S&P Capital IQ

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Arch Capital Group Ltd. NasdaqGS:ACGL

FQ1 2015 Earnings Call Transcripts

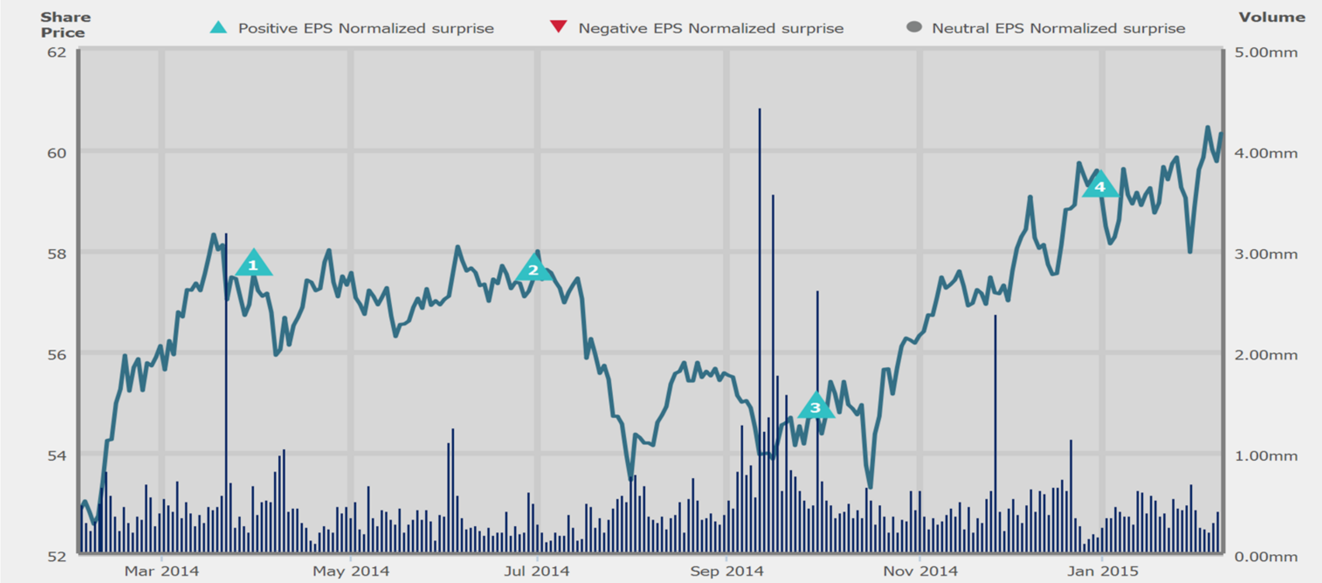
Wednesday, April 29, 2015 3:00 PM GMT

S&P Capital IQ Estimates

	-FQ1 2015-			-FQ2 2015-	-FY 2015-	-FY 2016-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	1.08	1.17	▲8.33	1.01	4.09	4.13
Revenue (mm)	1153.95	-	▼(7.54 %)	1112.64	4301.30	4516.47

Currency: USD

Consensus as of Apr-29-2015 3:45 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ1 2014	1.06	1.20	▲1 13.21 %
FQ2 2014	0.98	1.17	▲2 19.39 %
FQ3 2014	0.95	1.05	▲3 10.53 %
FQ4 2014	1.03	1.15	▲4 11.65 %

Call Participants

EXECUTIVES

Constantine P. Iordanou
Chairman and Chief Executive Officer

Mark D. Lyons
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Presentation

Operator

Good day, ladies and gentlemen, and welcome to the First Quarter 2015 Arch Capital Group Earnings Conference Call. My name is Kathy, and I will be your operator for today. [Operator Instructions] As a reminder, this call is being recorded for replay purposes.

Before the company gets started with this update, management wants first to remind everyone that certain statements in today's press release and discussed on this call may constitute forward-looking statements under the federal security 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 turn the call over to the host for today, Mr. Dinos Iordanou and Mark Lyons.

Constantine P. Iordanou
Chairman and Chief Executive Officer

Thank you, Kathy. And good morning, everyone, and thank you for joining us today. Overall, these years I thought I was the guy with a beautiful accent. But I think Kathy has put me to shame today. We had a good first quarter, as earnings were driven by excellent reported underwriting and investment results. Our gross written premium grew by 1.3% in the quarter, while our net written premium shrunk by 8.8%, as growth in our Insurance and Mortgage businesses was offset by a decline in our Reinsurance writings.

Changes in foreign exchange rate reduced our net written premiums on a U.S.-dollar basis by approximately $32 million or 3.4% of our volume in the quarter.

On an operating basis, we earned $1.17 per share, which produced an annualized return on equity of 10.2% for the 2015 first quarter versus a 12.1% return in the first quarter of last year.

On a net income basis, Arch earned $2.16 per share this quarter, which corresponds to a 15.8% return on equity on a 12-month trailing basis. Return on equity based on net income has averaged approximately 400 basis points higher than operating ROE over the past 4 years. Of course, net income movements can be more volatile, as these earnings are influenced by changes in foreign exchange rates and gains and losses in our investment portfolio. These effects have been more noticeable as we have increased our exposure to alternative asset classes and have remained focused on a total return strategy, where some components of total return are classified below the line in our results.

Our reported underwriting results were excellent as reflected by a combined ratio of 87.5% and were aided by low level of catastrophe losses and continued favorable loss reserve development.

Net investment income per share was flattish for the quarter at $0.55 per share, which is down $0.01 sequentially from the fourth quarter of the -- of last year. Our operating cash flow was $16 million in the quarter as compared to $197 million in the same period last year, and Mark would elaborate further on its components in a few minutes.

Our investment portfolio performed well, with a 205 basis points gain on a local currency basis and because of FX movements 111 basis points when measure in U.S. dollars.

Our book value per common share at March 31, 2015, was $47.80 per share, an increase of 4.9% sequentially, while book value per share grew by 15.1% from March 31, 2014.

With respect to capital management, we continue to have capital in excess of our targeted levels. And in the first quarter, we repurchased 2.7 million shares for an aggregate purchase price of $163 million.

We increased M&A activity in the sector. We continue to evaluate opportunities, such as acquisitions of other business units, people and renewal rights transactions. As you know, we prefer to deploy our excess capital back into our business; but as of today, these efforts have not come into fruition.

Currently, competitive conditions make profitable growth in our traditional lines of Insurance and Reinsurance difficult to achieve. The Insurance segment gross written premium grew by 5% in the quarter over the same period of last year, primarily as the result of the renewal rights agreement entered into last year in our alternative markets lines and modest growth in our excess and surplus casualty lines associated with our contract-binding business.

Net written premium in our Insurance segment was essentially flat in comparison with the same period a year ago, as reductions in our professional lines, energy and marine lines and determination of one of our programs offset our growth in all other lines.

In the primary markets in which our insurance group participates, we continue to obtain rate increases in most lines of business at approximately the same level as we observed last quarter. Competitive conditions in the property sector have negatively affected primary property rates and accordingly our U.S. premium volume in those lines.

In our Reinsurance segment, softening pricing and continued pressure on terms and conditions led us to reduce reinsurance writings by 6% on gross written or 1.7% decline, if it was expressed in local currency. The decline though in net written premium of 21.5% was influenced by sessions to Watford Re, which formed in the last days of the first quarter of 2014, but also reflects increased purchases of retrocessional protection in an opportunistic way.

