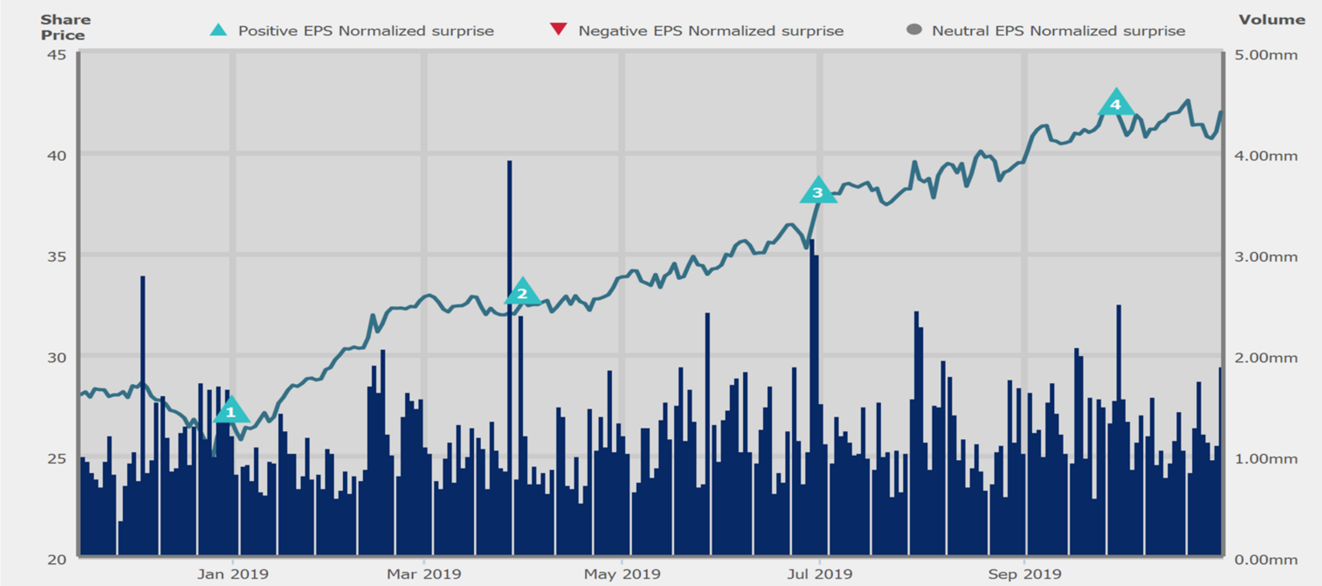
S&P Global
Market Intelligence

Arch Capital Group Ltd. NasdaqGS:ACGL
FQ3 2019 Earnings Call Transcripts
Wednesday, October 30, 2019 3:00 PM GMT
S&P Global Market Intelligence Estimates

	-FQ3 2019-			-FQ4 2019-	-FY 2019-	-FY 2020-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.62	0.63	▲1.61	0.74	2.78	2.94
Revenue (mm)	1292.15	1457.70	▲12.81	1276.24	5364.06	5624.65

Currency: USD
Consensus as of Oct-30-2019 9:34 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ4 2018	0.38	0.46	▲1 21.05 %
FQ1 2019	0.61	0.67	▲2 9.84 %
FQ2 2019	0.67	0.77	▲3 14.93 %
FQ3 2019	0.62	0.63	▲4 1.61 %

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EXECUTIVES

François Morin
Executive VP, CFO & Treasurer

Marc Grandisson
President, CEO & Director

ANALYSTS

Brian Robert Meredith
UBS Investment Bank, Research Division

Elyse Beth Greenspan
Wells Fargo Securities, LLC, Research Division

Geoffrey Murray Dunn
Dowling & Partners Securities, LLC

Joshua David Shanker
Deutsche Bank AG, Research Division

Meyer Shields
Keefe, Bruyette, & Woods, Inc., Research Division

Michael David Zaremski
Crédit Suisse AG, Research Division

Ronald David Bobman
Capital Returns Management, LLC

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Goldman Sachs Group Inc., Research Division

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Autonomous Research LLP

Presentation

Operator

Good day, ladies and gentlemen, and welcome to the Q3 2019 Arch Capital Group Conference Call. [Operator Instructions] As a reminder, this conference call is being recorded.

Before the company gets starts with -- started with its update, management wants to first remind everyone that certain statements in today's press released and discussed on this call may constitute forward-looking statements under the federal securities laws. These statements are based upon management's current assessments and assumptions and are subject to a number of risks and uncertainties. Consequently, actual results may differ materially from those expressed or implied. For more information on the risks and other factors that may affect future performance, investors should review periodic reports that are filed by the company with the SEC from time to time.

Additionally, certain statements contained in the call that are not based on historical facts are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. The company intends the forward-looking statements in the call to be subject to the safe harbor created thereby. Management also will make reference to some non-GAAP measures of financial performance. The reconciliation to GAAP and definition of operating income can be found in the company's current report on Form 8-K furnished to the SEC yesterday, which contains the company's earnings press release and is available on the company's website.

