Atlas Financial Holdings' (AFH)
CEO Scott Wollney
Q3 2015 Results - Earnings Call Transcript
Tuesday, November 10, 2015

Operator
Greetings and welcome to the Atlas Financial Holdings 2015 third quarter earnings results conference call. At this time, all participants are in a listen-only mode. A brief question-and-answer session will follow the presentation. [Operator Instructions]. As a reminder, this conference is being recorded.

It is now my pleasure to introduce your host, Scott Wollney, President and Chief Executive Officer. Thank you. Sir, you may begin.

Scott Wollney - CEO
Thank you very much and good morning, everyone. With me today is Paul Romano, our Vice President and CFO. Our third quarter 2015 results were highlighted by bottom line improvements on a year-over-year basis, continued premium growth in our markets, increased overall market share, continued successful integration of our acquisition of Global Liberty and a number of other operational achievements positioning us for future success. We also continued to see market trends in both our commercial auto and our niche segment that are encouraging for continued favorable pricing and growth in the coming year.

During today's call, we will discuss these operating results and how we intend to deliver consistent returns and return equity and our target levels of 500 to 1,000 basis points above the P&C industry. Based on statutory filings, P&C industry produced an approximate 9.5% pretax ROE in the past year.

While we are already generating return that is approximately 1,000 basis points higher than this, our expectation is that in the near term, we can improve on this result through continued margin expansion and responsible but increased operating leverage.

I will now turn it over to Paul to provide details about our quarterly materials and review our policy regarding forward-looking statements.

Paul Romano - CFO
Thank you, Scott and good morning, everyone. Yesterday after market close, Atlas issued its 2015 third quarter financial results. Copies of this press release are available at the Investor Relations section at the company's website at www.atlas-fin.com.

On this call, Atlas may make forward-looking statements regarding the company, its subsidiaries and businesses. Such statements are based on the current expectations of the management of each entity. The words anticipate, expect, believe, may, should, estimate, project, outlook, forecast or similar words are used to identify such forward-looking information. The forward-looking events and circumstances discussed on this call may not occur and could differ materially as a result of known and unknown risk factors and uncertainties affecting the companies, including risks regarding the insurance industry, economic factors and the equity markets generally and the risk factors discussed in the Risk Factors section of its Form 10-K for the year ended December 31, 2014.

No forward-looking statement can be guaranteed. Except as required by applicable securities laws, forward-looking statements speak only as of the date on which they are made and the company and its subsidiaries undertake no obligation to publicly update or revise any forward-looking statement, whether as a result of new information, future events or otherwise.

When discussing our business operations, we may use certain terms of art, which are not defined under U.S. GAAP. In the event of any unintentional difference between the presentation materials and our GAAP results, investors should rely on the financial information in our public filings. All amounts discussed on this call are in U.S. dollars, unless otherwise indicated.

We will be utilizing a slide show presentation in conjunction with this call. This presentation is available on our website's Investor Relations section and then under the earnings release info selection. For those of you following along with our presentation, we will begin on Slide 4.

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

Scott Wollney - CEO
Thanks, Paul. We are in a cyclical business and our strategy is designed to leverage each point in the market cycle. At this time, we are seeing a very favorable pricing environment and are taking full advantage of the opportunity to grow while continuing to expand margins on a year-over-year basis at the same time. We have put capital planning tools in place to self fund this growth in a managed and responsible way. We are also investing in people and technology to ensure that we can support this growth and continue to deliver our strong value proposition to policyholders and distribution partners.

While reinvesting in our business can create short-term drag on expense ratio improvement in any given quarter, it is critical to the long-term health and profitability of our organization. That said, we are also cognizant of the importance of achieving run rate objectives in terms of efficiency. In addition we have been proactive about positioning Atlas in advance of an evolving public auto market about which I will go into greater detail towards the end of the call.

In the third quarter, we delivered margin improvement as compared to the same quarter last year due to pricing activity. Our expense ratio, excluding debt treatment and equity incentive related costs, were at also near target levels. While our goal continues to be to drive the expense ratio into the 24.5% and 26.5% range through scale and operating efficiency, it's also important that we invest in the infrastructure necessary to continue to deliver sustainable growth in these current favorable market conditions.

After the acquisition of Global Liberty earlier this year, our entire team has been focused on vertical expansion and we are winning market share in just about every state in which we are writing, but are still not greater than 10% in any one state. Given our noted goal of achieving a proportionate 20% market share in the current market environment, there is still quite a bit of runway.

