S&P Capital IQ

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Arch Capital Group Ltd. NasdaqGS:ACGL

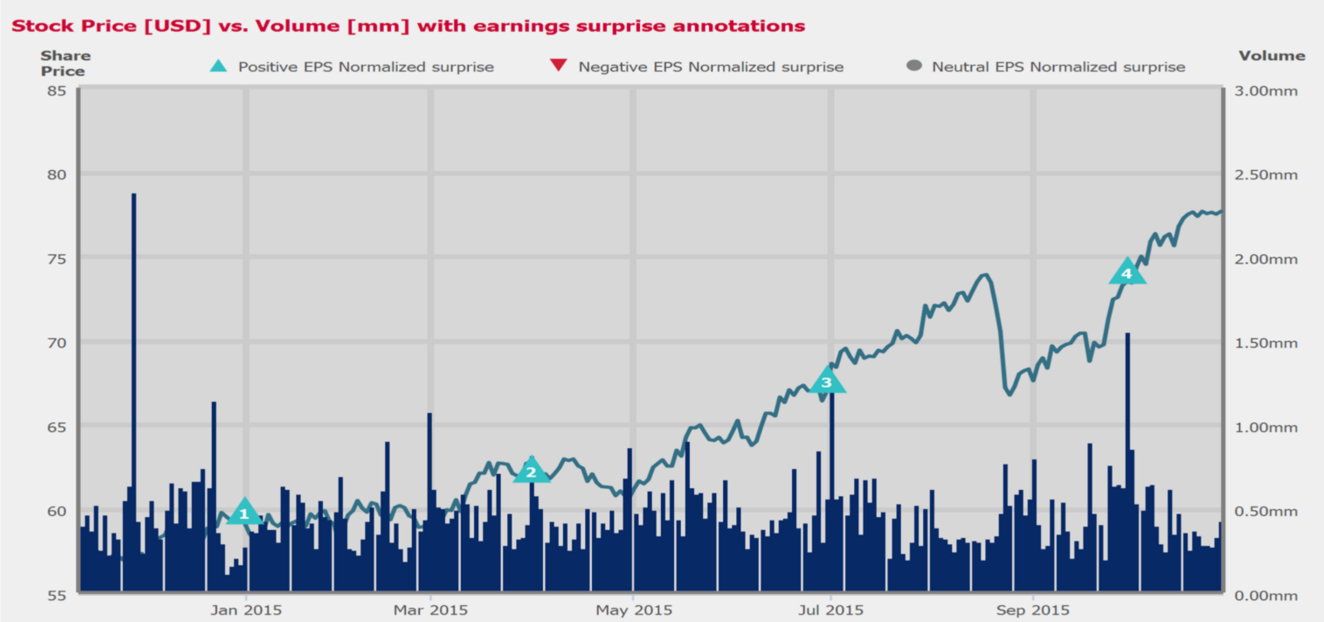
FQ4 2015 Earnings Call Transcripts

Wednesday, February 10, 2016 4:00 PM GMT

S&P Capital IQ Estimates

	-FQ4 2015-			-FQ1 2016-	-FY 2015-	
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	ACTUAL
EPS Normalized	1.06	1.15	▲8.49	1.09	4.38	4.48
Revenue (mm)	920.50	738.80	▼(19.74 %)	1108.20	3895.00	3351.57

Currency: USD
Consensus as of Feb-10-2016 12:13 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ4 2014	1.03	1.15	▲1 11.65 %
FQ1 2015	1.08	1.17	▲2 8.33 %
FQ2 2015	1.07	1.16	▲3 8.41 %
FQ3 2015	0.96	1.01	▲4 5.21 %

Call Participants

EXECUTIVES

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Chairman and Chief Executive Officer

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President and Chief Operating Officer

Mark D. Lyons
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Presentation

Operator

Good day, ladies and gentlemen, and welcome to the Arch Capital Group Fourth Quarter 2015 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 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 made -- in the call to be subject to the safe harbor created thereby.

Management will also make reference to some non-GAAP measures of the financial performance. The reconciliation to GAAP and the definition of operating income can be found on 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 host for today's conference, Mr. Dinos Iordanou. You may begin.

Constantine P. Iordanou
Chairman and Chief Executive Officer

Thank you, Abigail. Good morning, everyone, and thank you for joining us today. We would like to begin our call by first welcoming Marc Grandisson, who has joined us this morning and he will be part of our future presentations to you. For those of you who may have missed our recent release announcing Marc's promotion to President and Chief Operating Officer, let me remind you that all of our operating businesses now report directly to Marc. Many of you already know him, as he was an integral part of the original reinsurance team with Pauline Gray and others that helped establish Arch Reinsurance Group as the best-in-class global reinsurer. In addition, Marc played a prominent role in establishing our mortgage business, which has become a significant contributor to our group results. You will hear more about the business environment from Marc in a few minutes, but let me very briefly describe how we see the operating conditions in the market we participate in.

To invoke a bit of a sailing analogy, we're facing headwinds in our reinsurance group, overcapacity, pressure on ceding commissions, more excess of loss purchasing at inadequate pricing. So that describes a bit the reinsurance market conditions. We see reasonably calm conditions in our insurance group, some sectors under pressure from a pricing point of view, but other sectors offering good opportunities, especially in small customer segments. And, of course, there is tailwinds in our mortgage segment. The underwriting is very strong in this particular sector and the macroeconomic conditions affecting the housing market, they're very favorable.

Turning to our operating results. Our fourth quarter earnings were driven by solid reported underwriting results, while investment returns were challenging, continue to be affected by yields available in the markets. Group-wide and on a constant dollar basis, our gross written premium decreased by 3.6% in the fourth quarter over the same period in 2014, while net written premiums were down 8.2% as underwriting actions in our insurance and in reinsurance business were only partially offset by growth in our mortgage business.

We continue, and I know Marc will emphasize this, to emphasize underwriting discipline with all of our operating units. On an operating basis, we earned $143.6 million or $1.15 per share for the fourth quarter, which produced an annualized return on equity of just shy of 10%, 9.8% for the 2015 fourth quarter and as it compares to a 9.7% return on average common equity for the year ending December 31, 2015.

Net income movements on a quarterly basis can be more volatile as these earnings are influenced by changes in foreign exchange rates and realized gains and losses in our investment portfolio. Investment volatility during the fourth quarter and for the full year 2015 caused net income to fall below operating returns. This is, I believe, for the first time in the last 5 years that our operating returns were below net income returns.

On a net income basis, Arch earned $4.09 for all of 2015, which equates to a return on equity of 8.8% for the year. While operating return on equity generally produces a more stable stream of earnings in the short term, we believe that net income provides a better view of value creation and book value growth over time. Over the past 5 years, on average, net income ROE has added 230 basis points to our operating return.

Our reported underwriting results remain acceptable in the fourth quarter, as reflected by a strong combined ratio of 86.8 and were rated by low level of catastrophe losses and continued favorable loss reserve development. Group-wide, we believe that on an expected basis, the present value ROE on the business written in the 2016 underwriting year will produce ROEs in the range of 10% to 12% on allocated capital. Net investment income per share for the quarter was $0.53 per share, down $0.01 sequentially from the third quarter of 2015.

