S&P Capital IQ

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Argo Group International Holdings, Ltd.

NasdaqGS:AGII

FQ3 2014 Earnings Call Transcripts

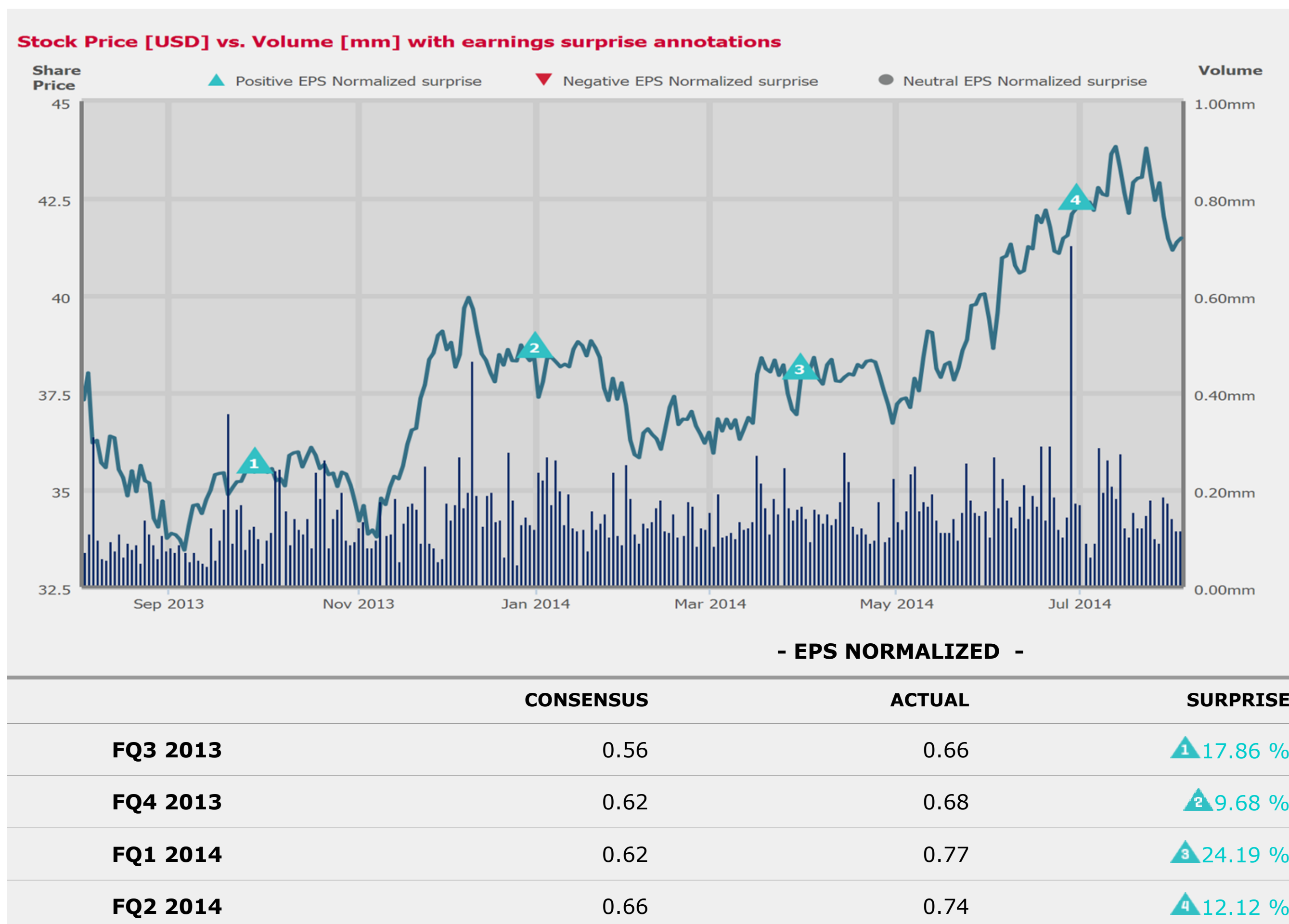
Friday, October 31, 2014 2:00 PM GMT

S&P Capital IQ Estimates

	-FQ3 2014-			-FQ4 2014-	-FY 2014-	-FY 2015-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.71	0.74	▲4.23	0.79	3.02	3.28
Revenue (mm)	381.00	372.90	▼(2.13 %)	353.95	1440.73	1546.11

Currency: USD

Consensus as of Oct-31-2014 12:22 PM GMT



- EPS NORMALIZED -	CONSENSUS	ACTUAL	SURPRISE
FQ3 2013	0.56	0.66	▲17.86 %
FQ4 2013	0.62	0.68	▲9.68 %
FQ1 2014	0.62	0.77	▲24.19 %
FQ2 2014	0.66	0.74	▲12.12 %

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Presentation

Operator

Good morning, and welcome to the Argo Group Third Quarter 2014 Earnings Conference Call. [Operator Instructions] Please note, this event is being recorded. I would now like to turn the conference over to Ms. Susan Spivak Bernstein. Please go ahead.

