Markel to Acquire Alterra - Conference Call

Company Participants

- Marty Becker, CEO
- Michael Crowley, President and Co
- Richie Whitt, President and Co
- Steve Markel, Vice Chairman
- Tom Gayner, President and Chief Investment Officer

Other Participants

- Adam Forsted, Analyst
- Adam McNestrie, Media
- Blaine Marder, Analyst
- Jay Cohen, Analyst
- Joe de Carlo, Analyst
- John Fox, Analyst
- Marcia Breen, Media
- Matthew Berry, Analyst
- Meyer Shields, Analyst
- Ray Iardella, Analyst
- Sachin Shah, Analyst
- Scott Redmond, Analyst

Presentation

Operator

Greetings. Welcome to the Markel Corporation investor call. 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. It is now my pleasure to introduce your host, Mr. Steve Markel, Vice Chairman for Markel Corporation. Thank you, Mr. Markel, you may begin.

Steve Markel {BIO 1433144 <GO>}

Thank you very much. Good morning to everybody. Welcome to the Markel Corporation and Alterra Capital Holdings joint investor call to discuss Markel's acquisition of Alterra Capital, which was announced this morning. A press release announcing the transaction was issued earlier this morning. And can be accessed through the investor sections of Markel's website at www.MarkelCorp.com, or Alterra's website, at www.AlterraCap.com. There's also a slide presentation with additional details regarding the transaction. And I encourage you to look at that. That presentation is available for download at each Company's website. Joining me this morning will be Marty Becker, the President and CEO of Alterra Capital, as well as Richie Whitt, Mike Crowley and Tom Gayner from Markel.

Before we go into the details of this exciting transaction, please bear with me as I go through a longer-than-normal legal disclosure. As a reminder, comments made on today's call may contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements are based on current assumptions and opinions concerning a variety of known and unknown risks. Actual results may materially differ from those contained in or suggested by such forward-looking statements. Please refer to the full disclosure regarding the risks that may affect Markel, Alterra. And the proposed transaction, which may be found in the current reports on Form 8-K filed today by both Markel and Alterra, as well as our most recent annual reports on Form 10-K and quarterly reports on Form 10-Q.

Finally, please note that the following communication is not an offer to sell, or a solicitation of an offer to buy any securities or a solicitation of a vote or approval. We urge investors and security holders to read the registration statement on Form S-4, including the definitive joint proxy statement prospectus and all other relevant documents filed with the SEC or sent to stockholders as they become available, because they will contain very important information about this proposed transaction. In addition, Markel, Alterra. And their respective directors and executive officers may be deemed to be participants in any solicitation of proxies, in connection with the proposed transaction. Information regarding the interests of these participants can be found in Markel's and Alterra's most recent proxy statements filed with the SEC. And additional information regarding their interests will be contained in the joint proxy statement prospectus to be filed by Markel and Alterra.

Okay, enough of that. Thank you, thank you for joining us on such short notice. We understand we have quite a few people on the call this morning. And we appreciate your interest in this transaction. And it is our great pleasure to discuss the transaction. We believe that we are forming a winning combination that creates value for both sets of shareholders, all of our policyholders, as well as all of our associates. The acquisition of Alterra makes Markel a new global leader in specialty insurance and investments, with approximately $6 billion in equity capital, more than $4 billion in projected annual gross premium volume. And an investment portfolio of over $16 billion. With Markel's focus on consistent underwriting profits and superior investment returns, we believe we will build book value per share over the long term. And this transaction will help make that happen.

The transaction is highly complementary, bringing together seasoned and accomplished management and underwriting teams focused on this underwriting discipline. And focused on building shareholder value. In addition, the addition of Alterra's reinsurance and large account insurance portfolios will serve to diversify and strengthen Markel's current book of specialty insurance business. Markel will have a footprint to operate effectively and opportunistically wherever the marketplace permits in specialty insurance and investments, whether those opportunities are in the United States, in Bermuda, London, Europe, Asia, Latin America, or for that matter, anywhere in the world.

Let me share with you some of the key terms of the transaction. Under the definitive agreement, Alterra's shareholders will receive consideration of approximately 0.04315 shares of Markel common stock, plus a cash payment of $10 for each Alterra share. Based on last night's closing, the value of this package was approximately $31. This transaction will be taxable to the Alterra shareholders. And Markel will continue with its United States domicile, as a United States taxpayer. Following the acquisition, Markel shareholders will own approximately 69% of the combined company on a fully-diluted basis, with Alterra shareholders owning approximately 31%. Upon closing, two Directors nominated by Alterra will be added to the Markel Board.

