Atlas Financial Holdings' (AFH) CEO Scott Wollney

2016 Fourth Quarter Transcript

March 14, 2017

Executives

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President, Chief Executive Officer, Director

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Chief Financial Officer, Vice President

Analysts

Sameer Khare - Capital Returns Management

Wally Walker - Hana Road Capital

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Operator

Greetings and welcome to the Atlas Financial Holdings 2016 Fourth Quarter Earnings Results. At this time, all participants are in a listen-only mode. A brief question-and-answer session will follow the formal presentation. [Operator Instructions] As a reminder, this conference is being recorded.

I'd now like to turn the conference over to your host, Scott Wollney, Chief Executive Officer of Atlas Financial. Please go ahead, Mr. Wollney.

Scott Wollney

Thank you very much Rob and good morning, everyone. With me today is Paul Romano, our Vice President and CFO.

This morning we'll discuss Atlas's results, trends and changes within the evolving niche like commercial auto market where we operate and share our expectations in terms of goals and general visibility regarding the future.

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

Paul Romano

Thank you, Scott and good morning, everyone. Yesterday, after market close, Atlas issued its 2016 fourth 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, 2016. 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. So we address a few slides specifically, in general we use this as a Company event. Feel free to follow along as we will follow the basic structure of this document. 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'll begin on Slide 3.

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

Scott Wollney

Thanks, Paul. Throughout 2016 Atlas remained focused on strengthening its market leading position in the specialty light commercial auto sector. There were certainly some challenges in the year, we encountered shifting market dynamics impacting our tax-related insurance policies and also strengthen reserves in certain isolated areas of our business, primarily related to older years [ph].

Once recognized, we addressed these issues in a proactive manner that we feel exemplifies Atlas's transparent approach. We also believe our ability to identify and isolate these issues in a timely way demonstrates our core strength as a hyper-focused underwriter and specific niche markets. Some key underlying factors related to the previously announced reserve strengthening which Paul and I will touch on are highlighted on Slide 3. To be clear, we take responsibility for this issue and the unfortunate impact it had in the short run but hope it serves as a positive example of how our team addresses adversity, learns from it and we'll ensure that it does not dilute the extraordinary value of our overall business.

That said, we can also confidently say that there were more examples of wins than losses in the year operationally. The experienced and dedicated team at Atlas achieved a number of milestones that we believe position us well for strong underwriting performance above our peers in the years to come. Commercial auto insurance overall has been cited as challenging for most large generalist recently. This type of environment creates incremental opportunity for Atlas as a specialist. The foundation we've built coupled with our increasing reach and analytics capabilities position us well to generate outsized returns on deployed capital, especially in the context of current market conditions.

Throughout 2016, we've been taking advantage of favorable pricing trends in virtually all of our markets. We have a high level of visibility to implement rate changes where appropriate and have been doing so. Leveraging the investment we've made in machine learning based predictive analytics, also allows us to better segment relative risk and should maximize the ultimate benefit of rate changes. The company continues to target a better than 60% loss ratio in all areas with a run rate expense ratio excluding amortization of expense related to stock-based incentives within the 24.5% to 26.5% range that we've communicated in the past.

While I'll go into further detail later in the call on our premium makeup and growth expectations, we do feel that it's notable that on a full year basis although Atlas increased its premiums in the face of a market that has seen considerable shifts unlike any other commercial lines of business in the P&C industry. The increased impact of transportation network companies and their significant effect on our markets did reduce taxi premiums during that year. However, as we've mentioned on past calls, we believe this reduction to be shorter term. At the same time the longer term trend is very positive.

Overall, the market for light commercial auto and drivers carrying people and things for money, increasingly dubbed first and last mile transportation is expanding and ultimately that's good for Atlas. We're focused on deploying our unique business model in three ways; first, continuing to grow to a proportionate 20% market share in our traditional niche market based on our strong value proposition while pricing conditions remain favorable. Second, thoughtfully pursuing opportunities to distribute our traditional specialty insurance products and the growing transportation network company based segment. And third, exploring entirely new ways to evolve our product offerings informed by the experience and expertise derived over decades in our traditional business to ensure that Atlas can maximize its opportunity set in this changing environment. We believe that our company is better positioned than any other commercial auto rider to accomplish these three objectives.

For the next few minutes I'll briefly address the recent reserves strengthening that we preannounced last month and about which I've spoken with many of you subsequent to that release. We feel very strongly that we've isolated the issue and that we were open with investors as to both, the cause and the short-term impact that had on our operating results. As a result of the proactive measures we took and are taking, we believe that Atlas is well positioned going forward. I certainly encourage everyone to review the materials we made available on our website in advance of the AFA [ph] Conference last week and the press release we issued last month.

For the 2016 fourth quarter and year-end, Atlas performed a comprehensive review of its reserves. As a result of changing loss payment trends identified through year-end actuarial work, we ultimately decided that it was appropriate to strengthen reserve as at this time. The impact on net income, after-tax and preferred share adjustments related to acquisitions was approximately $17 million. The primary cause of the reserve strengthening was related to increased severity in light commercial auto within the Michigan market for business written and prior acts in years. Certainly unrelated pre-acquisition claims at Global Liberty were also identified as requiring reserve strengthening. The bulk of the net impact on our balance sheet related to Michigan; so I'll provide more detail in that regard.

