S&P Global
Market Intelligence

Arch Capital Group Ltd. NasdaqGS:ACGL FQ4 2019 Earnings Call Transcripts

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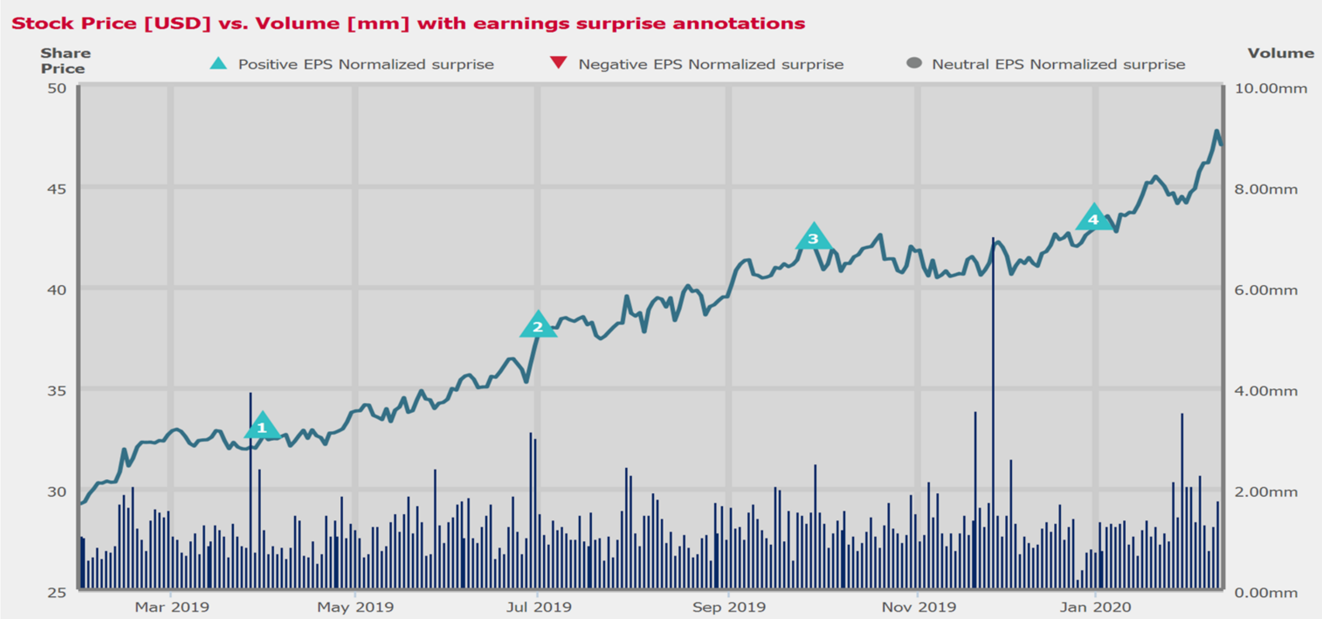
S&P Global Market Intelligence Estimates

	-FQ4 2019-			-FQ1 2020-	-FY 2019-		
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	ACTUAL	
EPS Normalized	0.68	0.74	▲8.82	0.74	2.75	2.82	
Revenue (mm)	1273.15	1343.10	▲5.49	1468.30	5436.29	5506.20	

Currency: USD
Consensus as of Feb-12-2020 8:30 AM GMT



- EPS NORMALIZED -	CONSENSUS	ACTUAL	SURPRISE
FQ1 2019	0.61	0.67	▲1 9.84 %
FQ2 2019	0.67	0.77	▲2 14.93 %
FQ3 2019	0.62	0.63	▲3 1.61 %
FQ4 2019	0.68	0.74	▲4 8.82 %

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ANALYSTS

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Elyse Beth Greenspan
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JP Morgan Chase & Co, Research Division

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

Michael David Zaremski
Crédit Suisse AG, Research Division

Ryan James Tunis
Autonomous Research LLP

Yaron Joseph Kinar
Goldman Sachs Group Inc., Research Division

Presentation

Operator

Good day, ladies and gentlemen, and welcome to the Q4 2019 Arch Capital Group Earnings Conference Call. [Operator Instructions] As a reminder, this conference call is being recorded.

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 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. Arch completed 2019 on strong footing as the mortgage insurance market remains healthy, and our property and casualty operations are well positioned for the pricing improvements taking place in many areas of the market.

Our operating income produced an annualized return on common equity of 11.7% for the fourth quarter and 12% for the full year, while book value per share grew 3.2% for the quarter and nearly 23% for the year.

While property and casualty rates are increasing in several lines of business, we believe the market remains in a transitioning phase between soft and harder conditions. Given the uncertainty of current claim trends, we believe our industry needs further rate increases to provide a more clear risk/reward proposition. In this transitional environment, risk selection and thoughtful capital allocation remain critical to generating superior returns.