Susan Spivak Bernstein
Senior Vice President of Investor Relations

Thank you, and good morning. Welcome to Argo Group's conference call for the third quarter and 9 months 2014 results. Last night, we issued a press release on earnings, which is available in the Investors sections of our website at www.argolimited.com.

With me on the call today is Mark Watson, Chief Executive Officer; and Jay Bullock, Chief Financial Officer. We're pleased to review the company's results for the quarter and the 9-month period as well as provide you with management's perspective on the business. As the operator mentioned, this call is being recorded. Following the opening remarks, you'll receive instructions on how to queue to ask questions.

As a result of this conference call, Argo management may make comments that reflect their intentions, beliefs and expectations for the future. Such forward-looking statements are qualified by the inherent risks and uncertainties surrounding future expectations, generally, and may materially differ from actual future results involving any one or more of such statements. Argo Group undertakes no obligation to publicly update forward-looking statements as a result of events, developments subsequent to this conference call. For a more detailed discussion of such risks and uncertainties, please see Argo Group's filings with the SEC.

With that, I'm pleased to turn the call over now to Mark Watson, Chief Executive Officer. Mark?

Mark E. Watson
Chief Executive Officer and Director

Thank you, Susan. Good morning, everyone, and welcome to Argo Group's Third Quarter 2014 Earnings Conference Call. I'll briefly share my thoughts regarding the highlights for the quarter after which Jay Bullock, our CFO, will add some comments to the financial results. We look forward to responding to any questions you may have during the Q&A portion, following our remarks.

Argo posted a solid third quarter results, with net income per share up over 50% from the prior year. At September 30, 2014, book value was $62.99, up 9.8% over the past 12 months, and tangible book value per share was up even more at 11.5% year-over-year. Book value per share, plus dividends, has compounded at an annual rate of 10.5% since 2002, continuing our track record of shareholder value creation.

Third quarter 2014 net income was $44.7 million or $1.69 per share, up from $31 million or $1.12 per share in the third quarter of 2013 or an increase of 44% and 51%, respectively. Comparable figures for the 9 months just ended show an increase of 30% and 36%, respectively.

Our third quarter 2014 operating earnings were $0.89 per share compared to $0.80 in the comparable quarter last year, or an increase of 11%.

For the first 9 months of 2014, operating earnings grew to $2.72 per share from $2.24 in the same period of 2013, or an increase of 21%.

We continue to see tangible improvement in our underwriting results. For the 9 months ended September 30, 2014, our underwriting income was $40.6 million, up from $15.7 million in the same period of 2013. And despite the decline in investment income and its impact on operating earnings, we continued to see good results in the investment portfolio from a total return perspective, given the prevailing rate environment. I'll comment more on this in a moment.

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For the quarter, we produced consolidated gross written premiums of $497 million, which is up slightly from the year-ago period. For the 9 months, our consolidated gross written premium was $1.48 billion compared to $1.475 billion in the same period of 2013. As we've pointed out over the last several quarters, the reported top line numbers are somewhat misleading, as underlying growth in selected lines is being offset by planned reductions and lines that are not meeting our profit objectives. We posted an improvement in the combined ratio to 96.4% for the quarter compared to 97.5% in the third quarter of 2013.

During the quarter, we repurchased 207,000 shares of stock at an average price of $52.12 for a total of $10.8 million dollars. Capital management has been a key part of our strategy for value creation, and over the last 6 years, we returned more than $360 million of capital to shareholders through share repurchases and dividends. We will continue investing in our stock at these prices and returning capital to shareholders, while remaining focused on our main priority, which is building the Argo franchise.

Spending just a moment on market conditions. Competition has increased in virtually all classes of business that we write. It's probably fair to say that such increase has accelerated even since the last time we spoke on this call. That said, we continue to find opportunities to grow in areas where we believe we have a competitive advantage. In addition, we have a number of initiatives underway that we believe will allow us to grow those opportunities more rapidly in the coming years, even in this environment.

From a rate perspective, for our book of business as a whole, rates are still increasing; but as reported last quarter, the pace of increase has decelerated. That metric can be somewhat misleading, however, as significant continued rate improvement in some of our U.S. businesses is being overshadowed by material declines in property-related lines, keeping in mind that that's not the largest part of our business.

Let me briefly comment on each of our operating segments before turning the call over to Jay, who will get into the numbers in a little bit more detail.

In our Excess & Surplus Lines business, gross written premium was up 5% to $146.5 million from $139.4 million in the third quarter of 2013. As I mentioned earlier, the underlying growth in higher-margin businesses is being offset by 2 things. First, the planned reduction in our transportation line, as we continue to run off the Commercial Auto book. Second, we continue to see a fundamental shift in the larger shared-risk property market, where several companies have material increased their to limit appetite as a result -- and as a result, are writing the business outside the traditional wholesale market. Excluding these 2 lines of business, the growth in our E&S platform would've been close to 15% in both the third quarter and 9-month comparisons to 2013. You may recall me making this exact same comment on the call last quarter.