Importantly, we are pleased that this transaction has the support of Alterra's two largest shareholders, Chubb and the Trident Funds, which, along with management and directors, represent almost 20%, after application of voting cut-backs of the Alterra shares voting to support this transaction. We believe the combination will provide stakeholders from both companies with significantly higher long-term value from the greater earnings potential, enhanced scale. And the financial strength of the combined Company. With that, I would like to turn the program over to Marty for his comments. Marty?

Marty Becker {BIO 1450037 <GO>}

Thank you very much, Steve. And let me add my own welcome to all of you on this morning's call. We couldn't be more pleased about the combination of Alterra with Markel. This transaction creates an incredibly strong company in the global specialty insurance and investment marketplace. The demonstrated track record of underwriting discipline in niche market segments by both organizations, along with Markel's proven asset management strengths, should bode very well for all stakeholders.

We have believed and discussed for some time the advantage for our shareholders to have their investment in a more diversified specialty insurance company. The increased size and scale of the balance sheet will enhance the competitiveness of our reinsurance and large account insurance businesses. And enhance our ability to capitalize on global opportunities. Markel has a long history of producing superior results and consistent sustained value creation for its shareholders, with a 20-year compound annual growth and book value of 17%. I don't know of many companies that can match the excellent returns that Markel has demonstrated over such a long period of time. In today's low-yield fixed income markets, Markel's asset management skills add another significant competitive advantage to this firm.

Alterra's Board was very comfortable taking a large proportion of the deal consideration in Markel stock, given their proven ability to grow book value per share on this larger asset base. I am confident that Alterra's clients and other business partners will continue to be well-served when Alterra's underwriting operations join forces with Markel's. And will benefit from the superior financial strength and expanded capabilities of this combined entity. With that, I would like to turn it over to Richie Whitt.

Richie Whitt {BIO 7084125 <GO>}

Thanks, Marty. Good morning, everyone. I'm going to talk a little bit more about the strategic benefits of the transaction. And give some of the operational pro forma highlights. By the end of my prepared remarks, I hope you will see how the combination is attractive for all shareholders, as we create a preeminent global specialty insurance and investment company.

First, Markel will benefit from the enhanced scale and size with a more diversified franchise created by adding reinsurance and large account insurance to our specialty insurance portfolio. Following the merger, Markel will write over $4 billion of premium, of which approximately 50% will be short tail, 50% long tail. 67% will be insurance and 33% in reinsurance. From a line of business perspective, approximately 29% will be property, 23% professional liability, 22% general casualty, 19% in our other specialty lines. And 6% in workers' compensation. Interestingly, these last numbers I just said don't change very much post the acquisition. Those break-outs between property, professional. And general casualty are pretty much the same before and after, just on a much bigger scale.

We'll expand our business platforms from three to five key business segments, with the addition of Alterra's global insurance and global reinsurance segments, led by Alterra's present underwriting leaders. We look forward to welcoming Alterra's talented professionals to the Markel family. The combination will bolster Markel's E&S and London platform by providing scale and additional underwriting expertise. As we went through due diligence, we were particularly pleased to see, in the two areas where we both compete, the E&S and London platforms, they were very compatible books of business. And the overlap was very manageable. So that was incredibly exciting to us. And sort of a bonus, if you will, as we went through due diligence. The deal is accretive to the key performance metrics that we look at hard here at Markel, including book value per share, premiums per share and, very importantly, invested assets per share. We expect to improve our expense ratios through efficiencies, economies of scale. And increased opportunities to write more business.

On the investment side, the application of Markel's investment expertise, as Marty said, should drive earnings higher on the combined investment portfolio of over $16 billion. Our capitalization will be excellent after the transaction. And we anticipate that both our financial strength and senior debt ratings will be affirmed by the relevant rating agencies. We also believe these ratings should improve over time as we demonstrate the risk management skills and profitability of the combined operation. In summary, we believe our improved scale and diversification will drive continued strong operating performance. We're very optimistic about the future outlook for Markel. And our enhanced opportunities to create value for our shareholders. With that, I would like to turn it over to Mike Crowley.

Michael Crowley {BIO 7345383 <GO>}

Thanks, Richie. Good morning, everyone. We are truly excited to welcome professionals of Alterra to Markel. Over the years at Markel, we have built a great Company by a consistent focus and dedication to underwriting profitability. The Alterra professionals have a proven track record of underwriting discipline, very much like Markel. Together we will continue to build and develop profitable lines of business and long-term value.

We think that the Alterra associates, the Markel associates, our investors. And our customers all benefit from this transaction. For Alterra associates, Markel is a permanent home with a long-term. And a long-term-only focus. Great underwriters and insurance professionals have always been the foundation on which Markel was built. We welcome you to the Markel family. And we think this will create a great environment for you to achieve career and personal success.

