S&P Global
Market Intelligence

Chubb Limited NYSE:CB

FQ4 2010 Earnings Call Transcripts

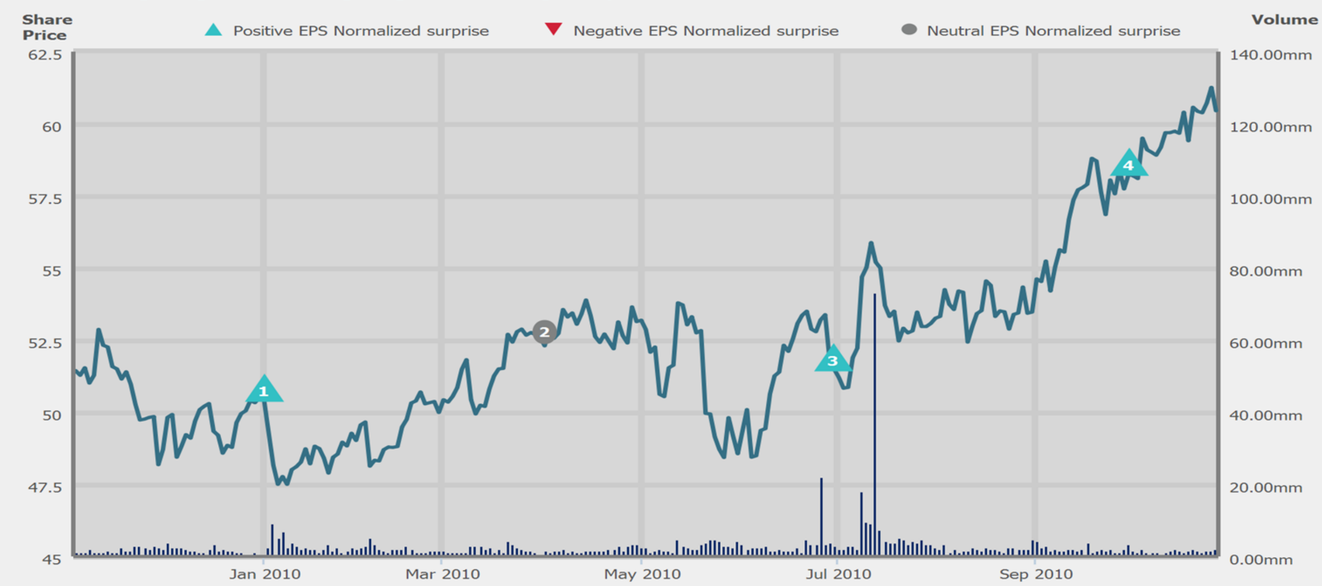
Thursday, February 03, 2011 1:30 PM GMT

S&P Global Market Intelligence Estimates

	-FQ4 2010-			-FQ1 2011-	-FY 2010-	
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	ACTUAL
EPS Normalized	1.83	2.05	▲12.02	1.85	7.53	7.79
Revenue (mm)	3302.90	3422.00	▲3.61	3691.33	13605.54	13708.00

Currency: USD
Consensus as of Feb-03-2011 11:02 AM GMT

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



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ4 2009	1.94	2.01	▲1 3.61 %
FQ1 2010	1.70	1.70	● 2 0.00 %
FQ2 2010	1.83	2.01	▲3 9.84 %
FQ3 2010	1.81	2.01	▲4 11.05 %

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EXECUTIVES

Bob Cusumano

Brian Dowd

Evan Greenberg

Helen Wilson

Phil Bancroft

Sean Ringsted

ANALYSTS

Brian Meredith
UBS

Greg Locraft
Morgan Stanley

Ian Gutterman
Adage Capital

Jay Cohen
Bank of America

Jay Gelb
Barclays Capital

Keith Walsh
Citi

Mark Dwelle
RBC Capital Markets

Matthew Heimermann
JPMorgan

Mike Paisan
Stifel Nicolaus

Paul Newsome
Sandler O'Neill

Robert Cusumano

Scott Frost
Bank of America-Merrill Lynch

Vinay Misquith
Credit Suisse

Presentation

Operator

Good day, and welcome to the ACE Limited Fourth Quarter Yearend 2010 Earnings Conference Call. Today's call is being recorded.

For opening remarks and introductions, I'd like to turn the call over to Helen Wilson, Investor Relations. Please go ahead, ma'am.

Helen Wilson

Thank you and welcome to the ACE Limited December 31, 2010 Fourth quarter and year-end earnings conference call.

Our report today will contain forward-looking statements. These include statements relating to company performance and guidance, recent corporate developments and acquisitions, ACE's business mix, economic outlook and insurance market conditions, all of which are subject to risks and uncertainties. Actual results may differ materially.

Please refer to our most recent SEC filings as well as our earnings press release and financial supplement which are available on our Web site for more information on factors that could affect these matters.

This call is being webcast live and will be available for replay for one month. All remarks made during the call are current at the time of the call and will not be updated to reflect subsequent material developments.

Now, I'd like to introduce our speakers. First, we've Evan Greenberg, Chairman and Chief Executive Officer, followed by Phil Bancroft, our Chief Financial Officer. And then, we'll take your questions. Also, with us to assist with your questions are several members of our management team. Now it's my pleasure to turn the call over to Evan.

Evan Greenberg

Good morning, everybody. ACE had a very good fourth quarter, which contributed to an excellent year. In fact, this is the first quarter in our history that we earned over $1 billion of net income. After-tax operating income for the quarter, as you've seen was $2.05 per share bringing full-year operating income to $779 or nearly $2.7 billion.

Given the challenging economic and insurance market conditions we faced in 2010, these are great results with all of our principal businesses making a positive and meaningful contribution.

In fact, full-year operating income was relatively flat with prior year. With our P&C lines of business down 6% really all due to increased catastrophe losses and our A&H and Life business up 5%. This speaks to the power of our diversification strategy while we manage the cycle, and our recent acquisitions continue to add to that trend.

