S&P Global
Market Intelligence

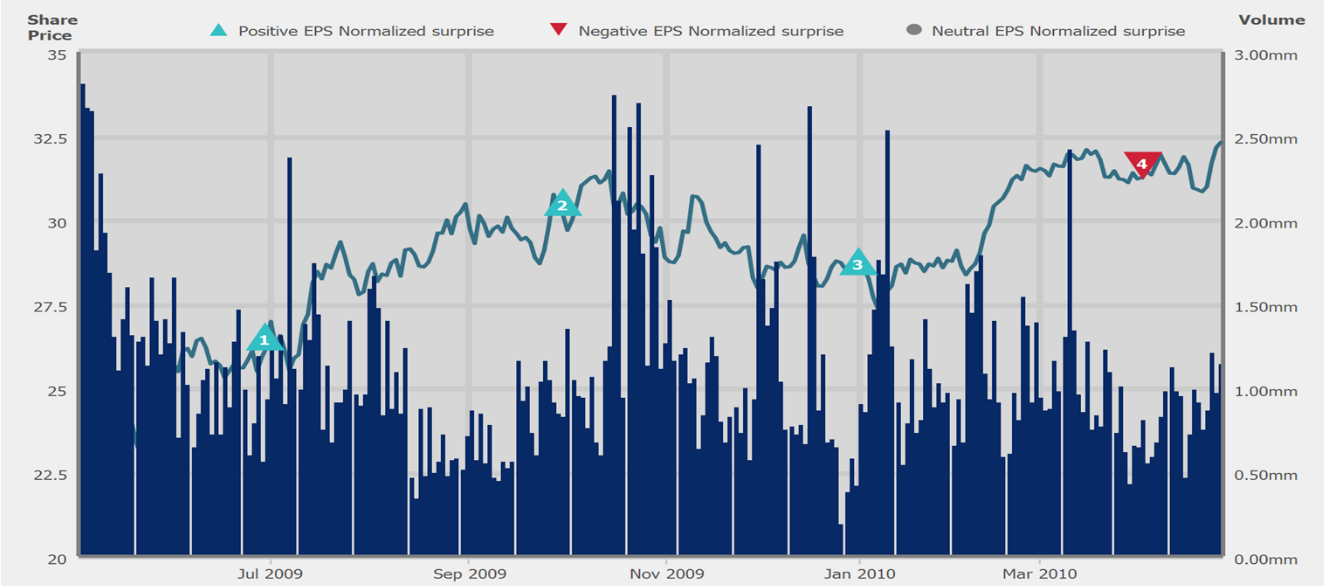
AXIS Capital Holdings Limited NYSE:AXS
FQ2 2010 Earnings Call Transcripts

Wednesday, August 04, 2010 12:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ2 2010-			-FQ3 2010-	-FY 2010-	-FY 2011-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	1.19	1.33	11.76	0.90	4.01	4.53
Revenue (mm)	721.45	788.94	9.35	619.98	3056.35	3172.15

Currency: USD
Consensus as of Aug-04-2010 12:00 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ2 2009	1.17	1.22	4.27 %
FQ3 2009	0.80	1.05	31.25 %
FQ4 2009	1.31	1.83	39.69 %
FQ1 2010	0.68	0.67	(1.47 %)

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Call Participants

EXECUTIVES

David B. Greenfield
Former Chief Financial Officer, Principal Accounting Officer and Executive Vice President

John R. Charman
Chairman & CEO

Linda Ventresca

ANALYSTS

Beth Malone
Wunderlich

Brett Shirreffs
KBW

Brian Meredith
UBS

Greg Locraft
Morgan Stanley

Keith Alexander
JPMorgan

Sam Hoffman
Lincoln Square Capital

Vinay Misquith
Credit Suisse

Presentation

Operator

Good morning and welcome to the second quarter 2010 Axis Capital Holdings Limited earnings conference call. All participants will be in listen-only mode. (Operator Instructions). After today's presentation, there will be an opportunity to ask a question. (Operator Instructions). Please note, this event is being recorded.

I would now like to turn over the conference to Linda Ventresca. Please go ahead, ma'am.

Linda Ventresca

Thank you, Andrea. Good morning, ladies and gentlemen. I am happy to welcome you to our conference call to discuss the financial results for Axis Capital for the quarter ended June 30th, 2010.

Our earnings press release, financial supplement, and quarterly investment supplement were issued yesterday evening after the market closed. If you would like copies, please visit the Investor Information section of our website, www.axiscapital.com. We set aside an hour for today's call, which is also available as an audio webcast through the Investor Information section of our website. A replay of the teleconference will be available by dialing 877-344-7529 in the U.S. The international number is 412-317-0088. The conference code for both replay dial-in numbers is 442139.

With me on today's call are John Charman, our CEO and President; and David Greenfield, our CFO. Before I turn the call over to John, I will remind everyone that statements made during this call, including the question-and-answer session, which are not historical facts, may be forward-looking statements within the meaning of the U.S. federal securities laws.

Forward-looking statements contained in this presentation, include, but are not necessarily limited to, information regarding our estimate of losses related to catastrophes, policies, and other loss events; general economic, capital, and credit market conditions; future growth prospects and financial results; evaluation of losses and loss reserves; investment strategies, investment portfolio, and market performance; impact to the marketplace with respect to changes in pricing models; and our expectations regarding pricing and other market conditions. These statements involve risks, uncertainties, and assumptions, which could cause actual results to differ materially from our expectations.

For a discussion of these matters, please refer to the Risk Factor section in our most recent Form 10-K on file with the Securities and Exchange Commission. We undertake no obligation to update or revise publicly any forward-looking statements, whether as a result of new information, future events, or otherwise. In addition, this presentation contains information regarding operating income, which is a non-GAAP financial measure within the meaning of the U.S. federal securities laws. For a reconciliation of this item to the most directly comparable GAAP financial measure, please refer to our press release, which could be found on our website.

With that, I would like to turn the call over to John.

John R. Charman
Chairman & CEO

Thank you, Linda, and happy birthday to you and David. Good morning, everyone and thank you for joining us. Given the historically low investment yield environment coupled with extremely challenging property and casualty market conditions, we are pleased with our performance during the second quarter.

For the quarter, we reported net income available to common shareholders of 2010 of $205 million or $1.51 per share, as well as operating income of $180 million or $1.33 per share. Our diluted book value per common share increased by 6% during the quarter and 9% from year-end to $36.57. The annualized return on average common equity for the second quarter of 2010 was 16.6% and the annualized operating return on average common equity was 14.6%.

