S&P Capital IQ

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Arch Capital Group Ltd. NasdaqGS:ACGL

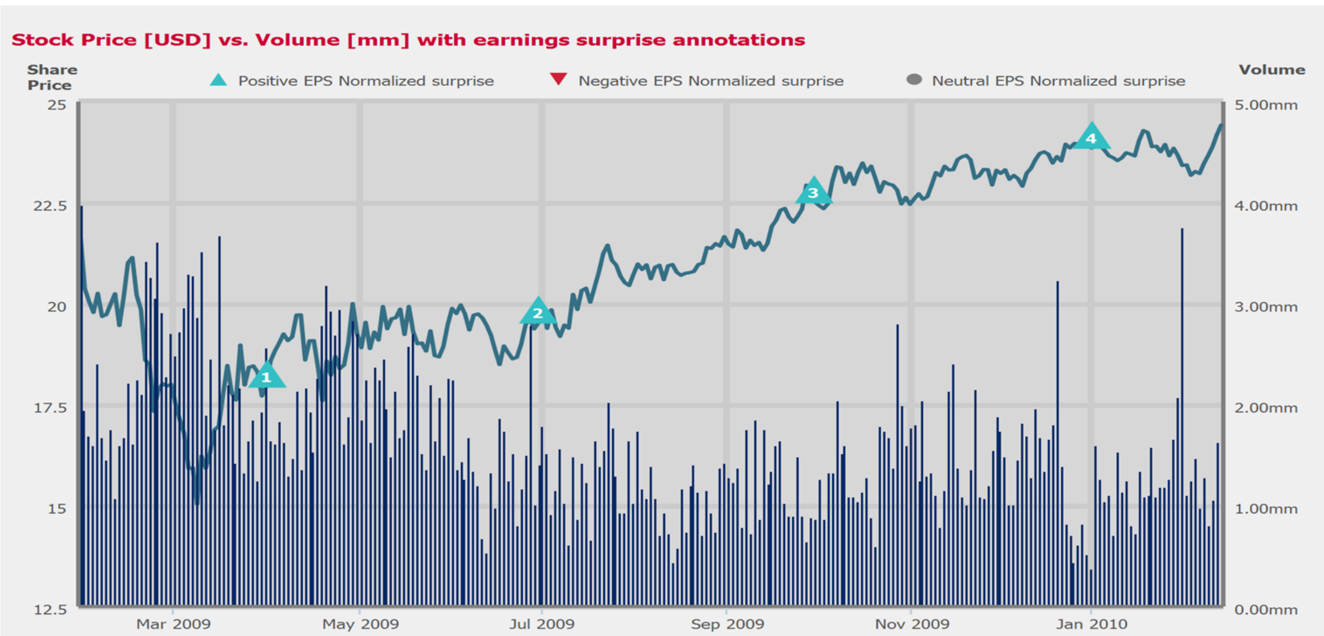
FQ1 2010 Earnings Call Transcripts

Tuesday, April 27, 2010 3:00 PM GMT

S&P Capital IQ Estimates

	-FQ1 2010-			-FQ2 2010-	-FY 2010-	-FY 2011-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.53	0.59	▲11.32	0.79	2.75	2.97
Revenue (mm)	812.74	844.89	▲3.96	687.91	2760.08	2822.71

Currency: USD
Consensus as of Apr-27-2010 1:31 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ1 2009	0.86	0.90	▲1 4.65 %
FQ2 2009	0.82	0.87	▲2 6.10 %
FQ3 2009	0.79	0.85	▲3 7.59 %
FQ4 2009	0.84	0.89	▲4 5.95 %

Call Participants

EXECUTIVES

Constantine P. Iordanou
Chairman and Chief Executive Officer

John C. R. Hele
Former Chief Financial Officer, Principal Accounting Officer, Executive Vice President and Treasurer

ANALYSTS

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Jay Adam Cohen
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Mark Alan Dwelle
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Matthew G. Heimermann
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Vinay Gerard Misquith
Crédit Suisse AG, Research Division

Presentation

Operator

Good day, ladies and gentlemen, and welcome to the First Quarter 2010 Arch Capital Group Earnings Conference Call. My name is Jennifer, and I'll be your operator for today. [Operator Instructions] Before the company gets started with this update, management wants to first remind everyone that certain statements in today's press release and discussed on this call may constitute forward-looking statements under the Federal Securities laws. These statements are based upon management's current assessments and assumptions and are subject to a number of risks and uncertainties.

Consequently, actual results may differ materially from those expressed or implied. For more information on the risks and other factors that may affect future performance, investors should review periodic reports that are filed by the company with the SEC from time to time. Additionally, certain statements contained in the call that are not based on historical facts are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995.

The company intends the forward-looking statements in the call to be subject to the Safe Harbor created thereby. Management also will make reference to some non-GAAP measures of financial performance. The reconciliation to GAAP and definition of operating income can be found in the company's current report on Form 8-K furnished to the SEC yesterday, which contains the company's earnings press release and is available on the company's website.

[Operator Instructions] I would now like to turn the conference over to your host for today, Dinos Iordanou and John Hele. Please proceed.

