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JRVR - Q2 2015 James River Group Holdings Ltd Earnings Call

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CORPORATE PARTICIPANTS

Kevin Copeland *James River Group Holdings Ltd. - VP - IR*

Adam Abram *James River Group Holdings Ltd. - Chairman, CEO*

Robert Myron *James River Group Holdings Ltd. - President, COO*

Gregg Davis *James River Group Holdings Ltd. - CFO*

CONFERENCE CALL PARTICIPANTS

Mark Hughes *SunTrust Advisors - Analyst*

Randy Binner *FBR Capital Markets - Analyst*

Charles Sebaski *BMO Capital Markets - Analyst*

Christopher Campbell *Keefe, Bruyette & Woods - Analyst*

PRESENTATION

Operator

Good day ladies and gentlemen and welcome to the James River Group Holdings Q2 2015 Results Conference Call.

At this time, all participants are in a listen-only mode. Later we will conduct a question and answer session and instructions will follow at that time.

(Operator Instructions)

As a reminder, today's conference call is being recorded.

I would now like to turn the call over to Mr. Kevin Copeland, Vice President, Investor Relations. Please go ahead.

Kevin Copeland - *James River Group Holdings Ltd. - VP - IR*

Thank you. Participants on this call should be aware that during the course of this conference call, the Company will make forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995.

The forward-looking statements are based on management's current beliefs, expectations and assumptions. In some cases, such forward-looking statements may be identified by terms such as believe, expect, intend, seek, may, will, or similar words.

The statements are subject to certain risks and uncertainties that could cause actual results to differ materially. Although it is not possible to identify all of these risks and factors, they include among others the following, losses of exceeding reserves, loss of key members of the Company's management or key employees, adverse economic factors, a decline in the Company's financial strength, loss of the group of brokers or agents that generate significant portions of the Company's business, losses in the Company's investment portfolio, additional government or market regulation.

The Company potentially becoming subject to United States taxation and other risks described in the Company's annual report on Form 10-K for the year ended December 31st, 2014 and other filings by the Company with the Securities and Exchange Commission.

The Company undertakes no obligation to update or advise any forward-looking information to reflect changes and beliefs, expectations, or assumptions, or the occurrence of unanticipated events, or otherwise except those required by law.

Additionally, the Company will discuss non-GAAP financial measures including references to underwriting profit, net operating income, and return on tangible equity.

Reconciliations of non-GAAP financial measures to GAAP financial measures are included at the end of the Company's earnings release, which is posted under the Investor Relations section of its website, www.jrgh.net.

With that, let me turn the call over to Adam Abram, our CEO.

Adam Abram - *James River Group Holdings Ltd. - Chairman, CEO*

Good morning everybody and thank you, Kevin, for that very stirring introduction.

I'm joined here in Bermuda today by Kevin and also by Bob Myron, our President and Chief Operating Officer; and Gregg Davis, our Chief Financial Officer. And we're looking forward to having a good discussion with you about our business, what's driving our profitability, where we see positive signs, and what we're working towards.

I think most of you will know that underwriting profitability has always been at the foundation of our business plan. And we're pleased that each of our underwriting segments, reported underwriting profits for the quarter and for the six months.

Our net reserve redundancy for the quarter was $2.5 million, and $5 million for the first six months.

We generally wait until the second half of the year to make major moves in reserves. If current trends continue and we have no reason to believe they won't, we expect to report greater underwriting profits in the second half of the year than in the first two quarters.

Expense discipline is and always really has been into growth to our plan. And I'd like to really commend our team for their successful focus on efficiency. After absorbing all of the costs of being a public company, our expense ratio is only 4/10 of a point above the second quarter of last year. For the six-month period, our expense ratio is actually slightly down year over year. I think our team did a good job.

We are also helped by the fact that a written premium is up materially, and also by growing fee income which reduced our expense ratio by 4/10 of a point in the first quarter, and 1.1 points in the second quarter.

The excess in surplus lines business continues to grow and to be a source of enduring profits for our shareholders. Roughly 70%, as some of you know, of our total net are in premium comes from the E&S market. As both our reinsurance company and our E&S primary company are active in that space.

