol
President, CEO & Director

I appreciate you're saying that because that is in fact one of the great values that we have here, which is we have access to both insurance and the reinsurance markets and we have them available both domestically in the U.S. and internationally. We don't have a preset view of how much percentage of our top line needs to come from insurance or reinsurance or for that matter international or the U.S. It is really about building the best portfolio that we can at the time.

And with regards to the pressures that I've described earlier with regard to the reinsurance market, there is no question that within the reinsurance market there is competition there, but at the end of the day the underlying markets are still improving and some of those benefits are coming to us. We will continue to write good business in the reinsurance market. At every renewal we take a look at what the terms and conditions available to us are. I mentioned earlier the various tools that we have to look at profitability.

I fully expect that we will continue to have a substantial and profitable business on the reinsurance side. There may or may not be as many new opportunities for growth in the market itself, but as we have demonstrated to you through the number of new initiatives that we have created, we are not waiting only on the market. We are creating new opportunities for ourselves. The example that we used last year was the fact that we were getting into the agricultural business in a bigger way. We have started a U.S. marine reinsurance business. This year we added a weather and derivative unit to our business. We're expanding our presence in Asia. We are masters of our own destiny. We find opportunities and although reinsurance markets are more competitive I have every confidence that Jay and his team are going to continue to do very well next year.

Operator

Our next question comes from Vinay Misquith from Evercore.

Vinay Gerard Misquith
Evercore ISI Institutional Equities, Research Division

The first question is just on the buyback and you've not said anything different now versus before, but just curious. Your top line is growing double-digits and yet you can buy back 100% of stock. Curious as to whether that's because you had lots of excess capital before or are you growing in lines of business that are diversifying and so therefore don't need as much capital?

Albert A. Benchimol
President, CEO & Director

I think your second point is the more relevant point, which is that we are in my mind doing an excellent job of diversifying the portfolio of making much more efficient use of our capital, which is why - and you and I have had this conversation before. I believe that we can actually combine a lower volatility portfolio with sustained high ROEs.

Vinay Gerard Misquith
Evercore ISI Institutional Equities, Research Division

Okay, that's helpful. Second was more of a numbers question. In the primary insurance segment we saw the G&A expenses shifting down sequentially quarter-over-quarter. Were there one-time items this quarter that helped it and should we expect a lower run rate in the future?

Albert A. Benchimol
President, CEO & Director

Vinay, I'll dig out the insurance G&A ratio comparable in a second, but we did have one or two one-time items in our overall expense structures and those get allocated down to our businesses. Again, you saw an improvement in the G&A ratio overall that, as I was saying, we're continuing to invest in the company. The reason our expense ratio went down was really because of the growth in our premium relative to our expense growth. Bear with me for a minute on the specific question on insurance.

Vinay Gerard Misquith
Evercore ISI Institutional Equities, Research Division

Sure, I mean I'll ask another one if I may. So at the Investor Day, I think you talked about a 10% ROE, roughly -- given what's happening in the reinsurance market, do you think that still is kind of ROE that the company is writing business at?

Joseph Christopher Henry
Consultant

Yes, I think, referring to the fact that we can see the marginal business coming in at a 10% ROE. In fact I would argue that with some of the pricing changes that we're seeing in higher underlying interest rates we're seeing some improvements on that. But again with regards to the reinsurance book, I would say two things. One is because notwithstanding, as I mentioned, the competition and some higher ceding commission we're still getting the benefit in many cases. So the underlying improvement, that's a net positive.

Secondly, as you know, the biggest driver of the E piece is the catastrophe book and by balancing our catastrophe book, by removing some of the peaks in the catastrophe book it actually resulted in a lower capital requirement for our overall reinsurance book such that again I see the ROE on the reinsurance business just like I do for the rest of the company moving in a favorable direction.