As we discussed last quarter, strengthening market conditions are evident to us from both the rise in our submission activity and our ability to achieve significant rate increases. Dislocation is ongoing as some industry participants derisk by tightening underwriting standards and by actively managing down their exposures. We believe that these conditions are likely to continue in the foreseeable future due to the continuing uncertainty regarding losses from the recent soft policy years.

While there are some lines of business where the rise in loss costs can be tied to social inflation, in our view, a large component of the stress on the P&C industry's performance is due to prolonged soft market conditions and optimistic loss picks over the last 3 to 4 policy years. But reported capital levels are still high, combined ratios are still below 100. Therefore, the duration of the transition or hardening market is unpredictable.

Within our insurance segment, conditions for growth improved throughout the year as indicated by 29% growth in our fourth quarter 2019 net written premiums. About 1/4 of our premium growth came from recent acquisitions, while 50% was created organically through new opportunities and the rest coming from rate improvement.

Following 3 years of elevated property losses in both the U.S. and internationally, property rate increases, particularly E&S risks in cat-exposed area in the U.S. are up more than 25%. We have also seen rate increases ranging from 10% to 20% in large commercial general liability and public company D&O policies. But as we discussed previously, rates are not rising in all lines and in some areas, rates are not rising enough.

Switching now to our reinsurance business. Pricing in that segment tends to follow primary insurance, and we have observed some signs of discipline returning to the reinsurance market. In our facultative reinsurance business, we are seeing increasing submission levels and much improved pricing. Fac reinsurance has been a leading indicator of treaty market conditions historically, and we like the positive signal fac is giving us at this point.

On the treaty side, we are beginning to see modest improvements in terms and conditions, including declines in ceding commissions ranging from 1 to 3 percentage points. Ceding commissions remain elevated, however, and are 500 bps above the level seen in the last hard market.

Focusing on the January 1 reinsurance renewals for a minute. Rate increases in what is primarily a property cat reinsurance renewal period created a few opportunities for our reinsurance group, but we remain underweight cat risk. As a reminder, our self-imposed internal risk limitation is 25% of equity capital. At this point, our 1-in-250-year PML stands at only 6% of equity capital.

Turning now to our mortgage insurance segment. Arch MI continued to perform well. As I mentioned earlier, the operating environment is characterized by strong credit quality and a healthy housing environment. In addition, lower interest rates led to strong new mortgage originations in the quarter. Accordingly, our new insurance written at Arch MI U.S. was strong at roughly $24 billion in the quarter. Overall, our U.S. insurance in force was $287 billion at quarter end and the underwriting quality of recent originations remain very high.

On a macro basis, lower interest rates and high employment have made housing more affordable. At the same time, demographic forces in the U.S. are creating a tailwind as millennials move into their prime household formation years. Lower interest rates also led to greater refinancing activity in the quarter, which explains the decline in our persistency rate in the fourth quarter, down to 76%. From a historical perspective, this level remains high and along with good mortgage origination activity, supported growth in our insurance in force in the quarter.

With respect to our investment operations, interest rates have returned to historically low levels. As in our underwriting approach, we have maintained our focus on risk-adjusted total return, which contributed to our growth in book value per share in this quarter and the year.

In summary, Arch's position following years of deemphasizing the most commoditized and soft business lines in property casualty markets is favorable. We have the human and financial capital to grow should the market continue its favorable trajectory into 2020.

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

François Morin
Executive VP, CFO & Treasurer

Thank you, Marc, and good morning to all. Before I give you some comments and observations on our results for the fourth 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 Ltd. In our filings, the term consolidated includes Watford.

After-tax operating income for the quarter was $308.4 million, which translates to an annualized 11.7% operating return on average common equity and $0.74 per share. Book value per share grew to $26.42

at December 31, a 3.2% increase from last quarter and a 22.8% 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 $30.4 million or 2.2 combined ratio points, compared to 9.7 combined ratio points in the fourth quarter of 2018. These losses impacted both our insurance and reins segments, and were primarily due to Typhoon Hagibis and a series of smaller events.

As for prior period net loss reserve development, we recognized $54.7 million of favorable development in the fourth quarter, net of related adjustments or 4.0 combined ratio points compared to 6.1 combined ratio points in the fourth quarter of 2018. All 3 of our segments experienced favorable development at $2.8 million, $19.1 million and $32.8 million for the insurance, reinsurance and mortgage segments, respectively.

