Q3 2016 Earnings Call

Company Participants

- Anne G. Waleski, Chief Financial Officer & Executive Vice President
- Richard R. Whitt, III, Co-Chief Executive Officer
- Thomas S. Gayner, Co-Chief Executive Officer

Other Participants

- Charles Gold, Senior Managing Director
- David McKinley West, SVP of Investments & Co-Head of Equity Research
- Jeff Schmitt, Analyst
- Mark Douglas Hughes, Analyst
- Mark Dwelle, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good morning and welcome to the Markel Corporation Third Quarter 2016 Conference Call. All participants will be in listen-only mode.

During the call today, we may make forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. They are based on current assumptions and opinions concerning a variety of known and unknown risks. Actual results may differ materially from those contained in or suggested by such forward-looking statements. Additional information about factors that could cause actual results to differ materially from those projected in the forward-looking statements is included under the captions Risk Factors and Safe Harbor and Cautionary Statement in our most recent Annual Report on Form 10-K and Quarterly Report on Form 10-Q.

We may also discuss certain non-GAAP financial measures in the call today. You may find a reconciliation to GAAP of these measures in the Form 10-Q, which can be found on our website at www.markelcorp.com in the Investor Information section. Please note, this event is being recorded.

I would now like to turn the conference over to Tom Gayner, Co-Chief Executive Officer. Please go ahead, sir.

Thomas S. Gayner {BIO 1896932 <GO>}

Thank you. Good morning. This is Tom Gayner, and it's my pleasure to welcome this morning to our third quarter 2016 conference call. I'm pleased to report to you that we made solid economic progress during the ongoing extremely competitive conditions that describe the first nine months of 2016. Markel is a diversified enterprise with three engines that drive our economic progress, namely insurance underwriting, investments and Markel Ventures.

As is always the case with the diversified portfolio of businesses, some areas performed better than others. That said, for the first nine months, the aggregate result of comprehensive income of $697 million and book value per share growth of 9% is a result we're proud to share with you.

As is always the case with Markel, we're quick to share challenges and bad news with you, and we're slow to talk about good news. This quarter is no exception to that pattern. We acknowledge to you and more importantly to ourselves where we need to change and adapt and improve. That is what we always do, and that mission of continuous improvement and learning of what has and will continue to drive the excellent long-term results you've enjoyed over the years at Markel.

Joining me in the room this morning are Anne Waleski, our Chief Financial Officer; Richie Whitt, our Co-CEO; and Mike Crowley, our Vice Chairman, and we'll review the numbers in some detail. Richie will cover all of the insurance underwriting operations, then I will cover investments and Markel Ventures. All of us will then be available for your questions.

With that, I'd like to turn things over to Anne.

Anne G. Waleski {BIO 16735457 <GO>}

Thank you, Tom, and good morning, everyone. I'm happy to report that our financial performance through the first three quarters of 2016 continues to be strong across our underwriting, investing and Markel Ventures operations.

While our underwriting results for the quarter were adversely impacted by unfavorable developments on our medical malpractice and specified medical product lines, our year-to-date results are in line with our expectations.

Growth in book value was driven by strong performance in our investment portfolio, and Markel Ventures continues to add significant value through organic growth and the inclusion of CapTech in 2016.

Now let's talk about our results for the first nine months of 2016. Total operating revenues grew 6% to approximately $4.2 billion in 2016 from $3.9 billion in 2015. The increase is driven by roughly 15% increase in revenue from Markel Ventures, which is primarily due to our acquisition of CapTech in the fourth quarter of 2015 and higher sales volume from one of our transportation-related businesses.

Taking a look at our underwriting results, gross premium volume for the nine months ended September 30, 2016 increased 3% compared to the same period of 2015. The increase is attributable to the U.S. Insurance segment and Reinsurance segment, partially offset by lower gross premium volume in our International Insurance segment.

As we discussed in previous calls, the increased volume in the U.S. Insurance segment is due in part to closing our underwriting systems one week later in 2016 as compared to the same period a year ago. Excluding the impact of this timing difference, we've also seen higher volume in 2016 as compared to 2015 within our personal and general liability lines of business. The increase in the Reinsurance segment was due to new business and to the favorable timing of renewals of multi-year policies in our general liability and property lines in 2016.

The decrease in volume for the International Insurance segment was due to unfavorable movements in foreign currency rates of exchange as well as lower premium volume within our marine and energy and credit and surety product lines.

Market conditions remained very competitive. Consistent with our historical practices, we will not write business when we believe prevailing market rates will not support our underwriting profit targets.

Net written premiums for the first nine months of 2016 were $3.2 billion, up 5% from the prior year due to increases in gross volume as just discussed as well as an increase in net retention to 83% in 2016 compared to 82% last year. The increase in net retention for the nine months ended September 30, 2016 was driven by a higher retention within the U.S. Insurance segment and the Reinsurance segment, partially due to changes in mix of business.

