S&P Global
Market Intelligence

Arch Capital Group Ltd. NasdaqGS:ACGL

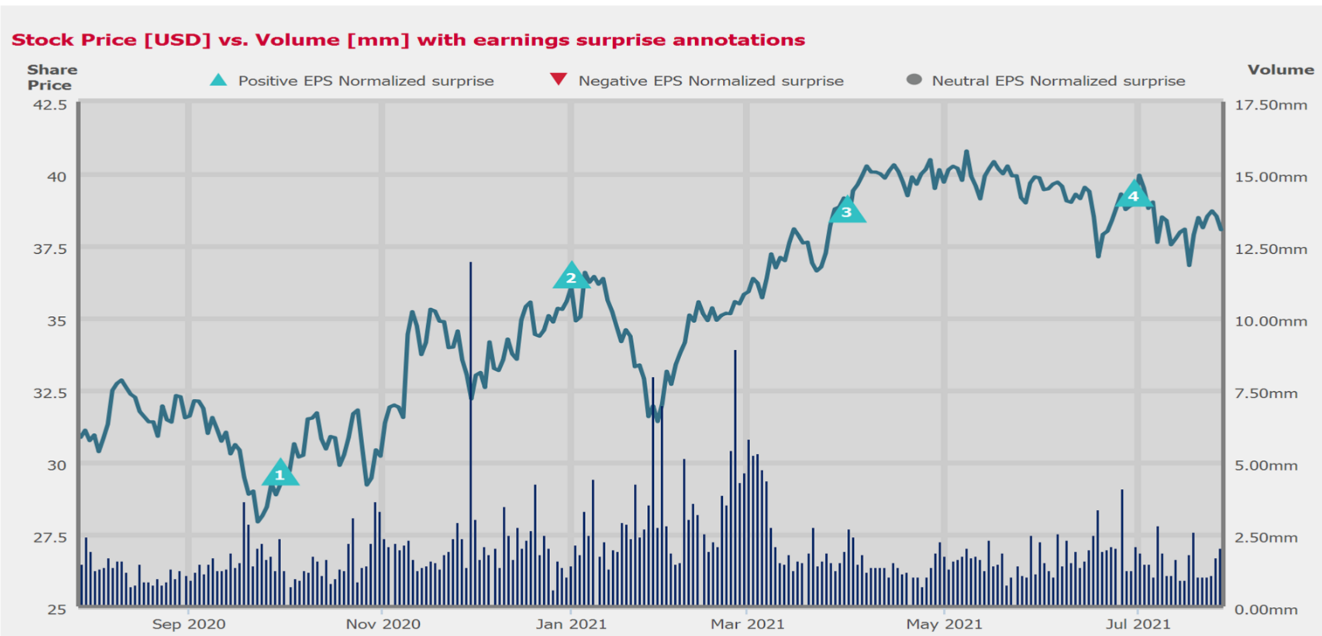
FQ2 2021 Earnings Call Transcripts

Thursday, July 29, 2021 3:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ2 2021-			-FQ3 2021-	-FY 2021-	-FY 2022-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.84	1.00	▲19.05	0.73	3.20	NA
Revenue (mm)	1949.38	2399.52	▲23.09	2254.80	8920.68	NA

Currency: USD
Consensus as of Jul-29-2021 10:34 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ3 2020	0.17	0.29	▲1 70.59 %
FQ4 2020	0.38	0.56	▲2 47.37 %
FQ1 2021	0.45	0.59	▲3 31.11 %
FQ2 2021	0.84	1.00	▲4 19.05 %

Table of Contents

Call Participants

EXECUTIVES

Francois Morin
Executive VP, CFO & Treasurer

Marc Grandisson
CEO & Director

ANALYSTS

Brian Robert Meredith
UBS Investment Bank, Research Division

Elyse Beth Greenspan
Wells Fargo Securities, LLC, Research Division

Jamminder Singh Bhullar
JPMorgan Chase & Co, Research Division

Joshua David Shanker
BofA Securities, Research Division

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

Philip Michael Stefano
Deutsche Bank AG, Research Division

Ryan James Tunis
Autonomous Research LLP

Presentation

Operator

Good day, ladies and gentlemen, and welcome to the Second Quarter 2021 Arch Capital Group Earnings Conference Call. [Operator Instructions] As a reminder, this conference call is being recorded.

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

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

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

Marc Grandisson
CEO & Director

Thanks, Liz. Good morning, and thank you all for joining our second quarter 2021 earnings call. At Arch, our playbook remains simple, yet effective. We protect our capital through soft markets and unleash our underwriters during hard market. We believe that this time tested strategy gives us the best chance to generate superior risk-adjusted returns over time.

