S&P Capital IQ

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AXIS Capital Holdings Limited NYSE:AXS

FQ4 2009 Earnings Call Transcripts

Tuesday, February 09, 2010 1:00 PM GMT

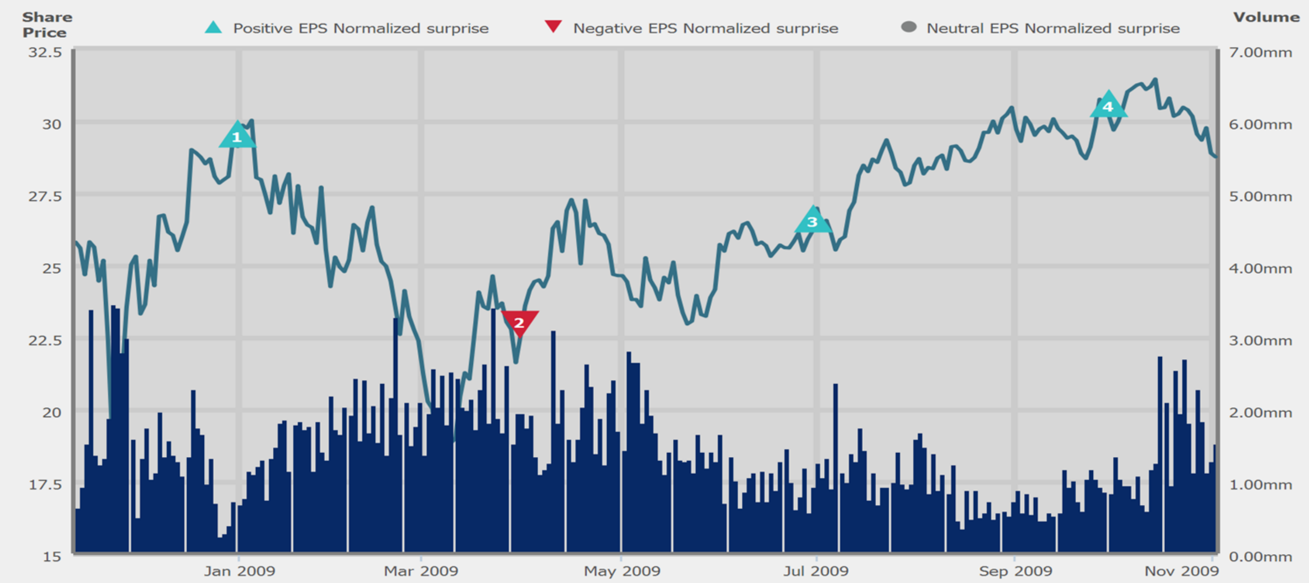
S&P Capital IQ Estimates

	-FQ4 2009-			-FQ1 2010-	-FY 2009-	
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	ACTUAL
EPS Normalized	1.31	1.83	▲39.69	1.16	4.58	5.10
Revenue (mm)	341.18	357.97	▲4.92	1219.27	2799.54	2816.43

Currency: USD

Consensus as of Feb-09-2010 9:30 AM GMT

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



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ4 2008	0.99	1.09	▲1 10.10 %
FQ1 2009	1.11	1.05	▼2 (5.41 %)
FQ2 2009	1.17	1.22	▲3 4.27 %
FQ3 2009	0.80	1.05	▲4 31.25 %

Call Participants

EXECUTIVES

David B. Greenfield
Former Chief Financial Officer and Executive Vice President

John R. Charman
Former Director, Chairman of Axis Re and Chairman of Axis Specialty Europe

Linda Ventresca

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Presentation

Operator

Good morning, and welcome to the Axis Capital Holdings' Q4 2009 Earnings Conference Call. [Operator Instructions] I would now like to turn the conference over to Linda Ventresca. Please go ahead, ma'am.

Linda Ventresca

Thanks, Andrea. 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 quarter and the year ended December 31, 2009. Our earnings press release, financial supplement and quarterly investment 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 U.S. The international number is (412) 317-0088. The conference code for both replay dial-in numbers is 436743.

With me on today's call are John Charman, our Chief Executive Officer and President; and David Greenfield, our Chief Financial Officer. Before I turn the call over to John, 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 the presentation include, but are not necessarily limited to, information regarding our estimate of losses related to catastrophes, derivative contracts, policies and other loss events, general economic, capital and credit market conditions, future growth prospects and financial results, evaluation of losses and loss reserves, investment strategies, investment portfolio and market performance, impact of the marketplace with respect to changes in pricing models 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 Factor section in our most recent Form 10-K on file 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, which is a non-GAAP financial measure within the meaning of the U.S. federal securities laws. For a reconciliation of this item to the most directly comparable GAAP financial measure, please refer to our press release, which can be found on our website.

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

John R. Charman
Former Director, Chairman of Axis Re and Chairman of Axis Specialty Europe

Thank you, Linda. Good morning, everyone, and thank you for joining us. By now, you would've seen our fourth quarter results, which we view as excellent. For the quarter, we reported net income of $282 million or $1.87 per share, as well as operating income of $276 million or $1.83 per share. We delivered record quarterly operating earnings per share, strongly supported by our highest level of quarterly underwriting profit.