For our existing Markel associates, we are creating new balance sheet strength and stability. As a direct result of this transaction, we will be able to pursue new business opportunities, expand existing relationships. And to develop new markets and products. For our investors, we're increasing the segments we can realistically participate in to grow and to write profitable insurance. In addition to the expansion of our insurance operations, Tom will touch on the changes possible and our combined investment approach in a minute or two. For our customers and distribution partners, we will be offering a stronger, more substantial balance sheet that stands behind the promises we made to you. And to your policyholders. Also, we can now accept larger and new risks that we couldn't have considered in the past.

The creation of this new Markel creates an exciting global leader in the specialty insurance marketplace. And we look forward to building on the existing legacy of success. With that, I will turn it over to Tom Gayner for a few comments on the growth in the investment portfolio that will occur as part of this transaction. Tom?

Tom Gayner {BIO 1896932 <GO>}

Thank you, Mike. Good morning. I, too, add my welcome to the Alterra shareholder group, as well as our existing Markel shareholders. And perhaps to some of you who may yet to be owners of this company. We look forward to building value for you for many years to come.

The fundamental financial proposition for Markel, for decades, has been to operate an insurance company that generates underwriting profits. When that condition is met, all of the investment income that comes from the investment portfolio is earned by the shareholders of the Company. And drives the creation of value over time. Markel has a long and distinguished history of doing exactly that. And the addition of Alterra increases our ability to do even more. Specifically, invested assets per share for Markel rise from $954 a share to $1,165 when you look at the September 30 numbers. Right off the bat, the amount of investment portfolio per share increases as a result of this transaction.

Secondly, Markel traditionally invests the majority of our shareholders' equity account into equity ownership positions of public and private companies. Today, our equities as a percentage of shareholder capital is 62%. After the close of the transaction, we will begin a process of recasting the Alterra investment portfolio towards our historical practices at Markel. Given the new level of equity capital in place, you should expect to see us allocate capital towards equity investments. And in rough terms, our equity portfolio could double from its current levels over time, as opportunities present themselves. In addition, the opportunities we pursue through our Markel Ventures operations will continue to grow. This new level of capital base allows us to consider larger businesses than we have to date. The increased size and profitability of Markel should increase the opportunity set that we can consider. And we look forward to continuing to build this component with its ongoing earnings power for Markel and its shareholders over time.

This is an exciting and dramatic opportunity for all of Markel, its shareholders current and future, our associates. And those are Alterra that will be joining us, as well as our customers and future business partners. With that, we would love to open the floor at this time for your questions. Thank you, if would you be so kind as to open the floor?

Questions And Answers

Operator

(Operator Instructions)

Our first question is from Sachin Shah of Tullett Prebon. Please go ahead.

Q - Sachin Shah {BIO 15433972 <GO>}

Just wanted to do some housekeeping. As far as some of the conditions, there's a $500 million condition for the cash. I think the presentation says $652 million, is that correct? So we're slightly above that threshold?

A - Tom Gayner {BIO 1896932 <GO>}

Yes.

Q - Sachin Shah {BIO 15433972 <GO>}

In regards to the 80% book value that's needed, in regards to the termination fee, can you walk us through possibilities of that occurring? I also see in the merger agreement, it says that you are carving out earthquakes and hurricanes and things like that. So I wanted to see, aside from those events, how else could we get a book value lowered by 20%?

A - Steve Markel {BIO 1433144 <GO>}

Quite frankly, we are hard-pressed to conceive of what those circumstances might be. The idea is that we all expect to close it as quickly as possible. And that provision is really in the event of some absolutely unforeseen event that could happen. But the expectation is, we're moving very quickly to get this thing closed as quickly as possible. And we think those events are extremely remote.

Q - Sachin Shah {BIO 15433972 <GO>}

Can you maybe give us an example?

A - Steve Markel {BIO 1433144 <GO>}

It's beyond my scope of thought. You can read it and dream.

Q - Sachin Shah {BIO 15433972 <GO>}

Okay, okay. And just one final question about the closing. Is there an estimated timeline for closing? I saw some of the approvals that were needed.

A - Steve Markel {BIO 1433144 <GO>}

We are saying certainly as quickly as possible. And we expect it certainly, most likely in the Second Quarter.

Q - Sachin Shah {BIO 15433972 <GO>}

Like April, or maybe later on in the quarter?

A - Steve Markel {BIO 1433144 <GO>}

It really depends. We want to get a proxy in our shareholders' hands as quickly as possible. And have the meetings as shortly thereafter as we can. It will be in the SEC's hands very shortly.

Q - Sachin Shah {BIO 15433972 <GO>}

Perfect. Thank you.

Operator

Thank you. Our next question is from Amit Kumar of Macquarie. Please go ahead.

Q - Ray Iardella {BIO 16279337 <GO>}

It's actually Ray Iardella asking questions today. Quick question. You mentioned that you are going to remain a US-domiciled company and a US taxpayer. But is this transaction going to favorably affect the tax rate at all? Is all the capital going to be generated and redistributed back to the US?

