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Q1 2020 Earnings Call

Company Participants

- Jeremy Noble, Senior Vice President and Chief Financial Officer
- Richard Whitt, Chief Executive Officer
- Thomas Gayner, Chief Executive Officer

Other Participants

- Jeff Schmitt, Analyst
- John Fox, Analyst
- Mark Dwelle, Analyst
- Mark Hughes, Analyst
- Phil Stefano, Analyst
- Ronald Bobman, Analyst
- Unidentified Participant

Presentation

Operator

Good morning, and welcome to the Markel Corporation First Quarter 2020 Conference Call. All participants will be in listen-only mode. (Operator Instructions). After today's presentation, there will be an opportunity to ask questions. (Operator Instructions).

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 opinion 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 can find the most directly comparable GAAP measures and a reconciliation to GAAP for these measures in our most recent Form 10-Q, which can be found on our website at www.markel.com in the Investor Relations 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.

Thomas Gayner {BIO 1896932 <GO>}

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Good morning, and thank you. Welcome to the Markel Corporation First Quarter Conference Call. My name is Tom Gayner, and I'm joined today by my Co-CEO, Richie Whitt; and our CFO, Jeremy Noble. While the nature of this call is financial, I want to start by thanking the people on the front lines. I want to thank the people who are manning our hospitals, our grocery stores, our utilities and countless other essential elements of our lives. I want to thank those. It may not be in the headlines but who keep supply chains working. In many cases, the people of Markel provide many of the essential products and services I speak of and I want to take this opportunity to thank them for doing so.

At the beginning of the year, we started with excellent operational momentum in our diversified insurance investment and ventures operations. We entered the year with a conservative balance sheet, marked by high quality fixed income holdings, no near-term debt maturities and a publicly-traded equity portfolio that stood at 69% of shareholders' equity. Those equity securities had a cost basis of $3.3 billion and a market capitalization of $7.6 billion at that time.

In mid-March, conditions changed suddenly and dramatically. COVID-19 driven shutdowns of the economy started to take place. Since that time, COVID-19 has come to dominate just about every aspect of life and Markel is no exception. Our focus has been and will continue to be on building Markel over the long term. That said, current conditions must be addressed. We're making daily and continuous decisions as we navigate through this historic time and we'll do our best to keep you informed of our progress as we do so.

During today's call, Jeremy will update you on our numbers, Richie will discuss conditions in our Insurance operations and I'll return with comments about our investments and Ventures operations. Following our brief comments we will attempt to answer your questions.

With that, Jeremy.

Jeremy Noble {BIO 20687803 <GO>}

Thank you, Tom, and good morning everyone. I'd be remiss if I didn't take a moment and echo Tom's sentiments of thanks and appreciation. First to medical professionals, frontline workers and public servants for courageously and tirelessly taking care of our communities. I'm equally grateful to our employees around the globe. I've been impressed at how they are taking care of their families, customers, distribution partners and each other during these unprecedented times. So again, thank you.

As you heard from Tom and on our earnings announcement, our consolidated quarterly performance was heavily influenced by COVID-19 and the adverse impact it had on both the asset and liability sides of our balance sheet, effects which can be seen in the results of our insurance and investment engines. Looking at our underwriting results, gross written premiums were $1.9 billion for the quarter compared to $1.7 billion in 2019, an increase of 13%. This increase was almost entirely due to our insurance segment, which reported gross written premiums of $1.4 billion, an increase of 19% compared to the 2019 period.

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This growth related primarily to increased writings within our professional liability and general liability product lines. Gross written premiums within our Reinsurance segment were consistent with the 2019 period by just over $500 million. Retention of gross written premiums decreased to 85% from 87% in 2019, driven by lower retention within our Reinsurance segment, resulting from purchases of additional outwards protection on our property product lines as we seek to effectively manage capital and reduce volatility around catastrophe exposures.

Earned premiums increased 11% to $1.3 billion in 2020 due to higher written premium volume in our Insurance segment. Our consolidated combined ratio for 2020 was 118 compared to 95 in 2019. Here's where we begin to see the effects of COVID-19 on the liability side of our balance sheet. During the quarter we recognized our best estimate, pre-tax net losses and loss adjustment expenses of $325 million for COVID-19. These COVID-19 losses increased our consolidated combined ratio by 24 points. So if you do the simple math, the consolidated combined ratio prior to the effects of COVID-19 was 94. These reserves were established after detailed policy level reviews, as well as a review of our enforce inwards and outwards reinsurance contracts. In those instances where we identified COVID-19 as the approximate cause of loss, we established loss reserves in the first quarter of 2020.