On average, rates were down modestly by less than 1% across the segment, with the biggest decline, surprisingly, in certain excess casualty lines of business.

Prior year development continues to have a positive impact on our results in E&S, and Jay will go into more detail in his discussion on loss reserve development.

On a current year basis, excluding catastrophe losses and reserve development for the quarter, our loss ratio improved to 58.6% compared to 59.2% in the third quarter 2013 and to 60.3% and 61.3% for the 9-month period.

In our Commercial Specialty segment, overall premium was $138 million, which was flat with the year-ago period. Growth at Argo Surety, Rockwood, our mining business, and in some of our other programs was offset by declines at Argo Insurance and Trident, our food merchant and public entity businesses respectively. And recall that this was the same case a quarter ago.

Overall, rate increases for the quarter across the segment were up 3.8% with higher increases in those lines that needed the most. For example, at Argo Insurance, rate increases averaged 9% across the segment, representing several consecutive quarters of meaningful rate improvement.

Renewal retention ratios remained strong and we're encouraged by a number of new business opportunities. The segment's loss ratio, excluding catastrophe losses and reserve development, was

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58.5% in the third quarter of 2014 compared to 59.6% in the same period a year ago; and for the 9-month period, the loss ratio was 59.9% compared to 62.3%, which I think is a nice improvement.

Overall, gross written premiums in our International Specialty segment were down 7% in the third quarter and flat for the 9-month period of 2014. Growth in our business in Brazil was offset by lower premium at Argo Re. Argo Seguros, which is our Brazilian operation, grew 12% in the third quarter and 17% in the 9-month period. Gross written premiums in our excess casualty and professional liability business in Bermuda were flat with the prior quarter -- excuse me, for the prior-year.

Rates in general remain under pressure, affecting all businesses. The segment's loss ratio, excluding catastrophe losses and reserve development, was 47.6% in the third quarter of 2013 compared to 49.3% in the same period of 2013. So we still had a nice improvement in our loss ratio.

Turning to Syndicate 1200. As you may recall, last quarter, I commented that Lloyd's is perhaps the most challenging broad market environment. Unfortunately, this hasn't changed. Competition continues to escalate, and new profitable growth opportunities are hard to find. Having said that, we are finding a few.

While we're working on a number of new initiatives, we will do what's right for the long-term profitability of our Lloyd's platform. Gross written premiums written were essentially flat with the year-ago quarter. However, margins remain favorable. On an underwriting basis, the loss ratio, excluding capacities and reserve development, was 54.9% in the third quarter and 55.6% in the 9-month period ending September 30. This despite, once again, the incidence of several large noncatastrophe-related losses in the quarter, a trend that has continued across the market for several quarters.

Turning to our investment portfolio. We continue to be pleased with the performance achieved through the first 9 months of the year, given the backdrop of the fixed income markets. Argo's portfolio was down a modest 0.3% during the quarter, bringing year-to-date performance to 2.5%. Our year-to-date return on the investment portfolio totaled $104 million, which compares favorably to the $54 million earned through the first 9 months of the period for last year. As of the end of the third quarter, the fixed income portfolio duration of 2.5 years is roughly flat from the prior quarter of this year.

Net investment income totaled $20.8 million in the third quarter. Investment income was flat quarter-on-quarter and down $3.3 million versus the same quarter of last year. Year-to-date, investment income is pacing at about 84% of prior year actuals. Low investment rates continue to pressure our portfolio book yield. Argo has continued to fund new investment mandates that generate new money yields in excess of the bond portfolio book yield. But some of that shows up in realized gains in the income statement, not in operating income, which Jay and I have been talking about and Jay will get into more in a minute, and then we'll talk about it in the Q&A.

In closing, the results for the 9 months of the year demonstrate, overall, improving performance of our platform. We continue to focus -- our focus on reporting consistent results that will generate stable returns for shareholders.

With that, I will turn it over to our CFO, Jay Bullock.

Jay S. Bullock
Executive Vice President and Chief Financial Officer

Thanks, Mark, and good morning, everyone. I'll take everyone through some additional detail on the financials, and then we'll open it up to Q&A.

In the 9 months of 2014, we continued to see validation of our efforts to increase underwriting income and grow our most profitable business lines. Mark talked about the underlying growth trends and mentioned the improvement in underwriting income.

For the 9 months of 2014, underwriting income more than doubled from the 2013 results. This improvement is a result of better risk selection, a more effective reinsurance purchase, reduced level of catastrophe losses relative to last year and the continued support of favorable development from prior accident years. And as Mark said, we have seen this trend despite the continued frequency of

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noncatastrophe-related large losses. We continue to maintain our focus on improvement in underwriting income.

For the quarter, away from the current accident year, we experienced overall favorable reserve development of $3.1 million, representing our 14th consecutive quarter of overall positive reserve development.

