S&P Global
Market Intelligence

Arch Capital Group Ltd. NasdaqGS:ACGL

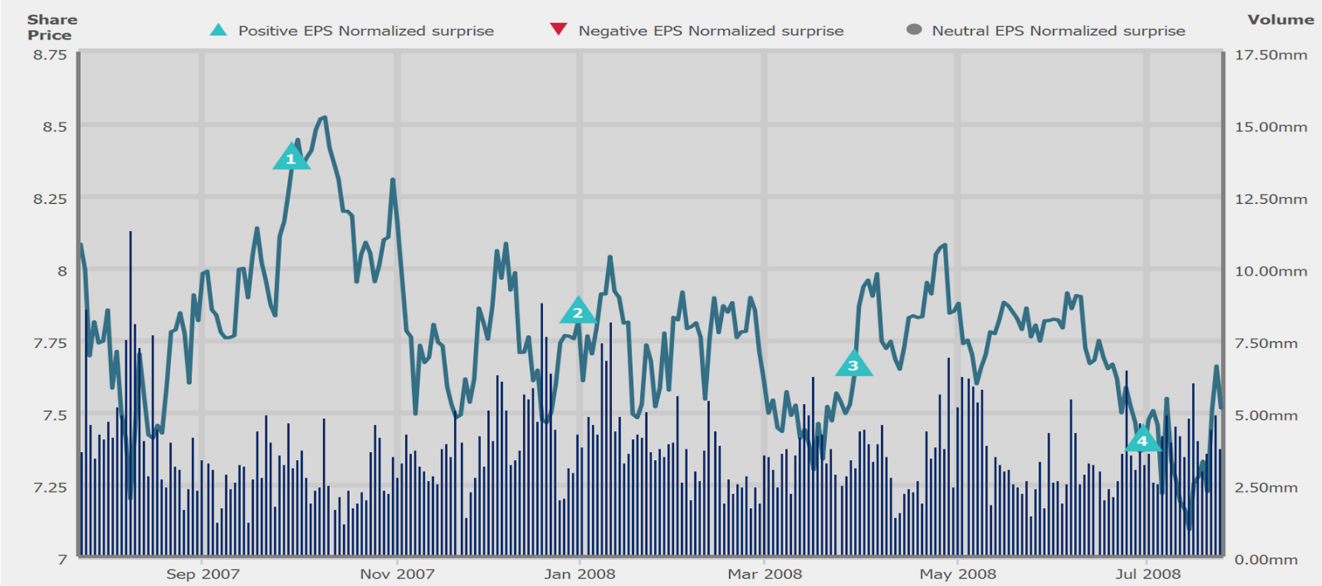
FQ3 2008 Earnings Call Transcripts

Friday, October 24, 2008 3:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ3 2008-			-FQ4 2008-	-FY 2008-	-FY 2009-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.07	0.11	▲57.14	0.29	1.02	1.10
Revenue	-	-	▲5.36	-	-	-
Revenue (mm)	657.44	692.69	-	562.23	2748.63	2602.05

Currency: USD
Consensus as of Oct-24-2008 3:56 PM GMT



	- EPS NORMALIZED -		
	CONSENSUS	ACTUAL	SURPRISE
FQ3 2007	0.26	0.32	▲1 33.33 %
FQ4 2007	0.31	0.35	▲2 12.90 %
FQ1 2008	0.30	0.31	▲3 3.33 %
FQ2 2008	0.29	0.31	▲4 6.90 %

Table of Contents

Call Participants

EXECUTIVES

Constantine Iordanou

John D. Vollaro

ANALYSTS

Brian Meredith
UBS

Ian Gutterman
Adage Capital Management

Jay Cohen
Merrill Lynch

Jay Gelb
Barclays Capital

Joshua Shanker
Citigroup

Mark Dwelle
RBC Capital Markets

Matthew Heimermann
JP Morgan

Ron Bobman
Capital Returns

Steven Labbe
Langen McAlenney

Susan Spivak-Bernstein
Wachovia

Thomas Cholnoky
Goldman Sachs

Vinay Misquith
Credit Suisse

Presentation

Operator

Good day, ladies and gentlemen and welcome to the third quarter 2008 Arch Capital Group Earnings Conference Call. My name is Sandy and I'll 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 today's conference. [Operator Instructions]. As a reminder, this conference is being recorded for replay purposes.

Before the company get started with its 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 assessment and assumptions and are subject in a number of risk 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 will also make reference to some non-GAAP measures of financial performance. The reconciliation to GAAP in 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.

I would now like to turn the presentation over to your host for today's conference, Mr. Dino Iordanou and Mr. John Vollaro. Please proceed.

Constantine Iordanou

Thank you, Sandy. Good morning everyone and thank you for joining us today. I'm sure you will all agree that the past few months have been challenging for all sectors of our economy, but more so in the financial services area. Entire fortunes have been lost and companies are only a few months ago were considered pillars of financial strength have either failed or forced to merge to avoid failure or require billions of dollars of government funds in order to remain in business.

The magnitude of the deleveraging of the global financial system and the speed in which is happening, is breathtaking. Given the difficult market conditions and the numerous pitfalls challenging the financial service industry in the past few months, we're pleased with third quarter performance.

Our annualized return on common equity was 7.6% for the quarter and 17.4% for the first nine months of 2008. Both the quarter and the year-to-date results were affected by the cat losses caused by Hurricanes, Gustav and Ike.

Book value per share was at $53.04, down from $55.12 as of the year end 2007, mainly due to mark-to-market adjustments on our investment portfolio. Over time, we believe that we will recover this temporary loss of book value per share.

Our net premium volume was essentially flat for the quarter, with insurance up slightly and reinsurance down slightly. Our cash flow from operations at $382 million in the quarter and $973 million on a year-to-date basis continues to be very strong. It not only provides us with a source of future earnings growth, it also reflects positively on the quality of our underwriting and reserves trend.

I might be stating the obvious, but in times like this, I would like to reemphasize what we are all about. We are first and foremost a specialty underwriting company with a deep bench of experience specialty underwriters and a broad distribution capability throughout the world. Our investment and capital management functions are there to support our underwriting operations by providing a strong and stable balance sheet with enough flexibility to allow us to take advantage of underwriting opportunities when they are available.

I would like to emphasize that this has always been our approach, not a recent reaction to the current environment. I believe we are on an inflection point in the cycle not dissimilar for those of us who are grey and old to the mid 70s when the stock market collapse created a hard market. The new realities in the financial markets need to be factored into our approach to the business going forward.

Capital is even more precious today and significantly more costly and the economic environment that we operate in is riskier today than yesterday. Our reselection, pricing and risk management practices much reflect these fundamental changes.