Our losses from COVID-19 are primarily attributed to the business written within our International Insurance operations and are primarily associated with coverages for event cancellation and business interruption losses in policies where no specific pandemic exclusions exist. Through the inherent uncertainty associated with our assumptions around COVID-19 which among other things include assumptions related to coverages, liability, reinsurance protection, duration and loss mitigation factors, as well as the fact that the economic impact of a pandemic continue to evolve, our estimates may be subject to a wide range of variability.

Excluding the effects of COVID-19 our current accident year loss ratio is higher year-over-year due to slightly higher attritional loss ratios in both our Insurance and Reinsurance segments. We have yet to reflect meaningful benefit from rate increases we've been achieving. With regards to the prior year loss reserve development, consistent with our loss reserving philosophy prior year loss reserves developed favorably by $104 million in the current quarter compared to favorable prior year development of $70 million in the first three months of 2019.

Next, I'll touch on our program services and ILS operations, both of which are included in the results of operations-- I'm sorry, results of other operations. Gross written premium volume for our State National program services operations was down 28% to prior year driven by the run-off of one large program and the cancellation of an in-force book of policies related to another large program, which resulted in the one-time unfavorable premium adjustments. As a reminder, almost all of this gross written premium is ceded. Ceding fee revenues were up 4% from last year due to growth in the program premium volumes during 2019.

Turning quickly to our ILS operations. Our combined ILS operations have roughly $12.5 billion of net assets under management at the end of March 2020. Our Markel CATCo

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operations are continuing to wind down as they work to return investor capital as quickly and efficiently as possible. Revenues from our ILS operations were flat compared to prior year, with the increases coming from our Nephila MGA operations being offset by decreases in management fees from Markel CATCo due to lower assets under management and a further reduction in management fees charged on side pocket shares. Operating expenses from ILS decreased compared to the prior year, which is primarily due to fewer professional fees associated with the review and investigation in Markel CATCo.

Turning to our investment results, as I've mentioned in prior calls given our long-term focus variability in the timing of investment gains and losses is to be expected. To that point, here's where you see the COVID-19 impact on the asset side of our balance sheet. Net investment losses for the quarter were $1.7 billion compared to net investment gains of $612 million last year, a year-over-year decline of $2.3 billion. Essentially all of our net investment losses in 2020 were attributable to the decrease in the fair value of our equity portfolio during the period as COVID-19 caused unprecedented volatility in the capital markets.

We've continued to see volatility in the equity markets over the course of April but have seen some of the equity price declines reversed. With the gross to net investment income, we reported $88 million in the first quarter of 2020 compared to $114 million a year ago and the decline is mostly due to losses recognized on equity method investments. Net unrealized investment gains increased $66 million net of taxes during 2019, reflecting an increase in the fair value of our fixed maturity portfolio resulting from declines in interest rates during the first quarter.

Now I'll cover the results of Markel Ventures segment, which as a reminder has its results reported in only one-month lag. Revenues from Markel Ventures increased to $511 million for 2020, compared to $455 million last year, an increase of 12%. The increase in revenues was primarily related to the acquisition of VSC Fire & Security which closed during the fourth quarter of 2019 and to a lesser extent an overall increase in our consumer and building products businesses. EBITDA for Markel Ventures was $67 million for 2020, compared to $55 million last year, an increase of 23%, reflecting improved operating results within one of our consumer and building products businesses and greater EBITDA within our transportation-related products businesses, as well as the acquisition of VSC Fire & Security.

Looking at our consolidated results for the year, our effective tax rate was 21% for the first three months of 2020 and 2019. We reported a net loss to shareholders of $1.4 billion for 2020 compared to net income to shareholders of $576 million a year ago. Driven by the net loss, comprehensive loss to shareholders for the first quarter was also $1.4 billion compared to comprehensive income of $732 million in 2019.