On slide five, we show our growth in terms of key metrics during the period, including Global Liberty, our gross premiums written improved by 55.3% to $65.3 million, the highest quarterly total in Atlas' history. Premiums written for our core market of smaller commercial auto operators improved 57.8%. The third quarter for Atlas is seasonally different than other quarters as a result of our Excess Taxi program in New York. This is a business arrangement providing excess coverage above the levels of risk retained by the insured and only a small number of large medallion owners qualify for this program.

As a result, we do not expect the premium volume related to the program to vary significantly year-over-year. Last year, gross premium written in the third quarter attributable to this program was approximately $12 million. As expected, this year it was relatively the same. Excluding this program and the premium from Global Liberty, gross written premiums grew 44%. It's also worth noting that at this time, our exposure to Yellow Cab Business in New York City is limited to just Excess Taxi program. Based on current rate levels, we are not writing a material amount of first dollars taxi business in the city. We also achieved underwriting improvement during the period.

Our combined ratio continued to turn lower on a year-over-year basis. In fact, as seen on slide six, our quarterly combined ratio has improved as compared to the prior year same quarter consistently for the past three years. In the most recent quarter, this led to operating income improving 66.9% to $6.2 million or $0.46 per diluted common share for the three month period ended September 30, 2015. Despite the fact that our GAAP results reflect the full U.S. tax rate this year, net income for the quarter still rose 15.2% on a year-over-year basis to $4 million o r$0.32 per diluted common share. Tax affecting last year's net income on a pro forma basis this quarters $0.32 per share compares to $0.19 per share for the same period in 2014. Book value per diluted common share for Atlas at September 30, 2015, is $9.88, a 19.9% increase from $8.24 at September 30, 2014.

We are also very pleased with our year-over-year improvements in the loss ratio. As I stated in last quarter's conference call, while this ratio can move up or down in any given quarter based on business mix and actual loss activity, it should generally continue to trend towards pricing targets for an unexpected extraordinary losses. Each of Atlas' operating subsidiaries are writing new and renewal business to below 60% loss ratio which we expect to continue delivering underwriting margin improvement in the future.

Beginning last quarter, we began providing information about our in-force premium. As you can see on slide seven, this figure continues to grow in a meaningful way. It's the best measure of our run rate revenue including the in-force premium at Global Liberty generated prior to being reflected in Atlas' numbers. This graph also demonstrates that our growth has accelerated in a relatively consistent manner which is the result of our managed process and efficient distribution channel.

On slide eight, premiums by state is summarized. We are achieving growth through the steady building of market share among a wider geographic base. Our goal is to continue to increase market penetration in each geographic area in which we distribute our specialty products. We are also increasingly focusing on expanding brand awareness among an increasing number of owner operators who are being dispatched via mobile apps. With the acquisition of Global Liberty, premiums in New York are significant as a percentage of the total, even excluding the effect of our Excess Taxi program.

In addition, our growth in markets such as California and Colorado has continued to remain well in excess of 100%. In fact, we experienced growth over 100% in 11 states in the quarter. Our business model is hyper focused and as such being close to the consumer is critical. We distribute our products only through specialized independent agents. It is specific to our niche, understand Atlas' value proposition and are able to communicate it to policyholders.

As you can see from our hit ratio and application submission data shown on slide nine, this channel is doing an effective job.

In addition, as seen on slide 10, vehicles represented our new business applications continue to come in at a rate that's even higher than last year. In addition, our renewal retention is at target levels. We have been able to successfully increase rate, while maintaining high retention and strong new business submissions.

Although there was a slight drop in the third quarter as a result of some geographically specific changes, we expect retention rates to return to above target levels prior to year end. We also lean on our agency network for their insights in terms of customer needs and priorities. It's a give-and-take. As we grow our business, it's critical that we not compromiser our value proposition. While growing pains are inevitable at some level any time revenue increasing nearly 50%, our commitment is to ensure that these challenges adjust quickly and with long-term customer centric solutions.

A good example of this is the rollout of our point-of-sale policy system which began in the third quarter. Development of this interface began almost two years ago, incorporating feedback from our business partners and we are now at a point where our agents and ultimately our expense ratio will start to benefit from its deployment. We always want to continue to improve from a quality and operating efficiency standpoint. To this end, we actively seek input from our agents and committed to using this information to guide our planning. Our frequent communication with agents and policy holders on a day-to-day basis as well as with industry and Atlas specific working groups also ensures that we are able to quickly learn about changes in the marketplace.

At this point, we continue to hear that the market remains firm and have not seen any credible signs of disruptive new entrants. Discussions with our agents have helped our company be proactive in connection with industry trends. For example this has helped Atlas properly evaluate opportunities related to drivers under dispatch with transportation network companies. We are also actively researching and coordinating with agents and policyholders to evaluate the impact of telematics and accident prevention technologies in vehicles. We believe that these high touch relationships are difficult to replicate and only possible as a result of Atlas' hyper focused model.