You should expect then from us at this stage of the cycle comes straight from that playbook. As long as rate increases support returns above our threshold, we will continue to grow our writings. We have seen this video before in the hard market of 2002 through 2005 when P&C results generated a sustainable stream of earnings for several years after market prices peaked and were fully earned. And so, again, this quarter, the power of Arch's diversified platform is evident in the strong underlying earnings in each of our operating segments.

We delivered a 13% annualized operating ROE and aided by good investment returns an annualized net income ROE of 21% this quarter. One item that stands out this quarter was our strong P&C underwriting activity. Our P&C insurance results demonstrate significant improvement in underwriting performance. Better market conditions allowed our teams to expand their overall positioning and grow net written premiums substantially over the same quarter last year. We are now in the sixth consecutive quarter of rate increases at plus 10% this quarter, comfortably in excess of loss cost trend estimates.

The higher level of premium earned from the post 2019 policy years is a primary driver of our improving underlying accident year combined ratio. About 2/3 of the combined ratio improvement was due to lower loss ratios attributable to rate increases and underwriting actions we have taken over the past several years. The balance of the improvement was driven by a lower expense ratio. Production increased across most lines of business and geography areas as pricing improvements spread.

While rate increases have tapered off from previous highs in some lines, we're seeing increases in lines that had been immune to meaningful change. And in lines where price increases have eased, we're still getting rate on rate increases on an improving margins. We estimate that approximately 30% of our insurance premium growth reflects rate increases. About 15% is from higher net retention level, and the remaining growth comes from new business and exposure growth with existing clients.

Both our international and U.S. insurance platforms continue to excel in the current market with substantial growth in professional lines, programs, property and travel and A&H writings. Our reinsurance group also had a quarter of strong growth while producing strong underwriting results. A large portion of this growth results from our ability to leverage our expertise and historical experience as a writer of quota share business. When markets dislocate, our clients need capacity and capital as they seek to reshape their portfolio. That's why, since 2019, we have been increasing our participation in side-by-side quota share arrangements. This has always been part of our reinsurance playbook and based on historical patterns we believe a good place to deploy our capital for the next few years.

As you may have heard, this market is notable as rate increases in traditional XOL reinsurance lag the insurance rate increases. So our current preference is to be closer to the primary rate increases through quota share with our clients. Property cat XL is one of the few areas where we have reduced premium writings. They are down 26%, as we are not finding enough opportunities that meet our return expectations. However, as you can see in our supplement, premium writings grew substantially in property other than cat and specialty segments.

Casualty and marine also produced excellent levels of growth. As with insurance, we expect the ongoing rate improvements to be reflected in our underwriting results over the next several quarters. The Arch reinsurance story is one of providing creative capital solutions during hard markets that enables us to leverage our growth faster than in our primary insurance markets. We have considered this a core capability throughout our history.

Our reaction to this market is no exception. All in all, it was a very satisfactory job of seizing hard market opportunities by our team. Carpe diem, as they say. From a strategic standpoint, it's worth noting that we, along with our business partners, successfully completed the purchase of Watford at the beginning of the third quarter and are focused on working to build a sustainable reinsurance franchise.

All me now to switch to inflation fears, which continues to be a hot topic for our industry. I want to reiterate our perspective on how we view inflation at Arch. As underwriters, we study inflation on a line-by-line basis to price the business and establish reserves. In some lines like workers' comp, inflation remains low at this stage, I'd say, 0% to 1%. However, in other lines like high excess general liability, we're estimating inflation to be in the 8% to 12% range. As a point of comparison, loss cost inflation from the ground-up has been in a 3% to 5% range for around 5 years, broadly across our portfolio. It's important to consider line of business specifics when we discuss claims inflation.

Second, it's worth noting that in every line of business, the inflation rate increases as you move up attachment points. The key in pricing or reserving for an excess policy is to start with the proper ground-up trend and then apply the best curve to select a range for the trend in the upper layers. As is often the case in insurance, we are estimating and there is a lot of uncertainty around the correct number. Our philosophy is to keep this methodology consistent through the cycle.

Third, we also supplement our analysis with some subjectivity. In the current environment and in certain lines, we had to try and account for the increased uncertainty, including the possibility of the so-called social inflation. We are typically more willing to adjust the trend above our indications than we are to reduce it, all with creating a margin of safety in mind. This is not a new concept at Arch, but a time-tested philosophy that has allowed us to navigate both soft and hard markets through our opportunistic cycle management approach.

Let's turn now to our mortgage group, which continues to operate as a well-oiled machine, generating $250 million of operating earnings in the quarter. Our insurance in force remained steady at roughly $278 billion for U.S. primary MI. Refinance activity has slowed, and we expect improving persistency throughout the remainder of the year and into 2022. Delinquency rates are decreasing across our portfolio, and we still expect a large portion of delinquencies to cure based on many factors, including the strong equity position of our current inventory, where more than 95% of delinquent policies have over 10% of equity.