A - Steve Markel {BIO 1433144 <GO>}

It definitely will not improve the tax expense in the deal. Alterra has enjoyed tax benefits in the past. And they will be less in the future. Our investment philosophy of buying and holding long-term equities. And the ability to buy tax-exempt bonds creates a bit of a tax-free environment in our investment shop. The efficiencies of moving capital around will be greatly expanded by not having sort of the tie-up of capital offshore, the ability of our sales team in Bermuda to physically talk to their customers in the United States is an extreme benefit in our sales and marketing. And building the Markel brand. The Alterra directors who approved this transaction had to fly to Montreal. How inconvenient is that? We're making this more efficient, more effective. And it is going to be good for everybody.

Q - Ray Iardella {BIO 16279337 <GO>}

Okay.

A - Steve Markel {BIO 1433144 <GO>}

Doing business in Bermuda is also expensive in some respects. So there are a number of great people in Bermuda who we hope will stay with Markel. And serve our customers and clients. There are also a lot of ex-pats in Bermuda who will be able to resettle in the United States closer to their homes and their families. So that will be a good thing, as well.

Q - Ray Iardella {BIO 16279337 <GO>}

Okay, I appreciate it. And maybe just one more question and I will requeue. I know at Markel, you tend to have a different sort of philosophy than maybe the industry overall with setting reserves. And I know historically, when you have done some acquisitions, there's sort of been a digestion period, if you will, in terms of reconciling the two reserving methodologies. Could you maybe talk about your reserving methodology versus Alterra's and how they're similar or different?

A - Steve Markel {BIO 1433144 <GO>}

Sure. First, I have to compliment Alterra, because they've been very diligent in managing their loss reserves. And they have shared to some extent, or a significant extent, the Markel philosophy of doing their best to make sure the loss reserves are redundant rather than deficient. We spent a huge amount of time and energy in due diligence. And it is our belief that the Alterra reserves are adequate. And more likely redundant than deficient. The margin of safety, as you point out, however, is not as extreme as Markel has done over the years. And it is expected that at closing, we will adjust the reserves to some extent.

Over a period of time, we will bring all of the reserves to the level that we feel very, very comfortable that Markel's reserves are more likely redundant than deficient. But the Alterra reserves are absolutely adequate. There's absolutely nothing wrong with them. They've done a great job in managing that process. And we will figure out the best way to put the two businesses and to meld the philosophies together. Richie, did you want to add anything to that?

A - Richie Whitt {BIO 7084125 <GO>}

The only thing I would add is, you have seen us run this play before. It's exactly what we've done with all the acquisitions in the past. Over time, we get to the consistent margin of safety that we desire here at Markel. And as Steve said, we were very impressed with what we saw in terms of our due diligence around loss reserves. Obviously we did a tremendous amount of work there.

Q - Ray Iardella {BIO 16279337 <GO>}

Okay, I appreciate all the answers. I will requeue.

Operator

Thank you. Our next question is from Blaine Marder of Loeb Capital Management. Please go ahead.

Q - Blaine Marder {BIO 2501159 <GO>}

Marty, could you give us a sense, if your Board participated in a sort of full process to sell the Company and that indeed sold to the highest bidder. And what comparable transactions might you point us to the in the industry that you would use as a benchmark? Thank you.

A - Marty Becker {BIO 1450037 <GO>}

This is a unique transaction with a unique partner. There are not many companies that can offer the combined organization what Markel did. Our Board did a significant amount of due diligence on Markel at the same time that they were doing due diligence on us. The industry, as you know, has not had many transactions recently. But most of them have been for companies trading below book value. And selling for below book value. So I think the Alterra shareholder should feel very good with the end result that's taking place here.

Q - Blaine Marder {BIO 2501159 <GO>}

Thank you.

Operator

The next question is from Matthew Berry of Lane Five Capital Management. Please go ahead.

Q - Matthew Berry {BIO 16846746 <GO>}

Can I just push you a little more on the reserves? Obviously this is nothing like the Terra Nova acquisition, very different beast. But a transitionary period will be necessary. So do you have a scale of the -- could you give us a sense of the scale of increasing reserves that would be necessary, roughly? And how long that would take?

A - Marty Becker {BIO 1450037 <GO>}

I tell you what. In relation to the size of the transaction, I don't think it's that significant. But we are going to be, obviously, filing the proxy in the next, hopefully next week or so. And so obviously there will be significantly more information when the proxy comes out. So we're working on all those things right now. But I would say in relationship to the size of the deal, not a significant number.