On slide 11, we have included an analysis of our net written premiums to statutory surplus. At September 30, 2015, our operating leverage, as measured by net written premium to surplus, remained at approximately 1.5:1, similar to the previous quarter. This ratio remained relatively flat as our retained statutory earnings grew by approximately the same percentage as net premium growth. We regard being a good steward of capital as a critical element of our business. Of course, our planning process must contemplate regulatory and rating agency constraints as well.

In the third quarter, we were pleased that the [indiscernible] affirmed the pre-Global Liberty acquisition ratings of all of our subsidiary insurance companies. As communicated previously, our upward bounds for the companies operating ratio is 2:1 and we do expect our leverage to move up in this range during the upcoming year. With the objective of self funding growth in mind, we will ensure that our operating leverage is properly maintained to support our growth.

We know that management volume, operating margin and financial leverage should result in the maximizing of return on common equity and long-term value creation for shareholders. Self funded growth is a priority and tools such as our quota share reinsurance program and credit facility provide important flexibility in this regard. Based on recent discussions with a number of reinsurers, we anticipate favorable reinsurance rates to continue into next year.

The company's quota share agreement provides both a seeding commission to offset both acquisition costs and other underwriting expenses. However, from an accounting perspective, the seeding commission only reduces acquisition costs in our financial statement and does not offset other underwriting expenses on the P&L. With this in mind and as mentioned on our last earnings call, our overall expense ratio, which is the combination of acquisition costs and other underwriting expenses, should be looked at collectively to measure operating efficiency. We will also continue to provide pro forma pre-quota share underwriting expense ratios in our financial release information for transparency purposes.

We continue to keep a total expense ratio target of between 24.5% and 26.5% before interest expense and share-based compensation and expect to progress to this level. This incorporates the pre-quota share expected gross, other underwriting expense ratio in the 10% to 12% range and acquisition cost remaining constant around 14.5% on an annualized basis. Although we were slightly higher than this target in the third quarter, due primarily to the timing of expenses and incremental hiring, on a full year basis we expect meaningful improvement over the prior full year and are comfortable with the target for future quarters, especially in consideration from the efficiency anticipated as we rollout and consolidate business under our newly released policy issuance system from the multiple legacy systems.

With that, I will once again turn the call over to Paul for a more detailed review of our financial results and then I will return for concluding remarks.

Paul Romano - CFO
Thanks Scott. Our financial overview in the presentation begins on slide 13. Here, we provide a number of our financial highlights for the third quarter and welcome each of you to review our press release and filings should you want more detailed information.

Gross premium written increased 55.3% to $65.3 million in the period compared to $42 million in the three month period ended September 30, 2014. We primarily target owner operators and small fleets with taxi, limousine and paratransit segments. Our gross written premium from these target accounts increased 57.8% in the third quarter 2015 as compared to the third quarter of 2014. Global Liberty accounted for $11 million of this increase to gross written premium in the quarter.

In the third quarter, we seeded 15% of premiums under our quota share reinsurance program for American Country, American Service and Gateway. Global Liberty is under a separate quota share reinsurance program that is in place other than the other three subsidiaries. Global Liberty cession rate was 20% of their subject written premium for the quarter. We do not anticipate making any changes to these cession rate during the remainder of 2015.

Net written premium was $52 million for the three month period ended September 30, 2015 or an increase of 37.6% as compared to the same period in 2014. Global Liberty accounted for $7.8 million of the increase in net premiums written. Managing our operating leverage by proactively utilizing quota share reinsurance is a key element of our self funding strategy, which is to continue benefiting from organic growth within our niche during a favorable market environment. Our reinsurance programs are under review with the objective of leveraging our operating scale to obtain the best possible terms for 2016.

Net premium earned increased by 62.9% in the three month period ended September 30, 2015 to $41.7 million. The Global Liberty net premium earned accounted for $8 million of this increase. The remaining increase in net premiums earned resulted from organic growth primarily in states of California, Louisiana, Minnesota, Oregon and Washington. Excluding the impact of Global Liberty's incremental premium, organic growth in the third quarter of 2015 was 29% from the prior year quarter. Further, excluding our New York Excess Taxi program, which is not expected to vary considerably in size year-over-year, organic growth was 44%.

On the expense side, the overall loss ratio for the three month period ended September 30, 2015 improved to 60% from 62.2% in the three month period ended September 30, 2014. The loss ratio improvement in 2015 as compared to 2014 is primarily a result of pricing activity related to our core lines. We continued to see opportunity to be price leader. Underwriting expense is comprised of acquisition costs, which are agent commission expenses, net of quota share reinsurance seeding commissions plus underwriting expenses.