Our consolidated combined ratio for the quarter, an important measure of profitability in our core property and casualty underwriting operations, was 86.2%. These underwriting results reflect current period underwriting profits and continued favorable reserve development, offset by a $24 million increase in our estimated net losses from the Chilean earthquake. Our underwriting results have continued to reflect the favorable impact of recovery from the global financial crisis, as well as more normal expectations for losses in credit related lines of business.

Finally, for the quarter, our total cash and investments portfolio delivered a total return of 1.3%, including net investment income of $83 million. As part of our long-term strategic capital management plan, we bought back $121 million of shares in the open market during the second quarter at an average valuation of 86% of diluted book value per share for the period. Given the current insurance and reinsurance market outlook, we feel buying back shares when they trade at these levels is an effective use of excess capital.

With that, I will now turn the call over to David to discuss these financial results in more detail.

David B. Greenfield
Former Chief Financial Officer, Principal Accounting Officer and Executive Vice President

Thank you, John and good morning, everyone. As John mentioned, we are pleased with our results for the quarter. Our diluted book value per share increased 6% this quarter to an all-time high of $36.57, bolstered by net income, the continued execution of share repurchases at a discount to diluted book value, and further improvements in the valuations for our fixed maturity portfolio.

We also delivered a strong annualized operating return on average common equity of 14.6% for the quarter. Net income available to common shareholders for the quarter was $205 million or $1.51 per diluted share compared with $159 million or $1.06 per diluted share for the second quarter of 2009. Operating income, which excludes the impact of realized gains and losses on investments, was $180 million or $1.33 per diluted share compared with $183 million or $1.22 per diluted share for the second quarter of 2009.

For the first half of 2010, net income available to common shareholders was $317 million or $2.28 per diluted share compared with $275 million or $1.84 per diluted share in the first six months of 2009. Operating income was $276 million or $1.99 per diluted share compared with - to $338 million or $2.26 per diluted share for the first half of last year.

Turning to our top line, our consolidated gross premiums written were $940 million for the quarter, up 3% from the second quarter of 2009 and driven by growth in our Insurance segment. Gross premiums written in our Insurance segment were $613 million this quarter, up 16% from the second quarter of last year.

Our property premiums increased due to select new business opportunities in the onshore energy market, as well as in the U.S. property markets where we have written new business, which is primarily non-CAT exposed. Rate increases on offshore energy business following the Deepwater Horizon explosion, as well as increased share on certain policies resulted in increased marine premiums.

Although we ceased underwriting E&S primary casualty business this quarter due to sustained unfavorable market conditions, we saw a good opportunity in the E&S umbrella market which resulted in an increase in liability premiums. Our aggregate terrorism exposures have declined. However, our gross premiums written in this line rose this quarter due to one multiyear policy and a restructuring for another significant policy. Aviation premiums were higher this quarter as a result of a shift in renewal dates on certain policies from the first to second quarter of 2010.

Gross premiums written in our Reinsurance segment were $327 million, down 16% from the prior-year quarter. The difference was largely due to shifting renewal dates on certain treaties in our property and motor reinsurance lines. Premiums for our property line were impacted by the renewal of a significant second quarter 2009 treaty in the first quarter of 2010, as well as the extension of another significant second quarter 2009 treaty for renewal in the third quarter of 2010.

Partially offsetting these decreases, our liability premiums increased this quarter due to the renewal of a first quarter treaty in the second quarter. With the various movements in renewal dates amongst quarters, it's more instructive to compare the first half of 2010 with the prior-year period.

For the first half of 2010, gross premiums written in our Reinsurance segment increased 2%. On a currency-adjusted basis, gross premiums in the segment increased only 1%. Our consolidated gross premiums written for the first six months of 2010 increased 6% over the same period in 2009, driven by an 11% increase in gross premiums written in our Insurance segment.

Consolidated net premiums written increased 13% in the quarter and 9% for the year-to-date, reflecting the previously mentioned growth in gross premiums written, as well as changes in reinsurance purchasing within our Insurance segment. We increased the attachment points on our property excess of loss reinsurance program and reduced the session rates on our professional lines quota share program on renewal this quarter. In line with these changes, our consolidated net premiums earned increased 4% in the quarter and for the six-month period.

Moving on to our underwriting results, total underwriting income for the quarter was $121 million compared with $141 million in the second quarter of 2009. Our combined ratio was 86.2% this quarter versus 80.4% in the prior-year quarter. Our current accident year loss ratio decreased 1.6 points from 67.2% in the second quarter of 2009 to 65.6% this quarter. I will now discuss these ratios for each of our segments individually.

Our Insurance segment's current accident year loss ratio decreased 16.6 points to 61.7%, primarily driven by reduced claims activity in our credit and political risk line and our aviation line of business. Our net losses for the quarter in this segment include $9 million from the Deepwater Horizon event, which is contained within our annual loss expectations for the marine class.

As some maybe aware, we reached final settlement in policy cancellation on Blue City this quarter. You may recall that this was our peak credit exposure. There was no impact to underwriting results from this in the quarter, as our net payment fell within reserving provisions previously established.

Moving on to our Reinsurance segment, the segment's current accident year loss ratio increased 9.3 points to 68.3%, primarily reflecting an increase in our estimated losses related to the Chilean earthquake. Any exposure to the Deepwater Horizon loss in our Reinsurance segment is expected to be contained within our annual loss expectations. Marine reinsurance treaties have not been a feature of our reinsurance portfolio since inception.

Our consolidated current accident year loss ratio for the year-to-date was 72.1%, 3.1 points higher than the ratio for the first six months of 2009, primarily due to the significant catastrophe activity in the first quarter. Our estimated net losses for the Chilean earthquake are $124 million and are net of related reinstatement premiums of $9 million. This net estimate increased $24 million during the quarter following a review of updated information from cedents, intermediaries, and other market sources.

As expected, complications associated with the investigation, adjusting, and handling of claims arising from the Chilean earthquake are resulting in a longer development detail than that observed for other catastrophes of a similar magnitude. These include restrictions on who is permitted to adjust claims, the scope of coverage on the original policies, and the practical and logistical issues associated with adjusting business interruption losses in Chile.