Positive returns on equities in the quarter were not enough to offset negative returns on fixed income as total return on a constant dollar basis on our investment portfolio was negative 10 basis points in the fourth quarter of 2015. The strengthening of the U.S. dollar also impacted total return, which was negative 33 basis points for the quarter on a reported basis.

Our operating cash flow, excluding Watford, was approximately $100 million in the fourth quarter as compared to approximately $225 million in the same period last year. Mark Lyons will discuss the changes in cash flow in a few minutes, but approximately 1/3 of the decline in cash flow reflects the timing of premiums paid to Watford. Our book value per common share at December 31, 2015, was $47.95 per share, a slight increase from the third quarter of 2015 and a 5.2% increase from December 31, 2014.

With respect to capital management, we continue to have capital in excess of our targeted levels. However, we did not find any opportunities to purchase shares in the fourth quarter that will meet our previously stated criteria for share repurchases. We have found some of those opportunities to purchase shares in the first quarter of 2016. Through February 5, 2016, Arch purchased 1,050,000 shares under our 10b5 program, $69 million. With those purchases, we have approximately $450 million remaining on our board authorization. We will review that in our board meeting in May of 2016.

Before I turn over the call to Marc Grandisson, I would like to discuss our PMLs, which continue to decline from underwriting actions we have taken in our cat portfolios. As usual, I would like to point out that our cat PML aggregates reflect business balance through January 1, while premium numbers included in our financials are through December 31, and that the PMLs are reflected net of all reinsurance and retrocessions we purchased. As of January 1, 2016, our largest 2015 year PML for a single event remains the northeast at $489 million or approximately 8% of common shareholders' equity. I believe that's the lowest level on a percentage basis in our history.

Our Gulf of Mexico PML decreased to $444 million at January 1, and our Florida Tri-County PML decreased to a low $362 million.

I will now turn it over to Marc Grandisson to comment on market conditions as he sees them before Mark Lyons discusses our financial results. And after Mark Lyons, we will take your questions.

So Marc, welcome, and go at it.

Marc Grandisson

President and Chief Operating Officer

Thank you, Dinos. It's great to be here. I already know many of you and I look forward to know you better as I move into my new role. As we look across our 3 segments, insurance, reinsurance and mortgage, we see not only the challenges of competitive conditions as Dinos mentioned and stop writing, but we also see opportunities in each of our 3 business segments. While macro events and the interest rate environment have brought down ROE expectations to a new normal level, we are positioning ourselves in all of our underwriting units, focusing on specialty niches that have some inherent competitive protection and for which we believe we will achieve our 15% ROE target over the cycle.

As far as the overall insurance markets are concerned, commercial pricing remains under pressure, especially in the more commoditized product lines. Primary P&C rates are declining in the mid- to low single-digit range, although there are pockets of rate strengthening. Terms and conditions in general are stable.

Turning first to our insurance operations in the United States. We saw a 140 basis point effective rate decrease this quarter, but a rate decrease of only 20 bps for the full 2015 policy year versus 2014. Expected ROE on allocated capital in many lines are still comfortably in the double digits. Those lines of business include construction, national account programs, some areas of low capacity, executive assurance and professional liability. Together, these lines represent over 70% of our 2015 volume.

In contrast, we have seen worsening, as mentioned by Dinos, of the rate levels in property, also in healthcare and higher capacity executive assurance. As a result, we are writing less in those lines. Our interest groups premium written decreased 2.5% in the fourth quarter 2015 versus 2014 on a gross basis, but 6% down on a net basis. The changes in our gross versus net reflects the change in our underlying mix as well as our ability to buy reinsurance on more favorable terms. Ceded written premium increased 6.1% in our insurance group this quarter over the same period last year.

Our international insurance operations, which are based in the U.K. and underwrites risk globally, are under heavier pressure from a rate level perspective. Rate changes there were minus 7% across all of our product lines. Needless to say, we are continuing to actively underwrite and manage this portfolio and are trying to move into areas such as accident and health where competition, we believe, is less intense.

Turning to our reinsurance group now. We continue to develop and allocate our resources to specialty markets and products that are somewhat more sealed [ph] from competition. Business lines such as property, including catastrophe, excess of loss and marine are yet again experiencing rate declines in the 10% range. At the same time, some segments like U.K. motor and U.S. professional liability have experienced small rate increases and that has created some opportunities for Arch Re. We find it challenging, if not impossible to uncover opportunities in the broader U.S. casualty, global aviation and medical malpractice reinsurance market. The returns there are just not satisfactory. In our view, capacity is plentiful. In short, the lines of business where we are focusing our efforts still provide us with expected ROEs on allocated capital in excess of 10%, but the days of low hanging fruit are gone.

Our reinsurance group net premium written has declined 26% in the fourth quarter of 2015 versus fourth quarter of 2014 led by decreased writings in our short-tailed segment. Our property cat portfolio for the full 2015 year is now over 30% over prior year 2014 on a net basis. In addition, we have seen and reacted to rate erosion by writing less in many other product segments such as international credits and surety, focused on Class and French motor third-party liability business.

Cheaper retrocessional protection has also led us to lower retention in our reinsurance group on a shorter tail line.

Switching now to our mortgage insurance segment, which includes, to remind you, our primary operations in the U.S., our mortgage reinsurance on a global basis as well as the GSE risk-sharing transaction business. We had another solid quarter of growth in written premium, growing this quarter by 30% over the third quarter of 2015 and 65% over the same quarter last year. The growth came mostly from the U.S. GSE risk-sharing programs and from the reinsurance contract with one of the major Australian lenders. We continue to make progress in the expansion of our U.S. market share. Arch MI has approved -- or U.S.

MI has approved 904 master policy applications, 460 of these clients have submitted loans to Arch MI. In addition, we are capturing additional share of the U.S. MI market through our GSE risk-sharing programs. At December 31, 2015, our total mortgage segment risk reinforced $11.5 billion, which includes $6.8 billion from our U.S. mortgage insurance operation, $3.5 billion through worldwide reinsurance operation and approximately $1.2 billion from the GSE risk-sharing transactions.

Our primary U.S. mortgage operation has $2.6 billion of new insurance written during the fourth quarter of 2015, which was approximately 60% through the bank channel and 40% via our credit union client. Our credit union channel continues to perform exceptionally well as our bank channel business developed -- development efforts gained traction. Our lender paid mortgage insurance singles net insurance written was only 80% of the total production as Arch MI responded to competitive conditions and lower returns as we see on this business.

Last quarter, we introduced our new risk-based pricing model, RateStar, and have rate filings approved in 46 states. Through December 31, 2015, 783 customers have elected to use RateStar and the technological transition has gone smoothly. We believe that RateStar enables us to improve our assessment of risk and will help Arch MI create better risk-adjusted ROEs. We are very pleased with the initial response and the applications that we are receiving through RateStar at this point.

We estimate the overall mortgage markets NIW that was down actually for the fourth quarter versus third quarter by 20%, most of the drop occurring in November and December as both purchase and mortgage refi volume declined. As one of the newer player in the mortgage insurance market, we are well positioned to take market share with our innovative approach to MI and the high credit ratings that our diversified business platform allows.

With that, I will hand it over to Mr. Lyons to cover the detailed financial results.

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

Great. Thank you, Marc, and welcome aboard. It's good to have 2 Marks and 1 Dino. I think I'm a little off [ph] . So let me just begin by saying what I said the last few quarters that, terminology wise, while I use the term core, I refer to our aggregate results excluding Watford Re when I use the term consolidated, as the term is results inclusive of Watford Re.