Constantine P. Iordanou
Chairman and Chief Executive Officer

Thank you, Jennifer. Good morning, and thank you for joining us today. We started the year with a mild reminder that cat [catastrophe bonds] risk is part of our business and should not be overlooked. With multiple cat, cat losses were above long-term average in parts of the globe, with the Chilean earthquake being the most significant event.

We fared reasonably well with our losses being slightly below that of industry averages. Our annualized return on average common equity was 9.8%, which in our view is not adequate over the long term.

As I mentioned in our call last quarter, given the current market conditions in which we're operating in, a 10% ROE for well-capitalized companies is a realistic return for the 2010 underwriting year, even though it is not what we desire to achieve. In a most important measure for creating shareholder value, which is our ability to increase book value per share, we had a much better result. At $76.91 per share, our book value per share increased 41% from a year ago and 5.3% sequentially from last quarter.

From an underwriting point of view, we achieved a 96.4% calendar year combined ratio, which is very close to a normalized accident year combined ratio, if you do the calculations. Cash flow from operations remain strong at $185 million, even though our book of business from prior years is maturing, our volume of business for more recent years has declined. And our mix of business is moving to more short tail than in the past. From a production point of view, our gross written premium was down 7%. And our net written premium was down 6.7%.

Insurance was down approximately 1% on gross, and up 2.6% on net written premium. Changes in the mix of business and reinsurance structure explain the increase in the net written premium. We retained more of our low limits Small Accounts business, as we continue to shift our book of business in that direction.

From a rate point of view for the first quarter, rates for all lines of business were down 2% in the aggregate. The area that we saw the most competitive pressure, it was Executive Assurance, with commercial D&O being affected the most.

Also, we have seen more competition in the property lines, with global property down 2% and E&S property down approximately 7% for the quarter. All of the lines achieved at least flat or slightly positive rate increases for the quarter.

Our Reinsurance volume was down approximately 17%, on both a gross and net basis. Most of the reduction was as a result of clients retaining more business net, and moving from quota share to excess of loss contracts, which although it may not affect the profitability of the business, it translates into less premium to reinsurers. Reinsurance rates and terms were generally stable, with renewal as expiring, the most common outcome. In the face of rate decreases, even though small on the underlying primary business together with claims inflation, we continue to see the deterioration in economics, both for us and our cedents.

In challenging markets, such as the one in which we are now operating, we're always more conservative in projecting the future erosion of economics over the business we underwrite in Reinsurance. And as a result, we're more cautious. In our Insurance operations, we can change our underwriting posture almost immediately, while in Reinsurance, we're making commitments for the entire year.

In our cat P&L deployment, we have committed slightly less so far this year. But depending on how market rates move, we intend to deploy most or all of our capacity by the end of the second quarter. On capital management, our capital management philosophy, which we believe is an integral part of managing through the cycles, has not changed. We intend to continue to return excess capital to our shareholders, as long as we do not see attractive opportunities to deploy it in our business.

In the first quarter, we repurchased 2.5 million shares at an average price of $71.65 for a total of $181 million. At March 31, 2010, we had $810 million authorized for future share repurchases.

Before I turn it over to John for more commentary on our financials, let me update you on our PML aggregates. As of April 1, 2010, our one in 250 PML from a single event was $719 million or 17.7% of common equity, down from $733 million at January 1, 2010. This PML and the comparison to the prior quarter is for Northeast win. And it was due in part of the seasonality of win programs. Our Tri-County Florida, which is usually our highest PML area, was reduced from $750 million as of January 1 to $674 million as of April 1. It was successful in deploying more PML. In the second quarter, we expect Tri-County, Florida to be our highest PML zone prior to the hurricane season as it has been in prior years.

With that, I'll turn it over to John for some more commentary. And when John is done, we will take your questions. John?

John C. R. Hele
Former Chief Financial Officer, Principal Accounting Officer, Executive Vice President and Treasurer

Thank you, Dinos. For the 2010 first quarter, premiums written by the Insurance segments represented 66% of our gross volume, and 59% of our net volume, about four points higher than the first quarter of 2009.

Property and other short-tail lines represented approximately 50% of our net premium volume for the first quarter 2010, about the same as a year ago. On a consolidated basis, the ratio of net to gross written premiums in the 2010 first quarter was 80%, the same as a year ago.

Turning to our operating results. The consolidated combined ratio was 96.4% for the 2010 first quarter compared to 86.7% in the 2009 period. The 2010 first quarter loss ratio of 63.9% included 8.7 points or $58 million, of current cat events, which were primarily related to the Chilean earthquake, compared to cat losses of 1.1 points or $8 million in the 2009 first quarter.

The 2010 first quarter combined ratio reflected 4.4 points or $30 million of estimated favorable development, net of related adjustments compared to 6.8 points or $48 million for the 2009 first quarter.

The prior year development in the 2010 first quarter primarily resulted from reductions in shorter tail property and property cat and other specialty reserves, along with continued favorable development in the Reinsurance segment, medium and longer tail lines from older underwriting years. These reductions were partially offset by an increase in the Reinsurance segment for casualty in the 2008 underwriting year, along with increases in the Insurance segment in a smaller number of high severity casualty claims from the 2003 and 2004 accident years.