The largest component of development this quarter was continued strong results out of our prior years in our E&S business, primarily from contract and casualty lines. Total favorable prior year development from the E&S segment in the quarter was $12.9 million.

The 3 other business segments were essentially flat, although, as always, there were small ups and downs by business unit.

These were partially offset by an increase to reserves in the runoff segment. Runoff had unfavorable development of $10.6 million, due to $6 million from asbestos and environmental, driven from exposures to asbestos, that were written many years ago on a primary basis and $4.6 million in risk management workers' compensation. The Primary asbestos development was due to increased severity largely from defense costs. In general, many of these accounts are remaining open longer than anticipated, and as a result, the defense cost for those insurers continue to grow.

The increase in workers' comp was largely due to the revaluation of one dramatic injury claim. Table in the press release provides a full breakdown for the quarter and 9 months.

We posted 0.3-point improvement in the current year accident noncatastrophe loss ratio of 56%. Catastrophe losses for the quarter were relatively modest at $5.5 million due to various small events. In addition to U.S. storms, the number includes small losses from events in China, Canada and Mexico, none of which individually was more than $2 million.

In the quarter, we reported $12.9 million of net realized gains. The largest contributor to the gain was from our alternative investments, as Mark mentioned, in addition to the equity portfolio and gains from certain private equity and strategic investments. Since the beginning of 2013, we estimate the incremental value added from the alternative allocation relative to foregone investment income has been in excess of $15 million.

In addition, as we reported last quarter, we retired a tranche of our trust-preferred securities at a discount. And the gain on that transaction, $2 million, is included in the total.

For the third quarter of 2014, the effective tax rate for the group was 7.5%. The lower-than-expected tax rate was largely a function of a greater proportion of income related to our Bermuda entities. We saw a similar trend in the third quarter 2013.

Turning to the balance sheet, the sum of investments in cash decreased by approximately $52 million since the year-end 2013. For the 9 months ended September 30, total return on the investment portfolio was approximately $115 million. Offsetting the increase was the settlement for the 2009 and prior reinsurance-to-close transaction at the syndicate, the redemption of the trust-preferred mentioned moment ago, funding of the share repurchase program, and dividend paid -- dividends paid and other smaller items. Adjusting for these items, cash flow was neutral, while we saw increases in other items, notably premiums receivable which should lead to positive cash flow. Paid claims for the 9 months were down slightly from a year ago.

As mentioned in the press release, the 9-month stock buyback total was $42.2 million. Since quarter-end, we have continued repurchasing shares and have spent an additional $7.4 million in share repurchases at an average price of $51.84.

We ended the quarter with a pretax unrealized gain position of $240 million, down from $285 million at the end of the second quarter of 2014. The decline in asset values was most pronounced in the fixed income portfolio, as dollar strengthening lead to a decline in the value of non-U.S. dollar-denominated assets and credit spreads widened generally during the quarter.

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Operator, that concludes our prepared remarks, and we are now ready to take questions.

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Question and Answer

Operator

[Operator Instructions] Our first question comes from Amit Kumar of Macquarie.

Christopher Martin

This is Chris Martin today, actually. So just to start off, as one of your recent underwriting actions take hold, can we revisit the topic of the double-digit ROE? What might sort of be the time frame to get there, and how should we think about it in the context of other headwinds, such as interest rate environment?

Mark E. Watson
Chief Executive Officer and Director

That's a multi-part question. We'll start with the last one. With interest rates -- 2 or 3 years ago, I think, we would have thought interest rates by now would be at least 200 basis points higher, meaning yields would be 200 basis points higher. They're not. The market is more competitive today than we thought it would be 2 years ago. So our top line hasn't grown as fast as we thought it would have grown. As I mentioned in my remarks, there are still opportunities for us and we'll continue to grow, but we may not grow quite at the pace that we felt we would have. And I think that a better way to think about return is relative to the risk-free rate. And we think a reasonable return is 700 basis points over the risk-free rate. And as long as the risk-free rate stays as low as it is, I think it's pretty challenging for insurance companies to be generating double-digit returns in this interest rate environment.

Christopher Martin

Got it. So then just sort of following up on that. Others made an issue of -- revisited their investment allocations and their riskier assets. And you've touched upon how much of your net realized income has come from, your hedge fund strategy in alternative investments. Could we sort of revisit where those are? And sort of is there any potential for changing in how you may be allocating your funds moving forward?

Mark E. Watson
Chief Executive Officer and Director

When you say potential, do you mean -- are you asking if we will continue to allocate more to our alternative portfolio?

Christopher Martin

Yes, and then sort of even more of a broader move from fixed income, generally, to moving more of a percentage into the alternative and hedge fund space.