During the first half of the year, we also incurred losses, which totaled $49 million related to other notable first quarter events including Australian storms, European windstorm Xynthia, and U.S. storms. There was no material change in the aggregate net loss estimate for these storms this quarter.

Our estimated net reserves from prior accident years continued to develop favorably during the quarter with prior-year reserves reduced by $79 million. Of this amount, $31 million was from our Insurance segment, representing a positive impact of 10.1 points on the segment's loss ratio.

In our Reinsurance segment, we recorded $48 million in net favorable prior-period reserve development, representing a positive impact of 11.1 points on the segment's loss ratio. Approximately $38 million of the net favorable reserve development this quarter was generated from our short tail lines. A further $36 million relates to our professional lines insurance and reinsurance businesses.

We continued to incorporate our own experience into our ultimate expected loss ratios for accident years 2006 and prior, with less weight given to industry benchmarks. We have yet to do this in any meaningful way for liability lines with longer development tails. Net favorable development of $13 million on our trade, credit, and bond reinsurance business was also reported in the quarter in recognition of better-than-expected loss experience.

Moving on to expenses, our acquisition cost ratio increased 2.3 points this quarter relative to the prior-year quarter, driven by the changes in our ceded reinsurance purchasing, as well as prior-year commission adjustments. Our G&A expense ratio for the quarter was 14.4%, which was a 2.1-point increase over the prior-year quarter of 2009, but comparable with the first quarter of 2010. As I have noted in the last several quarters, strategic initiatives such as our new A&H division has resulted in some upward movement in this ratio. We expect this ratio to be near this level until our investments are fully leveraged from an operating perspective.

Now, turning to our investment portfolio, net investment income for the quarter was $83 million, down $30 million from a year ago. The decline was driven by the lower yield environment, lower returns on our alternative investments, and to a lesser extent, negative foreign exchange movement. As a result, our pretax investment yield on our fixed maturity portfolio was 3.6% for the current quarter, down 20 basis points from the first quarter of this year. This compares with a pretax investment yield of 4.4% from a year ago.

Our total return on our cash and investments portfolio was 3.1% for the first half of 2010, consistent with last year. During the current quarter, our net realized investment gains were $25 million compared to net realized investment losses of $24 million for the same quarter in 2009. The 2009 balance was driven by $21 million of OTTI charges compared to only $7 million during the current quarter.

Our total cash and invested assets grew by approximately 5% to $12.2 billion for the first half of the year, driven primarily by strong operating cash flows and further improvement in the valuation for our fixed maturity portfolio. We continue to maintain a well-diversified portfolio with a duration of three years and a weighted average credit quality of AA. On a topical note, our total exposure to sovereign debt and banks in Europe represented less than 7% of our total cash and invested assets at the end of July.

We had no exposure to sovereign debt related to Portugal, Italy or Greece and our sovereign holdings related to Spain and Ireland were de minimis at 0.4% of the portfolio. We had no debt holdings related to banks domiciled in Greece or Portugal. Our debt holdings related to banks domiciled in Italy, Spain, and Ireland were also de minimis at 0.3% of the portfolio.

With respect to foreign exchange, our income statement gains and losses are primarily the result of a revaluation at each balance sheet date of our net insurance liabilities required to be settled in foreign currencies. This quarter, significant declines in the rates of exchange for the euro and sterling against the U.S. dollar drove the $27 million exchange gain for the quarter, as the U.S. equivalent of our foreign-denominated net liability balances declined.

In contrast, we recognized $24 million in foreign exchange losses in the prior-year quarter. However, from a book value perspective, these foreign exchange movements were offset by corresponding foreign exchange movements on our available-for-sale investments, which are largely recognized through other comprehensive income.

In anticipation of the expiration of our existing credit facility at the end of August, we entered into a new secured $750 million Letter of Credit facility during the quarter. We continue to remain strongly capitalized for the risks we hold and the risks we are targeting.

Our total capitalization at June 30th, 2010 was $6.5 billion, including $1 billion of long-term debt and $500 million of preferred equity. Our financial flexibility remains very strong with a debt-to-total capital ratio of 15.3%, a debt and preferred-to-total capital ratio of 23%, and total capital in excess of rating agency requirements. Our capital management approach balances the obvious rating agency and regulatory capital requirements with plans for reinvestment in our business and opportunistic capital requirements.

During the quarter, we repurchased $121 million worth of common shares or 4 million common shares this quarter at 86% of average diluted book value per share. We continue to believe this return of capital is in the best interest of our shareholders at this time, given depressed market valuations for the industry and a negative outlook for the insurance and reinsurance markets.

Since the end of the quarter, we repurchased a further 0.3 million shares for a total cost $10 million and currently have approximately $123 million of remaining authorization for share repurchases. We intend to moderate our repurchase activity for the third quarter and revisit it once the Atlantic hurricane season has passed.

In our quarterly financial supplement, we have updated information about PMLs as of July 1st for the Axis Group at various return periods for peak industry CAT zones. We have also provided estimates of industry losses at these return periods. The most notable change relative to the information provided with the prior quarter's earnings announcement occurred in net U.S. wind and earthquake PMLs. Group aggregates for these perils increased as our CAT retentions were increased on the reinsurance purchased for our Insurance segment during the quarter.

With that, I would like to now turn the call back to John.

John R. Charman
Chairman & CEO

Thank you, David. And as expected the market rather similar to the Titanic bearing down on its iceberg, continues on a steady ultra-competitive track. However, events in the first half of this year including the Deepwater Horizon loss and the Chile earthquake have had a positive but contained impact on pricing.

The overall rate change for our Insurance segment during the second quarter is estimated at minus 5%, a slight decrease over the prior quarter. Because of differences in mix of businesses between the two sequential quarters, the rate changes are not directly comparable. However, the trend is negative across most insurance lines and we expect to see a continuation of this negative trend through the balance of the year, absent a major catalyst. This modest decline in pricing across the portfolio was relatively consistent across most classes. The class of business experiencing the greatest change at the moment is the offshore energy class, which has been impacted by the Deepwater Horizon loss.

Renewal rate quotes, since the loss, are now averaging upwards of 25% for loss-free drilling contractor accounts and upwards of 15% for loss-free exploration and production renewals. We would describe the continuing market response to the loss as having two distinct phases. The first is the immediate reaction through increased pricing and scrutiny of coverage. The second market reaction will come following the renewal of carriers' marine and offshore reinsurance treaties, the majority of which will occur at the 1st of January.