Excluding the impact from debt service and share based compensation expense, the underwriting expense ratio was 27.2% in the three month period ended September 30, 2015 compared to 26.2% in the prior year quarter. On a pre-quota share basis and before the impacts from debt service and share based compensation expenses, the components of the underwriting expense ratio for the month period ended September 30, 2015 were 14.9% for the acquisition cost ratio and 13.2% for the other underwriting expense ratio compared to the three month period ended September 30, 2014 of 14.7% for the acquisition cost ratio and 11.6% for the other underwriting expense ratio.

The increase in the other underwriting expense ratio was primarily related to the retroactive reinsurance expense as a result of favorable development in our Gateway run-up workers compensation program, the amortization of software cost related to the company's new policy management system that went into production in the third quarter of 2015 and the timing of expenses versus the prior year quarter. As Scott mentioned, we also hired a number of people in the quarter in support of existing and continued growth. Overall, Atlas' combined ratio for the three month period ended September 30, 2015 was 88.8% compared to 89.6% for the three month period ended September 30, 2014.

Net underwriting income [indiscernible] prior to investment income increased to $4.7 million from $2.7 million in the prior year period, representing a 75.4% increase. Atlas generated net investment income of $1.1 million in the three month period ended September 30, 2015, as well as $350,000 of realized gains and other income. This resulted in a 2.1% annualized yield on our average invested assets portfolio for the three month period ended September 30, 2015. Overall net income attributable to Atlas was $4 million for the three month period ended September 30, 2015.

After the dilutive impact of the convertible preferred shares and stock options, earnings per diluted common share in the three month period ended September 30, 2015 was $0.32. This compares to net income of $3.5 million and diluted common share earnings of $0.29 in the three month period ended September 30, 2014. For the third quarter of 2015, the return on average common equity was 21% on a pretax basis and 13.6% after-tax.

On slide 14, we provide more detail regarding operating income. This analysis should be helpful in understanding the business outside of the few atypical items we have noted in the past two quarters and in light of our tax treatment. This internal non-GAAP performance measure is used in the management of the company's operations. It represents operational results excluding, as applicable, net realized gains or losses, net impairment charges recognized in earnings, net tax adjustments and other items. Operating income, which is a clear indicator of the overall incremental profitability growth of our organization, was $5.7 million or $0.46 per diluted common share in the third quarter 2015 as compared to $3.4 million or $0.28 per diluted common share in the same quarter last year.

On slide 15, we detail the components of book value. We increased book value to $9.88 at September 30, 2015 from $9.08 at December 31, 2014 and $8.48 at September 30, 2014. Towards the bottom of the slide, we step through the key elements that impacted book value year-to-date.

On slide 16, we include information on our balance sheet. Atlas' cash and invested assets at September 30, 2015 increased to $234.1 million compared to $180 million at December 31, 2014. The increase is primarily attributable to the addition of Global Liberty and a draw on our line of credit facility. Unearned premium balances which represent premiums corresponding to the time periods remaining on the underlying in-force policies were $108.1 million compared to $59 million. This increase is a result of continued organic growth plus the addition of Global Liberty.

As noted earlier, during the first quarter we established a credit facility with Fifth Third Bank which allows us to draw up to $30 million at LIBOR plus 450 basis points for the use in connection with our statutory entities plus another $5 million at LIBOR plus 275 basis points for other general corporate purposes. We have drawn $15.5 million in the $30 million credit facility and have used these funds into the ASI pool companies, which include American Country, American Service and Gateway in the form of surplus notes. We also drew $2 million from the $5 million facility to support the needs of the premium finance company we acquired in the Global Liberty transaction.

As an investment philosophy, we continue to place priority on preservation of capital to support future premium growth. Our investment duration is 3.65 years and remains consistent with the expected liquidity needs and claim payout patterns and the majority of our holdings are in fixed income securities rated AA or better by S&P.

The high quality nature of our portfolio is detailed on slide 17. Because we intend to hold the securities until maturity, while any increases in interest rates could create an unrealized loss in the short-term, we would not expect such losses to be realized. Working without our outside investment advisor, we monitor these positions in our portfolio closely, especially in light of recent world events.

With that, let me turn the call back over to Scott for his concluding remarks.

Scott Wollney - CEO
Thanks, Paul. Last quarter we concluded with our thoughts on the pricing environment based on what we were seeing in our niche and the market overall. The updated industry data that we generally share from Council of Insurance Agents and Brokers wasn't available when we reported last quarter. However we shared our opinion that commercial auto in general, would probably move sideways for a few quarters largely due to larger accounts putting pressure on generalists insurance companies despite their continued stated need for further rate increases.