Our E&S company continues to expand, growing gross written premiums by 31% in the quarter. This follows a 23% growth rate in the first quarter. Rates per unit of exposure in our E&S segment are essentially flat for the year. And frankly that suits us just fine because we believe these rates to be entirely adequate.

The growth in our E&S segment this period came from general casualty, manufacturers and contractor, and excess casualty divisions.

Interestingly, submissions were up slightly in the quarter. And this has been ninth consecutive quarter where we have seen more submissions than in the previous period. So as we continue to have more opportunities to grow, we continue to hire underwriters to better exploit this happy circumstance. And it really helps that our companies are one of the best rated places to work in Richmond and we're proud of that too.

Our average premium in the E&S segment continues to increase. For the most recent quarter, our average E&S premium was about $19,000 compared to $17,000 one year ago.

The kinds of accounts we are writing have not changed. So this increases generally reflect the fact that as our customers' businesses are expanding, they're paying slightly more to ensure they're growing enterprises. We think that's a good thing all around.

As everybody on this call probably knows, there's a tremendous amount of capital available to the insurance market today. So far, most of the non-traditional capital has been focused on the property market especially the catastrophe exposed property market. But we are casualty underwriters. And frankly we think most of the competition that we're seeing remains rational and healthy in the space.

In the specialty admitted segment, our traditional worker's compensation business continues to carry the day with about $19 million in premium written through six months. This is up from $14 million of the same point last year. We calculated that exposure adjusted rates for this already profitable business are up about 4% year to date. So that's a solid foundation. Claims frequency and severity remains mild on our worker's compensation book.

We continue to methodically build out our program business. There's substantial good business in this market, but there are also many programs that have been perennially unprofitable. Historically the industry has had difficulty with this business in that companies rely upon managing general agents to generate this business. And those agents are paid commissions based on gross written premiums.

This prompts the conflict between the economic interest of the Company in these agents.

We structure our contracts with sliding scale commissions that align our interest in underwriting profit with the managing general agent's compensation. And we're also careful to recruit knowledgeable reinsurance partners for this business in order to control our net exposure of the losses.

I'm emphasizing the complexities of this small segment of our business because we want investors to know that we appreciate the dynamics of this large market, and are comfortable that over time we can build a very profitable franchise.

Our plan is to build this business slowly, developing enduring relationships with MGAs to demonstrate the commitment to our underwriting philosophy.

The management team for our program unit is highly experienced. And we're going to be deliberate. That said, we're already seeing some progress. The specialty admitted segment grew materially and made a profit in the quarter and for the six months.

Turning to tangible book value, a measure that we pay a great deal of attention to, our TBV is slightly down for the second quarter, the results of interest rate increases that depressed the fair value of our bond portfolio. Our tangible book value was also affected by the dividend we paid in June of this year.

As we sit here today, we feel very good about our position. Given the growth we've enjoyed in our excess and surplus lines business, I think we may exceed our top line estimate for the year. The earned premium will not grow quite as quickly.

We continue to expect our underwriting results in the second half of the year will reflect our strong reserve position. And we anticipate that on average -- that our return on average tangible equity for the full year 2015 should be about 12%.

With that, let me turn to Bob to continue the conversation from our side.

Robert Myron - *James River Group Holdings Ltd. - President, COO*

Thank you Adam. We had a profitable quarter in our casualty reinsurance segment. Our gross written premiums this quarter were significantly higher than a year ago. But as that one in the press release, this was due to one proportional contract that was written in the first quarter of last year for a 15 month term. And as a result, it was renewed in the second quarter of this year. As you may remember this caused us a significant fluctuation in written premium that we discussed in our first quarter conference call.

Additionally there was a separate contract that was renewed in the third quarter last year, but was renewed in the second quarter of this year. If we normalize these timing differences, we expect that once the calendar year is complete, we will be roughly flat from a production perspective in the segment.