Our Mortgage segment includes primary mortgage insurance written through Arch MI in the U.S., reinsurance treaties covering mortgage risk written globally as well as other risk-sharing transactions, mostly in the U.S. Gross written premium in the Mortgage segment was $60.5 million for the first quarter of 2015 or a 26% increase compared to the first quarter of 2014, while net written premiums grew by nearly 20% over the same period to $51.9 million.

Our U.S. mortgage operations acquired in late January of 2014 produced a little more than half of the segment's net written premium in the first quarter with $24 million of net premium written emanating in the credit union channel, while the bank channel produced $4 million in premium written for the quarter.

As of March 31, 2015, we have approved more than 644 master policy applications from banks, and more than 190 of these banks have submitted loans for our approval. Of these master policies, 37% represent national accounts, and the balance is consisting of regional banks. Of the top mortgage originators for conforming mortgage sold to the GSEs, which mortgage insurance is usually bought, we now have approved master policies with each of the top 15 lenders and 21 of the top 25 and continue to make progress with the rest of the banking groups.

Mortgage reinsurance premiums written declined in the quarter as a new transaction agreed upon during the first quarter should begin to contribute to premiums written towards the end of next quarter.

On the other hand, net earned premium rose 13% over the same period a year ago as certain premium on quota share agreements written in prior periods usually produces a stream over a 6- to 7-year period.

We also continue to see opportunities in GSE risk-sharing transactions, which were primarily responsible for the $7.7 million of other underwriting income for the 2015 first quarter versus $800,000 in the same period of a year ago.

Arch participated in $490 million of insured limits via Freddie Mac's stacker transactions in the first quarter of 2015. No premium is reported for these transactions as current accounting treatment requires us to use derivative accounting. We expect risk-sharing transaction issued by Freddie Mac to receive insurance accounting treatment on a prospective basis for all in-force and also new transactions in the near future.

While some of our business lines are seeing very competitive pricing conditions, Arch diversified mix of business and our willingness to exercise underwriting discipline should allow us to generate acceptable returns in the current competitive environment.

Group-wide on an expected basis, we believe the ROE on the business we underwrote this quarter will produce an underwriting year return on equity in the range of 10% to 12%.

Before I turn it over to Mark, I would like to discuss our PMLs. As usual, I would like to point out that our cat PML aggregates reflect business bound through April 1, while the premium numbers included in our financial statements are through March 31 and that the PMLs are reflected net of all reinsurance and retrocessions.

As of April 1, 2015, our largest 250-year PML for a single event was essentially flat, and it was in the Northeast at $550 million or 9% of common shareholders' equity. Our Gulf of Mexico PML decreased to $495 million at April 1, and our Florida Tri-County PML decreased to $396 million.

I will now turn it over to Mark to comment further on our financial results. And after his comments, we will be happy to take your questions. So with that, Mark, you have the floor. Mark Lyons.

Mark D. Lyons
Chief Financial Officer, Executive Vice President and Treasurer

Great. Thank you, Dinos. And good morning, all. I was true -- as was true on last quarter's call, my comments today are on a pure Arch basis, which excludes the other segment, that being Watford Re, unless otherwise noted. Furthermore, since the accounting definition of the word consolidated includes the results of Watford, I will not be using that term but instead will be using the word core to refer to our combined segments of Insurance, Reinsurance and Mortgage. This permits an apples-to-apples comparison of Arch's current results with prior periods.

Okay. That being said, the core combined ratio for the quarter was 87.5%, with 0.6 points of current accident year cat-related events, net of reinsurance and reinstatement premiums, compared to the 2014 first quarter combined ratio of 84.6%, which also reflected 0.6 points of cat-related events.

Losses recorded in the first quarter from 2015 events net of recoverables and the reinstatement premiums totaled $4.6 million, primarily emanating from our insurance exposures in Australia.

The 2015 first quarter combined ratio reflected 7.8 points of prior year net favorable development net of reinsurance and related acquisition expenses compared to 9.5 points of prior period favorable development on the same basis in the 2014 first quarter. This results in a current core accident quarter combined ratio, excluding cats for the first quarter of 2015, of 94.7% compared to 93.5% for the comparable quarter in 2014.

In the Insurance segment, the 2015 accident quarter combined ratio, excluding cats, was 95.1% compared to an accident quarter combined ratio of 94.9% a year ago.

The Reinsurance segments similar accident quarter combined ratio, excluding cats, was 94% even compared to 92.6% in the comparable quarter last year.

As noted in prior quarters, the Reinsurance segment results reflect changes in the mix of premiums earned, including a lower contribution from property catastrophe and other property businesses. The proportion of the reinsurance segments net written premiums that is property or property-cat related dropped from 33.2% to 30.2% quarter-over-quarter, but falls further to 24.7% when Gulf Re premiums are removed.

As you may recall, Arch assumed a UPR and loss portfolio transfer and incepted 90% quota share treaty last quarter, which resulted in the explicit recording of business from Gulf Re through our income statement.

Previously, Gulf's underwriting results were recorded in other income under our 50% joint venture arrangement. Our expectation is that regulatory authorities will approve this acquisition in the second quarter of this year.

The Mortgage segment 2015 accident quarter combined ratio was 94.1% compared to 84.3% in the comparable quarter last year. This increase is predominantly driven by the substantial change in mix resulting from the January 2014 acquisition of our U.S. primary mortgage operations.

The Insurance segment accounts for roughly 13% of the total net favorable development this quarter and was primarily driven by shorter-tailed lines from the 2010 to 2013 accident years.

The Reinsurance segment accounts for approximately 84% of the total net favorable development this quarter, also excluding associated impacts on acquisition expenses, with approximately 2/3 of that due to net favorable development on short-tailed lines concentrated in the more recent underwriting years and the balance due to net favorable development emanating from all years, but primarily from the 2003 to 2010 underwriting years.

Similar to prior quarters, approximately 67% of our core $7.2 billion of total net reserves for loss and loss adjustment expenses are IBNR and additional case reserves, which remains fairly consistent across both the Reinsurance and Insurance segments.

The core expense ratio for the first quarter of this year was 34.5% versus the prior year's comparative quarter expense ratio of 33.9%, driven by an increase in the operating expense ratio of 2.2 points, partially offset by a decrease in the net acquisition expense ratio of 1.6 points.

This increase in the operating expense ratio component reflects mostly a decrease in net earned premiums and also continues to reflect the addition of our U.S. mortgage insurance operations, which is operating at a higher expense ratio until that business reaches steady state.

Moving to the segments. The Insurance segment improved to a 32.1% expense ratio for the quarter compared to 33.1% a year ago, primarily reflecting a lower net acquisition ratio driven mostly by improved ceding commissions on quota share contracts ceded. The Reinsurance segment expense ratio increased from 32.1% in the first quarter of '14 to 33.8% this quarter, primarily due to a lower level of net earned premiums.

The Mortgage segment's expense ratio will continue to be high until proper scale is attained, as I'd mentioned previously.

The ratio of net premium to gross premium for our core operations in the quarter was 71.9% versus 79.7% a year ago. The Insurance segment added 70.7% ratio this quarter compared to 74.7% a year earlier. This lower ratio, which implies increased reinsurance ceded, stems primarily from the second quarter of 2014 SPARTA renewal rights transaction that brought more alternative markets captive business on the books.

Absent this impact, the net-to-gross ratios are roughly flat quarter-over-quarter for the Insurance group.