On Slide 3 we outlined a few of the positive elements at the heart of the issue. On Slide 4, we further explained the analysis around our book, the origination of the challenge, how we proactively address the issue and ultimately how Atlas is positioned going forward. As we referenced before, Michigan had been underperforming for a number of years relative to the rest of our book. As a result, our exposure to the Michigan market was reduced significantly through a combination of rate increases, reduced policy count and most recently, by refocusing claim efforts based on developments in the past year in particular. While some of the macro level causal [ph] issues such as high unemployment in Detroit back in 2012 and 2013 have improved, we do not believe these changes are sufficient to achieve our underwriting profit expectations based on market rates in the state at this time.

As illustrated in great detail in the materials we presented at the AFA Conference, litigation percentages and paid severities in Michigan essentially doubled in 2016 as compared to the prior year. While the relative under-performance was not a surprise as evidenced by our significant actuarially supported rate increases in the past three years, the dramatic increase in paid severity in one year was the reason we felt it was important to strengthen reserves based on our 2016 year-end actuarial work. By the end of 2017 we expect Michigan to be less than 1% of our overall book of business. This doesn't necessarily mean that we're exiting the state to never return; we just understand that as a nimble operator we must focus on properly deploying our capital in states where we can achieve our underwriting goals. There are a number of states where we currently don't write due to environments that we believe will not support underwriting profit at this time for various reasons.

There are also other states that were historically challenged but have improved. In both cases our expertise coupled with an ability and willingness to adjust our exposure based on these changes it's something that distinguishes us from a large generalist. there are no other states or segments in our book of business that show the kind of rate need or severity challenges I just described and the predictive analytics was implemented in the claims area last year would help to ensure that any such trends can be identified even earlier in the future.

Moving forward we are pleased to directly address this issue, do not see any long term impact on our business as a whole and remain very positive with respect to moving forward in achieving our objectives of exceeding industry return on equity by 500 basis points to 1000 basis points. Despite the reserve strengthening taken at the end of 2016 we did improve book value modestly year over year and have maintained a strong rate of book value appreciation with a compound annual growth rate of approximately 12% since the creation of Atlas several years ago. I will now move into a discussion on premiums and the

current state of our markets. We continue to take advantage of favorable pricing trends and many of our markets which have begun to decidedly retrench as evidenced by industry data such as the information prepared by parkways research and the CIA date shown on Slide 5.

As you can see the vast majority of commercial auto business is experiencing accelerating rate increases in recent quarters and commercial auto is the only large segment within P&C insurance that is not softening. Today we're not seeing any indicators of a softening insurance market in our nation either. Also the fact that broader commercial auto writers are facing challenges suggests that the timeframe during which potential price aggressive new entrants such as Managing General Agents will be unable to find support will be extended. We are continuing to achieve sequential rate increases and are targeting better than average accounts to the increasingly sophisticated use of our predictive analytics tools.

On our last call based on feedback from our distribution channel and insured's, we noted that we expected the reduction in available taxes to flatten in a matter of quarters not years. Already we've seen signs that the decline was beginning to moderate towards the end of the year and are now seeing taxi volume flat and with an improved retention of vehicles and force as we move into 2017. Throughout the change in market makeup written by the rise of transportation network companies, we have not compromised our underwriting criteria or return un-deployed capital expectations. Many companies might have been willing to lower price in exchange for increased topline premiums but we've consistently maintained that underwriting profit will always take precedent and we remain firm in this belief.

Our research also suggests that people will have to drive for categories of T&C businesses that do not require commercial auto insurance, tend to do so for less than six months. Those who are or elect to become professional drivers generally transition to a category of service requiring commercial auto insurance or a return to the taxi space within twelve months. We remain patient throughout 2016 and have been pursuing areas where we can benefit from these changes. Where are has been a shift in terms of the sub-segments within our addressable market, we believe that the niche in which Atlas focuses still represents approximately $2.25 billion of the broader $31.3 billion in annual commercial auto premium.

To be clear this figure includes only full time professional taxi, limo, livery and paratransit drivers. Part time drivers who are not commercially licensed are incremental. Based on consumer demand and demographic preference anticipate the overall market size will continue to grow in terms of total vehicles in operation. As regulations continue to evolve across the country and as commercial realities become more clear to both drivers and passengers the size of the market for our products will likely expand further. We're seeing a number of indicators that the headwinds we saw in the taxi space are beginning to settle and growth in the livery and paratransit segments continues. As shown on Slide 6, on a full year basis comparing 2016 to the prior year, premiums from taxi trumped 29% while limo and livery grew 39% and paratransit grew 30%.

The result is a more diversified pool of potential insured's and a larger overall market unlike commercial auto. Our geographic diversification also continues as illustrated on Slide 7. These are good trends for our business and we continue to see pricing games throughout our book. As of December 31, 2016 28% of our book of business was taxi, 36% was limo and livery and 36% was paratransit. As compared to only a few years ago our book of business is now much more diversified both geographically as well as by business sub-segment.