During the quarter, we ceased underwriting E&S primary casualty business, given the extremely weak market conditions in this area and its near-term negative outlook. This will not have a dramatic impact on our top line as it has been a relatively small class for us in recent years. We have been pulling back from this line gradually since market conditions peaked for the class in 2004.

We concluded the 1st of July renewals in our Reinsurance segment a few weeks back. Approximately 15% of AXIS Re's 2009 expiring premium was renewable on the 1st of July. The majority of the business up for renewal at this date was property reinsurance business. We estimate our AXIS Re underwriting year premiums at the 1st of July were up 3% over the expiring amounts. On a currency adjusted basis, we were up 5%.

There could be other activity in the quarter that will impact top line for the segment, but these estimates generally give a good indication of how we are faring in the marketplace. Declines in our property catastrophe exposed premium volume were offset by growth in our new Latin America surety reinsurance line of business and select growth in our U.S. casualty reinsurance lines.

The decline in property catastrophe exposed business was driven by the removal of a significant aggregate excess treaty from the reinsurance market and a reduction in exposure to lower layers in property per risk business where competition was significant. In our opinion, the reinsurance market was more competitive across the board, but not irrational. Overall, AXIS reinsurance markets remained stable without material changes in pricing or loss trends.

At the 1st of July renewal, property CAT and reinsurance business saw a continued modest deterioration from the pricing level at the 1st of January renewal. As expected, pricing was not off at the 1st of July renewal as much as it was off at the 1st of June renewal where the dynamics around the Florida stand-alone market drove more pricing pressure. As a reminder, reinsurance of Florida stand-alone business has never been a feature within our portfolio due to the credit risk inherent in these smaller carriers. We don't view the deterioration that occurred at the 1st of July renewal as having a material impact on expected margins.

As I mentioned earlier, there has been greater rate deterioration experienced in lower layers which generally have more premium volume associated with them. Whilst this has had some impact on the quarter's production, low layers generally have not been a big feature for our portfolio.

Third-party reinsurance business in the U.S., namely professional lines and other casualty reinsurance lines, are reacting rationally to favorable trend and good experience, but still do not seem to be reacting to reductions in investment income or early signs of inflation as might - as we might expect.

Against the backdrop of a competitive market, underwriting discipline and out-performance remains paramount and we expect to continue to outperform. We expect the balance of the year to feature continued irrational competition, particularly in the insurance marketplace.

Regardless of where our premium volume ends up for the year, we are confident that we are maintaining a high-quality, diversified underwriting portfolio that will continue to generate significantly positive cash flow and market-leading underwriting profits. We remain well positioned to grow strongly and quickly, enabling us to benefit from any hardening that may occur within both the insurance and the reinsurance markets. Thank you. And with that, I will open the call up to questions.

Question and Answer

Operator

Thank you. We will now begin the question-and-answer session. (Operator Instructions). At this time, we will pause momentarily to assemble a roster. Our first question comes from Vinay Misquith of Credit Suisse. Please go ahead.

Vinay Misquith
Credit Suisse

Hi, good morning.

John R. Charman
Chairman & CEO

Good morning, Vinay.

Vinay Misquith
Credit Suisse

Could you help us understand a little bit more your growth in the primary insurance operations?

John R. Charman
Chairman & CEO

Well, casualty - primary casualty?

Vinay Misquith
Credit Suisse

Both property and marine, I believe. You said you found new opportunity.

John R. Charman
Chairman & CEO

Oh, growth? Sorry, I thought you said close. Sorry, forgive me. Well, we had - well, I've said to you before Vinay that we spent the last two or three years really investing a lot in our people and systems to try to make sure that we can squeeze a lot more efficiency out of our underwriting operations. And what this is showing that we have been able to around the margin squeeze production in the areas that we have skill sets, market standing, and a proven track record of squeezing underwriting profitability out of these businesses.

And I think that the growth within our insurance business this quarter is beginning to show that extra efficiency that we are deriving through our underwriting businesses.

Vinay Misquith
Credit Suisse

Could you say that you got higher shares on existing programs that you were writing or do you have higher submissions that drove it? And what is your -?

John R. Charman
Chairman & CEO

On the property side, Vinay, as we said that we have - we started a year ago an initiative, I have been saying that for the last couple of years I don't think that the primary market is being properly paid for the CAT exposure that it is accepting in the U.S. And so we decided a year ago to launch an initiative to market ourselves more strongly on the non- CAT property side. And I think that those results are now beginning to show through.

Vinay Misquith
Credit Suisse

Sure. So you are seeing higher submissions. Do you have any numbers about the amount of submissions this year versus last year and their close [ph] ratios?

John R. Charman
Chairman & CEO

No. I think we have done is we have rebalanced the weighting and we have been moving - drifting away from the CAT business that is being placed and gobbled up by the market, and working much harder at finding domestic business that is of a non- CAT basis. I think we have the standing within the marketplace and we have very good relationships, long-standing relationships with clients, and we have been milking that.

Vinay Misquith
Credit Suisse

Okay. That's great.

John R. Charman
Chairman & CEO

No secret to it. It's just a greater emphasis. And then you would expect it on marine, Vinay, because of what happened with the offshore BP-Transocean loss.

Vinay Misquith
Credit Suisse

Sure.

John R. Charman
Chairman & CEO

Go ahead.

Vinay Misquith
Credit Suisse

Yes. Can you help us understand your rationale in taking up your attachment points for the property excess of loss on the primary insurance operations?

John R. Charman
Chairman & CEO

Yes. I was tempted to do it last year, Vinay. But going into 2009 with the asset side of our balance sheet - and if you remember, the amount of uncertainty globally, we had around about $1 billion of unrealized losses there, which affected our capital position.

And then secondly, there was a concern that certainly most of us had in the first quarter of 2009 about the potential for a double-dip recession. And so we decided that we would continue to rebuild our balance sheet and as conservative as we could through 2009.

Having rebuilt our balance sheet in 2010 and the fear of the double-dip has receded substantially, we felt with a much a stronger balance sheet that we were able to - we didn't really increase, it was only a $50 million increase in our retention on the CAT side, as well as actually retaining more of the professional line business, which we were much more comfortable about and we have a proven track record of making significant underwriting profits out of.

So I would have done it last year, but I didn't feel that the balance sheet was as strong as it should be to do that.