Per share book value grew 2% in the quarter, bringing full-year growth to 17%. For the last five years, we've grown our per share book and tangible book at a compound annual rate of 14.5% and 15.8% respectively.

ROE for the year was just over 13%, an efficient and favorable risk adjusted return on capital, particularly when measured against risk free returns and that result includes a modest amount of fourth quarter share repurchases.

Our underwriting results, both calendar and accident year was simply excellent. The calendar year combined ratio for the full-year was about 90%, which included more than triple the catastrophe losses compared to prior year and favorable prior period reserve development roughly equivalent to prior year.

This quarter's cat losses $51 million, included $31 million of IBNR for the Australian floods and $5 million for the New Zealand earthquake.

Prior period development for the quarter includes the results of our own annual as well as the State of Pennsylvania's bi-annual reviews of A&E reserves and other run-off liabilities. We took a charge of $60 million after-tax and Phil will have more to say about this.

Our accident year loss ratio for the quarter, excluding cats was 58.5%, which is lower than last year and deserves some comment.

We had a number of nonrecurring items, which benefited the current accident year result. Due to the acquisition of Rain and Hail, our year-end adjustment normally taken in the first quarter, came forward to the fourth. In addition, we added couple of one-time premium-related adjustments that benefited the current accident year.

Lastly, our mix of business is changing. While most byline P&C ratios have increased as one would expect given rate and trend, we've continued to shed higher loss ratio lines, while grow or maintain lower loss ratio business.

Phil will provide more details around the accident year components and Brian and John will be available to provide more color during the Q&A.

The expense ratio was up in the quarter and full-year compared to prior, due almost entirely to crop and fewer loss portfolio type large transactions. Excluding these two items from both years, our expense ratio was essentially flat for the quarter and up slightly for the year, again Phil will provide more detail.

In December S&P upgraded the financial strength rating of our core operating insurance companies to AA minus. This development acknowledges not only the strength of our balance sheet but also our distinct global franchise and our well diversified balance of businesses.

During the quarter we closed on two of the acquisitions we announced last year, Rain and Hail in the United States and Jerneh Insurance in Malaysia. Our acquisition of New York Life's operations in Korea as you saw closed earlier this week; we intend to close the acquisition of their Life Company in Hong Kong by the end of the first quarter. These acquisitions are on track and should make a meaningful contribution to our results while further enhancing our diversification.

I want to make a few comments about the insurance market environment. As I said in the last quarter, we're observing typical, commercial ENC soft market behavior with prices continuing to soften around the world and more competition around terms and conditions.

Well I must say, overall the US market, Bermuda and the London wholesale market are more competitive than the other markets around the world.

Globally the second half of 2010 was more competitive than the first half, this is reality. We are not ringing our hands over it, the market is the market and these conditions will likely be with us for some time.

Rather we're managing the cycle prudently and not kidding ourselves about price or reserve adequacy. In fact as the market has softened, we've added even more rigor to our underwriting portfolio management. We have very good insights by product as to where we've opportunity and where we need to take corrective action.

With that, total company net premiums were up 4% in the quarter. In North America premiums were up 5%. As would be expected, in retail our new business writings were down about one-third from prior year while our renewal retention ratio in the quarter was over 90%, up from 88% prior year. Quite simply we're writing less new business and maintaining our renewals.

Retentions were up particularly in those areas of business were more than price mattered. For the business we wrote rates in North America were down overall about 2% in the quarter ranging from between up 3% for certain casualty lines and down 6% in property. To the business we didn't write rates were substantially below our targets.

For our international commercial P&C business, excluding the impact of foreign exchange premium revenues in the quarter was flat with retail up 4% and London wholesale down 10%. New business premiums in retail P&C were up 8% driven largely by Asia and Latin America and the renewal retention ratio was in the mid 80s.

Rates in the quarter were down overall, about 1% and our London wholesale business and new business writings were down over 25% in the quarter while renewal premiums were up 10%.

Turning to our reinsurance business, net written premiums were about flat in the quarter. However for January 1, on an underwriting year basis, Global Re was off about 10% from prior year with casualty related classes flat.

Our US Casualty reinsurance business shrank and our international casualty business grew. Our property cat and property per risk business writings were both down.

Brian Dowd and John Keogh are available to provide more color on their business in the market environment and their operations.

Turning to our A&H insurance business, A&H premium growth globally was again up with ACE International business growing and our combined insurance business down.

Our international A&H continued to pick up momentum this quarter as anticipated and grew 7%, with strong growth in Asia and Latin America. I believe our international business growth will continue to improve as we move through 2011.

Meanwhile, combined insurance premiums were down around 5% to 6% from prior year, and I expect this trend to continue in '11, given that our business is primarily concentrated in the most economically-challenged regions of the world, the US and Western Europe. It'll simply take longer for combined business to recover from the impact of the recession.

Another factor that impacts combined in the U.K. and Ireland is the change of the regulatory environment. Regulators in those two countries have adopted a new stance regarding sales practices. Combined has operated these for four decades without incident. However, the regulators' new stance has resulted in a need for us to retrain our agents and reengineer our processes.

We put these two operations under a sales moratorium, while we work on this. Ireland is back in operation; in the U.K. that moratorium is continuing though we hope to resume new business sales sometime in the future. However, with that said, combined's operating income for the quarter and full-year was up 11% and 12% respectively.

In summary, I believe ACE's financial results for the quarter and the full-year were excellent and distinguished our company as demonstrated by our strong operating income, book value growth and ROE. We're well diversified and our balance sheet is in great shape.

We've made great strides in the year, continuing to position our company for the future. We added to our executive management ranks, we completed a number of acquisitions, and we improved upon our underwriting figure. We are simply so well positioned for opportunity this year and beyond.