Earned premiums were flat for the first nine months of 2016 as compared to the same period of 2015. Our consolidated combined ratio for the nine months ended September 30, 2016 was 93% compared to 89% last year. The increase in the combined ratio was driven by less favorable development on prior year loss reserves, partially offset by a lower current accident year loss ratio in 2016 compared to 2015.

For the first nine months of 2016, prior year redundancies were $339 million compared to $459 million for the same period a year ago. Redundancies on prior year loss reserves during 2016 were net of $71 million or two points of adverse development on our medical malpractice and specified medical product lines.

Additionally, redundancies on prior year loss reserves in the first nine months of 2015 included $36 million or one point of favorable development attributable to a decrease in the estimated volatility of our consolidated net reserves for unpaid losses and loss adjustment expenses as a result of ceding a significant portion of our asbestos and environmental exposures to a third-party in the first quarter of last year.

The 2016 current accident year loss ratio include $26 million or approximately one point on the consolidated combined ratio of underwriting loss related to Canadian wildfires that occurred in the second quarter. These losses were more than offset by lower loss ratios in 2016 as compared to 2015 across a number of products in all three of our underwriting segments.

In our U.S. Insurance segment, prior year redundancies for 2016 were $126 million compared to $211 million a year ago. This segment was impacted in 2016 by adverse development on our medical malpractice and specified medical product lines.

The adverse development on both of these books was driven by an increase in the proportion of business written on classes with higher claim frequencies over the last several years, including correctional facilities and contract physician staffing. Beginning in late 2015, we saw an increase in claims frequency on these classes, which continued into the third quarter of 2016.

We've also begun to see increases in claim payments on these classes of business. While not consistent with our historical trends in these classes, we are now giving more credibility to this new trend and have increased loss reserves accordingly. We are also taking corrective actions for business written in the affected classes.

As a reminder, for the first nine months of 2015, the U.S. Insurance segment included $19 million or one point of redundancies related to the decrease in reserve volatility that I just mentioned.

In our International Insurance segment, favorable development on prior year reserves was $111 million, down from $178 million last year. This decrease in loss reserve redundancies was driven by less favorable development on our marine and energy lines in 2016. Additionally, the first nine months of 2015 included $17 million of redundancies related to the decrease in reserve volatility.

In our Reinsurance segment, we have recognized $90 million of prior year redundancies for the first nine months of 2016 compared to $66 million for the first nine months of 2015. More favorable development on prior year reserves in 2016 was across various product lines, but the most significant year-over-year improvements were seen in our workers' comp and property product lines.

Now, on to the results of Markel Ventures. Revenues from Markel Ventures for the first nine months of 2016 increased to $906 million compared to $784 million for the comparable period in 2015. The increase in revenues was primarily due to the inclusion of CapTech in 2016's results and to higher sales volume from one of our transportation-related business.

We also saw increases in Markel Ventures' net income to shareholders and EBITDA for the first nine months of 2016 compared to the same period a year ago, primarily due to higher sales volume in one of our transportation-related businesses, improved results across our non-manufacturing businesses and the contribution of earnings from CapTech, which were largely offset by the impact of a $10 million contingent consideration adjustment related to CapTech, which was recognized during the third quarter of 2016.

Moving into our investment results, investment income increased 3%, from $271 million for the first nine months of 2015 to $279 million this year. Net realized investment gains for the first nine months of 2016 were $66 million compared to a net realized investment loss of $3 million a year ago.

Given our long-term focus, variability in the timing of realized and unrealized gains and losses is to be expected.

Our effective tax rate was 27% for the first nine months of 2016 compared to 21% for the comparable period in 2015. The increase in the effective tax rate in 2016 compared to 2015 was primarily due to the 2015 impact of foreign tax credit and a decrease in estimated annual earnings attributable to foreign operation that are taxed at a lower rate in 2016 as compared to 2015.

As you may recall, in 2015, we recognized non-recurring foreign tax credits of approximately 8% of pre-tax income. Foreign tax credits of the magnitude recognized in 2015 are not expected in future periods.

We reported net income to shareholders of $323 million in the first nine months of 2016 compared to $385 million a year ago. Comprehensive income for the period, as Tom mentioned, was $696 million compared to $98 million a year ago. And as a result, book value per share at the end of September 2016 was approximately $609, an increase of 9% since the end of 2015.

Finally, I'll make a couple of comments on cash flows and the balance sheet. Net cash provided by operating activities was $324 million for the first nine months of 2016 compared to $550 million for the same period of 2015.

Operating cash flows for 2016 included higher claims payments, primarily in the U.S. Insurance segment, and higher payments for employee profit sharing and income taxes as compared to the same period of 2015.