Since we're here talking about year-end results, I'd like to take a minute and put our changing mix of business into perspective. On a full year net written premium basis, the insurance segment reduced by approximately 6%, as Marc just mentioned. The reinsurance segment declined by about 25%, there's an asterisk on that, that I'll get to later. And the mortgage segment increased substantially by 65%. More importantly, though, this resulted in a mix change on a core basis as follows. Insurance segment changed from 59% to 61% of total core net written premiums, the reinsurance segment shrunk from 35% to 31% and the mortgage segment increased from 5.7% to 8% of the core net written premium.

The mortgage segment's total contribution is actually larger though since some risk-sharing -- GSE risk-sharing transactions received derivative accounting treatment, and therefore, contributed no net written premium. And as we shall discuss shortly, the mortgage segment and its growth load combined ratio on an accident year basis, which also has an asterisk I'll get into in a bit, decreased by 530 basis points over that of 2014. So you can see we're growing and shifting in areas of improved profitability.

Okay. Moving to this quarter's results. The core combined ratio for this quarter was 86.8%, with 1.9 points of current accident year cat-related events compared to the 2014 fourth quarter combined ratio of 87.5%, which reflected 2.3 points of cat-related events. Losses recorded in the fourth quarter from these catastrophic events of this year, net of reinsurance recoverables and reinstatement premiums, totaled just shy of $16 million, primarily stemming from U.K. storms and other global events emanating mostly within our reinsurance operations.

The 2015 fourth quarter core combined ratio reflects 8.6 points of favorable prior year development, net of reinsurance and related acquisition expenses compared to 8.3 points on the same basis in the 2014 fourth quarter. This results in a 93.5% current core accident quarter combined ratio excluding cats for the fourth quarter of this year compared to an identical 93.5% accident quarter combined ratio in the fourth quarter of last year.

In the insurance segment, the 2015 accident quarter combined ratio excluding cats was 96.3%, essentially unchanged from the accident quarter combined ratio of 96.4% a year ago. The reinsurance segment 2015 accident quarter combined ratio x cat was 90.1% compared to 87.3% in last year's fourth quarter.

As noted in prior quarters, the reinsurance segment's results reflect changes in mix of premium earned, including a much lower contribution from property catastrophe business, as Marc has alluded to. The mortgage segment 2015 accident quarter combined ratio was 83.1% compared to 98.9% for the fourth quarter of 2014. It's important to recall that the concept of accident year is more of a P&C concept and not directly analogous to the mortgage business due to their accounting convention. Theirs is much more of a reported year convention.

The full year now. The full accident year 2015 core combined ratio excluding cats was 94.5% versus 94% even for the full 2014 accident year. By segment, insurance groups full accident year x cats was 96.1% versus 96.3% in the 2014 year, and the reinsurance group's full 2015 accident year was 93.3% versus 90.7% for the 2014 full accident year.

Mortgage segment on a same basis was 84.1% versus 89.4% of a full year from 2014, that's the 530 basis points improvement I referenced earlier.

The insurance group -- insurance segment accounts for roughly 14% of the total net favorable development in the quarter. This was primarily driven by shorter tailed lines from the 2010 to 2013 accident years and longer tailed lines from the 2003 to 2011 accident years. The reinsurance segment accounts for approximately 80% of the total net favorable development in the quarter, excluding associated impacts on acquisition expenses with approximately half of that due to net favorable development on short-tailed lines concentrated in the more recent underwriting years and the remaining half due to net favorable development on longer tailed lines, primarily from the 2005 to 2011 underwriting years.

The mortgage segment accounted for roughly 6% of the net favorable development this quarter, which translates to an 8.1% beneficial impact on the loss ratio, resulting from continued lower claim rates from the CMG business we acquired in 2014, along with excellent credit experience to date on business written since the acquisition.

So this favorable development is offset by the contingent consideration or earn-out mechanism negotiated within the purchase agreement. This contingent consideration impacts, however, in the geography sense and is reflected in realized gains and losses and not within underwriting income.

Our core operations across the full 2015 calendar year experienced $272 million of net favorable development. Again, net of reinsurance and reinstatement premiums and related acquisition expenses, which represents 8.2 combined ratio points versus $307 million on the same basis in 2014, which represented 8.8 combined ratio points. The full calendar year net favorable development was approximately 15% in the insurance segment, 80% in the reinsurance segment and 5% in the mortgage segment. Approximately 68% of our core $7 billion of total net reserves for losses and loss adjustment expenses are IBNR and additional case reserves, which continues to be consistent across the insurance and reinsurance segments.

The core expense ratio for the fourth quarter this year was 35.6% versus the prior year's comparative quarter of 34.7%, driven by the U.S. mortgage insurance operations, which is operating at a higher expense ratio until this business hits a steady state as well as the effect of an overall 5.2% smaller core net earned premium base quarter-over-quarter.

The insurance segment maintained a 32.4% expense ratio for the quarter compared to an identical 32.4% ratio a year ago, reflecting a lower net acquisition ratio, offset by an increase in operating expense ratio. However, we continue to focus on the total expense ratio as mentioned in previous calls, since the slotting of costs and benefits within the net acquisition and operating expense ratio is somewhat artificial and ceding commissions are fully booked in the net acquisition line and not allocated to every operating expense category that they represent.

The reinsurance segment expense ratio increased from 32.5% in the fourth quarter of last year to 36% this quarter, primarily reflecting a 14% lower net earned premium base. The reinsurance segment expense ratio was also weighted, though, by a reimbursement reflecting a favorable tax ruling affecting federal excise taxes. The ratio of net premium to gross premium for our core operations in the quarter was 71.6% versus 75% a year ago. The insurance segment had a lower 66.4% ratio compared to 69.1% a year earlier, driven by increased sessions on a larger alternative markets book that we've commented on in the past, increased sessions on capacities-driven product lines and a reduction in our P&C program business, which is kept predominantly net. It is important to note that on a written basis, the front-end gross commission ratio decreased by 110 basis points and the average quota share commission ratio improved by 260 basis points in the U.S. operation. These joint improvements will continue to be felt as they are earned over the next few quarters.

In the reinsurance segment, the net to gross ratio was 76.2% in the quarter compared to 85.5% a year ago, primarily reflecting sessions to Watford Re. Also as commented on during the last quarter's call -- last year's fourth quarter call, there was a onetime $50.2 million unearned premium reserve transfer associated with Gulf Re, which correspondently required a $50.2 million written premium to be recorded as well. This distorts the quarter-over-quarter comparison and can be seen in the financial supplement within the property other than property cat line of business. Adjusting for this, our premium reserve distortion results and the net written premiums for the total reinsurance segment this quarter declining by 8.7% quarter-over-quarter.

The mortgage segment, in addition to the premium growth that Marc mentioned earlier, had approximately $3.5 million of other underwriting income in the quarter from risk-sharing transactions receiving derivative accounting treatment and $4.6 million of underwriting profit associated with risk-sharing transactions receiving insurance accounting treatment. Over time, it is expected that more income will emanate from transactions receiving insurance accounting treatment than derivative accounting treatment.

The other segment, being wholly Watford Re at this point, reported a 103.8% combined ratio for the quarter, $96.2 million of net written premium and $119 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.