Finally, I'll make a few comments on cash flows, capital and our balance sheet. Net cash provided by operating activities was $66 million in 2020 compared to $19 million [ph] for 2019. Operating cash flows for 2020 reflected higher premium collections as we've seen strong growth in our Insurance segment over the past several quarters. The increase also reflects the effects of lower claim settlement activity in both our Insurance and

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reinsurance segment. Partially offsetting strong cash flow activity in the first quarter was an adverse impact to cash flows for the return of collateral held for unearned premiums on a large program within our program services business that was canceled in the period.

Invested assets to the holding company were $3.3 billion at the end of March compared to $4 billion at the end of the year. The decrease in the holding company invested assets was due to a decrease in the fair value of our equity portfolio again, arising from COVID-19 and its impact. Recognizing the importance of liquidity in times of uncertainty, we've taken several actions including retaining cash proceeds from the maturity of short-term investments and fixed maturities, pausing our purchases of equity securities and (inaudible) selling equity holdings, suspending repurchase of our shares and focusing on expense reductions across the company.

We continue to maintain a fixed maturity portfolio comprised high credit quality investment-grade securities with an average rating of Double-A. Our debt to total capital ratio at the end of March was 27% in line with our target range. We have no unsecured senior debt maturing in the next 24 months. We believe we are well-positioned to meet our ongoing capital and liquidity needs, including the cash required to complete our pending acquisition of Lansing Building Products.

Total shareholders' equity stood at $9.7 billion at the end of March compared to $11.1 billion at December 31. So in summary, the unprecedented event surrounding COVID-19, certainly impacted our quarterly results, however the actions we've taken over the years to build a diverse and resilient organization will help us navigate through the current uncertainty arising from the pandemic.

With that, I will turn it over to Richie to talk more about our insurance businesses.

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Richard Whitt {BIO 7084125 <GO>}

Thanks, Jeremy and good morning to everyone. First, please let me add my thanks as well to all the first responders and essential workers. Since 1930 Markel has earned a reputation of being there for its clients, partners and communities during good times and bad. This crisis is no different. As the situation has unfolded, thousands of Markel associates have done an outstanding job providing exceptional service to our customers. Our associates continue to exhibit the Markel style of flexibility spontaneity innovation and the pursuit of excellence as we all navigate this incredibly unique situation.

Now I'd like to give you an update on the current impact and potential future impact of the COVID-19 crisis on our insurance, reinsurance program services and ILS operations.

Collectively, these are our insurance businesses. As long-term followers of Markel will know we adhere to a consistent reserving methodology that is laid out in our 10-K. Inherent in our reserving practices is the desire to establish loss reserves that are more likely redundant than deficient. While we are consistently implementing our process as we analyze the COVID-19 situation, we cannot be certain that our estimates will prove to be more likely redundant than deficient. There are simply too many unknowns at this time given the unprecedented and ongoing nature of the event.

Having completed our initial ground-up review of each of our product lines and specific policy language, we have included management's best estimate of our ultimate direct COVID-19 insurance losses in our first quarter results. As we observe other insurance--insurers' reporting results, it is clear that a variety of approaches are being taken with some companies planning to more fully reflect their COVID-19 exposures in the second quarter.

Let's kick off talking about revenues. We started the year with substantial growth in the first 2.5 months continuing the momentum we had seen for the past several quarters. That quickly changed as much of the U.S. and world economies rapidly closed. We have seen a drop off in new business submissions over the past six weeks within our insurance operation leaving our written premiums during that time roughly flat to the prior year. Over the same period of time, our renewal business is holding up very well. This is obviously a small sample size and we do not believe the full impact of the COVID-19 situation and shut down is fully reflected yet. As one would expect, our small business has been hardest hit by the shutdown. We would expect premium volume to pick up as the economy start to reopen but believe it would be overly optimistic to predict a near to medium term return to the growth rates we saw at the beginning of the year.

While our program services businesses generate fee income, that fee income is calculated based on premium volume written in the insurance programs we support. We would expect to see a short to medium term dip in fee income and then recovery as the U.S. economy reopens. Regarding insurance pricing, while there is reduced demand in the short to medium term, recent events only provide more evidence that rates need to increase to align with the exposures the industry insures. We are obtaining and we'll continue to push for rate increases and believe that our peers will as well. We continue to see month-over-month increases in rates through the end of March. We don't have our April data yet.