Vinay Misquith
Credit Suisse

Okay, great. Just one last question if I may, just a numbers question for David. Will we see a higher acquisition cost ratio for the remaining few quarters in the Insurance segment because of lower ceding commissions?

David B. Greenfield
Former Chief Financial Officer, Principal Accounting Officer and Executive Vice President

That's generally what I think you will see based on the change in the reinsurance purchasing.

Vinay Misquith
Credit Suisse

Okay. Thank you.

John R. Charman
Chairman & CEO

Thanks, Vinay.

Operator

Thank you. Our next question comes from Beth Malone of Wunderlich. Please go ahead.

Beth Malone
Wunderlich

Thank you.

John R. Charman
Chairman & CEO

Good morning.

David B. Greenfield
Former Chief Financial Officer, Principal Accounting Officer and Executive Vice President

Good morning.

Beth Malone
Wunderlich

Good morning. Could you talk a little bit more about the Chilean earthquake experience? Has that changed the way you approach those markets or the way you are thinking about underwriting in that area at all?

John R. Charman
Chairman & CEO

Let me start with Chile, because the market is reporting all sorts of different numbers. When we reported at the end of the first quarter, we had done some pretty exhaustive analysis of every exposure we had to Chile and we pretty well totaled our exposures on the national programs that we wrote.

We then took a substantial loss on the regional programs that were in place. And the big question mark was really what losses we were going to get from the major international treaties that we write, excessive loss treaties, mindful of the fact that we do not write proportional business in that part of the world that would cause a loss and we certainly don't write FAC reinsurance.

So the extra provision we made this quarter was really where we were able to get into that international portfolio much more deeply and get much better information and analysis and put the reserves up to what we now feel very comfortable about. It's really interesting when you look at the Chile situation and I am sure - we have only paid 11% of our total reserves now and 56% of our reserves are IBNR. So we feel pretty comfortable about the loss itself now and having properly reserved for it.

I think coming back to the opportunity, I think that we - if you look at the losses that have occurred down in Australia, I think if you look at the losses that have occurred in Chile, I think it has caused the reinsurance market to look much more closely at exposure data and the solidity of that and to substantially question pricing and attachment points in these regions, which we have done. And it will take probably two or three years to reposition those sort of programs, but definitely it's a substantial improvement and going in the right direction.

Beth Malone
Wunderlich

Okay, thank you. And then another question on - a number of companies, including your own, have benefited from acquiring groups of underwriters to go into new markets. Do you see that as continuing to be an opportunity for you that there are still opportunities in good groups that you can take advantage of to expand your product lines and your markets?

John R. Charman
Chairman & CEO

Well, Beth, we are always looking for good people with good skill sets to supplement our existing skill sets. We are also very sensitive, and we have been from our inception, about raiding other companies and taking large groups of their employees. We are more sensitive than probably a lot of other people are, but we just don't believe it's the right thing to do. So that is our policy.

But nonetheless, we want good people to join with skill sets. If you look at the way we have substantially built our A&H business over the last 18 months, and we will continue to build that over the next 18 months because it's a two-and-a-half, three-year build, we have able to access very, very skilled individuals with wonderful track records and great experience. But that was in a new product line. I think we have first-rate underwriters throughout our existing product lines. So we are pretty well catered for on that. It's really new opportunities that we would look very closely at.

Beth Malone
Wunderlich

Okay, thank you.

Operator

Our next question is from Brian Meredith of UBS. Please go ahead.

Brian Meredith
UBS

Yes. Good morning. Two questions.

John R. Charman
Chairman & CEO

Good morning, Brian.

Brian Meredith
UBS

Yes. The first one on the change in the reinsurance program, just can you give us a sense of what that means from a premium perspective? How much you are going to be saving here going forward? I mean, should we expect that the premium retention levels in the insurance business are going to be much similar here going forward?

David B. Greenfield
Former Chief Financial Officer, Principal Accounting Officer and Executive Vice President

I don't have the number directly in front of me, but I will get it for you in a minute. But I - I mean, essentially, most of the reinsurance purchasing occurs in the second quarter for us. So the reduction in the net premiums or ceded premiums this quarter is going to be the bulk of the savings we will see this year in that program until we go through most of the renewals a year from now.

Brian Meredith
UBS

Okay, got you. And the second one, John, the shutdown of the casualty E&S business in the U.S., I mean it's pretty drastic measures there. Obviously, there is a long-term view on that marketplace as well here. Can you kind of elaborate a little bit as to why you would shut down the operation?

John R. Charman
Chairman & CEO

Well, I think that I have been surprised at the - I have been saying, Brian, for the last three years - you know that we are largely a short-to-medium tail business. And whilst we have a strong umbrella operation, we have always been very conservative about our primary casualty underwriting. But as I said before, we believe the market peaked around the middle of this decade.

And I have said time and time again that I have substantial concerns about people ignoring the tail risk and the excessive competition that we have seen over the last three years in the casualty side, not only on pricing of that business, but also in terms of self-insured retentions that clients are being asked to take and the reduction of those.

And we have a - we are an underwriting business, Brian and we have demonstrated before that where we believe the risk-reward has moved substantially against us, we will not stay in the market and just see it out. I am not going to throw good capital at a business that will produce underwriting losses, I suspect from about 2007 going forward.

So we have very little - we have really wound that business down over the last three years to some pretty immaterial numbers. And I am very sad, I don't like exiting business, but I am not going to put my capital at risk. A lot of people find that casualty business is a nice way to hide for a number of years, but my 40 years of experience in the industry has shown me that that comes back to hurt you.

Brian Meredith
UBS

Great. And then lastly, could you give us a sense of what's going on in the professional lines market right now? We keep hearing that competition is increasing there. Kind of what is your appetite going to look like going forward? Are we getting close to a threshold here as far as where you are willing to continue to write that?

John R. Charman
Chairman & CEO

You get competition from the smaller fringe businesses that, quite frankly, have no place to be in the market, and I say that most strongly. I think the core business - the core carriers in the marketplace are still behaving rationally, consistently and are still needed by the clients and by the brokers. So I am still pretty comfortable about the way that we are underwriting within the portfolio.

As I said, you are talking about peripheral stupidity which is always there - forgive me, Brian. And that will work its way through. But the core players, the quality players will continue to control the market - not control the market, but dominate the market and provide good products and demand good pricing.

Brian Meredith
UBS

Great. Thanks for the answers, John.

John R. Charman

Chairman & CEO

David?