Mark E. Watson
Chief Executive Officer and Director

Well. So if you look at our investment portfolio over the last 30 years, you'll see that we have pretty -- I don't want to -- we -- I was going to say aggressive, I don't think that's the right word, but we've been pretty nimble in how we've allocated our investment portfolio among different asset classes, primarily between fixed income -- investment-grade fixed income and public equities. Over the last 5 years, particularly over the last 3, we have taken part of the portfolio that we would have allocated to public equities and put it into more hedged strategies. They're mainly credit strategies although there a couple of equity strategies within the alternative portfolio. And that now makes up about 10% of the portfolio. Jay can correct me in a minute and be more precise. I think that we'll continue the evolution because we see good opportunities. It's not necessarily, because we're trying to chase yield. We found good opportunities that, we think, actually have less volatility than our fixed income portfolio. And so as we find new opportunities to invest money in alternative strategies, we'll continue that evolution. But in terms of what that means to investment income, Jay, I think you said in your remarks that, that's probably about $15 million worth of operating income so far this year?

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Jay S. Bullock
Executive Vice President and Chief Financial Officer

Well, what I was referring to is that the incremental value-add from these strategies ever since the beginning of 2013. So this is, say, 1/2 of it. In any given period, it's $7.5 million. We would have made the same -- against foregone investment income. So if you were going to make a return on the cash, we're making that return, plus an additional $15 million over that period of time.

Christopher Martin

Okay, great. That's very helpful. And just one last comment. You've mentioned that you have -- I think you said $4.1 million in buyback so far in the fourth quarter. So the stock has had a good run recently. And could there really be any sort of change of the pace in your capital management as the stock trades at a higher multiple than it had previously?

Mark E. Watson
Chief Executive Officer and Director

Well, I'll give you the same answer I give everyone every quarter. Capital is primarily to support our balance sheet, both the liabilities and the assets, and to support organic growth in the company. To the extent that we think we have excess capital beyond that, then we repatriate that capital back to our shareholders either in the form of stock buybacks or dividends. As our share price approaches book value, it makes us think about whether we might want to adjust our dividend policy in addition to stock buybacks. I would note that over the last several years, we have raised our dividend more than once. We paid a stock dividend a year ago as well. And a few years before that, we paid a special dividend. So I think all of those are still on the table to the extent that we have excess capital.

Operator

Our next question comes from Dan Farrell of Sterne Agee.

Daniel D. Farrell
Sterne Agee & Leach Inc., Research Division

You've been showing some good momentum in sort of core loss ratio improvement over the last few quarters. And I'm wondering, looking at the current rate environment that we might be facing going forward, how do you think about the potential for further improvement or other levers that could offset any rate headwind?

Mark E. Watson
Chief Executive Officer and Director

Yes, so if you look at the classes of business where we're growing, the loss ratio on average is less than the group loss ratio. And that's really where we're putting all of our investment dollars, both in technology to support the underwriting and our distribution management and in new products that are complementary in those classes of business where we see the most margin.

Daniel D. Farrell
Sterne Agee & Leach Inc., Research Division

Okay, and then just on the expense side. I mean, we're definitely still, I think, seeing slower expense improvement on the expense ratio than you may have thought initially. I'm wondering -- you also made the comment that you'll sort of do the right things longer term to sort of have momentum for the company. How do you think about the investments that you're making or the trade-off of a slowdown in expense ratio benefiting the loss ratio or benefiting the overall underwriting results? I'm just wondering how you sort of weigh those 2 things.

Mark E. Watson
Chief Executive Officer and Director

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Well, most of the investments that we're making are much more long-term focused. And when I look at the expense -- when I look at what we're spending relative to what we planned in absolute dollars, it's pretty close to what we planned. There is a couple of projects where we've spent a few million dollars more than we planned, but in the aggregate, we're pretty close to where we thought we would be. The challenge is that in the current environment, we're not growing quite as quickly as we planned a couple of years ago to be today. So if you then look at things on a ratio basis, the ratios don't look quite -- the expense ratios in certain classes don't look as good as we thought they would have been because the growth hasn't been there yet, but it's still coming. So I am appreciative that if you just focus on the expense ratio, it is higher than we thought it would have been right now. But if you focus on how we're investing, I'm pretty comfortable with that. And I see growth coming where we'd like to have it. And so I think the investments that we're making will continue to pay off. It just may take a little bit longer than we planned and a little bit longer is quarters, not years.

Operator

Our next question comes from Adam Klauber from William Blair.

Adam Klauber
William Blair & Company L.L.C., Research Division

Couple of different questions. I'll start with top line. Clearly the business is a little tougher. I mean, you're still showing some growth. But if that continues, will acquisitions come back on the table?

Mark E. Watson
Chief Executive Officer and Director

Adam, acquisitions, I would say, have always been on the table, but for a couple of years when we were consolidating the 3 businesses together, meaning the original Argonaut, the Bermuda Company and Lloyd's platform. That's pretty much done now. We've been looking at a number of opportunities over the last couple of years, which we've talked about from time to time on calls, but things just haven't been a really good fit mainly because of price. And while we'd like to get critical mass sooner rather than later and acquisitions help us do that to the extent that they are in line with our business strategy, we haven't found the right thing that we were willing to pay up for. But we're going to keep looking.