A - Steve Markel {BIO 1433144 <GO>}

I think it's also important to point out it's our belief that virtually all of the underwriting lines that Alterra is writing now, we're very comfortable that the underwriting standards and procedures are generating underwriting profits, with an appropriate reserve being charged. And so the book of business is also very, very solid.

Q - Matthew Berry {BIO 16846746 <GO>}

Okay. That's good to hear. Then, obviously on an operational basis, could you just talk a little bit about what impacts we would expect to see over the next year or couple of years, as you integrate these two businesses, what needs to be done. And what impacts you expect to see operationally?

A - Richie Whitt {BIO 7084125 <GO>}

As we said earlier, these businesses are very, very complementary. Markel operates in three basic segments now. Markel specialty, Markel wholesale. And Markel international. Alterra brings two new segments to Markel, as was mentioned earlier. The global large account business. And the reinsurance business. And I think in terms of a structure, you can think in terms of Markel going forward having five basic insurance operations versus three insurance operations. But again, the businesses are very complementary. We think that it is going to be very reasonable to integrate these companies. And that they're more complimentary than competitive.

Q - Matthew Berry {BIO 16846746 <GO>}

So you don't expect to see any significant hit to expense ratios in the short term?

A - Steve Markel {BIO 1433144 <GO>}

Well of course, we'll have deal expenses that, according to the accounting rules, have to run through the P&L after the deal. So those will be there. But of course, I mean, these are two public companies coming together, clearly. And like we said, there's not a whole lot of overlap in terms of underwriting teams. But, let's face it, it's two public companies coming together. And there will be some efficiencies there. So there will be some severance around those sorts of things. And obviously we'll be very fair to the people. But I think after the first year, we have the opportunity to see some meaningful expense synergies from the deal.

Q - Matthew Berry {BIO 16846746 <GO>}

Okay. That's great. Thank you very much.

Operator

Thank you. Our next question is from Meyer Shields of Stifel Nicolaus. Please go ahead.

Q - Meyer Shields {BIO 4281064 <GO>}

Steve, I guess, to start with the tax issue, because you raised it. And obviously I commend you for staying with your principles, which is as expected. Is there any impact on Alterra's book value retrospectively if they're moving to a US domicile?

A - Steve Markel {BIO 1433144 <GO>}

No. In fact, making the transaction taxable to Alterra shareholders means that on an acquisition, Markel will have sort of a stepped up basis on all of those assets, which will give us a great deal of flexibility in reallocating the capital. And so that was a critical element in making this transaction work.

Q - Meyer Shields {BIO 4281064 <GO>}

Okay. Then more strategically, I guess, I know you've gone through the One Markel strategy. And most of that work is behind you. Does anything like that have to be applied to the Alterra book of business?

A - Steve Markel {BIO 1433144 <GO>}

Not the same way at all, because the number of businesses, the Lloyd's business and some of the US wholesale businesses will fit neatly in what we're doing. And as Mike pointed out, we're adding two meaningful new segments to Markel. But there's a huge opportunity to rebrand those businesses with Markel. While Alterra is building a good brand, it's a very new brand that came into being just two years ago with its merger. And so creating a new brand with the capital base Markel has and the relationships we have, we really do expect that the One Markel brand will be bigger and better, in a different context from the reorganization we did in the US wholesale business.

Q - Meyer Shields {BIO 4281064 <GO>}

Okay. There was guidance for a Sandy loss estimate for Markel in the 8-K this morning. Is there any number available?

A - Steve Markel {BIO 1433144 <GO>}

Actually it was in the 8-K, Meyer. We put out an estimate of $75 million to $125 million. That is net of reinsurance, includes reinstatements. But is gross of tax.

Q - Meyer Shields {BIO 4281064 <GO>}

That's legacy Markel, not Alterra?

A - Steve Markel {BIO 1433144 <GO>}

Correct. That's Markel. Alterra also put out a release, I believe, in their 8-K, didn't they? I'm looking at Mike Jones. Marty?

A - Marty Becker {BIO 1450037 <GO>}

We did. We put out a release in a range of $90 million to $120 million.

Q - Meyer Shields {BIO 4281064 <GO>}

Perfect. Thanks very much.

Operator

Thank you. Our next question is from Scott Redmond of Redmond Asset Management. Please go ahead.

Q - Scott Redmond {BIO 18452590 <GO>}

Has Alterra ever been in the equity portfolio?

A - Tom Gayner {BIO 1896932 <GO>}

Scott, it's Tom Gayner. Not meaningfully, no. This will be the opportunity to reallocate what is now a $16 billion portfolio.

A - Steve Markel {BIO 1433144 <GO>}

The question was, have we ever owned alter reign our equity portfolio, I think. And the answer is no.