While Phil will provide full-year guidance, I want to add a comment. We expect 2011 revenue growth will be in the mid to upper single-digit range. So, given changes to our mix of business, there will greater variability from quarter-to-quarter than we've experienced in recent years with some quarters down and other quarters up. First quarter is the quarter we expect to be impacted to the negative, and don't be surprised.

In sum, again, I am quite optimistic about the coming year and barring unforeseen events, we expect 2011 will be another very good year for ACE.

Now, let me turn it over to Phil.

Phil Bancroft

Thanks, Evan. We ended the year with a very strong balance sheet and capital position, tangible book value per share grew 16.8% for the year and declined 2% in the quarter. Adjusting for the impact of acquisitions, predominantly Rain and Hail, tangible book value per share grew 21% for the year and 1.5% for the quarter.

Net realized and unrealized losses after-tax for the quarter were $270 million. Our operating and underwriting cash flow for the year were $3.5 billion and $1.8 billion respectively. Our cash and invested assets grew this year by $5 billion to over $52 billion

Investment income was $532 million for the quarter up 4% and benefited from private equity distributions. Normalizing for this, the quarterly investment income run rate is closer to $520 million. Current new money rates are 3.6% if we invested in a similar distribution to our existing portfolio.

Our net loss reserves were 1.4% year-over-year, while our paid-to-incurred ratio was 98%. Adjusting for prior period development our paid-to-incurred ratio was 91%.

There were several items in the quarter that had somewhat of an offsetting effect one related to the prior period and a number related to the current accident year. First, we had net positive prior period development of about $120 million after tax primarily related to short tail lines, it was offset by a charge of about $60 million also after tax related to our reserve review of runoff operations including Brandywine. About half of this $60 million charge was an addition to our asbestos and environmental reserves.

Second, concerning the current exiting a year, our P&C accident year loss ratio before Cat losses dropped about 5 percentage points over last year. Let me break this down by division.

In North America, if you eliminate the beneficial effect of the crop adjustment which was $32 million as well as the underwriting income benefit from a couple of non-recurring premium adjustments which totaled $80 million, the current accident year loss ratio was flat.

Line by line the loss ratio was actually up as one would expect but as Evan mentioned, there was a change in business mix. We are in less premium and higher loss ratio lines.

In ACE Overseas General, a number of large property losses negatively impacted our loss ratio in the fourth quarter of 2009; secondly lower loss ratio regions of the world of growing faster than other regions, again a mix of business change.

Our P&C expense ratio was up 1.6 percentage points from the prior year's fourth quarter to 32.1%. Adjusting for crop and large one-off transactions that we wrote in 2009 and did not repeat in 2010, our expense ratio was flat in the quarter and up half a point for the year.

We normalized for the crop adjustment and the one-time premium items, our current accident year combined ratio excluding cats was 93.8% for the quarter and 92% for the year and by the way we believe we've continued to reserve conservatively.

Our financial leverage were quite low at 16.7%, was up from the third quarter and will come down from this range over the next six to nine months as we repay the $1.3 billion of short-term financing associated with the purchase of Rain and Hail and the buyback of $300 million of our own shares in the fourth quarter. Reinsurance recoverables were down 5% from December 31, 2009 and our recoverable leverage is now 56%.

Finally, our press release issued last night included our guidance for 2011. Our range is $6.10 to $6.50 for the current accident year after tax operating income. This includes cat losses of $300 million after tax.

Again, just as with last year, guidance is for the current accident year only and includes no assumption for prior period development. We currently expect to be in the middle of the range.

For 2010 the comparable operating income per share excluding prior period development was $6.48. Our estimate for 2011 is down only about 3% which we believe is strong.

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

Helen Wilson
Thank you. At this point we'd be happy to take your questions.

Question and Answer

Operator

Thank you. Our first question comes from Jay Gelb with Barclays Capital.

Jay Gelb
Barclays Capital

Thank you and good morning.

Evan Greenberg

Good morning.

Jay Gelb
Barclays Capital

First, on the 2011 guidance, can you give us a sense of whether the impact of the Australian floods in the first quarter is taken into account for the cat load for 2011?

Evan Greenberg

Yes, it is.

Jay Gelb
Barclays Capital

Okay. I don't know if you have any thoughts on exposure currently?

Evan Greenberg

Sure, let me expand a little bit on Australia. As we said, we put up $31 million IBNR related to the floods. It's early days. Losses are developing slowly. And as you know this will take some time. The definition of the number of events and exactly when each started is still developing.

Our total net from what we've currently will likely be in the $75 million to $90 million range and the $30 million that we took is an offset to that $75 million to $90 million. The portion of that number not included in our fourth quarter reserves, i.e., that $45 million to $60 million is contemplated in our annual 2011 guidance and this loss is nearly 100% from our insurance operations as opposed to Tempus III. We really don't expect from the Australian floods of any single [ph] problem of any consequence from Tempus III.

Jay Gelb
Barclays Capital

Right. So the January losses are included in that $75 million to $90 million range, am I assuming it correct?

Evan Greenberg

They are. And then we've 31 million to be exact that we put up in the fourth quarter against that $75 million to $90 million.

Jay Gelb
Barclays Capital

And then the separate, just I wanted to touch on was the excess capital position after the announced acquisitions, the build-up of internally generated capital I don't know if you like to sort of refresh your view on where you stand on excess capital?

Evan Greenberg

We continue to have a strong balance sheet, and we've good flexibility, and we do maintain capital in that couple to a few range that is for flexibility, both for good and for bad. And I think there is plenty of opportunity over time in the marketplace and certainly, as we all know, there is plenty of risk out there.

Jay Gelb
Barclays Capital

So couple to a few billion dollars of excess capital?

Evan Greenberg

Surplus.

Jay Gelb
Barclays Capital

I see. Thank you.

Evan Greenberg

Thank you.

Operator

And we'll take our next question from Keith Walsh with Citi.

Evan Greenberg

Good morning, Keith.