Underlying trends in expectation in this regard are also summarize on Slide 8. We have a high level of visibility to implement rate changes where appropriate and have been doing so. For a number of periods now the company has targeted a better than 60% loss ratio in all areas with rate increases exceeding loss trend. Our expectation is that the 2017 loss and LE ratio should reflect these positive impacts and be at the low end or even below the range of 59% - 61% provided in our preannouncement. As I mentioned earlier

our annual expense ratio target excluding amortize expenses related to share based incentive compensation continues to be in the 24.5% - 26.5% range. As we've communicated in the past we anticipate being in the high end of that range as we grow and should be able to move lower when the markets eventually soften and/ or when we achieve incremental scale efficiency in the future.

2016 was an unusual year it was challenging to manage expenses in the face of the changing dynamics around each but we feel our team struck the right balance of expense control and investment in the future while the typical nature of our business has an impact on that dynamic we will always look for ways to become more operationally efficient while still delivering the strong value proposition that differentiates our business competitively and should allow us to support higher than average price levels at any point in the market cycle and as referenced previously we will never take a price aggressive approach just to move the top line. As the leader in this niche Atlas continues to take a long term broader view to identify means of taking advantage of market dynamics. We've implemented and continue to evaluate analytics and technology to ensure that we can both service and price effectively ahead of market conditions. We are also actively developing products that cater to the evolving needs of new and existing customers and our niche.

Atlas should be well positioned to deliver stronger margins with the goal of always exceeding the industry are we due to this hyper focused. I'll talk more about this after Paul reviews our financial results. At December 31, 2016 our operating leverage as measured by net written premium to surplus was roughly 1.5 - 1 as seen on Slide 9. Managing this ratio is important from a regulatory and rating agency perspective. As I indicated earlier we intend to ensure that this ratio is consistently evaluated to maximize our O.E. overtime. we're confident that there will be opportunities to benefit from the dry powder we have currently gotten our capital structure in terms of both organic and M&A growth opportunities and we feel comfortable with our current capital position.

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

Paul Romano

Thanks Scott. I will keep the quarterly financial overview relatively brief and as always encourage you to reach out to review our filings, our slide presentation and to reach out to Scott or myself with any questions. I will also highlight a number of full year figures which are good indicators of our relative performance. Because there are certain seasons on one time impacts that flow through our quarterly results as a rule we encourage users of our financial information to focus on the trailing twelve month comparison which remains a better overall representation of our results.

As indicated on Slide 11, gross premium written was $52 million dollars in the fourth quarter 2016 representing a decrease of 0.8% in the quarter when compared to 2015. This decrease is primarily due to the reduction of the company's traditional taxi business offset by increases in our paratransit limo and livery businesses. Premium in force as of December 31, 2016 $224.6 million representing 6.6% increase over the premiums and for us at the summer 31, 2015. As mentioned last quarter we have the flexibility to deploy financial tools such as a debt or quarter share reinsurance to adjust our operating leverage in order to maximize our ROE.

We remain in a growth mode based on current market conditions and are committed to finance or companies expansion in a way that optimizes the return on deployed capital. Our quota share reinsurance agreements allow Atlas the flexibility to make changes to section rates on a quarterly basis between a minimum of 5%t and a maximum of 50% of subject written premiums as we deem necessary. As of July 1, 2016 we've lowered the session rate from 15% to 5% of subject written premiums for American country, American service and Gateway insurance companies. The session rate for global liberty remains unchanged at 25% of subject written premium.

We have renewed these agreements for an additional two year period and as a result these agreements will continue to provide the flexibility to adjust the session rates depending on our premium growth. That premium earned increased 5.5% in the fourth quarter 2016 to $44.3 million as compared to forty $41.9 million reported in the fourth quarter of 2015. On a full year basis net premium earned increased by 12.5%. The increase in net premium earned was primarily the result of the timing of the global liberty acquisition in 2015 which was a fact of March 11, 2015 coupled with the increase in net premiums earned from ASI pool companies. Our previously announced reductions in the quarter to reinsurance questions for the U.S.A pool and mid 2016 also had a positive impact in the quarter and as you continue to have a positive impact on net earned premium into 2017.

On slides thirteen and fourteen, we have we lay out the components and comparisons of Atlas's combined ratio for the three months and twelve Months ended December 31, 2016 & 2015. Included in that impact of the prior year reserve strengthening the loss ratio was 135.7% in the fourth quarter 2016 compared to 60.9% percent reported in the prior year period. Without the reserve strengthening adjustments on a full year basis the company's 2016 loss ratio was 59.7%. On a full year basis our expense ratio excluding the impact of share based compensation expenses and the adjustments related to stock purchase agreements, Atlas reported a 26.9% underwriting expense ratio for the twelve months ended December 31, 2016 which is slightly above the high end of our target underwriting expense ratio of 26.5.

Including the impact of prior period reserves strengthening Atlas's total combined ratio for the fourth quarter 2016 was 156.5% compared to 88.2% for the fourth quarter 2015. Excluding the impact of reserves strengthening and stock purchase agreement related adjustments, our full year reported a combined ratio of 102.9% would have been approximately 85% which is a better representation of our run rate expectations for operating results. Atlas generated net investment income of $1.7 million and $1.1 million for the quarter that ended December 31, 2016 & 2015; as well as $206,000 and $183,000 of realized gains respectively. This resulted in an overall and investment yield of 2.2% for the quarter ended December 31, 2016.