New notices of default continues to decline and at 7,400 in the second quarter are better than pre-COVID levels. Outside of the U.S., we increased our writings in Australia as the housing market remains strong. We like the long-term opportunity in Australia as demonstrated by our announcement to acquire Westpac's LMI business, which we now expect to close later this quarter. Pricing remains competitive but rational across the MI industry has rated our back to 2019 levels. However, the credit quality of borrowers remains strong, similar to 2016, supporting our confidence in the continued earnings from our mortgage insurance portfolio.

As I close my prepared remarks, this quarter, I'll borrow from cricket, which is top of mind because this weekend marks Cup Match here in Bermuda when the entire island goes cricket crazy for a 4-day holiday weekend. I think of the current

P&C market like being the first team to bat during a cricket test match. Test cricket is one of the few sports that isn't governed by a clock. Unlike games that must be completed in 60 or 90 minutes, test cricket is about scoring as any runs as possible as long as you are getting favorable balls or pitches for baseball fans and for as long as it takes for all of your batsmen to be out.

The details are not critical, but the idea is that similar to this market, we're waiting for the right ball and scoring as many runs as possible while we can. Rather than swinging aimlessly, we'll do what we always do, play defensively when we have to but become aggressive and score as many runs as possible when the opportunity arises. We're not worried about the clock running out. We'll just keep scoring runs.

Now I'll ball it over to Francois to run through the financials.

Francois Morin
Executive VP, CFO & Treasurer

Thank you, Marc, and good morning to all on this first day of the Bermuda Cup Match Classic. Thanks for joining us today. Before I provide more color on our excellent second quarter results, I should remind you that, consistent with prior practice, the following comments are on a core basis, which corresponds to Arch's financial results, excluding the other segment, i.e., the operations of Watford Holdings Ltd. In our filings, the term consolidated includes Watford. As you know, we closed earlier this month on the transaction we announced late last year to acquire Watford in partnership with Warburg Pincus and Kelso. Concurrent with the closing, we will be making changes going forward in how we report our equity interest in Watford results, which I will share with you in a few minutes.

As Marc shared earlier, we had an excellent quarter with each of the 3 legs of our stool performing very well and our investment portfolio also producing solid results. After-tax operating income for the quarter was $407.2 million or $1 per share, resulting in an annualized 13% operating return on average common equity. Book value per share increased to $32.02 at June 30, up 4.8% in the quarter. In the insurance segment, net written premium grew 43.3% over the same quarter 1 year ago, 38.5% if we exclude the growth due to the COVID-related recovery in our travel, accident and health unit from the same quarter 1 year ago.

The insured segment's accident quarter combined ratio excluding cats was 91.4%, lower by 470 basis points from the same period 1 year ago. The improvement in the ex-cat accident quarter loss ratio reflects the benefits of rate increases achieved over the last 12 months and changes in our mix of business. In addition, the expense ratio was lower by approximately 180 basis points since the same quarter 1 year ago, primarily due to the growth in the premium base.

As for our reinsurance operations, we had strong growth of 63.6% in net written premiums on a year-over-year basis. The growth was observed across most of our lines, but especially in our casualty and other specialty lines where strong rate increases and growth in new accounts helped increase the top line. The segment's accident quarter combined ratio, excluding cats, stood at 87.1% compared to 87.5% on the same basis 1 year ago.

As we have discussed in the past, we believe the underlying performance of our reinsurance segment is better analyzed on a rolling 12-month basis, which typically smooths out the impact of certain large transactions and/or claims that can have an impact on quarterly results. On that basis, the ex-cat accident year combined ratio stood at 84.3% over the last 12 months, lower by 660 basis points from the prior 12 months where the improvement almost entirely reflected on the loss side as a result of the rate increases we have observed over the last 6-plus quarters.

Losses from 2021 catastrophic events in the quarter, net of reinsurance recoverables and reinstatement premiums, stood at $46.5 million or 2.4 combined ratio points compared to 13.5 combined ratio points in the second quarter of 2020. The activity in the quarter was the result of a series of small events across the globe and some late reported claim activity from the North American winter storms, Uri and Viola in February. Following up on the trends we have seen in the last few quarters, the ultimate impact of COVID-19 on our mortgage segment remains very manageable.

In particular, the delinquency rate, which came in at 3.11% at the end of the quarter, is now close to 40% lower than it was when it reached its peak during the pandemic at the end of the second quarter 1 year ago. We had another solid quarter in terms of production. And with refinance activity coming down from prior levels, we saw the insurance in force for our U.S. MI book remained relatively stable. Of note this quarter was the exercise of call features by the GSEs on certain vintage credit risk transfer contracts, reducing the insurance in force for our non-U.S. MI portfolio.