As shown on slide 19, this has in fact been the case, with a modest renewed increase in overall commercial auto rates in the third quarter. It's also worth noting that while most areas of commercial insurance are beginning to show softness, commercial auto is the only large segment of the P&C

industry that's still attracting rate increases. As usual, small accounts are also performing better than larger accounts from a rate standpoint as well.

Our niche traditionally lags broader commercial auto by 12 to 18 months. We have been achieving high single digit rate increases and gaining market share based on our increased marketing activities, coupled with larger carriers exiting our specific market in recent years and given the status of P&C in general and the size of our niche market, we just haven't seen larger new market entrants come in that would disrupt pricing. While we do expect that growth in margins will inevitably be impacted by new entrants with naïve capital, we have not yet seen signs of this occurring.

These are trends coupled with our own data that lead us to believe that we can continue to write business below a 60% loss ratio with incremental rate increases in the mid to high single digits while growing in the 30% to 50% range to which we have previously guided. We are on track to reach the $200 to $240 million premium levels for the full year 2015 and will provide perspective on our expectations for 2016 on next quarter's call.

Going forward, we will remain vigilant with respect to capital planning and increasing our operating leverage in a responsible manner to fully benefit from market trends. We recognize the importance of reaching our efficiency goals in terms of expense levels and believe that we have made the right decisions to achieve them by investing wisely in our infrastructure this year. In addition, we continue to stay on top of the market shifts in expansion that has resulted from the increased number of vehicles being dispatched by transportation network companies such as Uber, Lyft and Sidecar.

We are also monitoring other tangential market opportunity such as last mile distribution of products to consumers. The changes occurring in our customers market is currently benefiting Atlas from the perspective of market expansion and is also likely to create new potential horizontal markets that we may pursue overtime. While still early in development, we have been proactive in devoting resources to examining these markets, which are evolving in our own backyard. Insuring light vehicles that carry people and things that provide service for a fee is at the heart of our business model. We feel that Atlas is in an excellent position to take advantage as a hyper focused commercial auto specialist.

To conclude, we feel very comfortable with our previously discussed forecast, both in terms of premium and high teens ROE provided favorable market conditions persist and encourage investors to focus on full year-over-year results to gauge trends and the meaningful progress we have achieved in our business.

With that, let's turn it over for any questions.

Question-and-Answer Session

Operator

[Operator Instructions]. Our first question comes from the line of Jeremy Hellman with Singular Research. Please proceed with your question.
Jeremy Hellman - Singular Research

Hi. Good morning, gentlemen.

Scott Wollney - CEO
Good morning, Jeremy.

Paul Romano - CFO
Good morning.

Jeremy Hellman - Singular Research

I have a couple of questions on the transportation network companies longer term opportunity. Just first, I think it would be helpful to have just a basic cementing of my understanding in terms of, if I as a individual went and signed up with Uber, for example, to be a driver, do I need to carry some sort of supplemental insurance over the top what I might have as just a private individual? And then secondly, more broadly, do you expect customer acquisition costs in that space to deviate markedly from your traditional markets?

Scott Wollney - CEO
So addressing the first part of your question in a nutshell, it depends on the type of service you are going to provide for the transportation network company and also the geographic location which you are going to drive. So all basic personal auto policies exclude commercial use. So that would include driving for a TNC company, delivering pizzas or operating as a plumber stand, for example. So to the extent that an individual is using a vehicle for commercial purposes, they do need to have some sort of commercial insurance.

Now in terms of the requirements for the TNC companies, there are certain classes of service such as UberBlack and UberSUV that actually require that the drivers purchase commercial insurance and demonstrate that they have that coverage in-force to the TNC company before they can qualify to provide that type of service. There are other aspects of TNC operators in what are traditionally called ride sharing, where the TNC company may not require that, but a local regulator might.

So for example, in the New York market, which is the largest market for what we do, the New York Taxi Limo Commission mandates that all drivers driving for a TNC company in any respect have to evidence that they are carrying true commercial auto insurance. There are other jurisdictions that haven't quite come along that far in terms of regulation and so may not actually be requiring that. So most of the TNC companies do have an excess policy in place that may provide some limited coverage, but I think we are expecting overtime is that at least most major Metro areas will ultimately require that all drivers who are driving people around for a fee to actually purchase true commercial auto insurance. So because of that, in the short-term we have seen some benefit in those markets where coverage is required, in the longer term we think that we are going to see potential opportunities down the road.