Atlas reported in net loss after tax of $13.6 million during the three month period ended December 31, 2016 compared to net income after tax of 4.3%, $4.3 million during the prior year period. Atlas generated loss of a $1.13 per common share diluted for the three month period of December 31, 2016 as compared to $0.34 of common share diluted as reported for the three month period ended December 31, 2015. For reference purposes on a full year basis excluding the impact of the four quarter reserve strengthening adjustments net earnings per share would have been $1.60. We increase book value by $0.36 to $10.54 of December 31, 2016 from $10.15 at December 31, 2015; the details regarding changes in book value in the quarter as shown on Slide 15.

On Slide 16 we've modeled the component, the compound annual growth rate in our book value from year round 2011. We've made pro-forma just wants to allocate the reserve strengthening back to the relevant accident years, which based on these pro-forma adjustments our compound annual growth rate would have been 12.2%. As indicated earlier enforced premium continued to grow to $224.6 million on a year-over-year basis as shown on a Slide 17. 100 premium balances which represent premiums corresponding to the time periods remaining and the underlying in force policies were $113.2 million compared to $108.2 million at December 31, 2015.

Moving to the investment portfolio we continue to push priority on the Preservation of capital support future premium growth. The high quality of our investment portfolio as detailed on Slide 18 and 19, our caption of profit asset of the December 31, 2016 was $224.8 million compared to $233.3 million at December 31, 2015. Our investment duration is 3.4 years and it remains consistent with our anticipated liquidity needs and claim payout patterns and the majority of our holdings are in fixed income securities rated AA or better by SLP.

Because we intend to hold securities to maturity while any increases in interest rates could create an unrealized lost in the short term we would not anticipate such losses to be realized. Working with our outside investment and advisors we monitor positions in our portfolio closely. As indicated on page 64 of our Form 10-K 100 basis point move in interest rates would result in a $5.6 million change in accumulated other comprehensive income.

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

Scott Wollney

Thanks Paul. We have a positive long term view about Atlas's position within the overall commercial auto market and specifically our underwriting performance when compared to that of the market as a whole. As I mentioned previously as a hyper focused specialist we anticipate benefiting from the increasing challenges facing the broader industry. We're seeing the rate increases retrenching as a result of reserve strengthening throughout the industry with commercial auto rates trending up. Throughout 2016 we worked through a considerable shift on our specific market with liberal policies including those written for professional drivers under dispatch by transportation network companies representing an increasing percentage of active public auto vehicles.

We're navigating this shift and are well positioned to potentially see growth increase while still achieving rate levels necessary to ensure our target underwriting profits. Information shared by our distribution partners as well as other commercial auto carriers continues to suggest that the market will follow our price leadership and that there is room for incremental rate change. It seems unlikely that generalist insurers will choose to enter our space to price aggressive channels so long as opportunities for improvement exist in the larger commercial auto segments on which they focus directly.

Slide 21 illustrates the incrementally positive sequential pricing actions we've taken on a quarterly basis since our U.S. I.P.O. in contrast to those recommended by ISO. As you can see while we did moderate to strong rate increases taken in the early part of 2016, we're still pursuing incremental positive rate changes. We've grown our business while still maintaining our focus on improving profitability over the long term and have worked diligently in recent years to implement sophisticated prophecies and predictive analytics to identify both favorable and problematic conditions in our markets faster and more efficiently Furthermore we believe that the investment we've made in predictive analytics and point of sale distribution coupled with our commitment to partner with telematics providers will compound the underwriting benefit that can be achieved based on the competitive environment this year.

We are confident that our business will continue to grow profitably in 2017 as indicated in our third quarter call until we see a clear pattern of marginally less a reductions in the taxi space, we do not plan on providing specific expectations regarding future premium levels. we were going to be a good steward of capital as a critical core competency and as we did in 2016, we will manage the financial tools we control to maximize return on deployed capital at any level. I want to take a few moments to address the use of analytical tools and their impact on Atlas and the insurance industry.

I recently attended an insurance conference and the buzzword was certainly telematics and analytics. A few years ago the budget we're buzzword was big data. we feel that the impact of analytics for a company like Atlas are even more pronounced than those of the broader industry largely due to the highly specialized nature of the company's operations, the relatively high frequency of claims experience Byron sure and the significant repository of segment today that we've been able to accumulate as a result. For outlets the use of data analytics and telematics is not a new trend. Access to decades of data was a key element underlying our acquisition strategy from the beginning.

Our commitment to analytics has always been strong in the past couple years we embraced the machine learning approach which has already begun to prove its power and efficiency. For years we've also been focused on identifying evaluating and partnering with in vehicle technology firms to ensure we understand how their tools can measure an impact risk. this is the focus of our business strategy was featured at our Investor Day last May and will be something we expand on further at this year's meeting. Given Atlas is highly specialized market niche coupled with a large repository of niche specific data across each of our subsidiaries we can deploy these analytics tools in a way that cannot be accomplished by generalists.