In the reinsurance segment, the net-to-gross ratio was 71.8% this quarter compared to 85.9% a year earlier, primarily reflecting increased property and property cat retrocessions and increased sessions to Watford as a reinsurer.

Shifting gears. Our U.S. insurance operations achieved a 2 point -- a 2% even effective renewal rate increase this quarter net of reinsurance. As commented on last quarter, the pricing environment is quite different for short-tailed versus longer-tailed lines. Our short-tailed lines of business had an effective 4.5% renewal rate decrease for the quarter compared to a 3.5% effective renewal rate increase for the longer-tailed lines, both on a net of reinsurance basis.

Rates. Rate increases on these longer-tailed lines continue to be above our view of weighted loss cost trends.

Looking more deeply, some lines incurred rate reductions, such as an 8.5% rate reduction in property lines and 3% in our high-capacity D&O lines, while others enjoyed healthy increases, such as a 9% increase in our captive agents businesses, an 8% increase on lower capacity D&O lines, 7% in accident and health and 6% in our high-excess workers' compensation business.

Also, certain lines continued their achievement of strong cumulative rate increases. For example, our lower capacity D&O lines have now achieved 15 consecutive quarters of rate increases and have in fact secured double-digit increases for 2/3 of those 15 consecutive quarters.

The mortgage segment posted an 88.5% combined ratio for the calendar quarter. The expense ratio, as expected, continues to be high on the operating ratio related to our U.S. primary operation and will remain elevated until that prementioned proper scale is achieved.

The net written premium of $51.9 million in the quarter is driven by the $27.9 million from our U.S. primary operation and $24 million even of net written premium by our reinsurance mortgage operations, as Dinos has mentioned, which also includes the 100% assumed quarter share of PMI's 2009 and 2011 underwriting year as part of the acquisition of the CMG companies and the PMI platform.

As Dinos also has mentioned, this segment had $7.7 million of other underwriting income for the quarter versus approximately $800,000 in the first quarter of 2014. This change was primarily due to an increase in the risk-sharing transactions, which are triggered as derivatives and mark-to-market each period. This quarter included approximately $3.5 billion of catch-up income as a consequence of the timings of when GSEs incept the insurance product versus the corresponding capital market security.

At March 31, 2015, our risk-in-force of $10.6 billion includes $5.7 billion from our U.S. mortgage insurance operations, $4.2 billion through worldwide reinsurance operations and $619 million through risk-sharing transactions.

Our primary U.S. mortgage insurance operation down $1.8 billion of new insurance written during the quarter, which represents the aggregate of original principal balances of all loans receiving new coverage during the quarter. The weighted average FICO score for the U.S. primary portfolio remains strong at 734, and the weighted average loans-to-value ratio held steady at 93.3%. No states risk-in-force represents more than 10% of the portfolio, and our U.S. primary mortgage insurance companies are operating at an estimated 9.3:1 risk-to-capital ratio as of the end of the quarter.

The other segment, i.e. Watford Re, reported a 100.3% combined ratio for the quarter on nearly $125 million of net written premiums and $72 million of net earned premiums. As a reminder, these premiums reflect 100% of the business assumed rather than simply Arch's approximate 11% common share interest.

The total return on our investment portfolio was a reported positive 111 bps in the first quarter, primarily reflecting positive returns in our equity and noninvestment-grade fixed income sectors, partially offset by the strengthening U.S. dollar on most of our foreign-denominated investments.

Excluding foreign exchange, total return was a positive 205 bps for the quarter. Approximately 90% of invested assets are in U.S.-dollar-denominated investments as of 3/31/2015.

As Dinos mentioned, the impact of the strengthening U.S. dollar on our net written premiums was a reduction of approximately $32 million, which was split $23 million affecting our Reinsurance segment and $9 million affecting our Insurance operations. The foreign exchange impact on other components of underwriting income was not material.

Our embedded pretax book yield before expenses was 2.21% as of the end of the quarter compared to 2.18% as of year end, while the duration of the portfolio remains virtually flat at 3.35 years. The current duration continues to reflect our conservative position on interest rate in this current yield environment.

Reported net investment income this quarter was $70.3 million or $0.55 per share versus $72.6 million or $0.56 per share last quarter and $67 million or $0.49 per share in the corresponding first quarter of 2014.

As always, we evaluate investment performance on a total return basis and not merely by the geography of net investment income.

Cash flow. Cash flow from operations on a consolidated basis, including the other segment, was materially lower than prior quarters, as Dinos has mentioned, specifically 57% lower than the corresponding first quarter of 2014. This was caused by several factors, the most significant of which are, one, reduced premium inflows net of commissions; two, increased reinsurance sessions net of ceding commissions where appropriate; an increase in the cash outflow associated with net paid losses, which includes payments on deductible and captive losses as well as some unusual large claims; and fourth, an increase in the operating expenses, including bonuses, U.S. mortgage expenses and some nonrecurring expenses associated with certain business opportunities.

This quarter's level of operating cash flow, however, should not be viewed as a new run rate due to the timing issues and nonrecurring impacts.

Our effective tax rate on pretax operating income available to Arch's shareholders for the first quarter of this year was an expense of 3.9% compared to an expense of 1.7% in the first quarter of 2014. Fluctuations in the effective tax rate can result from variability and the relative mix of income or loss projected by jurisdiction.

Our total capital was $7.19 billion at the end of the quarter, up 2.3% relative to the prior year end.

During this quarter, we purchased 2.7 million shares at an aggregate cost of $163 million. These repurchases represents a multiple of 1.28x of the quarter's average book value and had the effect of reducing quarter-ending book value per share by $0.26.

On the other hand, the effective foreign exchange on book value was a gain of approximately $0.25 per share as the benefit of restating insurance and reinsurance liabilities outstripped the decline in non-U.S.-denominated investments.

Our debt-to-capital ratio remains low at 12.5%, and debt plus hybrids represents only 7% even of our total capital, which continues to give us significant financial flexibility.

As Dinos mentioned, we continue to estimate having excess capital above our targeted position. And additionally, $724 million remains under our existing buyback authorization as of the end of the quarter.

Book value per share is now $47.80 at the end of the quarter, up 4.9% from year-end and 15.1% relative to a year ago. And this change in book value per share this quarter primarily reflect the continued strong underwriting performance and investment returns.

So with these introductory comments, we're now pleased to take your call -- or take your questions.

Constantine P. Iordanou
Chairman and Chief Executive Officer
Kathy, we're ready for the question period.

Question and Answer

Operator

[Operator Instructions] The first question comes from the line of Michael Nannizzi, Goldman Sachs.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Just one question, I -- a couple of questions I have. One was on the decline in cat premiums in the Reinsurance segment. I was a little surprised that the underlying didn't change more just given I would expect that, that business probably booked at a lower loss ratio. Were there other -- I'm sure there are other mix issues that are impacting the underlying there. So I just wanted to get some context on that, if I could?

Constantine P. Iordanou
Chairman and Chief Executive Officer

Well, first, our approach to the cat business was to maintain as much of that business with a client base, so in essence be committed to the client base who purchases. And then we looked at the risk characteristics of that portfolio and where we felt it was advantageous for us to buy retrocessional cover to protect our book, we chose to do so. So that was the approach for the quarter. We believe that some segments of the cat business is still, depending part of the curve you're on, is profitable at very good levels, meaning mid-teens ROEs. And then on some other parts of the curve, they might be in the mid-single digits, which in our view we don't want to underwrite cat business with an expected return of mid-single digits. So that's in essence been our approach. Mark, I don't want to -- you want to add anything else to that?

