S&P Global
Market Intelligence

AXIS Capital Holdings Limited NYSE:AXS

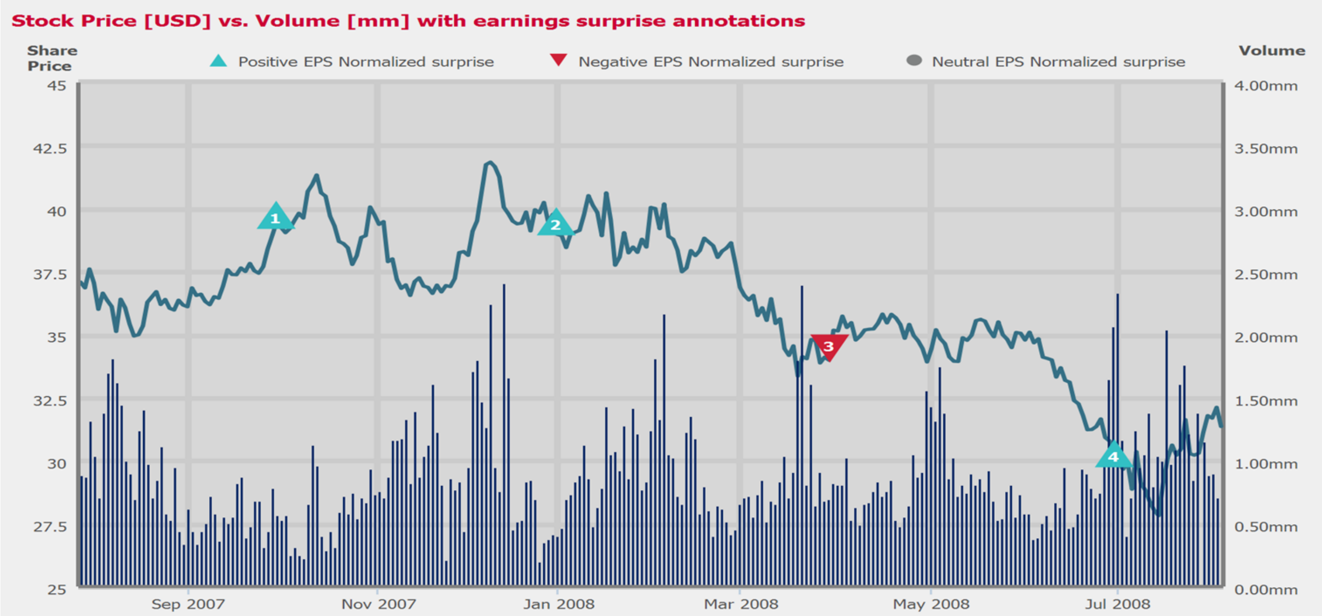
FQ3 2008 Earnings Call Transcripts

Tuesday, October 28, 2008 12:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ3 2008-			-FQ4 2008-	-FY 2008-	-FY 2009-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	(0.97)	(1.22)	NM	1.28	2.99	4.76
Revenue	-	-	▲1.90	-	-	-
Revenue (mm)	541.15	551.42	-	371.28	2692.05	2589.23

Currency: USD
Consensus as of Oct-28-2008 8:30 AM GMT



	- EPS NORMALIZED -		
	CONSENSUS	ACTUAL	SURPRISE
FQ3 2007	1.38	1.66	▲1 20.29 %
FQ4 2007	1.53	1.83	▲2 19.61 %
FQ1 2008	1.39	1.28	▼3 (7.91 %)
FQ2 2008	1.36	1.45	▲4 6.62 %

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Call Participants

EXECUTIVES

David B. Greenfield

John R. Charman

Linda Ventresca

ANALYSTS

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Merrill Lynch

Joshua Shanker
Citigroup

Matthew G. Heimermann
JPMorgan

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Goldman Sachs

Vinay Misquith
Credit Suisse

Presentation

Operator

Good day ladies and gentlemen, and welcome to the Third Quarter 2008 AXIS Capital Holdings Limited Earnings Conference Call. My name is Erica and I will be your coordinator for today. At this time, all participants are in a listen-only mode. We will be facilitating a question-and-answer session towards the end of this conference. [Operator Instructions].

I would now like to turn the presentation over to your host for today's call, Ms. Linda Ventresca Director of Investor Relations. Please proceed.

Linda Ventresca

Thank you, Erica and good morning ladies and gentlemen. I am happy to welcome you to our conference call to discuss the financial results for AXIS Capital for the quarter ended September 30, 2008.Our third quarter earnings press release and financial supplement were issued yesterday evening after the market closed. If you would like copies, please visit the Investor Information section of our website, www.axiscapital.com.

We set aside an hour for today's call, which is also available as an audio webcast through the Investor Information section of our website through November 21st. An audio replay will also be available through November 7th. The toll-free dial-in number for the replay is 888-286-8010 and the international number is 617-801-6888. The pass code for both replay dial-in numbers is 21842480.

With me on today's call are John Charman, our CEO and President and David Greenfield, our CFO. Before I turn the call over to John, I will remind everyone that statements made during this call including the Q&A session which are not historical facts, maybe forward-looking statements within the meaning of the U.S. Federal Securities Laws.

Forward-looking statements contained in this presentation include, but are not necessarily limited to information regarding our estimate of losses related to catastrophes 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 and 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 and Form 8-K issued last night which can be found on our website.

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

John R. Charman

Thank you Linda and good morning everyone. As you know during this quarter, the world's financial markets and industry and we at Axis have experienced an unprecedented confluence of events. All these unprecedented events were adverse with respect to financial results for the quarter including our results. More importantly, our view is that these events have acted as a catalyst eroding in a cluster board hardening throughout the P&C marketplace.