Albert A. Benchimol
President, CEO & Director

Vinay, I'll just come back on insurance. As you noted in the - our expense ratio actually dropped by about 1 point, but there is nothing unusual there. It's really just the growth in earned premium year-on-year. The reinsurance segment expense ratio jumped up a bit, but again Jay and team, through the new initiatives they're adding staff in that. So there's nothing unusual in that expense number on the insurance side is what I'm trying to say.

Vinay Gerard Misquith
Evercore ISI Institutional Equities, Research Division

Sure. I mean, I was talking about the absolute dollars was less this quarter versus last quarter, but you know what, I can catch later on if that's…

Albert A. Benchimol
President, CEO & Director

Okay. Thanks.

Operator

The next question comes from Charles Sebaski at BMO Capital Markets.

Charles Sebaski

First question is on the adverse development in the credit maturity in Europe. I was curious what kind of exposure still exists and what's running adverse on that?

Albert A. Benchimol
President, CEO & Director

You've seen the news about the Spanish surety bond losses.

Charles Sebaski

Yes.

Albert A. Benchimol
President, CEO & Director

Our piece of that was about $15 million. There is very little room for additional deterioration in that number. And it's really -- okay, I'll leave it there.

Charles Sebaski

Okay, didn't mean to cut you off. Then what do you want to say, please.

Albert A. Benchimol
President, CEO & Director

That's okay. I'm good.

Charles Sebaski

Regarding the Lloyds business, what's the expectation on what kind of business you expect to write through that syndicate in premium volume maybe not this quarter, but longer term?

Albert A. Benchimol
President, CEO & Director

Well, in the first instance the goal here is to transition some of our business that we're already writing on to Lloyds platform and seed a syndicate, which is based on business that we're currently writing mostly out of our London, Ireland or Bermuda books, mostly on the energy, the marine side, some property business. And so that will form the core. I don't see this as an expansion into new lines of business. I see this more as an expansion of our current lines of business into more international markets and more opportunities.

Charles Sebaski

Okay. Just one numbers question. In the reinsurance division the acquisition ratio jumped up a bit. Should we think this is a - it's a bit over 22 now, it's kind of a run rate from business mix shift or something unusual.

Albert A. Benchimol
President, CEO & Director

It's a combination of a number of things. As you know, there are three things that affect our ratios there. Obviously we mentioned earlier that in some cases ceding commissions are up. You'll notice that there is a transition in our reinsurance book towards writing a little bit more proportional. By definition proportional has a higher acquisition expense ratio, generally more stable, but has a higher acquisition expense ratio. There is always a little bit of noise in a quarter-by-quarter basis as it relates to sliding scale profits commissions up or down so on and so forth and that's really the three major pieces there. There isn't anything there that I would think of as a seismic shift.

Operator

The next question comes from Ryan Byrnes of Janney Capital Market.

Ryan J. Byrnes
Langen McAlenney

Quickly just on the underlying loss ratio in the insurance segment, I guess you guys noted that business mix played a factor there and I assume that's coming from the A&H growth. I'm just trying to figure out going forward should we look for that underlying loss ratio to continue to kind of be at the same levels going forward i.e.; less I guess improvement going forward as the mix shifts with the A&H build out, but I guess less volatility.

Joseph Christopher Henry
Consultant

As Albert indicated looking at loss ratios on a year-to-date basis is probably a better thing to do than just looking at one quarter at a time. If you take out weather from our accident year loss ratios, we've actually seen an improvement in insurance of 1.5 during the year. So as we indicated earlier in the year, we have some rate increases that were expected to come through earned premium and we would expect to see some improvement in the margins and I think we are realizing that.

Ryan J. Byrnes
Langen McAlenney

Okay, great. And then just quickly on this vantage surety stuff just want to -were you guys writing quota share reinsurance or there was excess of loss and was it over multiple years, just trying to figure out where you guys have the exposure from?