Adam Klauber
William Blair & Company L.L.C., Research Division

Okay. And then going back to the E&S business, I think you said, excluding a couple of lines, you're growing 15%, which is pretty strong. Have you seen any more interest from the standard cares and keeping some of those risks? Or has their risk appetite been pretty consistent these days?

Mark E. Watson
Chief Executive Officer and Director

It depends on the market. I would say that in the U.S, the market has been -- the appetite has been pretty consistent. Europe is kind of all over the place. And in Brazil, we've seen some of the larger carriers really reducing their risk appetite quite substantially over the last few months. Our submission flow in Brazil right now is up 100% year-over-year, and we think that's almost entirely a function of our competitors reducing their risk appetite.

Adam Klauber
William Blair & Company L.L.C., Research Division

How should we think about reinsurance? I mean, obviously, you buy a lot and your book is well protected, and your cat volatility is much, much more than it's been in the past. But is there potential to use reinsurance to actually lower your expense ratio more going forward?

Mark E. Watson
Chief Executive Officer and Director

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Well, we're certainly looking at that. Let me say it differently. Right now, and for the last 18 months, we've been buying less reinsurance. And by keeping more risk, that's actually helped our financial results. If you look at our loss ratios on a gross basis versus a net -- versus net, you can pick almost any time period and gross outperforms net, which is why we've been keeping more risk. If reinsurance pricing does move to a point where it makes financial sense for us to buy more reinsurance, and I'll define financial sense as, it goes straight to the bottom line directly, or I should say immediately as compared to capital release, then I think we'll definitely look at buying more reinsurance. But that's the only reason that we would. We have plenty of capital to support the risk on our balance sheet. So it doesn't make sense for us to buy more reinsurance as a substitute for capital.

Operator

Our next question comes from best Brett Shirreffs of KBW.

Brett Patterson Shirreffs
Keefe, Bruyette, & Woods, Inc., Research Division

Mark, in your prepared remarks, you mentioned some initiatives to help support growth kind of regardless of the external environment. I'm just wondering if you could expand on that a little bit.

Mark E. Watson
Chief Executive Officer and Director

Well, there is a lot of them. Let me just hit on a couple. And I've probably talked about some of them on previous earnings calls. The biggest investment that we've made in the last couple of years has been on helping our wholesaler's trade with us more easily in the U.S. mainly for small commercial accounts either on a package basis or in our small casualty business. And as those systems come online for more and more of our wholesalers, we're seeing much more submission flow and we're seeing much more take-up. And I think I have mentioned in my remarks that E&S, absent property and commercial -- and Commercial Auto was up 15%, and a lot of that's being driven by the investments that we're making on that small-account business. And we're just beginning to see the benefit of that. We're going to see more and more over 2015 and 2016. I don't think we really get the full benefit of what we're doing today until the beginning of 2016. So we'll see it continue to improve, I believe, all during 2015. And then I think it really start to move the needle in the first quarter -- probably fourth quarter of 2015 and first quarter of 2016.

Brett Patterson Shirreffs
Keefe, Bruyette, & Woods, Inc., Research Division

And then another nice quarter of realized gains. I mean, you talked about this also a little bit earlier. But I'm wondering if you could just expand on the composition of the other investments category and also what you are expecting in terms of returns for those investments.

Mark E. Watson
Chief Executive Officer and Director

Yes. So, well, let me start and then, Jay, why don't you jump in, in a minute? So again, we think of our investment portfolio in 2 pieces, or what we call our core portfolio, which is primarily investment-grade, fixed income. Most of that's in the U.S., but it's also in several other jurisdictions, depending upon where we need investment assets to pay claims. And that approximates 70% of our invested assets, give or take 100 basis points. The remainder, we refer to as our capital appreciation portfolio, the largest part of that is large-cap public equities. They're mainly global businesses that are listed either in the U.S. or in Europe, but mainly listed in the US. And then it also includes other components, which a lot of people refer to as alternative assets. In our case, they're primarily credit strategies that are run by hedge funds, although there are also some equity strategies. And I think I mentioned earlier, that makes up about 10% of the portfolio. And all of the movement, up and down, in those hedged strategies runs through the income statement as realized gains and losses each quarter. And so you don't see that -- sorry. For our fixed income portfolio and our public equities, the movement there is tracked on the balance sheet in unrealized

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gains. But for all the hedge strategies, all of that runs through the P&L each quarter in the realized gains section. Jay, do you want to add anything?

Jay S. Bullock
Executive Vice President and Chief Financial Officer

No, I think that's the right sort of characterization. And I think one of our focus -- the only thing I will add is, one of our focuses has been a lot of diversification in this portfolio. So we've gotten away from some of our larger sort of legacy equity allocations, which managers that we've worked with for more than 20 years. We've got allocations that are in the $20 million and $30 million range to a number of different strategies.