We are seeing an increase in demand for Reinsurance. Insurance capital has been reduced as a result of the fallout from the pandemic and more importantly, risk appetite has reduced. Reinsurance, of course, is a form of capital in a way that derisk the primary insurance companies. We expect increased pricing and demand for the foreseeable future in Reinsurance.

Our ILS operations provide a low correlation investment class to sophisticated investors. In the short run, given market disruptions, we would not expect to obtain significant new investment subscriptions. However, over the longer term we believe current events once again validate the benefit of ILS investments. Also, as I previously discussed, we see an attractive rate environment and insurance and reinsurance, which our ILS operations can take advantage of.

Switching to losses, as discussed in our 10-Q and previously on this call by Jeremy, we recorded $325 million of reserves, virtually all of it (inaudible) the for direct COVID-19

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insured losses in the first quarter. These reserves relate primarily to potential U.K. business interruption claims and worldwide event cancellation exposures. On the workers' compensation front, while we have received very few claims so far, we also expect to see an increase in claims that are directly related to COVID-19. It is worth noting that all of our U.S. property policies require physical damage to occur before business interruption coverage is triggered. Almost all of those policies also include a communicable disease or virus exclusion.

Here I'll stop and just say some of our policies have affirmative coverage, often sub-limited that would cover the events of COVID-19 and those included -- reserve estimates for those are included in our first quarter. Therefore U.S. property policies are not expected to respond to COVID-19 related business interruption losses although we will be investigating each claim on its own merits. Our reserve were based on the ground up analysis but we're also informed by very preliminary industry estimates that suggest over time COVID-19 could produce anywhere from a $50 billion to $100 billion insurance industry loss events. We would also expect to see meaningful losses indirectly related to the COVID-19 pandemic as a result of the disruption in the global economy and financial markets. These could include lines such as D&O, E&O, Workers' compensation, trade credit surety and casualty losses and the possibility of these types of losses impacting Reinsurance business that we write.

Similar to the losses that emerged as a result of the 2008 financial crisis, we would expect these losses-- these indirect losses to emerge over the coming quarters. Our underwriters, actuaries and claims personnel will be working to quantify the increases to our loss ratios potentially required by these indirect losses. Finally, we are prepared for elevated litigation expenses as it relates to COVID-19, particularly as it relates to business interruption claims in both the U.S. and abroad. We are taking steps to mitigate future exposure to pandemic losses by raising prices and adding policy terms and conditions including additional exclusions.

There could be insurance lines were underwriting loss trends decrease and partially offset the impact of COVID-19 direct and indirect losses. An obvious example of this is private passenger auto where our participation is small other than through our relationship with Hagerty and their classic car program. However, it is too early to speculate which lines if any other than auto could have their traditional loss ratios favorably impacted and by how much. In addition, we have already seen regulatory pressure to provide rebates in some of these areas.

In summary, while it is early and there are many unknowns, we believe the impact of COVID-19 to our insurance businesses is meaningful but also manageable. We have a diverse Insurance business portfolio both by geography and product line and solid liquidity and capital position. We look forward to continuing to serve our Insurance and production partners, especially as the world's economies begin to reopen.

Now I'd like to turn it back over to Tom.

Thomas Gayner {BIO 1896932 <GO>}

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Thank you, Richie. During the first quarter of 2020, our overall investment portfolio declined 7%, our equity portfolio declined 22.4%. This is the biggest quarterly decline since 2008, 2009. Our fixed income portfolio rose 1.9% during the quarter as overall interest rates continue to decline. After adjusting for foreign currency movements and investment expenses, the total return was a negative 7%. Over the years, we've allocated a meaningful portion of our equity capital to a portfolio of equity securities. Over 30 years, that level of allocation has ranged from approximately 50% to 80%. The level dependent on our views and comparisons of investment opportunities, insurance underwriting opportunities, acquisitions and other business alternatives.

As I mentioned in my introductory comments, we started the year at 69% and ended the first quarter at 58% from a combination of modest sales as well as the overall market decline. We continue to select our equity holdings by following our long-standing discipline of looking for good businesses with good returns on capital and limited debt, run by management teams with equal measures of talent and integrity, with capital discipline and reinvestment opportunities at fair prices. That discipline does not change.