Keith Walsh
Citi

Good morning, gentlemen. How are you? First question here just back to the guidance, when I think about the $6.10 to $6.50 range and I appreciate there's no reserves in that, but when we think about the deals you guys invested about $1.7 billion in deals this year. I think from the numbers we ran and heard you talked about should be about $0.40 accretion roughly in 2011 from those deal, so I think we normalize for that. I'm just a little surprised by the ROE deterioration ex-those deals in your core business if you could address that? Thanks.

Evan Greenberg

Sure. First of all, those deals are worth about $0.35 of accretion, number one. Number two, once you do the deals, they become core business, so I don't distinguish them from our other core businesses, but I take your point, look, you have rate and trend and it doesn't take a lot in rate and trend to erode current accident year results.

Anybody who expects that you have that going on and yet you have absolute stability and what have been excellent combined ratios is kidding themselves. And those who try to simply put up those same kinds of results will take charges in the future, there is no way around that, it's pretty simple math. I don't think the deterioration is that significant. I think it's logical.

And frankly, the acquisitions we made are both accretive, they are accretive to our hurdle rates and they were a good use of the capital rather than writing more organic business to build our core. We acquired more core, so that's kind of how I see it.

And as you say, so that we address this subject fully, we're guiding you really in the beginning to middle of the range. So as Phil said, it's like 6.30. In '10 we produced 6.48, so not so bad. You said it, but it's worth my mentioning it.

Again the guidance is for current accident year only, because that's what we can prudently project. By its nature we can't predict prior period development. However, if the loss development trends continue in a similar fashion and again that is unknowable, then we could have prior period development in the same range as we did in 2010.

Keith Walsh
Citi

Okay. That's helpful. And then just a follow up on one, just talking about retention, I apologize you gave different numbers for different segments, but I think the bottom-line is just looking at your numbers over the last several quarters, you guys are probably one of the highest as far as retention of business in the industry out there from the other large companies. I understand new business is down, but shouldn't your existing book be under pressure on pricing as well. So I don't get it, if you're such a conservative underwriter that your retention rates are so high. If you can just help me understand that, thanks.

Evan Greenberg

You're talking about net to gross retention?

Keith Walsh
Citi

Renewal retention.

Evan Greenberg

Brian, do you want to - ?

Brian Dowd

I'll give some thoughts on North America retention, maybe probably not a bad time just talking about the market in general to give you some feel for the pricing our retention and new business, because all three probably give you color on that. Evan mentioned North America. Our rates were down about 2.1%. Frankly, the themes in the quarter are consistent with last couple of quarters. Wholesale is a little more competitive than retail, commodity accounts and layers are more competitive than account for newer service capacities.

Our service capabilities are a key and awful lot our business is both insurance and service. People buy it, because we can front the policies, we can handle the collateral, we got the engineering to avail that. That differentiates us from a lot of other companies with our global network.

Some of the lines we saw the most competition were property and professional liability, where we saw rates go down by about 6%. The two main reasons I think they had the largest reductions, these were the lines, remember, in '09, we were still getting price increases in property and professional liability last year. And second, the early indications in 2010, both property and professional liability look like they were going to be pretty profitable, so I think people are competing for those lines on that basis.

We also saw some increased competition in medical liability and a few of the other lines and all of those have caused rate erosion, some decreased retention rates and lower new business.

On the other hand, some of our retail umbrella pricing and wholesale umbrella pricing helps steady. We also saw some modest price increases in the energy related casualty account as well as in our Private Risk Services business.

As we continue to differentiate ourselves with our insurance and service capabilities, our retention ratios are high. In North America, premium retention ratio was about 87% in the quarter, which is an improvement from 84% a year ago. And frankly, if the lines were our service capabilities, our retention ratios are in the high-90s.

Examples include our national accounts risk management business, our foreign casualty, our facilities business and where we're the lead in professional liability (inaudible). Frankly, there are only a handful of companies that can do those types of services. Three or more in most cases. So we tend to get retention ratios in those businesses in the high-90s. Lines that are more commodity-like, like our (inaudible), frankly, retentions do fall to the 70s in those lines of business.

And then lastly as we look at new business, competition is still robust and so we're still seeing a lot of submission activity. However, we remain just from our approach where new business has to meet the same hurdle pricing as our renewal business. And as a result, we wrote about a third less new business in the quarter than we wrote a year ago. And frankly, new business was down in virtually all lines with probable exceptions of ACE Private Risk Services and one large program we talked about last year.

So truth is we're about where we'd expect in the cycle right now. Our efficiency metrics are going down, are bound to submit, and are bound to close. They're down about two percentage points over where they were a year ago and (inaudible) expected for those points in the cycle. I do think the investment we made in our service capabilities differentiates us in our retention ratio from most of our competitors.

Phil Bancroft

That was a mouthful. Did it answer your question?

Keith Walsh
Citi

It did. Thank you, thanks a lot.

Evan Greenberg

You're welcome.

Operator

And we'll hear next from Matthew Heimermann with JPMorgan.

Matthew Heimermann
JPMorgan

Hi, good morning, everybody. A couple of questions; one, I'd love it if you could expand first you talked I think pretty specifically about A&H, but I'd be just curious how you're thinking about exposures in this (inaudible) property and casualty business and as well as the crop business and whether that exposure growth you view as incrementally positive as you think about risk-reward and earnings or neutral or negative?

And then the second question is obviously, lots of current events in the Middle East and I'd be curious what type of scenario you think needs to play out there to potentially really increase the risk around whether its political risk, political violence and physical damage, etc.,?

Evan Greenberg

Sure. Let's take the exposure first. When I look forward what do I expect. First, crop. I think if there is a one line of business that may surprise to the upside because of economic factors is crop insurance, because I think commodity prices are up. It was part of our thinking that we couldn't project with any certainty.