Mark E. Watson
Chief Executive Officer and Director

Yes, so I just would make 2 other points. One, we've always run a pretty balanced portfolio. I have been running the company for 15 years now, and one of the reasons that I invested in the company back in 1998 was the company's ability to manage both sides of the balance sheet. And I think that as our ability to take underwriting risk, when market conditions allow, has ebbed and flowed, so has our investment portfolio's asset allocation. And I think the only other point I would make is that while we have millions of dollars less in investment income now than we did before, most that is now showing up in realized gains on the income statement, and has been for the last couple of years.

Brett Patterson Shirreffs
Keefe, Bruyette, & Woods, Inc., Research Division

Okay, that's very thorough. If I could just squeeze a couple of quick ones in here. Jay, a couple of quarters ago you mentioned you have $100 million to $150 million of capital back in the runoff reserves. Is that number still kind of consistent today? And how would you expect that to evolve over time?

Jay S. Bullock
Executive Vice President and Chief Financial Officer

Well, I expect it to trail off very, very slowly in the same way that I expected those runoff reserves to be paid out very, very slowly.

Mark E. Watson
Chief Executive Officer and Director

With what's left.

Jay S. Bullock
Executive Vice President and Chief Financial Officer

With what's left, right. So there is -- they're relatively small amounts, the A&E exposure in total is $50 million and the comp in total is $200 million.

Mark E. Watson
Chief Executive Officer and Director

Yes, whereas 15 years ago, A&E was $300 million and the comp was almost $1 billion.

Jay S. Bullock
Executive Vice President and Chief Financial Officer

And if you look at the slope of the reduction, for example, in comp, it's what you would expect. It comes down fairly rapidly, and then it starts to go -- not flat, but it starts to take a much more general decline, because you have a number of unfortunate long claims left in the portfolio.

Brett Patterson Shirreffs
Keefe, Bruyette, & Woods, Inc., Research Division

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Okay, that's helpful.

Jay S. Bullock
Executive Vice President and Chief Financial Officer

But we do have, of course, running investment income.

Brett Patterson Shirreffs
Keefe, Bruyette, & Woods, Inc., Research Division

And then you announced a couple relatively significant and high-profile hires in the last couple of months. I was wondering if you could just comment on those and how that changes some of the responsibilities at the organization.

Mark E. Watson
Chief Executive Officer and Director

Yes, let me talk about that. I actually meant to talk about that in my remarks. The biggest change that we've made since the last earnings call -- wow, we've made 2. So we have reorganized how we run the company and -- well, let me rephrase that. We don't run the company differently, but I've brought someone in to help me run the international business, and that's Jose Ribeiro. José most recently run the insurance business for Generali. Before that, he ran the international operations of Lloyd's for a number of years. And before that, he was responsible for Latin American operations of Willis. And so if you think about how we're organized, in the U.S, we have our Excess & Surplus Lines business and then what we call Commercial Specialty. And a year and a half ago, I asked Kevin Rehnberg to come and run the U.S. so I could focus on the international business. And over that time, we've recruited David Harris to run the Syndicate and Jose to now come in and run everything outside of the U.S. as a joined-up strategy, which is really how we think about it. I guess the exception to that would be our reinsurance business, Argo Re, which also reports to Jose now. But even that is pretty joined-up with what we're doing with the Syndicate, particularly in the Far East. So I think that's a real good fit for our company going forward. We've added -- we've also added -- or I should say, we have replaced Andrew Carrier, who is head of Underwriting, who joins Everest Re actually, starting next week, with Axel Schmidt, who joined a couple of months ago. Axel was most recently at Aviva, and prior to that was at Zürich for most of his career, mainly in specialty lines. So Axel has really picked up were Andrew left off with his broad casualty experience. And I look around the table today and I think I've got the best management team I've had since I've been running this company over the last 15 years. So I'm pretty fired up.

Operator

Our next question comes from Ken Billingsley of Compass Point.

Kenneth G. Billingsley
Compass Point Research & Trading, LLC, Research Division

I just wanted to ask 3 questions here. One, on the cat losses in general, I saw obviously they were down for the quarter. But you've mentioned with a lot of people have talked about is non-cat weather. Can you talk about maybe how you're avoiding some of those risks that maybe others are seeing an increase even when they don't have to write a lot of property business? And will your international -- and I'm going off a comment you made. Will your international business increase some of the risk because of the change in business mix?

Mark E. Watson
Chief Executive Officer and Director

Ken, I'm not sure I understand the last part of your question with the international piece. I don't know that there is necessarily any more risk in our business outside the U.S. than there is inside the U.S. As respects the property losses in the U.S., I can remember sitting on these calls in previous years usually at the end of the second quarter talking about how it's amazing that every church we insured in the Midwest happened to have been hit that quarter. So while we have avoided some this quarter and last quarter, I'd like to say it is expert underwriting acumen. And we have changed our portfolio to get out of some of

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those tornado-prone areas. Some of that is probably a little bit of luck as well. Having said that, some of the large property losses that we've had at the Syndicate over the last couple of quarters, I think it's just opposite. I think it's -- I don't think it's that our portfolio has changed. I think that we've just kind of been unlucky. All -- if I look back over the last however many years, some large losses, whether it's property or casualty, they tend to kind of come in waves -- and it's not always a function of underwriting, it's mainly just a function of timing. And as we've grown and become more diversified, some losses that moved the needle years ago that we would talk about, we don't talk about as much now because they're spread out over a larger income base.