In the current environment and the circumstances we expect for the foreseeable future, we believe that some previously good businesses may be challenged to earn reasonable returns on capital going forward. With this thought in mind, we continue to come over each and every security we own. We continue to re-examine each holding in light of what has happened and more importantly, changes that we would expect to persist for some duration. As we do so, we've adjusted our views on the profitability and outlook for some companies and acted accordingly. We expect that some of those actions should serve to both improve our balance sheet and future returns. That same discipline applies to our fixed-income operations. Our focus has been and continues to be on the highest rated sectors of the fixed income market. Our portfolio is roughly 89% in various government-backed securities and 93% rated double-A or better.

In our Ventures operations, the year started well. As Jeremy reported, our diversified set of businesses produced revenues of $511 million compared to $455 million and EBITDA of $67 million compared to $55 million a year ago. Those results are reported with one-month lag and do not yet include our acquisition of Lansing Building Products. The Lansing transaction side in the early days of March was the culmination of a complicated multi-month process that involved two steps. We acquired Lansing from certain members of the Lansing family and Lansing acquired Harvey Building Distribution Products in conjunction with this transaction.

Lansing is a successful third-generation company based in Richmond. We've known and admired the Lansing family and their organization for years. Both Lansing and Harvey distribute building products for both new construction and repair and maintenance needs. Hunter Lansing will retain the vast majority of his equity stake in the combined firm and will serve as the CEO for the combined Lansing and Harvey businesses going forward. We are pleased to welcome Hunter and the Lansing organization to Markel, along with the Harvey organization. Their proven financial performance and long-term values and culture are consistent with all that we seek in Markel.

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Clearly economic circumstances changed since we began the acquisition process. That said, Lansing has operated successfully during previous challenging economic circumstances. They enjoy a large presence in the more stable repair and remodeling segment alongside their offerings related to do construction. We believe they will be meaningful long-term contributors to our results over time. We are not engaged in any other discussions on Ventures acquisitions at this time.

Turning to the balance of our Ventures operations, the COVID-19 economic shutdown taking place causes current conditions to be different than what was the case in the first quarter. We are responding accordingly and working diligently to operate the businesses in light of new business realities. We continue to operate our Markel Ventures businesses to meet our customers' needs for necessary and desirable products and services. The companies of Markel Ventures do things as basic as making the equipment to bake bread and process food, to make components for trailers used by trucking companies, to transport the goods needed for daily life, to provide housing and shelter, to protect against fire, to provide health care and many other essential goods and services.

We are proud of the work of all of our insurance, investment and ventures companies and what they do to provide for our customers and our associates. To close, a good friend of mine sent me a quote yesterday from former Secretary of State Madeleine Albright. That quote was the best response to disaster is resilience; we embrace that idea and believe that our diversified operations add to the resiliency of the Markel Corporation.

We now look forward to answering your questions. Sarah, if you'd be so kind to open it up.

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Questions And Answers

Operator

We will now begin the question-and-answer session. (Operator Instructions) Our first question will come from Mark Hughes with SunTrust. Please go ahead.

Q - Mark Hughes {BIO 1506147 <GO>}

Okay good. In the international business interruption, how do you judge the remediation? When do we get back to normal and what sort of limits are there on those policies?

A - Richard Whitt {BIO 7084125 <GO>}

Okay. Mark, I'll attempt that one. Most of our policies exclude business interruption as a result of communicable disease viruses and all of our policies require physical damage. So it's sort of a belt and suspenders approach. First and foremost requires physical damage and then in a lot of cases we have virus exclusions. We have gone through where portfolio of business there, it tends to be small to medium enterprise business in the U.K. and looked at the wording. There are various wordings and again they are different from our U.S. wordings and where we believe there is affirmative coverage, we have made an estimate of the losses that could potentially be there and obviously we are having to make a lot of assumptions in terms of what's the duration of the business shutdown; are

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they completely shut down? Are they partially shut down? So there is a number of factors that we've put in there, in our typical fashion. As I said in the beginning, we've tried to be more likely redundant than deficient, but there -- as I said, there is a lot of assumptions and a lot of unknowns at this point. In terms of the go-forward, when things getting back to normal, my assumption is going forward, there is probably going to be less grants -- coverage related to communicable disease and viruses in the international markets more like the U.S. markets, but that's -- that as we go forward.

