S&P Capital IQ

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Arch Capital Group Ltd. NasdaqGS:ACGL

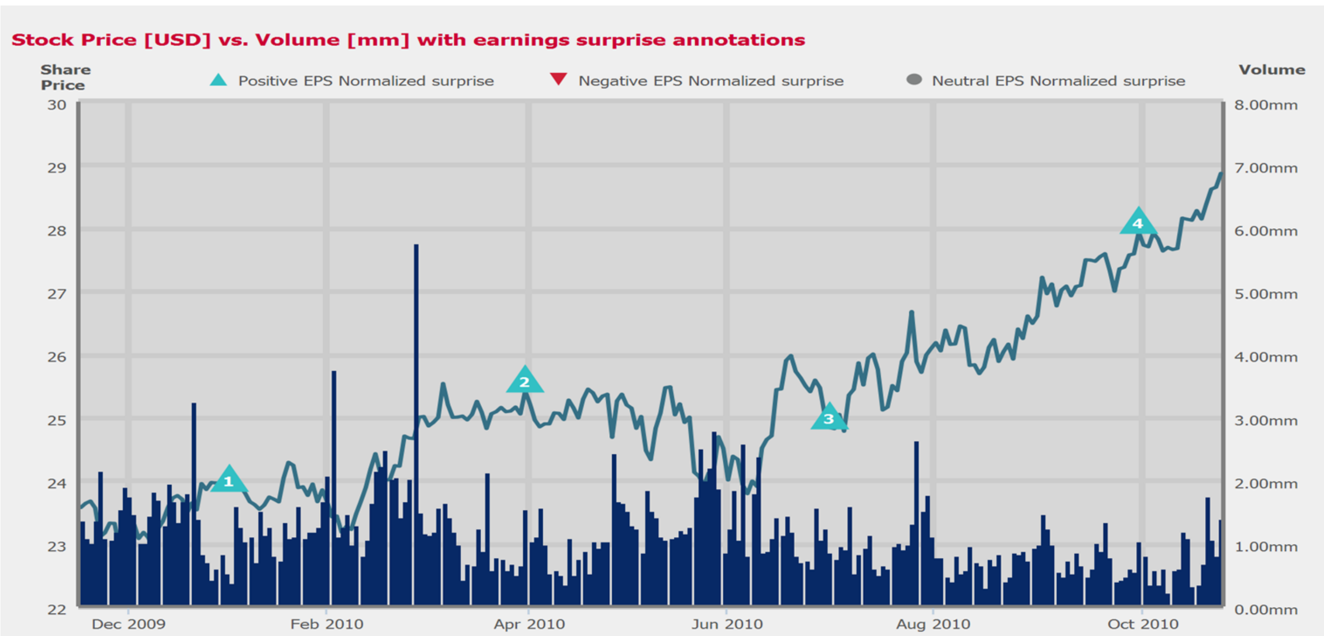
FQ4 2010 Earnings Call Transcripts

Tuesday, February 15, 2011 4:00 PM GMT

S&P Capital IQ Estimates

	-FQ4 2010-			-FQ1 2011-	-FY 2010-	
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	ACTUAL
EPS Normalized	0.79	0.86	▲8.86	0.71	3.11	3.12
Revenue (mm)	551.46	632.15	▲14.63	705.12	2649.33	2552.48

Currency: USD
Consensus as of Feb-15-2011 3:22 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ4 2009	0.84	0.89	▲1 5.95 %
FQ1 2010	0.53	0.59	▲2 11.32 %
FQ2 2010	0.77	0.83	▲3 7.79 %
FQ3 2010	0.71	0.85	▲4 19.72 %

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

Gregory Locraft
Morgan Stanley, Research Division

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Adage Capital

John Arthur Hall
Wells Fargo Securities, LLC, Research Division

Joshua David Shanker
Deutsche Bank AG, Research Division

Mark Alan Dwelle
RBC Capital Markets, LLC, Research Division

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

Vinay Gerard Misquith
Crédit Suisse AG, Research Division

Presentation

Operator

Good day, ladies and gentlemen, and welcome to the Fourth Quarter 2010 Arch Capital Group Earnings Conference Call. My name is Alicia, and I'll be your operator for today. [Operator Instructions] Before the company gets 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 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 these 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 reconciliations of 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 is contained in the company's earnings press release and is available on the company's website.

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, Alicia. Good morning, everyone, and thank you for joining us today. Our performance for the fourth quarter was reasonable as we continue to operate in a challenging underwriting environment.

Our annualized return on average common equity was 12.1% on a reported basis, which in our view is acceptable for current market conditions. These returns, which were aided by favorable prior year reserve development, were not significantly affected by cat activity, as the combination of major cats plus attritional cat losses approximated the expected cat load for the quarter.

The Australian floods impacted the fourth quarter by $22.5 million, while our early estimates for the 2011 Australian floods and Cyclone Yasi are estimated to impact the first quarter of 2011 by $30 million to $60 million in the aggregate. By our own estimation, in the current insurance and investment environment, on a normalized basis, we're achieving approximately a 9% ROE on business written in the 2010 underwriting year. This return, even though it does not meet our long term target of 15%, is realistic, given the operating and financial market conditions that exist.