During this quarter, we worked diligently to resolve certain peak risks and have achieved a rebalancing of our overall underwriting portfolio. First, we brought resolution to our exposure to an indemnity contract exposed to longevity risk. This resulted in a more favorable ultimate outcome than that contemplated in our third quarter results. Secondly, our results incorporated reserving provision for the Blue City project, which we are comfortable will be sufficient to bring finality to our involvement. Both of these items have been fully provided for in our quarterly results.

For the year, Axis delivered a 31% increase in diluted book value per share from very good P&C underwriting results and a strong recovery in asset valuations throughout our investment portfolio. Net income available to common shareholders was $461 million and operating income was $766 million. Return on average common equity for 2009 was just over 10% and operating return on average common equity was 17.1%, bringing our average ROE since inception to approximately 16% and average operating ROE to approximately 17%. These results are in line with our long-term goal of sustaining a 15% ROE over time.

Since inception, we have delivered a compound annual growth rate in diluted book value per share and accumulated dividends of 15%. And we believe we can continue to drive these returns for shareholders.

Our results this year were achieved despite extremely challenging competitive conditions and increased loss activity from lines impacted by the global financial crisis. Certain lines of business within our underwriting portfolio were precisely of such a nature as to be heavily affected by the prevailing global turmoil, and we believe we have finally turned the corner in terms of the impact of the global financial crisis on our results.

Meanwhile, the hard market we had expected at the beginning of the year and the anticipation of a flight to quality and a scarcity of available capital failed to materialize. Despite this, we were determined to maintain a steady course and conduct our business as defensively as appropriate. We managed our portfolios of businesses carefully. we protected our balance sheet. We built our book value. And under the circumstances, achieved excellent profitability. In short, we demonstrated the sound risk management practices and professionalism that have been the foundations of our success.

Our gross written premiums were up approximately 6%, although this was not evenly distributed across the company. Reinsurance rose approximately 17%, with a comparatively stable reinsurance market, whereas primary insurance was down 4%. As we have always maintained, we would turn away from business that does not meet our high standards for underwriting profitability, with an appropriate balance of risk and reward.

Our consolidated combined ratio for the year, an important measure of profitability in our core property and casualty underwriting operations, was 79%. I believe this will prove to be a leading result amongst the universe of diversified underwriting businesses.

Our investment portfolio recovered from the depressed asset valuations and market conditions of a year ago, delivering a total return of 8.5%, including net investment income of $464 million.

I am very proud of these results, given the very challenging conditions and issues we faced this year. I will now turn the call over to David to discuss these financial results in more detail.

David B. Greenfield
Former Chief Financial Officer and Executive Vice President

Thank you, John, and good morning, everyone. As John mentioned, we are pleased with the underlying performance of our business this quarter. Strong underwriting results and strong investment returns enabled us to achieve an annualized operating return on average common equity for the quarter of 22.3% and 17.1% for the full year. Our diluted book value per share reached its highest level since inception at $33.65, an increase of 31% this year.

Net income for the quarter was $282 million or $1.87 per diluted share, compared with $131 million or $0.88 per diluted share for the fourth quarter of 2008. Operating income, which excludes the impact of realized gains and losses on investments, was $276 million or $1.83 per diluted share, compared with $163 million or $1.09 per diluted share for the fourth quarter of 2008.

For the full year, net income was $461 million or $3.07 per diluted share, compared with $351 million or $2.26 per diluted share for 2008. Operating income was $766 million or $5.10 per diluted share, compared with $436 million or $2.81 per diluted share for 2008. Let me turn to underwriting results for the quarter, beginning with our top line.

Consolidated gross premiums written were $574 million for the fourth quarter, up 9% from the prior-year quarter. For the full year, gross premiums written were up 6% to $3.6 billion. This full year growth was primarily driven by our Reinsurance segment.

Gross premiums written in our Reinsurance segment were $103 million this quarter, compared with $78 million in the prior-year quarter. The increase was primarily due to new property reinsurance business. It should be noted, however, that the fourth quarter is not a major renewal period in our Reinsurance segment. For the full year, gross premiums written in our Reinsurance segment were $1.8 billion, up 17% over 2008.

Gross premiums written in our Insurance segment were $471 million this quarter, an increase of 5% over the prior-year quarter. The growth primarily emanated from property and marine lines of business, reflecting a combination of new business written, pricing improvement on Energy business and shifts in renewal dates for certain contracts.

Gross premiums written in our Insurance segment for the full year of 2009 were $1.8 billion, down 5% from 2008.

Much of this decline came significantly reduced writings in our credit and political risk line of business. This was partially offset by substantially increased activity in professional lines and the continued geographic and target market diversification that has been underway in our Insurance operations over the last several years.

Consolidated net premiums written increased 5% in the quarter and 6% for the full year, reflecting premium growth in our Reinsurance segment this year. Net premiums earned increased 8% in the quarter and 4% for the full year.