Q - Mark Hughes {BIO 1506147 <GO>}

Thank you for that. And then it looks like your reinsuring exposure there for business interruption there is that $15 million provision in the U.S., I think you said in the U.S., there are certain policies that have supplement. You had bigger exposure on the reinsurance side as opposed to the direct side. Could you talk about what that is?

A - Richard Whitt {BIO 7084125 <GO>}

It's very difficult at this point to estimate reinsurance exposures because the primary companies are still grappling with what their exposures are and obviously we would hear from them once they have a handle on that. But we have identified some business interruption -- some potential business interruption that we could potentially cover on the reinsurance side, some accident and health exposures that we could potentially cover and that's what we have tried to make an estimate of on the reinsurance side.

Q - Mark Hughes {BIO 1506147 <GO>}

And then the program business, you referred to two large customers, how much did that impact your revenue on a go-forward basis?

A - Richard Whitt {BIO 7084125 <GO>}

One of them was a customer that had -- and we knew of -- what we have known about this for quite a while, they received an upgrade to their rating and no longer required State National services. So we had budgeted for the gradual reduction of that business over the last year and a half actually. So that was planned into it and into our budgets and everything. So I would say minimal impact in terms of our first quarter results. The other one was a program that ended and it ended on a canceled rewrite basis, which is where you return the unearned premium and so that had a negative impact of about $55 million of premium in the quarter that was returned and we think that will have a $2 million to $3 million impact going forward on fee income for the rest of the year.

Q - Mark Hughes {BIO 1506147 <GO>}

Thank you.

Operator

Our next question will come from Phil Stefano with Deutsche Bank. Please go ahead.

Q - Phil Stefano {BIO 18965951 <GO>}

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Yes, thanks. Maybe I'm parsing word too finely. But it feels like there is a segment of the business interruption claim, where there was no specific pandemic exclusion but that reserve was established. Just trying to understand that. I think the concern is the extent to which there is the absence of a virus exclusion, the extent to which that can translate to maybe unintended or unsubstantiated losses, just given the environment. And can you help us think about (inaudible) reserves in that scenario? And how are you thinking about the potential for losses in that kind of situation?

A - Richard Whitt {BIO 7084125 <GO>}

Sure happy to. So in the U.S., what's taken the pieces, let's take it in the U.S. and primarily the U.K. would be the other bucket. In the U.S., we have a belt and suspenders approach, where all of our policies require physical damage, which COVID-19 is not physical damage. In addition on the great majority of those policies, we have fires or communicable disease exclusions. And that is not something new, by the way that -- those exclusions have been going on those policies since 2007. So that's over a decade that that has been in those policies. In some cases, we granted coverage or there is affirmative coverage. It's usually sub-limited -- usually about $25,000. So we have added up those policies and made an estimate for the losses that we could see from those. There is another subset of policies, where we have affirmative coverage in the U.S., often in the hospitality industry and we have assessed those policies and put up reserves for what we think potential losses could be there. Switching -- so we believe we've got losses up that are appropriate for those two subsets. And then on everything else, we have the belt and suspenders approach. In the U.K., it does require physical damage, but there has not historically been the use of virus or communicable disease exclusions. We have gone through our policies, reviewed the language and where we believe there is some level of affirmative coverage that has been granted, of course subject to policy terms and conditions, we have made estimates for what we think that business interruption loss can look like and we have looked out to the future on how long do we think these businesses could be shut down and put that into our loss reserve.

Q - Phil Stefano {BIO 18965951 <GO>}

Okay. Then it feels like from the U.S. perspective that there's two scenarios; either there is an exclusion or there is a sublimit.

A - Richard Whitt {BIO 7084125 <GO>}

Yes. I think that there is fair -- that is fair. There are some policies, where it's not the sublimit -- limited, but we've also looked at those limit and based on whatever that limit is, we've estimated what the potential loss can be.

Q - Phil Stefano {BIO 18965951 <GO>}

Understood. Okay. Were there any notable factum in the quarter? I didn't see any in the queue.

A - Richard Whitt {BIO 7084125 <GO>}

Certainly there were caps, they were tornadoes, hail all the usual things. It did not rise to a level that we felt required to break it out.

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Q - Phil Stefano {BIO 18965951 <GO>}

Got it, okay. And I was hoping -- you'd commented on the ability to -- the complications on the ILS side of the business with new investments subscriptions, I -- how does it feel with the launch Lodgepine? Is this largely on track? Have expectations around the timing, were the size of the business been changed? Maybe you can just give us some thoughts on that.