In both our underwriting and investment activities, we have always believed in taking a measured amount of risk and that approach has served us well in these difficult times. This quarter, we reported approximately $100 million in realized losses, most of which results from mark-to-market adjustments that reflects the current market pricing dislocation, and not our belief of the ultimate outcome. Having said that, to do our conservative approach our balance sheet continues to be one of the strongest and most flexible in the PNC specialty business. We're strongly capitalized, we've ample of liquidity and are ready to respond to any opportunity.

Now, a few thoughts on the current market conditions. The combination of the state of the financial markets, which has reduced the amount and availability of capital in the industry, and the acute financial difficulties that some major competitors find themselves in as a result of this, has began to affect market conditions positively. It is too soon to predict the level of correction or the velocity of correction, but we're encouraged by the early signs.

For example, in some lines of business, rate declines have become rate increases. Submission activity has increased significantly for us and we are sensing a flight to call by both customers and brokers. In addition, teams of experience and talented underwriters are becoming available as they see career opportunities with strong and stable careers. Further, changes in the valuation of many companies will also create buying opportunities.

Our views on expanding our business have not changed. We continue to prefer in order of importance, one, growing our business organizationally through our existing staff. Two, adding underwriting capabilities to them through the acquisition of teams and book of business, and three; when it fits our previously discussed criteria through acquisition.

Given the appropriate opportunity, we will utilize all of the above to expand our business. Yesterday, we announced that my good friend and partner and current CFO, John Vollaro will have a new role with the company starting April 1, 2009. His contributions to me as a partner and to Arch and its shareholders were invaluable.

But I'm pleased also... I am also very pleased that under his new assignment as Senior Advisor to Arch, we will continue to benefit from this wisdom, experience, knowledge and advise for at least the next three years and beyond, and I wanted to be a long beyond the three years.

I'm also very pleased John Hele has accepted our offer to join our organization on April 1st 2009 as our next CFO. John as CFO of ING is leaving a great position with one of the largest financial institutions in the world. His and his finest desire to relocate back to North America as well as the quality of Arch as an organization allowed us to attract such a high caliber individual. I'm looking forward to working closely with John for many years to come.

Before I turn it over to John and you are getting confused by how many Johns we have, for a more detail commentary on our financials, let me update you on the PML aggregates. As of October 1st our one in 250 PML for a single event expressed as a percentage of common equity was approximately 25% of equity with Tri-County, Florida and Northeast windstorm continuing to be the largest exposed zones. The increase from our last report which was at 23%, was entirely due to the reduction of common equity this quarter. John?

John D. Vollaro

Thank you, Dino and good morning everyone. Before I briefly walk through the key components of our financial results, I would like to add Dino's comment on yesterday's release.

First of all, I would like to express my gratitude to Dinos and the Board for giving me or being at an advance stage the opportunity to continue to contribute to Arch's future success, something I am highly confident of. For those of you with whom I worked over the past seven years, I've enjoyed the experience immensely and I hope that we can continue our relationship in my new role.

I'm also pleased that we're able to bring a highly qualified individual, John Hele into the company and I look forward to working with him to ensure a smooth transition to the CFO role.

Now, let's get back to the business at hand. Dino has commented a little bit on premium volume, but as usual, there are a few additional noteworthy items. On a trailing 12-month basis, premiums written by the insurance segment represented about 69% of our gross volume, and 60% of our net volume, while property and other short tail lines continue to represent about 44% of our net premium volume.

On a consolidated basis, the ratio of net to gross written premiums in 2008 increased to approximately 77% from 70% in the 2007 quarter, primarily as a result of the non-renewal of the Flatiron treaty. On the reported basis, we see today de minimis amount of written premium to Flatiron in the third quarter of 2008 compared $51 million in the prior year quarter.

On an earned basis, premium ceded under this treaty amounted to $26 million for the third quarter of '08 in comparison with $68 million ceded during the 2007 third quarter.

The overwrite in estimated profit commission recorded on the treaty with Flatiron are reflected as a reduction of the acquisition expenses of the reinsurance segment, which improved the expense ratio of that segment by 110 basis points in the 2008 quarter while the effect on their expense ratio in the comparable 2007 period was 260 basis points. The change in ceding commission was primarily due to the lower level of earned premium in 2008 and the effects of claims from Hurricanes, Gustav and Ike on profit commissions.

The unearned premium of business ceded to flatiron was approximately $35 million at September 30, 2008, most of the ceded yet to be earned at a related fees including profit sharing if there is any, will be reflected in earnings primarily in the fourth quarter of this year.

Turning to our operating results, our consolidated combined ratio was 105.3 in the 2008 quarterly period, which was 20 points higher than the comparable 2007 quarter. 2008 underwriting results include 19 points of estimated claims of catastrophic events, primarily Hurricanes, Gustav and Ike.

The 2008 cat losses were 17 points higher than in the comparable 2007 period. In addition, the loss ratio was affected by an increase in several large individual risk losses primarily in shore tail lines as well as to an increase to our loss from intermediate and long tail term business. This was partially offset by an increasing demand of favorable reserve development, net of related adjustment which totals $55 million in the 2008 quarter and $50 million in the third quarter of 2007.

Approximately 57% of the net favorable development in the 2008 quarter was from short and medium tail lines. In general, reported and paid claim activity across most lines of business continued at better than expected levels and IBNR and ACR remained at approximately 73% of total loss reserves at quarter end.

The consolidated expense ratio was 30 basis points higher on a quarter-over-quarter basis, due to a slight increase in the acquisition expense ratio. The operating expense ratio on a consolidated basis was unchanged as a decrease in the reinsurance segment's ratio was offset by an increase in the insurance groups. The increase in the insurance segment's operating expense ratio primarily resulted from charges of approximately $5.7 million or 80 basis points on the expense ratio for costs incurred in connection with actions that have been undertaken as part of an expense reduction initiative.

Turning to investment results, in the 2008 quarter pre-tax investment income per share rose by approximately 14% on a quarter-over-quarter basis to $1.86. On a sequential basis, net investment income per share increased by 5%. The increase in net investment income per share on a quarter-over-quarter basis was primarily due to a higher level of average investable assets. This growth resulted from the continuation of the strong cash flow from operations.

This quarter's cash flow brings total float produced since the recapitalization of the company to approximately $9.6 billion. After reflecting share repurchases and financial market turbulence, which I will comment in detail in a moment, investable assets on a reported basis declined slightly to approximately $10.1 billion at September 30 and the portfolio remains very well positioned.

Taking into account yields, realized and unrealized losses in certain investments that we account for under the equity method, the total pre-tax return on the portfolio excluding the effect of foreign exchange movements was a negative 2% for the third quarter of 2008. We've excluded the foreign exchange adjustment in this calculation because most of the investments in foreign securities are held as a hedge against our insurance obligations denominated in foreign currencies, and for which there is a corresponding credit in earnings.