I would now like to introduce your hosts for today's conference, Mr. Marc Grandisson and Mr. François Morin. Sirs, you may begin.

Marc Grandisson
President, CEO & Director

Thank you, Crystal, and good morning to you.

Our diversified business model of specialty insurance, reinsurance and mortgage lines of business produced good growth and acceptable risk-adjusted returns for our shareholders in the third quarter. Operating earnings generated an annualized return on common equity of 10% for the third quarter as our book value per share grew 3.9% and more than 21% on a trailing 12-month basis.

Before I discuss market conditions in a broader P&C sector, I would like to address a topic that is currently getting a lot of attention, namely the increased claims inflation or loss trend. In this part of the cycle, we are not surprised to hear about adverse claims development that some in the P&C industry are experiencing. We have discussed our view of loss trends on these calls over the past several years. And I'd like to remind our shareholders that at Arch, we approach pricing our products and establishing our reserves with a bias towards conservative loss trend estimates. As I have mentioned before, history teaches us that on average, the P&C industry experiences claim inflation rates about 200 basis points above the CPI, although this can fluctuate over time.

It seems to us that the premium rate declines seen by the industry over the past several years should have led to higher current loss picks. It is important to bear in mind that in many lines of business, it takes 3 to 5 years before an accurate level of trend can be confirmed. We believe that this gap between the estimated and actual loss trend has contributed to the uncertainty in reserve development. This uncertainty helps fuel both disruption and dislocation in several areas of insurance which we have been and are capitalizing on. Dislocation is evident in the rise in our submission activity this year, and it is also reflected by the fact that we are achieving higher rate levels on new business than on renewal business in several segments.

To give you some sense of the data, our submission activity in the third quarter was up more than 20% in E&S property and 15% each of E&S casualty and professional lines, specifically D&O. However, to date, we believe that these disruptions are more indicative of a transitional market than a traditional hard market as we have not yet seen rate increases and hardening across the board. Risk selection is still paramount. Across all lines in our insurance group, renewal rate changes average a positive 3.5% for the quarter as net premium grew 22% in the third quarter, above the same period in 2018. About 30% of that growth came out of an acquisition we completed earlier this year in the U.K. small commercial lines space. Rate increases contributed a quarter of the overall segment's growth while new business opportunities generated the balance. It is worth reminding you that we expect to close on our acquisition of the Barbican Group in the fourth quarter, and we believe that the enhanced presence and scalability of our Lloyd's operation will provide us with further opportunities.

Now turning to the reinsurance market. Reinsurance pricing tends to follow that of the primary insurance industry, but with a few twists. Catastrophe and large attritional losses can disproportionately affect reinsurance results, creating localized opportunities in areas of the reinsurance business. Property fac and marine are examples of improving markets.

Over the past several years, we have significantly reduced our net exposure to property cat risk in response to the declining level of risk-adjusted rates. The occurrence of Japanese typhoons in both the third and fourth quarter of this year has impacted global reinsurance industry results and should, should support the ongoing need for additional rate improvement.

Turning to our mortgage insurance segment. Arch MI continues to perform well, and market conditions continue to be characterized by strong credit quality in a healthy housing environment. In terms of new production, our third quarter new insurance written, or NIW, grew 18% over the same period a year ago. That production was driven by growth in the mortgage insurance market due to a broad increase in mortgage originations combined with an increase in the level of mortgage insurance purchased from private mortgage insurers. Overall, insurance in force grew about 2% sequentially in the quarter at Arch U.S. MI as higher prepayment activity was more than offset by new MI originations. We continue to be pleased with the credit quality of our insurance in force as key risk metrics and our U.S. MI portfolio remain at historically favorable levels. Notwithstanding the good market conditions in the MI sectors, we continue to mitigate our downside risk from an economic cat event through the purchase of insurance-linked notes.

With respect to our investment operations, we have maintained our focus on total return and continuously repositioned the portfolio to adjust to financial market conditions, which contributed significantly to our growth in book value per share this quarter.

And with that, I'll hand the call over to François.

François Morin
Executive VP, CFO & Treasurer

Thank you, Marc, and good morning to all.

Before I give you some comments on observations on our results for the third quarter, I wanted to remind you that consistent with prior practice, these comments are on a core basis, which corresponds to Arch's financial results, excluding the other segment, i.e, the operations of Watford Holdings Limited. In our filings, the term consolidated includes Watford.

After-tax operating income for the quarter was $261 million, which translates to an annualized 10.3% operating return on average common equity and $0.63 per share. Book value per share grew to $25.61 at September 30, a 3.9% increase from last quarter and a 21.1% increase from 1 year ago. This result reflects the effect of strong contributions from both our underwriting and investment operations.