While having a significant pricing advantage over smaller less sophisticated and lesser capitalized competitors we began to leverage this advantage in renewal throughout 2016 and are beginning to see the benefit which we anticipate may continue to improve underwriting performance throughout the coming year and beyond. Slide 22 demonstrates the bias towards better than average walks from issue accounts within a normal distribution of premium which is ultimately the desired objective of predictive analytics and underwriting. Slide 23 provides examples of the positive impacts we're already seeing in terms of claims handling which includes faster closure rates, reduced open inventory with high risk attributes and lower allocated loss adjustment expense, as a percentage of indemnity payments.

Also despite our growth over the past few years our overall claim inventory was actually lower at the end of 2016 as compared to 2015 as a result of these initiatives. while there were challenges over the past year Atlas remains committed to the company's previously stated goal of exceeding the P&C industry return on equity by 500 basis points to 1000 basis points going forward based on more recent accident years. As summarized on Slide 24 we have a very favorable outlook. We will remain proactive regarding market changes and expect to leverage our resources to maximize return on deployed capital. I want to specifically thank all of our exceptional employees and partners for navigating the past year in such a manner that leaves the company in a strong position because its growth as a specialty niche writer of light commercial auto. With that let's turn it over for any question.

Question-and-Answer Session

Operator

Thank you. [Operator Instructions] Thank you our first question comes from the line of Bill [ph] with Keaton capital. Please go ahead with your question.

Bill – Keaton Capital

Thank you. A couple of questions, first of all on the big picture front which you pontificate on how rising interest rates might act industry behavior relative to pricing?

Scott Wollney

Sure Bill, it varies a lot by line of business in particular duration of claim out patterns so in terms of the industry you know underwriting behavior is more likely to be impacted for longer tail lines of business where they're holding surplus in the investment portfolio for a longer period of time. in our case our duration is about 3.5 years and so while we will have some down and said from a rising interest rate environment in terms of investment income going forward, where we're investing new premium dollars as they come in and as Paul mentioned there will also be a near term mark-to-market impact in terms of un realized loss us if interest rates go up as well so I think in shorter tail lines of business like commercial auto you probably won't see a significant change in underwriting behavior.

As a result of increasing interest rates it's possible that you might see that in terms of longer tail lines of business and in fact that may be part of what's causing many other segments and property casualty or a

contributing factor. I don't think it's the driving factor but it could be a contributing factor in terms of the softening that you see outside of commercial auto particularly in some of the other long tail lines of business. I think the availability of relatively inexpensive reinsurance and general overcapacity in the industry are probably more significant issues in terms of underwriting behavior but all of those things put a factor.

Bill – Keaton Capital

Thank you and to two additional questions. The new systems and analytics that you're referencing had you had these Two years ago, how would it have led to either a different Outcome or different behavior of Atlas's part in Michigan specifically and then the second question is we discussed the mobile I relationship in New York please?

Scott Wollney

Sure I'd be happy to. so in terms of the analytics specifically focusing on claims, one of the key initiatives with our clients related predictive analytics is to early identify potentially severe clams and be as proactive as possible and bringing them to a favorable resolution. we have always taken the view that our industry requires us to quickly vet a legitimate meritorious claim and from a fraudulent inflated you know or not meritorious where it is claimed and based on which path the claim is on, either bring it to quick and fair resolution if it's legitimate and/or make our insurers a hard target if it isn't inflated or illegitimate claim and so the predictive analytics tools help us to sort of amplify or accelerate how quickly we can do that.

So if we look at the settlement time for claims over $50,000 for example which is a relatively small percentage of our total claims paid. You know it's about 1.5%, 1.5% - 1.6% of total claims paid in general not just in Michigan. You know we were able to reduce the days to settle those claims in 2016 by about 20%. And we've always from a best practice standpoint focused on doing that but the analytics tools give us the ability to do it more quickly and so if you apply that to the issue we saw in Michigan you know as we've talked about and I touched on the call Michigan have been underperforming or doing states specifically actuarial pricing or for the past five years.

Over the last three years that pricing Work indicated we should be increasing rates fairly significantly. we did increase those rates taking the full actuarial indication however it was really that significant increase in paid severity that we saw in 2016 that caused us to feel it was appropriate to increase reserves and so those increased severities might have been seen earlier if we had accelerated the time to close especially for the cohort of large claims earlier in the process.

So it's hard to tell for sure whether or not settlements in 2015 might have shown an earlier indication that we had the analytics tools in place but it certainly couldn't hurt and you know again it is one of the key benefits of focusing on analytics and early, either you know again earlier adjudication or identification of fraud is that it does give us the ability to collect paid data points as early as possible and then use that information to inform both our pricing and our reserving work from an actuarial perspective. The only other caviar I would drill into it there were definitely some macroeconomic issues that drove the exposure in Michigan in particular high unemployment and some other factors you know that that we talked in detail about.