The Hurricane activity in the quarter served as a healthy reminder of the significant risk borne in U.S. coastal regions, as well as a significant claims paying ability of the property and cash in the marketplace. Hurricane Ike now looks to have the potential to be third the largest hurricane on record, in terms of market loss.

Even in the face of this unprecedented confluence of events, our industry has demonstrated remarkable resilience. Meanwhile, financial markets have experienced significant and unprecedented volatility and liquidity. This is a transformational time and serves as an eye opener to the reality of capital and liquidity. It represents the first time since the 1930's that it is been a total collapse of confidence in the major international banking system. This in turn fuel significant concern about a major world recession lead by the U.S. and other industrial countries.

Fortunately, unlike the 1930's, governments and central banks remain active in stabilizing the situation. Finally, our major and most aggressive competitor has suffered significant weakness. This competitor who historically has had significant influence deployed substantial capacity and as part of its culture demonstrated extreme pricing competition across all of our product lines, is now so severely distressed as to require massive government financial and management assistance.

This situation in isolation is an after cause of positive change throughout our markets and products. Against the back drop of these unprecedented variance, our fundamentals remain strong. Even with share repurchase activity over the last 12 months, significant market loss activity in the year impacting our underline portfolio and substantial realized and unrealized investment losses following this financial market catastrophe.

Our diluted book value per share has declined less than 3% over the last 12 months. However, when considering the impact of share repurchase activity during the period, it is essentially flat. We believe a hard market in 2009 is a near certainty and we are amply prepared to maximize shareholder value throughout this important next cycle.

Since our inception we have demonstrated transparency and leadership in all of our lines of business through a combination of capital strength, global presence, diversification, specially underwriting skill sets and technical competency.

In a world where capital is scarce and the cost is necessarily rising everyday. We have every intention of deploying that capital when and where we are adequately compensated to do so. As David will discuss in more detail, our capital resources and liquidity position are very strong and we are more than prepare to address the market opportunity. We continue to vigorously monitor the impacts of sub-prime issues and the bolder global credit crises on our liquidity and capital resources. This obviously includes the impact of a worsening economic environment on both our underwriting and investment portfolios.

We remain comfortable that our identified exposures are within our risk tolerances and are manageable. We have scrutinized our professional lines, credit and political risk lines in the light of these events. We believe that based upon current conditions, we have addressed the potential for increased frequency of loss in these lines.

The decline in political risk premiums in excess of 60% by volume has clearly demonstrate yet again how quickly we can and do shutdown business lines within AXIS, when we believe markets or pricing conditions have moved against us.

Now I would like to turn the call to David, and who will discuss the financial results for the quarter. Following David's review of financial results, I will discuss market conditions in a bit more detail. David?

David B. Greenfield

Thank you John and good morning everyone. As John mentioned, the extraordinary events which have unfolded that have significant impact on our financial results this quarter, but our capital resources and liquidity position remained very strong. This positions us extremely well to benefit from the market turn we expect will commence across short tail lines at the January 1st, renewal date. Our net loss for the quarter was $249 million or $1.79 per diluted share, compared with net income of $270 million or $1.65

per diluted share to the third quarter of 2007. This quarter's results included $407 million of estimated net losses from Hurricanes Gustav and Ike.

When considering the associated earned premium impact, the overall after tax impact of these hurricanes on the quarter's results was $371 million. Net after tax catastrophe losses in the third quarter of 2007 were $34 million. Absent CAD events in both periods, operating income was $210 million in this year's third quarter compared to $307 million in last year's third quarter.

John has already shared with you the headline news with respect to the financial markets. And we were not immune to the impact of these events on our investment portfolio. Net realized losses in the quarter were $89 million. Our after tax operating loss which excludes the impact of realized gains and losses on investments was a $161 million or $1.15 per diluted share compared with operating income of $271 million or $1.66 per diluted share for the third quarter of 2007.

The net realized investment losses in the quarter included $50 million in other than temporary impairments on investment securities, largely relating to fixed income securities of Lehman Brothers. $60 million in losses from the sale of Fannie Mae and Freddie Mac preferred equity securities and $23 million in net realized gains on the sale of fixed maturities. We saw a marked increase of $346 million in our net unrealized loss position in the quarter as credit spreads widen significantly and the U.S. dollar strengthened.

We also repurchased 1.8 million shares of common stock during the quarter, at a cost of $58 million and we declared and paid dividends of $39 million to common and preferred share holders. After all these items, our shareholder's equity balance declined by $662 million in the quarter to $4.6 billion from $5.3 billion at June 30th. Our diluted book value per share has decreased 13% over the quarter, 9% over the year-to-date and less than 3% over the last 12 months.

For the first nine months of 2008, net income was $220 million or $1.40 per diluted share compared with $749 million or $4.53 per diluted share in 2007. After-tax operating income for the first nine months of 2008 was $273 million or $1.74 per diluted share compared with $754 million or $4.55 per diluted share in the same period last year.

Let me turn to the underwriting results for the quarter beginning with our top line. Consolidated gross premiums written were $725 million for the quarter, down 4% from the third quarter of 2007. While our year-to-date gross premiums written were $2.9 billion down 5% for first the nine months month of 2007. These reductions primarily emanated from our insurance segment where gross premiums written this quarter were down 16% to $403 million over the prior period. Disciplined and focus underwriting in the face of competitive market conditions drove exposure reduction in a number of our property and casualty lines.

In addition, our political risk premiums were down due to our decision to reserve capacity for expected increases in pricing when liquidity returns to the financial markets and a reduction in available transactions as private capital flows have slowed amidst the ongoing global financial crises.