We had solid net written premium growth in the insurance segment of 28.7% over the same quarter 1 year ago. The insurance segment's accident quarter combined ratio, excluding cats, was 101.6%, higher by 330 basis points from the same period 1 year ago. Approximately 220 basis points of the difference is due to an elevated level of large attritional claims in the quarter, primarily from our surety unit, which can experience some volatility from quarter-to-quarter. The balance is primarily due to a higher expense ratio, driven by investments we are making in the business and the integration of our U.K. regional book and other smaller acquisitions.

Now moving on to our reinsurance operations, where we had a relatively stable quarter. Net premium growth was at 4.3% from the same quarter 1 year ago and the accident quarter combined ratio, excluding cats stood at 92.3% compared to 96.2% on the same basis 1 year ago. The difference is mostly attributable to the presence of a large attritional casualty loss arising from the California wildfires in the same quarter 1 year ago. Our expense ratio remained essentially unchanged at 26.9%.

The mortgage segment's accident quarter combined ratio improved by 200 basis points from the fourth 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 0.9% is lower by 120 basis points than the result recorded in the same quarter 1 year ago, mostly as a result of better-than-expected claim experience.

The benefit to the loss ratio from current year favorable development was 510 basis points, in addition to the 940 basis points related to prior years. The expense ratio was 20.7%, consistent with the results from the same period 1 year ago.

Total investment return for the quarter was a positive 107 basis points on a U.S. dollar basis, as our high-quality portfolio continued to perform well. For the 12-month period, our portfolio returned 7.3%, an excellent result driven by particularly strong returns across our fixed income and equity investments. The duration of our investment portfolio at December 31 was down slightly to 3.40 years from 3.64 years at September 30, and was overweight relative to our target allocation as we continue to expect a lower-for-longer global interest rate environment.

The corporate effective tax rate in the quarter on pretax operating income was 6.9%, and reflects the geographic mix of our pretax income and a 30 basis point benefit from discrete tax items in the quarter. The 2019 fourth quarter effective tax rate on operating income includes an adjustment to interim period taxes recorded at an annualized rate. This adjustment increased the company's after tax results on pretax operating income available to Arch common shareholders by $12.4 million or $0.03 per share. As always, the effective tax rate could vary, depending on the level and location of loss or income and varying tax rates in each jurisdiction.

Turning briefly to risk management. With the recent improvements in catastrophe pricing, we have increased our natural cat PML to $612 million as of January 1, which, at slightly more than 6% of tangible common equity on a net basis, remains well below our internal limits at the single event 1-in-250-year return level. This change demonstrates our ability to deploy incrementally more capital in an improving market to opportunities that offer adequate returns on an expected basis.

In our mortgage segment, as mentioned on our prior earnings call, we completed our 10th Bellemeade transaction in the fourth quarter, with coverage of $577 million. As of year-end 2019, the in-force Bellemeade structures provide aggregate reinsurance coverage of approximately $3.3 billion.

With respect to capital management, we did not repurchase shares this quarter. Our remaining authorization, which expires in December 2021 stood at $1 billion at December 31. Our debt to total capital ratio stood at 13.1% at quarter end and debt plus preferred to total capital ratio was 19%, down 350 basis points from year-end 2018.

Finally, as you know, we closed on the Barbican acquisition in November of last year. The integration of their platform is well underway. For the 2020 calendar year, we expect to incur approximately $65 million of intangible amortization across all acquisitions we have made prior to December 31, 2019.
With these introductory comments, we are now prepared to take your questions.

Question and Answer

Operator

[Operator Instructions] And our first question comes from Yaron Kinar from Goldman Sachs.

Yaron Joseph Kinar
Goldman Sachs Group Inc., Research Division

So my first question just goes to growth in the insurance segment. If I heard your comments correctly, it sounds like you're so lukewarm in terms of the market opportunities and the rate environment and rate adequacy. And yet, I think, even excluding the acquisitions, you grew at a good 20% clip or so. I guess, where are you seeing the opportunities? And if you were to become more constructive on market conditions, where do you see that growth capping?

Marc Grandisson
President, CEO & Director

The first part is that -- thanks for the question. The first part is I think we're lukewarm in the sense of saying it is a full-on hard market. We just want to impress upon everyone that we're in the early stages of rate changes, and we don't know how long that's going to last. And I also made comments about the fact that the industry has an all-time capital high and still printing very reasonable combined ratio numbers. So I just wanted to make the point that it's not across all lines of business. Having said this, the growth that you see us experience and go through for the year and certainly, in the fourth quarter, are -- is in the areas where market are coming back to our pricing level and return expectations. So we had deemphasized those lines of business for quite a while, actually, as the softer years were eating into our -- on production.