David B. Greenfield
Former Chief Financial Officer, Principal Accounting Officer and Executive Vice President

Yes, Brian. Just to come back to the question, I had a quick look at the numbers. I am not going to quote the actual number on the treaties and things, but in terms of the change this quarter, as we said in the earlier remarks, the retention on the property is a big change and the professional lines treaties have been changed. The property is an (inaudible) loss treaty; the professional lines is quota share. But I think in broad terms to maybe get to your question, the relationship of net to gross that you are seeing this quarter should continue throughout the rest of the year.

Brian Meredith
UBS

Great, thank you.

David B. Greenfield
Former Chief Financial Officer, Principal Accounting Officer and Executive Vice President

Okay.

John R. Charman
Chairman & CEO

Thanks, Brian.

Operator

Our next question is from Keith Alexander of JPMorgan. Please go ahead.

Keith Alexander
JPMorgan

Hi, good morning and happy birthday.

John R. Charman
Chairman & CEO

Good morning.

Keith Alexander
JPMorgan

I just wondered if you could talk briefly about how much of the increase in the acquisition expense ratio was driven by the higher retentions.

David B. Greenfield
Former Chief Financial Officer, Principal Accounting Officer and Executive Vice President

Yes. Again, you are into the details. It will take a minute to get the numbers out. But it's a fair amount. I mean, we had some other adjustments - I think I mentioned in my remarks, with regard to commissions and things which are typical. But give me a minute and I'll come back.

John R. Charman
Chairman & CEO

On a general point, we are still holding our own. There is a lot of noise contingent commissions and naturally, brokers are pushing hard on commissions as they always have done historically. But we take everything on a case-by-case basis and we debate with the broker an appropriate level of commission.

And so from an overall point of view, I am pretty comfortable about performance in terms of the acquisition costs we are paying for the business we are writing.

Keith Alexander
JPMorgan

Okay. Well then, while David is looking into that a bit further, I will move over to catastrophe losses a little bit. Is there any change to your worst-case loss view for the Chilean earthquake? And also the loss that you reported on the Deepwater Horizon in the quarter, was that gross or net?

John R. Charman
Chairman & CEO

Yes, let me - I didn't catch what you said about Chile. But let me deal with the Deepwater loss first. We - at the end of the first quarter, I said that our gross loss was around $56 million. And don't forget, we were very quickly out of the bag in terms of the loss had only just occurred at the end of the first quarter, and our net loss was $9 million.

What we have done at the end of the second quarter is really just taken a little bit more of a conservative position on the liabilities that we write to Transocean, which I still don't believe - if you look at it on a pure coverage basis, I think - I'm still of the opinion that the insurance loss coverage will not be as great as people are talking about. There is so much litigation around this particular loss.

And my personal view from the very beginning is that I think it will be BP that will carry the majority of the burden. And the leakage into people like Transocean, as well as people like Halliburton who cemented the well, as well as Cameron Drilling that did the blowout preventer will not be substantial. But we believe that we have capped our direct exposure gross now. We may see inevitably some small reinsurance claims creep in, in addition to this. But that will be absorbed within our loss base, because as we have said earlier, we are not marine treaty underwriter - reinsurance underwriters. We avoided writing energy reinsurance contracts over the last - well, throughout our history.

Did I answer all your questions?

Keith Alexander
JPMorgan

Yes, I think that's fair.

John R. Charman
Chairman & CEO

Chile - on the Chile loss - sorry, forgive me, we are right at the high end of our worse case estimate, we are pretty close to it. And I think the detailed analysis we have gone through now - as I said, the real big issue for us at the end of the first quarter was really getting information out of the international programs and they were the last people really in the line to be able to get a fix on what their losses were going to be. So we are pretty comfortable now about our numbers.

Keith Alexander
JPMorgan

Okay, great. That is helpful.

John R. Charman
Chairman & CEO

David is just coming back I think.

David B. Greenfield
Former Chief Financial Officer, Principal Accounting Officer and Executive Vice President

Well, Keith, just to come back on your question, just looking at the numbers, because there is obviously, as I said, some noise in there with commission adjustments and things. So if you take the pieces of this, the changes in the reinsurance program which were implemented during the quarter, adjustments to the commissions, profit commissions, that occurred that don't occur regularly, if you will, the way I would look at it going forward is we will probably be flattish to maybe down slightly in the future quarters on the overall acquisition ratio as the full effect of the changes in the ceded program come in to the calculation and the adjustments move out of the calculation.

Keith Alexander
JPMorgan

Okay, that's helpful. Just one last question. In terms of the change - decrease in the reinsurance premiums, how much of that was due to shifting renewal dates? And maybe if you could, break it down by shift from 2Q to 1Q and then 2Q to 3Q as well?

David B. Greenfield
Former Chief Financial Officer, Principal Accounting Officer and Executive Vice President

Yes. I don't - we don't have - I don't have the actual details of all the reinsurance renewals that occurred in the quarter, Keith, in front of me. I mean, it's a - I think if you focus on the first six months were the premiums were really slightly -

John R. Charman
Chairman & CEO

Yes, pretty flat to up a bit.

David B. Greenfield
Former Chief Financial Officer, Principal Accounting Officer and Executive Vice President

Yes.

John R. Charman
Chairman & CEO

And there is a lot of movement going on. And so I wouldn't get fussed by it.

David B. Greenfield
Former Chief Financial Officer, Principal Accounting Officer and Executive Vice President

Yes.

Keith Alexander
JPMorgan

All right, great. Thank you.

John R. Charman
Chairman & CEO

Thank you.

Operator

Our next question is from Sam Hoffman of Lincoln Square Capital. Please go ahead.

Sam Hoffman
Lincoln Square Capital

Good morning.

John R. Charman
Chairman & CEO

Good morning.

Sam Hoffman
Lincoln Square Capital

Can you update us on the accident year loss ratios that were booked in credit and political risk insurance, credit reinsurance, and professional lines? That's something you have been -

John R. Charman
Chairman & CEO

I am really pleased you have raised this topic, because I have been waiting to be able to - I think - and David will get the information for you. But when you consider what we have said about those lines of business over the last three years and what we have done to reserves and the out-turn in terms of the loss ratios for all lines of business - those lines of business, as well as our recovery assumptions holding up very strongly, I do believe that everything that we said that we would do and achieve we have done.

But David will give you the details. David?