This was partially offset by growth in our profession lines business, stemming from rate increases for financial institutions on both new and renewal business. Gross premiums written in our insurance segment for the first nine months of 2008 were $1.4 billion, down 9% from the same period in 2007. Gross premiums written in our reinsurance segment were $323 million this quarter, up 18% from the third quarter of 2007. This increase was primarily due to reinstatement premiums of $29 million in connection with hurricanes Ike and Gustav.

Although we're able to identify opportunities within our property and professional lines business, we otherwise continue to observe modest deterioration in market conditions which generally limited the opportunity for growth.

For the first nine months of 2008, gross premiums written in our reinsurance segment were $1.5 billion, comparable with the same period in 2007. Excluding the impact of foreign exchange rate movements, gross premiums written were otherwise down 4% for the first nine months of 2008.

Consolidated net premiums written decreased 6% in the quarter and year-to-date, reflecting the previously mentioned reductions in gross premiums written. Net premiums earned in the quarter increased slightly over the prior year quarter. This was largely due to additional earned premium in our reinsurance segment in connection with hurricane loss experiences this quarter. Net premiums earned were otherwise down 3% reflecting period-to-period changes in net premiums written and business mix. Net premiums earned for the year-to-date were down 2%.

Total underwriting loss for the quarter, of a $186 million represented a decline in income of $386 million over the same period in 2007. This reduction was driven by net losses incurred from hurricanes Ike and Gustav of $407 million. Absent hurricanes Ike and Gustav, our total underwriting income for the quarter would have been $200 million.

Our total underwriting income for a year-to-date was $90 million and represented a decline of $440 million over the same period in 2007. Absent hurricanes Ike and Gustav, our total other underwriting income for the year year-to-date would have been $477 million. The year-to-date total underwriting income was also impacted by a higher frequency and severity of property losses within our insurance segment in the first half of the year.

The overall impact of net favorable reserve development in the three and nine months ended September 30, 2008 was largely comparable with the same periods in 2007. Absent to CAD losses our business is still generating very strong underwriting profitability, even against the backdrop of increased risk loss activity.

Our consolidated combined ratio for the quarter was a 128%, an increase of 53.9 points from the same period last year. Excluding catastrophe losses, our combined ratio would have been 69% which was comparable with the third quarter of 2007.

The quarter's combined ratio included 11 ratio points related to favorable reserved development, which I will describe in more detail later. The prior quarter combined ratio included 12 ratio points related to favorable reserved development.

Our year-to-date consolidated combined ratio was 97% an increase of 20.3 points from the same period of last year almost entirely due to the impact of Hurricane's Ike and Gustav.

Our insurance segments current accident year loss ratio for the quarter was 92.7% compared with 56.9% in the third quarter of 2007 an increase of 35.8 points. Net losses from Hurricanes Ike and Gustav adversely affected the quarter by $115 million or 39.2 ratio points.

The third quarter of 2007 included net losses of $11 million or 3 [ph] from hurricane Dean. Our reinsurance segments current accident year losses for the quarter was a 128.5% compared with 62.1% in the third quarter of 2007, an increase of 66.4 points.

Net losses from hurricanes Ike and Gustav adversely impacted the quarter by $292 million or 73.7 points. The third quarter of 2007 was adversely impacted by net loses from UK flood damages, hurricane Dean and other mid-size catastrophes losses of $25 million or 6.4 points.

Our consolidated net loss and loss expense reserves increased 8% in the quarter and 18% over the year-to-date to $4.9 billion at September 30, 2008. During the quarter, our estimate of reserves from prior accident years continued to develop favorably with prior year reserves reduced by a net amount of $76 million; of this amount $41 million was from our insurance segment and $35 million was from our reinsurance segment.

Favorable reserve development this quarter was primarily generated from accident years 2005 through 2007 and from our short-tail lines of business. We also recognized favorable reserve development from our professional lines insurance and reinsurance businesses totaling $29 million in the quarter. This favorable reserve development from professional lines business is very much at first for us and stems from the 2003 and 2004 accident years.

As we discussed in our earnings calls earlier this year, we have reached the point where we can begin to prudently incorporate our own loss experience into our reserving analysis with certain of our claims made professional lines of business.

Our current gross IBNR reserves relating to medium and long-tail lines of business totaled $3.5 billion or 80% of our total gross IBNR balance. Offsetting, the aforementioned favorable reserve development we strengthened accident year 2007 professional lines IBNR reserves by $33 million this quarter. This prudent reserve strengthening in both our insurance and reinsurance segments recognizes the continued and substantial market deterioration of the some part in crises which was precipitated by events in 2007.

Turning now to our G&A expenses; our G&A ratio increased 1 point to 12.6% over the prior year quarter. G&A cost of $87 million this quarter were inline with the guidance I provided last quarter. Our acquisition cost ratio declined 1.5 points to 13.1% this quarter. The reduction was driven by adjustments to prior year ceding commissions in connection with the prior year reserve releases within the professional lines book of our insurance segment.

Total net investment income for the quarter decreased $68 million over the same period in 2007 to $51 million. Our fixed income asset class produced $108 million of net investment income this quarter, an increase of 14% over the prior year quarter. However, this was more than offset by a decline in investment income from our other investment portfolio of $68 million.

Our other investments were primarily impacted by mark-to-market unrealized losses on our credit and hedge funds, stemming from the unprecedented market volatility, disruption to the financial system and de-leveraging throughout the financial markets. Total net investment income for the year-to-date declined $85 million over the same period in 2007 also due to the performance of credit and hedge funds.