And highlight in the dock for a fall some will go into Q&A but some of those macro level factors ultimately I think we're on a track to simply emerge in terms of lost payment in 2016 so I definitely think it would have helped it probably wouldn't have materially changed how quickly we were able to reduce exposure in Michigan but I think it would have allowed us to do some of the things we're doing now in terms of reacting to those changes even more quickly and so it is it is one of the reasons why we believe the predictive analytics tools are increasing our confidence going forward to something like that wouldn't happen again

and certainly wouldn't have a significant impact that it did in terms of our overall reserves and/or book value.

Bill – Keaton Capital

Great, thank you. And Mobilize?

Scott Wollney

In terms of mobilize, mobilize is an example of a technology provider that we have been working with for a number of years to make sure that we understood how their technology can be used to measure and improve risk related to the types of operators we insure. As was cited in a press release issued a couple of weeks ago, we successfully partnered with them to secure a large provider of vehicles to transportation network drivers in New York recently, and are continuing to work closely to see how we can together improve the quality of which we're insuring and obviously the impact of that is both better safety and risk management but also reduce cost of exposure which would ultimately is could follow from our loss ratio standpoint and also from the operator's cost of insurance standpoint.

So mobilize is not the only in vehicle technology firm that we've been focusing on we actually featured a number of them in our Investor Day last year in fact had some folks from some of those firms there talking about the types of things we're working on together, but it's a great example of - are making sure that we can leverage every resource and in particular new information that we can combine with the historic loss and severity information that we have from the decades of operations that our insurance companies have had in this space, to really come up with the most sophisticated solution, the most confidence in terms of expected cost of loss, and really be a market leader in a need that tends to be under-served.

Bill – Keaton Capital

Thank you.

Scott Wollney

Thanks for the questions.

Operator

Thank you. [Operator Instructions] Our next question is from the line of Sameer Khare with Capital Returns please start with your question.

Sameer Khare – Capital Returns

Good morning. I have few questions, first on the insurance, on the renewal of the insurance arrangements any of the terms and conditions changed or brought in line with expiring.

Scott Wollney

Now it was - it was renewed and while both quarter share and the excess of loss were renewed in line with, expiring in terms of terms-end conditions, on the cost basis on a quarter shares was unchanged and we actually are expecting a slight reduction in cost on the access a loss treaty.

Sameer Khare – Capital Returns

And then you guys show that exhibit on [indiscernible] gross premium to surplus, do you guys run your subsidiary yet, what is - what is the maximum that we should think that you should upgrade under.

Scott Wollney

Two times is sort of the Upward Bound that we've always thought was important to keep in mind from the net written premiums to surplus standpoint for statutory, because we have that statutory operating leverage that regulators in rating agencies look at, and so with the fact of the reserve strengthening we're at about 105 to 1 so still have sufficient room and that is using the minimum 5% quarter share session and the ASI pull [ph] companies and 25% of global liberty. So in that exhibit in the dock we show the growth and then net, so even on a gross basis if we weren't using any quarter share we'd be right below the 2 to 1 and obviously if we saw more significant growth this year than we did last year for example, that would be something if it took that surplus you never in print a surplus ratio up closer to 2, we have the ability to use the quarter share as a way to moderate that.

So it's an important role and we were glad that Swiss reconfirmed that for another two years in the first quarter of this year.

Sameer Khare – Capital Returns

Okay. And for the foreseeable future it sounds like 5% quarter share, you guys will keep it at that level.

Scott Wollney

Yes, and we extract to continue the same protocol that we've used before if we anticipate a change to the quarter share its actions, we would articulate that on the earnings call in sort of before the quarter that we would make the change, but at that point we're anticipating keeping it as is.

Sameer Khare – Capital Returns

Okay. And just on Michigan of the $24 million of adverse development, how much would you say it came from the indemnity side versus defense cost containment.

Scott Wollney

The vast majority of it was related to indemnity. Obviously we did see a big percentage increase in Michigan crimes that were attorney represented, which does or did increase the - allay as a percentage of indemnity there, but the biggest impact was really the indemnity itself.

Sameer Khare – Capital Returns

And is there any evidence that the incidence rate we're getting - trends are changing there and are you guys - how you guys are changing your strategic tact and how you guys are combatting the issues there?

Scott Wollney

Sure. So in 2016 the number of lawsuits we received were equal to 64% of all Michigan claims, and that figure was up about 39% or up from about 39% in 2015, and 35% in 2014. So the attorney representing claims as a percentage literally doubled in a year. And the percentage of open features we have in Michigan, when we look at that - compare that to the national average 63% in Michigan were litigated the national average we have is less than 20% so that's was a significant shift, and it's the only jurisdiction where we see that extraordinarily high percentage of attorney representation on an incoming claims. And in addition

to the much higher percentage of the Michigan claims being attorney represented, the settlement amounts for those claims also increased about 42% in 2016as compared to 2015, the demand amounts or the amounts claimed in 2016 for attorney representing claims increased about 75% year-over-year.

So it's all those things in mind. We definitely have been adjusting our approach to claims handling, we do have Michigan specific adjusters some of whom were promote in that state and the goal is always to achieve the best possible outcome, so I think there are two things that we observed in 2016 that are impacting operational behavior. The first is as we always said if we believe a claim is inflated we are going to use our experience and technology to defend against that claim inflation and unfortunately in 2016 in that state we really saw that the indemnity amounts were simply not benefiting from additional Defense and expertise, and so we are now focusing more on early settlement, again leveraging that with the analytics tools we have and learning from what we observed during the year in 2016 so that we're not effectively throwing good money after bad, so that's one piece.