A - Richard Whitt {BIO 7084125 <GO>}

Sure. On the ILS side, the exposure to actual losses from COVID-19, we believe is fairly minimal. But there is obviously been significant disruption in the broader financial markets and whenever that happens, people tend to seek liquidity and so our expectation -- and we're still out there talking to potential investors, but we've sort of in our own mind just -- are assuming that that process could take longer, as people deal with the uncertainty in the markets right now. So we still would hope to raise capital both at Nephila and Lodgepine, but we're trying to be realistic in terms of what the situation is and in our own minds thinking that could be a longer path to getting those additional subscriptions. At Nephila, we are at about $10 billion of assets under management. That's been pretty stable. We haven't seen a lot of redemptions, and we are working to see if we can add subscriptions. Lodgepine -- timing for COVID-19 was not good for Lodgepine, just talking about that disruption. It's going to take longer to raise capital there. We have written most of the portfolio for Lodgepine for the year, and that's being warehoused on Markel Bermuda. So the portfolio was written, and Markel is housing that portfolio on our balance sheet. And as we raise capital, we can seed some of that business to Lodgepine.

Q - Phil Stefano {BIO 18965951 <GO>}

Got it. Okay. I've got a few more, but I'll re-queue. I just wanted to add a quick note that the level of detail that you broke out for the COVID thoughts on the potential losses is far more than we've seen from peers thus far, and I know I truly appreciate it. So thank you so much, and look forward to discussing in the future.

A - Richard Whitt {BIO 7084125 <GO>}

Thank you.

Operator

Our next question comes from Ron Bobman with Capital Returns. Please go ahead.

Q - Ronald Bobman {BIO 17308423 <GO>}

Hi, thanks a lot. Thanks for the help, given how early days we are on trying to get arms around exposures and losses. I had a question about sort of the ILS world in a particular sort of collateralized rate [ph] and sort of the implications for collateralized capital at sort of contract expiration. Have you gotten any indications or thoughts from the teams there as far as the prospects for capital getting locked up, given sort of the tail risk associated with BI?

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A - Jeremy Noble {BIO 20687803 <GO>}

Ron, yes. We are thinking about those things, and there is a belief that teams will look to trap more capital because of that tail risk that you discussed. So we are planning for that potential. I will say that there are provisions in the contracts that -- if you want to trap that capital, you have to put up a certain amount of reserves. So themes [ph] will be required to put those reserves up in their financials to be able to trap capital in ILS. They can't just think or want to be really careful and hope that they can -- they can't just tie up the capital without putting up a reserve. So they're going to have to feel like the exposure is known enough to record it to be able to trap capital. But we are considering that, both at Nephila and Lodgepine, and planning for it. And honestly, yes, I think there will be capital trapped as a result of COVID-19, and that's -- I think will continue to lead to more tightening in the reinsurance and collateralized reinsurance markets.

Q - Ronald Bobman {BIO 17308423 <GO>}

You may have accidentally come across a new term right there. Hopefully it's not too common that we need that we need that word. It's another topic. Obviously, the world is going through a dramatic economic shutdown contraction, and sadly, it's going to persist for some period of time. Hopefully it alleviates, but it's going to suffer -- we're going to suffer. In your core E&S business, obviously all risk bearers are going to suffer that decline in the size of risk units and protection purchased. But on the flip side, you talked about rates going up, which will be a bit of an offset. But I would imagine that the admitted markets may reduce their appetite for sort of the gray area of risks that could migrate back to the E&S market. What do you think of sort of -- will the positives of rate and declining admitted underwriting appetite exceed the economic contraction? Or is the economic contraction just sort of too great? And I'm talking about later this year and next year, sort of the pluses and the minuses. Which one do you think sort of rules the day?