The average credit quality of the portfolio remained high at AA plus and the reported duration remained relatively short at approximately 3.4 years. The portfolio continues to be comprised primarily of high quality fixed income securities with essentially no investments in hedge or private equity funds, and no direct exposure to public equity securities.

In addition, we have no CLOs, no CDOs or credit default swaps in the portfolio. We have is, we have done over the past several quarters included additional information on the ABS, MBS and CMBS portions of the portfolio. In addition, we have added a schedule of our 10 largest corporate names in our bond portfolio. We hope that this data is useful to you, and I encourage you to review it.

We have also provided in the release a rough estimated total return of the portfolio through October 22. Please note that this estimate was derived without the benefit of our quarterly controlled procedures and therefore maybe subject to significant variability. As I'm sure you know, credit spreads have continued to widen this month and this was the primary driver of the month to date return.

Our balance sheet remains in excellent shape, and our financial flexibility remains strong with total capital amounting to approximately $4 billion at quarter end and with debt in the hybrids representing less than 20% of total capital. The hybrids are all perpetual preferreds, while our revolving credit borrowings mature in August of 2011 and our long-term bonds mature in 2034.

We began the year with a significant level of excess capital and at September 30th, we continue to hold a comfortable cushion over the capital required to maintain our current ratings. Our liquidity is also at a very healthy level. As cash, short term investment and treasury and agencies securities represents about 22% of investable assets. In addition, we currently project that the fixed maturity portfolio will generate cash from income maturities and collections of approximately $400 million in the fourth quarter of 2008 and $1.5 billion in 2009.

Our strong capital and liquidity positions should allow us the necessary flexibility to take advantage of insurance market and investment opportunities that may arise as a result of the chaos that continues to affect financial markets.

With respect to capital management, during the early part of the third quarter of 2008, we repurchased approximately 1.9 million common shares for a consideration of $124 million, which represents an average price per share of roughly $66.14.

For the quarter, share repurchase net of accretion reduces book value per share by approximately $0.40. Since the inception of the repurchase program in the first quarter of 2007, total share repurchases have represented approximately 85% of our net income during that period. We currently have approximately $450 million remaining under our current share repurchase authorization. However, given current financial market conditions and the potential for attractive opportunities in the insurance market, we are currently taking a wait and see approach to further share repurchases.

In summary, for the first nine months of the year, our operating return on equity was 17.4%. Our book value per share as a result of the extreme financial market conditions declined 4%, including the effects of share repurchases and 1% excluding them.

And with that, we'll open it up to questions.
Question And Answer

Question and Answer

Operator

Ladies and gentlemen. [Operators Instructions] And your operation comes from the line of Joshua Shanker of Citigroup. Please proceed.

Joshua Shanker
Citigroup

Good morning, everyone.

Constantine Iordanou

Hi, Joshua. Good morning.

Joshua Shanker
Citigroup

In terms of the first question I have is, look, we're getting a lot of very positive commentary on the insurance space. In terms of allocation for 2009, when would you have to decide how much capital you want to allocate towards insurance versus reinsurance and sort of set your business mix up for the upcoming opportunities?

Constantine Iordanou

I mean the opportunities, there on both sides. We see opportunities on the insurance side, but also we see significant opportunities in the reinsurance side. In a time that capital is precious, reinsurance is a form of capital for some of our customers and we're going to take advantage of both opportunities.

The flexibility you get with Arch is that even though we're a significant company when it comes to management, we are a closed group that we can make adjustments literally on a week or monthly basis. So we're going to react to the opportunities and what the returns are going to be based on what we believe the better opportunities and that's where we're going to put our capital.

John D. Vollaro

Josh, one of the things, again to go back to that Dinos mentioned earlier. We haven't changed our view of world since day one and on day one, we believe this was cyclical business, and so we structured the company in a manner that we can actually... the capital can be allocated. It's very, very easily. There's no need to move capital among units in order to support the writings.

Joshua Shanker
Citigroup

Okay. And then the question I would have at that point is looking back at the peak of the last hard market I guess, let's call second half of '04? The company's premium surplus levels around 1.5 times. Not to say that we're predicting a revolution in the world of insurance and reinsurance here. But do you think that where you are right now, at below 0.721 you get above one within a year, I mean if opportunities present themselves, can you deploy that capital that quickly?

Constantine Iordanou

Well, if the opportunities are there, yes, absolutely. At the end of the day, it has to do with what's available, how can you get it and at what prices are you going to get that business. But we have a lot of room on the balance sheet for us to take advantage of that.

Joshua Shanker
Citigroup

Okay. And then finally, I was pleasantly surprised with the results from the equity ownership and the bank loan portfolio. I must admit, I was little worried about it going in. How is that performing and it's surprising that it's better than I thought? Could you talk about a little bit more about that?

John D. Vollaro

I thing you remember about that... and that's not say that it's not going to subject to the volatility we're seeing in the marketplace. But there is two components of it. One is income and then one is movement. And these are floating rate loans, floating over LIBOR. So you have some dramatic moves within LIBOR which has moved the income as well as the other side of equation. And that's not to say, Josh, that in the fourth quarter we can't get some volatility on that book of business.

So, the spread duration is shorter, which helps, number one. But having said that, there could be some more volatility there, we still sort of like the underlying assets either secured assets, so whatever you're... our view in general is, which we have some direct corporate exposure, which most corporates are unsecured as opposed other forms of loans which have hard assets specifically backing them. We sort of like that equation.

Joshua Shanker
Citigroup

Okay, very good. Well, John, privileged on the new move, I hope as a senior advisor, we will be seeing plenty of you in the future.

John D. Vollaro

Thank you.

Operator

And your next question comes from the line of Susan Spivak of Wachovia. Please proceed.

Susan Spivak-Bernstein
Wachovia

Good morning. I echo the comments, I'm glad to still be working with you. I was just hoping Dinos and John, you could give us just a little more color on what's going on with the whole impact of the follow up from AIG and some of your specific markets? Are you getting significant increases in submissions? Is it more that you are hiring the teams of people or just give us an update of what's going on?

Constantine Iordanou

Well, I don't this call to be about AIG, I want it to be about Arch.

Susan Spivak-Bernstein
Wachovia

Of course but --.

Constantine Iordanou

It's all of the above. Let me start with the business first. We've seen increased inquiries and submissions in our reinsurance business as people were looking for more capacity especially for January 1. That's why in my prepare remarks, I was more cautious because there's a lot of time between now and January 1. So, we don't know where that goes, but is encouraging. And also we got significantly more submissions in our insurance operations. Yes, we are in discussions with underwriters and teams and they're not specific from AIG. I don't want to make this, let's attack AIG. That's not what is all about. But people in general, they're looking for opportunities and if you are a strong company we are or you have perceived to be a strong company and we are that too, people send their resumes to us and of course, we always look to add to our capability.