Terms and conditions continue to hold up pretty well in the reinsurance segment and equally important in the underlying contracts we reinsure, season's got about 3.5% rate increases on the quarter. This [endorse] directly to our benefits and so much of our reinsurance book is share in nature.

Year to date, for 59% of our gross written premium and our casualty reinsurance segment, the underlying business has excess from surplus lines insurance. We reported a 98.6% combined ratio on this segment for the quarter. But we did have a modest level of adverse reserve development in the quarter. This development was largely offset by loss of mitigating contract features, principally reducing ceding commissions payable.

Onto investments. Where we outperformed our net investment income in the quarter, as of June 30th, the carrying value of our cash and investment portfolio was approximately $1.3 billion. We have a modest unrealized gain in the portfolio which as of June 30th, has an overall book deal of about 3.7%, and an average duration of about 3.5%. Overall, our portfolio has a weighted average of credit rating of A.

We extended duration a bit during the quarter as it had been around three as of March 31st, 2015. This was principally due to opportunistically putting some positive cash flow and cash and short-term investments to work during the quarter in longer-dated investment grade fixed income assets in the higher interest rate environment.

During the quarter, we had a good result from our renewable energy investments, specifically limited partnership investments in solar and wind energy generation. These partnerships which had a carrying value of $28.8 million as of June 30th 2015 rose in value by $2.2 million during the quarter, which was reflected in net investment income. For reference, this amount was $724,000 in the second quarter of last year.

The oil and gas portion of our bank loan portfolio continues to be in good standing. The exposure we have to oil and gas bank loans approximates $24.5 million over 10 different issuers. The credit store in each is good, and accordingly the market value of these loans is $22.8 million, $1.7 million below our carrying value as of June 30th.

With respect to our Puerto Rico investment exposure, during the quarter, we sold the two long-dated municipals we had previously owned for a small gain. Our remaining exposure is in two senior secured syndicated bank loans to two of the island's power plants.

One of these loans matures in 2016, and the other in 2017. Their carrying value is $5.6 million as of June 30th, which is 85% of outstanding principle. Both of the loans are current and are amortizing down on a quarterly basis. Obviously the situation right now in Puerto Rico was influx, but our overall exposure to these credits is manageable. These two plants produce Puerto Rico's lowest cost electricity.

We continue to actively pursue investments and investment strategies are well understood by our management team and investment committee, and on the margin will help to generate compelling net investment income going forward.

Regarding reinsurance purchases, since we last spoke to you in May, our access in surplus lines segment renewed all of its ceded reinsurance [trees]. On the casualty side, we saw improved pricing in terms and conditions. Overall, the price we paid for reinsurance was down 3% to 4% on an exposure adjusted basis. We attribute this both to the stated reinsurance marketplace, but also to how attractive our insurance business is to our reinsurers.

We also buy a small property catastrophe treaty for the limited amount of property risk that we retain. The pricing on this was a decrease of 9% on an exposure adjusted basis.

Lastly, there is no change to our earnings guidance. For calendar 2015, we continue to expect our diluted net operating income to be between $1.95 and $2 per share.

With those comments, I'd like to turn it over to Gregg Davis.

Gregg Davis - *James River Group Holdings Ltd. - CFO*

Thanks Bob. And again, good morning to everyone on the call.

The combined ratio for the Company was 97.8% for our just completed second quarter. This includes favorable development of $2.5 million pre-tax, or $2.1 million after tax.

In the prior year for the second quarter, we had a combined ratio of 96.7%, which included favorable development of $2.7 million pre-tax or $2.2 million after tax.

With this quarter over quarter amounts, this development represents 2.4 points and 2.7 points of loss and combined ratios for 2015 and 2014 respectively.

Now for the six months, the combined ratio for the Company was 97.6% for 2015. This includes favorable development of $5 million pre-tax or $4.1 million after tax.

In the prior year for the six months period, we also had a combined ratio of 97.6%, which included several development of $3.7 million pre-tax or $3 million after tax.

For these six month year to date amount, this development represents 2.2 points and 2.0 points of our loss and combined ratios for '15 and '14 respectively.