Mark D. Lyons
Chief Financial Officer, Executive Vice President and Treasurer

Yes, sure. I'll just add that -- and you -- the way you phrased your question you kind of answered it. This clearly is a mix difference beyond the pure cat aspect that Dinos mentioned. And an example of that would be -- we seldom talk about it other than the fabulous results -- is the facultative group, which had fabulous results for the quarter but not quite as fabulous as the prior quarter. So you get a little bit of mix differences, and in the case of property businesses, the combined ratios can move. As far as longer- and medium-tailed businesses, the combined ratios associated with those are consistent with what you'd expect in a declining market, inching up higher as it's simply a mix that caused the quarterly results to be what it is.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Got it. And then -- and should we think about in terms of like the capital intensiveness of your business declining as you continue to maybe mix away from more capital-intensive business in reinsurance? Did that have an impact on your appetite for buybacks in the quarter or maybe the amount of capital that you're willing to allocate to those sort of activities?

Constantine P. Iordanou
Chairman and Chief Executive Officer

Yes. As a matter fact, usually historically I would say that in the third quarter we refrained of buying back shares even when we have big buyback programs on the basis that it's the cat season and when we were committing 20% or 21% or 22% of our equity capital to a single event -- to a single -- 250-year single event, that is changing. And as you saw with the numbers we have reported, we're in the sub-10% of capital in any one zone. And for that reason, I think buyback opportunities are not going to be limited to the second quarter but also in my view in the third quarter because the cat PML aggregations we have and the excess capital that I have -- we have in the company there are such that I don't worry too much about an unusual event that it will cause us significant harm during the third quarter.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Great. And then just one quick one. Just in terms of thinking about Watford and the Reinsurance business, I mean should we be thinking that your gross premiums might stick around where they are but that we'll see just the sessions line just increase as you sort of toggle the premiums between those 2 segments? Is that how we should be thinking about it? Or if reinsurance market conditions continue, should we expect to see gross premiums decline as well?

Mark D. Lyons
Chief Financial Officer, Executive Vice President and Treasurer

Mike, good question. It is a difficult one to answer because it is the vagaries of the marketplace that drives that as to what we might bound and what might be negatively written on Watford paper versus written by Arch re, Arch Reinsurance and ceded. So it's really hard to say what that direction might be. Just like I'd make a similar comment on any one of our units, it's hard to predict it. So I'd really prefer to not give a strong direction of response on that. But all I can tell you is that we're continuing to be really happy with the flow, the kind of business we're seeing and the sources of that business.

Constantine P. Iordanou
Chairman and Chief Executive Officer

It's hard to predict the future. I don't know where the market is going to go. At the end of the day, every single reinsurance transaction we do is based on the return characteristics. If it fits for Arch first, that's our priority. We put it on our paper and we retain the risk. And if it doesn't but because of additional potential investment return in Watford it fits their model, then we will put it there. And that's the guiding principles that we have and we have been operating since the formation of Watford. And that will not change. So trying to predict where the market is going to be is a dangerous -- it's a dangerous proposition. I don't know where the reinsurance market will be 6 months or a year from today. My instructions to our troops -- and I think we got great underwriters, all you got to do is look at their performance over the last 10, 12 years -- is behave prudently in the market that has been given to you and make the prudent underwriting decisions and don't focus just on volume, just focus on return. And that's our guiding principles.

Operator

The next question comes from Amit Kumar of Macquarie.

Amit Kumar
Macquarie Research

Just a few questions on the MI segment. The first question is on the discussion on the stacker program. Clearly, that's a meaningful number this quarter. How should we think about that opportunity, I guess, going forward?

Constantine P. Iordanou
Chairman and Chief Executive Officer

It's -- I'll make 3 points, and I'll turn it over to Mark. He knows the numbers better than I do, but -- well, as well...

Mark D. Lyons
Chief Financial Officer, Executive Vice President and Treasurer

Time will tell.

Constantine P. Iordanou
Chairman and Chief Executive Officer

The -- it's lumpy business. However, the incentives for both Fannie and Freddie have been increased. Their targeted amounts have been increased as I think we talked in the last quarter significantly by 50%. Last year, the GSEs they had a target of $90 billion each. This year's target is $150 billion for Fannie and $120 billion for Freddie, which we believe they're going to reach, as they reached their goals last year. So in essence, they're going to be more in the marketplace. Of course, they can use the cash market, the bond market or they can use the reinsurance MI market for those transactions. We were the innovators of these type of transactions. The first one we did it was a combination of effort between us and Freddie Mac. Their incentive is to put more and more of that business into different sources of private capital pools, including the reinsurance market. So it's going to be lumpy. We don't know how many of these opportunities they're going to be there that they're going to come our way. But we believe they're going to be at an increased level from a year ago. And depending on pricing, we will continue to participate. And that's the best I can tell you because I -- we're not magicians. We can't predict the future. But we feel confident that stacker transactions -- stacker-like transactions will be more in '15 than they were in '14.

Amit Kumar
Macquarie Research

Got it.

Mark D. Lyons
Chief Financial Officer, Executive Vice President and Treasurer

Yes, I'll just add to that, Amit, because I think you're trying to understand some of the mechanics of it is the -- as you know, there's capital market securities, and there is the insurance fee. And the capital markets, kind of as I alluded to in my prepared remarks, the capital markets incept quicker, and the corresponding insurance transaction tends to get bound 3 to 9 months later. So it has a built-in delay. Yet that the GSEs still wanted to incept identically and concurrently with the capital markets product. So once we buy, we may have 3 months, 6 months or whatever of catch-up premium that we have to book. So any given quarter could have some component of catch-up, given that we continue to have a stream of these stacker transactions, per Dinos' comment. The other way you should think about it is -- think about the notional loans that make these tranches up. As such -- just like a subject based on a treaty, you have a rate that applies to it; however, this subject base declines over time. So each of these stacker deals have a 10-year maximum, but the average life is probably closer to 7, 7 to 8 years. But you have a declining base to which these monthly rates are applicable. And it declines basically through prepayments, people moving, refis, the normal reasons why these things would roll off. So that -- mechanically, I think, that's how you have to think about it.

Constantine P. Iordanou
Chairman and Chief Executive Officer

Yes, and to make your life a little more difficult for your modeling, right now, all this is accounted as derivatives. That's the $7.7 million that we talked about in other income. But we're hoping soon they're going to be converted to insurance accounting. So you're going to have maybe a little more clarity because we'll be reporting premiums, but we don't know exactly when that is going to happen. And it's going to be done on a prospective basis for all new contracts but also for existing ones. Because don't forget, everything we bound last year or this year, it will still have a life for 6, 7 years into the future. So it will get a little more complicated, and I feel bad for your models, but eventually, you're going to get it when we get it.

Amit Kumar
Macquarie Research

Life is complicated. Just one more question. And I'll take the rest off-line. If I look at the loss ratio for the MI segment and if I compare that with some of the other, I guess, non-legacy MI player with the guidance they gave and your presentation from March, are you -- is your loss ratio running higher because it just shows the level of conservatism? Or is there more to it?

Mark D. Lyons
Chief Financial Officer, Executive Vice President and Treasurer

Well, your reference points -- well, our loss ratio is mid-20s. And but that -- underneath that, that continues to have improvement on, basically, our relative delinquency percentages and things like that. That continues to drop. So -- but remember, you got other things going on. We are reporting a segment total. So we are seeing in the U.S. MI declines, but you also have any readjustments associated with our reinsurance divisions, our reinsurance mortgage transactions that come through. I think prior quarter we had, I think, some reevaluations favorably on a reinsurance contract, and this win may -- or one big deal may have gone a bit the other way. It's -- you're going to get a little bit of the noise, but I think the key core of your question is are you continuing to see improvement in delinquency and claims in the U.S. MI book? And the answer is yes.