The other thing that works in our favor is that, we're distributed and we have quite a few offices in strategic locations, where some of the major competitors that they're having difficulty there. And it makes it easier from the perspective that some employees might come and work for us. And the only thing they have to do is get out of the same subway station and/or same bus. And instead of going in one building, they are going across the street.

So that makes it easy without relocation et cetera, et cetera. So, I think we're well positioned. We're not going to do it in a wholesale matter. We've got or estimate as to what the market opportunities are. But anytime, I can get my hands on talent, we will always do that because talent in the end is going to make you a winning company.

Susan Spivak-Bernstein
Wachovia

All right. That's great. Dinos, thank you so much for the answers.

Operator

And your next question comes from the line of Vinay Misquith of Credit Suisse. Please proceed.

Vinay Misquith
Credit Suisse

Hi, good morning and John congratulations on your move.

John D. Vollaro

You can't get rid of me, Vinay. You can't get rid of me.

Vinay Misquith
Credit Suisse

No, we're happy that you are with the firm. Dinos, a question to you on the opportunities on the primary insurance versus reinsurance. So, first of all, some one speculated that this is more of a reinsurance hard market than a primary insurance hard market. So, if you could comment on that, number one. Number two is, that the AA rated reinsurers are saying that this is a flight to quality therefore business should come to us. You are A rated reinsurer though, I mean... my assumption is that you are better than that. But just in terms of the business you're getting versus the AA reinsurer. Do you think it's more of a primary insurance play for you than a reinsurance play?

Constantine Iordanou

Well, as I said, is both on the insurance side is not across the board, is not yet on small accounts et cetera but is on larger accounts and specialty accounts that you don't have a lot of participants, especially with some companies that they're in difficulty that they were dominant. So that's what we see and we're starting to see that on the insurance.

On reinsurance, we are pleasantly surprise, is more of a capital issue for some of the cedents and they're anticipating that maybe they want to have all the capital that they will need... the capital markets are close to everybody. So in essence, their only avenue to capital is through reinsurance and we see that.

Now, the other part of your question was on ratings. And I don't want to really try to diminish what the rating agencies do. I always try to keep great relationships with them. But the market is responding in an unusual way in my view on ratings. There are companies that they have higher ratings than us that their paper might not be acceptable to some companies or companies wouldn't write excess of them et cetera. Where our paper even though is A across the board from A.M. Best, S&P and Moody's is readily acceptable to us. As a matter of fact, our reinsurance brokers you know do not hesitate to send us additional submissions because what perceive to be a very strong carrier from a financial prospective. And hopefully, over time the rating agencies will recognize that. But like I said, they have their hands full with a lot of other issues to be focusing on Arch.

John D. Vollaro

And, again not to go overboard on the rating agencies, but I think recent events toward a lot of people that just looking at ratings is not really the way to go. We buy as well as sell reinsurance, and I know on our committee, we just don't look at ratings. Ratings went back there, but we're going to look at a whole lot of other factors and essentially come up with our own rating in terms of who you will use when we buy reinsurance? So I'll tell you, we haven't seen it. We're seeing people come to us. We're perceived as one of the stronger, more stable companies, so I think that is more important to have that perception than to have a rating in this environment.

Vinay Misquith
Credit Suisse

Fair enough. And John for you on the large loss activity. If you could just gives us a number on that and the primary insurance side and because the accident to your loss ratio

John D. Vollaro

It is about... it's probably about 5 points in the loss ratio.

Vinay Misquith
Credit Suisse

Okay 5 points and so should we look at it more of a one-time item or

John D. Vollaro

Well, that's the question we always ask ourselves. You can get severity happening in any given quarter on large limit losses and the question is, is that indicative of something or is it going to quiet down in the fourth quarter. We believe it will quiet down in the fourth quarter, and so it shouldn't repeat itself but we'll have a better handle on that in three months.

Vinay Misquith
Credit Suisse

And one last question, if I may. So it seems that business is wanting to move, do you see a trend in terms of higher pricing too on the business that is moving?

Constantine Iordanou

Yes. I mean basically the market is not responding to the movement of business at the same expire rates. And as a matter of fact, that's one of the reasons that you have not seen a lot of mid-term cancellations because there is a short rate penalty they have to... the 10% on the earned premium plus potentially a readjustment to the price because the carriers that you're going to move it to and it's not just only us, it is other companies, they're looking for better pricing. The combination of that caused some insurers to wait until anniversary to move their business. But we sensed that early on from the submission uptick on the activity. We got submission activity that is much higher. In a lot of our sectors in the insurance school and we measure that on a weekly basis to know this allocation of resources and where do you put emphasis. So it is that improved pricing.

Vinay Misquith
Credit Suisse

Now was that because that business was under priced relative to your ratings or do you think that there is now more of an opportunity, so people want a better price?

Constantine Iordanou

Well, It depends on your return characteristics. Our return characteristics is 15% on ROE. So, in essence, we look into price the business with that kind of a return characteristic. And as I said in my prepared remarks, we got to also readjust now. Cost of capital is, has gone up significantly. And the environment that we operate is riskier. Riskier from the perspective that a lot of our insurers they're going to be under the same financial pressures that a lot of the businesses as they're going through. And now that reflects to, is it less maintenance if you're issuing credit products like surety or others. You got to be more vigilant about the availability of credit and what it does to your customers.

So we're operating in a riskier environment and you got to make adjustments. The beauty of Arch is that we're still nimble as a company and we can deliver these messages to our underwriting staff very, very quickly and make those adjustments. Now, will the market respond to our needs, that's a totally different question.

Early on, for me to have a definite answer to that. Hopefully by the next quarter, I will have more tangible evidence. We like the taste of what's happening. This is the buzz around it. It's not a lot of accounts that we have bound with significant rating increases, in order for us to say this is really a change. It's science, the positive early on. We need another quarter before we know.

Vinay Misquith
Credit Suisse

Sure, that's great. Thank you.

Operator

And your next question comes from the line of Matthew Heimermann of JP Morgan. Please proceed.

Matthew Heimermann
JP Morgan

Hi, good morning everybody and best wishes, John. Is it you wanted to stay or just can't get away?

John D. Vollaro

I am sorry, would you repeat that Matt?

Matthew Heimermann
JP Morgan

I said that was it did you want to stay or you can't get away?

John D. Vollaro

I guess it's a combination of both. He's a lot bigger than I am. I have a change in garage. I definitely would... I wanted to stay obviously. That was I was kidding. And I'm really pleased that Dinos is willing to put up with me for a few more years here.