And then the second is as newer clamps come in the door making sure that they're being treated with the more recent outcomes in mind, to ensure that a claim is either on the right path and or that it's being reserved in a way that we're comfortable, represents kind of the new normal, but all of the things we're factored into the actuarial analysis that was done at year-end 2016 and so we do believe that the reserve strengthening is appropriately conservative. Reflecting both the disproportionate amount of reserves that claims in Michigan used up through the end of 2016, as well as the expected future payment for the runoff of remaining claims, again with the expectation that what we saw in 2016 would not improve from a reserve standpoint, but operationally we're doing everything we can do to achieve the best possible outcome.

So we're optimistic that those things will have a positive impact and that would ultimately be a good factor of course.

Sameer Khare – Capital Returns

Okay, then just average claim cost in Michigan for all your Michigan claims in 2016 and then I guess all your litigated claims in Michigan in 2016.

Scott Wollney

Yes, so to give you some context I mean we in 2016 all coverage combined in Michigan had an average severity paid of about $12,700 for pep which is about half the claims we paid. It was about $24,000. And again, that was up from about $12,315 so a significant increases there. So in terms of the current inventory, at the end of 2016 we had approximately 665 Michigan claims pending about 59% of which were pep, the average reserves per claim were at about 11,000 for perhaps more consistent with 2015, and again those were reserved to a great extent that had been sat in 2014 and 2015 and then about $6,200 for non-pep, so that was before the reserve strengthening, and then as a result of the 2016 reserve analysis we did increase IDNR but not individual case reserves, and the rationale for that is to ensure that our actuaries can best track the runoff of that cohort of claims relative to expectations, but if you divide the gross reserve strengthening by the current open inventory, it would be something like $38,000 per claim, obviously that simple comparison doesn't factor in additional new claims which will come in during the duration of the runoff, but as we show and I think it's Page 6, of the doc we published for the April conference the claim inventory in Michigan is declining both the open Michigan inventory as well as the new claims presented.

So we are confident that the approach we took as I said is appropriately conservative with the total impact of the runoff in mind. And it does seem clear from the data that the high watermark for both open inventory and new claims presented was 2015 we saw settlements accelerating in 2016. And the average days to close is starting to again come down consistent with what we've been able to achieve across our overall book of business. So average days close at Michigan claims of 2016 was about 554. The average age of open claims

is about 412, keep in mind for Michigan in particular these are driven by third party liability claims most of which are attorney represented.

To give just in context the average days to saddle non-Michigan claims in 2016 were 224 days and that number is about 30% better than just a few years earlier, so you can see there is a real difference between what we're seeing in the rest of the country and what we had seen in Michigan, and we are definitely learning from what we've seen and making sure that we can do everything possible to not only isolate that exposure and quantify it, but ultimately deliver the best possible outcome in the face of some of these challenges.

Sameer Khare – Capital Returns

I'll re-queue for the majority of the questions. Thanks.

Operator

Thank you. [Operator Instructions] The next question is from the line of Wally Walker with Hana Road Capital. Please proceed with your questions.

Wally Walker – Hana Road Capital

Thank you and good morning. Just a point of clarification, did I hear Paul say that normalized earnings throughout better term is with average reserve strength that would have been $1.60 in 2016.

Paul Romano

Correct.

Wally Walker – Hana Road Capital

And as you say quote remaining growth mode, I know you're not giving guidance nor am I asking but just that is that a baseline for growth then just as you think about it.

Paul Romano

I think so, I mean we believe that operating expenses as a ratio will be pretty constant again and within the high end of that 24.5% to 26.5% range we do expect loss ratio excluding the effective reserve strengthening in 2016 to be fairly consistent or slightly better than 2017 as a result of the rate activity. Though - and there really were not any significant sort of non-recurring benefits or expenses that didn't sort of generally wash out on a full year basis, so yes, I think it's a reasonable baseline to assume that the growth we're anticipating would build on that level.

Wally Walker – Hana Road Capital

Okay, very helpful, thank you, good luck.

Operator

Thank you. Our next question is a follow up from the line of s Sameer Khare with Capital Returns. Please start with your question.

Sameer Khare – Capital Returns

Just on the year 2016 loss ratio; there is - it seems like there is a true-up in Q4; what was that attributable to?

Scott Wollney

So we did strengthen 2016, an excellent year by about $1.8 million total, which was about 1.1% on the loss ratio. I think part of that was our wanting to just apply some conservatism given that we've strengthened the older [ph] years. So it wasn't a specific isolated issue but again to give us confidence that the reserves were caring going forward a robust.

Sameer Khare – Capital Returns

Thanks. And over there you would expect the business you're writing now into solve ultimately between 59% and 61% loss ratio or even below that range? Do you think that's what you will book X near 2017 at or - or what you guys think of there?