Starting with underwriting results. Losses from 2019 catastrophic events in the quarter net of reinsurance recoverables and reinstatement premiums stood at $68 million or 5.2 combined ratio points. These losses impacted both our insurance and reinsurance segments and were primarily due to hurricane Dorian and Typhoon Faxai. As for prior period net loss reserve development, we recognized approximately $51.7 million of favorable development in the third quarter net of related adjustments are 3.9 combined ratio points compared to 6.7 combined ratio points in the third quarter of 2018. All 3 of our segments experienced favorable development at $3.9 million, $14.7 million and $33 million for the insurance, reinsurance and mortgage segments, respectively.

We had solid net written premium growth in the insurance segment, 22% over the same quarter 1 year ago. While approximately 30% of that growth comes from the U.K. regional book of business we acquired earlier this year, we also had a strong quarter of new business and an improving renewal rate environment in most of our lines of business. The insurance segment's accident quarter combined ratio, excluding cats, was 100.3%, essentially unchanged from the same period 1 year ago. Some of the pricing and underwriting actions we have taken over the last several years have begun to filter through the loss ratio while our expense ratio remained slightly elevated primarily as a result of investments we are making in the business. In particular, as discussed on prior calls, the integration of our U.K. regional book and other smaller acquisitions is ongoing and increased the overall insurance segment expense ratio of this quarter by approximately 130 basis points. Investments in our underwriting claims and IT operations explained most of the remainder of the increase in the expense ratio. We continue to expect that the expense ratio for this segment will remain higher than the long-term run rate until the growth in net written premium we achieved over the last few quarters, both organically and from acquired businesses, is fully earned.

Now moving to -- on to our reinsurance operations where we also had solid growth this quarter with net written premium up 40% over the same quarter 1 year ago. Over 60% of the growth came from the casualty segment where we were able to write select new opportunities in distressed sectors of the market, including a multiyear treaty that represented approximately 65% of the growth for this line of business.

As we have said in the past, some of these opportunities can be lumpy and distort quarter-over-quarter comparisons. Property excluding property cat -- and property cat make up most of the rest of the increase in net written premium. The reinsurance segment's accident quarter combined ratio, excluding cats, stood at 92.8% compared to 92.5% on the same basis 1 year ago. Part of the large attritional loss activity we experienced this quarter include some exposure to the Thomas Cook collapse. Our expense ratio remained satisfactory at 26%, down 140 basis points since the same quarter 1 year ago.

The mortgage segment's accident quarter combined ratio improved by 290 basis points from the third quarter of last year as a result of the continued strong underlying performance of the book, particularly within our U.S. primary MI operations. The calendar quarter loss ratio of 3.8% is higher by 60 basis points than the results observed in the same quarter 1 year ago, although last year's loss ratio benefited from favorable prior year development that was approximately 320 basis points higher than what was observed this quarter. The expense ratio was 20.8%, lower by 60 basis points than in the same period 1 year ago.

Total investment return for the quarter was a positive 100 basis points on a U.S. dollar basis as our high-quality portfolio continued to perform well. Our investment portfolio duration is over rate relative to our target allocation, up slightly to 3.64 years at quarter end, as we continue to expect a continued slowdown in economic growth and a lower-for-longer global interest rate environment.

The corporate effective tax rate in the quarter on pretax operating income was 11.7% and reflects the geographic mix of our pretax income and a 40 basis point benefit from discrete tax items in the quarter. Excluding this benefit, the effective tax rate on pretax operating income was 12.1% this quarter. At this time, we believe it's still reasonable to expect that the effective tax rate on operating income will be in the range of 11% to 14% for the full year. As always, the effective tax rate could vary depending on the level and location of income or loss and varying tax rates in each jurisdiction.

Turning briefly to risk management. Despite the recent increases in catastrophe pricing, our natural cat exposures on a net basis remained at historically low levels at October 1 with the Northeast still representing our peak zone at slightly more than 4% of tangible common equity at the 1-in-250-year return level. We remain committed to deploying more capacity in these segments if rates and expected returns on catastrophe-exposed accounts continue to improve over time.

In our mortgage segment, we recently completed our 10th Bellemeade transaction earlier this month with coverage of $577 million. Currently, the in-force Bellemeade structures provide aggregate reinsurance coverage of over $3.7 billion.

With respect to capital management, we did not repurchase any shares this quarter. Our remaining authorization, which expires in December 2019, stood at $161 million at September 30, 2019. Our debt to capital -- our debt-to-total-capital ratio stood at 13.5% at quarter end; and debt plus preferred to total capital ratio was 19.5%, down 300 basis points from year-end 2018.

In terms of fourth quarter activity, we expect to use resources on hand to fund the Barbican acquisition at closing once we receive regulatory approvals.
With these introductory comments, we are now prepared to take your questions.

Question and Answer

Operator

[Operator Instructions] And our first question comes from Mike Zaremski from Crédit Suisse.