The slight increase in our loss ratio in current accident year loss ratio picks over both the prior year and quarter are indicative of nothing more than following our past practice of booking prudent initial loss ratio amounts. We continue to see benign loss trends and negligible cost inflation.

And an important point also in this regard is that on the year to date basis, our accident year loss ratio of 66.0% is less than the full accident year loss ratio for all of 2014 of 66.8%. This is the time of the year that we begin a thorough review of our actuarial assumptions which will be corroborated by our independent external actuaries, both the September 30th and December 31st.

In relation to our reserves, even after the favorable reserve developments we have taken, approximately 70% of our net reserves as of June 30th 2015 within IBNR, which is similar to where we were both December 31st 2014, and March 31st 2015.

Accordingly we had net operating income from the quarter of $12.4 million and net income of $12.5 million. This is a significant increase over the prior year's net operating income of $10.9 million and net income of $9.5 million.

Given our fully diluted shares in $29.2 million, our net operating income per share for the quarter was $.42 cents per share, which represents a 10.5% increase over the prior year second quarter of $.38 cents per share.

On a year to date basis, we had net operating income for the six months of $24.1 million, and net income of $21.9 million. Again, this is the significant increase over the prior year six month net operating income of 21.4, and net income of $18.7 million.

Given our fully diluted shares in $29.2 million, our net operating income per share for the six months ended June 30th 2015 was $.82 cents per share, which represents a 10.80% increase over the prior year of $.74 cents a share.

So that was a whole lot of numbers. But let me give some meaning to all of these detailed metrics.

We feel very good about our performance for the first half of the year. Additionally, we feel very good about our position as we begin the second half of the year. Earnings and earnings per share grown appreciably year over year and quarter over quarter. We are growing significantly and each of our underwriting units were reported in underwriting profit. Net investment income is up, and we enter the second half of the year with a well-positioned balance sheet.

With these continued good results, yesterday our board declared another $.16 cent dividend to be paid on September 30th, 2015.

And this concludes our prepared remarks. So [Nicholas], our operator, could you please open the lines for questions? Thank you.

QUESTIONS AND ANSWERS

Operator

Certainly. (Operator Instructions)

And our first question will come from the line of Mark Hughes with SunTrust. Your line is now open. Please proceed with your question.

Mark Hughes - *SunTrust Advisors - Analyst*

Thank you very much. Good morning.

Unidentified Company Representative

Good morning.

Mark Hughes - *SunTrust Advisors - Analyst*

Could you give us a little more detail on where you saw the strength in terms of written premium? I think you gave us a broad category, general casualty, manufacturers and contractors. A little more detail on that, please?

Adam Abram - *James River Group Holdings Ltd. - Chairman, CEO*

Well there are two parts, Mark to the growth. One is in it's roughly -- and I'm going to just tell you, it's roughly half and half. We're seeing growth in the per account total premium. And I referenced that in that growth from $17,000 to $19,000 average premium size. And really, you know, we're measuring that in our renewal book principal, we were measuring it from our cost of our book, but we were seeing it in our renewal book.

And what's going on is you know, contractors and other small business people and medium sized businesses, the kinds of accounts that represent the overwhelming majority of our book of business, their revenues are up. And so consequently since they are rated by revenues in many cases, we're getting more premium as their business expands. So you know, we're benefiting from the growth in their underlying business. And I think that reflects the slow, steady, but improvement in the US economy for small and medium-sized businesses.

Very -- you know, so that's a good thing as we remarked from both sides.

We -- additionally, you know, some of the new products we're in, we have experienced growth in them. And I think, you know, it's been publicly said that we ensure a number of these transportation network companies and you can see on the press that they're growing and doing well. And so those accounts in that whole category has increased for us as well.

So it's a combination of new products and growth in our existing business, and it's about half and half.

Mark Hughes - *SunTrust Advisors - Analyst*

Okay. And then the increase in submissions, do you think that is reflective of an underlying growth in the E&S market, or is it some distribution initiatives, perhaps on your part that have been driving that?