As you all know, our target over a complete cycle is to achieve a 15% ROE, and all of our incentive compensation targets are based on that metric. We still believe that in the long run, the target is achievable. And as a company, we have chosen not to make any changes to this rate due to the current environment.

In terms of creating shareholder value, we believe that our ability to increase book value per share is the most important measure. And in this respect, we had a good result in a very challenging investment environment.

Viewed against a backdrop of a significant increase in interest rates in the fourth quarter, our investment returns were excellent. And combined with adequate reported operating returns on our underwriting activity, book value per share grew to $89.98, which is an increase of 23% from year end '09, and 1% from September 30, 2010.

From an underwriting point of view, we achieved a 92.7% calendar year combined ratio, which by our estimation, is five to seven points better than our normalized accident year combined ratio of 98% to 100%.

Cash flow from operations remained good at $145 million, which is down from $184 million from a year ago. The lower level of cash flow was affected by a reduction in exposure and premium writings, as well as from the maturation of claims from early accident years that had bigger exposure base.

Another factor influencing cash flow, emanates from our movement to our short-tail lines over the past several years, which has an effect on claim payment patterns. In essence, it accelerates the payment patterns significantly.

From a production point of view, our gross written premiums were down 8%, and our net written premiums were down about 6%. Our reinsurance operations were down 13% on a gross written and 12% on a net written basis. Our insurance operations were down 6.3% on a gross written and 5% on a net written basis.

During the fourth quarter and in our January 1 renewals, we saw no significant change in market conditions in our Reinsurance business. We continue to see pressure from seedings to increased seeding commissions, and in general, saw a reduction in primary rates of approximately 5%. We also noted that clients are continuing to look for opportunities to switch some pro rata contracts to excess of loss in order to maintain a larger amount of net premiums on their books.

In our cat opportunities, the anticipated introduction of RMS 11 had no noticeable effect on either demand or pricing as of yet. However, in anticipation of the model changes during the January renewal period, we adjusted our pricing for certain non-coastal exposures in anticipation of the rollout of RMS 11.

Even in the most difficult markets, we always look for opportunities to find acceptable books of business to underwrite without sacrificing underwriting discipline. On January 1, we were successful on medium-tail opportunities, as we found that the improved pricing levels will produce acceptable risk-adjusted returns, and we took advantage of those opportunities.

Our Insurance Group continues to emphasize and move their book to less volatile lines and to reduce their writings in U.S. casualty business. Despite these actions, due to the challenging market conditions that exist, margins generally continue to be under pressure. And as a result, we saw a reduction in writings in our Insurance Group. We are pleased with these actions, as underwriting discipline will always take priority over premium production.

In the primary casualty E&S sector in the U.S., we are starting to see isolated areas in which price increases are demanded and achieved by the market. These increases are specific to certain classes and territories, but it is an indication to us that the bottom may have been reached for this segment and underwriters are not willing to go further down in pricing.

Having said that, looking at price adequacy on an absolute basis, it does not appear that the pricing corrections are enough for us to be interested in significantly expanding our book of business. As we indicated in the last quarter call, third quarter share repurchases were relatively light due to the hurricane season. As you know, we accelerated our share repurchase activity in the fourth quarter of 2010, and we purchased 2.9 million shares for $258.2 million, which represents an average price of $89.23 per share.

Also, during the first quarter through February 11, we have invested an additional $140 million for 1.6 million shares at an average price of $87.87 per share. With these repurchases, our remaining available authorization is $90 million. And in light of that, we expect to review our share repurchase program at our next board meeting.

I would like to emphasize that our capital management philosophy has not changed. We will continue to return excess capital to our shareholders until such time that we can profitably deploy it in our business.

Before I turn it over to John for more comments on our financial results, let me share a few thoughts on our cat writings and PML aggregates. As of January 1, 2011, our one in 250 PML from a single event was $733 million, or approximately 17.5% of common equity, down from $809 million as of October 1, 2010.

Our Northeast wing area PML is now the largest PML exposure at $733 million, down from $756 million as of October 1, 2010. The PML for the Florida Tri-County area now stands at $683 million, down from $809 million at October 1, 2010. Both zones are significantly below our self-imposed limitation of 25% of equity. John?

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

Thank you, Dinos. Good morning. I will now cover some of the financial highlights of the quarter. For the 2010 fourth quarter, property and other short-tail lines represented approximately 48% of our net earned premium volume compared to 47% in the 2009 fourth quarter.

On a consolidated basis, the ratio of net to gross was 72%, the same as a year ago. Our overall operating results for the quarter reflected a combined ratio of 92.7% compared to 88.8% for the same period in 2009. The 2010 fourth quarter loss ratio included $31 million, or 4.9 points, of current accident year cat activity compared to $3 million, or 0.4 points, in the 2009 fourth quarter.

Fourth quarter current year cat activity was primarily related to the Queensland Australia floods totaling $23 million and attritional property cat events in the U.S. of $7 million. In the 2010 fourth quarter, development on cat events from earlier in 2010 were negligible, with a $9 million increase in the 2010 third quarter New Zealand earthquake event, substantially offset by reductions and estimates for the Chilean earthquake and windstorm Xynthia of $8 million.