So in terms of the second part of your question, acquisition cost. Today we are continuing to distribute only through specialty independent retail agents. Our traditional target market were owner operators and small fleets. So we think that our current distribution channel is well-positioned to distribute not only to the traditional commercial auto operators, but also to serve this emerging class of operators in the transportation, the person or people transportation field as we see future evolutions, last mile distribution products, for example, obviously we will start with our existing distribution channel to determine whether they feel they have good access to those types of opportunities, but then we also may look at augmenting that if for example, going after those target client is not consistent with the goals of our current agents. But I wouldn't expect a significant increase in our acquisition costs, but over time we may ultimately expand our distribution channel if our product focus expands beyond the moving of people around.

Jeremy Hellman - Singular Research
Okay. Thanks. That's very helpful. I appreciate it.

Scott Wollney - CEO

Thanks for the question, Jeremy.

Operator

Our next question comes from the line of Dan Farrell with Piper Jaffray. Please proceed with your question.

Dan Farrell - Piper Jaffray
Hi. Good morning. Scott, I wondered if you could expand a little bit on your comments on just your thought process around horizontal expansion and how you think about potential products you might do? It seems like a longer term sort of timing for that? Is there a threshold you want to get to in your core business now before you do that? Thank you.

Scott Wollney - CEO
Sure. Great question. As you know, we have always talked about potential horizontal expansion as part of our strategy, specifically thinking about expanding into other specialty commercial auto segments in a softer market environment with the idea that the best and highest use of our capital and resources in a favorable market like we are seeing today is getting to that 20% proportionate market share in our current niche markets. So that remains our highest priority. As I mentioned on the call, we have got about 10% nationwide market share within our current niche. We think we can grow that to about 20%. So there is certainly a lot of potential opportunity there.

That said, we are spending time evaluating other potential specialty commercial auto segments that exist today as a logical horizontal expansion markets that we will pursue in earnest when we do ultimately see the insurance market or at least that the market in our niche shifting. And between now and then, we will be opportunistic if a situation comes up that we think is really a true scenario where we can deploy our capabilities in terms of finding, diligencing and fixing challenged insurance businesses in a way to give very attractive valuations by company that at its core could support logical horizontal expansion in other specialty commercial auto fields.

Augmenting that or adding to that is now this evolution of TNC type distribution model or deployment model, both within the current niche we focus and other niche markets. So as that evolves, we are obviously going to be keeping a close eye on it. It is growing up in our backyard. So we would like to take advantage and leverage the data and information expertise we have to be a first mover provided that we determine that we can be a first mover and generate premiums that will deliver an underwriting profit.

So to be clear, we aren't going to chase new opportunities simply to put premium on the books or simply because they exist. Sometimes the best thing you can do in insurance is make sure you are the first person to understand the risk, but then let somebody else underwrite it for a little while until the market is disciplined enough to accept the appropriate rate for the right type of coverage and service. So I don't want to suggest that next quarter you are going to see us writing a significant amount of premium in some expansion area so that you think is important to understand that we are going to be very focused on making sure we are well prepared so that as those opportunities come up, we can pursue them. But I think the best and highest use of our time and energy right now is continuing to capture market share in our current niche market and make sure that we continue to be the nationwide market leader in that respect.

Dan Farrell - Piper Jaffray
That was helpful. Thanks. And then just one other question. You have talked about your expectation that you will continue to move towards closer to a 2:1 premium to stat surplus overtime. Do you think organic opportunities will get you all the way there? Or do you think it's going to be a combination of the organic opportunities plus opportunistic M&A, book rolls, et cetera?

Scott Wollney - CEO
I think organic opportunity will get us there over the next year or so. The "good problem" that we have right now is the fact that our surplus is growing through retained earnings at about the same percentage as our premium. So that's causing operating leverage to bring be maintained in a relatively flat way. Obviously we want to maximize retained earnings. So from that perspective, it's sort of a good problem to have, but if we continue to grow at the rates that we are currently seeing and expecting and continue to modestly extend margin, holding all of our other capital planning to a constant, the quota share and the debt facility, we do think that operating leverage is going to move up in 2016.

But as I mentioned as a concluding part of the formal remarks, we will provide more specific guidance in the next quarter's call and can give everybody more clarity on the terms of expected operating leverage on that call as well.

Dan Farrell - Piper Jaffray
Okay. All right. Great. Thank you very much.

Scott Wollney - CEO
Thanks for the question.

Operator
Our next question comes from the line of Samir Khare with Capital Returns Management. Please proceed with your question.

Samir Khare - Capital Returns Management
Hi. Good morning. How are you?

Scott Wollney - President, Chief Executive Officer, Director
Good, Sameer. How are you?

Paul Romano - Chief Financial Officer, Vice President
Hi Sameer.

Samir Khare - Capital Returns Management
Good. Thanks. Maybe you have touched on this some already, but can you elaborate on the pricing that you guys are seeing in your core organic book and that varies by geography?