Matthew Heimermann
JP Morgan

Well, hopefully, we won't make it too hard on you. I guess I had really just one question and that question was clearly you would think about the look of the company in the past hard market, much more casually focused, the property exposure was less of an issue from a leverage perspective and it would seem for you to broad turn that clearly those other areas could lever it for you very quickly. My question is just how big of a constraint is PML to really taking the property business for it to that's kind of first opportunity that presents itself? Particularly given what you wanted to do with the fac business already?

Constantine Iordanou

Well. We have risk management principles that would have kind of violate. I never wanted... I don't really care how attractive the opportunity is. That if you get it wrong, you can really kill the company. I don't think AIG would have been in a place they are today if they had a little more worry about the downside risk than just purely focusing on the upside risk.

The one major lesson that I learn when I worked for Buffet, when I was at Berkshire Hathaway, and he once told me, he says, he say, son, spent 95% of your time worrying about the downside risk and only 5% about the up, and if you do that, that things will work out. So we... the 25% of equity rule is a very good rule for us. Monos, they are not... they have no precision that we can feel comfortable with so you got to have a little bit cushion around that et cetera. So that I don't think we're going to change our posture to that.

Having said that, we're still a big participant in that market and within those limitations, we'll try to take as much advantage if it as possible.

John D. Vollaro

Matt, it's... given what's going on in the market, I think it's a function there we are making sure, we get the return opportunities within the capital linked to allocate, they give us the best returns. So I think... and I think we won't be alone in that. I think a lot of people going to sit back and say the cost of capital has gone up and I want to allocate the capital I've available to this area to the best possible returns.

Matthew Heimermann
JP Morgan

Yes, that's fair. The other... I guess the one follow-up I'd have to that then is, one of the factors that I see as compelling to why certainly in the reinsurance and property areas, the reinsurance market that you get increases all of the capital markets decline. I kind of wanted to ask a question about contingent capital or non-traditional capital support to you and maybe not to just similar to Flatiron. But how willing... how practical in this environment are those type of vehicles to assist companies like yourself in expending your appetite without exceeding risk?

Constantine Iordanou

I mean if we can recreate it, we will do it. But I can tell you in the state where the capital markets are, we don't see an avenue to it. I mean I'm not so sure that even cap bonds, they're going to be a relief to the need. And don't forget that the excess, the perceived excess surplus that the industry have, it might disappear between the third and fourth quarter through mark-to-market adjustments. It could be in the aggregates somewhere between $50 billion to $100 billion of adjustments to balance sheet. Yes, they might be temporary, but when you look... for everybody looks at their year end capital they have available to operate, and how the rating agencies are going to look at it. They are going to be less capacity in the marketplace and that's what we believe they want one renewals. I think they're going to be better renewals than a year ago.

John D. Vollaro

Yes. I mean we're probably well positioned than any one to do that if it was possible. We're certainly not counting on it. I think it's... given the difficulty for capital to be... the excess capital, it's pretty unlikely that you're going to see a lot of sidecar capital coming to the business.

Matthew Heimermann
JP Morgan

Okay, that is what I thought. But I appreciate the color and the thought behind it. That's all I have. Thanks very much guys.

Constantine Iordanou

Thank you.

Operator

And your next question comes in the line of Jay Gelb of Barclays Capital. Please proceed.

Jay Gelb
Barclays Capital

Thank you. First, I have a question on capital management. Should we take your commentary on share buybacks to mean that we shouldn't be modeling in any share buy backs for 2009?

Constantine Iordanou

If you tell me where the market is going to go, I can answer the question. If my thesis proves to be correct, that if the market will improve significantly, that's a good assumption. Our first preference always is to take all of our excess capital and deployed in the business at acceptable returns. That was our thesis from the beginning. When we are unable to do that, then we say the best place for that capital is to go back to shareholders.

So, it's kind of a chicken and egg question. If I have clear vision that I can utilize our capital into and deploy it in our business at attractive returns, that's where the capitalist is going to go. That's what we get paid, we get paid as underwriters and if we find underwriting opportunities with good returns, that's what we should be doing and we shouldn't be worrying about share repurchases.

On the other hand, if the market doesn't respond in the way I would like it to and I believe it will, then we can always go back and buy shares back. So very, very hard for us to predict the future and it's very hard, that's why we have new guidance and that's why we can't help you with your models.

Jay Gelb
Barclays Capital

Okay. And then separate issue on looking at the investment marks on page 12 and 13 of the press release, can you talk about your comfort level? If I am reading it right, CMBS portfolio market about $0.97 and the asset-backed securities, the main portion of it the autos, credit cards, reduction bonds and the other, the sum total of that market $0.97. Just kind of give where we are in the market?

John D. Vollaro

We talk about this all the time and we're looking at this all the time. So we are pretty comfortable with the quality where we are and we've stressed that most of this. Interesting in it, in October, our RMBS was actually was one of the... to date in October anyway, RMBS was doing much better than many other sectors of the spread market. CMBS did come under some more pressure. But if you look at as opposed to focusing on marks, I think one of the reason the marks are where they are is when you look at some of the metrics behind them such as the loan to value and the subordination, you can see these securities at least the once we have, we feel we are in a pretty good shape.

The ABS for instance, we've looked at scenarios where you got a really unemployment on credit cards for instance. You could double unemployment and it wouldn't have any impact even on the over collateralization that protects you. So you got to go three-fourth x on unemployment from where we are, to really impact these securities. The short duration, the throwing off cash to continue to throw off cash, so we feel pretty good about the ABS, the MBS and the RMBS in the portfolio.

Jay Gelb
Barclays Capital

Okay, thank you.

Operator

And your next question comes from the line of Tom Cholnoky of Goldman Sachs. Please proceed.

Thomas Cholnoky
Goldman Sachs

John, I guess you'll be able to hit them a lot further and straighter now?

John D. Vollaro

Obviously, if that happens, I'll be really pleased but I'm not betting on it.

Thomas Cholnoky
Goldman Sachs

Dinos, I wanted to go back and talk to you about acquisitions and just trying to get a sense from how we should think about your appetite and also your ability to finance. I guess what I'm getting at is, you know how big of an acquisition you could make. Second, as you acknowledge the capital markets are not very accommodating right now, if this were something beyond your immediate cash available, the available cash you have, would you consider issuing stock or just talk a little bit more in detail about that and also from an accretion standpoint, with something have to be accretive immediately or would you be willing to have something to be not accretive right away?

Constantine Iordanou

Well, let me start by stating the obvious. Acquisitions is the third in order of importance in our slate book, how to grow the business. Number one is organic, number two finding teams of book of the business, and number three is acquisitions. Having said that, yes, we understand our limitations. Our balance sheet is strong, it has excess capital but it is not significant to make a large acquisition. So if it is small because it is just a unique opportunity, we will probably can do it and pay cash. If it is larger, meaning in excess over $1 billion or $2 billion, in essence then we have to issue stock. It got be a stock.