And I think of late, we've seen a resurgence of submissions, and we're able to hit and get our pricing and return. So in the areas where we're growing, I would say that it is definitely an improving market and improving such that we believe we're clearing some of the loss trend or loss cost trend concerns that one may have. So I also want to remind that we had not grown as much as the market would have, probably could have indicated over the last year. So this is high -- no, this is good growth on a lower number. For instance, on the D&O side, we -- our premium written was about half of what it was last year versus 5 years ago. So you don't need much of an increase to really make a dent in the overall price increase.

And the second question is, we can grow a lot. And as we saw -- you asked, Yaron, whether we can grow based on the conditions. If conditions continue on and we're seeing right now still getting -- still being very, very good, I think we could still grow a fair amount. I think we have been -- our guys -- people have been very busy even in those softer years, but I do believe that we have extra capacity and appetite to write more, quite a bit more if it happens. How much will depend and be dictated by overall rate level in 2020.

Yaron Joseph Kinar
Goldman Sachs Group Inc., Research Division

It sounds like that premium growth could accelerate then in the right market conditions.

Marc Grandisson
President, CEO & Director

That is a fair statement.

Yaron Joseph Kinar
Goldman Sachs Group Inc., Research Division

Okay. And do you have any sense where you're booking the current -- the new business coming on relative to the overall portfolio in insurance, like with the adequacy of returns there is?

Marc Grandisson
President, CEO & Director

Yes. So we haven't changed much of the loss picks. Now I want to put things in perspective as well, is that the rate changes that have taken place that we're talking about really started to be, we believe, enough above the loss cost trend since the middle of 2019. So it's a bit early and premature to make any changes to your booking your loss ratio, you look at it on an accident year basis, plus things could develop on historic -- history, all the accident years prior to 2019. So it's premature to make any comment into loss pick as we speak. Frankly, loss pick if they are to improve, and we believe everything else being equal, they should improve over the next couple of years, they'll take 6 to 7 quarters to really see good tractions and see some movement there.

Operator

And our next question comes from Jimmy Bhullar from JPMorgan.

Jamminder Singh Bhullar
JP Morgan Chase & Co, Research Division

First, I just had a question on the tax rate. It improved a lot '18 to '19. And I think it was lower than what you had expected as well. What's driven that? Is it just the geographic makeup of income? Or -- and what's your expectation or sort of likely range for 2020?

François Morin
Executive VP, CFO & Treasurer

Well, yes, a couple of points here. I think the -- it was a bit lower than what we had, I guess, given as a range earlier in 2019. There's a couple of discrete items that played out throughout the year which helped out in terms of publishing the final tax rate. So when I just -- I took some of those, I look back. And without these adjustments, which is really how we think about when we give you a range, the 2018 tax rate was 11.2%, this year was 10.9%. So very close. Ultimately, we had some additional benefits that brought it down to 10.4% for the year. So yes, I mean, as you know, tax rate is very much a -- it's hard to have a lot of precision on the tax rate because we just don't know where the losses are going to be before they happen. So whether there's a cat or favorable or unfavorable development on prior years, et cetera.

So looking at 2020, I'd say, we're very comfortable saying that we're going to probably be in the same range, maybe if you want to expand it, maybe to try to make sure we're in the range, maybe 10% to 14%. In the years past -- last year, we said 11% to 14%. So maybe there's -- potentially, it could be a bit lower, but I think it's a bit early again. I mean we're in the early days of 2020. And hopefully, that's enough for you to update the models.

Jamminder Singh Bhullar
JP Morgan Chase & Co, Research Division

Okay. And then on the MI business, obviously, your overall margins have been very strong, and the same goes for peers as well, and a lot of that's just the strong results on the legacy block. But if you look at new business ROEs, are those in the sort of double digit range? Or is this more sort of a single-digit ROE type business in terms of new sales? And I realize it will take a while for your overall [margins] to shift towards new business ROE.

Marc Grandisson
President, CEO & Director

I'm almost choked out now. We're solidly well in the double-digit returns still in the market. It's still very good quality. I would even argue that the risk of the later -- last half of the year actually improved somewhat for the industry, not only for us. And I think that had to do with Fannie and Freddie, sort of putting a bit more constraints on the risk layering in the business. So no, it's still very, very healthy returns, very healthy.

Jamminder Singh Bhullar

JP Morgan Chase & Co, Research Division

And then just lastly, on any comments on 1/1 renewals? And specifically, were they better or worse than your expectations? And anything -- any sort of views on the sort of upcoming 4/1 renewals and midyear's?