Scott Wollney - CEO
Sure. So as we have confirmed before, we are pricing to below a 60% loss ratio in every jurisdiction what we are writing. That equates to high single digit rate increases in most cases. As we said before too, it is not our intention to provide more granularity on what we are doing in particular areas for competitive purposes, but what I can say is that we are continuing to see opportunities to grow with those kind of rate increases, both in terms of new and renewal business.

Obviously we want to be sensitive to the fact that we want to retain profitable good accounts over time but we think that we will continue to see the kind of opportunities we seen over the last 12 months in the next 12 months, barring some new dramatic change in terms of the competitive environment. We did have a team of people at the TLTA Conference last week, which is the large industry conference of our customers and what they heard was very consistent with the kinds of things we have been communicating in terms of the real increased demand for specialty insurance, value being placed on the types of things that we do particularly from a claim standpoint and no real signs of any significant disruptive new entrants.

So we do think it's going to be a favorable market going forward. Again, for competitive reasons, we really don't want to drill down into exactly what we are doing in specific geographies.

Samir Khare - Capital Returns Management
Okay. That's fair. Maybe you could give us one, I am not sure if it's fair game then, but the CIAB, they seem to be bouncing around, have been for the last few quarters. Does your experience, does it merit that? And is your outlook for placing, is that accelerating in light of many in the industry taking pain in commercial auto?

Scott Wollney - CEO
Right. So I think the short answer is, yes. And I would like to explain, why. So broader commercial auto which the CIAB data you reference, is the broader $27 billion overall commercial auto segment. And it has kind of bumped around. We think it will continue to do so for a little while. A lot of the large generalist commercial auto writers in the last couple of quarters have had some severity challenges related to older accident years, particular 2009, 2010, 2011. And so for those reasons, we are seeing

those companies want to increase their rates generally. How that helps us specifically is really in two areas.

The first, to the extent we have local less sophisticated competitors who are relying solely on industry rate levels like those published or recommended by ISO, as the commercial auto industry generally raises rates, those types of competitors will generally follow. And so the "more naïve" rate levels are going up, which creates broader buoyancy.

The second thing it does is, typically the thing that will really disrupt our market is going to be third-party intermediaries like managing general agents getting access to an insurance company's paper. Typically the type of companies that will support those intermediary distribution channels only begin to do so when they are actually generating a desired return in the larger segments that they focus on consistently across market cycles. So to the extent that the larger generalists are still trying to figure it out, they are less likely to jump into our niche and support these distribution channels that will tend to be price aggressive.

So we regard both of those things as positive and then obviously we are relying solely on our own data and our understanding of the niche market to make sure that we are fully taking advantage of the environment and appropriately pricing to the specialty segment on which we focus.

Samir Khare - Capital Returns Management
Great. Thank you.

Scott Wollney - CEO

Thanks for the question.

Operator
Our next question comes from the line of Ryan Byrnes with Janney Montgomery Scott. Please proceed with your question.

Ryan Byrnes - Janney Montgomery Scott
Great. Thanks. Good morning, guys. I just had a question on claims frequency. Obviously on the personal auto side, there has been some issues there. Obviously their drivers have been on the road more often and obviously your drivers are on the road plenty. But just want to see if the increased congestion on the road is creating any sort of frequency issue in your market as well?

Scott Wollney - CEO
Sure. It's a great question. And it is something that we are paying very close attention to and have been for a number of quarters. In general the larger personal auto carriers who have been articulating concerns about frequency have sort of attributed it to two main areas, one distracted driving and the second lower gas prices causing individuals to drive their cars more. So in our particular niche, our drivers have always been relatively distracted just because of the nature of what they do.

They are looking for passengers. They are paying attention to navigation systems. They are interacting with dispatch bases, et cetera. So we have already built the expectation for some amount of distracted driver frequency into our modeling over the years. As I don't think in terms of accidents caused by our insured, we are going to see as much difference there. In fact, so far we haven't really seen any. In fact, most of our clients are really strong advocates of minimizing distracted driving and making sure drivers aren't texting while they are driving or doing the sorts of things that a lot of individuals and private passenger autos might be doing and hopefully curtailing over time. So that's the first piece.

The second, our customers think of their vehicles as an asset that they want to fully utilize. And so traditionally and today, our customers are going to have those vehicles on the road as much as they can to clear whatever demand there is to ride. And so the price of gas doesn't really cause our customers to drive more or less. It will affect their profit margin. And so it isn't necessarily going to increase utilization of the vehicle. So again, in that area, I don't we are seeing as much of an impact as personal auto insurers are.