The total return of our cash and investment portfolio for the quarter was negative 3.6%. This comprised net investment income of $51 million, offset by net realize losses of $89 million, which I discussed earlier and an increase in net un-realized losses of $346 million. Approximately 96% of the increase in net un-realized losses emanated from our high quality fixed maturity portfolio.

The main contributors to this were our U.S. and Euro investment grade corporate's and commercial and residential non-agency mortgage backed securities, where credit spreads widened to historically high levels during the quarter. Our foreign denominated fixed maturities and equity securities were also negatively impacted by the strengthening of the U.S. dollar.

Our overall portfolio is well diversified, liquid, high quality and short duration. Our investment grade fixed income asset class has a duration of 2.9 years, with a AA plus average quality. Exposure in our direct investment portfolio to sub-prime and Alt-A collateral is negligible at a $161 million or less than 2% of total cash and investments.

Our fixed maturities portfolio at quarter end also included $2.1 billion of corporate debt with a weighted average rating of A. This includes $876 million of direct exposure to the unsecured debt of financial issuers of which no individual issuer represents more than $85 million. This quarter, we've expanded disclosures of holdings in corporate bonds in our financial supplement.

We encourage you to review this for a better understanding of our credit exposure to individual issuers. In the quarter, we have initiated efforts to wind down our securities lending program and expect our securities on loan to be under $300 million by the end of the year.

With respect to foreign exchange during the third quarter, changes in exchange rates and changes in net currency exposure resulted in foreign exchange gains of $8 million which was comparable with the gains of $7 million in the prior year quarter. Our interest expense for the quarter was $8 million, substantially below the $14 million occurred in the prior year quarter. The reduction reflects the termination of the $400 million repo agreement in place through most of the third quarter of 2007.

We continue to generate strong operating cash flows of $489 million in quarter and $1.2 billion for the year-to-date. Market and liquidity persisting throughout the U.S. and other financial markets this year has had minimal impact on the liquidity of our own investment portfolio, which includes over $4.8 billion of cash and cash equivalents and U.S. government and agency backed securities.

Further, most of our securities have liquid markets so there is significant liquidity available to us in our investment portfolio. We actively manage and monitored liquidity and asset duration of our portfolio to meet the anticipated cash flows of our insurance liabilities.

Our debt to capital ratios compare favorably with those of our peer group and are significantly below thresholds indicated by all of our rating agencies. Our business is supported by $1.5 billion credit facility, the terms of which provide for direct borrowing of up to $500 million on an unsecured basis. This facility expires in August 2010. Issuances of letter of credits currently total approximately $300 million. As of September 30 2008, there was no debt outstanding under this facility and we were in compliance with all covenants.

Our operating companies could provide over $1 billion of additional dividends to our holding company if needed. The bottom-line as we said earlier is that our capital resources and liquidity are very strong. And we believe we're well capitalized relative to rating agency requirements.

Further, our stock has traded near or below book value at various points during 2008. We've taken advantage of attractive valuations this year to repurchase shares. As mentioned earlier, during the quarter we repurchased 1.8 million shares for a total cost of $58 million.

Since the end of the quarter, we repurchased an additional 1.8 million shares for a total cost of $50 million. We believe repurchases this year will deliver meaningful returns to our shareholders overtime. With the expectation of a hardening market in 2009, we've now suspended our share repurchase activity.

Now I'll turn the call back to John.

John R. Charman

Thank you David. And I would like to begin with a brief review of current market conditions and move on to the infinitely more important future prospects for market conditions. As I mentioned when I started of the call, we expect a positive turn in the cycle across all lines of business, with the timing of this term bearing by line.

Over the last two to three years, nearly all insurance business lines have been under extreme pricing pressure with only one notable exception. We continue to see improvement in the financial institutions classes within our professional lines business and for larger financial institutions availability of capacity has now become an issue.

The balance of our professional lines business meanwhile has remained under pressure with the high access commercial business under the most severe pressure. Pricing for natural and catastrophe exposure in the insurance marketplace had reached marginal levels followed by the third quarter, particularly for California and the earthquake. Sub-prime and excess casualty market remained very soft, and in a state of flux.

Downward pricing pressures remain consistently strong through the quarter. We expect for our determined actions over the last two years to materially reduce net risk in our insurance segments, at a time when cycle risk was increasing will serve as well. Needless to say there has been significant activity emerging from the AIG situation. But in our view, it will take a little time for all the dynamics influencing a positive pricing turn to work their way through the insurance market.

In my view, AIG is the hay stack not to scroll the broker industry camels' back. Turning to the reinsurance market, as we have noted for sometime this market has remained relatively stable with moderating pressure experienced throughout most lines.

Our reinsurance portfolio has been significantly impacted by seasons retaining more business for sometime. Before I move on to a discussion about the anticipated market turn, I would like to briefly discuss our underwriting portfolios performance, resulting from the catastrophes of the third quarter.

As you know, we incurred net losses of $407 million from Hurricanes Ike and Gustav with the majority emanating from our reinsurance segment. These losses in the reinsurance segment mostly arise from our allocation of Texas capacity to the Texas windfall.

Hurricane Ike with its wide and Cat-3 storm profile moving right over Galveston and inland through the Midwest; as a result in an outcome consistent with what our models have projected for such an occurrence, including our estimated total loss from the Texas wind fall. It was painful this was actually highly affirmative for us.

Our underwriting approach coupled with our interpretation of model results were tested by real events and found valid. Importantly, our expected Texas market share in our reinsurance segment were event sizes over $20 billion is well below 1%.