The 2010 first quarter loss ratio also benefited from relatively light claims activity in non-CAT property classes. The 2010 first quarter underwriting expense ratio of 32.5% was three points higher than the 2009 first quarter, with a 0.5% decrease in the acquisition expense ratio and an increase in the other operating expense ratio of 3.5 points. The 2010 first quarter acquisition expense ratio was influenced by a change in the mix and type of business, as well as Reinsurance commission and also reflected a plus 0.5 point, due to net favorable development of prior year loss reserves, the same as in the 2009 first quarter.

The 2010 first quarter, other operating expense ratio, reflects the impact of lower end premiums in the Reinsurance segment, and approximately 0.9 points of expenses in the Insurance segment, which are not currently expected to impact the ratio for the balance of 2010, while the 2009 first quarter benefited from a higher earned premium base and approximately one point of reductions in compensation costs, which were non-recurring. Operating expenses also reflected costs related to the expansion of the Insurance segment's presence in Executive Assurance and Professional Liability lines, the expansion in Canada and the addition of the Lloyd's syndicate.

On a per-share basis, pretax net investment income was $1.67 in the 2010 first quarter, 9% higher than the $1.53 in the 2009 first quarter, and 7% higher than the $1.56 in the 2009 fourth quarter. The growth reflects the accretive impact of share repurchase activity on per share results.

Total return on the investment portfolio was 1.58% in the 2010 first quarter. Excluding foreign exchange, it was 1.98% in the quarter. This return has been accomplished, while maintaining our investment portfolio's average credit quality of AA+. Our duration remained basically the same at 2.77% at March 31, from 2.87% at year end.

Given the significant impact on insurance company of increasing interest rates, we continue to prefer a shorter duration versus the longer one. With our conservative investment outlook and low yields, we see new money, three-year duration investments at approximately 2.5% to 3.5%.

We were able to increase our participation in TALF, late in the first quarter, adding $153 million in assets, with the corresponding increase in TALF borrowings of $128 million. Our total TALF assets are now at $407 million, with a corresponding non-recourse loan balance of $347 million. There are also additions of $90 million to other investments, reflecting new multi-asset portfolios in energy and global investments to further diversify the portfolio. The combined total of other investments and equity method funds remains at 6% of the total investment portfolio.

Our balance sheet remains in excellent shape. And our financial flexibility remains strong, with total capital amounting to approximately $4.8 billion at March 31. Debt represented 8.4% and hybrids represented less than 7% of our total capital.

As of March 31, we continue to hold approximately $600 million to $700 million over our targeted capital level, based on current rating agency models with an appropriate buffer. Our liquid cash, short-term investments and U.S. Treasury security represent about 21% of our investable assets.

As Dinos mentioned, we bought back 2.5 million shares of our common stock under the share repurchase program in the first quarter at an average price of $71.65 or 96% of the average book value per common share for the period. This added $0.25 to book value in the quarter, and $2.52 on an inception-to-date basis.

Just to start the share buyback program in 2007, we repurchased 24.5 million shares for $1.7 billion. We remain committed to efficient capital and insurance cycle management, and continue to view buying back our shares when they trade below or close to book value, as the best way to use excess capital.

With these introductory comments, we are pleased to take your questions.

Constantine P. Iordanou

Chairman and Chief Executive Officer
Jennifer, we're ready for questions.

Question and Answer

Operator

[Operator Instructions] Your first question comes from the line of Jay Gelb from Barclays Capital.

Jay H. Gelb
Barclays PLC, Research Division

I was hoping to get a bit more color on a couple of issues. First, premium volume for the second quarter, if Arch intends to deploy the majority of its reinsurance capacity in the first half, first, should we expect a decline in premium volume in the Reinsurance segment, similar to what we saw in the first quarter?

Constantine P. Iordanou
Chairman and Chief Executive Officer

Well, we don't try to project, as you saw from my prepared remarks. It will depend the rating environment, what kind of deals we believe make the cut for us. But it's our intention to use our PML capacity between now and the beginning of the hurricane season. But there is a big if. I don't know where the market is going to go. Right now, we're anticipating a slight reduction in rates, maybe 5%, maybe 10%. And if it's 5%, we'll deploy more, if it's 10% maybe a little less. If it's more than that, we'll probably won't deploy as much. But I seize to be a predictor of the future a long time ago.

Jay H. Gelb
Barclays PLC, Research Division

Next, can you give us a sense of -- given where the stocks valuation is, how quickly you might finish up the remaining share buyback authorization? I believe you said $810 million?

Constantine P. Iordanou
Chairman and Chief Executive Officer

Well, in our usual style, and you've seen our performance, usually, fourth quarter, first and second is where we do most of our purchasing. We try to ride out the hurricane season because we have significant cat exposure there, and holding on to the capital to see how that happens. So we have no intent on changing that. And basically, depending where the price is, if we're trading at around book value, as John said, we'll continue to buy shares, and we'll try to buy the maximum that we're allowed on an average day.

Jay H. Gelb
Barclays PLC, Research Division

And then my final question is a bit more a big picture. Can you give us a sense of how you're thinking about what type of return on equity Arch can generate in the current environment, assuming maybe a bit more normalized catastrophe results?