Marc Grandisson
President, CEO & Director

The 1/1 renewals were in continuation, right, you had some rate increase in the third quarter, broadly in the industry. Fourth quarter was a bit better. The first quarter lined up to be better yet. So yes, better rate environment at 1/1, clearly, for the first quarter. We don't know what it means for 4/1. I am done prognosticating what the future will hold. I -- it's the law of supply and demand and perception of relative risk is a market-based thing. So sometimes, I think markets should go up, and it doesn't, and sometimes it goes down, and it's all over the place. So it's too early to tell where 4/1 and 7/1 will end up. But clearly, if the momentum at 1/1 continues, it's going to be -- it's an improving market, clearly.

Operator

Our next question comes from Elyse Greenspan from Wells Fargo.

Elyse Beth Greenspan
Wells Fargo Securities, LLC, Research Division

My first question is, I guess, on 1/1 a little bit. We've heard about the retrocessional market being pretty strong this year. Was -- has Arch written more of that business? And just how did you observe what went on in the retro market at 1/1? And is that a sign of potentially better things to come? Or would you think it would be for some of the 4/1 and 6/1 renewals?

François Morin
Executive VP, CFO & Treasurer

Yes. I mean, certainly, on the -- I mean, you see that a little bit in our cat PMLs, they went up in large portion because of additional retro business that we wrote that I would say was very much opportunistic. So whether that sticks and whether that means, tells us something about 4/1s or 6/1s, we just don't know. But for sure, we saw some definite -- some good opportunities in the -- specifically in the retro space at 1/1, that we were happy to have the capital to be able to deploy and take advantage of the opportunities.

Elyse Beth Greenspan
Wells Fargo Securities, LLC, Research Division

Okay. And then with the insurance book, I know you guys in the past have talking about that expense ratio being elevated just due to the accounting and the earn-in from some of the more recent deals you guys have done. I'm assuming that there was still somewhat of an impact on that in the fourth quarter. And can you just kind of give us a sense to think about if you have Barbican coming on, how we should think about the expense ratio within the insurance book in 2020?

François Morin
Executive VP, CFO & Treasurer

Yes. So as I said in my remarks, I think the expense ratio was roughly, call it, 130 bps or so was -- in this quarter was the result of the effectively bringing on online, the U.K. regional book. So we're now a year into it. So everything else being equal, 2020, we should see the premium being earned out and the expense ratio coming down. The new twist is Barbican. And as you know, the Lloyd's market, in particular, has a slightly higher elevated expense ratio, which we think is -- there's an offsetting benefit on the loss ratio. But I mean, to give you a bit of -- directionally, a bit where we think the 2020 expense ratio is going to be for insurance, we think it should be right around where it was for 2019. It's not going to improve materially. And I don't think it's going to get worse because we're going to see some benefits, but I think it should be about at the same level.

Elyse Beth Greenspan
Wells Fargo Securities, LLC, Research Division

Okay, that's helpful. And then lastly, on the insurance pricing, Marc, you seem to be pretty positive, especially relative to where you've -- your comments have been for most of the -- most of 2019. And it's a developing market. And I guess, every market seems to be different and capital, obviously, a lot more robust than if we went back to past upturns. Is there any market, like if you think back through Arch's history, does this compare to the early 2000s? This compare to kind of 2013? Is there a market that this feels similar to when we can kind of think about pricing improvement? Or does it feel because of the social inflation issue maybe different than any of these past markets?

Marc Grandisson
President, CEO & Director

Well, it's different in terms of the health of the industry and the combined ratio, as I mentioned, that's for sure. So that makes it a very unique opportunity. But I do believe we have major players pulling capacity out. So even though it's printed capacity, effectively, used capacity is definitely lower in the overall market, specifically on the large risk. You know some of the players, and we've talked about them, Lloyd's being clearly one of them.

I think I would tend to think it looks and feels a bit more like 2005 after Katrina, Rita and Wilma because capital was still plenty, people pay their claims, a couple of companies had some issues. But by and large, the pricing went up, and it was largely as a result of perceived risk. And I think this is what's going on. I think people are, as an industry, this uncertainty about -- around social inflation is creating a lot of uneasiness and pushes us to want to charge more to make sure we cover as much of the eventuality as we can. So that's sort of what I would say, the perceived -- the heightened risk perceived is higher. It's not a bankruptcy-driven, reinsurance-driven necessarily market turns. So it's a blend of a few of those. It's hard. Every market -- I guess, you live and learn and experience new things as you go. But yes, that's what I would summarize it to be.

Operator

And our next question comes from Mike Zaremski from Crédit Suisse.

Michael David Zaremski
Crédit Suisse AG, Research Division

First question on U.S. MI. One of your competitors this morning spoke to decline, an expected decline in premium yields in 2020. Any color there, whether you expect a similar dynamic, given pricing on new business might be a little tighter versus using risk-based pricing?