The impact of the Australian flood events and Cyclone Yasi are still preliminary in developing. And as Dinos mentioned, beyond the $22.5 million already booked in 2010, the range we are estimating at this time for 2011 is from $30 million to $60 million based on a total industry estimated loss of $3 billion to $5 million for the aggregate Australian floods, and a total industry estimated loss of $500 million to $1.5 billion for Cyclone Yasi.

The 2010 fourth quarter combined ratio reflected 6.1 points, or $39 million, of estimated favorable development net of related adjustments compared to 2.3 points, or $16 million, in the 2009 fourth quarter. The prior development in the fourth quarter 2010 reflected net favorable development primarily in property and other short- and medium-tail lines, as well as in the reinsurance segment casualty business from the 2002 to 2006 underwriting years.

For the 2010 full year, our net favorable development impacted the combined ratio by 5.4 points, or $138 million. We compare it to 6.4 points, or $183 million, for the 2009 full year.

The 2010 fourth quarter current accident year loss ratio, excluding large cat events and net favorable development, is about the same as the year ago, which reflects the overall change in the mix of business away from U.S. cash re-writings where we have increased the current accident year loss picks to shorter and medium-tail business that have relatively lower current accident year loss picks. It also reflects the shift during the last several years in the Insurance segment from larger comp business, which has a higher current accident year loss pick to smaller account business, which has a lower current accident year loss pick and less volatility but a higher expense ratio.

The 2010 fourth quarter expense ratio of 34.6% was 3.7 points higher than in the 2009 fourth quarter, mainly due to the 2010 fourth quarter other operating expense ratio, which was 4.1 points higher than in the 2009 fourth quarter. Contributors to the higher ratio included approximately $7 million, or 1.1 points, in our Insurance segment, resulting from an accrual for certain employee benefits that are not expected to recur in 2011, and approximately $6 million, or one point, in our Reinsurance segment related to higher incentive compensation costs, primarily related to better experience in business written in prior years, which should be averaged out over the year to estimate a run rate. Approximately 1.7 points of the other operating expense ratio was attributable to the lower premium volume.

On a per share basis, pretax net investment income rose to $1.81 in the 2010 fourth quarter, compared to $1.56 for the same period a year ago and $1.77 in the third quarter of 2010. The growth reflects the accretive impact of the share repurchase program, more than offsetting lower reinvestment yields. Our embedded pretax book yield before expenses was 3.52% in the 2010 fourth quarter, about the same as the 2010 third quarter.

Total return on the investment portfolio was minus seven basis points in the 2010 fourth quarter. Excluding foreign exchange, it was minus four basis points in the quarter. The net total return was affected by the increase in interest rates during the quarter, which impacted our fixed income portfolio by a minus 70 basis points, which were almost all offset by good returns in equities and other alternative assets.

Throughout the past few quarters, Arch continued to allocate more assets to equities and alternative investments. Our allocation to equities was approximately 3% of our investable assets at year end, while alternative investments and equity method investments were 7% of our investable assets. The investment grade fixed-income portion portfolio, including the TALF portfolio plus short term investments in cash at the end of 2010, was 85% of total investable assets of $11.8 billion compared to the end of 2009, when it was 91% of $11.4 billion.

We continue to maintain a very high quality fixed income investment portfolio with an average credit rating of AA+. Our municipal bond portfolio of $1.2 billion had a market value of 102% of the book value at the end of 2010. Pre-refunded and revenue bonds account for 42% of this portfolio. The general obligation bonds have an average rating of AA+ and an average duration of four, with the three largest concentrations in Texas, which is 9% of the total mini portfolio; Maryland, 7%; and North Carolina, 7%. Our exposure to uninsured general obligation bonds at states of interest today of California, Michigan, Illinois, New York, New Jersey, Nevada and Arizona, altogether only total 0.2% of the total municipal portfolio.

The duration of the investment portfolio in total decreased to 2.83, down from 3.11 at the end of the third quarter of 2010. The shortening in duration during the 2010 fourth quarter reflects the potential movement I mentioned on our last call in response to rising interest rates.

As a reminder, we matched the duration of the portfolio of the portion of our investments that back our insurance and debt liabilities in order to economically immunize this large portion of our balance sheet. But we currently maintain a low duration target to remain in investments to dampen the impact from rising interest rates.

For the 2010 full year, our annual effective tax rate on pretax operating income was 0.5%, down from the 2% annual effective rate used in the third quarter, which resulted in a tax benefit in the 2010 fourth quarter of $5 million, or $0.10 per share.

Our effective tax rate fluctuates from period to period based on the relative mix of income reported by jurisdiction. The full year effective tax rate was below the range indicated last quarter of 1% to 3% due to changes in the relative mix, which resulted from favorable reserve development, cat activity and expense items by jurisdiction.

Reserve development, by its nature, is not predictable. And as indicated earlier, fourth quarter expenses reflected certain non-recurring items. Our expected range for 2011 is a gain 1% to 3%. But certain factors as experienced in 2010 can cause the tax rate to fall outside this range.