The overall impact of these calls was an approximate onetime $31 million benefit to our underwriting income, approximately 2/3 of which came from the release of prior year loss reserves and the rest from the call premiums received. The combined ratio for this segment was 26.5%, reflecting the lower level of new delinquencies reported during the quarter. Income from operating affiliates was strong at $24.5 million, mostly driven by an excellent first quarter at Coface. As a reminder, we report our ownership interest in Coface's results on a quarter lag into our financial statements.

As regards to Watford, the closing of the transaction on July 1 gave rise to a reconsideration event. And as a result, we revisited our VIE analysis. Based on the new governing documents of the entity, we have concluded that while we will attain significant influence, we will not control the entity going forward. Accordingly, we will no longer consolidate the results of Watford in our financial results, starting with our third quarter financials. And our 40% share of Watford's results will be reported in the income from operating affiliates line, along with our proportionate share of other operating affiliates such as Coface and Premia.

As a result of the closing of the transaction, we also expect to report a onetime nonrecurring gain of approximately $65 million in the third quarter. Total investment return for our investment portfolio was positive 150 basis points on a U.S. dollar basis for the quarter. Net investment income was $89.4 million during the quarter, up $10.7 million on a sequential basis, driven by lower investment expenses and interest received on funds withheld transactions. The duration of our portfolio remains at one of its lowest levels in our history, 2.31 years at the end of the quarter, reflecting our internal view of the risk and return trade-offs in the fixed income markets.

Equity and net income of investment funds accounted for -- accounting for using the equity method returned approximately $122 million during the quarter, a key contributor to the growth in our book value. The effective tax rate on pretax operating income was 7.6% in the quarter, reflecting changes in the full year estimated tax rate, the geographic mix of our pretax income and a benefit from discrete tax items in the quarter. Turning briefly to risk management. Our natural cat PML on a net basis decreased to $676 million as of July 1 for the Northeast peak zone down to approximately 5.6% of tangible common equity and well below our internal limits at the single event 1-in-250-year return level.

On the capital front, we issued $500 million of 4.55% perpetual fixed rate preferred shares in June. We expect to use the proceeds to redeem all or a portion of our outstanding Series E noncumulative preferred shares in September 2021 and to use any remaining amounts for general corporate purposes. Separately, we repurchased approximately 7.8 million shares at an aggregate cost of $306 million in the second quarter, bringing our year-to-date share repurchases to over $485 million or approximately 45% of our year-to-date net income, all while growing our book value and top line.

As we have said since our formation 20 years ago, we are strong proponents of active cycle and capital management. We believe this quarter's results demonstrates our ability to execute on this philosophy and leads us to invest in opportunities where we believe the returns are most attractive. At current prices and with the prospect of improving returns, we believe buying back our shares represent another compelling value proposition for our shareholders without compromising our capital flexibility.
With these introductory comments, we are now prepared to take your questions.

Question and Answer

Operator

[Operator Instructions] Our first question comes from Elyse Greenspan with Wells Fargo.

Elyse Beth Greenspan
Wells Fargo Securities, LLC, Research Division

My first question was on capital. Do you guys -- Francois, you just said, right, you bought back less than half of your earnings to start this year. And I believe going into the year, you guys thought you had more than enough capital to support your growth -- the growth that you thought you would see. So should we think about a pickup in potentially capital return if that statement is true in the back half of the year? And can you just update us? Would you be willing to be active buying back your stock during wind season just given that it seems like you have a good level of excess capital?

Francois Morin
Executive VP, CFO & Treasurer

Sure. On the second question, Elyse, yes. We're -- while in our early days and I'd say pre-mortgage years, we were somewhat more careful with share buybacks during the wind season. We're not -- we're now, as you know, a lot more diversified. So I think that constraint or that reality is maybe less applicable than it used to be. But yes, certainly, as we think about share repurchases or capital deployment throughout the second half of the year, we certainly think that we could be buying back more shares. I mean our top priority is still to invest in the business and grow the business as best we can. But as you saw this quarter, I mean, we were able to do both and then some and like to think that if things stay where they are or within reason, we'd be doing the same in the second half of the year.

Elyse Beth Greenspan
Wells Fargo Securities, LLC, Research Division

Okay. And then in terms of your insurance segment, so you guys still seem pretty positive, right? 30% of the growth came from rate increases in the quarter, positive on pricing, a little bit concern of that inflation, which we've heard throughout the industry. So broadly, as you guys are thinking about the pricing environment as well as just what's going on with inflation, do you have a sense of for how long you think pricing should continue to exceed loss trend just broadly across insurance, recognizing, obviously, it's many different lines that comes together?