As industry losses for Hurricane Ike continue to increase, we expect our overall market share of the loss will also reduce. Just last Thursday, RMS nearly doubled its range of expected industry losses from Ike to a range of $13 to $21 billion. We are confident that we have formulated the right strategy.

First, we deemphasize Florida in our reinsurance portfolio due to prevailing political issues in Florida, significant competition and insolvency risk associated with personal lines take out companies.

Second, our analysis indicated that we were more appropriately compensated at Texas capacity, if we allocated it to the windfall, particularly in light of our analysis of the impact of assessments, when the windfall back to other programs.

Finally, following the Hurricanes of 2005, we made the decision to restructure our insurance offshore energy portfolio. We reposition this portfolio to drilling contractors and move away from fixed platforms owned by the major oil companies. That's our net losses from offshore exposure were comparatively small at $23 million. We believe that market offshore losses will exceed $3 billion. With this further validation of our under writing risk analysis, we want to discuss the opportunity which lies ahead for a strong market participant like AXIS. 2008 has presented the property markets globally with historically high levels of risk losses and a material number of modest size pat losses throughout the world.

Just to remind you, the industry has faced no storm and earthquake losses in China, mining and energy losses mainly due to flooding in Australia and South Africa, steel mills and sugar refinery explosions, record numbers of Tornados in North America, deluges and river flooding in the Midwest in the U.S., creek hail storms in Germany and finally three land falling hurricanes in the U.S.

In our view this hurricane activity in the third quarter coming on the back of this extensive worldwide loss activity has caused a property reinsurance market to pause and begin to reverse this downward price slide. Further to this, the industry faces significant value of reductions of many types of assets, as well as potentially significant D&O claims arising from financial institutions in the wake of the sub-prime crisis.

Capital market's turmoil had led to concerns by the State of Florida and recognition by the rating agencies that the Florida Hurricane Cat Fund [FHCH] may not be able to raise sufficient funding in the capital markets to meet its obligations. This in turn has led the rating agencies to review the reinsurance programs of all carriers who depend on the cat fund for the cat cover in Florida. We believe this will lead to strong and increased demand in the spring of 2009 that will have a python like effect on cat program capacity, reminiscent of the early part of 2006. Pricing for Cat business will react positively to the supply-demand imbalance as expected, but the story does not end there.

Several of the world's largest commercial insurers including some European financial conglomerates with material insurance interest are suffering from credit related exposures. We expect this will lead to substantial amounts of business, flowing to other carriers through in this capital constrain market are now more than likely to be more reinsurance dependant.

For the market as a whole, reinsurance will be unavailable and necessary source of capital, even as prices rise. In our opinion, the property catastrophe market will be the first to respond. Public statements by the largest global re-insurer would indicate that Europe will not be immune from these price increases at the January 1st renewal although we expect some of the positive effect will be meted.

Year wind and year flood exposure are material global consumers of re-insurance capital. The pricing for these parallels under steady downward pressure over the last few years, we expect to see increases. We anticipate that the Asian markets should witness a halt in price reductions and capacity driven programs will see re-insurers seeking and requiring better data, improved pricing and tighter terms and conditions.

China is likely to see its lead re- insurers tighten terms and increased pricing to react to winter storm losses of historically high levels. Alternative capacitive for cat coming from side time [ph] investors in cat funds is expected to be significantly less available than it has been over past several years.

Well reported downgrades of four cat funds forms due collateral quality and counter party credit issues also will have a material impact and should drive more business back to the conventional reinsurance market. Our underwriters at AXIS are focused and ready to translate the increased cost of capital to price increase requirements.

Heading into pre renewal conventions, we're around with estimates of the price increases required to generate high returns for our investors on capital deployed in our underwriting business. Cat seemed to have accepted the direction if not the magnitude of the changes that will be necessary to generate the returns to will allow reinsures to maintain their ability to respond to material claims activity. The anticipated hardening in the reinsurance market, as I have described should force primary insurers to pass along price increases.

Our global specialty insurance business should benefit strongly from this dynamic in the market, coupled with the emergence of huge volumes of business, we expect from the weekend operating platforms of our competitors.

Our insurance business stands today enormously and we've already seen submission activity increase in our insurance segment. In both our insurance and reinsurance segments, which are global and diversified, we are established in all of the lines of business we want be in and all of these lines will likely be subject to significant hardening of the market to come.

We believe we are the most diversified and focused underwriting business in our sector to be formed in the last decade. We have the experienced people, we have the acknowledged skills, we have state of the art technology, we have the needed products and we operate on a global platform.

As strong and proven business model is well prepared to deliver extraordinary value to our shareholders and our clients whose needs for quality and strengthen their business partners are growing daily.

Finally, we have been extraordinarily patient and product defensive over the last two to three years. The gloves, thanks goodness are now nearly off. All of that in AXIS of all that today AXIS can hardly wait to step strongly back into the global arena.

And with that, I would now like to ask to take your questions.
Question And Answer

Question and Answer

Operator

[Operator Instructions]. Our first question comes from the line of Matthew Heimermann with JPMorgan. Please proceed.

Matthew G. Heimermann
JPMorgan

Hi good morning, everybody.

John R. Charman

Good morning Matt.

David B. Greenfield

Good morning Matt.

Matthew G. Heimermann
JPMorgan

Hi. John, you said with near certainty you thought you'd get a pricing turn across; it seems like actually most of the industry. I guess what's the different between certainty and near certainty? Is that have to do with resolve of your competitors or is there something fundamental that could change, that would explain that small doubt there?

John R. Charman

I am pretty comfortable about the market situation that we are moving towards in a relatively short period of time. And as I'd tried to say that some products will react much more quickly than others. But, the reality of it, of the market change is there.