Q - Scott Redmond {BIO 18452590 <GO>}

Okay. So you wouldn't buy it for the equity portfolio. But you would buy the whole company. So it seems that Markel is growing past this phase where it was a predominantly niche-y company, diversified by niche, where Markel Ventures had niche investments that had been growing to become a very meaningful contributor to the Company. And now it's kind of grown past that into a global stage where your competition is a little different than golfers trying to make holes in one.

A - Steve Markel {BIO 1433144 <GO>}

I think it's an interesting point, certainly one we talk about a lot, because we still think of our insurance business as being a specialty insurance business. And the acquisition of Alterra does not change that one bit. If you look at this transaction in the context of Markel increasing our premium volume from $2.3 billion or $2.4 billion to something north of $4 billion, it's a big deal. And there's no doubt about it, it's a big deal for Markel. Our capital is going from $4 billion to $6 billion. So it's a meaningful deal for Markel.

If you look at the $550 billion insurance industry. And that's just in the United States, I don't know what that global number would be, we're still a pipsqueak. And there are huge, huge specialty operations and opportunities long, long before we have to worry about being branded as a commodity insurance company. And I don't see that happening for quite, quite, quite, some time. We'll stick to our specialty products and we'll look for niches where we can add value and be a market leader in the context of providing the greatest customer service and solving unique problems for our customers. Just on a larger playing field.

Q - Scott Redmond {BIO 18452590 <GO>}

You mentioned Chubb being a willing seller. What sort of advantage do you have in your thinking over them?

A - Steve Markel {BIO 1433144 <GO>}

Well I shouldn't try to speak for Chubb. They became a shareholder of Alterra because they were large shareholders in Harbor Point, which merged with Max to form Alterra a couple of years ago. They own a chunk of Alterra as a result of, legacy-wise, creating Chubb Re, which was merged into Harbor Point. Marty may want to comment further on Chubb. But I'm hopeful that they would like to be a long-term loyal Markel shareholder and continue to hold some of the stock in their equity portfolio. But it's really up to Chubb. Marty, do you have anything you would want to add to that?

A - Marty Becker {BIO 1450037 <GO>}

Steve characterized it exactly right. Chubb Re was the foundation of the formation of Harbor Point. Chubb received their equity ownership as part of that transaction. With the merger with Max, they were very delighted to hold on to their shares. But it was always a passive investment. It was never considered to be an operating investment by Chubb or its senior management. And for them to be supportive of this transaction is just an acknowledgement on their part that they think the combined Company will be a superior one.

Q - Scott Redmond {BIO 18452590 <GO>}

Thank you very much.

Operator

Thank you. Our next question is from John Fox with Fenimore Asset Management. Please go ahead.

Q - John Fox {BIO 18976738 <GO>}

I have three questions. First, how is the cash portion being financed?

A - Steve Markel {BIO 1433144 <GO>}

John, the way the cash is going to be dealt with is $500 million from Markel's holding company. And $500 million from Alterra's holding company.

Q - John Fox {BIO 18976738 <GO>}

Okay. And if I recall, you had about $1.1 billion at the holding company at 9-30, at Markel?

A - Steve Markel {BIO 1433144 <GO>}

That sounds about right. Ann is shaking her head.

Q - John Fox {BIO 18976738 <GO>}

Okay. Number two, when I look at Alterra's financials, it looks like they used a fair amount of reinsurance in terms of gross and net written. Markel is retaining 89% of what you write. So do you anticipate any changes there?

A - Steve Markel {BIO 1433144 <GO>}

John, thank you for pointing that out, because we see that as a huge opportunity. Yes. We do see changes over time. It won't be on day one. But I think you would see retention start to look more like Markel's. Now, I can't promise they get up to the 88%, 89%, 90% sort of range, because these are different profile types of businesses. But Alterra, given their size and how long they have been in business, they were prudent in terms of what their net retentions were. The bigger organization, the new Markel, we can take bigger net. So we see that as a big opportunity.

Q - John Fox {BIO 18976738 <GO>}

Okay. And last question is, could you talk about the change in the catastrophe risk profile at Markel, given the addition of the reinsurance business and kind of what is an acceptable amount at risk. So to speak?

A - Richie Whitt {BIO 7084125 <GO>}

Right. Well probably the easiest way to say it is, it is going to be halfway between what Markel is today and what Alterra is today. And I think Alterra, in their filings would tell you how much of their shareholders' equity they're willing to expose. And we're in the he low teens in terms of what we're willing to expose. This transaction will move it sort of to the middle of those two numbers. And then we're going to evaluate. And you know what? We're going to be very opportunistic. We're dog see what the markets look like and what the pricing environment is. And that will dictate how much catastrophe business we can write. But we clearly, with a $6 billion balance sheet, will have a bigger appetite than we did as Markel.