As for business sourcing, approximately 37% of the gross written premium this quarter was written directly on Watford paper with the remainder ceded by Arch affiliates. It should be noted that this sourcing can vary materially quarter-by-quarter.

The total return on investment portfolio on a local currency basis was a reported negative 10 bps in the quarter, as Dinos mentioned, reflecting positive returns on our equity sector that were more than offset by negative returns in both investment-grade and noninvestment-grade fixed income as well as the alternative investment portfolio. Even with our shift into a greater equity and alternative allocation over time, 80% of the portfolio is still comprised of fixed income security. On a U.S. dollar basis, total return for the quarter was a negative 33 bps. On a full 2015 calendar year basis, total return on a local currency basis was a positive 162 bps. And on a U.S. dollar basis, the return was a positive 41 bps in the quarter led -- for the year, led by the equity and investment-grade fixed income sectors.

The embedded pretax book yield before expenses was 2.16% as of year-end and duration remains fairly consistent at 3.43 years. Fixed income duration, as we said in the past, can fluctuate due to tactical decisions as opposed to long-term strategic shifts and the current duration continues to reflect our conservative position on interest rates in the current yield environment.

Reported net investment income in the quarter was $67 million or $0.53 per share versus $67.3 million in the 2015 third quarter or $0.54 per share and $72 million or 56% share in the fourth quarter a year ago. As always, we evaluate investment performance on a total return basis and not merely by the geography of net investment income.

Core cash flow from operations, as Dinos mentioned, was approximately $100 million in the quarter versus $227 million in the fourth quarter of last year. This reduction primarily reflects higher ceded reinsurance payments in total across all reinsurance and retrocession areas as well as some timing differences associated with the Watford Re ceded payments. It also reflects lower gross premium collections reflecting the drop in volume, particularly from the loss of a large MGA acquired by a competitor within our insurance group as has been discussed in previous calls, and a lower level of paid reinsurance recoveries received, due merely to timing differences.

The full calendar year 2015 core cash flow from operations was $705 million versus $998 -- $705 billion versus $998 million in this full -- I think I misspoke that. The full calendar year 2015 core cash flow from operations was $705 million versus $998 million in the full 2014 calendar year. Core interest expense for the quarter was $12.8 million, which is consistent with our longer-term run rate. Consolidated, therefore inclusive of Watford, interest expense was $15.8 million and since because we consolidate Watford, approximately $3 million of interest expense is associated with the use of leverage within Watford's investment portfolio. And as you recall, roughly 11% of Watford's results impact Arch's financial statements.

Our effective tax rate on pretax operating income available to Arch shareholders for the fourth quarter was an expense of 6.9% compared to an expense of 1.7% in the fourth quarter of last year. The full year effective tax rate on pretax operating income was 5.1% versus 2.4% for 2014 calendar year. This reflects $2.9 million or 26% of this quarter's total tax being a true-up of the first 3 quarters of the year to this 5.1% annual tax rate. Fluctuations in the effective tax rate can result from variability in the relative mix of income or loss reported by jurisdiction as was the case in this quarter. Our total capital was $7.1 billion at the end of this quarter, up 0.6% relative to September 30 and up 1.1% relative to 2014. Our debt-to-capital ratio remains low at 12.6% and debt plus hybrids represents only 17.1% of our total capital, which continues to give us significant financial flexibility.

We also continue to estimate having capital in excess of our targeted position. During the full 2015 calendar year, we repurchased shares at an aggregate cost of $365 million versus a 2014 share repurchase aggregate cost of $454 million. These represent 71% of net income during 2015 and 56% of net income during 2014.

Book value per share was $47.95 at year-end, up $0.06 of a point and up 5.2% relative to a year ago. This change in book value per share this quarter primarily reflects the company's continued strong underwriting performance, virtually offset by the challenging quarter in the financial markets.
So with these introductory comments, we are now pleased to take your call -- your questions.

Question and Answer

Operator

[Operator Instructions] Our first question comes from the line of Sarah DeWitt with JPMorgan.

Sarah Elizabeth DeWitt
JP Morgan Chase & Co, Research Division

First on the mortgage insurance business. I just want to get your latest thoughts on the growth opportunities there. You've probably seen some of the mortgage stocks are down 40% in the past 6 months, some concerns about growth, pricing and competition. So I'd be interested in your latest thoughts on that sector.

Constantine P. Iordanou
Chairman and Chief Executive Officer

Well, as I said in my prepared remarks, the -- we like the environment in the sector. The underwriting quality of these mortgages is very high. The macroeconomic conditions, the positive. You will get fluctuations on a quarter-to-quarter basis on demand. There's nothing we can do about the demand. However, let me point out to you that the GSEs are through the bulk transactions. They're transferring a much more significant portion of the risk to the private market. So there is ample opportunity on this risk-sharing transactions to expand the demand for transferring risk to the private market, which we participate. So that is the environment. As far as pricing, yes, there's been spots of competition, especially on the lender single premium sector. But we've seen that easing in the first quarter on the basis that with P. Myers [ph] and the capital requirements from P. Myers [ph] coming into effect, there is a higher capital charge on discounted LPMI business. So in essence, we've seen not only us doing a lot less in that sector, but some of our competitors doing less. So I still -- we're very, very bullish on that. But I'm going to turn it over to Marc Grandisson, to give a little bit of the color because he is embedded in that business and he has been since the beginning. So he probably knows more detail than I do.

Marc Grandisson
President and Chief Operating Officer

Yes. At a high level, I think the U.S. MI, I'll break it down into 2 pieces, the 2 areas, the credit union channel that we have. We had already a very significant market share. We're maintaining and actually growing it somewhat. So the growth there is going to follow the overall market growth in MI origination and MI purchases. The bank channel is going through a tremendous growth over the last year, and most of the growth is on the MI or, in fact, 90% of the growth comes from the bank channel. We're still in the early stages of establishing our presence, establishing our relationships and contacting our clients and growing that and establishing the pipes, if you will, to deal with this. At the same time, we have this, as you know, established RateStar. And RateStar's initial, as Dinos and I know, because we see the numbers, it's been a very initial -- very good response on the market. And that I think will lead to, hopefully, get -- giving us more penetration in the bank channel for the next 12 months. And that's not even counting the U.S. risk-sharing that Dinos mentioned. The new mandates, the new score card, the new -- and evaluation that FHFA will do for the GSEs, they have to -- from our expectations right now, the GSEs will have to, in the risk-sharing transactions, probably buy 50%, possibly more, over 2016 versus 2015. So that's actually a very bullish statement that private market is going to get a bigger place at the table.

Constantine P. Iordanou
Chairman and Chief Executive Officer

Let me add also one more point. It's more subtle point, but I think it's important based on where the financial markets are today. At the end of the day, we won 2 or 3 of the highest rated MI companies. And I believe that a lot of the originators, I don't care if it's commercial banks or mortgage originators, et cetera, they're going to stop paying more attention to where they're placing their business. Even though they're not the counterparty, Fannie and Freddie or the counterparty, I think it's prudent to be placing your business with more highly rated financial companies. So we're bullish about that because I think you're starting to be recognized, especially by the small banks that, "Hey, we'd rather do business with people that they have a better -- a stronger financial rating than others who don't."