Constantine P. Iordanou
Chairman and Chief Executive Officer

Well, we truly believe that we're around the 10%. Part of it is not because our business is not healthy. It's a little better than that. But we're carrying excess capital. So in essence, the ROE might be still adequate but they ease a little higher than what we will normally have. But when I look at our numbers and our mix of business, and I think we have a good mix, I think we're more weighted to short tail than long tail, and more to small accounts than larger accounts. I truly believe that's where we are as an organization. And it's the best you can expect in this market. I don't think this market, on a policy-year basis, is giving the industry the opportunity to do much better than that.

Operator

Your next question comes from the line of Josh Shanker from Deutsche Bank.

Joshua David Shanker
Deutsche Bank AG, Research Division

I was interested in your PML disclosure and wanted to find out whether or not coming into the upcoming season, whether you're preparing that, that might change again? Or what sort of are the drivers behind the adjustments in the PML?

Constantine P. Iordanou
Chairman and Chief Executive Officer

Well, because it's seasonal, there is more deals that expose us into the Northeast on the January 1 renewals. You saw that our Northeast exposure jumped ahead of our Florida exposure, especially Tri-County, which was always our peak zone. Because we deployed a little less PML in the first quarter, as I said, if all things being equal, we see the opportunities and what supply and demand the market might show us for the Florida season, probably we're going to increase PML in Florida, and then you know where our risk tolerance is. We will never go over 25% of common equity. But it's a big room between 6 74 [ph] and 25% of $4 billion. So we got plenty of room to deploy PML, it would only depend on market conditions.

Joshua David Shanker
Deutsche Bank AG, Research Division

And do you think, in terms of the early chatter that reinsurers might be able to extract a pound of flesh out of Chile? Or that there's more respect for the risk associated with earthquakes?

Constantine P. Iordanou
Chairman and Chief Executive Officer

Well, we've seen a little bit of movement in the Chilean market. As a matter of fact, I have an underwriting team from our Reinsurance Group going down there in the next couple of weeks to get our boots on the ground, so to speak, and see exactly, first hand, what's going on. But so far, it hasn't translate to great opportunities for us, even though there's a lot of talk in the marketplace. But we're looking at that. Unfortunately, we haven't seen the Chilean earthquake move attitudes in other parts of the world, as of yet.

Operator

Your next question comes from the line of Vinay Misquith from Crédit Suisse.

Vinay Gerard Misquith
Crédit Suisse AG, Research Division

A question on the range on some margins. Gross margins was really profitable this quarter, 49.1% accident year loss ratio x cat. Just wondering whether that's sustainable? And I believe you mentioned a higher profitability on the Fac [property facultative] business. So if we just normalize that, what should we expect it of, for the rest of the year?

Constantine P. Iordanou
Chairman and Chief Executive Officer

Well, our book of business is in the Reinsurance segment, is predominantly short tail. And we expect to underwrite that business to an 85% combined ratio or better. And sometimes we do a little better, sometimes we do a little bit worse, depends what happens with either regional cat activity or big cats. But on a normalized basis, that's not a bad number.

Vinay Gerard Misquith
Crédit Suisse AG, Research Division

Okay, so an 85 combined ratio for the entire range or in segment, correct?

Constantine P. Iordanou

Chairman and Chief Executive Officer

Yes, based on the mix of business we have today. And we don't see opportunities for that mix to be changing for the time being.

Vinay Gerard Misquith
Crédit Suisse AG, Research Division

And that excludes any favorable result development?

Constantine P. Iordanou
Chairman and Chief Executive Officer

Yes.

John C. R. Hele
Former Chief Financial Officer, Principal Accounting Officer, Executive Vice President and Treasurer

But as we mentioned last quarter, this is going to bounce around more given we're in shorter tail businesses now, property fac can have very low claims in the quarter, it can have some higher claims in a quarter from time to time. So you need really to think about this on a rolling four-quarter average or something versus any one quarter.

Constantine P. Iordanou
Chairman and Chief Executive Officer

Attritional losses might go up and down a bit. It's short tail. And you put some big limits out and occasionally, in one quarter, you might have. So I think the profitability we like -- the smoothness is not there, but who cares? We underwrite always for the long term. So that's where we focus our underwriters to be thinking about.

Vinay Gerard Misquith
Crédit Suisse AG, Research Division

And could you give us some color on the adverse reserve development on the primary Insurance segment, please?

Constantine P. Iordanou
Chairman and Chief Executive Officer

Yes, it's pretty simple. We had one account that we rolled a lead umbrella on $25 million in '03, $25 million in the '04. It was a product involved but I'll give you more detail that you want to hear. But that had phosphorus in it. It was in the market for 70 years, never had a problem. And then in -- I don't know exactly '07, '08 that there was starting to be some claims, some allegations that it was causing bladder and kidney problems to certain individuals. There were several lawsuits. We were defending those lawsuits. We felt pretty comfortable with the outcome. Unfortunately, the outcome went against us. So in essence, out of one account, we had a significant loss, a $50 million gross loss, and a net of about 50% of that, around $25 million. Having said that, instead of us trying to either reduce IBNR and all that, we took it as, kind of, a cat loss. And we reserved for it fully. And we let it flow through our books. The big question is, should our claims department would have put a bigger number earlier on or later? Listen, based on the facts of how we knew them and we were very confident both us and our client that we had a good case. Sometimes you lose good cases, and in this particular one, we've lost it.