Our holding company has $2 billion of invested assets at September 30, 2016 as compared to $1.6 billion at the end of December 2015. This increase was primarily the result of net proceeds from the issuance of long-term debt during the second quarter of 2016 and repayment of an intercompany note during the third quarter of 2016.

With that, I'll turn it over to Richie to talk about underwriting results.

Richard R. Whitt, III {BIO 7084125 <GO>}

Thanks, Anne. Good morning, everybody. Today my comments will focus on our three underwriting segments covering the U.S. Insurance, International Insurance and Reinsurance segments. I'll also provide some brief commentary on our Markel CATCo operations.

First, let's start with U.S. Insurance segment. Gross written premiums for the segment were up 4% for the quarter and 6% for the first nine months compared to the same period in 2015. For both the quarter and first nine months, this increase continues to be driven by growth in personal lines, primarily our classic car program and property lines, as well as in our general liability lines, mainly excess and umbrella and brokerage contractors business.

The combined ratio for the third quarter of 2016 was 101% compared to 90% for the same period a year ago. For the nine months, the combined ratio was 95% compared to 89% in 2015. The increase in our combined ratio for both periods of 2016 is driven by the adverse development in our medical product lines, as Anne just discussed.

Our combined ratio for the third quarter of 2016 includes $50 million or nine points on the segment combined ratio of losses resulting from our actions taken during the third quarter in response to the claims trend seen in these product lines. Our product line leaders, underwriters, actuaries, and claims professionals have been working hard taking a look at these books and corrective actions are in place for all classes of business within these product lines.

Of this $50 million of development in the quarter, $37 million or seven points was on prior accident years. For the first nine months, prior years' development on medical lines was $71 million or four points on the segment combined ratio. In addition to this adverse development, we also experienced lower takedowns in our property lines in both the quarter and nine-month results. The current accident year loss ratio increased slightly in the quarter, but is flat for the year due to lower loss ratios across a number of product lines, partially offset by higher attritional loss ratios in our medical lines.

Next, I'll discuss the International Insurance segment. Gross written premiums for this segment are down 5% for the quarter and 4% for the first nine months, due in part to the continued strengthening of the U.S. dollar in 2016. Additionally, we continue to experience tough market conditions, especially within our marine and energy, professional liability and credit and surety lines of business.

The third quarter combined ratio was 91% compared to 87% for the same period a year ago. The combined ratio for the first nine months was 95% compared to 87% in 2015. The increase in the segment combined ratio for both the quarter and nine months is mainly driven by lower prior year redundancies in 2016, most notably in our marine and energy and property lines.

As Anne mentioned, the segment also had a one-time benefit in the first quarter of 2015 related to the decrease in estimated volatility of our net reserves, which contributed $17 million or three points of prior year redundancies last year.

Our current accident year loss ratio was up slightly for the quarter due to increase in our marine and energy product line. This was attributable to the Jubilee Tullow Oil energy loss. This was partially offset by a decrease in management's best estimate of ultimate loss ratios on various product lines, which is also the driver for decrease in the current accident year loss ratio in the first nine months of 2016.

The expense ratio for the quarter decreased three points compared to the third quarter of 2015. This is mainly due to lower profit-sharing expenses as well as the reallocation of some expenses between the International and Reinsurance segments in 2016. These favorable items were partially offset by an increase in broker commissions due to mix of business and a decline in net earned premiums.

Last, I'll discuss the results of the Reinsurance segment for the first – excuse me, for the third quarter, gross written premiums for the segment are down $42 million or 18% compared to the third quarter of 2015. For the first nine months, writings were up $44 million or 5% compared to last year.

For the quarter, the decline is almost entirely due to the renewal of a large multi-year mortgage deal booked in the third quarter of 2015. We also saw some smaller declines in our workers' comp, general liability and auto lines, which were more than offset by modest growth in our property due to both new and renewal increases.

As I've discussed in the last couple of quarters, the growth in premium this year is driven by a few large quota share reinsurance treaties within our property and general liability products as well as the timing and impact of multi-year deals year-over-year.

The combined ratio for the Reinsurance segment was 94% for the third quarter of 2016 as compared to 86% for the same period a year ago. The combined ratio for the nine months was 87% compared to 92% in 2015.

Favorable development on prior year's loss reserves in 2016 was $5 million lower in the quarter, but $24 million higher for the nine months. In the quarter, the decrease is primarily due to some adverse development on professional liability lines. For the nine months, we experienced higher loss reserve takedowns on our property, agriculture, workers' compensation product lines.

The current accident year loss ratio was relatively flat on both the quarter-to-date and year-to-date basis, due to lower attritional loss ratios in 2016 as well as lower ultimate loss picks across multiple product lines in 2016. And this, I think, Anne previously discussed this.