Sarah Elizabeth DeWitt
JP Morgan Chase & Co, Research Division

Okay, great. And then on the excess capital. I know it's a high-class problem. But given the stock back above the level where you'd repurchase stock, how do you think about deploying that? And how long would you sit on the excess capital if the valuation stays at these levels?

Constantine P. Iordanou
Chairman and Chief Executive Officer

Well, we don't try to sit on excess capital. I mean, at the end of the day, we look at opportunities to deploy as much of our excess capital. Our first choice is to deploy it in the business. As we can see now, most of our opportunities they are coming on the mortgage side and when we get dips in the market as we have seen in the first quarter, they are all -- stock got punished unfairly, as far as we're concerned. But at the end, it gave us the opportunity for us to buy some of our shares back. If people don't like them at certain price, we like it. And that's the opportunities and we take advantage of it. It was in the close window, by the way. And I did put a 10b5 plan that it worked for us and it gave us the opportunity to purchase 1 million shares at reasonable pricing as far we were concerned. So we're going to continue with that philosophy. And I believe we're going to get opportunities as the market is starting now with some of our competitors to be putting pressure on their financials that we can deploy more capital in the business. Because at some point in time, it's going to improve. Now if you look at it quarter-to-quarter, you might be too anxious. We have a more longer-term view. We'll look at it year-over-year, and I don't mind carrying a certain amount of excess capital for the next year or so in order for me to have my powder dry case, I get opportunities to deploy.

Operator

Our next question comes from the line of Vinay Misquith with Sterne Agee.

Vinay Gerard Misquith
Sterne Agee & Leach Inc., Research Division

First question is on RateStar. I believe you mentioned 783 players have signed up for RateStar, if I'm correct. How many of them are the large players? Are you getting any of the large mortgage insurers? I mean, are there large banks signing up for this program?

Constantine P. Iordanou
Chairman and Chief Executive Officer

In general, we -- the smaller banks and smaller in size originators, they embrace RateStar more than the larger banks. But as you know, we give the opportunity to all of our customers to choose either RateStar and/or the rate card. We haven't abandoned the rate card. What the RateStar does, it tries to evaluate

[Audio Gap]

ROE expectations for the entire book of business.

We're pricing the business -- as matter of fact, we believe RateStar will give us even better ROEs than the old rate card. But that has been the environment.

The incredible thing about RateStar is that we have the ability live to see every single originator who is using the system. So independent if that mortgage is going to be placed with us, that -- the mortgage insurance are going to be placed with us or not, we see every single originator, every mortgage officer who is live on our system, instantaneously. So we monitor the volumes, we see who is using it and which territories they're using, et cetera, which for us is an incredible thing especially also from a marketing point of view because, to tell you the truth, we find some banks that maybe 3, 4 or 5 of their loan officers use RateStar significantly and the other 3, 4, and we know all of them by name, don't use it at all, and then it gives us an opportunity to go and have proper conversations as to why and why not.

So Marc, you want to add anything on the RateStar?

Marc Grandisson
President and Chief Operating Officer

No. The only thing I will concur and further confirm that there's the highest level of application that we received are coming through the regional and commercial credit union channel. The banks are bigger, but they are a bit longer to go over and make the change and adopt the RateStar application. But we -- it's going to take time, but we're going to get there.

Constantine P. Iordanou
Chairman and Chief Executive Officer

Yes. We have approvals on RateStar, I believe, on 46 states. Correct?

Marc Grandisson
President and Chief Operating Officer

Yes.

Vinay Gerard Misquith
Sterne Agee & Leach Inc., Research Division

Right. And have you seen a pickup in business from RateStar? And I believe one of your large competitors are not doing it. Have you seen some more competitors trying to do something similar to what you're doing?

Constantine P. Iordanou
Chairman and Chief Executive Officer

Well, early signs is a little bit of pickup. Where we see more of a pickup in utilization. And -- but like I said, we only released this about 2 months ago. It was early December. Now we're in February. Sometimes the process takes 6 to 8 weeks for a mortgage to be placed. So -- but clearly, there is an uptick, a noticeable uptick in the utilization of the system and the applications that they go through with the RateStar and they get a quotation for that mortgage insurance.

Now if that loan is going to be made and if they're going to place it with us because I'm sure they're comparing what our price is versus the rate card from some competitor, it's too early to tell. But I'm optimistic.

Vinay Gerard Misquith
Sterne Agee & Leach Inc., Research Division

Sure. And are you seeing other competitors also do something similar to your RateStar?

Constantine P. Iordanou
Chairman and Chief Executive Officer

Marc? You're closer to...

Marc Grandisson
President and Chief Operating Officer

Yes. You heard the call on Radian and MGIC. I mean, you can go through that and hear what they have to say. And there's trying -- there's definitely a trend in the industry to go in that direction to actually try and address the inefficiencies, frankly, that resides within the rate card pricing to better address and better assess the risk within a portfolio.

But I want -- I need to remind you, as Dinos and Mark did on last call, that, that endeavor of ours to create RateStar took over a year to put together. This is no small feat. It included having an amazing dedication and a big group of our people to really put it together. So I will not be surprised, I know I can't speak to that, but I wouldn't be surprised that our competitors feel compelled to have to react to this as well.

Constantine P. Iordanou
Chairman and Chief Executive Officer

It's predictive analytics, independent if it's in the auto insurance business or in the mortgage insurance business, et cetera. It's the norm now. And if you're not willing to assess risk appropriately and price it appropriately, at the end of the day, you might be subject to adverse selection over time. And we don't want to be in that category. So we do challenge our people to create that innovation, independent of the workup for that symbol.

Believe me, it's a 5-quarter effort. I was involved in it, Marc Grandisson was involved in it, and all of our senior guys from Andrew Rippert to David Gansberg and his team in Walnut Creek. We've put a big effort to do this. This is not something that, as one of our competitors says, it's just some black box that spits out. It's a lot of effort, a lot of analytics, a lot of historical data that we have used, both from within the old PMI books that we're running off on behalf of the regulator, but also with external databases that deal with mortgage risk. And we're proud of what we have achieved.

And believe me, it's still a work in progress. We will continue to improve it and improve it and improve it because it's not something that is static. As we learn about the predictability of the model, then we will adjust.

And it's no different what we've done on the cat business, right? And you've seen our performance on the cat business. I think we have fared well over the years taking catastrophic risk because, at the end, we -- let's face it, I'm the only non-actuary in the senior management team. I think they're ready to expel me from the group. Everyone we have is one here, except me. But I keep up with them. Everyone [indiscernible].

Marc Grandisson
President and Chief Operating Officer

Yes. Exactly.

Vinay Gerard Misquith
Sterne Agee & Leach Inc., Research Division

Just one follow-up. Just a numbers question, primarily quick. So first is the -- on the expense ratio. So just on the operating expenses, those were higher this year versus last year. Just wondering if you plan to keep them flat next year.

And the second piece is on the P&C insurance, on the acquisition expense ratio. Do you expect that to decline this year because of higher ceding commissions?

Constantine P. Iordanou
Chairman and Chief Executive Officer

Well, Mark, do you want to address this?

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

Yes. Let me do it in -- and this is Mark Lyons.

Constantine P. Iordanou
Chairman and Chief Executive Officer

Because I've got 2 Marks. I've got Mark square now. So it's...

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

Hopefully, there's not a third. It's what I'd call a question mark.