Our balance sheet continues to be conservatively positioned, with total capital at $4.9 billion at December 31, 2010, down from $5.1 billion at the end of September, and reflecting the share repurchase activity during the quarter.

In the quarter, as Dinos mentioned, we repurchased 2.9 million shares for $258 million at an average price per share of $89.23. The estimated accretive impact of the cumulative share repurchase activity since 2007 added $0.75 to the diluted operating earnings per share and three points to our ROE. Our debt plus hybrids represent approximately 15% of our total capital, well below any rate-in-agency limit for our targeted rating. Our book value per share ended the year at $89.98, up 1% in the quarter and 23% for the year.

As of December 31, 2010, we estimate that, including AOCI, we hold approximately $600 million to $800 million above our targeted capital level based on current rate and agency models with an appropriate buffer. Excluding AOCI, our excess capital position would be $400 million to $600 million.

Our liquid cash, short term investments in U.S. Treasuries represent about 18% of our investable assets. With these comments, we are pleased to take your questions.

Constantine P. Iordanou
Chairman and Chief Executive Officer
Alicia, we're ready for questions.

Question and Answer

Operator

[Operator Instructions] Your first question comes from the line of Josh Shanker from Deutsche Bank.

Joshua David Shanker
Deutsche Bank AG, Research Division

John, kind of explain the tax situation? But I realize there's a lot of moving parts in that. I note that you guys are forecasting, again, a 1% to 3% tax rate for next year, and John mentioned that it's differences in mix that caused the tax benefit this year? Maybe I just need a little bit more clarification, trying to understand why it got better, but why we're resuming the old prediction for next year's taxes?

Constantine P. Iordanou
Chairman and Chief Executive Officer

Well, I'll give you a few comments and then I'll turn it over to John who will give you more detail. It depends where our income is emanating from. And as you can see, what we booked in the U.S. on an accident year basis is not producing any underwriting profit. So when we have a light cat activity, we have significant income from our overseas operations. So depending where the income comes from, it will determine what our effective tax rate is. That's why it's not very predictable. Of course, everything we keep, almost everything -- not quite everything we keep in the U.S., we invest in triple tax-free municipal bonds. So on the investment income side, we don't have much tax. The FET, we booked as an expense item. That's why you don't see it on that line, because anything we reinsure overseas, then we have to pay an FET on that. It's that combination, and those are the moving parts. So for this quarter, a lot of our income came from the business we wrote overseas, and that's the reason that the true up of the tax rate from all four quarters into the fourth quarter reduced the rate to that point.

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

Yes. So Josh, we had reinsurance favorable development from these casualty lines, and it mainly came from Bermuda, and that was an impact in the quarter. We had some of the cat events, some came out of the U.K., which would lower the effective tax rate. And also, the expenses, the higher non-recurring expenses in the quarter, also lowered what we thought we might be paying in taxes, and we had to adjust for the whole year as we go through this. So we have to true it up as we move through the year. And thus, it is hard to predict where these are going to come sometimes in various different jurisdictions. And that's why it can fluctuate around a bit.

Joshua David Shanker
Deutsche Bank AG, Research Division

Now I don't mean to sound too dark, but it's not a long shot to say that you may not make an underwriting profit on the insurance side of the business in 2011. Would that cause you to have lower than 1% to 3% taxes for the aggregate business?

Constantine P. Iordanou
Chairman and Chief Executive Officer

No, don't think it will go lower than that, because the effective tax rate we pay on the U.S.-generated business, excluding the FET, it's approximately 9% to 10% when you do that calculation. And that excludes the FET we pay outside that calculation. So I don't think that will change. It's just that a significant part of our income for 2010 came from what we do in other parts of the world, especially in our cat book. And also, most of the reserve releases, they were from business we wrote overseas.

Joshua David Shanker
Deutsche Bank AG, Research Division

And then along those lines, about the underwriting in the Insurance business, obviously Reinsurance becoming a smaller part of the business given the opportunities you have there, Insurance is kind of stagnating here, is there -- given a reasonable amount of catastrophes and not a lot of insurance underwriting profits, sort of, what's your outlook, I guess, for the next 12 to 18 months on underwriting? I guess it's a loaded question, but obviously, the source of underwriting income are drying up to some extent.

Constantine P. Iordanou
Chairman and Chief Executive Officer

You're pretty smart in asking me to give you guidance when we don't give guidance.

Joshua David Shanker
Deutsche Bank AG, Research Division

How about industry guidance?

Constantine P. Iordanou
Chairman and Chief Executive Officer

There is a lot of what-if scenarios that you can go through. The only thing I can tell you is what has happened. And we don't have that view for the future because I can't predict the future. I don't know a lot of -- what cat events will happen? I don't know. We go and we underwrite business where we believe we're getting adequate returns. As I said in my prepared remarks, we think the business in the aggregate, between Insurance and Reinsurance, is producing about a 9% ROE on a normalized basis. This is not allocating our entire capital to the business, because I don't hold my operating units responsible for the excess capital I have. So in essence, it's not a great environment. Having said that, we're not unhappy with what we're achieving on the Insurance Group and/or the Reinsurance Group. And from the volume point of view, it's too early to predict. But on January 1, it was very decent. The best we had in the last couple of years, with probably both Insurance and Reinsurance being flattish. But the quarter is not out yet, this is just the general business that we already know what we have. So that's the best we can do. At the end of the day, we don't run the company in trying to predict the future. We try to react as best as we can to the market conditions that get presented to us.