Matthew G. Heimermann
JPMorgan

All right. So, compensate just from a under the just restate just to make sure I got it, the near certainty just reflects the fact that there might be some lags, so you'll get lots of turnings somewhere lag that initial turn and that's the difference certainty in there?

John R. Charman

As you know, Matt, there are businesses that have much less control over their underwriting operations that we have and it can take a little bit of time for those businesses to exert management influence save the underwriters. But undoubtedly it's there and its not far away.

Matthew G. Heimermann
JPMorgan

Okay, that makes sense. The other, I have got two other quick ones, one is, there is obviously the distress in the financial markets has impaired some companies has... have you changed your appetite for M&A activity given some of the distress pricing you've seen out there or is with the prospect of our cycle turn your mindset and efforts exclusively focused on organic?

John R. Charman

I think its fair to say that the with a potentially unique opportunity presenting itself now on the underwriting side, a market changing event so that we are more much more focused on organic growth. We believe that we can achieve significant incremental value for the foreseeable future.

Matthew G. Heimermann
JPMorgan

Okay, that makes sense. And, then the last question I had, with on the political risk book. It seems... I am just trying to get a sense of how much of the pull back had did you with what's happening with the financial markets and kind of maybe the risk prospect changing versus with holding capacity for pending renewals as we go forward?

John R. Charman

Primarily, it was the former, because that we've demonstrated time and time again, if you go back three years our withdrawal from the aviation market. We have now actually withdrawn from most parts of the marine market and this is no different from the way we run all of over underwriting activity. We have become increasingly conservative and concerned about what was taking place in the global financial markets and we were able to step back from that marketplace. It was very deliberate and you can see the evidence of portfolio with over a 60% reduction so.

Matthew G. Heimermann
JPMorgan

The change in the financial markets in anyway change your comfort with the business you brought in up to this point. We haven't see that take it to zero, so there is still some business out there that you are comfortable with, but I just be curious.

John R. Charman

We obviously very closely monitor our reinforce business; we are very happy with that. I have said time and time again, this is business that our group of people included myself have been underwriting for many, many years. It's a tight ended team, risk selection is critical, due diligence is critical, and we're comfortable with our in force portfolio. But, we do see, substantial opportunity in that line of business, probably emerging after the first quarter of next year.

Matthew G. Heimermann
JPMorgan

Okay, excellent. Thank you very much.

John R. Charman

Thank you.

Operator

Our next question comes from the line of Susan Spivak with Wachovia. Please proceed.

Susan P. Spivak
Wachovia Securities

Hi, good morning, everyone.

John R. Charman

Susan, good morning.

Susan P. Spivak
Wachovia Securities

How are you? Thanks for the very detailed commentary John, its great. And I just want to follow up, I have the same questions as Matt about the certainty that, could you just give us an idea you mentioned sending your teams out to the conferences I am assuming you mean the PCI embodied with an idea of what massage to send across that rates are going higher. But what's the magnitude of the message that you are sending out given the increased cost of capital?

John R. Charman

Well, I think you've summed it up to yourself, its not an increase cost of capital, we have to.... we take a lot of the ground that the industry has given away over the last two or three years and it's pretty well across the board. Some businesses take longer to arrive to the table than others but without a shatter of a down season, everybody has to move in a very different direction. And I've been very encouraged over the last few days that the statements are emerging from these recent conferences based from the insurance side and from the reinsurance side.

Susan P. Spivak
Wachovia Securities

Have you ever John seen such a consensus amongst market leaders in anticipation of a cycle turn like this?

John R. Charman

I think that this is a much broader and I'd say sustainable opportunity than 9/11.

Susan P. Spivak
Wachovia Securities

Really. And with that being said how much more premium do you think you could right on your current capital base?

John R. Charman

We have significant capacity. We have as I said we've been very patient and you know me, that's really tough. We've been very patient for two or three years. We have significant capacity and capital to do what's necessary, when is necessary and how is necessary.

Susan P. Spivak
Wachovia Securities

Okay. That's great John thanks again for all the comments.

John R. Charman

My pleasure. Thanks.

Operator

Our next question comes from the line of Vinay Misquith with Credit Suisse. Please proceed.

Vinay Misquith
Credit Suisse

Hi, good morning.

John R. Charman

Good morning Vinay.

Vinay Misquith
Credit Suisse

John you seem suddenly more positive on the industry, what could go wrong with price increases here.... certainly most companies seem to be very positive so my question is that, what could go wrong and prices would stay flat? Thanks.

John R. Charman

Its just not possible with the balance sheet within the industry, and we've been talking about market conditions soften and its softening and a rational competition over the last couple of years, that now must be feeding its way through into company's balance sheet with deteriorating financials and then if you look at the capital losses that the balance sheets are having to deal with. And the reality of the capital constraint that the industry has gained a very quickly find itself in, going into next year and for the near term future and near term is probably the next two to four years. So I just cannot see how the market cannot positively react both on the insurance side and on the re-insurance side, unless they are suicidal and they want to go out of business.

Vinay Misquith
Credit Suisse

I recall about a year or two, you were marketing heavily with mutual companies, could you refresh my memory as to how much of business you actually wrote from them and do you see more opportunities from those mutual companies, on the re-insurance?

John R. Charman

I think that we have, I haven't got the share about both side of the for mutual, but we have been marketing more heavily through the U.S. for the mutual's, that it will be very interesting that mutual's having a greater proportion of equities within their balance sheet investments. And to see the impact that has on those mutual's and to see whether I'm pretty sure that there's going to be in a boost in their reinsurance demand over the next two or three years and I think we're well placed because that's pretty sticky business. And we've been working hard over the last two or three years to establish relationships with them, convince them of our capital, convince them of our service capability and sustainability. So I would expect us to benefit very strongly from that position.