So let's take in reverse order. I think this is the third quarter I've commented on the quota share improvement on the pre-ceding commissions. And it's been about 260 bps. It fluctuates a little bit, 260 bps. I think the proportion getting that is increasing, so you get more of a gearing factor, firstly.

Secondly, I'm quoting those on a written basis. So you asked a semi-forward question, and we don't give guidance. But I think it's fairly straightforward that if you're getting those kinds of benefits on a written basis, they're going to eat their way in over the next 3 or 4 quarters. So I think it's reasonable to expect improving and then likely flattening at that point. However, there's continued improvement in the gross commission ratio, mostly as a function of mix, and that was 110 bps. And that's a big part of it, a reason for it as well.

On the OpEx side, let's say, we like to look at these things in total. We -- on the insurance group side, you had some specials in there that were related, I think, to our U.K. operation. We had some compliance things we dealt with. We had some Lloyds cost. We had some overlap of some IT, which I view as nonrecurrent, shifting from exchanging to an internal facility we have in the Philippines actually, which I view those as nonrecurrent.

The reinsurance, the mortgage stuff side we know about. It hasn't come up the scale. On the -- I think on the reinsurance side, that was dominated by the reduction in the net earned premium. There's a little accounting going on when we brought Gulf Re in, Vinay, that -- but roughly an additional $2 million of costs that come in more explicitly because Gulf Re is now a profit center in the reinsurance group versus before with more equity accounting, so a little of that sleight of hand.

So to make a long story short, I would expect continued improvement on the team commissions in insurance group and I would expect increasing management and flattening on the OpEx side.

Constantine P. Iordanou
Chairman and Chief Executive Officer

Let me give you also a little bit of the strategic view that we have when it comes to expenses. I said many, many times in many calls, we're not willing to part with our underwriting capability. So we're going to maintain underwriters even if the market might cause us to reduce writings because we're going to maintain -- the 2 things we -- the 2 religions we have is underwriting discipline and complete commitment to our good people, especially on the underwriting side.

Having said that, we expect our managers to chew gum and walk at the same time. And as a company, we have a very good turnover ratio, but still we have a turnover ratio which is around 11% on an annualized basis. So within that parameter, you try our non -- what I would call our noncritical underwriting jobs to make adjustments on your expenses through natural attrition. And that's been our philosophy from day one. A well-managed company plays with those parameters and make the right judgments. And our people are very good and very flexible and they accept reassignments and we move them from one operating unit to another where the opportunities are plentiful, especially if we have the work in -- we have to reduce volume.

So with all that in the mix, I think, Mark, can you -- you got into the minutia. You got into the nitty-gritty on the financials. But I want you to get the flavor of our philosophy and how we are going to operate the company.

Operator

Our next question comes from the line of Amit Kumar with Macquarie Capital.

Amit Kumar
Macquarie Research

Two Marks and one Dinos. Just very quickly going back to the realized losses line, did you talk about what exactly was going on in the Watford segment and why it had a realized loss?

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

No. I have not talked about that, but I think I'll take that as a gas pedal.

Well, I guess, a couple of things. First off, as you know, we kind of report Watford's results. We don't drive Watford's investment results, we're minority owners. But as far as the accounting world of it, they have elected the fair value option on investments. So in their line of realized gains or losses, it's actually the sum of realized and unrealized gains embedded in there. So hopefully, you find that helpful.

Amit Kumar
Macquarie Research

Got it. And then, for the x other segment, what did those realized losses stem from?

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

Well, that's called harvesting or reverse harvesting. But it's just your standard churn of fixed income and other investments that would have occurred throughout the course of the quarter.

Amit Kumar
Macquarie Research

Okay. I was just trying to figure out if there anything more going on. That's helpful.

The other question I had, going back to the -- obviously, you spent a lot of time discussing RateStar. And you are correct, other competitors are talking about it. And it's similar to auto insurance where there's an early adopter advantage. Do you -- how should we think about sort of the time line here where you still have that early adopter's advantage for some time before others catch up. Is it fairly easy for them to sort of get up to speed as to what you're doing because it has been done before and it sort of puts you at parity at some point of time? Or is there so much of a separation that it will take a long period of time for the ANMIs [ph] or Radians or others to really catch up with you? How should we think about that?

Constantine P. Iordanou
Chairman and Chief Executive Officer

If -- the way you think about it, if you remain standing still, they're going to catch up to you. But we keep walking. You see, as a matter of fact, we're -- I hope our guys, they keep running because -- and improving in the center.

At the end of the day, it's the -- it's cargoed as your thought process, what kind of algorithms that you build into it, how much of empirical data and whatever database is that they give you predictive analytics you're incorporating. And this is not nuclear physics. We're not putting the next man in the moon, but it requires a lot of effort. I don't know how quickly they can catch up. It depends on what kind of resources they throw at it. But I can tell you, it was not a small effort on our part. But we're behind it. We incurred the expense. We had a lot of our very senior guys working on it because both me and Marc Grandisson and Andrew and David Gansberg, we were very committed that, that's the way in the -- for the future. So we made it a very senior priority within the group to do this. Then this is 5 quarters ago. This is not today. So Marc?

Marc Grandisson
President and Chief Operating Officer

Yes. I think from our perspective, it is the competitive advantage. I want to say we were a first mover because you're right, you pointed out that some others have done it, again, other competitors in fact. But clearly, this is creating, we think, some breathing air, some headroom for us and at least know because of the fact that we're already have installed it. It's being used by our clients. And we're actually going to be dynamic, just like Dinos said, going through the portfolio, analyze it and modify and adjust it as we go forward. So we feel pretty good where we are.

Amit Kumar
Macquarie Research

Got it. And then final question related to that. Does the ratings downgrade of Genworth from S&P and Moody's, does that create a meaningful opportunity for the marketplace? How should we think about that?

Constantine P. Iordanou
Chairman and Chief Executive Officer

I -- it's too early to tell. So far, to my surprise, Amit, hopefully a financial executive with average intelligence, I would have thought that credit on a credit business will have more of an effect as to who gets the business. But to my unpleasant surprise, it seems that a lot of the mortgage originators sometimes don't care as to where they place the business because, at the end, they're not the counterparty, Fannie and Freddie is. But I don't think that's the wise choice for them to do.

Over time, I believe that will have to have some effect because why would you continue doing business with somebody with a -- financially challenged and -- but I leave that up to the market to determine.

Operator

Our next question comes from the line of Charles Sebaski with BMO Capital Markets.

Charles Joseph Sebaski
BMO Capital Markets Equity Research

Double question on mortgage. How much of your business in 2015 was refi versus purchase?

Constantine P. Iordanou
Chairman and Chief Executive Officer

Mark will give you that number in a minute. I think he can dig it up.

Charles Joseph Sebaski
BMO Capital Markets Equity Research

I guess, I just wonder, on the U.S. side, if there's a potential slowdown on refi at this level, if that's at all a headwind for you guys in that business? And I guess...

Constantine P. Iordanou
Chairman and Chief Executive Officer

I mean, refi creates more opportunities to write more insurance especially -- and if you're penetrating the market, will have an effect on us because, at the end of the day, we like more refis along with new originations, but I don't know.

Well, Mark, do you have the number? We can always offline. Don Watson will give you the percentages. I don't have all the books in front of me right now.