Michael David Zaremski
Crédit Suisse AG, Research Division

In the prepared remarks, I think you talked about some stress in the marketplace. And it's my understanding that in the primary insurance space, and I could be wrong, and it's reinsurance, too, it feels like the greatest dislocations kind of in the mega sized account space where capacity is very constrained is -- just curious, is that an opportunity Arch can gravitate to or that's not your sandbox? Maybe you can kind of talk to where you see the greatest dislocations in the marketplace and -- which could benefit you.

François Morin
Executive VP, CFO & Treasurer

I think your assessment is right on. I think that you will hear on other calls and from the marketplace that the risks that are larger that carry more limits are going to more dislocation because competitors are reevaluating their risk appetite and this is where most of the capacity deployment was, shall I say, overextended in the last several years, and this is where most remediation is taking place. And you will find that mostly in the E&S and the large commercial risk, and this is where we have seen most of the increase in submission activity. We have been historically being who we are on the defensive for those risks, and we are very well positioned to take advantage of that. I think we are on a receiving end of looking at more of those opportunities as we speak, and this is where we're able to flex more of our muscle.

Michael David Zaremski
Crédit Suisse AG, Research Division

Okay. So I just want to confirm. So you obviously have a great rating from the rating agencies. And you have a relatively large balance sheet, but the primary insurance balance sheet is smaller. So can you -- in terms of like counterparties and the brokers, they -- do they see you as like they look at the total Arch entity balance sheet when kind of assessing whether you guys can take a big piece of the large account space?

Marc Grandisson
President, CEO & Director

Yes. They are. And I think they are also looking at us from a perspective commercial -- some commercial anecdotes for you that we are one of the few that said we have heightened appetite for risks that are priced appropriately. And I think the community, the broker community and client community is very open to that and very willing to engage with us.

Michael David Zaremski
Crédit Suisse AG, Research Division

Okay. That's helpful. And switching gears to mortgage insurance, there was a recent agreement with the FHA and Department of Justice earlier this week. And there's been some talk about maybe it shifts mortgage insurance volumes, banks coming back kind of to the FHA and maybe out of the private marketplace. I don't know if you have any thoughts there if I'm barking up something that could take place.

Marc Grandisson
President, CEO & Director

I always have thoughts about everything. So my initial comment to you, Mike, is that it's very early, right? It was announced last week. It's not early this week. And I think it's an attempt to, I guess, decriminalize being FHA as the result of the banking system sector sort of being reluctant to provide FHA product to its channel. But we'll see how that goes and where it ends up. There are also uncertainties as to whether a different administration would have a different view. And usually, an agreement with DOJ, like you said, and had as to how it will be treated. It's too early, I will say, to tell you. In general, what we hear in Washington, though, is that the private sector is still a most favored area where the government wants the mortgage insurance risk to be deployed. And we have seen this for many years. We'll see where that takes us. But we're watching it, and we'll have more sense for where it goes. And it's going to take a long time over the next several years.

Michael David Zaremski
Crédit Suisse AG, Research Division

And just one last one on mortgage insurance volumes. Do you -- I believe in past quarters, you've kind of alluded to maybe giving back some market share as competitors all have their own proprietary systems. It feels like probably didn't give up market share this quarter, but it's too early to tell. Is that -- is your view still kind of you might over the next year or so move down a little bit of market share still strong obviously on absolute basis?

Marc Grandisson
President, CEO & Director

We don't manage the company on a market share basis, as you know. We just put out there our pricing and see where the market gives us after a quarter. But you're quite right with the new black box environment, it's a lot harder to see where everything falls out. And I think we're not the only one. I think most of our competitors will feel the same way. And we're still in the early innings of how they deploy their pricing modules, how we -- how the client react to theirs versus ours. So I would just see that we put our pricing up there with our return, and it so happens that we receive and we're able to write the amount of business that we wrote in this quarter. I would not ascribe any market share target from where we sit.

Operator

Our next question comes from Elyse Greenspan from Wells Fargo.

Elyse Beth Greenspan
Wells Fargo Securities, LLC, Research Division

My first question is on your pricing commentary. So in insurance, you said 3.5% price in the quarter. And so I'm trying to get a sense, I know there's a lot going on within that book and some new business as well as your acquisition. But how do you guys view loss trend, I guess, if you're getting 3.5 points of price? I would assume trend in aggregate is probably in excess of that. And can you just kind of help us think to that a little bit better?

Marc Grandisson
President, CEO & Director

Yes. The 3.5% for our portfolio, as you're pointing out rightfully, is that it's a very, very diverse book of business. Some lines of business are still -- as I said, it's not across-the-board hardening market. Some lines of business are flattish and some are actually getting way in excess of a 10%, 12% rate increase. And some new business are getting quite a bit above, even a 5% or 6%, even if you're in the middle of the road. So I would just have you thinking about -- the starting point is also pretty important. So it's not -- the 3.5% is one number that attempts to encapsulates everything. And it works well when you have a very monolithic marketplace or very monolithic book of business. But as you pointed, our market -- our business is very diverse. So I think that where you see growth is either because we're seeing good opportunities in terms of good return, healthy returns regardless of the rate change. And if we have a rate change in a growing opportunity is because then the rate change is clearly beating the loss trend. We always look for margin of safety. We are looking at rate change and claims loss trend. It's not a game of decimal.