Vinay Misquith
Credit Suisse

How about your ratings, put your single A rating. I thought you were just competitive with double AA ratings?

John R. Charman

I would love to have a higher rating but at the end of the day, and if you are an A rated company in this day and age and you have a great reputation, you've got great capital, you've great people, you've got great market and you're diverse both globally on by product line. There is damn old difference between the double AA and A.

Vinay Misquith
Credit Suisse

All right that's fair. Thank you.

Operator

Our next question comes from the line of Alain Karaoglan from Bank of America. Please proceed.

Alain Karaoglan
Bank of America

Good morning John.

John R. Charman

Good morning Alain, how are you?

Alain Karaoglan
Bank of America

Fine, thank you, a couple of questions. So from your point of view, are you changing your return on capital requirements for business on average going forward. So next year, we're going to have a hard market. But is this whole uncertainly leading you to... we need more than a 15% now going forward or you're staying with your all goal?

John R. Charman

That a number of different questions in that one question. The reality is that we will maintain the fact that regardless of market conditions, we expect to run a minimum of 15% over any cycle that you like to call. The reality is that we will be very demanding because we've had to be patient over the last two to three years. We will be very demanding in the returns that require in the near-term future and we expect to maximize whatever profitability that there is out there in the marketplace and still stay within acceptable risk tolerances for the business.

Alain Karaoglan
Bank of America

Okay. And in terms of... it seems that reinsurance is going to react first. The insurance business is a little bit later as companies come to risks with more with the situation. Are you... and in terms of the situation of AIG, isn't the risk in the short-term that they become more competitive in order to retain business and are you seeing that today in the market. They've always been extremely competitive historically, but are they being more competitive now in order to retain business and thus that hurt the market because of their situation it gives you opportunities?

John R. Charman

Well let me just answer the point about the re-insurance market. I have not understood why the re-insurance market hasn't been better valued by the investment community. The outlook for the re-insurance market for the foreseeable future is more positive than I have seen for many, many years. I think the reality of the capital markets substantially withdrawing from providing capacity will lead to a re-energization of the reinsurance market place and a better understanding of what the reinsurance market provides to the insurance marketplace. And I believe that that will be witnessed over the next two or three years.

As far is AIG are concerned, I shed no tears for them. I have been in the business for 37 years and I believe that any normalization of AIG and I'm not talking personally to the individuals. Any normalization of AIG will be very beneficial to the marketplace because it will release huge volumes of business throughout the insurance portfolios, both by product and by geography. So I don't want to jump on their grave but I do believe it's a very, very important and significant event so, I think its very positive in the marketplace.

Alain Karaoglan
Bank of America

Thank you, very much.

John R. Charman

And you have mentioned about, sorry, you mentioned about near term disruption, yes of course, but the brokers are very careful in terms of making any market that is weakened forcing that market to complete even more aggressively on price risk renewal business, but without a shadow of a doubt new business will be steered away and is being steered away.

Alain Karaoglan
Bank of America

Thank you, John.

Operator

Our next question comes from the line of Jay Cohen, with Merrill lynch. Please proceed.

Jay Cohen

Merrill Lynch

Yes. Thank you, a couple of questions.

John R. Charman

Good morning, Jay.

Jay Cohen
Merrill Lynch

First is on the political risks side, have you gotten any political risk claims, notices yet and if you could remind us, because I'm not an expert in political risk

claims I got to tell you that, if you could remind us what kind of credit exposure do you have there, because if you read the description in your supplement, you do take, you are providing a corporate credit insurance, so could you just remind us what kind of risk you have there, that's the first question. And, then secondly have you been able to hire any teams or people out of AIG at this point and do you expect to?

John R. Charman

As far as the political risk account is concerned. I didn't discuss individual losses. But we have had what I would consider to be minimal loss activity in our portfolio and we do not expect material loss activity in that book in our enforce book either. Now we monitored it on our daily basis. The portfolio itself is over 50% corporate credit, these are individual transactions. I have said to you before, we partner with a limited number of international banks. We do full due diligence along side the banking due diligence. That is strongly collateralized, and our banking partners have significant skill in the game and we are very diligent about our monitoring our exposure by industrial and country.

And we correlate those industries both nationally and globally. And then second largest part of that portfolio is the confiscation and expropriation, nationalization and deprivation product and we have been very careful with the industries that we ensure within different countries around the world. We have embedded knowledge all the global, international countries and we are very mindful of staying clear of industries that are more likely to being nationalized than those that are not. And we have avoided the events within Venezuela and Bolivia specifically because of our proactive approach to this portfolio and it is absolutely critical and I just stress enough that the risk selection is critical in this portfolio, but we have had a settled team of the individuals here for over 10 years.

Jay Cohen
Merrill Lynch

John you think you will see industry losses you mean you may not suffer where other suffer being in losses here?

John R. Charman

I just had if a large loss that might be around in London a Brazilian loss, but we're not involved in, we declined it. And then secondly, I think when you're talking about the AIG personnel with regard to political risk or on a broader basis.

Jay Cohen
Merrill Lynch

I was seeing it more broadly John?

John R. Charman

Yes, we are always on the look out for some really good people. We always have been a we will continue to be to do so and we have had a reputation for finding good people individuals or groups of people where ever they come from and if we feel that they fit our culture and our ethos we'll bring them in.

Jay Cohen
Merrill Lynch

No big hires yet I assume?

John R. Charman

We don't have any people in the cross way between AIG and us.

Jay Cohen
Merrill Lynch

Very good.

John R. Charman

Thank you.