Marc Grandisson
CEO & Director

There's a question that will lead all of us, if you get the right answer, to riches, Elyse. But I think it's fair to say that the market momentum is clearly there. I think you heard on other calls that, that push for rate and increase in the rate adequacy and getting to a better level is shared among most in the industry. I think there's a recognition between some of the losses that have occurred in the past and cat losses included some uncertainty in such inflation, cyber risk as well as no property cat events. Obviously, that have occurred.

I think there's a -- and the interest rates being lower, I think there's a recognition that the prices need to go up. I think I will just give you a quick anecdote. Some of our folks are doing file audits on the reinsurance side, that is, with some of our clients who are competitors of ours as well. And the common thread or theme that seems to come through the audit is that the underwriting community is recognizing that more needs to be done, and you can see this evidenced in the discussion that they have with brokers. So we're very secure. I think there's going to be quite a bit more runway to this pricing improvement.

Elyse Beth Greenspan
Wells Fargo Securities, LLC, Research Division

And then one last one on the reinsurance side. It sounds like, Francois, from your comments that the deterioration in the quarter was more just kind of one-off. I guess as we think about going forward, my question more is, as we've seen the shift to more longer tail lines within that book, and away from property, would you expect the underlying loss ratio to deteriorate? Or was it just that there was just some one-off factors in the quarter, we could still see improvement in that on a go-forward basis?

Francois Morin
Executive VP, CFO & Treasurer

Yes. If you're -- in terms of modeling, I think it's going to go up and down, right? And I would say the numbers we quoted in terms of the rolling 12 months is probably as good a -- it's a good starting point. The business mix, yes, there'll be some fluctuations here and there, but -- yes, we wrote more casualty, but we wrote also a lot more other specialty, which is -- maybe combined ratios there a bit better. So it's hard to pinpoint exactly where everything -- I mean, what's going to happen, obviously, in the next few quarters, but I'd steer you to the kind of the rolling 12-month number that I quoted to be -- that should be a good starting point.

Marc Grandisson
CEO & Director

Elyse, if I may add to that point. I mean, also bear in mind at Arch, we tend to be prudent in reflecting all the margin improvement early on. So we'll have to wait and see where the data takes us. I just want to make sure we keep that in mind as we go forward.

Operator

Our next question comes from Jimmy Bhullar with JPMorgan.

Jamminder Singh Bhullar
JPMorgan Chase & Co, Research Division

So first, just had a question on pricing and -- obviously, your comments are pretty positive, but can you sort of compare and contrast what you're seeing on the primary side versus what you're seeing in reinsurance broadly?

Marc Grandisson
CEO & Director

Yes. So on the insurance side, there's a lot more activity, more price pickup on the insurance side. And that's why on a quota share basis, even though the seeding commissions have not decreased as much as they would have otherwise in other hard markets. I think that if you're on a quota share basis, you've essentially taken -- you're participating alongside your clients in terms of rate increases. So whatever rate increase I would have included in my remarks on the insurance, you could ascribe to the quota share reinsurance participation.

On the excess of loss, it tends to always lag a little bit behind. There's some benefit from the underlying rate because the excess of loss pricing typically is a percentage of the underlying portfolio. So to the extent that some rate increase, at the primary level, the excess of loss would get presumably a bigger percentage. But I think that it would be safe to say that the softer markets probably gave a little bit less adequacy or probably more of a need for price pickup in the excess of loss, in general. And we're probably expecting this to start to happen soon. I think there will be some recognition that is sort of a second derivative of typically of a hardening market. I hope that helps.

Jamminder Singh Bhullar
JPMorgan Chase & Co, Research Division

And are you equally optimistic? Or are there signs because you mentioned property cat may be slowing down a little bit? But are you equally optimistic about the sustainability of the trend on pricing in both reinsurance and in insurance?

Marc Grandisson
CEO & Director

Yes, on the excess of loss because, like I said, if I go back to 2002, 2005 market, I think that the excess of loss market got probably a lot better. It took to like 2004 to get there. So you need a couple of years of primary rate increases to start to find its way or their way onto the reinsurance excess pricing. It's a very normal hardening market. So I'm very encouraged, actually.

Jamminder Singh Bhullar
JPMorgan Chase & Co, Research Division

And then just lastly, you mentioned credit quality on the MI side being strong. How are you -- and obviously, the labor market is very good as well. But how are you thinking about high property prices and just inflated values for homes? And how that factors into your view of the business that you're writing now?