Charles Joseph Sebaski
BMO Capital Markets Equity Research

Okay. Well, as -- and then, looking at that, is the mortgage insurance part of the driver in the change of the effective tax rate this year? If you kind of look at 2015, a bit over 5%. Is that a realist -- a reasonable expectation for 2016 or going forward? Or does the growth in U.S. mortgage have a lifting effect on overall consolidated tax rate?

Constantine P. Iordanou
Chairman and Chief Executive Officer

Well, Lyons will give you the answer to that.

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

Yes. I love taxing questions. So Chuck, I -- it's a good point to bring up. It's partially contributory. There's a lot of areas that, in higher tax jurisdictions like that, that had very good results in the year, mortgage being one of them, our Arch Re Facultative group, our Morristown Arch Re Co. operation and the core insurance operations. So a lot of that kind of skewed it.

So as mortgage becomes a higher proportion of total and if we continue to have these margins, it will only creep up the effective tax rate, keeping everything else constant. We don't know what's going to happen in the P&C dynamics.

Charles Joseph Sebaski
BMO Capital Markets Equity Research

Okay. I guess, and then, finally, on the P&C side, on the programs, I think you said you had a large nonrenewal of a program this quarter. And I wanted to kind of get your take on is there -- is that a competitive reason? Is there -- was that just an absolute result? I guess I'm trying to get some insight on what's going on, on the smaller account risk side of the insurance business because a lot of competitors keep to -- talking about that as a means to deal with the pricing in the large account space.

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

Right. Well, it's good to be in a position where we had it for years and years rather than trying to gain it. So there's more renewals to us than new business to others. And in a tough market environment, getting -- to get on a new basis is a little tougher.

Chuck, it was a program that was bought by a competitor. It was fairly large. It was, on an annualized basis, north of $80 million. Hence, $20 million in the quarter. [indiscernible] roughly flat on it. And -- but yes, and we talked about action and other ones, but they -- for calendar 2015, they were immaterial, and this is one program that really affected it.

Charles Joseph Sebaski
BMO Capital Markets Equity Research

Okay. I guess your competitors as well, what you guys unfortunately haven't seen is some adverse development that -- in some of the lines. I was wondering if there's any comment on loss costs trend going on, on some of the longer tail liability lines. Have you seen any changes coming up or things kind of just status quo as they've been in the last few quarters?

Marc Grandisson
President and Chief Operating Officer

We've got very favorable loss cost [indiscernible] where we do an analysis every year, which we had not anything in the data that makes us to change our expectation of loss cost trend. It's still pretty low, but it's very stable for last couple of years.

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

I mean, Chuck, as we talked about in the past, it really -- it's a different story by area. Marc's right. Across the board, weighted. We don't see anything material happening. You probably saw that series class action suits, for example. That's kind of returned to a long-term normal. It had been below normal, things like that.

But luckily, we don't seem to get hit by a lot of the SCAs. So we'll make them someone else's problem.

Marc Grandisson
President and Chief Operating Officer

Yes.

Constantine P. Iordanou
Chairman and Chief Executive Officer

You've got the number? Charles, while I have you in, so I want to make sure I got the numbers right before I quote it. It was a market where it was mostly a purchase market, 75% purchase, 25% refi. The mortgage rates went up and it became more of a purchase market in the fourth quarter.

Operator

Our next question comes from the line of Michael Nannizzi with Goldman Sachs.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Just a couple of numbers ones, if I could. In the mortgage -- or I'm sorry, the reinsurance segment, Mark, could you quantify the impact of that tax item that you talked about in your script?

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

Yes. Well, that wasn't really in the reinsurance segment. That was overall. That was $2.9 million, which I said was 26% of the total tax on pretax operating income. That's because the effective tax rate is 5.1% for the year, it was less than that as of third quarter. We have to true it up. We have to bring them up to the same level.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Maybe we're getting our signals crossed. I think -- I thought you said in the script that there was a -- some settlements of some tax matter.

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

I'm sorry. That's -- and we're not alone in this. So you probably heard it on some other calls. It's a thing they call tax rolling with regard to cascading FET where we had paid it in the past and then the favorable ruling came down, so there was a reimbursement associated with the prior cost expenditure.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Got it. And that rolled up into the other operating or in the acquisition?

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

Well, there's some in insurance and some in reinsurance. It's mostly in acquisition.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Okay. And then just trying to figure out like what we should be thinking about on the forward, anyway we could get some quantification of that?

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

Well, it was about $3 million and onetime.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Got it. Okay. And then, sticking to reinsurance for a sec, the other operating expense there. I mean, how should we be thinking about that on the forward? I think -- Dinos, I think you might have mentioned talking about redeploying folks from one place to another. You -- if we continue to see the business there kind of recede, just given a lack of opportunities there to invest, do you see that -- is that an area where you would -- where we would see that coming down? Or do you expect to maintain your infrastructure there?

Constantine P. Iordanou
Chairman and Chief Executive Officer

You got to break it into components, right? You got to break it into components. So how much is internal expense and how much is commissions, ceding commissions, et cetera. You don't write the business, you don't have the ceding commission expense.

Our intention is, and I've said it many times, and I know Marc Grandisson and I, we see eye to eye to it, we have no intention for eliminating underwriting capabilities we have. I'm not going to give my underwriters to the competition. So we're going to maintain that because our view of the market is more long-term than short-term. These are the same underwriters that generated significant profits for us in -- when the market was good for reinsurance and that market will come back again to supply and demand and, at some point in time, it will readjust.

So from that perspective, for you, when you're looking at your numbers, look at the operating expense, break it down into what's internal versus external, meaning ceding commissions and all that, and the internal run rate we're going to maintain because I don't expect us to reduce our underwriting capability.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Okay. And then, just sort of thinking about the underlying loss ratio there in reinsurance. I mean, you saw year-over-year improvement despite some mix shift away from what I would guess are higher profitability property lines, at least relative to the rest of the book. How should we think about that? I mean, was there anything sort of happened either in the quarter or the year, just top of your mind, maybe Mark, just to help to support that result? Or do you feel like 2015 was sort of what it was and that's a good starting point to think about for the future?

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

Well, there's always seasonality in the business, firstly. So you got to watch the serial comparison. But there is some of the mix differences. I mean, the facultative unit performed well as it generally does, and the degree by which it varies quarter-by-quarter. But as Marc said, the property cat being deemphasized and if it continues where the margins are not, we're likely to continue in that way. So the third party businesses -- and the other opportunities that they've been getting, they're, I'll call, out of the mainstream opportunities continue to be in the pipeline. So it's a little hard because that it's probably only half of the business. It's probably what I'd call standard business at this point. But I think fourth quarter is more of a reasonable go-forward.

Marc Grandisson
President and Chief Operating Officer

Yes. To further add to this, we're focusing on returns and always we have very, very agile underwriting teams across the platform in reinsurance enable to maneuver in and out of markets as they see the returns get better or worse. A great example, as I've mentioned in my notes, is the U.K. motor. It has a higher loss ratio component by virtue of being a quarter share. You're not going to get a 20% loss ratio in that business under extreme circumstances. So we are expecting to have a higher loss ratio. But in the end, we don't really worry so much about the components of the loss or expense. We worry about the margin that we can derive from the business.

And as I -- I will echo with what Dinos has said, I mean, we have a pretty decent agile team that's able to seek and source and seek and capitalize on opportunities. And we have more, always.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Great. And then just maybe one last quick one, if I could, on the MI. Can you break down how much of the action in your underwriting profitability has come from U.S. MI versus whether it's reinsurance for the other business?