David B. Greenfield
Former Chief Financial Officer, Principal Accounting Officer and Executive Vice President

Sam, I was actually well prepared for this question. So I have my usual charts in front of me on this. I mean, overall, on the lines that I have talked about over the last several quarters and have quoted specific numbers, the trend continues to be favorable and down with overall - with respect to overall combined ratios. I think in some cases, particularly like the political risk, the credit and the political risk business, the amount of premiums earned in the quarter or in the year 2010 are much lower than they had been in previous years. So the ratio there is still somewhat elevated, but that's really a function of the fact that the earned are down. But I can tell you overall, the trends on those lines that I previously mentioned are all down and positive and we are very pleased with that outcome.

John R. Charman
Chairman & CEO

And we have only lost money one year out of the last eight years, nine years on our political risk business, which was 2009, which I said we would do. Every other year is profitable. And we still have over $300 million of unearned premium coming on that business.

Sam Hoffman
Lincoln Square Capital

Okay. So can you explain then in the reinsurance business, if you exclude the $24 million of adverse development on Chile within the accident year, you go from, I think, 68% accident year loss ratio to about 60%, which is kind of in line with the accident year loss ratio that you had last year.

And yet the way we look at the trade credit reinsurance is that if you look at some of the primary companies' trade credit insurers, such as Euler Hermes, they had a combined ratio last year of 105%. They are projected to be down to 72% for this year. And since this is about 15% of your premiums, we would have expected by now that the accident year loss ratio would be coming down significantly in the reinsurance business and yet it seems to be about the same if you exclude the Chile development. So maybe you could comment on that as to whether there is a significant improvement baked in and whether there may be more going forward.

David B. Greenfield
Former Chief Financial Officer, Principal Accounting Officer and Executive Vice President

Yes. Well, I think in regard to the specific line, the trade, credit, and bond, it's more dynamic to think about it than just the accident year loss ratio. I mean, there has been substantial improvement in the acquisition cost ratio related to that line of business over the last several years. And then with respect to the loss ratio point, I think while they may be talking about their loss ratios, we are still in a very conservative position with respect to the way we are looking at that business in terms of reserving. So we are carrying a bit of IBNR.

John R. Charman
Chairman & CEO

Yes. And I think you would expect us to us to in turn. So the fact that I mentioned earlier about concerns about double-dip recession, whilst they have mitigated substantially, I think we are still reasonably cautious in our outlook.

Sam Hoffman
Lincoln Square Capital

Okay. Because I am just looking at the Euler Hermes report for their second quarter -

John R. Charman
Chairman & CEO

I know, I saw - I read it yesterday as well. But -

Sam Hoffman
Lincoln Square Capital

Yes. It's a 40-point improvement and you guys - it doesn't look like you have taken much improvement at all.

John R. Charman
Chairman & CEO

Well, we won't comment about individual pieces of business, but you would expect that we have a very conservative reserving philosophy. And we will continue with that until we are comfortable that we have greater certainty.

Sam Hoffman
Lincoln Square Capital

Okay. Two other quick questions. On the insurance retention increase, is that something that we could view as being ongoing or just in the quarter?

John R. Charman
Chairman & CEO

I think that - again, the majority of it was actually on the professional lines quota share, which we have reduced down from 50% to 25%. And we have a very substantial portfolio of highly profitable business, which has been very sustainable. And so it was natural with our substantially improved balance sheet having gone through the financial crisis in '08 and '09 to really feel very comfortable about retaining more of that business.

Sam Hoffman
Lincoln Square Capital

Okay. And then finally on the investment yield, I guess it went down by 20 basis points. To me, that was a little bit of a surprise. I mean, I guess the market conditions are what they are, but you did deploy, I think, $300 million of cash during the quarter. I think it was probably from the debt offering that you raised at the end of last quarter. And so do you think that yield should stabilize or go up because of that?

David B. Greenfield
Former Chief Financial Officer, Principal Accounting Officer and Executive Vice President

I think there is just going to continue to be downward pressure on yields given the rate environment that we are in. And while we deployed a certain amount of funds into the portfolio in the quarter and those were in various asset classes, the overall market yield rates are down. And we are going to continue to see that pressure across the entire portfolio.

Sam Hoffman

Lincoln Square Capital

Okay, thank you.

John R. Charman
Chairman & CEO

Thanks.

Operator

Our next question is from Greg Locraft of Morgan Stanley. Please go ahead.

Greg Locraft
Morgan Stanley

Hi, good morning.

John R. Charman
Chairman & CEO

Good morning.

Greg Locraft
Morgan Stanley

Just wanted to get an update on - and I actually cut out part way through, so if you have already talked on this, please we'll go just to the next one. But accident and health, can you give us an update on how that buildout is progressing and whether or not there is anything material to report in terms of the quarter on the results from that segment?

John R. Charman
Chairman & CEO

I think we are at - as I said earlier that we are at a - this is a completely new product for us and a strategic initiative that we embarked upon over 18 months ago. And we now have operations through the U.S. and in Dublin and in London, and we will continue to build out in Singapore and Australia.

On the insurance side, we are probably about just over halfway there in terms of getting all of our licenses. It does take time, we have filed all our products domestically, we have probably got another six to nine months before we actually get hold of our license, I hope, on the primary side. And that will obviously put us in a materially different position.

On the reinsurance side, we - at the 8th of July, we put out a press release announcing that Paul Chapman named the CEO of our International Accident & Health Operations. We are offering reinsurance coverage now out of Ireland and the U.K. and the U.S. on a quota share basis and excess of loss basis, and an aggregate of excess of loss basis for corporate personal accident and business travel accident products on things like association and affinity programs and catastrophe health products, that sort of stuff.

Obviously, we are trading. We are writing business, but it's not material enough. It won't be material enough until we actually get into early next year. But everything is going to plan. We have got the people we want, we need the licenses, we have got the standing, and it's going to be a very important business to us in the near future.

Greg Locraft
Morgan Stanley

Okay, great. That's helpful. And I guess there is a perception out there that it's a difficult line to break into.

John R. Charman
Chairman & CEO

I don't believe that.

Greg Locraft
Morgan Stanley

How big do you need to be to break in?

John R. Charman
Chairman & CEO

I don't believe that, Greg, because I'll tell you why. This sort of business is buried within legacy companies and I was at another company back in 2001 and prior. They inherited a great business that most of these - most of this business is buried in legacy companies with legacy systems, legacy infrastructure, and legacy management.