Vinay Gerard Misquith
Crédit Suisse AG, Research Division

So just to get this right, you had $25 million adverse reserve development from that one case?

Constantine P. Iordanou
Chairman and Chief Executive Officer

Not entirely 25% because we had some reserves. Because he thought we might get a settlement. But we didn't think we're going to lose the entire amount for both years. And that was the outcome.

Vinay Gerard Misquith
Crédit Suisse AG, Research Division

When you enter your Primary Insurance business, you've been reserving it at a very high level. So I would've expected some amount of favorable reserve development. Is there any reason we've not seen that so far? Have you not looked at your prior years...

Constantine P. Iordanou
Chairman and Chief Executive Officer

Well, we don't look at every line of business, every quarter. So all of our casualty's are going to be reviewed at midyear. We do the reviews at midyear and year end. So whatever our triangles tell us, we'll take appropriate action in due time.

Operator

Your next question comes from the line of Matthew Heimermann from JPMorgan.

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

First, I did see conversation we've had around the accident year combined ratio and Reinsurance segment makes a lot of sense to me. I guess I'm struggling a little bit more with, given the commentary on pricing versus loss costs and primary insurance that the ratio there is maybe not deteriorating a little bit more than it has. And I guess, could you just talk to that? And whether or not there are any, I don't know, if maybe economic-related reserves or losses are fading and that's influencing that? But just any color on that would be great?

Constantine P. Iordanou
Chairman and Chief Executive Officer

Well, you saw us how conservative we are on the Reinsurance side. So we rather loose volume than really reduce margins significantly. Not that we're not trying to maintain volume, we try as hard as we can. But sometimes, we have a bit disagreement between what we believe the profitability of the underlying book is versus what our cedents believe it is. So you see us walking away from some business and, of course, sometimes and usually, some of our clients when they book a business, it's profitable. They retain more net themselves. So that's been our approach on the Reinsurance. Having said that, you've seen our mix starting to change. We're writing a lot less quota share, not that we're growing the excess of lost that much but in essence, as a ratio, that has been changing because we don't write as much quota share. We believe that we're maintaining margins and we keep looking at the accident year loss ratio in what we do by segment in the Reinsurance. And we feel comfortable with the numbers that we have.

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

I mean, with respect to the Primary segment though. I mean the Reinsurance, it make sense. I mean, if I look at the percentage of property and others have gone up, almost doubled. But in Primary, if I look relative to, like, the last three years, it hasn't changed all that much?

Constantine P. Iordanou
Chairman and Chief Executive Officer

Well, but don't forget, the mix has changed significantly, right? If you go in a supplement and you look where we're writing business, you will see that there is more Property, or short tail. There is more A&H. There is more of Professional Liability. All these segments, especially our Professional Liability Small Accounts, they have a much lower loss ratio. They do have a higher expense ratio. And that's why you see our expense ratio going up. It's the same thing with the Property. Property E&S business has a higher expense ratio because most of the business come from wholesalers. The commission cost is higher. So you have to go and analyze the book and the shift in mix that we have before you can see that our accident year loss ratio -- as a matter fact, our accident year loss ratio improvement this quarter versus maybe a year ago or a quarter ago, which is slight, is mostly because of the change in the mix.

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

With respect to the -- I just wanted to clarify something in Reinsurance and with the quota share in XOL or the less quota share. Is that primarily affecting the casualty writings? Or is there some impact on property as well?

Constantine P. Iordanou
Chairman and Chief Executive Officer

Well, property cat is always XOL, property other than cats. Sometimes we write at XOL, sometimes on a quota share. A lot of the casualty lines, especially excess casualty lines, we always like to write on a quota share. When cedents try to move it to XOL, we usually don't find an agreement, what is the proper rate. And for that reason, I think, we write a lot less than most reinsurers.

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

I think the increase in the privately held securities that was addressed in the quarter, what is it about those assets that you put them in privately held versus the equity method accounting?

Constantine P. Iordanou
Chairman and Chief Executive Officer

Well, John will give you an explanation.

John C. R. Hele
Former Chief Financial Officer, Principal Accounting Officer, Executive Vice President and Treasurer

As opposed to holding them in a mutual fund or something, we actually created a separate account. We're going to own the assets in our own account and we have an outside manager manage it for us in this sort of, specialty fund. But then, we have the book value accounting, we get the full investment income flowing through.

Constantine P. Iordanou
Chairman and Chief Executive Officer

You see, it's our preference not to be a participant in a fund. We like the manager and they're willing to do a segregated account for us. That's our preferred way of investing. And we're not always successful, but we always look for those opportunities. And where we find them, we do it in that fashion.

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

Am I right to assume that even though it's in that account for balance sheet presentation, it will get mark-to-market treatment on the income statement?

John C. R. Hele
Former Chief Financial Officer, Principal Accounting Officer, Executive Vice President and Treasurer

No, mark-to-market on the balance sheet.

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

Yes, but will that change in value fall through the income statement?

John C. R. Hele
Former Chief Financial Officer, Principal Accounting Officer, Executive Vice President and Treasurer

No. Only when assets are sold, or if a -- certain assets might, if they do some -- if they bought a derivative, it gives us a multi-asset. But there won't be much of that. But the domination of it will be realized P&L.