Elyse Beth Greenspan

Wells Fargo Securities, LLC, Research Division

Okay. And then a lot of new business, right? I think you guys said 3/4 of the insurance growth were some new business this quarter. So I guess as we think about you're getting good price on that, you said, better than renewal. But I would assume you're probably setting the loss picks a little bit higher than where the legacy Arch business would be. So how do we think about kind of the ongoing margin profile of the insurance book, right? And like bringing on this business and the goal, I think, to get down towards that mid-90's underlying margin?

Marc Grandisson
President, CEO & Director

Yes. I think if we -- if you look at the way we react to the marketplace, acquiring business that gives us good return and a good margin because -- and it doesn't have to be because of rate change. It may just be because of wanting to find a new home because of risk appetite of other players are such that, that business finds its way to our balance sheet. That's one aspect or whether the rate is going up. I think that we have a very, very straightforward actual method to look at where we were, assuming the loss trend and the rate change and we booked that appropriately and, I would argue, conservatively so that we don't have surprises or we actually have enough room to maneuver going forward. But broadly speaking, margin has -- is expanding as we speak on business that we write at -- in this segment -- in this time, this point in time.

Elyse Beth Greenspan
Wells Fargo Securities, LLC, Research Division

Okay. That's helpful. And then my last, just a numbers question. I think it's -- the last time you guys updated us mortgage earnings were about within the ballpark, I think, like 75%. Is that still kind of about the right level? Or maybe it's gone a little bit higher this year?

Marc Grandisson
President, CEO & Director

Well, yes. It's definitely higher this year because mortgage has done phenomenally well, and we've got some cats on the P&C side. We're -- as the P&C market I think is improving slightly over the last few quarters and hopefully there is more room to grow, we'd like to think that the P&C earnings are going to start growing as a proportion of the total, and mortgage will be a bit less so. I mean mortgage, we still think has a lot of runway in it as well. But just -- I think we can see more earnings coming thru the P&C segments, and that should help balance it out a little bit more.

Operator

Our next question comes from Josh Shanker from Deutsche Bank.

Joshua David Shanker
Deutsche Bank AG, Research Division

Two questions, one P&C-related and one mortgage-related. On the P&C side, obviously, the growth is very strong in the quarter. Can we foresee and when can we foresee it, a reduction in the expense ratio based on amortizing a larger premium base across a similarly sized cost structure?

François Morin
Executive VP, CFO & Treasurer

Yes, Josh. I think we don't like to have -- make forecast, but I think it's realistic to see or think that sometime in 2020, as we earn some of the premium that we've -- again, the U.K. regional book that will filter in, in second half of 2020, I'd like to think that maybe we should see some improvement. Everything else being equal, I think that's kind of what we're thinking about. You guys have heard it. We've said before, we're still on -- we still have a target to achieve a 95 combined ratio, that we're not committed to win, whether that's a year, 2 years, 5 years down the road. We're making the right improvements along the way. But we certainly, at least in the interim and over the next 12 to 15, 18 months, like to think that we're going to see some improvement coming through on the combined ratio.

Joshua David Shanker
Deutsche Bank AG, Research Division

Great. And then specifically the expense ratio, obviously, the loss ratio is up to the underwriting of course.

François Morin
Executive VP, CFO & Treasurer

Correct. Yes.

Joshua David Shanker
Deutsche Bank AG, Research Division

And then on the mortgage side, obviously, a lot of new insurance written in the quarter, but a very high proportion came from refis and contracts with LTV lower than 85%. Can you talk a little about that new business, whether it has persistency to it, whether the housing appreciation suddenly takes that business off your books? How should we think about the growth in the quarter specifically and how it differs from prior quarters?

François Morin
Executive VP, CFO & Treasurer

Well, the growth -- the overall market is getting better. And you're quite right. The purchasing is actually growing despite the -- if you look at the purchasing for the NBA for the -- for over next couple of years, the growth in mortgage and origination is still there on -- in the purchase market. The refinancing was not a surprise, but it's a reaction to the drop in mortgage rate by about 110 bps over the last 12 months. And that's to be expected. So we have this, I wouldn't say flurry, but we have this heightened activity of refinancing that is occurring. And the reason we -- and the reason that the refinancing is still the biggest -- no, I would say, like a bit bigger proportion with MI attached to it, a lot of it was originated recently. And they still haven't crossed the LTV below 80%. So it allows us actually to go back again to the same client and re-up our mortgage insurance offering to them. That's it.

Joshua David Shanker
Deutsche Bank AG, Research Division

Is that refi business more profitable on a risk-adjusted basis because it's closer to getting to a point where there's a lower risk that needs MI? Or is it lower risk because it has a lower persistency because it's close to getting below 80%? I mean how should we think about that business versus the rest of the book, i guess?