Marc Grandisson
President, CEO & Director

I think that we -- the phenomenon that's going on as a result of refinancing, clearly, points you to a lower price, a lower premium rate. And that's because the risk is lessened, right? A lot of the refinancing we saw in the last 2 quarters and accelerated in the third -- in the fourth quarter, is people sort of refinancing because the interest rates are just that much better, and it makes sense for them to refinance. By doing so, the LTV that was originally put in our book of business 2 or 3 years ago is actually lower, which is lowering the risk and everything else being equal, it also has a knock-on effect on the DTI, right, on the debt to service -- to income servicing. It improves them as well. So that risk that you -- it's the same people, same house, same environment, but -- and there was also some house price appreciation.

So you get all these things going on, this is not as risky a proposition now than it was 2 or 3 years ago. So it would lend itself to say that the pricing should be -- indicate a lower pricing because of all these various moving parts. But it doesn't mean the returns has changed. And that's really the key that we want to share with you guys is top line in MI is really, really hard to pin down. They're single, there's cancellations and it's very hard to see how it all evolves. But in the end, what we care about and what we've seen is that the return characteristics of the things that were refinanced, which one could say is underlying this somewhat decrease in price and premium rate is actually just a top line phenomenon. It's not a return phenomenon. The returns are still very healthy, and that's what we are actually focusing on.

Michael David Zaremski
Crédit Suisse AG, Research Division

Okay, that's helpful. Next, just kind of broad question about the reinsurance segments. If I kind of look at the combined ratio over the last couple of years, it's been in the mid-90s. I think that translates into a single-digit ROE, but you can -- please correct me if that's not right. And I guess, catastrophe levels don't appear to have been materially higher than expected either. So just kind of thinking about the future, is that largely reflective of just simply the competitive operating environment? And I guess, hopefully, there's continued momentum in 2020 to improve the ROE profile of the segment?

Marc Grandisson
President, CEO & Director

So first, you're wrong. It's not in the single digits. So let's make sure we're clear here. Yes, I think it's much better than this. I think that the -- our reinsurance portfolio is not a -- is a different one. And then there's been mix shift over the last 2 or 3 years. We were a lot more property cat probably 10, 12 years ago. So there's still -- there's always moving parts in the reinsurance platform. And I would say that our play, for instance, in motor, in Europe, will, by definition, lead us to a higher combined ratio, but the returns are still pretty -- very well in excess or well in the range of where we would want them to be to write that business.

So I think the combined ratio in reinsurance, it's just a reflection of this constant culling, pulling, pushing through realigning capital within the various lines of business. And I think what you're seeing is a combined ratio that is just reflective of what we see in terms of opportunities. In terms of returns, I can tell you for certain that our reinsurance group has a very, very ambitious return on equity expectations when we write the business. And that's what every underwriting decision is based on, not on combined ratio.

Michael David Zaremski
Crédit Suisse AG, Research Division

Okay. Got it. So I was wrong that there's -- your portfolio holds probably less capital than I was assuming than -- versus some peers.

François Morin
Executive VP, CFO & Treasurer

But the one thing I'll add to that, Mike, just quickly on the returns. I mean, and that really is all about our cycle management, where our premium volumes went down quite a lot over the last number of years on the reinsurance segment. If the market gets healthier, which it's showing some signs of that, I think -- I don't think our returns will necessarily get that much better, but I think we'll be able to have a bit more growth on the top line, expand the platform and see more opportunities.

Operator

And our next question comes from Brian Meredith from UBS.

Brian Robert Meredith
UBS Investment Bank, Research Division

A couple of questions here. First, just on the insurance segment. I know you talked about how Barbican is going to impact your expense ratio. Will it have any impact to your underlying loss ratio? And I guess, just to add on to that. Is it going to prevent you from maybe achieving an underlying combined ratio below 100% in that -- the insurance area in 2020?

François Morin
Executive VP, CFO & Treasurer

Well, Barbican is, in the big picture, it doesn't really move the needle. It brings a lot of nice traits with it. It has some fee businesses that we like. It has also -- gives us -- makes us more relevant in London, but the one thing that you should be aware of is, a lot of the capacity that Barbican is deploying is actually third-party capital. So that doesn't stick to our ribs. In terms of the combined ratio, yes, we'll have some benefits on the fees and et cetera.

But big picture, Barbican, on a net basis, wrote about $125 million of premium last year, in 2019, split roughly 50-50 between insurance and reinsurance, whether that business, we're certainly going to shut down some lines. We're going to do some re-underwriting along the way. So once you do a bit of math on it, you'll quickly, hopefully appreciate that. For the insurance segment on its own, I mean, Barbican is not going to be a big factor in how 2020 plays out in terms of the combined ratio.