In the first nine months, lower attritional losses were partially offset by the impact of the Canadian wildfires that occurred in the second quarter of 2016. The current accident year loss ratio for the Reinsurance segment includes $21 million or approximately three points of underwriting losses related to the Canadian wildfires.

Finally, the expense ratio for the Reinsurance segment increased for the quarter and the first nine months, primarily due to higher profit-sharing expenses this year as well as the reallocation of expenses between our International and Reinsurance segments that I previously mentioned.

A few other things to comment on. There is very little to add from last quarter regarding pricing and competition. Our markets remain competitive with little change from what we reported to you last quarter. Our view is that Hurricane Matthew is unlikely to change Florida property insurance or reinsurance property - reinsurance pricing or overall property pricing in any meaningful way.

Our own Matthew estimated loss range is necessarily wide, as there are very few reported losses at this point. By the time we release our fourth quarter results, we will have a much better handle on the actual impact from the storm.

We are mercifully nearing the end of insurance conference season. We attended Reinsurance Rendez-Vous, NAPSLO, CIAD (21:51), Baden-Baden, PCI and many, many more. Despite the competitive markets that we've talked about many times, we came away from these meetings with many fantastic opportunities to judiciously grow our business.

Finally, I'll make a few comments about our Markel CATCo operations. Assets under management increased to $3.6 billion at September 2016 from $2.6 billion at the end of 2015. Markel continues to invest $200 million in the Markel CATCo funds.

Markel CATCo recently reported a 3.5% reduction to net asset value related to reserves for the Jubilee-Tullow energy loss. You may recall, in the second quarter of 2016, Markel CATCo reported a 1% reduction in net asset value related to the reserves for the Canadian wildfires.

As of this point, we are currently monitoring the impact of Hurricane Matthew on Markel CATCo's 2016 performance.

That is it for me. And now, I'd like to turn it over to Tom.

Thomas S. Gayner {BIO 1896932 <GO>}

Thank you, Richie. Well, we've got the good news to report on the investment side, and I'd like to add a bit of color to the numbers that Anne shared with you a few moments ago. First, I'm pleased with the equity return of 8.1% through the first nine months of the year. This number exceeds the 7.8% return of the S&P 500 and continues our long-term trend of our performance.

As headline after headline proclaims these days, active management has a tough time outperforming passive approaches like indexing. Our three decades of outperformance stands in ongoing contrast to those headlines though.

Additionally, our costs are so low that we really wouldn't pick up any cost savings by switching the index. Also, indexes are not as passive as you think. Turnover within an index causes taxes to be incurred, while we also regularly realized gainings over the years on our equity holdings. At September 30, we had an unrealized gain on our equity holdings of roughly $2.1 billion from holding on to our successful investments.

To extend some simple math, at a 35% corporate tax rate, that means that we have a little over $700 million in the portfolio that we otherwise would not, if we realized gains more frequently. That $700 million-ish times our 8.1% return means that we made almost $60 million pre-tax income during the first nine months due to our internal control of investments.

We don't farm out our investment thinking. We do it in-house at an extraordinarily low management and tax cost, and that approach continues to contribute mildly to the economic returns of Markel. Secondly, we continue to similarly think for ourselves and act somewhat unconventionally in the world of fixed income.

For the first nine months, we earned a return of 5.1% on our fixed income holdings, which includes the weight of nearly immeasurable returns from our cash in short-term holdings. We maintain pristine credit quality to the best of our ability and we match the duration of our portfolio to our insurance liabilities. Foreign exchange changes netted out to zero so far in 2016.

Our equity holdings moved up from 52% to 53% of our shareholders' equity so far in 2016. While we continue to make additional equity investments in a steady and disciplined fashion, the good news is that our large fixed income portfolio appreciated due to lower interest rates. As a result, increasing the percentage of the portfolio allocated to equities involves chasing a moving target, and that target moved in the right direction. I'm happy to be engaged in that sort of race. When interest rate increase that math will change and the process of increasing the percentage of the portfolio allocated to equities will change as well.

On the Markel Ventures front, in a word, the first nine months of 2016 were fantastic. Operating revenues grew 15% from $784 million to $906 million. EBITDA grew 75% from $76.2 million to $133.8 million. In short, our cyclical business has enjoyed strong revenues and earnings as the management team did a great job of making hay while the sun shines.

Our steady-eddy businesses continue to earn their reputation for steadiness. And it is no small thing to be able to reliably delight your customers and produce dependable earnings from doing so. That's exactly what those companies continue to do.

Finally, we enjoyed improved results in some of the units that experienced weak results in prior periods, and I'm proud of the management teams that made appropriate changes and adaptations to improve their performance.