When we bought Rain and Hail, it was just the macro trend that you have a middle-class growing around the world. People are eating more meat around the world and so grains and crop naturally, there was a shortage of food and the US is a major exporter and grower of food. We are seeing right now crop prices is very strong and that could have a beneficial impact on both revenue and potentially income beyond what we've projected so far.

In the balance of P&C, I'd say and Brian can give a little more of a breakdown into three categories. What we've seen is, in one or two categories of economic development, we've seen a flattening, so no further deterioration, in fact, some growth and activity which benefits exposure, which benefits applied against rate benefits premium, but there are one or two where we've like equipment-related, business assetrelated where we haven't seen I believe the same level of pick up. I mean he could give a little more on that if you like.

When I look forward I think there will be a beneficial impact and I think it's going to be modest and will increase as the year goes along. And we can't project it with any certainty. That's in the US.

On the other side of the coin, Europe, I expected to continue to be flat, but Asia and Latin America, we're growing our business and it's growing, because business activity is increasing.

When you turn to Egypt and the Middle East and your question was what would create material losses? Interesting. You're relating to political violence, et cetera. We've very little political risk PV exposure in our political risk portfolio. PV is political violence. And most of our exposure that we've in Egypt or in other countries, particularly, in Egypt is not in the urban center. We have very little exposure in the urban center.

Look, what would create significant loss? And I say significant, and I'll clarify that in a moment, but you'd have to go to a complete Iran-type situation. Even with all the projections, the predictions that are out there right now, that's not foreseen.

And let me maybe then just give you a little more. The political events in Egypt are unfolding. And no one knows the outcome obviously with any certainty.

Our political risk exposures relate mostly to areas of vital importance for the country to function. Natural resources, critical infrastructure-related. Our urban venued exposures are, as I said, they are minimal, they are tiny. All of our policies have conditionality and have substantial reinsurance.

We insured defined perils, as you know. And in the case of Egypt, you're talking about confiscation, ex-appropriation, nationalization, and currency and convertibility. At this time, we don't know of any losses developing. And at this time, we do not envision any losses developing that are not contemplated within our loss reserves impacts.

Matthew Heimermann
JPMorgan

That's very thorough. I don't think surprising and the grand scheme of things. Just so to summarize I mean we're really talking about not only a change in control at the company, but effectively, an internalization of the country as well, which would be to ex-appropriation and potentially convertibility risk or you're really talking about a situation in which this not only spreads to other countries, but spreads in a way that leads to an internalization that's reflective about a word of the entire region?

Evan Greenberg

Your comment of internalization of the country, in essence, like Iran, you start hitting back to the Stone Age and you pull up the ladder and you decide that those things related to critical infrastructure like gasoline and jet fuel, which were the kinds of things we've covered, you don't want any of that anymore, you don't need that, you're just going to burn coal, number one.

Number two, when you talk about contagion, the countries most at risk, which I'm not going to go into, that are discussed, that could go next, we've virtually no exposure.

And I have read some of the papers that have been written by analysts and I think there is some confusion as to what countries constitute the Middle East. For instance, I don't consider Turkey, a Middle East country. I don't think they consider themselves that either. There are a lot of things to worry about. And while we're vigilant about this, I'm not concerned.

Matthew Heimermann
JPMorgan

All right. Very thorough. Thank you.

Evan Greenberg

You're welcome.

Operator

And next we'll hear from Greg Locraft with Morgan Stanley.

Greg Locraft
Morgan Stanley

Hi, good morning. Wanted to just understand a little bit more on the prior period development comments that you made earlier, Evan. You mentioned I think that you could have prior period in the same range as 2010 and I totally appreciate that that's a difficult thing to forecast and you don't actually in your guidance. Is that assuming kind of current loss trend and could you give us some understanding as to what current loss trend needs to be for you to have effectively $500 million of PPD in the 2011 period, which again is my number, based on 2010?

Evan Greenberg

Greg, thanks. I can't give you a satisfying answer there. I'm not going to get that granular. It really varies by line of businesses, etc. But maybe to help you with it a little further, we've a very clear process. We review all of our major reserves, each category of reserve. We study them in a thorough way, ground up once a year, and we've a calendar to do it all throughout the year. You can't study everything at once and then we really best practice we think for the industry and the company. We have external actuaries review each of those portfolios also. So they all come up during the year.

At this moment in time, there are studies; there are portfolios that were studied 9 months and 12 months ago, some were studied six months ago, some were studied three months ago, and so we're at various points of maturations since the last reviews of each and from what I can see right now if the trends that have developed, in aggregate, when I add it all up. It's the trend that we've seen since the last reviews continue then I could imagine prior period benefits easily in the range of what we saw this year.

Greg Locraft
Morgan Stanley

Shifting gears, just wanted to get some thoughts on the capital deployment side, in particular, the only way your share price makes any sense at current levels is if you guys on our math are going to earn, call it, high single-digit ROE in perpetuity in the eight [ph] kind of range. One of the things, it's like PPD for us, very hard for us to predict what you're going to do in capital deployment and yet you have a lot of optionality there. How should we model that or think about that because the current guidance actually takes your ROE below double-digit ranges which would begin to justify that kind of implied ROE in your current share price. So how should we be thinking about capital deployment optionality going forward for you guys?

Evan Greenberg

Here is how I'd think about it. Number one, the ROE, you are projecting is current accident year only as we both know, in the way you are projecting that and we will see what happens. But we've been pretty good at producing double-digit ROEs and I feel fairly bullish about this year, I feel quite bullish.

When I look at capital and think about capital going forward, you've seen us have a track record of good ROE, we've been patient over the years taken aggregate period, five-year period, take a three-year period. Our ROE has been I believe quite good, and take it over a total cycle of 10 years or longer and our ROE has been excellent as well, so we're patient about it and we've contributed to that ROE through both organic growth at the right times in the right areas and we've a lot of optionality in that regard because of our mix of business and because of our geographic mix.