Operator

Our next question comes from the line of Josh Shanker with Citigroup. Please proceed.

Joshua Shanker
Citigroup

Yes.

John R. Charman

Good morning, Josh.

Joshua Shanker
Citigroup

Good morning. This is one of the concerns and I am with hard market pieces, now one of the concerns there's been no real loss experience in the clone of our standard business. What are you prospecting will eventually come of the 2007, 2008 as for the years for the industry. And what do you expect exclusive of catastrophes, what 2009 hold before we took these price increases really impact our underwriting results?

John R. Charman

Well, sorry. I am a bit confused. No, I can't predict what catastrophes are going to occur in 2009, but the reality is the market has to have significantly enhanced premium volumes on both the insurance side of the business and the reinsurance side to be able to deal with increased catastrophe numbers and risk losses to continue to be profitable. And that has to reset its pricing to make sure that there is a reasonable margin which is acceptable to our investors.

Joshua Shanker
Citigroup

And trying to... ignoring for statutory losses for a second and stripping them out, what do you think the industries commercial property and casualty combined ratio is running out right now if pricing were to hold flat?

John R. Charman

Well I've said to you many times, I've said to this audience many times that I've not understood why, with the breaching environments, substantial rating competition that has been throughout the insurance market close for the last two, two and half years. Why we haven't seen greater deterioration in the financials coming out of the underwriting side. I'm not going to predict what combined ratio is going to be, but I suspect they will be different from what companies currently expect.

Joshua Shanker

Citigroup

And obviously you can't control other company's financials but you would expect ultimately that the 2008 or 2007 as for the industry would likely have unfavorable developments on it?

John R. Charman

Well that was going to work its way through. As we've said before that if you look at the excessive competition, pricing competition not only the short tail lines but equally as importantly on the professional lines business as well as casualty business which we have stepped substantially back from during that period. That has to work its way through the system sooner or later.

Joshua Shanker
Citigroup

Okay. And very good, well I appreciate that its a different question I understand but good luck from its real opportunity coming up.

John R. Charman

Okay. We will certainly mindful from away. Thank you, Josh.

Operator

Our last question comes from the line of Tom Cholnoky with Goldman Sachs. Please proceed.

Thomas Cholnoky
Goldman Sachs

Good morning, John.

John R. Charman

Good morning Tom.

Thomas Cholnoky
Goldman Sachs

I guess I have got its interesting as I listen to this conference call everybody is talking about the damage to the supply side of the equation and nobody seems to or at least nobody has addressed the issue that, you have grown in a period of a global slowdown and in a period of very low inflation. Is it conceivable that you could have better pricing, but not really much in the way of incremental premium volume growth, because exposures are actually declining or not growing, I guess that's the first question and the second...

John R. Charman

And just hold on? Let me give thoughts on that...

Thomas Cholnoky
Goldman Sachs

Go ahead.

John R. Charman

I think its sort of important question. I believe there will be a substantial increase in premium take across the globe and across product lines. Because, the markets have in my view substantially under priced, so many of the primary products and regardless of whether clients wish to pay or do not wish to pay. Historically, that price is at relatively low level. These are products that are absolutely necessary and but frankly one of the benefits that I see very clearly coming down the line, is actually again to come from the problems of the banking community currently have.

The banks on their lending facilities, their lending covenants, they are not been enforcing, in my experience very much at all over the last three or four years. They've been turning up blind eye to the requirements that they have within those covenants for insurance purchasing, later lay into significant levels.

I believe going forwards, the change in the risk appetite within banks and the identification of risks and the enforcement of those covenants is going to produce a great deal of new business or old business back into the market. And I've invested very, very positive step. So, I think both I have two comments. One is the fact that I believe that there will be a general increase in actual premium take and then secondly I think there'll be a boost to that by the way the banks are going to have to enforce their lending covenants.

Thomas Cholnoky
Goldman Sachs

But that's more for property, isn't it rather than causally?

John R. Charman

Yes. But it's a pretty important amount.

Thomas Cholnoky
Goldman Sachs

I understand it, but I guess from a casualty perspective you got declining payroll, declining sales and most insurance premium are driven off of those types of exposures and I would think that the actual pick up....

John R. Charman

We're heavily involved in casualty business and so that because you know it brings me out in spots most of the times.

Thomas Cholnoky
Goldman Sachs

Right.

John R. Charman

But we have a casualty business, and an umbrella business which is a very good business. So we will incrementally benefit from the hardening of the marketplace because there will be a flat to quality back to people like us. So we'll have better earnings from the casualty side, more much better quality earnings, that all of other products, we will significantly benefit from.

Thomas Cholnoky
Goldman Sachs

Okay. And I guess just the last question I mean to the extent that do you think managements have been shake up enough that even if a lot of the unrealized gains that the industry has incurred today and if those start to reverse themselves over the next six to nine months. And capital gets rebuild back up. How much damage do you think really will have been done to the industry?

John R. Charman

I think that the underwriting is damages is clear for all to say. And nobody can tell whether the volatility in the financial markets is going to reverse over the next six, 12, 36, five years. So, whether regulators, rating agencies, or managers of businesses have got to work on what they know and that's going to lead to this market changing event.

Thomas Cholnoky
Goldman Sachs

Okay, great. Thank you very much.

John R. Charman

Great pleasure.

Operator

I would now like to turn the call over to John Charman, for closing remarks.

John R. Charman

Well, thank you everybody for bearing with us during this typical third quarter. Market and I much look forward to a very changed report as we enter underwriting for next year. Thank you very much.

Operator

Thank you for your participation in today's conference. This concludes the presentation. Everyone have a great day. .