François Morin
Executive VP, CFO & Treasurer

So risk wise, it's a little bit -- it's about the same risk wise. It's the same -- goes to the same process of evaluating. I think there is pricing. It's a little bit less pricing, and a lot of it has to do with -- it's sort of rolling forward the same book of business. It's like a renewal book of business. So we'd say it's slightly less. But I think risk adjusted, they're very, very similar after you factor everything in.

Joshua David Shanker
Deutsche Bank AG, Research Division

And are these customers likely the same customers you had before or -- because of your procurement skills? Or is -- does the mix change that depends on who picks it up, the crapshoots you get that refi from a previous customer?

François Morin
Executive VP, CFO & Treasurer

I think you can make some action points to try and protect our book of business, but the latter is more likely if you don't do anything else. I think it just goes thrown back. It's thrown back into the pool. It may be refinanced by a different mortgage originator, to begin with, so that will have different relationships going along with that. So...

Operator

Our next question comes from Geoff Dunn from Dowling & Partners.

Geoffrey Murray Dunn
Dowling & Partners Securities, LLC

First, could you provide the net ILM cost in the results this quarter?

François Morin
Executive VP, CFO & Treasurer

Well, the way we look at it, it varies obviously by layer or some of the old Bellemeades have amortized. But big picture, Geoff, I mean you should think about roughly 3% of the outstanding balance as the cost. So we told you we have about $3.7 billion of outstanding Bellemeade limits in place at 3%. And I'll let you do the rest of the math.

Geoffrey Murray Dunn
Dowling & Partners Securities, LLC

Okay. And then can you talk about the trend this year in terms of detachment points? It looks like the new business deals we've seen this year have moved beyond just being mezz cover. And now we're really looking at mezz plus cat cover. Can you talk about the decision to do that, the market reception for continuing to do that going forward? And how you weigh the risk benefit versus cost?

François Morin
Executive VP, CFO & Treasurer

Right. Well, certainly, initially, the attach and detach structures were very much focused on PMI coverage and capital requirements. I want to say in the last few, we've moved a little bit. Like you said, beyond that, there's a bit more of a focus with rating agencies that have slightly different views on capital requirements. So we're always interested in the tradeoff and making sure that, yes, maybe we can get some additional protection at a rate or at a cost that is efficient for us. And that's part of our capital management decision. So it's -- that's how we look at it. And I think part B of your question there is tremendous appetite in the investment community for these types of product, as you know, and the fact that we're expanding the programs a little bit and going up a bit more into the, like you said, pass the mezzanine layers of risk. We've had tremendous success in placing those instruments. And we think they're -- hopefully, they're for us down the road.

Geoffrey Murray Dunn
Dowling & Partners Securities, LLC

Okay. And then just a quick last follow-up. The other IIF was basically flat sequentially. Are you -- is that just lapse rate experience? Or are you seeing any change in the attractiveness of the GSE-CRT market?

Marc Grandisson
President, CEO & Director

It's just a normal roll-off, Geoff, or -- of -- we -- as you know, we've been at it since 2014, so you would have a sort of a seasoning and so getting a sort of a run rate in terms of appetite. And having, frankly, our allocation did more stabilizing over the last 2, 3 years.

Operator

And our next question comes from Yaron Kinar from Goldman Sachs.

Yaron Joseph Kinar

Goldman Sachs Group Inc., Research Division

I guess my main question is just around the premium growth in insurance and reinsurance. We're seeing some growth in kind of longer tail lines, and I think you even explicitly talked about a multiyear program that you signed in -- or multiyear treaty you signed in casualty reinsurance. Just given the loss trends that we're hearing about and just kind of increased concerns around deterioration thereof, can you maybe tell us or talk us through how you gain comfort in growing those lines here?

Marc Grandisson
President, CEO & Director

Yes. That transaction is very unusual. And I would call -- I would put in a camp of a bit more opportunistic in nature. Not that we don't want to renew it for the foreseeable future, but this is -- this came to us with a lot of the changes to the pricing, the attachment point and whatnot. So it's not that you renew the same structure you necessarily are on. So there's a lot of moving parts to that transaction. That one would be squarely in the camp of tremendous distress, which you said in your comments, François, and definitely at the heightened level of return, that we believe more than covers any of the range of outcome or potential outcome on the loss trend going forward. So it's about margin of safety here.

Yaron Joseph Kinar
Goldman Sachs Group Inc., Research Division

Okay. And that specific transaction. And then more broadly, the other growth in programs, construction, that's a surplus casualty?

Marc Grandisson
President, CEO & Director

Very similar. I mean the construction in national accounts would have a bit more workers' comp, so we have a bit more view on the loss trend in there. So that helps taking our loss picks. On the E&S casualty, I think you would have a very similar phenomenon not to the same sort of distress level, that I've just mentioned in the reinsurance transaction, but certainly you have similar overtones of distress being pushed in to the different marketplace and having to be repriced. And at price level that we believe far make up for any uncertainty we may have in terms of loss trend.