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

Is it actually private investment in private companies? Or is it broad PE portfolio?

John C. R. Hele
Former Chief Financial Officer, Principal Accounting Officer, Executive Vice President and Treasurer

It's a broad range of some energy, assets and also some multi-asset categories with another manager. That can also be a bit global in nature.

Constantine P. Iordanou
Chairman and Chief Executive Officer

But on a segregated account, it's only for us.

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

Are any of the underlying investments in publicly traded securities or...

Constantine P. Iordanou
Chairman and Chief Executive Officer

Yes, absolutely.

Operator

Your next question comes from the line of Mark Dwelle from RBC Capital Markets.

Mark Alan Dwelle
RBC Capital Markets, LLC, Research Division

I know on the acquisition costs a lot. That moves around as a result of mix. But are you seeing any significant changes just in the underlying rates that you're paying, in terms of the different...

Constantine P. Iordanou
Chairman and Chief Executive Officer

You mean commissions that we're paying, right?

Mark Alan Dwelle
RBC Capital Markets, LLC, Research Division

Correct, yes.

Constantine P. Iordanou
Chairman and Chief Executive Officer

Probably, it's costing us about -- forget about the mix change. Probably it's costing us about one point higher year-over-year. So I think we're compensating our producers a little better this year than we did a year ago.

Mark Alan Dwelle
RBC Capital Markets, LLC, Research Division

Is that both on the Reinsurance side, as well as the Insurance?

Constantine P. Iordanou
Chairman and Chief Executive Officer

Yes, I think there is pressure on both sides, ceding commissions ask and what we pay in Reinsurance, having inched up. And also commissions have moved up on the Insurance side too.

Mark Alan Dwelle
RBC Capital Markets, LLC, Research Division

And then the other question is, I'm sure you probably don't know amounts yet. But do you have any exposure on the Deepwater Horizon rig failure?

Constantine P. Iordanou
Chairman and Chief Executive Officer

Yes, we have some exposure. It's minimal. I think between Insurance and Reinsurance on the first-party covers, if it's a total loss like $800-plus million for the industry, it probably will cost us around $13 million. On the liability side, we have exposure excess of $0.5 billion. Too early to tell. First of all, it's a lot of issues as to, is the owner responsible or the operator, and how those contracts go, et cetera. But also is the third party a liability, which is mostly depending if they will pluck the well or not, and how much oil they'll be losing and will it get to the shore? Too early to tell about, if that is going to be a significant loss. The limits we have excess are $0.5 billion. And that's significant to really, to be a big event for us. But that's what we have and that's what we know so far about that platform.

Operator

Your next question comes from the line of Brian Meredith from UBS.

Brian Robert Meredith
UBS Investment Bank, Research Division

Dinos, can you talk about how you protect yourself in Florida in the Reinsurance business from credit issues from cedents? It wasn't a problem, right?

Constantine P. Iordanou
Chairman and Chief Executive Officer

Well, yes and no. It Depends whom you underwrite and what you do. We don't have a significant number of these, what we call monoline pops that might not be able to pay your reinstatement premium, et cetera. So when you're going to price or you're going to structure the deal, you've got to take that into consideration that, are you writing the business with the probability that if you have that event, if you're going to try to reinstate limits, you might not get the reinstatement premium. Because that's where most of your exposure is going to be. Of course, you might get exposure if you're trying to write it with installments, which we don't like to do. So there is a little bit of risk but it's part of the underwriting process, understanding what credit risk you have in a particular deal and how to deal with it. We don't write a lot of these small monolines. A lot of what we write in Florida that comes from the bigger companies and national programs.

Brian Robert Meredith
UBS Investment Bank, Research Division

Dinos, can you talk about any changes you've seen in the marketplace, in terms and conditions in the first quarter? I've heard from some other carriers that things started to weaken up a little bit more?

Constantine P. Iordanou
Chairman and Chief Executive Officer

Well, I just came from a nationwide trip. I've visited a lot of our branch offices just to stop being bored in Bermuda. So I visited the U.S. I'm scheduled to go to Europe in a week. The flavor of what I got in -- there's been more ask and more request for broadening terms. And I believe the E&S market is resisting it. They're losing business because of it. We've seen a more rapid movement of, either classes of business that in our view, of course, is a buyers view being an E&S writer belong in the E&S market, moving into the standard markets. And also, we see standard markets writing a broader contract with less exclusions on it. But it hasn't affected our book other than volume. And basically, I think, it might affect some that the standard markets are writing. But only time will tell if they're making the right calls or the wrong calls. It's not just price. It's ease of doing business, getting admitted paper and not having to collect surplus lines stocks and remit it, having a broader contract. Some of that business is moving to the standard markets. And I don't like it, but I know that the market won't turn until that happens. And it's always in my view a predictor that we're getting on totally the bottom of the market. And I think we had probably reached close to the bottom of the market. And at some point in time, it's got to go the other way because we've seen these kind of things. But it hasn't got as crazy as it was in '99, for example. This is not 1999 yet. We've got a little more room to go before we get crazy. But not a good market to operate in.

Operator

Your next question comes from the line of Dean Evans from KBW.