Operator

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

Vinay Gerard Misquith
Crédit Suisse AG, Research Division

Your margins have stayed remarkably strong in 2010 versus 2009 because of business mix changes. Should we expect some sort of favorable impact because of mix changes in '11, too? Plus, you could also add in the fact that you mentioned pricing is flat. So since loss trends are up, should we see some sort of deterioration on the margins this year versus last year?

Constantine P. Iordanou
Chairman and Chief Executive Officer

Yes. I would think that pricing is about flattish, in some sectors down. We've seen a few glimpses of hope in some isolated instances, as I have mentioned. Our Reinsurance Group found certain opportunities in Europe to write some decent business, medium-tail type of business on a quota share basis. So we see exposure of demand to be slightly increasing. You've heard that from other calls from a lot of our competitors. That means that the four years of negative premium growth for the industry might be over, with 2010 maybe being at the same level as '09, and then '11 projected to have some slight increase in revenue for the industry. So all that is positive. But on the rates, I think you're absolutely correct. So depending how a mix -- if a mix stays steady state and it doesn't change, yes, our accident year is going to go up a bit. If we continue to be affecting changes, and we try all the time to make sure that we're going where we believe is the best returns, that effect might be dampened a little bit.

Vinay Gerard Misquith
Crédit Suisse AG, Research Division

The second question is really on the pockets of hardening you mentioned. Do you think these are just isolated incidents, or do you think this is a process of the market bottoming out? And do you expect positive price changes later on during the year?

Constantine P. Iordanou
Chairman and Chief Executive Officer

No, I see it as very isolated and is on a specific book of business in some parts of the country. And sometimes, it is precipitated because a major writer says we're not going do this business anymore, and we had certain examples of that. Some of it being the E&S casualty, primary casualty, which is a major leading candidate -- carrier says we're shutting that operation down. So that creates a bit of angst on those accounts, they've got to find another home. And it happened in a few cases. These are tougher underwriting risks, they belong in the E&S market, but I don't get too excited about it because it's isolated. The reason I mentioned it is I'm trying for us, and also for you guys, to find signals as to -- is the market going to continue to drift, or are we, in certain cases, hitting the bottom? And I think, in those cases, we have hit the bottom, and it's got to go the other way. When people say, "No more, I don't want any more of this," it tells you that it can't get any lower than that. So that's the only message I want to send. No tremendous opportunities, I'm not predicting a market trend. I still believe the market won't turn neither in '11 or '12. It will probably be '13 to be a broad-based market turn, because more pain has to come. But we're starting to see it in isolated cases.

Vinay Gerard Misquith
Crédit Suisse AG, Research Division

On the tax rate, if I may, we saw yesterday the Obama administration, once again, put up reinsurance taxes. Do you have a sense for what the probability of that passage would be? And also, since you're making less underwriting income in the U.S, do you think it's going to be a major impact, or a minor impact to you?

Constantine P. Iordanou
Chairman and Chief Executive Officer

Well, listen. There is not a lot of detail on what the administration's new proposal might be. And keep in mind, this is only a proposal, and there is no bill drafted that we can react to it. We don't believe there is broad support for that, and for its enactment. But these kind of proposals, even acted, will probably lead to increased cause for policy holders. Also, it will affect the relationships the U.S. has with other jurisdictions, European and otherwise. With all that said, I ask our tax people to give me an indication. Let's say, if something like that was enacted, what it would cause U.S. businesses from an additional tax spend for 2010 calendar year, the proposal would have no adverse impact on us. As a matter fact, our tax rate for the U.S. group, including the federal excise tax, wouldn't have changed. But don't forget, I said before that, our effective tax rate in the U.S. -- and we buy a lot of municipals in the U.S. -- is hovering around 9%, 10% for the U.S. business. So it was never zero. You're looking at our aggregated tax for our global operations. And I keep reminding people we're a foreign corporation with some U.S. subsidiaries. We're not a domestic company doing business overseas. So I don't expect a significant change and a big impact on our business. It will take years to build up even if they do pass and enact a tax legislation that is protection, and we don't anticipate that for the time being.

Operator

Your next question comes from the line of Greg Locraft from Morgan Stanley.

Gregory Locraft
Morgan Stanley, Research Division

I wanted to just understand, even a little more perhaps, Dinos, on this bottoming in the E&S. Is it all kind of excess casualty? Is that sort of where you see it, excess in primary casualty? Or is it broader than that in terms of pockets?