And we've also complimented that ROE from accretion with acquisitions that's further along our strategy, we are patient about that, you've seen that we've made a few acquisitions in '10. I must say nothing that analysts could have imagined because you're looking at a very narrow cohort of potential companies.

When you look at market, much narrower than what we imagine because we're in a perch that looks across the globe. I think there's a lot of stress in the world and there's a lot of reassessment of strategy.

Cost to capital in the world I believe is going to rise and that's going to cause more stress and more reassessment of strategy and I think that provides opportunity. With all that said, you know, we're not shareholder unfriendly, we're not going to be unmindful, we're not going to hold capital just for the sake of holding endless amounts of capital, we're going to hold what we think is right for risk and what we think is right for opportunity over a reasonable time horizon and if we can't do something with it or think we can, we're going to return it to shareholders.

Greg Locraft
Morgan Stanley

Okay, thanks. .Last one for Phil. Could you just comment on the tax rate in the quarter? It was much lower than we had been thinking, what occurred there?

Phil Bancroft

There's nothing unusual. As you know, it depends on where our income is earned and we had higher earnings and lower tax jurisdictions in the period.

Greg Locraft
Morgan Stanley

Great, thanks.

Operator

And moving on we have a question from Vinay Misquith with Credit Suisse.

Evan Greenberg

Good morning, Vinay.

Vinay Misquith
Credit Suisse

Hi, good morning. First, just a numbers question on the Australian losses, just wondering if the Cyclone Yasi loss was also included within the first quarter number that you gave us?

Evan Greenberg

Vinay, I have no bloody idea. The thing just hit, I got a note this morning that said, Oh, my god, it's like it went through the uprights between two cities and looks like it didn't hit them and that it was in some area that was far less populated. It's way too early.

But remember, we don't do quarterly guidance on cat. We do an annual guidance on category. And cat losses first quarter last year were high. And our overall cat losses for the last year were really close to our guidance. Our guidance comes from us imagining from calculating what is the average annual expected cat losses using years of data to go through a sausage machine and I'm looking at my Chief Actuary who better not have been imagining, we calculated it, so it varies, it jumps all over the place by quarter, but you look it over an annual period and it has a little more creditability to it.

Vinay Misquith
Credit Suisse

Just curious from your perspective, how much lower is your exposure to the Middle East versus what I expected? What am I missing?

Evan Greenberg

I'm not going to go there but I'm going to say, I know the two documents you looked at to sort of piece together that build a beast of a number, and you dig back through a couple of exhibits but I tell you what they are dated. You couldn't put those two together that way. I've said in the past and I think it's worth repeating and I know you don't love the answer, but I hope you respect it and that is we don't put out sort of gross exposure numbers in really any area, because then we get the whole analytical community playing underwriter and imagining and starting as that's exposure that could be subject to loss, which is very unrealistic.

It breaks down by country. You then have to seriously PML it because it depends on the kind of risk you're talking about and whether it straight credit risk, which could be short-term, one-month or three-month, related to oil purchases or something like that or oil service equipment down to permanent facilities that you're covering, the equity, simply a confiscation risk to a different kind of a risk that might be a property political violence that on a grocery store or something, so you got it all mixed up together.

And we tease it out into its categories and we PML it and then there is lots of reinsurance and conditionality around it. So you just can't. I think look it that way. And I know the one exhibit looked at had the Middle East and Turkey, let's imagine, Turkey was a large part.

Vinay Misquith
Credit Suisse

One last question if I may. On frequency and severity trends what are you seeing in that?

Evan Greenberg

Sean Ringsted, would you like to talk about frequency and severity? He is our Chief Actuary; he will give a little detail. But let's say that what you've heard before. Frequency has been fairly benign among most classes and severity has been. It's where you have seen trend, but it varies by class of business significantly. If you want a little more, Sean is going to give you a little more.

Sean Ringsted

If we're not seeing any dramatic changes in frequency, Vinay, on a relative basis year-on-year, I think it's true to say there is a flattening of declines in industry experience that we've seen in recent units, it's a little hard to read the tea leaves with everything has gone on with the changes in the economy and so on 2010, 2009.

So you have to look at changes and exposures in ordered premiums but generally, we think we're seeing a flattening of declines in that frequency, as Evan mentioned. I think there are a handful of states where comp frequency is increasing and in certain casualty (technical difficulty) we're seeing increases in frequency. Overall severity, I think it's fair to say is within our expectations, if not better.

Vinay Misquith
Credit Suisse

That's great, thank you.

Operator

And we'll hear next from Paul Newsome with Sandler O'Neill

Evan Greenberg

Good morning, Paul.

Paul Newsome
Sandler O'Neill

Good morning. I just have one follow-up question really. Could we talk about the increase in goodwill and what the components roughly were? Obviously, they are from the acquisitions we've got a lot of moving parts as well.

Phil Bancroft

So for the two acquisitions we closed in the quarter, the increase in goodwill was about $700 million and it related principally to Rain and Hail.

Paul Newsome
Sandler O'Neill

But very little for the rest of the bit?

Phil Bancroft

That's right. I mean the other acquisition of Jerneh was relative small and had very little goodwill associated with it.

Paul Newsome
Sandler O'Neill

And we haven't touched this at all, but there are couples, which US peers are making some changes in their investment portfolios principally because they have a lot of muni exposure, but could you maybe just touch on that, there may be little changes or not, but obviously, you have changes in the international exposure as well that can possibly be addressed. Should we be looking for any changes in the investment portfolio this year?

Phil Bancroft

We don't see any major strategic change. Obviously, we've made some tactical changes around the year. With respect to municipal bonds in our portfolio, we've got an average credit quality of AA. It's very well diversified along states, both general obligation and special revenue bonds. It only represents about 5% of the portfolio.