But having said that, in my view, it has to be accretive. We will not... we have a company that has a very strong balanced sheet with a lot of clarity to it. We got to go through the four factors that really get us excited on acquisition. Number one, it fits the business model we have; number two, it's strategic, meaning is in the lines of business we want to be. Number three, we can see through the balance sheet and then number four the culture has to be similar to ours. And at the end we look at the price and the price has to make sense.

In a market like this, you never know what opportunity might show up. We're not spending a lot of time and effort in trying to be pick out acquisition opportunities. I think we're spending a lot of time and effort trying to expand our business more in the traditional fashion. So organically, you're finding some teams and enhance products that we have and distribution and underwriting capability in the marketplace. But I wanted you all to know that if given the right opportunity, we will not take acquisitions off the table.

Thomas Cholnoky
Goldman Sachs

Are there any assets of AIG that you might be interested in?

Constantine Iordanou

Well, so far, the only... to our understanding, in our sector, they only put out to us, they are 59% of Transatlantic and we believe the Hartford steam boiler, it will be coming up shortly. We'll look at them, but it's a lot of factors. It depends, of course, Hartford steam boiler much better asset than Transatlantic because of the structure et cetera. Transatlantic is a more difficult transaction because it's only the 59%. I'm not so sure they want to sell the whole company. It's a more complicated situation. But we'd probably take a look at both.

Thomas Cholnoky
Goldman Sachs

Okay. Great, Thank you.

Operator

And our next question comes from the line of Brian Meredith of UBS. Please proceed.

Brian Meredith
UBS

Yes. Good morning everybody. John, I'm glad that you're sticking around for a little longer here.

John D. Vollaro

Thanks Brian. You didn't hear, Brian, a lot longer.

Brian Meredith
UBS

A lot longer, a lot longer, that's great.

John D. Vollaro

Please bring it up, it keeps getting longer.

Brian Meredith
UBS

It get longer and longer. Like I said, did you lose the bet with Dinos. Let's see. Dinos, question here loss cost. If I think about the last couple of cycle turns that we've had, and one of the key ingredients there was that you had acceleration in loss cost and you had balance sheet that were overstated because reserves were obviously very deficient. I'm wondering what component that could have in the cycle turning? Can we really get a hard market here without that component and then maybe you can refresh us on what happened to the 1970s.

Constantine Iordanou

Let's start with the 1970s. I was a rookie and went behind the years then. But I'm a student of this business, so I'd like to understand why cycles happen and what was them, et cetera. There was less regulation in the insurance business in the 70s, meaning that there was no difficult rules from a statuary point of view as to how much in equities you can hold in your investment portfolio.

A lot of companies that will quote with significant investments in equities, we had the market correction in 73, 74. Literally, companies went to sleeve writing 2:1 and they woke up writing 4:1. So at the same time, loss ratios, they were deteriorating. So the balance sheets, they were viewed solid because the asbestos environmental issues, they were not yet in the horizon.

But overnight, the market really chine and 75, 76, 77 they were very good years in the insurance business and in my view the market turning was because not just loss cost was going up and the loss ratio is starting to inch up, because the active side of the balance sheet was remarked and a lot of capital went out.

Now, today I think what you said is absolutely correct. The company that's coming all out of a hard cycle, the cycle actually starting to turn in the last probably 10 quarters or so with rate reductions, call it, 2.5 years it depends by line. We're starting to see accident year loss ratios to inch up to the point that most companies barely have the ability to have adequate returns and most companies have stated returns anywhere from 10% to 12% ROE to 15% over a long period of time, and the business without a correction it was performing in my view in the low double-digit area.

So we're having a little bit of a sign that loan scores is going up, but there was excess capital and for some companies as you see with reserve releases, they were on strong reserve repositions. But all that is changing for two reasons. One is that your ability for the asset side of the balance sheet to contribute significantly is not as good as it was in prior cycles because interest rates are going to be very, very low. And two, overnight in two quarters, we might lose the perceived excess capital. So to me, it has a lot of similarity to what happened in 73, 74 and what emerges as a good three years after that.

John D. Vollaro

Brian, Let me just add because unfortunately as I admitted earlier, I am a lot older than he is and so I actually went through that period. But two things to keep in mind vis-à-vis this cycle versus the ones you are kind of used to, which were driven more by far more results rather than anything else. One is as of the beginning of the year, and I am not sure as it is updated but believe or not, the industry had just short of

$300 billion in the stock market. So that's a big number, that's going to come out of capital accounts for the industry as a whole.

The second which is different, and I did go through that and Dinos hit it right on the head. It wasn't pricing per sale that was purely capital this time, it is their first time that I can remember this really happening, capital availability is severely constrained. So that in my view has an impact on how people think, so there's the pure capacity that's represented by capital and then there's the willingness to use capacity and the fear that what happens if something goes wrong. So I'm not saying that's necessarily going to drive it but those are factors I think you have to take into account when you sort of look at the entire mosaic or what it is that changes a market.

Brian Meredith
UBS

Okay. And then last question here kind of adding on to Tom's question about M&A and then even just generally capital and ability to get capital. What you all willingness to potentially tap your original founders or partner for some opportunities in your capitals? That's maybe one area you can actually get capital for acquisition or to really ramp up growth.

Constantine Iordanou

I think, I can speak at least for Halman and Warburg which we know them well environment et cetera. I think they think that, I hope they still think highly of us. At least last information I have, they think highly of us. And yes, that's an avenue for us and there might be other private equity firms given the right opportunity. So, it has to do with the opportunity we can find a capital. What the course of that capital is going to be and what alternatives we have. And you factor all that in or you may get decision.

Brian Meredith
UBS

Great. Thank you

Operator

And your next question comes from the line of Mark Dwelle of RBC Markets.

Mark Dwelle
RBC Capital Markets

Yes. Good morning, gentlemen. A lot of my questions have kind of already been covered. But I had one another additional point I wanted to touch on. When you described your PMLs, both of the higher risk items you have mentioned were both wind related. Do you have a level of PML exposure to things like quake or is that dissimilar?

Constantine Iordanou

Yes. We measure a lot of different PMLs. A quake PML is significantly lower than the 25% of common equity. I don't have the number right in front of me but it's probably in the 16%, 17% or thereabouts.

Mark Dwelle
RBC Capital Markets

Okay, thank you. And then the second question I had, several of your lines particularly the construction is very economically sensitive. Have you seen any particular fall off in demand in that area just as it relates to as an economic influence?

Constantine Iordanou

Yes, in different sectors. In the construction business, we do two things. One is we write a lot of I would say, medium size business, but for us the large accounts or larger contractors on a loss sensitive basis. In essence, they take big deductibles of big self insured retentions for their programs. There, we haven't seen any reduction of opportunities. Yes, maybe their payroll is going down a bit and maybe they have a little less activity et cetera, but also the result that carriers that they're having difficulty that they were in that sector and in essence for us, its creates opportunities because it's not because the sector itself is growing, but the movement from one carrier to the other gives us the opportunities.