Total underwriting income for the quarter was $216 million, of which $86 million was generated from our Insurance segment and $130 million from our Reinsurance segment. Our consolidated combined ratio for the quarter was 77.5%, compared to 67.6% in the fourth quarter of 2008, an increase of 10 points, primarily due to reserving actions in the credit and political risk line in our Insurance segment.

Total underwriting income was unchanged from the prior-year quarter. Contributing to this was an increase in Reinsurance segment underwriting profit. This increase offset a decline in our Insurance segment underwriting income, which was affected by an increase to credit and political risk loss reserves.

Positively impacting insurance underwriting income was the cancellation of our only indemnity contract exposed to longevity risk. We worked hard during the quarter to create an opportunity to cancel this contract at an amount more favorable than the fair value liability carried at the end of the third quarter. Under this cancellation agreement, we paid $200 million in exchange for a full release and discharge from any and all obligations under the contract. This resulted in other insurance-related income of $28 million for the quarter. For the full year 2009, we incurred a loss of $133 million for this contract, net of premium. We are now off-risk for the contract and have no further exposure to longevity risk.

Total underwriting income for the full year of 2009 was $525 million, up $218 million, or 71% from the prior year. Our combined ratio for 2009 was 79.3%, compared to 89.8% for 2008. This included a consolidated accident year loss ratio for 2009 of 66.2%, compared to 77.7% for 2008.

Our Insurance segment's accident year loss ratio for the quarter was 76.9%, compared with 58.1% in 2008. The increase was primarily driven by our reserving provision related to the Blue City peak risk in our credit and political risk portfolio, which had been stressed by the global economic downturn. No claim has been presented to date.

However, we had been closely monitoring the status of the project and identified an opportunity to work and negotiate with interested parties to settle our exposure.

We have reserved for the ultimate amount payable that we believe will eliminate our exposure. As a result, in the quarter, we have also recorded additional earned premium of $25 million related to the contract.

Loss activity related to Credit and Political Risk business otherwise showed significant improvement this quarter.

IBNR reserves for Credit and Political Risk business, which include the reserving provision for Blue City this quarter, are $215 million at year end. Under in premium reserves, stand at $357 million. Our inception-to-date loss ratio for this line of business stands at 51%.

For the full year 2009, our Insurance segment reported an accident year loss ratio of 71.1%, compared to 72.9% in 2008. Although these amounts are comparable, the 2009 accident year includes increased credit and political risk reserves and 2008 includes Hurricane Ike losses. Our Reinsurance segment's current accident year loss ratio for the quarter decreased 5.8 points to 56.8%, relative to the same period in 2008. The reduction was driven by improved loss experienced on property and trade credit and bond reinsurance lines of business relative to the fourth quarter of 2008. For the full year 2009, our Reinsurance segment reported an accident year loss ratio of 62.6%, which was 19 points better than the prior year.

During the quarter, our estimate of net reserves from prior accident years continue to develop favorably, with overall reserves reduced by $120 million this quarter. This represented a positive impact on the fourth quarter combined ratio of 16.8 points overall. $73 million of the favorable development was from our Insurance segment, representing a positive impact of 23.9 points on the segment's loss ratio. $47 million was from our Reinsurance segment and represented a positive impact of 11.6 points on the segment's loss ratio. Approximately half of total favorable prior-year reserve development this quarter was generated from short tail lines of business. The balance came from professional lines and Credit and Political Risk business.

We did add to prior-year reserves in the quarter. Specifically, we strengthened casualty reserves in our Insurance segment, primarily for accident years 2007 and 2008, by $30 million. This action was taken to prudently address higher-than-expected incurred loss development and assumes that the unfavorable frequency and severity experienced for those years continues to ultimate.

Moving on to expenses, our acquisition cost ratio increased 1.6 points to 14.3% this quarter, largely driven by business mix changes. Our G&A expense ratio for the quarter was 14.6%, which was a slight increase over the fourth quarter of 2008. As I noted last quarter, new initiatives such as our new A&H division have introduced some upward movement in this ratio. As we continue to invest in new initiatives, we would expect our G&A expense ratio to be near this level until our investments are fully leveraged from an operating perspective.

Turning to our investment portfolio. In aggregate, the total return on our cash and investment portfolio for the quarter was 1%. This was comprised of net investment income of $118 million, net realized gains of $6 million and a positive change in net unrealized gains or losses of $6 million. Our allocations to other investments, in particular our investments in credit funds, contributed strongly to performance.

Net investment income for the quarter was $118 million, up from net investment losses of $26 million in the prior-year quarter, primarily due to the positive contribution from other investments this quarter. In the quarter, income from cash and fixed maturity investments was $97 million, and income from our other investments was $25 million.

Net investment income totaled $464 million for 2009, an increase of 88% over the prior year. The primary driver of this was the increased contribution from our other investment portfolio, which was accounted for at fair value with the change in fair value included in net investment income. This year, our other investment portfolio comprised primarily of hedge funds and credit funds, contributed $82 million to net investment income versus a loss of $221 million in 2008.

During the quarter, we recognized net realized investment gains of $6 million. For the year, our net realized investment losses totaled $312 million, which included $337 million of OTTI charges. The charges primarily related to the OTTI taken on medium term notes in the third quarter.