Yaron Joseph Kinar
Goldman Sachs Group Inc., Research Division

Got it. And then maybe more broadly, as you're looking at deploying capital into insurance or reinsurance, when you think of quota share reinsurance, you're getting the benefit of improving underlying conditions and then maybe additional improvement on the reinsurance side, does that start to become more attractive than the insurance book?

Marc Grandisson
President, CEO & Director

I think the reinsurance playbook is a little bit different. I think you have -- you can by a strike of a pen, embark on a significant partnership with this leading company under reinsurance and really move the needle quickly as we saw in that transaction I just mentioned. On the insurance, it's a slower build. But I think if you look back at our 2002, 2003 history, the reinsurance team is a lot quicker because I had the ability to be much quicker and get access to business that's going through rate change and improvement rather much quicker than our insurance group will. But the insurance group is not far behind, as you saw, in the numbers this quarter. So that's more of the same playbook, Yaron.

Operator

Our next question comes from Brian Meredith from UBS.

Brian Robert Meredith
UBS Investment Bank, Research Division

A couple of questions here. First, I'm just curious on the big transaction, reinsurance transaction, did it distort any of the ratios? And also, was there any earned-premium-type portfolio that came into, which would have maybe inflated the earned premium?

François Morin
Executive VP, CFO & Treasurer

No. It's early. So there's no LPT. There's no incoming port in. So it's a straight up multiyear deal and then distort the ratio is not really -- so there's normal level of -- it's loss ratio, expense ratio. It's been -- not a whole lot has been earned as it is. So it really -- and the big picture for the segment, there's no impact at this point.

Brian Robert Meredith
UBS Investment Bank, Research Division

Great. And then just curious, in the insurance segment, some of the investments that you're making that you highlighted claims, et cetera, et cetera. How long are those expected to continue here for? And maybe another way to think about it is, if I look at your other underwriting expenses kind of growth that you're seeing, how much of that is due to the acquisition versus just investment you are making?

François Morin
Executive VP, CFO & Treasurer

I'd say, roughly speaking, there's probably a good -- I mean more than half, maybe 2/3 is from the acquisition that we've made. So we brought on a fair amount of people with the acquisition. And as we said before, the earned premium has to earn. And we think that by early 2020, that portfolio will have been fully with us for a full year. And then on top of that, there's still a few more adjustments or investments we've made in terms of staff. We brought in some other underwriters to help supplement some of the lines of the business where we're seeing opportunities and other small areas, like I had mentioned, claims and IT where there's still investments we think are -- we're making that are appropriate then at the right time for us to make them. I don't think those will keep growing as much. So once the premium that we're putting on the books now earns out or earns over the next 12 months, it should stabilize and level up and maybe even kind of go down a little bit.

Brian Robert Meredith
UBS Investment Bank, Research Division

Great. Great. And then another question. If I look at some of the growth that you guys are putting on, excluding this big multiyear kind of treaty that came on, a lot of it's heading more towards property, kind of property cat, businesses that tend to be a little bit more volatile. Is that something we should expect perhaps going forward, a little more volatility in the results, but maybe lower underlying combined ratio as kind of a shift kind of mix of business?

Marc Grandisson
President, CEO & Director

The property that we're growing in leaps and bounce is actually not necessarily -- some of it got exposed on the insurance side, but there's a cat cover and other reinsurance protections against the volatility of the results. On the reinsurance side, I think most of the property growth is actually not necessarily cat exposed. So it's a bit of a different growth. Some of the cat exposed, you're seeing some cats that we've written growing, although we would say we were -- we are relatively underweight, exactly, very small compared to what you would expect a [Bermuda] in our size. So no, we don't expect much more volatility as a result of that.

Brian Robert Meredith
UBS Investment Bank, Research Division

Great. And then my last question, just curious. As we look at this kind of terrific growth you guys are putting on in the insurance and the reinsurance area, I'm just curious how fungible is the capital between your mortgage insurance business and your insurance and reinsurance businesses? Is it easy to take money out of the MI operations, maybe fund growth in the insurance or reinsurance? How does that all work?

François Morin
Executive VP, CFO & Treasurer

Well, it's not, 100% fungible. But I mean -- maybe you noticed in our numbers this quarter, the PMIERs ratio went down in the third quarter as a result of a fairly substantial dividend that was upstream from the U.S. MI operations to the group. So that is money that was -- that is available to fund growth in both the insurance and all our other lines of business or segments. So how easy is it to do? It's a process. It's not -- certainly, you can't do it on a whim or just overnight. But once we get the regulatory approvals and we sit down with them and show them scenarios and stress scenarios and forecasts and certainly figuring out also contingency reserves, so there's a lot of statutory rules we have to abide with. But big picture, we have the ability to use some of that capital and move it around and use it in other areas.

Operator

Our next question comes from Meyer Shields from KBW.

Meyer Shields
Keefe, Bruyette, & Woods, Inc., Research Division

I only have one question. Marc, I was hoping you could help us understand how to think about the expenses associated with the submission flow uptick in P&C.