Scott Wollney

Well, we will see how the losses come in I mean as always we want to allow loss development especially early frequency to inform our decisions about how quickly to take the benefit of any rate changes. That we're very confident in the pricing work that's been done, and the positive impact of the predictive analytics but in particular and we think about the potential incremental margin from the use of the predictive analytics and our ability to better select more favorable risks. Because it is a relatively new initiative over the last couple of years, I think we want to be fairly measured in terms of how quickly we take that benefit, so those are the two things I think that we're going to look most closely at in terms of how quickly we start reflecting our target underwriting levels and our actual financial results.

We've commented before the rule of thumb probably 18 months from the time we take the rate initiative to the time it shows up in our financial statements is reasonable, so that lag is not set in stone but that is a pretty reasonable window to give us the opportunity to see claims come in and 98%, 99% of all of our claims in terms of count are presented within 12 months following the end of a given accident year, so we get a really clear idea of the total inventory and then obviously we want to understand expected severity and ultimately determine whether or not we can take the benefit of pricing action, that went into the business return of the accident years.

So I'm not giving you a precise answer, but again we're comfortable when we get the prerelease we are comfortable with that range of 59% to 61% again the full year non-accident 2016 loss ratio is strengthen a little bit and we obviously want to see the positive benefit of the things that we did in 2015 and 2016 come through and that will ultimately determine what we --what we book in 2017.

Sameer Khare – Capital Returns

Okay. And the business that that remains in Michigan is if that - what loss ratio or you guys booking that at. Is that business that you guys ultimately want to keep.

Scott Wollney

So the dynamic there the rating paradigm of Michigan requires actuarial support when we submit rate changes. Which we can do annually and last year our rating increased there was about 60% that was supported by the year-end 2015 actuarial work now we obviously have new actuarial support and are in the process of again submitting a rate increase. Our rates last year were already above the state pool rates and in fact in the April presentation on Slide 6, we show the consistent decline in both vehicles and policies in

force throughout 2016, which I think really was a result of the fact that our price level had gotten at or above the state funds rate, and I think we've made that comment even on causes of certain points last year with an incremental rate increase, I don't think from a practical standpoint we are going to see much retained business.

If we do retain it, it should ultimately deliver a more acceptable loss ratio but again our goal is not going to be to retain business it's focusing on putting a price in the market that would achieve an appropriate return on that to put capital in, again just being realistic we don't expect that we're going to see any meaningful amount of renewals or new business being written.

Sameer Khare – Capital Returns

Okay. And that - and then just on the Mobile-I Technology press release. What kind of near term Talk Line opportunity do you think that will provide for.

Scott Wollney

It's hard to put a number on that specifically but we have been over the last year in particular talking with a lot of operators, especially those who are supplying vehicles to drivers and full time professional drivers in the transportation network space. And that is a real opportunity for us to leverage what we've learned about that technology as well as other in-vehicle technologies. And it's not limited just to the transportation network space out there, I think that the first significant deployment of the Mobile-I Technology that we supported was actually in Las Vegas where we had an account that had a significant incidence of rear end collisions on the strip, and by instituting the Mobile Technology. We were able to see a very meaningful reduction in rear end collisions, which generally resulted at fault claims against our driver, and so there's a pretty broad potential application of that, and so I don't think put a specific number on it is a great example of how our commitment to the concept of telematics has really been one that's - it's been on going and it's now we have sort of planted the seeds over the last few years make sure that we understood which technologies work, which technologies don't, what the relative benefits are. And we can articulate that to our insurers and contemplate it in terms of how we structure their insurance program.

So it's a real world application of the sort of the buzzword that today everybody's talking about, but I think it's really a great example of Atlas as a relatively small company being innovative and nimble [ph] and doing things that ultimately now the whole industry is saying gee I think we need to do that, we definitely want to continue to be on the front end of that curve. And we'll continue to look for opportunities we can - we can cultivate incremental profitable business as a result.

Sameer Khare – Capital Returns

The press release I suppose we saw on the side of a fleet of 4,500 of cars. It seemed - it seemed to reach - you guys had some kind of exclusive deal with them or maybe some research project I can - I can figure out which one, is that is that a program that looking at is it just a research stage.

Scott Wollney

What was referenced in the press release and I don't want to get into the specific details for competitive reasons but the scope of what was described in the press release is describing an account that we were able to successfully secure working together in 2017, so it's not something that was reflected in our gross written printed 2016, but again obviously when we announced our first quarter, we could probably get into some additional detail in terms of the revenue impact it had, but again obviously we don't want to get into a whole lot of detail for competitive reasons, but it is something that is generating or will generate revenue for us in 2017.

Sameer Khare – Capital Returns

Great, thank you.

Scott Wollney

Good questions.

Operator

Thank you at this time I will turn the call back to management for closing remarks.

Scott Wollney

Great, thanks again. As I mentioned earlier we are again this year going to hold an investor day following our annual general meeting that will be scheduled on the morning of May 16, in the Chicago land area more details will be forthcoming as we get closer, but hope many if not all of you can attend, and thanks to everyone for joining us on today's call and we look forward to speaking with you again soon.

Operator

Thank you. This concludes today's teleconference. You may disconnect your lines at this time. Thank you for your participation.