During the quarter, we reduced U.S. agency debt and increased U.S. Treasury holdings. We also continued to reduce mortgage-backed holdings, investing proceeds in non-U.S. government holdings and U.S.

government guaranteed issues. We maintained relatively low cash reserve balances and emphasized short duration, high-grade liquid investments.

Our portfolio repositioning earlier in the year, reducing mortgage-backed holdings and increasing corporate exposures, aided our performance. We do not expect to add significantly to our corporate bond exposures from our current position.

At December 31, 2009, we held cash and cash equivalent balances of $864 million, or 7% of total cash and investments. Our fixed maturity investment portfolio, which represents 84% of total cash and investments is well diversified, with a weighted average credit quality of AA and an average duration of 3.1 years.

Our other investments represent 5% of our total cash and investments at year end. We are maintaining allocations to alternatives and long-only equity strategies and continue to monitor opportunities in these areas.

With respect to foreign exchange, during the fourth quarter, changes in exchange rates and changes in net currency exposure resulted in foreign exchange gains of $2 million, compared to a gain of $22 million in the prior-year quarter.

Total capitalization at December 31, 2009, was $6 billion, including $500 million of long-term debt and $500 million of preferred equity. We have accreted significant capital this year through our strong underwriting results and recovery of the financial market. Our financial flexibility is very strong, with debt-to-total-capital at 8.3%, debt and preferred to total capital at 16.7% and total capital in excess of rating agency requirements.

In December, our Board of Directors approved a 5% increase on our quarterly dividend to $0.21 per common share. We have increased our dividend every year since we began paying dividends in 2003. Our board also approved a new share repurchase plan, with the authorization to repurchase up to an additional $500 million of our common shares. During the quarter, we repurchased 5.9 million shares of common stock for $170 million. And subsequent to year end, through February 5, 2010, we repurchased a further 4.4 million shares of common stock for $125 million.

We believe this return of capital is in the best interest of our shareholders, particularly given current depressed valuations. Our approach balances the obvious rating agency and regulatory capital requirements, with plans for reinvestment in our business and opportunistic capital requirement. We currently have approximately $417 million of remaining authorization per common share repurchases.

In our quarterly financial supplement, we've updated information with respect to our group PMLs and associated estimates of industry losses as of January 1 at various return periods. We remain within our tolerance levels for these risks. Our European wind aggregates have decreased this quarter due to planned reductions at the January 1 renewal date. We have been actively reducing our European wind aggregates, partly in response to a deteriorating rate environment.

Our California earthquake aggregates incorporate implementation of the new vendor models. This may make comparison with prior quarters difficult. However, the important point that we remain within tolerance levels remains the same.

To summarize, we ended the year in an excellent financial position with ample capital for the risks we hold. And we are well-placed to fund any targeted growth activities or new opportunities, while also returning capital to shareholders at very attractive valuations for share repurchase.

With that, I'll turn the call back to John.

John R. Charman
Former Director, Chairman of Axis Re and Chairman of Axis Specialty Europe

Thank you, David. And I will begin my market commentary with an overview of our Reinsurance renewals at the important January 1 renewal date.

Approximately 50% of Axis res 2009 expiring premium was renewable on the 1st of January. At this renewal, we estimate our Axis re-underwriting-year premiums were up 7% over the expiring amounts. Overall, we were up 4% in terms of currency-adjusted premium.

There could be other activity in the quarter that will impact top line for the segment, but these estimates generally give a good indication of how we are faring in the marketplace. The modest growth of this renewal supplemented the strategic share we gained throughout last year on attractive treaties due to concerns over the financial strength of distressed reinsurers, particularly for U.S. Casualty Reinsurance business.

Just over 80% of our 2009 expiring premium from our Europe-based Reinsurance business renews on January 1, and it was this portfolio that drove our growth. Across the board, the market was more competitive but not irrational, and we continue to walk away from business that was not attractively priced.

The select areas where we chose to grow, combined with a modest shift in our portfolio towards more proportional business, resulted in growth overall in the European Reinsurance account. The most significant areas of growth were our trade, credit and bond reinsurance and motor reinsurance lines of business.

As you know, since the onset of the global financial crisis, the trade credit reinsurance line experienced significant dislocation. And at last year's renewal, we were able to begin consolidating our position at pricing and terms we believe to be advantageous given prevailing market conditions. We continued this consolidation during the most recent renewal and expect to return to profitability in this line in 2010. Also, our Latin American surety reinsurance team, who joined us midyear in 2009, contributed to growth in the trade credit and bond reinsurance line with new business written at January 1.

In our motor reinsurance line, we reduced our participation in excess of loss market in France due to the failure of the market to secure rate to compensate for escalating loss costs. However, this reduction was more than offset by new proportional motor treaties in the U.K., where cedents are experiencing rate increases on the underlying account.

Overall, Axis property cat reinsurance premium was down about 10% at the January 1 renewal, as we reduced our exposure to European windstorm. Increased competition has led to expected margins reducing gradually over the last few years. This business is still attractively priced at current levels, but the expectation of continued pressure in Europe prompted us to rebalance our worldwide cat portfolio.