Adam Abram - *James River Group Holdings Ltd. - Chairman, CEO*

I don't have current -- you know, immediate statistics on the E&S business for 2015. So I wouldn't want to hazard that.

I will stay that our team at James River Insurance Company has done a really good job over a number of years of working to strengthen and deepen the relationships with the really wonderful distribution partners we have there and the wholesale distributors who control this business. And I think, you know, we've had big growth in the Company in terms of personnel. A lot of it is underwriters who are in the seats to make sure that we can be -- and this is very important that we can be responsive quickly and intelligently to the accounts they bring to us.

And remember that, you know, in the E&S business, we intend to see accounts that have a little complexity to them. And so we've worked very hard to have more people who are qualified in those seats to respond quickly to those inquiries by brokers. And we forge stronger and stronger relationships to them.

Unidentified Company Representative

And Mark, let me -- and I'll add another thing to this as well, one other point. We have been actively hiring people in this segment, both overall as well as underwriters. We're certainly hiring underwriters to handle the increase in submissions, in the increase of activity there. But hiring underwriters also results in getting more submissions, right. So I mean, it's because of relationships that they may bring with them and so on and so forth, depending on the level that we bring them in.

So if there's sort of a push and pull that is -- it goes on with that as well.

Mark Hughes - *SunTrust Advisors - Analyst*

Gotcha. And then a final question, the rates, I think you would suggest that in Q1, rates were generally up. You're talking about flat rates here. Have they -- how much have they moved and where do you anticipate they might go? Are they leveling out here? Do you think they're going to go negative?

Adam Abram - *James River Group Holdings Ltd. - Chairman, CEO*

I have no forecast to them to going negative.

But they're definitely leveling out. But these margins, Mark, are really -- you know, I would describe them as completely adequate. And as I sit here today for 2015, I'm not concerned about rates in 2015 given what we're seeing right now.

And you know, the fluctuation by the way, the way we measure rates is only on renewals. And the fluctuations can have a lot to do. You know, the small fluctuations can have a lot to do with the mix of business in that particular quarter.

But we feel very -- I mean, the message that I want to give you is you know, there's not a big acceleration in rates, there's not a big deceleration in rates, it's basically flat. And we're very comfortable with where they are.

Mark Hughes - *SunTrust Advisors - Analyst*

Thank you.

Operator

Our next question comes from the line of Randy Binner with FBR Capital Markets. Your line is now open. Please proceed with your question.

Randy Binner - *FBR Capital Markets - Analyst*

Hey, good morning.

Unidentified Company Representative

Good morning, Randy.

Randy Binner - *FBR Capital Markets - Analyst*

I would like to just talk about reserves, I think. So you know, you mentioned that there's kind of favorable trend that you see continuing in regard to benign loss trends. I guess frequency and then cost inflation which gets to severity.

You know, what accident years, I guess, you know, are feeding the reserve releases you've had thus far in the year, kind of the initial look at the book? And do you think that potential redundancies would pull more from recent accident years? Maybe you can have, you know, 11 later, or is it looking further back?

Unidentified Company Representative

Yeah, you know, the -- hi Randy. The favorable development that we saw in the E&S segment was actually from some of the more recent accident years. Small amounts; 12, 13, and 14.

But I think that in our history when we've had larger reserve releases that come about as a result of the back-ended work that we do at any given year, you know, the reserve releases are -- have generally been pretty broad and have been sort of more focused on years that are a little bit more mature.

And so you know, we head into the second half of the year from what we look at, you know, not seeing really anything different than we have in the past based upon the information that we have available to us right now.

And obviously that certainly could change. But you know, we continue to see a good underlying loss trends with respect to what may happen with our reserves. And obviously that those -- that forms a material part of our -- as you pointed out in your own model, of our operation EPS for the full year in the last two quarters.

Randy Binner - *FBR Capital Markets - Analyst*

That's helpful. And so kind of how to -- how should we think of that -- those comments against the kind of the accident year loss pickup of around 66%, excuse me. It seems conservative, again, kind of relative to where you're developing. You know, can you elaborate more on why that seemingly is on the conservative side?