Marc Grandisson
CEO & Director

If you were in an equilibrium in terms of supply and demand or the supply was plentiful, we'd be worried. That would take us back to the 2006 and '07 period. But the supply and demand on the housing is such that it should help maintain the pricing for quite a while. We have 1.5 million to 2 million homes missing in the marketplace. It takes a while to find their way to the market. There's also underbuilt, as you know, as we all read in the press. So from our perspective, the house price appreciation is there. We look at over or undervaluation. We also have these metrics from our economist and we're not seeing significant national overvaluations. So that's not another -- yet another -- not a concern. And the interest rates are still pretty low at 3% -- the mortgage rate that is at 3%. So the affordability is still pretty high compared to historical metrics. So all of these put together, it's never one dimension, right? I mean, you look at, I think overall, if you across everything, it tends in a positive direction.

Operator

Our next question comes from Josh Shanker with Bank of America.

Joshua David Shanker
BofA Securities, Research Division

So I think I've asked the same question like from the last 2 conference calls. I'm going to ask it again. I look at the reserve releases in mortgage and I look at the reserves per new case in the 2Q '21 numbers and you're reserving more than ever for new defaults or delinquencies as you're releasing the reserves. Yet the housing prices are appreciating. I'm trying to figure out what the math is about why the potential claim per loss keeps getting worse?

Francois Morin
Executive VP, CFO & Treasurer

Well, you're asking a very good question, Josh. I think big picture, as you know, we're still -- there's still a lot that has to happen before we have more visibility until -- in how the forbearance loans are going to pan out, how they're going to -- whether they're going to cure, whether they're going to turn to claim. And as you know, those are -- I mean that's an 18-month process. So we -- if we look at the peak months of April and May of last year, their 18-month period will expire -- unless things change should expire in the fourth quarter this year. So that's when we'll certainly have, again, more visibility and have a more definitive view on how to -- I mean, whether reserves were too high or not. And so that's where we sit on that at this point. We're reacting a little bit to the data. But again, we still feel there's quite a need -- a lot that needs to be settled before we take, I'd say, action on the current reserve levels.

In terms of the new delinquencies, there's always tweaks that happen every quarter. You look at the average -- the incidence rate and how -- severities and frequency assumptions that we put on the new delinquencies that get reported this quarter, Again, it's a smaller inventory of new delinquencies. So I wouldn't -- there's a bit more leverage in how those numbers play out. But big picture, I think, we're still very comfortable with our reserve levels. Yes, I think you're implying maybe that we got too much. That's a possibility. But again, we'll know more in the second half of the year.

Joshua David Shanker
BofA Securities, Research Division

So when I look at the reserves, I guess, the $55 million in reserves for current accident year period put up in the fourth quarter, is that a strengthening of average claim for the entire portfolio? Or is that a new -- we think the new claims being put on 2Q '21 have the potential to be worse in terms of severity than the average claim currently on the book?

Francois Morin
Executive VP, CFO & Treasurer

Yes. I think it's the latter. We didn't really make any adjustments in terms of prior notices, so notices that were on the books before the quarter started. The thinking on the new notices is that the fact that they became delinquent kind of this late in the game, I'd say, given that forbearance programs have been available for some time over a year, we think that there's a possibility that they could turn out worse than the ones that we got earlier. So there's a bit of a mindset or a philosophy that and time will tell. But given that they might have gone through all their savings and they might have tried a lot of things and now they finally turned delinquent. So that's a little bit of the -- I think the rationale behind these numbers.

Operator

Our next question comes from Ryan Tunis with Autonomous Research.

Ryan James Tunis
Autonomous Research LLP

Marc, I guess my first question. Can you hear me?

Francois Morin
Executive VP, CFO & Treasurer

Yes, we can. Go ahead.

Ryan James Tunis
Autonomous Research LLP

Sorry about that. So I had a cycle management question in -- with property cat. And I'm not being critical. I'm just curious. So a year ago, it looks like you wrote $118 million of premium. And this year, you wrote $88 million. So you wrote less. I get the property cat is not the best place to be, but it feels like the rate environment was incrementally a little bit better. So I'm just, I guess, a little bit curious like what goes into the decision to, as conditions improve, actually decide that 2Q of '21 we don't want to write as much as we did in 2Q of '20?

Marc Grandisson
CEO & Director

It's a really, really good question. So I think a couple of things happen, right? Number one, we probably, like everyone else, have a different perception on the riskiness of the cat book, right? There's a -- we just had a wind storm in January. So that will definitely make you take a different look at the non-model losses, right? There's a lot of non-model losses that seem to have percolated way more than we expected over the last 2, 3 years. So there's an element of loss cost expectancy and also as a result of that needing a higher margin of safety for your return. That's clearly the #1 consideration. And as a second one that is not to be forgotten is also -- it's an allocation of capital.