In North America, any price reductions at the 1st of January renewal did not also expected margins materially. Property cat reinsurance remains by far one of our most attractively priced lines of business. Pricing for regional property per risk and excessive loss accounts was, for the most part, driven by experience. The exception to this was Continental Europe, where the market did not react similarly.

Our U.S. Casualty Reinsurance account, which was dominated by the specialty area of professional lines and is predominantly excess in nature, reduced slightly at the 1st of January renewal. Professional liability treaties that showed deterioration in experience received pricing increases as was warranted.

Conversely, there were moderate downward movements in areas with less loss experience, for example, commercial D&O. In general casualty, accounts were renewed as expiring with some exceptions where rate was up modestly. Those accounts warranting large increases because of poor experience generally came through with rate increases.

For our Insurance segment, the first quarter is less significant in terms of production. However, I'd like to share a few observations with you. The market, which had stabilized in the first half of 2009, is experiencing slippage in pricing once again. And a number of lines with casualty lines, which are not significant feature for us, an outlier with the greatest price reductions. Generally, terms and conditions as well as breadth of coverage remain stable with terms of trade holding firm.

Rate change in our overall portfolio during the fourth quarter was marginally positive. Positive rate changes decelerated in the fourth quarter, much like rate change in the third quarter. However, this combined with loss cost, better-than-original expectations and stable terms and conditions, still translates to good levels of underwriting profitability for us. We continue to see some markets fight for market share, with the most aggressive behavior, in our view, coming from admitted markets in the U.S. and the new markets.

CAT-exposed property has been weaker whereas energy lines have remained more stable, particularly in the offshore area. We expect to see a continuation of this trend as we head into the key March 1 and April 1 renewals.

In Professional Lines insurance, in the last year, our well-placed franchise was able to take advantage of the exceptional market conditions, particularly in the financial institutions arena. We continue to do so with the expectation that 2009 and 2010 years will produce exceptional results.

We are very happy with the overall portfolio we have secured through the repositioning of market participants over the last year, and we do not expect our business to move back in any meaningful way to carry us with financially distress through the credit crisis. Financial institutions pricing is up 20%, and this is the third straight year of significant rates increases.

Meanwhile, commercial D&O pricing has flattened out after gradual declines over the last few years. The gradual declines were in response to loan loss activity in the product line. The recent stabilization in rate reductions were driven by the view that there was potential for activity related to the credit crisis to bleed into the commercial side. This has not happened. And we would not be surprised to see a return to gradual rates erosion reflecting the loan loss activity experienced. For the most part, E&O pricing has been flat to modestly down.

Against the backdrop of a competitive market, underwriting out performance remains paramount, and we expect to continue to outperform on this front. Our inception-to-date combined ratio stands at 81%. As I have said earlier, we have taken the opportunity to rebalance our portfolio by flushing out the few peak individual risks we have. Many lines we write experienced substantial softening some years ago, and we withdrew from these lines before our competitors reacted. We have the discipline and drive required to outperform through all phases of the cycle and are absolutely committed to maintaining first-rate underwriting results.

We have continued to invest in our future, especially in terms of intellectual capital and infrastructure. We have recruited senior-level people of the highest caliber as well as talented professional support. We focused on building out our robust and modern systems to process increasing volumes of business, strengthened our product lines and have expanded into areas of specialization in new geographies where we perceive excellent long-term opportunity.

Our largest single investment over the last year has been in the build out of a major new specialization in global accident and health. These products are short term in nature and traditionally are consistently profitable when well managed. We consider this business highly complementary to our other product lines. We believe there is abundant room for serious new entrants in this sector, and we anticipate a strong advantage by introducing modern systems and technologies, especially when coupled with our industry-leading professionals.

Geographically, we required that it complete in the necessary groundwork so that our newly-established offices in Canada, Australia and Singapore would be well positioned to grow at the appropriate time. The global financial crisis appears to have stabilized and its effect on asset values and on our underwriting portfolio. We expect most loss activity associated with the crisis in professional lines will be contained in the 2007 and 2008 accident years, as we have said before.

We continue to see a high level of dismissals for credit crisis D&O and E&O claims. We estimate that it will take 12 to 24 months to see the full impact of the credit crisis on the most affected accident years. But we are comfortable that we are well reserved for claims that have been notified.

In trade, credit and bond reinsurance, we are seeing a decline in incurred losses and believe we have passed the inflection point with respect to loss activity stemming from the financial crisis and global economic downturn. Further, outside of the reserving taken action taken this quarter for Blue City, loss activity has normalized in our credit and political risk business. We look very carefully at actual claims we have as well as its stressed situations throughout our portfolio.

There had not been any new situations at it for monitoring for some time. With longer experience monitoring stressed situations and managing our claims arising from the global financial crisis, we have an even higher level of confidence that our estimates of loss and recovery are prudent. Further, in a number of cases, we believe that the recovery potential has improved substantially relative to our original expectations.