But the third potential issue is, if other people are on the road more, those are more people to crash into or be crashed into by. And so that is the area that we are really keeping a close eye on to make sure that the frequency is just up on a macro level. Is there going to be any pressure on our figures. So we really have not seen it, but it is something, as I said, that we are keeping a close eye on.
Ryan Byrnes - Janney Montgomery Scott

Great. I appreciate the color. Thanks guys.

Scott Wollney - CEO
Great question.

Paul Romano - CFO

Thanks, Ryan.

Operator

[Operator Instructions]. Our next question comes from the line of Paul Newsome with Sandler O'Neill. Please proceed with your question.

Paul Newsome - Sandler O'Neill
Good morning. I was hoping you could do a little bit more to quantify what appears to be some elevated expense levels in the third quarter, perhaps to give us a run rate of what you think the expense ratio is roughly speaking at the moment, if you take at some of those timing issues, et cetera?

Scott Wollney - CEO
Sure. I appreciate the question. So on the quarter, obviously we did have some elevated expenses. We reference the fact that part of it was attributable to our rolling out a new policy management system which includes a point of sale interface for our agents. So there were IT and banking fees that were increased because of that. We did a transition of our bank account as part of rolling on to the new system and so are maintaining two platforms in the third quarter.

Starting with the fourth quarter, we will only have a single platform. And then unrelated to that, we have boards and bureaus and other regulatory costs, et cetera that are just timing issues where those costs will ultimately be divided across our full year's earned premium. So all-in, the impact of those expenses were about 1.3% of the other underwriting expense ratio in the quarter.

If we prefer to slide six of the deck that we provided in conjunction with this call, I think the best thing to think about is our year-to-date run rate at this point, which as at September 30 was more like 26.9%. So very close to the 26.5% high end of the 24.5% to 26.5% range we have given. So we do expect, on a full year basis, that we will continue to see underwriting expenses trending to that 26% range or better.

And then I would reiterate the comment we have made before which is, as we continue to see opportunities to grow in that 30% to 50% range, we will be at the end of that target. So while it is our expectation that on an annual basis we should be able to be at the 26.5% target range, we will be on the high end of that range as long as we continue to see opportunities to grow at expanded margins. And that really just comes from the fact that it is more expensive to generate new business than it is to generate renewal business and we obviously want to make sure we continue to deliver a strong value proposition, both in terms of claims as well as the other things that we do because that is what allows us to charge incrementally higher rates relative to a generalist.

So I would say, I would refer people to the annualized number to get a better sense of where we really are today. So that 26.9%, before debt treatment and equity incentive costs, with the expectation that we are going to drive that down to a 26.5% top end of the range in the short-term and then obviously over time, we want to see it go down even further.

Paul Newsome - Sandler O'Neill
Excellent. I have a very quick modeling questions. The outlook for the noncontrolling interest, what would that be?

Scott Wollney - CEO
So that is a vehicle that allowed us to make a nonpublic commercial real estate investment. The overall invested assets by year-end this year are going to be less than 1%. So we did have to break it out because our percent ownership in that LLC is more than 50%. But the actual impact on earnings per share will be less than $0.01. So it will be de minimis from a modeling standpoint in the near term.
Paul Newsome - Sandler O'Neill

Great. Thank you very much.

Scott Wollney - CEO
Great. Thanks for the questions.

Operator
Our next question is a follow-up question from Sameer Khaire with Capital Returns Management. Please proceed with your question.

Samir Khare - Capital Returns Management
Hi. I apologize if you have covered this already, but any plans to change the seeding level of the quota share, one way or another in coming quarters? And my other question is, what are your plans to pay down the note?

Scott Wollney - CEO
So we do not have any intention to change the seeding levels in the fourth quarter, to the extent that we reevaluate that for 2016, we would articulate any expected changes on our next quarterly call. So we do want to be in a habit of articulating any expected changes in advance of those being seen in the financials, but for the time being we don't expect a change there in the fourth quarter.

And then we also are not planning on drawing on the note in the fourth quarter any further as well. So I think for modeling purposes, you can assume that those two capital planning tools, the use of those will remain constant relative to the third quarter.

Samir Khare - Capital Returns Management
Okay. Thanks.

Scott Wollney - CEO

Thanks for the question.

Operator
Mr. Wollney, we have no further questions at this time. I would now like to turn the floor back over to you for closing comments.

Scott Wollney - CEO
Thanks, Christine. Before we wrap up, we would like to acknowledge that tomorrow is Veterans Day and thank all of those who serve and have served our country. We also appreciate everybody on the call joining us today and look forward to speaking with each of you again in the future.

Operator
Ladies and gentlemen, this does conclude today's teleconference. You may disconnect your lines at this time. Thank you for your participation and have a wonderful day.