Marc Grandisson
President, CEO & Director

And so on that note, to add to Francois' point, realistically, Brian, we need to focus on and as we are right now, growing and seizing the opportunities that are presented into our insurance segment. And if anything, that will bring us to the combined ratio that will lead us to a 12-ish return on equity, I think, it's going to come through the current opportunity that we see and our ability to seize upon it, which is plenty.

Brian Robert Meredith
UBS Investment Bank, Research Division

So I guess, what you're saying is that it could be -- the underlying combined ratio kind of dropping below 100% and getting to those returns, we not -- may not see it here in 2020, but it's 2021 or whatever as the opportunities continue to come in?

Marc Grandisson
President, CEO & Director

That's right. If you look, Brian, the rates really move starting middle of last year, and a lot of stuff is being renewed, still in the new "rate environment." So we have to write the business first. You have to earn it. So 2020 and '21, you're exactly right. You're exactly where we are. Yes. That's why it takes a while to see the good deeds being reflected. The same way, it takes a long time for bad deeds to get reflected, may I add.

Brian Robert Meredith
UBS Investment Bank, Research Division

Got you. And then under the reinsurance -- Marc, I'm just curious, I know a lot of the business that you write is quota share type business. How much of your reinsurance business is, call it, exposed to areas where you're seeing a significant amount of price increase, be it E&S, certain property lines? And then you might see a good benefit from the subject premium pricing coming through?

Marc Grandisson
President, CEO & Director

I think the beautiful thing about our friends on the reinsurance group is that they're a go anywhere kind of a company. They can do anything, go anywhere, do anything. So in general, they have access and are able to see the deals that are E&S, casualty, property, whatever. So there, we have a -- we've been around for 18 years. We've written a lot of reinsurance, we're still $1.5 billion-plus. We're not a small -- we're smaller in the grand scheme of things, but we still have a lot of selling point in London, in Zurich, in the U.S. and Bermuda. So we're able to grow if the growth opportunities are there. There's no issue there whatsoever.

Brian Robert Meredith
UBS Investment Bank, Research Division

Got you. But what about your subject premium basis already in the books, are you seeing kind of growth there?

Marc Grandisson
President, CEO & Director

I think that by virtue of the improvement -- for 2020, we don't give guidance, obviously, as you know, nice try. But if rates keep on increasing and keep at the level they are at a healthy positive rate, and if it keeps into 2020, 2021, we will have more premium, clearly. I'm not sure that's what you're asking. I'm trying not to answer the right question. So I'm trying to give the right picture, Brian. So help me out.

Brian Robert Meredith
UBS Investment Bank, Research Division

Okay. I think I'm just -- what I'm just trying to get at is that I get the premium growth situation, right? And it's more the underlying, obviously, business is actually seeing improved price too, right, and rates, just like you're seeing in your own business. And just what impact that could potentially have on your reinsurance margins?

Marc Grandisson
President, CEO & Director

Oh, yes, of course, yes, you're right. We're seeing it through the quota share. And you're referencing newer phenomenon, it's anecdotal, it seems to be starting, even the excess of loss pricing now is picking up in speed. So that's also encouraging. So we may have some -- and to your point, you're right, we're not a huge excess of loss, at least in the traditional general liability lines and professional lines. You're right. Yes, we're benefiting from our quota share participants and companies. Yes, we are.

Operator

And our next question comes from Meyer Shields from KBW.

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

Had a couple of small questions to start off with. First, are there any plans to change the amount of mortgage insurance that's retained on U.S. paper versus ceded to Bermuda in 2020 versus 2019?

François Morin
Executive VP, CFO & Treasurer

No plans at this point. I mean, as you know, it's all about -- we try to have as much capital as we can in offshore just because it's a better domicile. It gives us more flexibility. But at this point, and as you know, there's tax implications, we don't want to trip the BTAX issue. So at this point, no plans to change anything.

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

Okay, perfect. Second, I know in the past, you've talked about capital deployment opportunities that ended up at Barbican and in the U.K. And I was wondering if you could give us a sense as to what you're seeing now in the pipeline in terms of other potential opportunities.

Marc Grandisson
President, CEO & Director

I think we're seeing a bit less -- actually I think people are busy more looking at their stuff and trying to improve their book of business. I think that's really more of an inward focus. I think M&A, we have -- we see all of them or we believe we see most of the transactions that are being talked about. I think we were a bit more open, and we're able to strike some transactions over the last year because the pricing was right and the opportunities was there. But yes, no, we don't see acceleration or somewhat of a decreased activity, but I think it just serves as a result of the -- this current marketplace being a bit more dislocated. That's really what I would say.

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

Okay. And then that brings me to the third question. I'm wondering whether -- you talked about how combined ratios are still being reported as profitable, but there's also the soft market impact which, at least I would interpret as suggesting that maybe the real combined ratios aren't as good. Does that delta look any different now than it is before past hard or hardening market?