The peak Blue City risk was unique and exceptional in size. The balance of our credit and political risk portfolio is well diversified in the emerging markets, with average line sizes of approximately $35 million. The larger individual exposures, of which there are no more than a handful between $100 million and $200 million, are primarily trade-related contracts where our government is responsible for payment, either through a specific guarantee from the buyer's Ministry of Finance or when the buyer is owned and controlled by the government. The recovery potential in the event of a loss for the portfolio remains strong and should be in line with previous experience.

Despite the favorable impact to the dramatic recovery from the global financial crisis in our results, the impact of the recovery on the broader property and casualty market remains another matter. We expect the current soft market cycle will continue pressuring margins. We remain cautious with respect to issues that have yet to emerge, such as inflation and a negative impact on the market. Highlighting these potential negatives, we remain abundantly cautious when taking on long-tail business. In addition, there are always unforeseen risks through which we must nevertheless be prepared.
Over AXIS' history, we have built a company that brings the strength of our balance sheet through opportunities in the marketplace with a view toward creating shareholder value over time. With this in mind, we continue to reinvest in our business while maintaining capital levels that are important to our clients and opportunistic capital levels that are critical to our plans to move our franchise to the next level. For amounts in excess of these strategic requirements, we are returning some capital to shareholders at very attractive valuations. I'm confident in our ability to continue producing excellent results for shareholders through our specialized businesses and prudent capital management. And with that, we would now like to open the line for questions.

Question and Answer

Operator

[Operator Instructions] Our first question is from Vinay Misquith of Crédit Suisse.

Vinay Gerard Misquith
Crédit Suisse AG, Research Division

Could you provide some clarity on exactly how much of the reserve you hold on Blue City?

David B. Greenfield
Former Chief Financial Officer and Executive Vice President

We're not going to talk about specific claim actions or amounts involved as is normally our policy. So I think it would be inappropriate for us to comment on that number.

John R. Charman
Former Director, Chairman of Axis Re and Chairman of Axis Specialty Europe

Vinay, if I could just make a point there. I heard said since the inception of AXIS that we managed our portfolios of underwriting activity proactively and on a daily basis which is our job, and it is very important for us to do so. And if we see opportunities to rebalance portfolios, and especially after the dislocation and disruption that has occurred in the global financial market over the last 12 months or 18 months, to reset a portfolio, taking back extra volatility into account, is a very sensible and reasonable thing to do, and that's what we've done.

Vinay Gerard Misquith
Crédit Suisse AG, Research Division

You mentioned that you had a chance to negotiate on the contract. Could you elaborate more? Have you managed to bring your loss exposure down to some mechanism on that contract?

John R. Charman
Former Director, Chairman of Axis Re and Chairman of Axis Specialty Europe

I think, Vinay, that as David quite rightly pointed out, that we can't discuss any individual issues.

Vinay Gerard Misquith
Crédit Suisse AG, Research Division

We've been hearing news on Ukraine, Kazakhstan, Spain, Portugal. Could you give us some clarity on your exposure to those countries?

John R. Charman
Former Director, Chairman of Axis Re and Chairman of Axis Specialty Europe

Well, I think that it's in interesting how the world's attention potential is changing from week to week. But I think you have to split Europe from Ukraine and Kazakhstan, which I think you'll understand. And as far as AXIS is concerned, we don't have any material credit exposures in our credit and political risk account to Spain, Portugal or Greece, and that's a fact. With regard to Ukraine and Kazakhstan, we had no peak exposures. And we, if you remember, we started proactively increasing our reserves in that area nearly two years ago as we saw the financial situation, and they were pretty early to be affected by the financial crisis. And so what we did, we took our entire portfolios, which are diversified and well within our risk tolerance limits set by our risk committee. We took those portfolios, and I remember talking on our previous quarterly call about our stress test. And as a result of those stress tests, we identified some transactions where we believe we should proactively put reserves forward on, and we have continuously monitored those situations since we did that. And we've remained very comfortable with our reserving positions within both countries. I think Ukraine is in a slightly more difficult position than Kazakhstan. But we're comfortable with where we are, because we got there first.

Vinay Gerard Misquith
Crédit Suisse AG, Research Division

If you could just give me the impact on the owned premiums and the loss ratios for the credit and political risk insurance and the credit and bond reinsurance for this year?

David B. Greenfield
Former Chief Financial Officer and Executive Vice President

Sure, Vinay. I don't have the earned premium numbers in front of me. I did mention in my prepared remarks, one adjustment we made in earned premiums as it relates to political risk. But if you'd like, I'll go through the same numbers up given in the prior quarters, which is on the political risk business, that accident year loss ratio at the end of the year stands at 151%, and that compares with 100 -- sorry, combined ratio. That compares with the combined ratio of 128% reported at the end of the third quarter so you can compare those two numbers. And I'm sure the second one you wanted was credit and bonds, is that right?

Vinay Gerard Misquith
Crédit Suisse AG, Research Division

Yes.

David B. Greenfield
Former Chief Financial Officer and Executive Vice President

In credit and bonds, the combined ratio moved a couple of points, but essentially is flat with where we were at the third quarter. It came down three points at 128% at the third quarter, and we finished the year at about 125%.