We continue to look for additional opportunities to grow our Markel Ventures operations, but it remains a sellers' market out there and we remain disciplined in the prices we are willing to pay for acquisitions. Our reputation at Markel Ventures continues to grow along with our success, and we are seeing interesting opportunities that we would've never seen in prior years. We're hard at work meeting people and reviewing opportunities, and I have every confidence that we will find appropriate opportunities to continue to build value as time goes by.

Finally, we've also learned something each and every day as we look at new opportunities, oversee the businesses we currently own and as we look at insurance-based risks and publicly traded investments. In doing so, we gather information and intelligence across the breadth of Markel. This network-based intelligence is more robust than it was in the past, and we continue to work to increase the value we obtain from being immersed in our diverse operations and capital allocation activity. Those activities have been fruitful for our customers, our associates and our shareholders, and they've also been fun.

We thank you for your ongoing support and allowing us to build this company on your behalf, and we now look forward to your questions. Thank you.

Q&A

Operator

Thank you, Mr. Gayner. We will now begin the question-and-answer session. And your first question this morning will be from Jeff Schmitt of William Blair. Please go ahead.

Q - Jeff Schmitt {BIO 19747235 <GO>}

Hi. Good morning, everyone.

A - Thomas S. Gayner {BIO 1896932 <GO>}

Good morning.

A - Richard R. Whitt, III {BIO 7084125 <GO>}

Good morning, Jeff.

Q - Jeff Schmitt {BIO 19747235 <GO>}

Looking at the U.S. Insurance business, it looks like the accident year ratio is up a bit, not a lot, but maybe 60 basis points. I think you'd mentioned, you saw an uptick in frequency and severity in a couple lines, is that correct?

A - Thomas S. Gayner {BIO 1896932 <GO>}

That's correct.

Q - Jeff Schmitt {BIO 19747235 <GO>}

Are you seeing any changes on the litigation front that may be driving that? I mean, is there increased litigation or settlement sizes or anything you're seeing there?

A - Richard R. Whitt, III {BIO 7084125 <GO>}

No, I think it really – one of the strengths of our business, one of the beauties of our business is that we have over hundred lines of business at Markel. And certainly in some, we've seen some frequency or severity, i.e. the medical lines, but it's not across the board.

Q - Jeff Schmitt {BIO 19747235 <GO>}

On the medical lines, you're seeing severity increase there in terms of, what, just the cost of underlying surgeries and so forth, or....

A - Thomas S. Gayner {BIO 1896932 <GO>}

Sure, yeah. Why don't we talk about that for a minute? In the medical lines, I mean, that's an area we've written for decades. And one of the things that has been very interesting about medical over the years is, it tends to move quickly. It can go from being really good to really bad fairly quickly. It can go from being really bad to really good fairly quickly. So it's a line of business that you have to stay on top of.

On top of that, there has been tremendous change. I think, as everybody's aware in just sort of how healthcare is being delivered, the smaller practices, the two, three, four doctors, they've been forming bigger practices, been joining hospital groups, so the landscape has changed.

We have definitely seen some change in frequency in the medical lines as well as some uptick in severity, and that's really what we have been reacting to, particularly in the third quarter, trying to make sure we were on top of those trends that are going on in medical.

Q - Jeff Schmitt {BIO 19747235 <GO>}

Okay. And then, on the competitive environment, you spoke on it a little bit, are you seeing any change in terms and conditions? I mean, are they eroding here?

A - Thomas S. Gayner {BIO 1896932 <GO>}

I think, like I said in my comments, things are, I would say, flattish right now. It's a competitive market. Last year and the years before that, you were seeing bigger decreases. Now, I think things are relatively flat but still very competitive. I don't think people are drastically opening up coverage at this point.

We seem like we've hit sort of – I don't know if it's an equilibrium point, but we've certainly gotten close to it, it feels like.

Q - Jeff Schmitt {BIO 19747235 <GO>}

Okay. Thank you.

A - Thomas S. Gayner {BIO 1896932 <GO>}

Welcome. Thank you.

Operator

The next question will come from Mark Dwelle of RBC Capital Markets. Please go ahead.

Q - Mark Dwelle {BIO 4211726 <GO>}

I just want to build a little bit more – you talked a little bit about the reserve addition in the medical lines. I guess it's surprising to me here, I mean, having followed for a long time, it doesn't normally take you guys two or three bites at the apple in order to get on top of these. What's been different about this that has made it so difficult to kind of get in front of the trends?

A - Thomas S. Gayner {BIO 1896932 <GO>}

Yeah. Sure, Mark. I think part of the issue has been – our actuaries, you have your triangles and you can often see, in the triangles, things starting to change. As I sort of alluded to with the first question, this was a very abrupt change. There wasn't a great deal of warning. All of a sudden, the development factors, the frequency, the severity just ticked up.