They're saying, well, where is a better use of capital? Is a risk-adjusted of X in cat worth as much as a Y in other property, for instance, or in casualty? And those decisions are made on a quarterly basis, I would almost say, almost daily. So as you get a broader range of opportunities, on the reinsurance side specifically, you're able to manage your portfolio and sort of reoptimize the portfolio as you go, at least, maybe in a quarter or 2 quarters ahead. So that's sort of a thinking beyond the stock management with a view of optimizing your return, not necessarily betting all out, right? I mean that's sort of a one thing that [Pauline] told me way back when is that you don't want to be unlucky. Property cat, if you have all these great opportunities and not excluding out of the cat realm, it probably be who is your manager to taper it down a little bit, also provided because it's not as juicy perhaps as the other lines are appearing at this point in time. So it's a bit of a window we think.

Ryan James Tunis
Autonomous Research LLP

Yes, that makes sense. That's interesting. And then I guess just in mortgage insurance, seeing the attritional loss ratio, I mean, yes, pretty much at pre-pandemic levels. I guess I was a little bit surprising just given there are some new notices, and I felt like back in '19, they're almost none. So is this sustainable kind of the 15% to 20% attritional? Or is it something this quarter that was an unusual tailwind?

Francois Morin
Executive VP, CFO & Treasurer

Well, I mean, attritional excluding PYD, that's how we think about it. Again, I think I mentioned it in prior quarters where a 20% loss ratio is kind of plus or minus that should be what you should get over the cycle. And there's a bit of noise with the CRT transaction. So I mean, there's moving parts within that. But yes, 20% is absolutely sustainable.

Ryan James Tunis
Autonomous Research LLP

Got it. And then just lastly, just out of curiosity, I was wondering if you guys would be willing to share like an internal view of what your excess capital position is?

Francois Morin
Executive VP, CFO & Treasurer

Well, that's not something we've made public in the past. And I think we're -- because it's a daily kind of a moving target, right? I mean there's -- we don't know what the market is going to give us. So we could give you a number, but then next tomorrow will be different. So it's just -- we rather want to keep the flexibility there. And that's...

Ryan James Tunis
Autonomous Research LLP

I hear you. I thought I'd try.

Francois Morin
Executive VP, CFO & Treasurer

Yes.

Operator

Our next question comes from Meyer Shields with KBW.

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

Two, I think, basic questions. First, I know there's a lot of commentary at Arch and elsewhere about if that was like prudent reserves because of current uncertainties with regard to inflation. Is that -- let me phrase it differently. Are you releasing reserves more slowly now than you would have in the past because of that issue? Or is that a current accident year issue?

Marc Grandisson
CEO & Director

I think, Meyer, you're an actuary as I am. So you know that inflation impacts current accident year and prior accident year, right? So clearly, we are -- it's part of the recipe, if you will, of establishing reserves. So we're trying to peg the historical trend, as you know, in a triangle is the best we can to the extent it's not captured within a loss development factors. So I think it's on both sides. Does that mean that we are releasing less? I think that probably means that we historically have been a bit more careful in establishing our loss pick. If you look back at our history of combined ratio in the insurance group specifically, you'll see that we were much higher than what most people were in the industry. So I think that tells you that we were reserving at that point with a view of loss inflation that was more in the 3% to 5%. We haven't changed our view really at this point in time, except for like I said in my comments, certain lines where it's probably appropriate to do a bit more.

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

Okay. No, I think that's the right call and it makes a lot of sense. Second question in reinsurance. How should we think about the catastrophe exposure in the non-property cat property book?

Marc Grandisson
CEO & Director

Well, it's part of the $676 million that Francois mentioned. We're accounting for that, but it's definitely less of a cat exposure. There is some in there, but it's definitely not the driver of the exposure at all. So it depends on what kind of business you look at. The cat load on these premium is anywhere from 5% to 10%, sometimes a bit higher, depending on the quota share you're writing. But in a lot of our other specialty quota share, you had some but again, much, much smaller. So I would say that still the larger contributor to our PML is through the cat XL portfolio.

Operator

Our next question comes from Phil Stefano with Deutsche Bank.

Philip Michael Stefano
Deutsche Bank AG, Research Division

Yes. One or two focused on the MI business. So of the $44 million in favorable development, it seems like just shy of half of that was due to the GSEs and the cancellation of the CRT deal. The other $24 million, give or take, can you give us a sense of the vintage years associated with that? Or what's driving that development?

Francois Morin
Executive VP, CFO & Treasurer

Well, I'll be -- yes, I'll give you a bit more specifics. So yes, you're right, just about half of the -- under half -- just slightly under 1/2 of the total was from the GSE call deals. And about 1/3, I'd say, is little tweaks, again, in, call it, COVID assumptions that we've kind of brought down a little bit. And that's across -- it's across all our books. So it's like a U.S. -- primary U.S. MI. It's across some CRT deal that are still around that we've made some adjustments on those reserves and also on the international book. So that gives you a perspective. And then there's just -- call it, just under 20% of favorable development on runoff businesses or second lien and student loan businesses that have been in runoff for quite some time. So hopefully, that gives you the split, Phil, and answers your question.