And of the portfolio, 17% of the bonds are prerefunded and backed by US Treasury, so we're very comfortable. You might have seen a small increase in the munis in our portfolio in the quarter, but that related to the consolidation of Rain and Hail, which had a small portfolio of municipal bonds. We don't see any real change to our portfolio.

<TAG>Paul Newsome - Sandler O'Neill:

Thank you very much.

Operator

And next we'll hear from Jay Cohen with Bank of America.

Evan Greenberg

Good morning, Jay.

Jay Cohen
Bank of America

Yes, thank you. Good morning, Evan. Two questions; first is, on the buy backs in the quarter, I think you said it was $300 million, is that basically to offset shares issued for compensation purposes?

Evan Greenberg

Yes. When we announced this that we would do this, I think we announced $600 million and that would authorize to buy back our dilution for a couple of years and that's what with the $300 million was towards that, it wasn't necessarily one year of dilution.

Jay Cohen
Bank of America

Got it. And then the second question, on the run-off reserve increase, can you talk about some of the factors that gave rise to the A&E reserve increase? And what were the other lines of business where you experienced reserve deficiencies in the run-off book?

Evan Greenberg

Sean is really getting a chance to talk today. So, we're going to give it to him. He'll talk about that. But on the A&E, it wasn't anything that was systemic, and it wasn't a big number, it was case related. I think Brian is going to give the A&E. Sean, are you doing the other?

Brian Dowd

I'll do both.

Evan Greenberg

Oh, Brian's doing both.

Brian Dowd

Yes. I mean we finished both the internal, external reviews for Brandywine and Westchester. First on the asbestos side, frankly, it was a handful of individual accounts, really a class of accounts, about five or six accounts in a given class that formally we really want to target that are now have become targets and we've increased our case reserves for those and that was most of all the increase first. We had modest increase on environmental.

Remember, in the restructuring order, besides the specialists in environmental, other long-term casualty liabilities including workers comp, (inaudible) any general liability, umbrella type thing, we did have increases in a number of those types of classes. And lastly, we had some increase in our assumed reinsurance settlements and all taken into totals what they added up to. But, as Evan mentioned no real changes to the environment. The environment is basically as we saw last year and it's just that we went through it all the book again and there is no major changes to the trends.

Jay Cohen
Bank of America

I'm assuming the State of Pennsylvania saw things in a similar vein. Was there any differences in views of these reserves?

Brian Dowd

Yes, our difference actually narrowed. We're down to about $30 million difference between the outside actuaries and ours. That difference over the last 10 years continues to narrow and is almost on the total base we're held now is next to meaningless.

Evan Greenberg

We've converged. By the way, we converged overtime with them coming down while we came up, it wasn't one way.

Jay Cohen
Bank of America

Thank you.

Operator

And moving on we have a question from Ian Gutterman with Adage Capital.

Ian Gutterman
Adage Capital

I guess, first for Phil, the share count didn't go down at all with the $5 million buy back, it actually went up some, was it all that management compensation shares come in this quarter, was there anything else unusual that share count would have gone up with a meaningful buy back?

Phil Bancroft

When you look at the EPS calculation, one of the things that we include there obviously is the effect of dilutive securities and so as our share price increases we've more options to become dilutive. I mean that's just the mechanics, they call it a treasury stock method.

Ian Gutterman
Adage Capital

I understand, I always believe in a little bit for that, but I guess I wondered if that would offset a full $5 million?

Evan Greenberg

Yes it did. More than offset.

Ian Gutterman
Adage Capital

And then similarly, was the goodwill in Rain and Hail greater than you originally thought or was that - ?

Evan Greenberg

It was right on target with what we expected.

Ian Gutterman
Adage Capital

Okay. And then just lastly for you. That big short-term debt amount for the quarter, is that going to go away next quarter, and what does that become long-term debt or you are going to use cash?

Evan Greenberg

What we're planning to do is use cash flow to pay it off over the next six months to nine months. Our idea was, we didn't wanted to disturb the portfolio, the financing cost, we're doing it with reposes is very, very low, so we see that as the best way to handle it.

Ian Gutterman
Adage Capital

And then just back to the asbestos, can you talk about, it looks like I'm going through your Qs that you did some restructuring throughout the course of the year with Brandywine, and with Century that you now have the full $800 million limit available again, and it looks like that there was, I guess that allowed you to get some capital out of that, is that correct? Can you just talk what those transactions were and what they accomplished?

Phil Bancroft

I'm going to ask Bob Cusumano to talk about that, our General Counsel and will give you a cliff note thumbnail, because if we went into the detail it is crazy complicated.

Bob Cusumano

It does get very complicated, but in a nutshell, the restructuring agreement from the late 1990s would impair Century ability to pay back money that owes to our active companies for as long as, in current terms, there is any kind of impairment of the excess of loss contract that the active companies have over Brandywine's liabilities.

Midyear, there was no such impairment. So midyear, those valves, if you will, were released. And the result was that we could pay back a lot of the intercompany charges and kind of rationalize all the financing at the Brandywine level, so we did that. That was done in the third quarter.

Ian Gutterman
Adage Capital

So that essentially allowed you to get cash out of there with the caveat being that you're so-called on the hook for the 800 million again?

Bob Cusumano

It didn't have that effect. It had no real effect on the overall exposure or gross liability level. There it was simply delivering cash in exchange for the extinguishment of age old obligation. So a wash from the perspective of Brandywine and the active companies and the excess of loss, but the delivery of cash from the Brandywine company in exchange for a reduction of liabilities going the other way.

Ian Gutterman
Adage Capital

Got it. So, Century takes capital untrapped, is that a fair summary?

Robert Cusumano

That would be a good colloquial way of putting it.

Ian Gutterman
Adage Capital

Perfect, okay, thank you.

Phil Bancroft

It was a good thing.

Ian Gutterman
Adage Capital

No, agreed, agreed, I just want to make sure I fully understood it.