And that, I guess, in some way has been the experience in medical, it tends to move quickly when it moves. So we weren't able to sort of see that in our triangles. And one of the questions we've asked ourselves is, what other tools do we need to make sure we have at our disposal such that we're not just relying – not that we just rely on the triangles, but what can we glean from the claims data? What can we see in terms of the mix of business?

Make sure we're using all the tools at our disposal, because believe me we never put a number out in a quarter that we think is wrong. We always try to put out the best number we possibly can. And quite honestly, it's taken us three quarters to get here in terms of getting the numbers where we hope we believe are correct. And that's not the way we like to do things.

Q - Mark Dwelle {BIO 4211726 <GO>}

Okay. One further question on that, if I may. You suggested in the comments that you've taken some underwriting actions, particularly with respect to a couple of particular lines you highlighted. Is that a matter of just raising prices or not writing those lines, or would – maybe just a little more detail about how you adapted to try to seal off the issue?

A - Thomas S. Gayner {BIO 1896932 <GO>}

Yeah, it's really both. There's been some problematic parts of the business that we've identified where we've raised prices significantly. And in some cases, in one of those areas, we've written one account since we've put those actions in place. So, I mean, while we're still in that business, it have to meet our pricing targets.

So, yeah, it's a bit of both. It's tightening up the underwriting standards around parts of the book. It's increasing pricing and it's deemphasizing and remixing the book. So it's a little bit of everything. And as I said, the entire team is involved, and we've got the product line leaders, the actuaries, our information management people as well as our claims folks all working together to make sure we're putting the best plan in place that we can.

Q - Mark Dwelle {BIO 4211726 <GO>}

Okay. That's enough on that then. Now we jump over to Tom. I saw, you have, I guess, the high-class problem of a contingent payout related to CapTech. I recall last time when we had the same thing with Cottrell, there was kind of a couple of iterations to that, are there additional future contingent payouts that they might could possibly earn or is this the only one that's, I'd say, reasonably foreseeable?

A - Anne G. Waleski {BIO 16735457 <GO>}

The CapTech accrual that we've put up for the contingent payment is at its upper limit. So we should not see any additional increases to that in the next quarter.

Q - Mark Dwelle {BIO 4211726 <GO>}

Okay.

A - Richard R. Whitt, III {BIO 7084125 <GO>}

She is correct.

Q - Mark Dwelle {BIO 4211726 <GO>}

Will they be eligible for a – sorry, I over-talked you. Go ahead.

A - Richard R. Whitt, III {BIO 7084125 <GO>}

I'm sorry, go ahead.

Q - Mark Dwelle {BIO 4211726 <GO>}

All right. As you can say, will they be eligible for an additional one next year?

A - Richard R. Whitt, III {BIO 7084125 <GO>}

Yeah.

Q - Mark Dwelle {BIO 4211726 <GO>}

Okay.

A - Richard R. Whitt, III {BIO 7084125 <GO>}

(36:35).

Q - Mark Dwelle {BIO 4211726 <GO>}

It's definitely a high-class problem to have you pay more.

A - Thomas S. Gayner {BIO 1896932 <GO>}

Indeed so, and they do have certain compensation structures in place, so they continue put numbers on the books, they get paid for that. It feels like everybody helps, Mark.

Q - Mark Dwelle {BIO 4211726 <GO>}

We help. And on the tax rate, the tax rate in the quarter was a little bit elevated, is that just because there were a little bit higher blend of capital gains this quarter or was there anything else driving that?

A - Anne G. Waleski {BIO 16735457 <GO>}

No. I think it's mostly coming from the foreign tax – sorry – foreign operations having less projected earnings in a lower tax environment than in the prior period of last year.

Q - Mark Dwelle {BIO 4211726 <GO>}

I guess, I was thinking more in terms of on an absolute basis, so it was 30% in the quarter and not relative to last year. Your longer-term trend is normally kind of 25% or 26% and I guess I was thinking more from that perspective than a year-over-year?

A - Anne G. Waleski {BIO 16735457 <GO>}

Yeah. So, I still think even in the quarter it's mixed, slightly different outcome but same sort of rationale.

Q - Mark Dwelle {BIO 4211726 <GO>}

Okay. I guess, one other – a couple other questions. One, were there any notable catastrophe losses in the quarter? I didn't see any mention of it, but maybe there were some.

A - Anne G. Waleski {BIO 16735457 <GO>}

No.

Q - Mark Dwelle {BIO 4211726 <GO>}

As far as the Matthew losses, Richie, you had suggested some range; that's not a range you're prepared to share at this stage?

A - Richard R. Whitt, III {BIO 7084125 <GO>}

No, we...

A - Anne G. Waleski {BIO 16735457 <GO>}

It's in the Q.

<: It's in the Q.