Constantine P. Iordanou
Chairman and Chief Executive Officer

No, it's not. I wish it was excess casualty. It's not excess casualty. Excess casualty, being a very long line of business, that's what people that are still very optimistic. This is primary E&S, and it is in risk, like maybe New York City contractors, which they have a lot of exposure to the third party over kind of claims, that experience is not good and more and more underwriters don't want to write it. It might be habitational risk that -- the claim activity for frequency and severity started to perk up in some companies. They say, "We don't want to write certain type of habitational risk." So it's isolated in this kind of pocket. On the energy sector, we've seen some of that. But it's not broad-based yet, and it is primary. Where you're going to feel the effect of the claims, a lot quicker than you will feel it when you're writing excess liability, that you might be happy for a few years and then very unhappy when the losses start getting into the excess layers. So I haven't seen it on excess casualty. The excess casualty area, we still believe as a company, is the most challenging. And when I say excess casualty, I'm talking U.S. -- Canada, Europe is a different story. And unfortunately, we don't see any signs of improvement in that yet.

Gregory Locraft
Morgan Stanley, Research Division

And again, you sort of see the primary lines you mentioned as a response to one big carrier? Exiting or...

Constantine P. Iordanou
Chairman and Chief Executive Officer

No, no. It's a combination of things. Don't forget, sometimes a big carrier will move -- like big carriers, a year ago, will say, "I'm not going to write this," and then you have 15 other people that they will write it. That's what the market is all about. Now though, we're starting to see resistance by the broad market on certain classes. And they say, "No. He doesn't want it, but I don't want it either. It's a new piece of business from me, I'm not going to write it unless there is a price improvement." To me, that's the beginning of the most distressed segments starting to get attention by underwriters. And we've seen that even in 1999, early 2000, even though the market didn't start moving until mid-2000 and it accelerated in '01, and then got real good in '02, '03. There were early signs that people that were saying no more.

Gregory Locraft
Morgan Stanley, Research Division

And I guess, building on that as context, you had mentioned 2012, '13 is sort of more in line with when you think the market, on a more broad basis, could be better and more pain has yet to come. How do you think that will manifest itself in the reported development? What would you be watching in our shoes?

Constantine P. Iordanou
Chairman and Chief Executive Officer

It will manifest in two ways. The things that I watch the most is -- actually I watch three empirical data points. One is the cash flow relationships. Because cash flow, you can't fool around. Either you have the cash or you don't. And usually, when cash flows get to around 5% -- this is cash flows to net written premium for the industry, it had signaled that when it gets below that number, you have a market turn. Second is when the relationship of IBNR to total reserves gets into -- for the industry around the 45% level. And that happens when people exhaust their reserve redundancies by releasing them as the older years mature, and then the diagonals indicate that they had too much and they have to release it and the more recent years being -- had more realistic accident years and there's nothing to release, so it will change the relationship between total reserves to what is case versus IBNR. And that relationship is another indicator that we usually watch. So if I were you, I will look a cash flows, I will look at relationships to total reserves, IBNR, the scheduled piece, what that tells you, and I will look at the change in the tone of how the calendar year results get reported without -- if there is no rating by reserve releases, all of a sudden, people, they are not going to like -- we don't feel proud producing 8%, 9% ROEs. Don't forget, 9% ROE that I mentioned, it's on a pro forma basis, eliminating my excess capital. In total, capital is going to be a little less than that. And that's not a report card that you want to write home about if you're only producing 7%, 8%. And if there is no reserve releases and benign cat activity, those numbers are going to be not as attractive. And I think that's what causes markets to turn.

Operator

Your next question comes from the line of Matthew Heimermann from JP Morgan.

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

Just on the January 1 renewals, can you remind us how much of your reinsurance book is 1/1?

Constantine P. Iordanou
Chairman and Chief Executive Officer

I don't have that number with me, but it's significant. I think it's about 40%, a little over 40%.

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

Not that different...

Constantine P. Iordanou
Chairman and Chief Executive Officer

And it's not just January. I would say, the first quarter.

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

And then I guess just in terms of -- the PML has been falling. I guess as we think about -- and you mentioned that some of the reason that your volume is potentially stable in 1Q versus a year ago is quota share business and medium-tail lines. So should we think about -- if we were looking at property, cat property, ex-cat, that, that would be a pretty good barometer for how we should think about your PML changing over the course of 2011?

Constantine P. Iordanou
Chairman and Chief Executive Officer

Well, don't forget, the Florida business doesn't come up until second quarter. So usually, if you go back and you look at how we report quarter by quarter, a least amount of PML is usually deployed in the first quarter of any one year, and then it grows up when the contracts come up. And what we're going to do, depending if we like the rates, we might deploy a little more, having the capacity for the Florida business. But too early to tell. We're going to look at what's available, what kind of pricing can we get it and do we like that, and we'll go from there. That's the reason we shy away from giving guidance on anything, because that's not the way how we run the company. I'm not trying predict what we're going to do quarter after quarter after quarter, because I don't know it myself. What I try to emphasize to the underwriters -- maintain discipline and do what you believe is appropriate, and write the business that it will have margin on it.

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

I guess I wasn't looking for guidance so much as just as we see the numbers reported, if that'll be a good barometer, because I'm trying to get a sense of what adjustment, if any, when we're looking at your book, we should be making for RMS 11, for example. Because when you say, PML 683 in Tri-County from 809, is that net of RMS or not? So that's where I was coming from.