Operator

And we'll hear next from Scott Frost with Bank of America-Merrill Lynch

Scott Frost
Bank of America-Merrill Lynch

Just a touch on Middle East exposure again. I just want to make sure I understood. You said you may experience significant losses if Egypt, for example, would deteriorate into and Iran and the risk is confiscation, exappropriation, nationalization, that's not expected, no loss is contemplated currently. From a credit perspective, we've seen Iran develop. On the outside chance that would happen. Could you give us an idea of what the impact on your credit ratings might be?

Evan Greenberg

None. Zero. Let me clarify significance. I think right now any loss we'd see develop would be covered within reserves in PEGs, that's what I think and if it went beyond it, it'd be modest.

Scott Frost
Bank of America-Merrill Lynch

On ratings or on…

Evan Greenberg

Not on ratings, it's on operations. (inaudible) size of law.

Scott Frost
Bank of America-Merrill Lynch

I imagine it's too soon to talk about Cyclone Yasi, but just making sure that's not contemplated in your cat guidance or is it?

Evan Greenberg

Yes, it is. Maybe I wasn't clear the last time I was asked question. We don't do quarterly guidance for cat, we do annual guidance for cat, and it contemplates $300 million after-tax of losses. We don't know what quarter, we don't know what geography it comes from, and so we've a reason to believe we've cat losses that are approaching or exceeding $300 million, but we consider that it's all covered. That's why I said last year, if you looked at the first quarter significant losses, we didn't change our cat guidance, because other quarters some were quiet, some were noisy, and at the end of the year, it added up, we were very close, so, yes, sure this is covered in our guidance.

Scott Frost
Bank of America-Merrill Lynch

Okay, great, thank you.

Evan Greenberg

You're welcome.

Operator

And we'll hear next from Mark Dwelle with RBC Capital Markets.

Mark Dwelle
RBC Capital Markets

Most of my questions have been covered. You had mentioned in your opening remarks about a sales moratorium in the U.K. and Ireland related to the combined units. Can you just frame that a little bit? Is that sort of $1 million a day, $5 million a day kind of run rate on those moratoriums?

Evan Greenberg

No. We don't give a breakdown, but the new sales volume is very small per day, you'd measure in thousands.

Mark Dwelle
RBC Capital Markets

Okay, that all my questions, thank you.

Evan Greenberg

You're welcome.

Operator

And moving on, we'll hear from Mike Paisan with Stifel Nicolaus.

Evan Greenberg

Good to hear from you.

Mike Paisan
Stifel Nicolaus

Good to talk to you. Just one quick, most of my questions were answered, but I do have one question on the agriculture business as that kind of incorporated in my model and then North America sector [ph]? I was just wondering when you look at the statutory numbers the net to gross as a standalone or independent company was around 40% or so. So they obviously utilized a ton of reinsurance and I just want to know if that strategy going forward as you incorporate it into ACE is going to continue?

Evan Greenberg

Remember, there is statutory in government, but let me let Brian give you a little more color.

Brian Dowd

I agree in general, Rain and Hail, they are largest reinsurer frankly was us. Remember, over the years, we've gone from 50% to 40% to about 30% of the reinsurance. It was actually written on our paper first. If we look at how we write it and then we see it to them, then they see it to the government and then they bought a little bit of stop loss and a little bit of quarter share. The quarter share goes away and we largely still have a stop loss protecting our book. I think when you roll it all into ACE, you are going to see the net retention is higher than it was when the two were separate.

Evan Greenberg

In fact I don't have the number in my head. I believe when we announced this, we told you this could be a substantial increase and that we gave you an amount, $900 million.

Brian Dowd

We said our net would increase about 900 was on a commodity prices that were at the time of acquisition and commodity prices are probably up 30% since then.

Mike Paisan
Stifel Nicolaus

Okay, great, thanks so much.

Evan Greenberg

You're welcome.

Operator

And next we'll hear from Brian Meredith with UBS

Brian Meredith
UBS

Yes, good morning. Just a couple of quick ones here for you. First one, Evan, can you tell us what you're thinking about with respect to loss trend in your guidance or your PEGs?

Evan Greenberg

Using the same, roughly, the same trends we've been using. We're not believing that the relative benign environment we've seen in the past is an indication of the future.

Brian Meredith
UBS

And then the second one on the run-off business adverse development, outside of the A&E, can you tell me a little bit more about what lines of business or where is that adverse development came from? It's kind of surprising that you've development on that stuff thus far down the road?

Evan Greenberg

Remember, on an after-tax, you are looking at about $30 million number. On total reserves, I mean in particular, you look through our 10-K or 10-Qs, you see these kinds of movements up and down among different years of cohorts and comp or in GL or any of that and you know that, so I think what just puts a point on this, which is a small number or gets people a look on, that is it's in the runoff lines where we do a special reserve review every two years. But this is related to things like, as Brian said, sexual molestation, latent development in products, workers comp, those kinds of things going that are years back. They are pretty case specific. Not pretty, they're very case specific.

Brian Meredith
UBS

And then lastly could you give us a sense of what the M&A environment or pipeline looks like out there right now and opportunities to deploy your capital?

Evan Greenberg

First of all, Brian, at this time last year, when you guys asked me what I saw, I said well, you know, there's a bunch of stuff that passes our desk but I don't see anything on the horizon. As the year went along, three things made sense to us and came around. I'd say the pipeline right now, it's not overly robust. We have things we're looking at. It's not a whole lot different that it was a year ago, though the environment I'd say is a little more stressed. So there's more chatter in every region of the world, but I don't see anything on the horizon at the moment.

Brian Meredith
UBS

Thank you.

Evan Greenberg

You're welcome.

Helen Wilson

Okay, operator, we'll conclude the call now please. Thank you, everyone for joining us this morning. We look forward to speaking with you again at the end of the next quarter. Thank you and good day.

Evan Greenberg

Thank you, everybody.

Operator
So that does conclude today's conference. And we do thank you for your participation.