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

I just wanted to tie back a little bit to the discussion we had on the accident year loss ratio. We covered a lot on the Reinsurance side. Could you give a little bit of color, maybe on the Insurance side? That also seems, sort of, a bit lower than what we've seen for recent trend. Is there anything, one-off in there driving it or anything?

Constantine P. Iordanou
Chairman and Chief Executive Officer

Well no, it's in the change in mix when you add the components. As a matter fact, we have insured accident year anywhere from one to three points, depending on the line of business based on what we see from our rate monitoring systems. But the mix is changing by, what I said before, we're writing more a little more Professional Liability. We'll write a little more of A&H business. We're writing a little more of, even Executive Assurance, both in the U.S., a concentration in the not-for-profit or small account, D&O. And most of what we do in Europe is all in the SME, which has a lower loss ratio. So I think it's the mix that is causing it.

John C. R. Hele
Former Chief Financial Officer, Principal Accounting Officer, Executive Vice President and Treasurer

It's almost the same as it was in the fourth quarter, I think, if you look at the trend. And a year ago, there were some just one-time current year losses in there. I think, there's an aviation loss a year ago that booked it up a little bit.

Constantine P. Iordanou
Chairman and Chief Executive Officer

Right...

John C. R. Hele
Former Chief Financial Officer, Principal Accounting Officer, Executive Vice President and Treasurer

[indiscernible] different, really, between what we've been doing.

Constantine P. Iordanou
Chairman and Chief Executive Officer

And you saw we're booking it at about 72 or so thereabouts, which is what we believe our mix on an accident year is.

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

I guess I also wanted to touch on item that's a little bit less exciting now than it was maybe a year ago. But the bank loan pools? Can you just, sort of, give us an update on those? Where they're marked and, kind of, how those are playing out so far? Has it been active at all...

John C. R. Hele
Former Chief Financial Officer, Principal Accounting Officer, Executive Vice President and Treasurer

They have been performing extremely well in the quarter. We have still on our supplement on Page 16, the $4 million and $39 million and I believe they returned about 5% in the quarter. So they really had a solid return. These are senior loans. And as the global economy stabilizes, then these are going to be in continuing better shape.

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

At this point, how much -- I guess I'm just trying to get out how much upside is there really left in them? Or where are they -- do you know where they're currently marked?

John C. R. Hele
Former Chief Financial Officer, Principal Accounting Officer, Executive Vice President and Treasurer

Yes, we didn't print it in this supplement. It's around slightly over 80%, 85%. We'll see how the global economy goes.

Constantine P. Iordanou
Chairman and Chief Executive Officer

They're not at par yet. But they're very close to where we actually bought them. And we were buying these things at about $0.85 on a dollar. Before even we delever some of them. And when we delever, actually, our cost even went below that. So I don't know if there is a lot more upside to it but they're performing very well. Don't forget, we're clipping a pretty good coupon on these.

John C. R. Hele
Former Chief Financial Officer, Principal Accounting Officer, Executive Vice President and Treasurer

I'm personally not counting a lot of upside from this. But the good coupon, as Dinos said, and gives us some solid investment income.

Operator

Your next question comes from the line of Jay Cohen from Bank of America Merrill Lynch.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Question is on the Claims side. You look at your accident year numbers ex-CATS, and again, as a business mix shift. But clearly, there's no disturbing trend there. You're still seeing, at least, in the Reinsurance side, the favorable development. You take this data -- it appears as if the claims trends really haven't escalated yet. Is that an accurate assessment?

Constantine P. Iordanou
Chairman and Chief Executive Officer

Yes, I mean the trend is positive. If so, you've got to account for it. But when we see frequency and/or severity -- listen, forget about the one account that we slipped on a banana peel. Occasionally, it happens and it happened to us on that account '03, '04 writing. But other than that, we haven't -- I mean, I'm not seeing anything in the data that tells me that I ought to worry a lot about frequency or -- severity is going up. But it's part of the trend. And basically, we try to adjust our accident year projections in that combination where we see trends going from a claims trend, and also trying to factor in rate increases or reductions that we're getting. In a lot of our business right now, we're flattish, a little bit plus, at least for our book. Of course, as I said, Executive Assurance in the second quarter and Property brought the overall aggregated to a minus two. That's not a good number in a soft market to be still losing a little bit of rate. And then you have to make up for claims inflation for the trend. So things are getting slightly worse. The margins are getting slightly worse. But that's the environment that we live in.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Clearly, you guys are obviously -- as evidenced by the declining premiums, you're allowing business to go and instead buying back stock, which...

Constantine P. Iordanou
Chairman and Chief Executive Officer

Not easy to do, Jay. Sometimes, when I go home, my wife beats me up.

Operator

Your next question comes from the line of Ian Gutterman from Adage Capital.

Ian Gutterman
Adage Capital

First, can I get you to clarify, it sounded like you said that you have $500 million of liability on the oil rig. I assume you meant the market does?

Constantine P. Iordanou
Chairman and Chief Executive Officer

Yes. If the first party loss, which is over $800 million or so, goes, which we believe is probably a good outcome, our net exposure to that is $13 million.

Ian Gutterman
Adage Capital

Right, but on the liability, you said something about a $500 million? It sounded like you said that was your line?

Constantine P. Iordanou
Chairman and Chief Executive Officer

No, we were excess of an attachment point for $500 million.

Ian Gutterman
Adage Capital

And what's your line size on that?