A - Steve Markel {BIO 1433144 <GO>}

Yes, I would like to add just one thing. We've spent a lot of energy around this issue throughout the process. And one of the really strong points of Alterra is that they have consistently had very, very strong risk management in the cat area. They have -- their property cat systems are recording their exposures very efficiently and effectively. And they have an extremely good process to manage their catastrophe exposure. If you look back over time at Alterra's track record, relative to the other Bermuda companies, these guys have well out-performed their peers in the exposures that they have taken on. Marty, it's an opportunity, I think, for you to share some of what you guys have done so well with John.

A - Marty Becker {BIO 1450037 <GO>}

Sure. Our teams, over all the big events in the past few years, have shown themselves to be extremely good at picking their way through the marketplace. And if you look at the table of results, we've always been on the lower end, in terms of capital lost in any kind of major event. And at the same time, well-positioned to take advantage of the uptick when prices change. I think the other skill that we bring to the table that can only be enhanced with Markel's capabilities is our ability to use third-party capital. We're on New Point V now as a managed sidecar vehicle. The demand for third-party capital to find product in the marketplace is greater today than ever. And I think you will see more opportunity on that front in the future. So we feel real good about what this can mean for our participation in the property cat space.

Q - John Fox {BIO 18976738 <GO>}

Okay. Thank you.

Operator

Thank you. Our next question is from Jay Cohen of Bank of America, Merrill Lynch. Please go ahead.

Q - Jay Cohen {BIO 1498813 <GO>}

Thank you very much. I guess on the expense savings, you mentioned it could be significant after the first year. Could you give us a quantification of that? What kind of a range are we talking about?

A - Richie Whitt {BIO 7084125 <GO>}

Well I hate to get into specifics right now. But I mean, we think it could be 1 point or 2 on the combined ratio. 2013, obviously, the deal has got to get closed. We'll have a lot of severance, excuse me, there will be some severance obviously. But we will have change in control payments, we'll have lots of deal related expenses. But in 2014, I think we've got a real potential to have 1 point or so on the expense ratio.

Q - Jay Cohen {BIO 1498813 <GO>}

That's helpful. The pro forma book value that you showed, that doesn't take into account some of these deal expenses, I assume, or P-GAAP adjustments?

A - Richie Whitt {BIO 7084125 <GO>}

I'm sorry. Can you repeat that one?

Q - Jay Cohen {BIO 1498813 <GO>}

Yes. You showed a pro forma equity or book value figure in the slide deck. And I assume that doesn't incorporate any of these extra deal expenses or any accounting adjustments that have to be made on the acquisition.

A - Richie Whitt {BIO 7084125 <GO>}

No, no, no. That would be sort of day one or day zero, quite honestly. In fact, the way that number is built, taking Markel's 9/30 book shareholders equity and simply adding the stock that would be issued in the transaction.

Q - Jay Cohen {BIO 1498813 <GO>}

Great. Let's see. I guess when I think about the cost associated with the cash, I assume it's relatively low, you wouldn't have to raise any debt for this $1 billion-plus cash payment, is that correct?

A - Richie Whitt {BIO 7084125 <GO>}

No. We don't need to raise any debt for this.

A - Steve Markel {BIO 1433144 <GO>}

We'll give up the yield on those three-month treasury bonds.

Q - Jay Cohen {BIO 1498813 <GO>}

All right. Thanks a lot.

Operator

Thank you. Our next question is from Adam Forsted of Locust Wood Capital. Please go ahead.

Q - Adam Forsted {BIO 16483276 <GO>}

I apologize if I missed it, can you just run through again what the break-up fee is as well as what the required regulatory approvals?

A - Richie Whitt {BIO 7084125 <GO>}

Breakup fee is $94.5 million, 3% of the transaction. Regulatory approvals, they're the ones you would expect. Obviously Bermuda, the insurance companies in the US, some various other locales, due to where Alterra operates and Markel operates. We don't foresee any problems.

Q - Adam Forsted {BIO 16483276 <GO>}

Great. Thank you very much.

Operator

Thank you. Our next question is from Marcia Breen of The Royal Gazette. Please go ahead.

Q - Marcia Breen

I heard a couple different callers ask about the meaning of a US-domiciled company. And you talked a bit about it being expensive business in Bermuda and giving some Alterra employees the opportunity to resettle in the US. Could you please talk about the future of Alterra's Bermuda operations?

A - Steve Markel {BIO 1433144 <GO>}

We believe that Bermuda is an important insurance center and will always continue to be one. For Markel, of course, it will be less important as a corporate home office, because of the redomicile of that operation to the US. But I think Bermuda will always be a place and marketplace for the insurance industry. And we will always continue to maintain, I hope, a very, very significant presence with underwriting expertise in Bermuda to respond to clients' needs. But I think the acquisition does create a lot of flexibility, for especially for the US clients who are doing business there. And creates a flexibility that will allow our underwriters in Bermuda to actually visit their clients in the United States, which was sort of outside the scope of what was permitted to try to maintain the tax-free nature that Alterra had to keep.