Q - Mark Dwelle {BIO 4211726 <GO>}

I am sorry, I missed it then.

A - Richard R. Whitt, III {BIO 7084125 <GO>}

That's okay. We put $40 million to $100 million net. The problem we have and everyone else is, we have very few reports at this point. And if you look at the ranges on the various models, it's a pretty wide range. So we're probably relying much more heavily at this point on the models than on actual information from insurers. So we've put a pretty wide range out there. We've tried to be conservative and we certainly would hope to be towards the lower end of it. But it's early days. We'll know a heck of a lot more when we release fourth quarter.

Q - Mark Dwelle {BIO 4211726 <GO>}

Would the losses there be most likely on the U.S. book or perhaps in the reinsurance book?

A - Richard R. Whitt, III {BIO 7084125 <GO>}

It's going to be a fairly wide spread. The U.S. market and Florida in particular is the biggest property market in the world. So, both our U.S. Insurance business will pick it up, our Reinsurance business will pick it up, both Markel Re and in London. So it will be spread around nicely in our divisions.

Q - Mark Dwelle {BIO 4211726 <GO>}

A less high-class problem. That's it for me. Thanks for the call.

A - Anne G. Waleski {BIO 16735457 <GO>}

Thank you.

Operator

And the next question will be from David West of Davenport & Company. Please go ahead.

Q - David McKinley West {BIO 1838548 <GO>}

Good morning.

A - Thomas S. Gayner {BIO 1896932 <GO>}

Good morning, David.

A - Richard R. Whitt, III {BIO 7084125 <GO>}

Hi, David.

Q - David McKinley West {BIO 1838548 <GO>}

It sounded like one area of good news on the redundancy side was workers' comp. Could you talk a little bit more about that line of business, and particularly what you're seeing in current pricing trends?

A - Richard R. Whitt, III {BIO 7084125 <GO>}

Sure. Workers' comp, I think we've said it a few times in past quarters. It's been a bright spot for the last few years. Things have been competitive across the insurance market but workers' comp has been very – done very well. There's always the other side of the coin, because workers' comp has done very well, the states have been reducing the loss cost numbers, and thus prices are decreasing some at the moment.

So, it continues to be a good area. But because of those good results, the base loss costs have decreased and so we're seeing some decrease in the pricing in the various states. But you're absolutely right, Dave, it's been a nice place to be for the last several years.

Q - David McKinley West {BIO 1838548 <GO>}

And a switch in product lines, but sounds like similar things on Hagerty and the antique car lines of business?

A - Richard R. Whitt, III {BIO 7084125 <GO>}

Yeah, Hagerty continues to do just a fabulous job. They are the undisputed leader in the classic car market by a wide margin, and the results continue to be excellent.

Q - David McKinley West {BIO 1838548 <GO>}

Very good. And Tom, it sounds like as far as your approach to equities that the company is continuing that gradual, systematic investment in equities. Are you finding more new names in this market or are you predominately adding to existing portfolio names?

A - Thomas S. Gayner {BIO 1896932 <GO>}

It's a mix; there's probably a few more new names in the course of 2016 (41:53) than have been the case in the past. But it's the steady drip, drip, drip, drip, drip, and we're just trying to wear the opposition down.

Q - David McKinley West {BIO 1838548 <GO>}

Okay. Very good. All right. Thanks so much.

Operator

Our next question will come from Charles Gold of Scott & Stringfellow. Please go ahead.

Q - Charles Gold {BIO 17653874 <GO>}

Thank you, and good morning. I have one question and one comment. The question was asked about Matthew, and Richie, I thought I heard you say $40 million to $100 million net, and the Qs talks about $40 million to $100 million before taxes – before taxable income.

A - Richard R. Whitt, III {BIO 7084125 <GO>}

Sorry, Charles. Got to be clear about my language. Net of reinsurance pre-tax.

Q - Charles Gold {BIO 17653874 <GO>}

Okay, thank you. And then the comment is, I can't help but recall quarter after quarter after quarter, all the questioners were wringing their hands about Markel Ventures but took for granted that you guys knew how to underwrite at a combined ratio in the low-90%s. And here we have the opposite going on. It looks like Markel Ventures is starting to become a beautiful flower blooming after years of hibernation, and everybody has decided that maybe you don't know how to underwrite anymore. So, I haven't given up on the underwriting side. I just wanted to make that comment.

A - Richard R. Whitt, III {BIO 7084125 <GO>}

Neither have we.

A - Thomas S. Gayner {BIO 1896932 <GO>}

Well, thank you, Charles. This quarter – it provides some lessons. I mean, like I said, we have over 100 product lines out there. And the reality is, when you have that many product lines across the specialty insurance spectrum, they're not all going to be hitting on all cylinders at the same time. We have had the good fortune over, I would say, about the last 18 months or so where pretty much they were all hitting on all cylinders.