Marc Grandisson
President, CEO & Director

That's a really good question, Meyer. I don't know the answer to this. I haven't looked at the numbers at the end of '99, 2000. It doesn't seem -- I'll tell you my gut feeling by now, it doesn't feel to be as much of a delta. And also in terms of what impact it could have on a capital market that we were more levered as an industry, '99, 2000. And we were running at 1.3, 1.4 premium to surplus. Now we're at 0.7, 0.65, 0.8, whatever. So a lot less levered. So it's probably more absorbable. But at the same time, there's less investment income. So if you look at -- if you think that the market changes as a result of being cash flow negative or having to -- not having recurring income, then I think that it's -- we're probably in a similar position, meaning that the loss -- the losses or if you combine the underwriting income with the -- which was negative at the end of '99, with the investment income, which was very positive, I think we're probably in a combination in a similar place. But we have higher capital, so more cushion to absorb it.

Operator

Our next question comes from Ryan Tunis from Autonomous Research.

Ryan James Tunis
Autonomous Research LLP

I just had a couple. I guess, first one, thinking about 2020 as a potential year, given what's happening from a pricing standpoint for margin improvement for the industry, I understand why that could be a challenging -- like why it could be challenging for some. But I think when I look at Arch relative to competitors, there's more of a short-tail mix, whether it's in primary insurance and also facultative re. So I guess, Marc, if you could just comment on why isn't there a more constructive near-term outlook for margin improvement given you're clearly getting rates, in some cases, rate on rate in some of these property lines where there does seem to be kind of a layup argument for margin expansion.

Marc Grandisson
President, CEO & Director

So let me correct you quickly, Ryan, on the insurance side. We're 70%, 75% liability in terms of premium written. So that would sort of -- sort of dampens, if you will, the acceleration or the recognition of the improvement in terms and conditions. So it makes us a little bit more cautious. So that's something you need to bear in mind. This is on the insurance segment. And again, on the insurance segment, even speaking to the short tail, it still does take a while to get through. Again, like I said, significant improvement in rates really took place starting middle of -- middle-ish of 2019. So it does still take a while to recognize and really see the earning coming through. The earned premium is a combination of, as you know, for other underwriting years.

On the reinsurance side, I'm trying to think of it. I think it's also -- there's a fair amount of liability as well in there, right, Francois? And there's also a fair amount of property, although property, as you -- as we mentioned, is also -- it'll deleverage on the property cat. We did increase the other property. We're running a lot more on the non-cat XL. This is more opportunistic. And that -- you're right. We should probably see whether we were -- what margin expansion there was, and we believe it's there. We should see it. But again, it was written last third, fourth quarter, so it will come again over the next 12 months. So it takes a while. It takes a while. You have to be patient. Patience is a virtue in our industry.

Ryan James Tunis
Autonomous Research LLP

Understood. And then my second one is just around -- I think we've -- it seems like we've heard less from the reinsurers about the casualty environment and the losses coming in. Maybe you could just talk about the extent to which your -- what are you seeing on the reinsurance book in terms of claims activity on the casualty side versus primary? Like, is there a real lag how the claims started to happen? Or if that's probably still on the comp? I mean, any theory as to when and how we might see more paid losses, I guess, on the reinsurance side?

Marc Grandisson
President, CEO & Director

It's a very, very good question. I think when we -- we do have a tale of 2 cities here. I think that our insurance are seeing the claims. Of course, we have the advantage or the luxury to have an insurance company that's on top of claims and know and participate in the marketplace. When we look at what information our reinsurance folks are getting, there is clearly a lag. I'm not saying it's misinformed or whatnot, but there is clearly a lag, and it's been there forever. This is not a new phenomenon, Ryan. This has been going on for years, for as long as we've been -- as I've been in the business. It's been there and it was there before my time. So there's always information asymmetry and information delay. By the time it gets to the insurance company, they have to look at this, evaluate, book the reserve or not book the reserve and then they, in turn, inform their reinsurance partners.

On the quota share, it's a little bit easier because you're able to do more claims review and be on top -- be side-by-side with them. You can also compare whether we have other of our clients on similar risks and whatnot. On excess of loss, as you could expect, it's a little bit more difficult. There's a further lag on that one as well. So we clearly have a lag in recognition, and our reinsurance company has been really, really adamant and proactive in trying to recognize some of the losses that may not be enough reported. And that's also what made us be a bit more careful in our current writings or lack thereof in the liability space. But there's clearly a lag on the reinsurance side.

Operator

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

Marc Grandisson
President, CEO & Director

Thank you, everyone. Happy Valentine's Day. Make it a Happy Valentine's weekend if you have a chance. Talk to 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.