Kenneth G. Billingsley
Compass Point Research & Trading, LLC, Research Division

Okay, good. And on the international side, I think -- I thought I heard a comment that was talking about increased property losses, and that's what I was referring to.

Mark E. Watson
Chief Executive Officer and Director

Yes. No, no, we did. We were saying at the Syndicate that we had more than we usually do, but I think that's just a function of timing as opposed to risk portfolio.

Kenneth G. Billingsley
Compass Point Research & Trading, LLC, Research Division

Okay. On the alternative investments and actually just kind of, essentially, the non-fixed income portion, and the fact that you've changed some of the investment strategy over the last, I guess, couple of years. Can you just talk about what the trade-off there is from a statutory capital perspective or just how it is treated? Was there any trade-off by moving those investments, obviously, from fixed to equities and maybe from equities into the hedged alternative investments?

Jay S. Bullock
Executive Vice President and Chief Financial Officer

Yes, in some cases there is, right. And in some cases, some of those assets sit in jurisdictions where we can -- where we have a bit more flexibility, if you will, or a bit less of a statutory capital impact. But clearly, they consume -- from a regulatory basis, they clearly consume more capital than traditional fixed income. When you look, however, at a more dynamic modeling of all the risks in the portfolio, and by that I mean all of our insurance risks and all of our asset risks, and then you look at all the underlying strategies that we've invested in, on an economic capital basis, they actually don't consume a lot more capital. So we try to keep an eye on the impact of those strategies on a regulatory and ratings basis, but also mindful of what they're doing from a return standpoint and what they do from an economic capital standpoint. And on average, we're getting a lot more benefit out of those strategies than we are the detriment of additional capital consumed.

Kenneth G. Billingsley
Compass Point Research & Trading, LLC, Research Division

And I am assuming you're talking about obviously the $15 million, you referenced, through excess returns into operating earnings, as opposed...

Jay S. Bullock
Executive Vice President and Chief Financial Officer

Well, it's just overall total return. But yes, that would be the -- that would be a measure of that benefit.

Kenneth G. Billingsley
Compass Point Research & Trading, LLC, Research Division

And when you discussed that $15 million, that's not -- I mean those are actual booked realized gains, not something that hasn't been sold yet, and is flowing through. I mean, that's actually book gains to book value. Is that correct?

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Jay S. Bullock
Executive Vice President and Chief Financial Officer

Yes, it's reflected in book value. That particular number just so happens to have come through in addition to a larger number, but it has come through that realized gains and losses. So it's been recognized, if you will, through the income statement.

Kenneth G. Billingsley
Compass Point Research & Trading, LLC, Research Division

But it's not an unrealized gain that's flowing through the income statement. It's actual cash in hand?

Jay S. Bullock
Executive Vice President and Chief Financial Officer

It's cash in hand of the portfolio manager, yes.

Kenneth G. Billingsley
Compass Point Research & Trading, LLC, Research Division

Got it. And the last quest I had is just -- it is on the fee income line. I know it was small in the quarter. But could you just briefly discuss what is coming in through the fee income line and maybe what creates some of the volatility there?

Mark E. Watson
Chief Executive Officer and Director

Well, most of the fee income line comes from our program operators in the U.S. And we've got a lot of moving parts there as we reconstruct some of the businesses that we have within -- that's the Alteris part of Commercial Specialty. And we've been -- as some of the insurance companies have been changing their risk appetite in the U.S., they've been getting in and out of program business, which means some of the markets that we use have been getting in and out, in this case out. And so the revenue stream has been pretty lumpy there in the last couple of years, and probably will be for another year.

Brett, I wanted to come back to a question you asked a minute ago. Susan made me stop talking because I was talking about people too much. But there is one other thing I wanted to add and that is: by moving Jose Ribeiro into the role of Head of International, it freed up Nigel Mortimer, somebody else that we issued a press release actually about, actually, earlier this week to take on the business development and strategic planning role. This is a lot of what Barbara Bufkin used to do. Many of you know Barbara. And so it allows us to really focus and get more strategic on how we're looking at the future and investing in the future. And I think that's a really important part of how we focus strategically going ahead.

Operator

And at this time, I'm showing no further questions.

Mark E. Watson
Chief Executive Officer and Director

All right. Well, I'd like to thank everyone for being on the call today. A lot happened since the last quarter, and I think we are doing a good job of getting focused. A lot of the initiatives that we've been working on are starting to pay off. And I thank everyone for their questions, particularly about people, because I think that's the biggest strength that we have going forward. And I'm looking forward to talking to you all at the end of the year about the fourth quarter. Thank you again for joining us on the call today.

Operator
Thank you. The conference is now concluded. And thank you once again for attending today's presentation. You may now disconnect.

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