Constantine P. Iordanou

Chairman and Chief Executive Officer

Don't forget, our PMLs are calculated beyond RMS. We do make adjustments to the models. And I think I mentioned that, in my prepared remarks, that in anticipation -- when we get data, it's from Seatons. We don't just run it through RMS and then we take your answer and that's the way we end underwrite. Our cat team makes adjustments. As a matter of fact, we did make adjustments on anything we wrote in the first quarter, in anticipation that the RMS model, even though it's not increasing coastal PML calculations, it is increasing, and in some cases, significantly. 30%, 40%, 50%, 60% on more inland exposures. And we made adjustments to the way we underwrite. As a matter of fact, our cat team, from our own analysis of the 2004 storms -- you remember we had four storms in Florida, one of them, Charlie, went right through and exited the other way. And based on our own analysis, we never really believe that if you're three or five miles inland, you had a significant less PML from a property that it was two miles from the coast. And we had made those adjustments. So for us, it wasn't huge adjustments, but we looked our own way of underwriting the cat business, based on a combination of outside models we used, plus our own internal -- I wouldn't say manipulations, but changes to those models because we have our own ideas and we continue to factor that in. So my comments were more about -- there was a market anticipation that RMS 11 would've increased demand and maybe tone down the pricing, which went down 5% to 7%. And I saw none of that. Demand didn't go up, and it didn't affect, in a positive fashion, pricing. The buyers, they had good deals this year.

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

And I'm sure I'm reading way too much into this, but your press release, when you talked about the Australia floods and Yasi, had a different line with respect to potential variability in your catastrophe loss estimates. And the difference really is centered on kind of reinsurance performance. So I guess, is there anything specific that you're dealing with behind this thing?

Constantine P. Iordanou
Chairman and Chief Executive Officer

No, it's just in a language we've put in to make sure that -- investors should know that even though we have reinsurance recoverables, if you don't get the recoverable, a recoverable will become your net loss. So it's no difference to what we've done in the last nine years.

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

It's just different in previous press releases. I just thought I was reading too much into it.

Constantine P. Iordanou
Chairman and Chief Executive Officer

Well, I don't know if we change your language a little bit.

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

The language has changed a little bit, but it's really the same meaning now.

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

I would have been remiss to ask if there are any questions around the number of incidence, et cetera.

Constantine P. Iordanou
Chairman and Chief Executive Officer

No, no. That's fair.

Operator

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

Mark Alan Dwelle
RBC Capital Markets, LLC, Research Division

First, in the $30 million to $60 million of additional Australian-related losses, will those primarily be on the reinsurance book? Or will they be in the insurance book affected there?

Constantine P. Iordanou
Chairman and Chief Executive Officer

It's both. But from a size perspective, I would say 25% might be insurance and 75% reinsurance. So maybe $30 million, $70 million, something like that. I haven't done the calculations. We go unit-by-unit, and we build it up. So John, do you have any more color on that?

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

No. It's about that, like 1/3, 2/3. 1/3 insurance, 2/3 reinsurance. But it depends upon the range. And of course, these numbers will move within this range on how all this works out between Yasi and the floods and how things recover, mines and everything else. So there's going to be variability around these numbers until all this gets sorted out.

Constantine P. Iordanou
Chairman and Chief Executive Officer

And on our insurance book, comes from our London operations. Lloyd's and non-Lloyd's, both.

Mark Alan Dwelle
RBC Capital Markets, LLC, Research Division

The second question I had related to, just a little additional detail related to the reserve releases, particularly on the insurance line. What accident years were involved there? And was that net of any particular -- any offsets in terms of charges? Or was it all, primarily, all releases?

Constantine P. Iordanou
Chairman and Chief Executive Officer

John is going to look for the details. But basically, we do analysis on our reserves by IBNR family and then for accident year. So you always get positive and negative movements. Some years, we'll put a little up, and some years we'll take some down. It depends how the empirical data points to us. As you get another diagonal on the triangle, you'll make those determinations.

Mark Alan Dwelle
RBC Capital Markets, LLC, Research Division

I understand. Sometimes you have four points of favorable, and one or two points of unfavorable and it's discernible.

Constantine P. Iordanou
Chairman and Chief Executive Officer

And listen. That's not unusual, especially if you're writing -- the actuaries will react to a single large loss on a book of business that I swore. If you're writing high limits and -- one year, we'll look at 40 loss and loss adjustment then. And other, I might I look at 60. And there was not that much difference in the marketplace, but one year, I had the big loss and the other year I didn't have the big loss. So you get those kind of variations, and they react to it depending of how the case reserves as we adjudicate some of these cases. That's the process that we go to. It's a very detailed process. But you know...

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

Yes, I can give a little bit of color on it. We had a total net favorable for the Insurance Group in the quarter as mainly short-tail and some medium-tail lines. And of course, there's always some rebalancing by years to -- of course the short-tail is more recent years, the medium-tail was like '06 to '08. And then a lot of other little lines had net to releases as well. We did see some releases, but some net strengthening in both executive assurance, a little bit for the sub-prime timetable, '08, '09, '07, as well as some cash we've presented for some specific events that happened in '07, '04, '05. But then we had released in '06 and '07. So it just balances out as you go across year by year, and line by line.

Operator

Your next question comes from the line of John Hall from Wells Fargo.