Constantine P. Iordanou
Chairman and Chief Executive Officer

And when you compare those numbers with the other public numbers from the U.S. MI business, we are as good or it's even slightly better than that. However, when you get into the Reinsurance sector, I -- we have a little more flexibility on the reserving side to be conservative. And I'd rather do that than be very aggressive on those ratios because at the end of the day, early on, on any business independent, if it's the P&C business of the MI business, you pick is a self-grading exam. And your real exam comes when the real results comes. So that's been our approach in everything we do, and if I have the opportunity to do a -- be a bit conservative, I will take that opportunity than the alternative. Don't forget, we have excess capital. We're not capital constrained. So in essence, we got a lot of flexibility there.

Operator

And the next question comes from Kai Pan of Morgan Stanley.

Kai Pan
Morgan Stanley, Research Division

And first question is on the cats. Do you have any potential exposure to Nepal earthquake, the Baltimore riots as well as some other large losses like Pemex?

Constantine P. Iordanou
Chairman and Chief Executive Officer

I can never say none because I don't know every contract we wrote. But it's minimal. My phone hasn't rung, and nobody whisper anything. And usually, I'm the first to know, so.

Kai Pan
Morgan Stanley, Research Division

Okay, that's good. Then on the Insurance side, you mentioned the casualty line pricing still outpacing loss cost trend. So -- but we haven't seen that flowing through in your underlying combined ratio. Just wondering, are we going to see that in the near future?

Mark D. Lyons
Chief Financial Officer, Executive Vice President and Treasurer

Well, actually, you have seen it. It depends on your time period over which you're looking. But clearly, the core x cat actually combined ratio and loss ratio has improved. They have been relatively flat or moved a couple of tenths here or there from the corresponding quarter, and that's just mix and noise.

Kai Pan
Morgan Stanley, Research Division

Okay. So you'll continue to see that. Is there -- overall for your insurance second because what I see here is really flattish, but you do expect that given the pricing in casualty line...

Constantine P. Iordanou
Chairman and Chief Executive Officer

Yes, but what you got to -- you see, you got to look at the components. When you're losing 8% to 10% rate on property, which is a low attrition -- a low loss ratio business, so that has to move up. If it is at 45, you might go to 52, 53, maybe 55. And then you get the improvement on the other. So when you do it as a mix, in my view offsetting some of the gains, so maybe it's not that visible to you because you got to look at the mix. We're reporting the numbers as we see them. We look at the segments. Some of the low loss ratio business has been declining for us because rates have been actually declining significantly. It's not that we're not trying to hold on to that business, but we do -- but that mix also has to be taken into consideration to see if -- our casualty loss ratios have improved by more than a couple of points over the last, I would say, 6, 7 quarters.

Kai Pan
Morgan Stanley, Research Division

Okay, that's great. And then on MI, I just want to follow up on that and to say at what premium level do you think you can reach to kind of -- I don't want to call it steady state but more reasonable to leverage your expense base?

Constantine P. Iordanou
Chairman and Chief Executive Officer

I don't think about it in that fashion. I think we're going to reach probably a steady state in approximately 3 years because you do 2 things. One, you have a minimum fixed expense that it requires for you as you're building up the business. But also, depending if that business is built fast or slower, you have the ability to also adjust your staffing as you go along. I would think we're not going to be at a steady state on the MI business until probably the end of '17. So probably, '18 will be our first year that we'll say, "Hey, this is our steady state numbers." So that's the way I think about it, and I think our people think about it about the same way. Having said that, internally we look at the profitability of the business as we do with everything that we do independent of sector to optimize [ph]. If I'm make an underwriting decision today, what is that going to mean for the shareholders? Because the shareholders, they are forever. And that's the way we view shareholders. We don't view them, "Oh, today, they're with us, and tomorrow they're going to trade and get out." I view every dollar of capital that's given to me that I have to guard it, that it's there forever. And that's the way we think, and that's the way we behave.

Kai Pan
Morgan Stanley, Research Division

That's great. Lastly, if I may. If you look at the Watford, investment return over the last few quarters have been about 3%, 4% annualized run rate. I just wonder, could you give a little bit more color on the portfolio allocation as well as that -- what kind of target return you have in mind?

Mark D. Lyons
Chief Financial Officer, Executive Vice President and Treasurer

Well, the portfolio, it's a fixed -- as we've mentioned before, it's a fixed income-based portfolio and generally lower investment grade or some non-investment grade. And that -- so that hasn't changed. It's more a function of the performance and what's rebounded in -- really in this quarter. So there's really, Kai, no really change in the asset allocation to talk of.

Kai Pan
Morgan Stanley, Research Division

And do you have target return for that portfolio?

Constantine P. Iordanou
Chairman and Chief Executive Officer

Well, it's not us who have a target return. I think Watford and Highbridge have targeted returns. They have -- I believe -- but you got to check with them -- I believe their target returns on an unlevered basis will be in the probably 5% to 6%. And then on a levered basis, because they expect to put about 50% leverage on it, it will boost that return to high single digits. So that's their target, returns over time.

And don't forget, they're building up, and they're trying to invest all the investable assets that they have. They're getting very close to that. But I think these are questions for Watford, not us. We're just a minority shareholder in that.

Operator

The next question comes from Ryan Tunis with Crédit Suisse.

Ryan James Tunis
Crédit Suisse AG, Research Division

I guess my first question is probably for Mark, and it's a little sort of pesky accounting one just on understanding these stacker deals. But just trying to think of how to think of the normalized run rate here on the $7.7 million, I mean, should we think about if you guys don't write another deal in the second quarter would that stay kind of around here? Or I think you mentioned $3 million of catch-up revenue. So that'll be $3 million less? Or would it be 0? I'm just kind of trying to understand how low [ph] is the profitability.

Mark D. Lyons
Chief Financial Officer, Executive Vice President and Treasurer

Well, again, without any forward looks and taking your assumptions, saying there's nothing else written on a go-forward basis what's on the books. This -- let's round the numbers. The $7.5 million had $3.5 million of catch-up. So that's $4 million. And then you need to apply your own persistency assumption of how fast those loans fall off. And that -- that's about it. You have to apply a decay factor on that, and that's your best way of doing it.

Constantine P. Iordanou
Chairman and Chief Executive Officer

Let me give you a number and then you can do your decay factor yourself, right? The -- all those target transactions we've done they're pretty much last year, this year. They have $617 million of insurer limit. And our lifetime premium, it will be approximately $111 million. That's the lifetime premium over the period. Now you can say it's going to take 6 or 7 years or 7 to 8 years, whatever. We believe that 2015 it's approximately -- if we don't do another transaction -- about $20 million. That will average about $5 million run rate a quarter. That will decline a bit if we don't write any other transactions in '16, decline a little bit in '17 until you get to around $111 million over the lifetime of the contracts.

Mark D. Lyons
Chief Financial Officer, Executive Vice President and Treasurer

Yes, the only clarification, because that's a good view Dinos gave you, but that's an ultimate view.

Constantine P. Iordanou
Chairman and Chief Executive Officer

Yes.