And this is a reminder that things don't always move in one direction. Med mal has given us some problems this year. I think we are very confident we're on top of it. But it is a reminder to us that you have to stay ever vigilant about these products, especially products for a reason.

Q - Charles Gold {BIO 17653874 <GO>}

Thank you.

Operator

And the next question will be a follow-up from Jeff Schmitt of William Blair. Please go ahead.

Q - Jeff Schmitt {BIO 19747235 <GO>}

Thanks. Sorry, I had one more question. Regarding Markel Ventures, could you speak on the deal pipeline right now?

A - Thomas S. Gayner {BIO 1896932 <GO>}

Yeah. Just to expand on the comments, we see some fascinating stuff just like we have a diverse and eclectic set of insurance risk that we underwrite, we have a diverse and eclectic set of businesses that are part of Markel Ventures. And the very, very, very good news is that now that we have a decade-long track record of buying, integrating and successfully partnering with people who run these businesses, word gets out. And as the old Breck shampoo commercial used to say, they told two friends – he told two friends and they told two friends. So we see some cool stuff.

At the moment, it's a sellers' market. So (45:35) of our range and the beautiful thing about Markel is just, as we are disciplined on underwriting, we're disciplined on buying a stock, buying a bond, buying a Markel Ventures business so we can build up capital, we can look at our own shares. We have a 360 degree view of where and how to allocate capital. And let me emphasize the fact that while it's out of style these days and it's the most contrarian thing you could do, when Anne says we have $2 billion of liquidity at the holding company.

There may come a day when that would really come in handy, and who knows where that will be, but we will stand in a small crowd when that day comes, periodically we've done that from time to time, and that is a core component of the way we think.

Q - Jeff Schmitt {BIO 19747235 <GO>}

Right. Okay, that's great. Thank you.

Operator

And we do have a question from Mark Hughes of SunTrust. Please go ahead.

Q - Mark Douglas Hughes {BIO 1506147 <GO>}

Yeah, thank you. Good morning.

A - Thomas S. Gayner {BIO 1896932 <GO>}

Hey, Mark.

A - Richard R. Whitt, III {BIO 7084125 <GO>}

Hey, Mark.

Q - Mark Douglas Hughes {BIO 1506147 <GO>}

On the favorable development front, anything that you've seen in the last couple of quarters as development in 3Q that would color your outlook for future quarters, you've always had a very consistent attractive track record on that front, anything about when you look at kind of the pricing development in the recent past, kind of how things have been emerging, any reason we should look differently at your prospect in coming periods?

A - Richard R. Whitt, III {BIO 7084125 <GO>}

Mark, it's Richie. I don't think so. We've obviously talked a lot about medical, and we believe we're on top of that. But just as a backdrop, keep in mind, pricing has been coming off for the last few years. And as a result, that would suggest there's not as much margin in the business we're putting on the books today as it was a few years ago. So we all have to remain mindful of that, and we're talking to our underwriters about those sorts of things. But - just other than what we saw on medical this year, no, the trends seem pretty consistent.

Q - Mark Douglas Hughes {BIO 1506147 <GO>}

And on the medical, you had, I think, addressed the legal environment more broadly. You said you weren't seeing meaningful changes. When I think about correctional facilities, for instance, I wouldn't think of that as a very volatile market in terms of how many prisoners are suing, or I'm not sure who initiates the actions in those cases. Was there some sort of precedent that was set and spurred more activity or this is just something...

A - Thomas S. Gayner {BIO 1896932 <GO>}

Well, yeah, two things happened. That has always been a high-frequency class, the correctional medical, in that you saw a lot of claims, but they tended to settle at no cost or at low-cost. And what changed is, it appears that the plaintiff's bar has sort of recognized that as an opportunity. So we've seen some increase in the frequency but we've seen a decent amount of increase in severity.

So, a previous person asked, are we seeing that happen across our various specialty lines? The answer is, no, we're not seeing it happen across specialty lines, but we did specifically see that happen in correctional medicine. And then the other thing that happened, we talked about how the landscape has been changing in healthcare. One of the things that happened is, we saw correctional medicine become a bigger part of our medical book. And we're paying attention to that, but it was a bad time for it to be a bigger part of our medical book. So those are really the two things that happened there.

Q - Mark Douglas Hughes {BIO 1506147 <GO>}

Thanks for the detail.

Operator

And I'm showing no additional questions at this time. I would like to hand the conference back to Tom Gayner for his closing remarks.

A - Thomas S. Gayner {BIO 1896932 <GO>}

Thank you very much for your support. We look forward to catching up with you along the way and we'll talk to you next quarter. Thanks.

Operator

Ladies and gentlemen, the conference has concluded. Thank you for attending today's presentation. You may now disconnect your lines.