John Arthur Hall
Wells Fargo Securities, LLC, Research Division

I just wanted to address the share repurchase real quickly. First off, I was wondering when the next board meeting is? And then secondly, I was wondering if you could just talk a little bit about how book value plays into your repurchase decision, or your decision to be in the market at any given point in time.

Constantine P. Iordanou
Chairman and Chief Executive Officer

Well, first one is easy. The board meeting is in the next 10 days or so. We don't give specific dates, this way you don't know when we're traveling. But it will be next week sometime. Of course price has an effect on how we decide to return capital to shareholders. As long as our share price is at book value or below, there is not a lot of thinking here.

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

That's a very easy calculation.

Constantine P. Iordanou
Chairman and Chief Executive Officer

A very easy calculation. Of course, if share price goes to a multiple to book -- we have a grid, and I think we have presented it to investors. And the calculation that we do is we look at what is our ROE return expected, what the multiple to book we need to buy, and what the recovery period should be. And if it's three years or less, we continue to buy shares back. And if it's more than three years, we'll look for other ways to return capital. And we build this grid that give us guidance as to which way we're going to go.

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

And right about now, if you would look that up with Dinos' 9% to 10% ROE number that he just mentioned, we can get by it just under 1.2%. 1.15% to 1.2% would be sort of the ratio that we could buy up too. Of course we're looking forward to that trading level at some point, but historically, the last few quarters when it has been below booked, it's been a pretty easy calculation.

Operator

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

Ian Gutterman
Adage Capital

First, to clarify that last one, is that bookside value evaluation ex 115 or full book?

Constantine P. Iordanou
Chairman and Chief Executive Officer

That's at full book.

Ian Gutterman
Adage Capital

Just making sure [Audio Gap]

Operator

[Operator Instructions]

Ian Gutterman
Adage Capital

The excess capital I was looking at, and let's focus on the excellent 15 that went down $100 million from last quarter, and I'm looking at your excellent 15 equity was essentially flat, and your PML was down $75 million, which would free up $300 million of capital. So why is your excess capital less than last quarter?

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

We allocated more investments to equity to alternative investments that has a very high capital charge on the S&P capital formulas.

Constantine P. Iordanou
Chairman and Chief Executive Officer

We moved, as you saw -- 3% now is in equity. So it takes a bigger charge.

Ian Gutterman
Adage Capital

Follow up on the cash question, I'm looking through the supplement. It looks like round numbers, your net premiums are about $1.5 billion in the U.S. and about $1 billion in Bermuda. I guess, first, is that $1.5 billion in the U.S., is that before you quote a share to Bermuda? Or is true net premium that stays in the U.S.?

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

That's pre quote a share.

Ian Gutterman
Adage Capital

I'm just trying to think through how you're not making -- essentially making very little money to have a very low tax rate on basically 60% of your premium.

Constantine P. Iordanou
Chairman and Chief Executive Officer

Well, because most of our income, most of our underwriting income is coming from the overseas operations. We've been booking the Insurance Group, over 100. So in essence, you're taking an underwriting loss. And we don't have, in the U.S., a significant portion of investable assets that is not triple tax-free. All of our muni bond portfolio, which is about $1.2 billion, we buy U.S. operations. So in essence, that comes with no underwriting income and tax-free. So a lot of our income is coming from the investable assets we have overseas, plus the underwriting gain we have from the business that we write overseas. So that's the reason that tax rate is so low.

Ian Gutterman
Adage Capital

And the reason the combined is over 100 on that business? Is that more of a long-tail business? Or is there some other reason?

Constantine P. Iordanou
Chairman and Chief Executive Officer

Yes, some of it is long-tail business. We write some comp, excess comp, et cetera. And some of it is because the market is so tough that we don't think -- there is a lot of margin in that business, and your next question is going to be, "Why don't you cut it off totally?" Anticipating your last question is, the answer is it's because you can't shut down your operations. You minimize as much as you can in sectors you don't have profitability and you wait for the rainy day to go and then the sunshine to come and then you can capitalize with that opportunity when it shows up.

Ian Gutterman
Adage Capital

Professional liability, insurance that has been growing all year this quarter, was down about 25%. What happened there? And also, can you remind me, in the Reinsurance business, that other specialty has about double year-over-year? What exactly is other specialty?

Constantine P. Iordanou
Chairman and Chief Executive Officer

The first one, Professional Liability, we have reduced significantly in Europe. In Europe, we were writing for small, medium-size enterprises, a lot of D&O. But also, we had PML business, and we didn't like the profitability of that business. So we have discontinued that, and it went to another carrier. That's the difference in that. And your second question was on...

Ian Gutterman
Adage Capital

Your Reinsurance. That business that you classify as other specialty, was about $130 million of net premium this year versus $65 million last year? I'm just wondering...

Constantine P. Iordanou
Chairman and Chief Executive Officer

A lot of that movement is trade credit business.

Operator

There are no further questions at this time. This does conclude the question-and-answer portion of the call. I will now turn the call back over to Dinos Iordanou for closing remarks. Please proceed, sir.

Constantine P. Iordanou
Chairman and Chief Executive Officer

Thanks, Alicia, and thanks for everybody that shared their one hour with us. And we're looking forward of talking to you in the weeks ahead. 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.