John R. Charman
Former Director, Chairman of Axis Re and Chairman of Axis Specialty Europe

And Vinay, just to clear the compound what they said, I made some comments at the beginning of 2009 where I thought would be with our credit portfolio is either on the insurance side or the reinsurance, and I believe we are pretty well where I thought we would be.

Vinay Gerard Misquith
Crédit Suisse AG, Research Division

Both same numbers for 2008 were once again, what were the numbers for '08?

David B. Greenfield
Former Chief Financial Officer and Executive Vice President

For '08 on the political risk, we were at around 64% combined ratio and for credit and bond, it was 142%.

Operator

Our next question comes from Matthew Heimermann of JPMorgan.

Matthew G. Heimermann
JP Morgan Chase & Co, Research Division

First, could you just give us a little bit more color on the -- I know it's small, but the reserve increase in the casualty business for '07, '08? Just a little bit more specifics on what type of products within casualty?

John R. Charman
Former Director, Chairman of Axis Re and Chairman of Axis Specialty Europe

Well, I would give you a little bit of an over -- we saw a tick up in loss experience for those years. And I just want -- I'm pleased you mentioned it, because we have had substantial concerns about the ever increasing competitiveness within the primary casualty insurance business, and we started to react three years ago to reduce participation throughout that marketplace. But nonetheless, we saw some increased loss activity occur in '07 and '08, and we're not sure whether that's just a spike or whether it's a trend because you know that we reserve conservatively in nature, we've decided to identify it as a trend and reserve for it prudently.

Matthew G. Heimermann
JP Morgan Chase & Co, Research Division

Is this umbrella business or excess casualty? Can you just give us a little bit of flavor in terms of just the type of product too?

David B. Greenfield
Former Chief Financial Officer and Executive Vice President

It covers all of the lines in the casualty portfolio, but the things that John were mentioning were really more primary casualty and some umbrella.

John R. Charman
Former Director, Chairman of Axis Re and Chairman of Axis Specialty Europe

I think it was in the traditional stuff. There was nothing -- we don't write non-traditional. I think you'll get a find, this may be a feature for the market to deal with.

Matthew G. Heimermann
JP Morgan Chase & Co, Research Division

Just with respect to your comment that things are turning in the corner, is that primarily just driven by kind of your view of the pipeline on the loss side? The trade credit business, I think it's a little bit easier to Steve, but with respect to the professional lines D&O as well as the political risk?

John R. Charman
Former Director, Chairman of Axis Re and Chairman of Axis Specialty Europe

I'm pretty comfortable. I said at the beginning of 2009, this was a year to get through. It said it wasn't a comfortable year for us at AXIS to get through. We had some issues on our asset side of our balance sheet, we had some issues on our liability side of the balance sheet. We've been very open about them, we've fixed them. I believe that we're perfectly placed, even within a soft insurance market, to continue to squeeze whatever margin happens to be out there. Well, I'm much more looking forward to 2010 than I was going into 2009, I can assure you.

Matthew G. Heimermann
JP Morgan Chase & Co, Research Division

One clarification, just on the acts of your combined ratios that you gave. The 151% was full-accident year 2009, 151%. The 128% was as of nine months, correct? Is that the right time frame for those?

John R. Charman
Former Director, Chairman of Axis Re and Chairman of Axis Specialty Europe

That's correct.

Operator

Our next question comes from of Ron Bobman of Capital Returns.

Ron Bobman
Capital Returns

John, it looks like for the first three quarters of '09 as it relates to political risk and trade credit, you were sure leased of with any word focused and writings for those lines, sort of evaporated but it picked up in the fourth quarter a bit. And I was wondering sort of perspectively, what's the company's appetite basically to sort of -- and I know you're not market-share driven at all, but in effect, what's the company's thoughts or appetites for sort of returning to the marketing presence that used to maintain in those lines?

John R. Charman
Former Director, Chairman of Axis Re and Chairman of Axis Specialty Europe

Let me just split it all up again because we obviously had trade credit and bond reinsurance business, which renews at the 1st of January this year, and that market to us has been essentially restructured. And we played quite an important role within that. With regards to our credit and political risk business, back in the middle of '08, essentially we put that into near suspension because we were extremely concerned, and quite rightly so, as to what happening within the global financial markets, and especially within the credit markets. And so what that did was to allow us to step back and then put all of our efforts into managing our in force portfolio which, it's a multi-year portfolio, just don't forget. And really be able to reflect upon, not only what was the dramatic changes and the stresses that were taking place within the global economy, but also try to look forward to see what lessons we needed to learn and how to reshape our thinking and therefore, our underwriting on a go-forward basis. We are still within that period, but I would expect us to re-emerge sometime during the course of this year. But as I took some time to explain to you all, we have remodeled our approach in the light of the change global economic conditions and potential volatility in the future, rethought our underwriting, rethought our underwriting structure, rethought our underwriting approach. Still, I think you'll find that our emphasis will be on emerging markets because it works very well for us, but our line structures are much more balanced. I gave you the average line structure, which I think we'll be very indicative of the vast majority of our business. If there's one thing that we've learned, peak risks are probably not very good when you get a global financial crisis, and so it will be much better balanced going forward. But you won't see an explosion of activity. It'll be a nice, steady, deliberate re-entry into the market. But in a very just as calculators will work previously, but even more so going forward.