Mark D. Lyons
Chief Financial Officer, Executive Vice President and Treasurer

First, it's nominal dollars. Secondly, it's ultimate. You kind of asking a question on vagaries of timing and timing of catch-up. It's hard to predict quarter by quarter by quarter. Dinos is right, but it doesn't address the timing of when they're recognized.

Constantine P. Iordanou
Chairman and Chief Executive Officer

Right.

Ryan James Tunis
Crédit Suisse AG, Research Division

Okay, that's helpful. And I guess kind of staying on the GSE deals, it sounds a little more, I guess, higher level. But I guess up until now, I think I've -- either you guys have said it or I read it somewhere, but 70% of the capacity has been, I guess, capital markets driven. Do you guys have a view, maybe looking out over the next 2 to 3 years, how much of that comes to the MI side as opposed to capital markets?

Constantine P. Iordanou
Chairman and Chief Executive Officer

We don't know that. I think that's a question for Fannie Mae and Freddie Mac. I -- actually, in '14, it was 80-20. It was only on the first quarter of '15 that it was 70-30. They determine that. And they -- and that's why it's so hard to predict. They view -- I believe they view the insurance/reinsurance marketplace as more of a steady capital, where they view the capital markets as having unlimited capacity, but that capacity can be fickle. It can be priced very high at some points and very low at some other points. So it will depend on the pricing. They test the capital markets first. They see what they can get. From there, they test the insurance and reinsurance market, what they can get from there, and they make those determinations. But they do have an incentive to broaden the base for private capital willing to take credit risk so they can de-risk the pool significantly so they can go back to Congress and say, "Hey, we have de-risked the entire portfolio, so the taxpayer is only taking the very end tail risk, the black swan scenario," which I think it's a good thing. It allows private markets to price it and take the risk. And nobody has the unlimited capacity to take unlimited risk. Only the federal government can do that. But that's the very end, the tail event, that none of us has the ability to do.

Ryan James Tunis
Crédit Suisse AG, Research Division

Got it. And then I guess just quickly my last one on the MI business. It looked like half of the NIW it sounded like didn't come from credit unions. So I'm assuming it came from banks. I'm just interested, I guess, in kind of the breakout of that NIW. How much of that maybe came from kind of your top 5-type banks? How much of that came from some of the other nationals and some of -- how much of it then came from the smaller guys? I don't know if you can give me that level of granularity, but I'd be interested in that.

Constantine P. Iordanou
Chairman and Chief Executive Officer

I don't have that in front of me, that granularity. Maybe when we have a -- I think we have an Investor Day coming up in June 8. And probably, we'll -- I'll make a note and then we'll have a little more granularity to share with you there, right? I -- usually, we don't try to focus at this level of our development to specific originators. We're trying to get as broad as we can and sign as many of these originators. And as you saw, we're pretty happy with where we are. We have 15 of the top 15. I don't know what that top 15 is, but it might be may be 60%, 70% of the market. Now the question is, how does that flow? The fact that you have connected all the pipes and you have all the agreements it doesn't mean the water is flowing freely. It starts trickling in and then it accelerates because all these things have to -- there is a lot of work that needs to be done on getting the systems to work with each other and start getting the flow. So -- but we'll give you more of a color in our -- we're going to have our MI make -- people doing a presentation, and then we'll get into that granularity at that point in time.

Operator

The next question comes from Charles Sebaski of BMO Capital Markets.

Charles Joseph Sebaski
BMO Capital Markets Equity Research

Had a question. I'm trying to understand the ROE impact on the ceded business to Watford Re. So we don't know exactly what it is, but this quarter it seems like this may be $50 million of business ceded to Watford. And I assume that that's 10% ROE business like the rest of yours, but the income to you guys from Watford, the minority ownership and other fees and other stuff, how does that transition? How do you look at that? You go, "Okay, we transitioned $50 million of premium that's generating a 10% ROE." How does that return from Watford look relatively? And does that free up capital?

Constantine P. Iordanou
Chairman and Chief Executive Officer

Well, I -- you're starting with a premise that is incorrect, right? If the $50 million had a 10% ROE, it will be on our books based on the investment returns we achieve. Don't forget, we have an A+ rating. It requires a different capital. And also, it requires through the rating agencies and regulators a different investment philosophy. Now that business for us would have been maybe mid-single-digit ROEs. By putting it into Watford, we're boosting the ROE because that's set of shareholders are willing to take more investment risk. And the way you got to think about it is that they have at least, I would say, 250, 300 basis points investment advantage over a traditional P&C operation. Having that advantage on business that it has approximately 3.5-year duration and 70% is loss and loss adjustment expense, you can do the math. You compound 300 basis points for 3.5 years for 70% of the premium and you're adding 7, 8 points of ROE on an after-tax basis. So you take something that is in the 6, 7 and it becomes 14, 15. And so that's the way you got to think about it. Now 5, 6, 7 is not acceptable to us because, first of all, it creates a lot of tension within our ranks. Our incentive compensation for our underwriters is based on us achieving a minimum of 8% ROE. If we don't achieve that, I think we run home with empty pockets. Our wives are really upset about that. So at the end of the day, there is a culture here when we get to our underwriting that we got to hit on an expected basis certain targets. If we don't hit it, that's when we go -- now to do the math, we get -- not utilizing our own capital, we get -- well, 11% we get by utilizing our investment, which is our own capital. But of course, we get fees and we get profit commission through the back end, which is accretive to our shareholders because there is no utilization of capital for that. I haven't done the math on $50 million. But if you want me to do it, I can do it. And I have done -- give you the arithmetic. But you can probably do the arithmetic yourself, yes.

Charles Joseph Sebaski
BMO Capital Markets Equity Research

So I just -- so that's what I thought, I mean, regardless of the initial premise of 10% ROE being wrong and it's mid-single digits, but when you see that, conceptually whatever capital was supporting that to begin with is now free and clear. It can go under capital management.

Constantine P. Iordanou
Chairman and Chief Executive Officer

That's correct.

Charles Joseph Sebaski
BMO Capital Markets Equity Research

And the return then generated from the 11% ownership is a magnitude higher relative to now that freed-up capital, right? I mean, because it's for...

Constantine P. Iordanou
Chairman and Chief Executive Officer

That's the right way to think about it, yes.

Mark D. Lyons
Chief Financial Officer, Executive Vice President and Treasurer

With the investment return -- long-term investment return leverage over a traditional insurer being realized.

Constantine P. Iordanou
Chairman and Chief Executive Officer

Yes.

Charles Joseph Sebaski
BMO Capital Markets Equity Research

Yes. And so then, on that basis, so just -- and that construct, how much business currently can you cede to -- when you look at your book, if we look at this year, I mean, what's the potential -- obviously there's changes in market and pricing -- that can be ceded? Or is there a governor or a limit on in any given period how much business you can cede to them?

Constantine P. Iordanou
Chairman and Chief Executive Officer

Yes. There's limitations on the basis of their capital base. They -- when we cede business to them, they collateralize it for us on the expectancy. So in essence, there is limitations from their point of view as to how much they can write based on their capital base independent if it's cessions from us or things they write directly into the market themselves and, of course, how much capacity they have on either LOCs or other collateral they have to put up depending where their business is emanating. So -- but we -- since it's a new company and it has quite a bit of capital, they have in excess of $1.1 billion in capital, they're -- they got a size 10 shoe and a size 3 foot right now. So there's plenty of room for the foot to grow into the shoe.