Unidentified Company Representative

Yes, I think you had all our historical data and you know, particularly over the last three to five years. The booking sort of overall and the high 60s on a group-wide basis and maybe even a little bit higher than that in the E&S segment has been generally what we have done.

And philosophically, you know, we think the right way to do this and fully supported by appropriate actuarial now and the like is to book that loss pick and then we've been fortunate in that we have seen favorable development after the fact that based upon those loss picks once years have seasoned.

So I don't think we're really -- that 66 is you know, plus or minus very similar to what it was in the prior yearend and you know, what we've done in the past periods as well.

Unidentified Company Representative

That's the formula.

Randy Binner - *FBR Capital Markets - Analyst*

Yeah, understood. Just one more detailed question and I'll drop off. The Puerto Rican, the bonds there on the power plant, I apologize if I miss this, but where do you have that marked on the dollar, those two bonds?

Unidentified Company Representative

Yeah, we've got those marked at -- we have actually taken us on impairment on those of about 15% of principal, right. So we've got -- we're carrying them at 85% of their principal value.

And you know, so the balance is recently small. We've been watching that carefully though, because as we would with any investments like that. And you know, these are senior secured loans to the power plants themselves. And you know, they are producing the lowest cost electricity on the island, which I think what we're insinuating there is that you know, certainly there could be an issue with this -- with these, but it is a situation whereby it's hard to imagine that there's no electricity running at Puerto Rico.

Unidentified Company Representative

We have a loan to a profitable entity that we've marked to 85% of face. Now, we all know that the entity is producing electricity for an island that's got a lot of financial problems.

But we think the entity itself is in decent shape. It's got a customer that's troubled. But we think we've got -- you know, we've consulted this with the experts so we can find on this, and we think we're in -- we've used our best judgment to get where we are today based on all the facts and circumstances that we can get from the people who are experts in this area.

Unidentified Company Representative

Yeah. And I guess to be a little bit more succinct, these are the lowest cost producers of an essential service. And so anything could obviously happen.

Unidentified Company Representative

But it's very, very short-term maturity.

Randy Binner - *FBR Capital Markets - Analyst*

Got it. Okay, that's helpful. Thanks so much.

Unidentified Company Representative

Thanks Randy.

Operator

Our next question comes from the line of Charles Sebaski with BMO Capital Markets. Your line is now open. Please proceed with your question.

Charles Sebaski - *BMO Capital Markets - Analyst*

Good morning guys.

Unidentified Company Representative

Good morning.

Charles Sebaski - *BMO Capital Markets - Analyst*

I wanted to get some color on the E&S competitive environment. I know you've said that the pricing is flat and adequate and obviously it's good returns to that business.

Given the overall PNC market and the pricing pressures, have you seen or you have any traditional admitted markets skipping into your space, getting more aggressive?

Unidentified Company Representative

We look for this pretty carefully, because you know, that is -- that can be an important sign. So you want to do something that we're also attentive to. And right now, that's not what we're seeing. You know, we're not seeing the admitted markets coming and trying to buy some of the complex kinds of risks that we right in its kind of routine basis, even in a firm market for sometimes you'll see an account or two. But that's not a trend right now.

Charles Sebaski - *BMO Capital Markets - Analyst*

And as the -- has your retention in the E&S been pretty steady? Or what is the retention? And then obviously you've got exposure growth, I guess on a policy basis or account basis ...

Unidentified Company Representative

It is very consistent

It's very consistent, you know, our retention ratio which we also look at. And maybe up a little bit this quarter, I think. But we'll get you the exact number we're pulling off in a second.

Charles Sebaski - *BMO Capital Markets - Analyst*

okay.

Unidentified Company Representative

So you know, that retention ratio is consistent with our history and just fine from our point of view.

Charles Sebaski - *BMO Capital Markets - Analyst*

Excellent.