Albert A. Benchimol
President, CEO & Director

It's a combination of a number of things, but we did not have large quota shares, matter of fact, I'm not sure of these things are significant and in case. And the $15 million that we took is the combination of not only a small incremental reserving increase that we're putting with regard to the Spanish bonds, but also just a little bit more money across the board just for the additional uncertainty of legal risk if you would with regard to European portfolio. So it's literally $7 million that are related to the Spanish bonds and the rest is just more caution with regards to the regulatory environments in Europe.

Operator

Next question comes from Meyer Shields at KBW.

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

Can I start with one on the PML side, if you look at, I guess, the major risk I'm thinking of South Eastern hurricane and California and Japanese earthquake. There wasn't much change in the 50-year or 100-year PMLs but there was a pretty decent sequential drop in the one and 250. Is there any way of sort of extrapolating from that, what the reduced capital needs are?

Albert A. Benchimol
President, CEO & Director

I wouldn't try, it's a - when we do our capital is on a line by line, risk by risk analysis, we calculates, I mean, you want to imagine we calculate all permutations of capital requirements on a per risk basis, on a line of business basis, a stand-alone, diversified, and there is just way too much in there to be able to extrapolate a specific percentage. But I - the one thing that I think is absolutely worth taking away from this is the management of the PML and the management of the diversification of the book of business is such that we are today a much more efficient user of capital, which is why, we can - as Vinay brought up earlier which is why we can grow at double-digit rates and still give back all of our incremental capital to our shareholders.

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

Okay. That makes sense. There was a bit of a slowdown in the insurance, accident health premium growth and I was wondering there is something significant going on there just quarterly variation?

Albert A. Benchimol
President, CEO & Director

If you look back at last year, the third quarter was by far the slowest production quarter of the year. It's just a nature of that - of that business that the third quarter is - doesn't do much. I think if you take a look at it. On a nine month basis, the growth rate is very impressive and continues to move forward, Chris and his team are doing a great job, they know exactly what they need to do. And they are very focused on achieving their goals.

Operator

Our next question comes from Brian Meredith at UBS.

Brian Robert Meredith
UBS Investment Bank, Research Division

Yes, just a couple of more questions on A&H business here, I'm wondering just, is it possible to give a kind of a breakdown of what the impact of the mix shift from more A&H and the insurance business had on the overall combined ratio?

Joseph Christopher Henry
Consultant

Actually we do an analysis of all of the contributors and in fact and if you look at it, I believe A&H is actually the single largest contributor to the increased loss ratio for the insurance division overall, both through a combination of mix and the fact that it's a higher number.

So if we look at our A&H book, it was 9.6% of our premiums in the third quarter of 2012. It was 13.7% of the premiums in 2013 quarter and that's in the mid-60. So imagine the fact that it's a higher ratio than the average of the lien [ph]for the insurance segment and it's a much larger proportion of the earned premium and that's why it's having that impact on these.

Brian Robert Meredith
UBS Investment Bank, Research Division

Okay, very helpful. Thank you. And then back on the A&H, at what rate is now the mix of reinsurance versus primary and A&H business right now and I guess kind of looking forward, how do we expect that to continue to progress?

Albert A. Benchimol
President, CEO & Director

As you will recall through our various presentations, reinsurance continues to be the larger part of the book of business, but over time our goal is to bring that business down to 50% of the overall book and this is the good time to kind of speak to where we are in the various spaces of our A&H business.

The reinsurance business is the part of the business that is easier to grow, you can only have offices across the world, it's a more concentrated distribution mechanism and in fact not only have we grown fast around the A&H, but in fact we have already broken even and made a profit on the reinsurance part of the A&H business.

The insurance business is a much slower business to pickup. You have to have all the licensing in place and I think we have shared with you some of the frustrations we've had in getting all of those licenses in place and we have those now, the on the board representation and it's the quoting on a risk by risk basis. So it's a slower ramp up and again this is very consistent with the plan that we had in place.

We needed to have a better balance between insurance and reinsurance, we need to have more granular risk by risk composition of our portfolio and I really view that as Phase 2 of our A&H strategy. Phase 1 was, get to the size of the business that will allow you to at least breakeven, get the name out there, get the platform established and I continue to believe that we will have completed Phase 1 by the end of 2014. And I think beyond that as you go from 300 to 500, it's much more of an insurance based growth, it's much more of a risk by risk growth.