Charles Joseph Sebaski
BMO Capital Markets Equity Research

And outside of your return dynamics in the Reinsurance book, the mid-single-digit ROE profile, is that really the only limit -- limiting factor for you in ceding business there? It's just sort of this business is below our return threshold? Outside of that, there's no other, "Hey, we're not going to do more than this." Or there's -- what other factors might be?

Constantine P. Iordanou
Chairman and Chief Executive Officer

Well, there's 3 scenarios here, okay, and I'll give you the scenarios. Let me start with a premise. We have an obligation -- it's an contractual obligation. As a matter fact, I think, I don't know, a dozen or more of our employees are actually dual employees. They're employed by us and also they're employed by Watford. They're -- a portion of their salary is paid for them for activities that they do on their behalf. Now business comes to us. We underwrite it, and we decide that it fits the Watford model we put it there. Business originates from Watford. They're still in the market. And then -- and that's -- and then they use those employees, and they say, "Hey, we sourced this. We got this phone call directly. Underwrite this piece of business for us." That can take 2 paths. One path is the client, it might be a European client, will accept the Watford paper, or it might be a U.S. client or -- and they say, "Well, we want Arch to issue the paper and let them reinsure back to you." So those are the 3 scenarios that happen. In the first one, we determine the ROEs based on what we've seen. It doesn't fit our book, it fits theirs, we will put it there. In the other 2 scenarios, we got an obligation to work the deals on their behalf. We work the deals. And in some cases, we might say, "Can we have a little piece of this because?" And depending on how much of that deal they want to give us, we might even take it at Arch. Don't forget, Arch takes 15% of those deals through the back end for underwriting consistency. So when I generate some activity for Watford, that it was originated and it was Watford paper, not only I have 11% ownership in the company but also I take a 15% quota share through the back end. So it's not -- it's hard for you guys to look at all the components. And even our reporting with the other sector sometimes might be getting a bit confusing to you. But at the end of the day, I'm trying to explain to you all the scenarios, and those are the 3 scenarios usually that happen on a day-to-day basis.

Mark D. Lyons
Chief Financial Officer, Executive Vice President and Treasurer

And the only thing I would add is a different cut of it by the line of business as opposed to the flow of business as Dinos was talking about. And it's been more decision up-front not on return characteristics as much as preservation of capital to not put a lot of cat business in there because you could get unlucky and have a cash call early. And it -- you want that compound interest on a fixed income strategy to have the ability to work and compound. So if you have a big cash call early, you hurt the ability for that to happen. So that's only other thing I would add.

Constantine P. Iordanou
Chairman and Chief Executive Officer

And the longer the tail, the better the advantage they have. So the construct of that book is not to feed it with a lot of short-tailed business. That's not really where they have the advantage. The advantage is on longer-tail lines. Low volatility, more predictable combined ratios, longer tail. Hard to find, hard to do, but that's the premise.

Operator

The next question is from Meyer Shields of KBW.

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

Two quick questions, if I can. First of all, I guess the corporate or other expenses were down about 30% year-over-year. Is that sort of decrease sustainable?

Constantine P. Iordanou
Chairman and Chief Executive Officer

What I can tell you on corporate expense, we're not -- I don't like overhead, and I'm not adding to it. So I would say they'll probably be steady. I haven't really forecast on the delta this quarter to see if it was significant or not, but I can tell you we're keeping a very lean holding company staff. Mark, do you have any more detail on that?

Mark D. Lyons
Chief Financial Officer, Executive Vice President and Treasurer

Yes. Yes, Dinos. On corporate expense, we're categorizing it the same way, Meyer. It was down around 13% to 15%. I don't -- and it was mostly driven by a reduction in stock option expense. So that's depends on what people do and that -- how it gets exercised and so forth. So I would say we continue to look to push those down, but I wouldn't go crazy expecting a compounded benefit every quarter.

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

Okay, that's helpful. Is -- does the opportunity exists now that there are lower premium volumes in the Reinsurance segment to reduce the expenses there?

Constantine P. Iordanou
Chairman and Chief Executive Officer

I -- the -- well, most the expense on the Reinsurance segment comes with ceding commissions. If you don't have the business, you don't have it. When you talk about the factory, which is all of our underwriters, I have no intention of destroying any -- a high-performing factory. We have great underwriters in our Reinsurance business, and we have every intention to keep every single one of them because I'm not going to be running around finding them when I need them a couple of years later. So no significant reduction on what I would call personnel expense, et cetera, because I want to maintain those groups at the level we have them today. And they can produce significant earnings for us in the good times. And basically, that's a pretty valuable piece of the company.

Mark D. Lyons
Chief Financial Officer, Executive Vice President and Treasurer

And Meyer, we as management and the board, both look at that delta, if you will, as it goes through, as the cost of an option to keep that intellectual property ready, banked to explode when it's appropriate to.

Meyer Shields

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

Okay. No, that makes sense. I just wanted to understand it. And lastly really quickly, with the other underwriting income in mortgage insurance, are there any expenses associated with that? Or is that a net number?

Constantine P. Iordanou
Chairman and Chief Executive Officer

The expenses they're in the MI bucket, and that is a clean number. When internally we'll look at it, we have a different set of numbers. But accounting requires you to report in a certain way, so we report all the MI expenses under the MI sector and the other income comes clean of any expenses.

Operator

The next question comes from Jay Cohen, Bank of America Merrill Lynch.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

A couple of questions, I guess, starting with the Mortgage side. When the accounting -- if and when the accounting changes for the stacker transactions, will the bottom line impact be vastly different on a quarterly basis if you're accounting as insurance versus derivative?

Constantine P. Iordanou
Chairman and Chief Executive Officer

No.

Mark D. Lyons
Chief Financial Officer, Executive Vice President and Treasurer

No, it should be just more explosion of a single line into a lot of lines: written premium, earned premium expense, acquisition cost, loss reserves, paid losses.

Constantine P. Iordanou
Chairman and Chief Executive Officer

But bottom line ain't going to change anything.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Okay, that's good to know. And I guess the other question, within the Mortgage segment, you do have these other operating expenses kind of moving up as you build out that business. When do they start to level off?

Constantine P. Iordanou
Chairman and Chief Executive Officer

Oh, we -- they'll -- we're on a steady state now on dollar expenditure. Our marketing team is fully deployed. There is no significant positions for us to fill. So right now, it's just for them to go out and execute in the marketplace. But the buildup after we bought the assets from -- the CMG and the assets from PMI, it was to create this marketing team that we have, which is approximately, give or take a few heads, about 60 people. And we have reached that level now. We have filled every single key position.

Mark D. Lyons
Chief Financial Officer, Executive Vice President and Treasurer

So I would just add to that. Depending on whether you're looking at it quarter-over-quarter or you're looking serially, Jay, quarter-over-quarter you got the distortion because the first quarter of '14 was only 2 months -- no, 3 months, which I think you know. But on the serial point of view, the one other tweak for what Dinos says is all the salespeople now onboard is there's a split of the expenses of the U.S. MI staff that's kept net to us versus what goes back to PMI. And that changes as a function of the work that's done. So the simplest thing to think of is -- and it varies by function, controllership and IT and so forth -- but is a claim function. As claim inventory liquidates on that finite set of claims, the dollars associated with the claim function would shrink. And therefore, Arch, as opposed to PMI, would absorb those. So that mixture changes over time, and that's the only other tweak I would make to Dinos' comment, right.