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

No. We generally don't talk about that. We do it and we manage it in a total segment basis. So the whole strategy that Marc and his team, Andrew and his team has, is they balance the mixture of that, but they have a common macroeconomic view and everything else. So we tend to look at it in totality and report it in totality.

Operator

Our next question comes from the line of Josh Shanker with Deutsche Bank.

Joshua David Shanker
Deutsche Bank AG, Research Division

The Australian business, how should we think about revenue going forward for the Australian business?

Marc Grandisson
President and Chief Operating Officer

It's hard for me to tell what's going to happen. It's an ongoing -- the relationship that we have established, as we mentioned, for last year has been very fruitful -- the quarter share agreements that we have with one of the major lenders down under. We have -- it's ongoing. There are things going on down under as you know, various option that we're looking at. So it's really hard for me to tell you how it's going to go for the next year.

Constantine P. Iordanou
Chairman and Chief Executive Officer

It won't be any less, but we can -- we don't know, hard to say what the new opportunities are because we're engaged in a lot of discussions that sometimes they bear fruit and sometimes they don't.

Joshua David Shanker
Deutsche Bank AG, Research Division

Is it going to be lumpy by necessity?

Constantine P. Iordanou
Chairman and Chief Executive Officer

No. It will be steady. Lumpy on the upside if we get -- if we do other transactions, but -- and if we interrupt a relationship, it can be lumpy on the downside, but we don't anticipate that.

Marc Grandisson
President and Chief Operating Officer

Yes. I think I will -- Josh, I will say it's going to be lumpy on the written base because the business in Australia is written all upfront. The earnings is going to take years to go.

Constantine P. Iordanou
Chairman and Chief Executive Officer

Right.

Marc Grandisson
President and Chief Operating Officer

So a bit more stability on the earnings over time, but the written, yes, rightfully, could be very lumpy.

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

And just to reemphasize and clarify that, Josh, because I think it's easy to get some confusion, that deal is not a single upfront premium like in the totality to the exposure. Instead, it's a single premium market in Australia. So you're going to have -- there is no monthlies really. So it's going to be a series of singles that come out through month by month by month that come in and we'll record accordingly. It's not an upfront number.

Marc Grandisson
President and Chief Operating Officer

Yes.

Constantine P. Iordanou
Chairman and Chief Executive Officer

Right. It's quite mortgage by mortgage by mortgage. And you're earning that over the duration of that. And it's a long duration, 7, 8, 9 years.

Joshua David Shanker
Deutsche Bank AG, Research Division

Very good. And on Watford -- and I don't know enough about the investment strategy at Watford. It looked like the investments had a good quarter last quarter. Now we're in this bumpy market right now. How should market volatility affect investment results at Watford?

Constantine P. Iordanou
Chairman and Chief Executive Officer

Well, I mean, we don't make those decisions, Highbridge makes that. But in essence, their approach hasn't changed. I know when the spreads have widened, they're going to take marks. But they feel comfortable with the quality of the portfolio and the embedded yield, which is in the 7% and higher. And now it will be a question as to where the economy goes and would they have any defaults in it, but we don't see -- based on our reviews that we get on a quarterly basis, the 11% orders, we don't see a significant risk to that. They analyze every investment one by one and they put probabilities of default and recoveries. It depends on where the economy goes. But if they can't -- if we don't have a recession, I think they're in good shape.

Operator

Our next question comes from the line of Meyer Shields with KBW.

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

Great. Two quick mortgage questions, if I can. First, if you look over, I don't know, fourth quarter conference call, a lot of Bermudans are talking about mortgage reinsurance. Are we seeing -- are you seeing a more competitive market in general for that?

Constantine P. Iordanou
Chairman and Chief Executive Officer

A little bit more, but I don't think it's the competition. It's more participation and a lot of that we see in the bulk transactions, the GSEs. They're purchasing now for the 20% to 40% down payment. This is the 60 to 80 LTV business that the GSEs buy through the [indiscernible] and Connecticut Avenue Security transactions in the market. And you have a broader participation there by other reinsurance. And of course, some of the MIs that they needed to comply with the PMIER capital requirements, they might have done some transactions in order for them to come up to the capital standards that they need to prove to the GSEs that they're complying. But I don't see a major change of that going forward. I think most of that participation is going to happen on the bulk transactions. Marc, you want to add to it?

Marc Grandisson
President and Chief Operating Officer

I agree with you. Agreed. Yes. Well said.

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

Okay. And then, second, as -- I get that mortgage LE's written premium growth were going to be lumpy. But as we see better market conditions there than in insurance and reinsurance, does that have an impact on the investment portfolio? Does that give you even more room for longer term investing philosophy?

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

Yes. I would say, Meyer, that it's a function of the duration of the aggregate portfolio at that point in time. So I'd say as it becomes a higher proportion of total, it's going to inch up the duration that -- on it and, therefore, have it matching on it on the investment side.

Constantine P. Iordanou
Chairman and Chief Executive Officer

Our investment philosophy is basically, on the liability side of the business, we match durations with those liabilities. And on the shareholder capital, we have a view that it can be very short. It's a 0 duration all the way up to 5 years duration depending how our investment committee and the board believes the market conditions dictate. So -- and right now, on the shareholder capital, we're about neutral. So our duration is, what, 3.6, Marc?

Marc Grandisson
President and Chief Operating Officer

3.4.

Constantine P. Iordanou
Chairman and Chief Executive Officer

3.4, and our duration of our liability is not that different from that. So we're kind of neutral where we are today.

But we can elongate that or go short on that depending what we do with the shareholders' equity capital.

Operator

Our next question comes from the line of Matt Carletti with JMP Securities.

Matthew John Carletti
JMP Securities LLC, Research Division

I just had a follow-up on Amit's question on the realized losses in the quarter. Mark, that's really helpful, the kind of color on the other segment and how Watford treats it. But I guess my question is on the subtotal of the operating segments. It's still a pretty big number in the quarter relative to history at least, particularly in a quarter where equities are up. So I'm just wondering is there any OTTI to note there or performance of alternatives? Or was it just kind of more very run-of-the-mill?

Constantine P. Iordanou
Chairman and Chief Executive Officer

Our OTTI was very small for the quarter. It was in the single millions of dollars. It's -- we have a total return philosophy. And our portfolio trades quite a bit and sometimes you're going to see realized losses coming through because they might be repositioning the portfolio from one security to another and we take those marks, where other companies, when they buy in whole, they might have more unrealized marks where we might have more realized.

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

There's also been a purposeful repositioning of the portfolio. You probably noticed that -- not just the movement into U.S. corporates and municipals, but a deemphasis of mortgage-backed securities and commercial mortgage-backed securities and so forth. So we just compare it year-over-year. So Dinos' point is right. As you know, as you make these decisions in insurance, you're moving them into the bucket of just marks that would be unrealized [indiscernible]. But that's done with the thought of the future view of the portfolio returns.

Operator

I'm showing no further questions at this time.

I would like to turn the call back to Dinos Iordanou for closing remarks.

Constantine P. Iordanou
Chairman and Chief Executive Officer

Well, thank you, all, for listening to us. And we're looking forward to talking with you in the next quarter. Have a wonderful afternoon.

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