Where we've seen significant reduction is on the Orizon [ph] contractors we write on the surplus line spaces. And there we have seen and as you can see our casualty volume on the insurance group is down like 40% or so. And some of it is coming from that because we sensing significant reduction in work in those sectors. I'm talking about the electricians and plumbers and dry wall guys et cetera that if one, it was competitive as of few months ago and we didn't like the pricing so some of it was our own underwriting posture that caused us to write less. But also we've seen less activity of that.

Mark Dwelle
RBC Capital Markets

Okay

Constantine Iordanou

And the one I was relating to residential.

Mark Dwelle
RBC Capital Markets

Okay. Thank you.

Operator

And your next question comes from the line of Ian Gutterman of Adage Capital. Please proceed.

Ian Gutterman
Adage Capital Management

Thanks. First, I had to say I was very surprised when I read the release yesterday. I think you looked a day over 63.

John D. Vollaro

Thanks Ian, with friends like you.

Ian Gutterman
Adage Capital Management

Dino, it's about the market. I mean, all the things you said and for why the markets are harder, it make a lot of sense and I agree with every one of them. My concern is that when did annuals don't go down without a fight and the early reports of AIG is being aggressive in places to defend their tariff and when business is moving because of that business is moving without price increase or at least in certain areas. So, I guess my questions is will we have the next call on January, what are the chances that we hear you come back and say, we tried to get pricing and we need pricing but between AIG being competitive and a few of our competitors getting weak in the knees, and not holding the line and just trying to take business from AIG lines and take it with a price increase, things didn't turn out the way we hoped.

Constantine Iordanou

Well, that's one of the possibilities. Ian, we've seen some defensive moves by some of our less fortunate competitors in trying to hold on to the business and they do it through price. But how long can you continue to that? If your digits come to be correct and there is a possibility that's what plays out, I think the cycle will deteriorate, but it will come out of it with more velocity in a shorter period of time.

We never tried to predict the future. It is very hard for us to predict the future. So give our operations to be more responsive to the opportunities, respond to what the market gives you. And if we got to do less, so be it. And we're not ashamed to report 5%, 10%, 15% reduction in volume, if it is the right thing for us and our shareholders and we can grow by 20%, 30% or 40%. We will do that also independent that we get criticized sometimes by the rating agencies.

Ian Gutterman
Adage Capital Management

Do you think... again, and I'm hoping it doesn't, but if that scenario plays out the way I suggested maybe it could, what's your appetite? I mean if we are getting pricing similar today, is that worth growing given as you said, what the... how about with the cost of capital and the risk investment portfolios and--

Constantine Iordanou

No, we want to grow and we believe we are returning at least 15% return on equity. So on the capital committed, that's what we want to do. If that doesn't happen, where my share price is, I'll take our excess capital and buy myself back through share repurchasing rather than trying to chase business that it gives me single-digit ROEs. I'm not in that game.

Ian Gutterman
Adage Capital Management

Do you think most of your book today on an accident year basis, is priced at 15 ROE?

Constantine Iordanou

On average, there is... some above and some below, but on average, I think my book of business is around that. Yes.

Ian Gutterman
Adage Capital Management

So to grow the book then, you need pricing to go up and if pricing stays you'll probably stay about flat.

Constantine Iordanou

Yes.

Ian Gutterman
Adage Capital Management

Okay. So do you think that again going back to the scenario I laid out where things don't materialize, we hope at Jan 1. Could this be something like what we in property after Katrina where January 1 was disappointing, but then the momentum built throughout the year as the capacity shortfall became more apparent?

Constantine Iordanou

Listen, I can give you... we're trying to predict the path of the hurricane. I mean sometimes, this...

John D. Vollaro

Ian, if you recall because you were roll over it back in '01 as we went into '02, we started in property and the velocity of the price changes really in casualty didn't really start to come until you got to the middle of '02 and towards '03. So it may sort of roll as you suggest, my roll by one, is going to depend.

Constantine Iordanou

It depends what people fill in their buckets. And when... you have shortage of available capital capacity. People I don't think they are going to help rate on the basis. You see two months ago, everybody was operating on the basis we have excess capital. So whatever we can write is not a problem. There is not a capital issue here. So, I can write as much as I want, in any sector I like. I think you'll going to see more rationing now. And anytime you ration those capital decisions, prices go up and I'm expecting that. If it doesn't happen, we'll go back to the all played book, being conservative.

John D. Vollaro

In certain areas of reinsurance business, we are seeing sort of the different mentality among the brokers. You know it's no longer change totally from things have to go down to things are going up. So, I mean there's another anecdotal evidence but the proof will be in the pudding and as Dino said, we prefer to act on actual observable data rather than try to prognosticate what's going to happen.

Ian Gutterman
Adage Capital Management

My final question, why I was leading with all those is, again if we don't see things up as much as we like in January, would it make sense for you guys actually go for your insurance book to start buying a lot more reinsurance knowing that, it's reasonably priced right now and if you have the courage and conviction that this market needs to hard in, you go by the reinsurance now and the when things harden later in the year, you've locked in what will then be cheap reinsurance to grow your insurance progressively?

Constantine Iordanou

You're making a presumption that reinsurance, bunch of dumb people around. I haven't seen a lot of them. I compete with them and I think the reinsurance market is being very disciplined and at the end of the day, you buy reinsurance because you want to manage horizontal and vertical accumulations, not because you want to arbitrage. And I don't think there is that significant arbitrage in the reinsurance business. So if that happens, of course we'll... I always want to buy things cheaper and cheaper, but that's not a big part of our strategy.

Ian Gutterman
Adage Capital Management

Okay.

John D. Vollaro

And our sense is right now that that's not what's going on the reinsurance market.

Ian Gutterman
Adage Capital Management

Right. And to ask the arbitrage means, so much that it is poorly priced business that's pre-launch for arbitrage meaning that if that turns out to be a great market opportunity, you're going to want as much capacity as you can get. And one of the ways to do that is to buy reinsurance before the pricing of--

Constantine Iordanou

Yes. They may have a different view of what kind of returns they want and what their cost of capital is than we do. That's possible. And if that's the case, then we're certainly not afraid to buy reinsurance.

Ian Gutterman
Adage Capital Management

Okay. All right. Thanks guys. I appreciate it.

Operator

And your next question comes from the line of Ron Bobman of Capital Returns. Please proceed.

Ron Bobman
Capital Returns

The long wait. Congrats. I just want to check Dinos when Buffet made that statement to you, did he start out by saying, son?