And then on the specialty admitted side, I was wondering if you could just help us, I guess a little better to understand how we can think of the growth of fee income from the program and [fronting] business, and kind of how the economics of that, you know, plays out? I mean, obviously it seems to have had a pretty good effect on your expense ratio and the specialty admitted market. And just -- you know, as we get to you know, a few hundred thousand dollars and pretty substantial growth year over year in fee income, how can we think of that evolving and playing into the economics of that business?

Unidentified Company Representative

Two things. One is we're really committed to developing this business at a methodical and careful way. I think that the growth in that is likely to be bumpy, because the program business comes with accounts, you know, and you get an account and you want to start slowly with it and you build it. It doesn't come at least in our experience so far has not come with, you know, major, major, you know, $4 million or $5 million all of a sudden pops out.

So I think it will be a slow build and a steady build.

I was pretty pleased to see that fee business across our growth this quarter brought a 1.1 point in reduction in our expense ratio. And I do think that that will in absolute dollars. Our fees are going up. They will continue to build up. The growth has been not big in terms of dollar amount period over period. I think we've got a disclosure coming on that in the queue.

Unidentified Company Representative

It's in the press release.

Unidentified Company Representative

It is in the press release, sorry.

But I think over time that we can build a substantial business here that will have a big -- you know, a material numerical impact on our EPS.

But right now, this is small, it has a really good incremental effect mostly in our expense ratio right now.

Charles Sebaski - *BMO Capital Markets - Analyst*

So you know, the current specialty admitted and just on the number side, expense ratios, you know, 37.5 this quarter, is that -- which is you know, incredible improvement over, you know, last quarter last year. Is it sort of a reasonable level, you know, with the G&A kind of running at $4 million, or should we ...

Unidentified Company Representative

I think -- no, we expect it to come down.

Charles Sebaski - *BMO Capital Markets - Analyst*

Okay. So that's $4 million in the G&A for that business is kind of what you need. And so that should keep coming down as the business grows.

Unidentified Company Representative

That's exactly right.

Unidentified Company Representative

Yeah, we would hope to get that once all divisions in that segment are just scaled. So that gets that into the low 30s, have been much more consistent with our group-wide expense ratio.

Unidentified Company Representative

Absolutely.

And let me just follow up your question about retention in the E&S segment. We look at both premium and policy account retention, right? And so those are respectively in the second quarter 63% and 62%, which is right in line with our last few years of history in this space.

Charles Sebaski - *BMO Capital Markets - Analyst*

Excellent. And then just last, to understand -- on the tax rate, you know, in the mid-8s again, for a couple of quarters. Is this a reasonable level to think about the business going on an annualized basis, or are there some effect here in the first half of the year?

Unidentified Company Representative

I think that our internal expectations at our budget is that we generally expect that tax rate to be a little bit higher. And just based upon where we ultimately expect to earn our income, right, with just the jurisdiction where it ultimately lands with the various components we have to our structure.

So we do expect it to be a little bit higher than that. You know, the fact that it's been lower than that year to date has been obviously beneficial to us. But I think we do sort of think more like low-double digit tax rates in terms of our expectations.

Unidentified Company Representative

Yeah, the expectation for the last two quarters of the year with a favorable reserve releases that we've had in the past. The Q3 and Q4 tax rates have been higher than the Q1 and Q2.

Charles Sebaski - *BMO Capital Markets - Analyst*

Excellent. Thank you very much for all the answers, guys.

Unidentified Company Representative

Thanks Chuck.

Unidentified Company Representative

Thanks Chuck.

Operator

Our next question comes from the line of Christopher Campbell with Keefe, Bruyette & Woods. Your line is now open. Please proceed with your question.

Christopher Campbell - *Keefe, Bruyette & Woods - Analyst*

Yes, good morning.

Unidentified Company Representative

Good morning.

Christopher Campbell - *Keefe, Bruyette & Woods - Analyst*

My first question is in light of all the recent M&A in the specialty E&S space and the multiples being paid, why not actively shop yourself?

Unidentified Company Representative

We were busy. You know, listen, we sold many companies in the past. And I think that most people know that we are a board and we are a company that is commercial and that we would be -- we're going to do the right thing for shareholders.