Marc Grandisson
President, CEO & Director

Yes. It's more expensive. And I think that one of the investments that we talk about is to get much more efficient in dealing with those submissions and being more proactive using tools, such as predictive analytics to really get to the ones that we have a higher chance of hitting. So this is certainly part of, yes, absolutely, Meyer, to the point that we're investing to be able to augment the throughput in -- on the platform. That's one of them.

Meyer Shields
Keefe, Bruyette, & Woods, Inc., Research Division

Okay. In general, do the distribution -- I'm trying to think the right way to ask this. Are more of the -- as a percentage, are more of the submissions priced adequately now? Or is there enough disruption in the marketplace that you're seeing -- or that agents are pushing stuff, which just doesn't make sense to Arch right now?

Marc Grandisson
President, CEO & Director

So right now, we're seeing more submission coming to us. Our hit ratio is not -- it's still in its early stages of finding its footing. It's also reactive to the marketplace price. So -- but clearly, we are finding in the new business a similar and possibly in a growing mode more of our liking as to what's being proposed in the marketplace. By virtue of the fact that, that business did not put out any E&S market for pricing or for consideration tells you that it will be most likely repriced. The problem that we have with this, as you could appreciate it, it doesn't mean it's repriced, it's priced adequately, right? You could come in -- come out of a place where it needs probably a 30% increase to get to this E&S and thrown into marketplace and only command a 10% to 15% or go for 10%, 15%. That's not enough for us to do. So the -- it's still very important to be selective in what you do and maintain as we have our underwriting discipline.

Operator

Our next question comes from Ron Bobman from Capital Returns.

Ronald David Bobman
Capital Returns Management, LLC

I had a question about Watford. It's obviously trading at a huge discount to book. And it sort of indicates sort of a disbelief in -- from my view, a disbelief in either the underwriting quality or the investment portfolio or strategy. And not that I subscribe to it, but at least the market seems to describe -- subscribe to sort of 1 of those 2 justifications. What are Arch's thoughts about where it sits stock price wise and the plan and maybe the use for capital at Arch to remedy it if it -- if you're so motivated? Obviously, there's been some personal investment, sizable, the last few months by Arch executives. But beyond that, would you comment, please?

François Morin
Executive VP, CFO & Treasurer

Yes. I'll start, and I'm sure Marc will chime in. I think at a high level, certainly, there's only so much we can say, but we're still very committed to the Watford platform. It's been good for us. I think it gives us the ability to access business in a different way that we wouldn't be able to do so just with Arch. In terms of the stock price, who knows what the market is thinking. I would argue that maybe there's overreaction in -- based on some of the other hedge fund reinsurers and how they perform. So I wouldn't speculate or think that -- where it's going to go, but I -- my personal belief is it's probably a bit -- there's some overreaction going on. So, Marc, anything you want to...

Marc Grandisson
President, CEO & Director

I think the one thing I would add, Ron, to this is we're -- I'm still in. And I still like the company's perspective, and I would even argue that it's even better at this point in time. I think that the marketplace is getting better and Watford is uniquely positioned to be side-by-side with us and as we underwrite and help them write good business on the books. So I'm actually more positive, if anything, today than I was 6 months ago, which I was already positive to begin with. There you go.

Operator

Our next question comes from Ryan Tunis from Autonomous Research.

Zhang Lu
Autonomous Research LLP

This actually Crystal Lu in Ryan Tunis. One question I had was just on the elevated large losses on reinsurance. I think you mentioned there's some impact from Thomas Cook collapsing. Could you maybe give a breakdown of how much of an impact the large losses had on the underlying results there?

François Morin
Executive VP, CFO & Treasurer

Yes. I mean it's not major. I think I just made the point to let -- have you guys think about it so that -- it can happen. These things happen. This quarter was Thomas Cook. It could have been something else. It's been other things in the past. We've had property tax losses. So -- right? It's not out of norm. It's -- right now I think it's around a 3% impact on the loss ratio this quarter. That's what we're in the business of doing. We ensure. I mean we're in the risk business, and we're not making excuses. We're just letting you know. We're just -- I mean very consistent with what we've seen in the past and highlighting it. So that's all I think I want to say now.

Zhang Lu
Autonomous Research LLP

Okay. That's helpful. And then one more question on just getting the insurance profitability down to your 95% target eventually. How is the changing pricing environment changed your view on your internal time line and strategy in terms of business mix there ?

Marc Grandisson
President, CEO & Director

I think it's not changing where we're going. I think that the market is most likely helping us getting there quicker or sooner. That's what I would tell you.

Operator

And I am showing no further questions from our phone lines. And I'd like to turn the conference back over to Marc Grandisson for any closing remarks.

Marc Grandisson
President, CEO & Director

To everyone there, happy Halloween. Thank you and see you next quarter.

Operator
Ladies and gentlemen, thank you for participating in today's conference. This does conclude the program. You may all disconnect. Everyone, have a wonderful day.