Constantine P. Iordanou
Chairman and Chief Executive Officer

It's difficult on -- and the reason I'm hesitating is because, on the Reinsurance, I don't know how many of our clients they have at position yet. So very hard for me to count. But our limits of what we are line sized, when we participate in these treaties, they're small. So it's not going to be a significant event for us.

Ian Gutterman
Adage Capital

Just following up on the whole accident year topic, and I guess on the Reinsurance. That 85, sort of, normalized you talked about, what's the cat load involved in that?

Constantine P. Iordanou
Chairman and Chief Executive Officer

The cat load is about 18, 20 points, normalized cat load.

Ian Gutterman
Adage Capital

So I guess when I'm looking at your accident year, x cat, for the last several years, it's been in like the 83% to 85% range?

Constantine P. Iordanou
Chairman and Chief Executive Officer

Yes.

Ian Gutterman
Adage Capital

But you're saying, with cats, it's in 85%. No?

Constantine P. Iordanou
Chairman and Chief Executive Officer

Well yes, with normalized cat. That's what we expect. That's where we're pricing that business, yes.

Ian Gutterman
Adage Capital

But I'm saying, when I look at it x cats, right? If I look at your reported accident year x cats...

Constantine P. Iordanou
Chairman and Chief Executive Officer

In the Reinsurance side?

Ian Gutterman
Adage Capital

Yes, like the last four years: 83% in '06, 83% in '07, 85% '08, 84% '09?

Constantine P. Iordanou
Chairman and Chief Executive Officer

I don't get to those numbers unless you're looking at the total booking including the casualty book.

Ian Gutterman
Adage Capital

I'm looking at the Reinsurance segment. So you were just talking about the Property segment?

Constantine P. Iordanou
Chairman and Chief Executive Officer

That's correct.

Ian Gutterman
Adage Capital

I thought that 85% was...

Constantine P. Iordanou
Chairman and Chief Executive Officer

No. I hope we're that good, but I don't think we are. Just the Property, right.

Ian Gutterman
Adage Capital

And what sort of -- when I look at the accident year x cat this quarter, I mean, I think it's the lowest you've ever had almost. And I understand there were a lack of attritional losses. What's sort of like a normal attritional loss load?

Constantine P. Iordanou
Chairman and Chief Executive Officer

Well, I mean, we have a normal attritional, depending by class and all that, that we underwrite to. When we report numbers is whatever happens. In some quarters, it's a little less, in some quarters, a little more. We don't publish our numbers based on expectancy. We base our numbers on actuals, right? So I'm not trying to avoid your question. But if I'm writing, let's say, a homeowner's quota share with a cat load, maybe the attritional might be in the 30%, 35%, sometimes 40%, depending on what part of the country. And then I have a cat load that it might be, maybe as low as 15% or as high as 20%, depending if it's wind cat or it might be middle of the country and is more tornado/hail cats. So there is a lot of determinations that goes into our pricing when we price a particular line. And then when you aggregate all these deals, then you come up with your annual expected attritional for that year. And it might change your view the following year, because the deals change.

Ian Gutterman
Adage Capital

The reason I'm asking is...

Constantine P. Iordanou
Chairman and Chief Executive Officer

I know why you're asking, you want to build your model, right?

Ian Gutterman
Adage Capital

No, what's interesting is, pretty much everyone who's reported so far, has shown improved accident years, which -- and a lot of the arguments from most companies has been the attritional loss. But there's been other quarters. There's been light losses. And we don't see this kind of improvement. Given what's gone on in pricing over time, you would think accident years would be getting worse.

Constantine P. Iordanou
Chairman and Chief Executive Officer

Right, but don't forget a year ago, you're comparing me too. And we mentioned in our call, if you go back and look at the transcripts, we had unusually high attritional losses a year ago.

Ian Gutterman
Adage Capital

I'm looking at the trend, to be honest, not just a pure year-over-year. I'm just looking at where it is now versus the past four to six quarters. It seems everyone is doing better than that, which thinking where pricing has gone, you would think everyone would be taking to pick stocks [ph]?

Constantine P. Iordanou
Chairman and Chief Executive Officer

There is probably, everybody -- and we agree with that assessment on the -- let's face it, the Executive Assurance, the D&O were, probably had worse years in '07, '08 because of the financial crisis. '09 and '10, they're going to be better numbers. We might have disagreements, some they're more optimistic than others. But I think that has improved even though we're competing so hard with it. Maybe whatever improvement, we might be giving it back because of rate reductions. But we tried to see where that's going. But other than that, I don't...

John C. R. Hele
Former Chief Financial Officer, Principal Accounting Officer, Executive Vice President and Treasurer

And the shift from long tail to short-tail in Reinsurance is quite a big shift over the last three years. I mean, if you think of the mix, that's going to affect the current accident year loss PIK.

Operator

There are no further questions at this time. I would like to turn the call over to Mr. Iordanou for closing remarks.

Constantine P. Iordanou
Chairman and Chief Executive Officer

Thank you, Jennifer. Thanks everybody for listening to us. We're looking forward to talking to you a quarter from today. Have a good day.

Operator
Ladies and gentlemen, that concludes today's conference. Thank you for your participation. You may now disconnect. Have a great day.