But we are very busy right now building a great franchise and we've got really tremendous runway in front of us. I mean, we're growing the most profitable segments of our business you know, huge. And we think and responsibly and very profitably, and we're building, strength in our franchise and we're building strength in our balance sheet, and we're producing good earnings.

And so we think that you know, two things are going along. One is we're focused on delivering value to our shareholders. And we're also focused on building a very valuable franchise. And we're aware of the M&A thrown out there. But we don't think there's any reason to shop ourselves while we're building a tremendous franchise.

But the world is aware of us. And you know, we're -- we will do the right thing for shareholders under every circumstance that develops.

Christopher Campbell - *Keefe, Bruyette & Woods - Analyst*

Perfect. Thank you for those insights.

My next question relates to the extension of the portfolio duration, increasing from 3% to 3.5% this quarter. I guess my question is two parts. One, what are you seeing on the new money yields, and did the liability duration increase allowing you to push out the asset duration and put some more of those cash in short-term investments to work?

Unidentified Company Representative

So the liability duration didn't really increase. It's still about the same as it's always. It's been a little over four years.

I would say that the extension was we've been a little bit shorter in the last few quarters than we had been prior to that at 3%. And right moved up a little bit, and we saw ourselves with a material amount of cash in short-term investments. And so we put a bit of that money to work in the investment grade fixed income space. And that money was put to work in securities that had an average duration of weighted average above between 6.7% and 7%. And we've got the new money yield of like, two and three quarters on that.

And so I think it was really just in -- between some positive operating cash flow and sitting on a pretty big cash in short-term investment balance, we put a bit of it to work.

And to go -- I think 3.5, we are probably still on the shorter end, if not sort of right in the middle of our peers from a duration perspective. And as mentioned, it's still shorter overall than the liability duration.

Christopher Campbell - *Keefe, Bruyette & Woods - Analyst*

Great. And just one final question, I notice that the net of gross written premium is about 180 BPS higher. Where I may have expected it to drop a little bit in your E&S and specialties segment just to take advantage of some of the softening reinsurance market. Can you please share your thoughts on just this market overall and James Rivers' opportunities has been at the purchaser through E&S, and as a writer through casualty.

Unidentified Company Representative

Yeah, I guess our -- first of all, the reinsurance that renewed, we didn't make any significant changes and that -- in what we bought, right, in terms of limit or share or anything like that. So that pretty much stayed the same.

And while there are obviously I think reasonable pricing in the reinsurance purchasing market, our results on their own had been very good, right. So we need to strike a balance between how much we keep and how much we lay off, right.

And so we didn't really change that. If you see -- it changed what we've purchased. If you see differences in those ratios, it largely can be due to mixed shift. For example, when we have growth in excess casualty, we have a reinsurance treaty that is structured in a little bit of a different way than for some of the other divisions.

So that is really mixed. We didn't change what we bought by division or by type of risk. And you know, we're focused on striking the balance between seeding off the volatility, but yet at the same time keeping as much of the good profitable business that we think makes sense to us in our business model.

Unidentified Company Representative

So to put it on another way, we're really comfortable with the profitability of our net retained. There, we think it's really a great profit embedded in it. Of course that has to prove out over time.

And we were pleased with the pricing we got in the reinsurance. We primarily in that segment by reinsurance to control our net exposure, and to control the volatility in the book.

Christopher Campbell - *Keefe, Bruyette & Woods - Analyst*

Thank you very much and congratulations on the quarter and best of luck in Q3.

Unidentified Company Representative

Thanks a lot.

Operator

Thank you. And with no further questions in the queue, I would like to hand the call back over to James River Group for closing remarks.

Unidentified Company Representative

Thank you everybody for attending. And we look forward to seeing some of you with various conferences that will occur between now and our next earnings call, and to listening from time to time. And thank you for your interest in our company. We very much appreciate it.

Bye.

Operator

Ladies and gentlemen, thank you for your participation in today's conference. This does conclude the program. And you may now disconnect. Have a good day, everyone.

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