Ron Bobman
Capital Returns

The company, whether it be relating to political risk and trade credit, maybe that's really the only relevant area, but have you lowered the retained policy limit that you're willing to offer from what they used to be in certain peak instances down to some meaningfully lower level?

John R. Charman
Former Director, Chairman of Axis Re and Chairman of Axis Specialty Europe

Yes, short answer.

Operator

Our next question is from Jay Cohen of Bank of America Merrill Lynch.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Question is on the asset side, that non-U.S. Government exposure, if you could drill down, let us know what's in there and how has that portfolio held up here in the first quarter?

David B. Greenfield
Former Chief Financial Officer and Executive Vice President

The so called non-U.S. PIGs portfolio, if you will, our exposure there has been relatively minimal. Without getting into the details of it, we were actually had investments at year end and only two of the countries included in that group. And we're talking about less in roughly in the range of $50 million of investment, that has subsequent to year end, dropped somewhat and been redistributed. So we looked at it as a pretty minor exposure although we're monitoring it very closely given the news that's out there.

Operator

[Operator Instructions] Our next question is from Sam Hoffman of Lincoln Square.

Samuel Hoffman

Assuming the continuation of the current economic environment, when do you expect the accident year loss ratios for credit and political risk, bond reinsurance and D&O to get back to kind of normalized 2006, 2007 levels?

John R. Charman
Former Director, Chairman of Axis Re and Chairman of Axis Specialty Europe

If that's what you want to hear. Forgive me, I believe we're well reserved now. We've been very proactive in flushing out situations so I think our track record speaks for itself on that, where we believe we need to reserve even though we have not had claims made on our policies. And I am comfortable about our financial position, and I think will go back to -- as I said in my prepared remarks, we'll go back a normalized positioned. I'm looking forward to being there.

David B. Greenfield
Former Chief Financial Officer and Executive Vice President

I would just add, when we talked a little about this earlier, I think when Matt asked a question, but when you're looking at the accident year ratios, combined ratios we talked about, the political risk business, particularly really shouldn't be looked at a one-year basis because as we've talked many times, these policies are long term in the sense that they're multi-year. And so I made a comment in my prepared remarks, on an inception-to-date basis, the portfolio's a 51% loss ratio. I think that's important to keep in mind as you're looking at each individual year. And as I've said also repeatedly, the only side of the under and premium reserve that sits there, which is again related to policies that span many years in terms of contract terms.

Samuel Hoffman

Investments were about flat actually in the quarter. In fact, sequentially, they were down about 3%, and so can you comment on how we should think about the growth rate of cash and investments going forward?

John R. Charman
Former Director, Chairman of Axis Re and Chairman of Axis Specialty Europe

I think you really have to look at the other side of the equation and that if you look at our cash flow for the quarter and for the year, you'll notice a tick up in paid claims and some of the activities we've been talking about. So that consequently, we didn't put more money into the portfolio as a result of that. And as we go forward, when you look at cash flow, you'll see, we have a very strong record over a number of years of higher cash flow. The cash flow in this current year is down, we're talking about operating cash flow, is down somewhat because of paid claim activity, and we'll see it tick back up in 2010 to a more normalized level. Actually, the other point on paid claims is, recall I said in my remarks, we also settled that life contract for $200 million, which was a negative cash flow item, as well.

Samuel Hoffman

And then on the investment portfolio, we calculated the yields on six income investments decline from about 3.96% in the third quarter to 3.7% in the fourth quarter. And maybe if you could comment on whether that's correct? If there were any unusual items in there and then when your new money rates start going forward?

David B. Greenfield
Former Chief Financial Officer and Executive Vice President

I don't think I can comment on your calculations, but I think they're roughly in line with numbers I was looking at. The yields have come down slightly as we've repositioned parts of the portfolio or moved money around. In terms of the new money rate, we're looking at the rate in about the mid-threes, around 3.5% or so.

Samuel Hoffman

And then finally, can you comment on your objectives for the Accidents and Health business this year and going forward?

John R. Charman
Former Director, Chairman of Axis Re and Chairman of Axis Specialty Europe

Well, I think we've made it clear. We've spent the last 12 months bringing in extremely talented and well-experienced individuals to establish a new business. I think the reasonably complete within our senior management group within the next two or three months. So from May to June of this year, we expect to see production ramping up. And initially, obviously through to the U.S., but then quickly through Europe and through our offices situated within the rest of the world. And we have a three-year business plan, and we think it's an excellent opportunity, it's a core competency of ours. We've had experience of it in our previous lives, and we believe it's a marketplace that if you're a serious contender, and you bring really good people with really good capital, with really good technology, we can be a very good addition to that marketplace. It's a very profitable area to be in, very complimentary to our existing portfolio.

Operator

That concludes our question-and-answer session today. I would like to turn the conference back over to Linda Ventresca for any closing remarks.

Linda Ventresca

Thank you, all for joining us, and we look forward to talking to you at the end of the first quarter.

John R. Charman
Former Director, Chairman of Axis Re and Chairman of Axis Specialty Europe

So do I.

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