Philip Michael Stefano
Deutsche Bank AG, Research Division

Yes, that's great. That's great. And I think the PMIER's efficiency ratio -- sorry, go ahead.

Francois Morin
Executive VP, CFO & Treasurer

No, you go.

Marc Grandisson
CEO & Director

No. We're good.

Philip Michael Stefano
Deutsche Bank AG, Research Division

Yes. So the PMIER's efficiency ratio is pushing up near 200%. Maybe you could talk to us about the ability to upstream capital? When the GSEs might let you do that? Or do you go to the state regulators and contemplate getting permission for a special of some sort?

Francois Morin
Executive VP, CFO & Treasurer

Yes. That -- as we discussed last quarter, that's in the works. Second half of the year, we are -- we've begun the process already to upstream. As you mentioned, the dividend from our regulated entities to the holding company in the U.S. It's -- some of it will have to be extraordinary and some of it is ordinary dividends. So there's -- we'll have to have some discussions with the regulators on that. I'd like to think that we can get them comfortable that with our current levels of total capital and some of it, as you know, a lot of it being trapped in within the contingency reserves, I think they'll -- I think we'll be able to get them comfortable that the levels of dividend that we're talking about will be -- will meet their needs and ours. So stay tuned, but I'd like to think that we'll be able to extract some dividends in the second half of the year.

Marc Grandisson
CEO & Director

If I can address for one second, fill the GSE. The GSEs are allowing you to do a dividend without any approval at 150% or above right now, PMIER. So at the end of the year, it's going to go down to 115%. So we think we have flexibility even from that perspective, even if you consider them as another gatekeeper of that dividend payout.

Operator

Our next question comes from Brian Meredith with UBS.

Brian Robert Meredith
UBS Investment Bank, Research Division

A couple of quick questions here. First, the decline you saw in your property cat reinsurance, I'm assuming that was just reduction in Florida exposure. And I guess on that question, what does your Southeastern kind of Gulf exposure look like today versus last year?

Marc Grandisson
CEO & Director

It's down versus last year. But the first question on Florida, we had some decrease in flow. But if you look at premium, it's not as -- it's not a one-to-one thing, Brian. I think that the reduction was also as a result of buying a few things to, if you will, round of the portfolio. So it's not necessarily all like because if we get into this market, trying to get our net exposure to a different level because of returns, we use also some reinsurance buying to take care. So it's not only Florida decrease.

Brian Robert Meredith
UBS Investment Bank, Research Division

Got you. Got you. And then my second question is now that the Watford deal is closed. It is in some private hands, no longer a public company. Any material or any meaningful changes in strategy here that you're anticipating with Watford here going forward, different types of business they could write, et cetera, et cetera?

Francois Morin
Executive VP, CFO & Treasurer

Yes, I'd say at a high level, I mean, still early days, but at a high level, I think you should think more of Watford as a closer clone to Arch Re business or underwriting than what Watford was. Watford was -- didn't necessarily do all the same classes of business, was very much focused more on the longer-tail stuff because of the additional pickup, the assumptions that were in terms of investment returns that we're going to get. So the, call it, the 2.0 business model of Watford makes it more similar to what the Arch Re portfolio or book looks like.

Brian Robert Meredith
UBS Investment Bank, Research Division

Got you. So results should actually trend towards -- ultimately trend towards what Arch Re looks like?

Francois Morin
Executive VP, CFO & Treasurer

Much more so, correct. Yes.

Brian Robert Meredith
UBS Investment Bank, Research Division

Got you. And then I'm just curious on Watford. Is there ability or any contemplation of maybe kicking on some of your mortgage insurance exposure going forward?

Marc Grandisson
CEO & Director

We actually write some mortgage on Watford. Yes, there is some already existing. It's actually been 1 of the things they've done for quite a while. That's also something that the Watford shareholders were very pleased with, giving them the opportunity to participate.

Francois Morin
Executive VP, CFO & Treasurer

The only -- I mean, that's an issue with ratings too like, Brian. So that's something that the ratings do matter for -- in terms of getting GSE and regulators comfortable. So that's something that they're going to look into as well.

Operator

I'm not showing any further questions. I'd now like to turn the conference over to Mr. Marc Grandisson for closing remarks.

Marc Grandisson
CEO & Director

Thanks for everyone to be here and listen to our call, and we're off to Cup Match, and we'll talk to you next quarter. Thank you.

Operator
Ladies and gentlemen, thank you for participating in today's conference. This concludes the program. You may all disconnect.