Constantine P. Iordanou
Chairman and Chief Executive Officer

But with this, based on activity, we have the ability to manage that, right? It's -- but the activity from us managing the PMI run-off, so to speak, it will diminish over the next 3, 4, 5 years. And now it's a question, do we need all that personnel? And if we do, we'll keep them because we're building our business versus allocating all that cost back to PMI.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Got it, perfect. The last question was with Watford Arch earned some fees for running or helping run Watford. Where do those show up in your reported results?

Mark D. Lyons
Chief Financial Officer, Executive Vice President and Treasurer

There's more than one place, but most of them at this point in an offset to acquisition.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Got it. Acquisition in your Reinsurance segment?

Mark D. Lyons
Chief Financial Officer, Executive Vice President and Treasurer

Correct.

Constantine P. Iordanou
Chairman and Chief Executive Officer

Yes. Well...

Mark D. Lyons
Chief Financial Officer, Executive Vice President and Treasurer

And M&A, some of it[indiscernible].

Constantine P. Iordanou
Chairman and Chief Executive Officer

On the [indiscernible], right. That's right. And don't forget, Jay, profit commissions are not in that yet, right? You got to see that cooking first.

Operator

The next question comes from Ian Gutterman of Balyasny.

Ian Gutterman
Balyasny Asset Management L.P.

Dinos, I think this [indiscernible] going to be gone this call has gone so long here, but...

Constantine P. Iordanou
Chairman and Chief Executive Officer

No, no. Today on the menu is Keftedes. Keftedes is Greek meatballs.

Ian Gutterman
Balyasny Asset Management L.P.

Okay. I hope we'll have some of those in June.

Constantine P. Iordanou
Chairman and Chief Executive Officer

Yes, you will.

Mark D. Lyons
Chief Financial Officer, Executive Vice President and Treasurer

See, Ian, we all learned something.

Ian Gutterman
Balyasny Asset Management L.P.

So I guess my first question is the other specialty Reinsurance has been declining at a fairly notable pace the past few quarters. Can you just give a little color on what specific lines in there are shrinking and maybe even what's left that remains that's a big part of that line at this point?

Constantine P. Iordanou
Chairman and Chief Executive Officer

Well, Mark, do you want to handle that?

Mark D. Lyons
Chief Financial Officer, Executive Vice President and Treasurer

Yes, let me just pull to something. Okay.

Constantine P. Iordanou
Chairman and Chief Executive Officer

Well, the one obvious place is property cat, which -- and then we reduced significantly on the moro [ph] quota shares overseas. That's the -- that's another area. And then, it will give you more granularity, Mark.

Mark D. Lyons
Chief Financial Officer, Executive Vice President and Treasurer

Yes. Because as you know, we're -- I think our Reinsurance group is good at finding opportunistic opportunities. And you get them, they hit a quarterly statement, and they're really not renewable. So you may recall we had conversations of some relatively large premiums a year ago's quarter that were opportunistic in nature, and those didn't repeat. So -- and that's where all those specialties are. There was also a bit of a falloff in some accident and health business. But I think predominantly you can focus -- besides what Dinos said -- you focus in on these opportunistic transactions that were unique to the marketplace at that time.

Ian Gutterman
Balyasny Asset Management L.P.

Perfect. I just want to make sure on that. With the decrease in the cat exposure and the short-tailed exposure, can you give us a sense of how much your cat load has come down on a model basis?

Mark D. Lyons
Chief Financial Officer, Executive Vice President and Treasurer

Let's see. Well, pretty material as you might guess.

Constantine P. Iordanou

Chairman and Chief Executive Officer

Ian, do the calculation. I haven't done it. But go to the OPMLs and do the division between the new PML and the old, and that will give you an indication as to what the -- okay? And...

Ian Gutterman
Balyasny Asset Management L.P.

Okay. But I was wondering if that would work or not.

Constantine P. Iordanou
Chairman and Chief Executive Officer

I would say right now, if I would take a guess, it will be around $40 million a quarter or thereabouts. So it will be about -- I would say, instead of 200-plus, it might be about 160.

Ian Gutterman
Balyasny Asset Management L.P.

Got it, okay.

Constantine P. Iordanou
Chairman and Chief Executive Officer

But listen, this is back of the envelope. I'm pretty sure on the back of the envelope, but there's no precision in that number.

Ian Gutterman
Balyasny Asset Management L.P.

That's okay, I was just trying to get ballpark. Okay.

Constantine P. Iordanou
Chairman and Chief Executive Officer

Yes, yes.

Mark D. Lyons
Chief Financial Officer, Executive Vice President and Treasurer

Might be 159.

Ian Gutterman
Balyasny Asset Management L.P.

Exactly. 0.2. The other thing I was wondering on PML is, can you give us a sense of how different -- how much your gross PML has come down relative to your net PML, meaning how much of the PML reduction is -- there was an increased retro buying versus actually cutting the gross?

Constantine P. Iordanou
Chairman and Chief Executive Officer

Well, the gross came down a little bit. It was maybe in the order of about 5%, 6%, thereabouts. And then most of the other reduction is reduced writings and also retrocessional buying.

Ian Gutterman
Balyasny Asset Management L.P.

Okay, got it. And then my last thing before letting you get your meatballs is...

Constantine P. Iordanou
Chairman and Chief Executive Officer

No, Keftedes, there's no meatballs in Greek language.

Ian Gutterman
Balyasny Asset Management L.P.

I know. I can't pronounce that, Dinos. I'm not as good -- I don't have that dialect down yet. The -- just as far as how to think about excess capital, right? I mean, obviously, with much less cat you should be able to write it at a different premium to surplus than you used to, right? So how should we -- is there a good metric to think about rule of thumb for how to evaluate excess capital [indiscernible]?

Constantine P. Iordanou
Chairman and Chief Executive Officer

There is no rule of thumb. We want to be S&P model of course. Yes, if you're having less cat, the allocation to the cat business from a capital point of view is less. We factor that in into our excess capital calculation, and then we make decisions off of that. I -- listen, I got a guy, my Chief Risk Officer, François -- you know François Morin -- he's got to do some work at some point in time. I got to ask him to do something. So he does a lot for us.

Ian Gutterman
Balyasny Asset Management L.P.

I mean, if I were to just look at sort of the capital charge for your PML, how much that's come down, and then, say, that's one part and then the other part would obviously be the difference between earnings and return of capital, is that a fair way to look at it, that essentially...

Constantine P. Iordanou
Chairman and Chief Executive Officer

Yes, it is. And also you got to look at the Mortgage side as we're deploying more capital. Even though in the Mortgage we're overcapitalized already, it's going to take us another, I don't know, 6 quarters, maybe even longer, to fill the shoe, but -- so.

Ian Gutterman
Balyasny Asset Management L.P.

Okay. I guess if I want the answer I may be will ask a little bit more directly. It seems like excess capital is getting to be -- maybe I have to go look back to some of the times when it was really high -- but it's maybe getting in the upper quartile of where it's been historically. Is that [indiscernible?

Constantine P. Iordanou
Chairman and Chief Executive Officer

It's up there, yes.

Mark D. Lyons
Chief Financial Officer, Executive Vice President and Treasurer

But from a rating agency perspective to your point, pretty close to every dollar we have a reduction in cat PML, it adds $1 of excess capital.

Operator

You have no further questions. I would now like to turn the call over to Dinos for closing remarks.

Constantine P. Iordanou
Chairman and Chief Executive Officer

Well, thank you, all, for listening, and we're looking forward to the next quarter. Have a wonderful day.

Operator
Thank you for your participation in today's conference. This concludes the presentation. You may now disconnect. Good day.