We can come into this business and as an - as a newcomer and determine to build a substantial business with high-quality systems and high-quality people and much better control over our expense ratios, because we can come in and bring in the best systems and decide just how much we want to transact and then as part of the transaction, what we want to outsource.

So I think there is a very overlooked opportunity, which we have seized upon to come into the marketplace. And I think the market welcomes us, because we can be very innovative on product. Even though these are pretty simplistic short-tail products, we can be very innovative and very responsive to clients who have actually not had a lot of choice. And so I expect us to be able to make a substantial difference and a very positive one.

Greg Locraft
Morgan Stanley

Okay, great. Shifting gears, I know you mentioned political risk earlier. I just wanted to get a little more granularity there because there is a wall of worry on this particular part of the portfolio. Can you give us any more -?

John R. Charman
Chairman & CEO

We have been pretty consistent. Sorry, forgive me. We have been pretty consistent. I would like people to go back over our quarterly commentaries over the last three years and really look at what we have said about this class of business, how we go about it, how we source it, how we monitor it, how we make sure that if defaults occur or if issues occur how we actually deal with them and the recovery resumption - assumptions we make and then we have actually delivered. So - and it has been a hugely profitable business for us over the years and I hope will continue to be so.

Greg Locraft
Morgan Stanley

Okay. So it's a business that you still like at the right terms?

John R. Charman
Chairman & CEO

Yes. And I think if you look at the opportunities on a go-forward basis -and I have said it before, what's happening is that the opportunities that at much better credit quality. I think that the structures are simpler that are being offered to us, so the ability not to get locked into difficult litigation is much reduced. I think the underlying assets that we would have the ability to recover from are much stronger and much cleaner and the pricing is much, much better. And I think we - what we did do was to be able to rebalance our portfolio, which has been completely. So it's not as lumpy as we previously had.

Greg Locraft
Morgan Stanley

Okay. Does it - are there any other - I mean, I guess with -

John R. Charman
Chairman & CEO

And it will be a slow buildup. Sorry, forgive me. And it will be a slow buildup.

Greg Locraft
Morgan Stanley

Okay. With Blue City now behind us, are there any other transactions to call out in particular that might represent a problem? Obviously, the claims trends in the quarter were great relative to past.

John R. Charman
Chairman & CEO

Yes. We - of course there are issues that we are working through, but there is nothing of any materiality.

Greg Locraft
Morgan Stanley

Okay, great. Great. And then last one for me is just on capital deployment. You mentioned $300,000, I think, so far quarter to date. Is that correct?

David B. Greenfield
Former Chief Financial Officer, Principal Accounting Officer and Executive Vice President

That's correct, yes.

Greg Locraft
Morgan Stanley

Okay, great. And then you mentioned you will sort of stay at a reduced level through the Atlantic season. Does the Atlantic season for you - does that represent kind of an October-ish time frame or will you go all the way through November?

David B. Greenfield
Former Chief Financial Officer, Principal Accounting Officer and Executive Vice President

Yes, I don't want to be necessarily pinned down, Greg, to a specific date. But I mean, we are looking at - we are not putting it on the shelf and not going to think about it at all till November. We do think about our capital management virtually daily. We have decided we are going to moderate repurchases during this period, which is - obviously as everyone well knows, it's a highly volatile period and we think it's prudent to slow down, but we will continue to take advantage of opportunities in a volatile market if we see that there is a good reason to deploy some more of our repurchase program.

So it will be a moderate amount over the next several months and we will be back to talk to you about it next quarter, and we may or may not do anything different between now and then.

Greg Locraft
Morgan Stanley

Okay. And how much capital do you have at the holding company level at the current time?

David B. Greenfield
Former Chief Financial Officer, Principal Accounting Officer and Executive Vice President

I'm not sure how to answer that question. I mean, obviously, the holding company - if you are asking about separate liquidity at the holding company level, we keep it fairly low. It's - all the capital is deployed in our insurance operations and throughout our Group, but not held at the holding company

Greg Locraft
Morgan Stanley

Okay, okay. So then you pull it up. Okay, great. Thank you very much.

David B. Greenfield
Former Chief Financial Officer, Principal Accounting Officer and Executive Vice President

Yes. And we have - I guess, if you are asking about like dividend capacity, we have substantial amounts of dividend capacity at - we disclosed that as is something over $1 billion, I think at year-end. So we have capital availability and we can move the capital as efficiently as we need to when we need to.

Greg Locraft
Morgan Stanley

Okay, great. Thanks.

John R. Charman
Chairman & CEO

Thanks.

David B. Greenfield
Former Chief Financial Officer, Principal Accounting Officer and Executive Vice President

Okay. Thanks, Greg.

Operator

Our next question comes from Brett Shirreffs of KBW. Please go ahead.

Brett Shirreffs
KBW

Good morning.

John R. Charman
Chairman & CEO

Good morning.

David B. Greenfield
Former Chief Financial Officer, Principal Accounting Officer and Executive Vice President

Good morning.

Brett Shirreffs
KBW

I was wondering if you could give us your view on some of the Chinese and Asian floods we have heard about and any potential losses.

John R. Charman
Chairman & CEO

Well, I don't expect them to be material to us at all, because we have been very conservative in our deployment of our underwriting capacity in China. It's very different; you have to look at previous catastrophes in China.

The economic losses are so much greater than the insured losses, which is a feature, because whilst you have enormous economic activity throughout China, the Chinese companies still are pretty backwards in terms of their buying and understanding the need to protect themselves by a way of insurance or reinsurance products. And I think most of it will fall within what losses there are will fall largely within the major Chinese carriers like the PICC [ph].

Brett Shirreffs

KBW

Okay.

John R. Charman
Chairman & CEO

So I don't expect it to be material at all to the industry.

Brett Shirreffs
KBW

Okay. Thanks very much.

John R. Charman
Chairman & CEO

Okay.

David B. Greenfield
Former Chief Financial Officer, Principal Accounting Officer and Executive Vice President

Okay.

Operator

Thank you. This concludes our question-and-answer session. And I would like to turn the conference back over to our speakers for any closing remarks today.

John R. Charman
Chairman & CEO

Well, thank you all again for taking the time to listen to us. And I wish you well. I hope you had a great summer and look forward to talking to you again next quarter. Thank you.

Operator
Thank you for joining us today. The conference has now concluded. You may now disconnect.