Ultimately, lower expense ratios, acquisition expense ratios on that part of the business. So where we are right now is in my mind on plan with what we wanted to be and where we need to be.

Brian Robert Meredith
UBS Investment Bank, Research Division

Okay.

Joseph Christopher Henry
Consultant

Brian, the one thing I will add is that, growth in insurance year-to-date last year was about 22% and growth - I am sorry in the quarter was 22% and year-to-date basis, it's 118%. So it's up to about 20% of our total premium across A&H and growing pretty rapidly.

Brian Robert Meredith
UBS Investment Bank, Research Division

Great, very helpful. And just lastly Albert, I am just curious any opportunities with your A&H business and especially [indiscernible] with the Affordable Care Act?

Albert A. Benchimol
President, CEO & Director

Well, I think right now as you might imagine, there is lot of turmoil in the U.S. market with regards to the Affordable Care Act. I am actually quite and so it's difficult right now to see how things are going to fall down, but I am convinced that in fact you are going to see more limited coverages in the standard healthcare contract, which in my mind is going to create significant opportunity for alternative coverage for additional wrap around covers and I'm actually very optimistic that on the backend of resolving the transition to the ACA, there will be increased opportunities for us in our A&H business.

Operator

Our next question comes from Ian Gordon at Bank of America.

Ian Gordon

Not quite, but close enough. A number of my questions were asked, I just have a couple left I guess. Just to clarify couple of things on the reserve releases. Professional lines sounded like it was favorable this quarter. I think the past couple of quarters there was a little trouble. Do you feel like that's behind you now given what you saw in the quarter?

Albert A. Benchimol
President, CEO & Director

Yes. As you know, we took a pretty hard look at our professional lines business in the second and third quarters and feel that our professional line reserve position is adequate overall. We saw no need to strengthen those reserves further.

Ian Gordon

And on the short-term releases, can you give a little color on - was prior year large cat-driven or do you book sort of attritional property losses and then if nothing happens, you release it the next year and just kind of wondering sort of the context of those releases.

Albert A. Benchimol
President, CEO & Director

Right. For the most part, it's a combination of the two. We have had some releases from prior, earlier accident years, but for the most part it's our actual experience versus expected and our actual losses have actually been lower than we've expected. So we've been able to release them.

Ian Gordon

Got it, great. And Albert, I guess the only…

I am sorry, go ahead.

Albert A. Benchimol
President, CEO & Director

I am sorry, go ahead. Go ahead, please.

Ian Gordon

I was just going to ask, Albert, is there any update on your own plans in the ILS world?

Albert A. Benchimol
President, CEO & Director

I'm not sure there's much to do or to talk in terms of updates and as you know we have initiated over the summer a third-party capital initiative that will allow us to partner with some sources of capital and provide them with a portion of the business that we write in certain lines of business. We're having tons of conversation. We're having a couple of small deals that we've done, which look a lot more like retro than anything else really. And I expect that in 2014 there will be some small portions of certain portfolios that will be shared with some external sources of capital. But this is a long-term play, there is lot of things happening, lot of headlines happening in the ILS base in 2013. But when we're approaching this thing, as a longer term play making sure that we match the right investors with the right risks. And again our goals here, our anticipation is that this will be a gradual buildup of good partnerships over time and it's progressing as we expect it to.

Ian Gordon

Got it, great. Thanks so much.

Operator

(Operator Instructions) At this time we show no further questions. I'd like to turn the conference back over to management for any closing remarks.

Albert A. Benchimol
President, CEO & Director

Well, thank you all for participating in our conference call. Obviously very pleased for an excellent quarter and we look forward to speaking with you again in the early part of next year. Have a good day.

Operator
The conference is now concluded. Thank you for attending today's presentation. You may now disconnect.