Constantine Iordanou

I don't recall exactly what he said, but I

Ron Bobman
Capital Returns

It was 1987 or 98.

Constantine Iordanou

I was much younger, I was 37 and I have... I don't know how much you know about Mr. Buffet. But he is... for his employees, he's always... he treat them like father. If he likes you and I hope he did like me of the 5 years that I worked for him. He always give me very, very good and solid advice and I listen to every word he said.

Ron Bobman
Capital Returns

I am sure it is a treasured experience. I have a question about the implications for reinsurers of book of business, primary business that was underwritten by a company in distress and sort of what are the implications for the reinsurer the performance of that in-force book, the ongoing assumption of business for current treaties and freshen that sort of on an ongoing basis. What are the thoughts that practices the limitations their vulnerabilities to reinsurers that have that situation of it, of a distressed ceding company?

Constantine Iordanou

Well. You always worry about... don't forget, independent if you are on a prorate or on excess of loss, at the end of the day, you... the performance of the claims department that is going to handle the claims from the primary insurer will determine the outcome for both, you and the cede. And usually, companies who are in distress and they start losing personnel, so in essence the aggregate quality of that personnel diminishes, it doesn't fare well for their book of business, how he is going to perform and also you participating on that book as a reinsurer what portion of that loss is going to come to you. It is always a concern to us and we look at it, we audit and we try to make sure. But in general terms, that usually what happens.

John D. Vollaro

I mean, it's Ron, it's part of the underwriting process, is going to evaluate how solid the company or underwriting is. Sometimes you can protect yourself somewhat in terms and conditions reinsurer structure things, but it is important underwriting consideration when you're evaluating whether or not to reinsure some one.

Constantine Iordanou

Right. In some cases it works into your favor, and I have seen it on companies watch surely when under, so they were in liquidation where if losses there significantly higher, particular claim is significantly higher that the guarantee fund protection, which starts at $300,000, the liquidator will get a better settlements because of the fear that if the claim and wage out towards the end, you might get nothing versus a partial payment. And I've seen that happen but that's more real if get a company that were in the end you go at a $10 million claim. And you don't know if this is going to be enough funds for you to get you $10 million, you might settle for $5 million or even less, just to get an early resolution for that before the money runs out. But there is always negative to be in that position.

Ron Bobman
Capital Returns

Okay. How about litigation, claims that are in litigation obviously being reviewed I don't know by a jury or a judge, do you think the popular press and the coverage of AIGs was on average result and litigation outcomes worse than they would otherwise have accomplished by virtue of--?

Constantine Iordanou

It is very hard to predict that. Don't forget 98% of claim activity is only a very small percentage that gets adjudicated. And so, I can't talk on behalf of how juries would think, but it's not going to change the dynamics significantly.

Ron Bobman
Capital Returns

Okay. Thanks again and John, best of luck and thanks for everything you contributed. Much appreciate it.

John D. Vollaro

Thank you.

Operator

And your next question comes from the line of Steven Labbe of Langen McAlenney. Please proceed.

Steven Labbe
Langen McAlenney

Hi guys.

John D. Vollaro

Hi, Steve.

Steven Labbe
Langen McAlenney

John, I'll reiterate the last comment.

John D. Vollaro

Thank you.

Constantine Iordanou

Hello?

Steven Labbe
Langen McAlenney

Hi guys. John, I'll reiterate that last comment. Thank you very much and congratulations.

John D. Vollaro

Thank you.

Steven Labbe
Langen McAlenney

I was wondering if in your risk management committee as it relates to your own reinsurance buying, if you've made any changes recently in the list of your acceptable partners.

John D. Vollaro

Luckily for us, we've been very, very particular in terms of that list, particularly where it would pertains to any kind of business that's got any kind of a tail to it. So we have in to make any major changes but as I said, we've always been proactive. We've always paid more attention to all the factors surrounding the company's financial health, not just its credit rating or financial strength rating. So we haven't yet to do that, but we're always watching very, very carefully. We meet every single quarter and we'll review everybody on the list.

We've always tried to take a pretty measured approach to how much reinsurance recovery we want from anyone named regardless of how strong we perceive them to be. So we're in pretty good shape. I know other people have taken some of the people you might be alluding to of their list. I mean, we've seen some people not only have they come off the reinsurance list, but other people won't write excess of them in an environment like this because they're afraid of the drop down problems that when a company that's primary has problems and you've written excess over them that causes or can cause problems for the excess carriers. So we look at it, we look at reinsurance, we look at who we write excess over and we try to be proactive instead of reactive.

Steven Labbe
Langen McAlenney

Is there a... recognizing your earlier comments about the rating agency, is there a minimum rating that you have regardless of again your comments earlier?

John D. Vollaro

Yes, We'll start with the rating but the rating won't... you might have someone with a high rating. And we might limit the amount of business we're going to do with them or not do business with them at all.

Constantine Iordanou

Or the classes.

John D. Vollaro

Or the classes or you might someone else where and we've have instances, I won't name names where we with the rating was fine but we looked at the balance sheet and it wasn't the right side of the balance sheet that caused us concern. It was the left side of the balance sheet that caused us concern. So, we did business with them but only on the basis of so we would have security. So, where we have concerns, our view has always been if we can get security that helps us keep the portfolio diversified from a reinsurance standpoint. But we're not going to, one, we are not going to put all our eggs in one basket, but we're also not going to accept people on the list for the benefit of diversity, if we're not comfortable with the underlying credit.

Steven Labbe
Langen McAlenney

Okay. Thank you very much.

John D. Vollaro

Thank you.

Operator

And your next question comes from the line of Jay Cohen of Merrill Lynch. Please proceed.

John D. Vollaro

Jay you're the last one.

Jay Cohen
Merrill Lynch

Well, I don't need... my questions have actually been answered, but I feel like I should say congratulations to John and just say you've been a great spokesman for Arch and you have done a great job as Chief Financial Officer. I think I speak for everyone, when I say we learnt a heck of a lot from you over the years and last when I make it. I think the transition here is pretty impressive. It looks like... I don't know John Hele very well, but his credentials are quite good and I think it was managed remarkably well. So, that's it.

John D. Vollaro

Well, thank you very much. And on John Hele, you can talk to some of your maybe older Merrill colleagues; they might remember him because he worked there for a while.

Jay Cohen
Merrill Lynch

Absolutely.

John D. Vollaro

Good. Thanks, Jay.

Constantine Iordanou

Thank you. Operator, I think we have no more questions.

Operator

Thank you. There are no more questions.

Constantine Iordanou

Okay. We appreciate everybody, giving us the opportunity to share our thoughts with you today and we're looking forward to seeing you in three months. Have a good afternoon.

Operator
Thank you for your participation in today's conference. This concludes the presentation and you may now disconnect. Have a great day. .