A - Marty Becker {BIO 1450037 <GO>}

Steve, if you can let me add on to that, this is Marty, if you look at the other companies that have redomiciled from Bermuda, whether it's Ace or XL or Allied World, the significant underwriting presence which has remained in Bermuda is quite extensive. And we would expect a similar treatment out of this transaction.

Q - Marcia Breen

So you anticipate maintaining most of your staff here?

A - Marty Becker {BIO 1450037 <GO>}

We anticipate having a very robust underwriting operation in Bermuda.

Q - Marcia Breen

Great. Thank you very much.

Operator

Thank you. The next question is from Amit Kumar of Macquarie. Please go ahead.

Q - Ray Iardella {BIO 16279337 <GO>}

Thanks for taking the follow-up. But all of my questions have been answered. Thanks again.

A - Steve Markel {BIO 1433144 <GO>}

Take it easy.

Operator

Thank you. The next question is from (Joe de Carlo of Logan Circle). Please go ahead.

Q - Joe de Carlo {BIO 17905230 <GO>}

Just really quick, what does Markel plan to do about Alterra's debt? Are you guys going to assume that debt?

A - Steve Markel {BIO 1433144 <GO>}

Yes.

Q - Joe de Carlo {BIO 17905230 <GO>}

Okay. And who would the guarantor be in that scenario? Is it just going to be where Markel is issuing now, or is it going to be in a different kind of intermediate holding company structure?

A - Steve Markel {BIO 1433144 <GO>}

We would probably look at it and come up with the simplest method for SEC reporting. I think the public debt most likely over time Markel will guarantee. So that we won't to have continue Alterra's separate SEC reporting company.

Q - Joe de Carlo {BIO 17905230 <GO>}

That's it then. Thanks.

Operator

Thank you. Our next question is from Adam McNestrie of Insider Publishing. Please go ahead.

Q - Adam McNestrie

Excuse me if I'm going over ground that was covered. I came on the call quite late. I wanted to ask, I was looking over your latest 10-K, the latest 10-K. And in 2011 for Markel the effective tax rate was 22%. I'm curious to know, because I know you must have run these numbers. How much money is being left on the table just in terms of straight tax expense as a consequence of not off-shoring the business?

A - Richie Whitt {BIO 7084125 <GO>}

The structure will change over time. So that there's no answer to that question. To go out of your way to cede US premiums to a Bermuda affiliate to avoid US taxes. And you're paying excise taxes and other things, will be reduced. So there will be benefits as well as tax costs. The point you made, I think, is a good one. Our tax rate is 2011 was positively improved because we have a meaningful part of our investment portfolio in tax-free municipal bonds. We have a meaningful part of our investment portfolio in common stocks, where our total return and capital appreciation, the taxes are deferred for years and years and years. And so the whole philosophy Markel has around building book value per share over the long term makes the current tax rate a much, much smaller obstacle in looking at this transaction.

Q - Adam McNestrie

But I presume that if it were, if you did merge into Alterra in Bermuda, you wouldn't be paying over 20% effective tax rate. I'm sure there are other various sundry benefits.

A - Steve Markel {BIO 1433144 <GO>}

It would be impossible almost for Markel to merge into Bermuda and retain any sort of tax benefit. Number one, the transaction would become fully taxable to all of the Markel shareholders, which would be totally impractical given the very low cost basis is that most long-term Markel shareholders have. Furthermore, the relative sizes of the two institutions would have made the transaction extremely cumbersome. So it really wasn't a practical option. More importantly --

Q - Adam McNestrie

Sorry, I was under the impression that you could do it so long as Alterra shareholders have more than 20% of the ownership of the new entity.

A - Steve Markel {BIO 1433144 <GO>}

The hoops and mechanics just are so impractical. And it's not of interest to us. The more important thing is sustain a philosophy of building shareholder value over the long term. That's what this is all about.

Q - Adam McNestrie

Okay. Thank you very much.

Operator

Thank you. We have no further questions in queue at this time. I would like to turn the floor back over to management for any closing remarks.

A - Steve Markel {BIO 1433144 <GO>}

Well I would like to thank all of you for participating in our call today. We look forward to welcoming the Alterra shareholders, as well as the associates and clients of Alterra to the Markel family. We hope that if you have any further questions or comments, we would love to hear from you. We're always open to questions and comments.

We will be working to get a proxy out as soon as we can. And encourage you to read that when it is available. And we appreciate the long-term support of our Markel shareholders as well. And look forward to successful transaction here. Wish everybody a happy and healthy holiday season. And we'll look forward to talking to you soon. Thank you very much.

Operator

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