A - Jeremy Noble {BIO 20687803 <GO>}

That's the million-dollar question, Ron. What we saw in April was a lot of the things you just said. We are seeing E&S pick up because I think there is a reduction in risk appetite out there as a result of all the disruption. So we've got certain areas of our book where rates are up substantially and are rising, are up substantially. In April, that did offset the decreases we saw in small business in places that you would expect to be hit hard by COVID-19. I got to believe we haven't seen all of the impact from COVID-19 yet, insurance business comes in (inaudible) a bit of a delay. So I think we'll see more of that in the second quarter and that's the million-dollar question -- how will those things offset each other? We're trying to plan for that in our businesses and we're keeping an extremely close eye on it. But you're absolutely right, there is going to be positive, such as rate increase and decrease and risk appetite. But how will that float against just passive -- less businesses seeking coverage on the primary side. On the reinsurance side, it's a hard market. Appetite is down, demand is up, and you're going to see more people looking for coverage and pricing going up accordingly.

Q - Ronald Bobman {BIO 17308423 <GO>}

All right, thanks for the help gentlemen.

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Operator

Our next question comes from Jeff Schmitt with William Blair. Please go ahead.

Q - Jeff Schmitt {BIO 19747235 <GO>}

Hi, good morning. The COVID-19 losses $325 million, just trying to make sure I understand that. And it sounds like there really haven't been many claims, so it's mainly IBNR. But are those your estimates of business interruption event cancellation for the year or should we be expecting this type level of losses for the next couple of quarters?

A - Jeremy Noble {BIO 20687803 <GO>}

That is our best estimate of business interruption losses and event cancellation losses through the remainder of the year. Obviously a lot of assumptions are baked into that, but that is our best estimate. In terms of, for example, event cancellation -- our cancellation book goes from wedding cancellation to the Olympics and Wimbledon. So, it is -- it runs the gamut. And we have tried to look out for the rest of the year in terms of what we think the potential exposure could be and we've tried to book that in the first quarter. The thing that is not represented here in this number is the secondary losses or the indirect losses and -- that's things like the potential for D&O around bankruptcies or E&O for brokers. That we're going to be dealing with just like after 2008 over the next several quarters.

Q - Jeff Schmitt {BIO 19747235 <GO>}

Okay. Yes. And I guess theoretically that could be fairly large. I mean the workers' comp piece that doesn't seem like the other component outside event cancellation business interruption was small. What's your expectation there just on the workers' comp?

A - Jeremy Noble {BIO 20687803 <GO>}

Our workers' comp book is not weighted towards first responders. That's an actually a very small part of our book, but obviously we would expect claims there. When you get into essential workers, maybe like restaurants, retail, depending on how the rules work there, we've got a little more in that bucket. So we would expect to see claims. In addition, in workers' comp, you're going to see claims because of the change in the economy. Workers' comp claims go up when unemployment goes up. So we are -- we are going to be trying to factor that into our picks as we go forward.

Q - Jeff Schmitt {BIO 19747235 <GO>}

Okay. And then you touched on Markel Ventures, but I guess obviously quite a few manufacturing businesses in there. I mean, what type of impact are you seeing now over the last few quarters, just on the top and bottom line? I mean could there be a contraction in revenue growth there potentially?

A - Jeremy Noble {BIO 20687803 <GO>}

Yes, I don't think anything that we would report over the next quarter or two would surprise you given the nature of the economic shut down. When the economy is shut down, it is shut down. But that being said, all of our businesses are operating, all of them

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are fulfilling orders and the operating business within the constraints that they have, obviously following public health protocols and compliant with every letter and spirit of the law, plus the spirit of Markel to take care of our employees. But clearly economic activity is diminished at the moment and our businesses will reflect that.

Q - Jeff Schmitt {BIO 19747235 <GO>}

Okay, thank you.

Operator

Our next question comes from John Fox with Fenimore. Please go ahead.

Q - John Fox {BIO 18976738 <GO>}

Hi, good morning everyone. I have lot of [ph] questions. Hey, Richie. I just want to add, I thought your opening comments were very good and complete and it's an uncertain situation you gave us a lot of information, so I appreciate that. My question is Richie, I wasn't totally clear, you talked about the losses which are basically all IBNR right now. You mentioned business interruption event. Are the expected workers' comp losses in that 325 number or is that an addition?

A - Richard Whitt {BIO 7084125 <GO>}

I don't think -- there is very little with any workers' comp in that number right now, John. I don't know that we had any claims in yet as we were establishing the number, but we would expect claims as we go forward and workers' comp. And so that's, yes, this is a very strange event and I don't have to say that, everybody knows that. But this is an ongoing event, usually you have a hurricane or something and it's over and you start adding up your exposure, but this one is ongoing. So there are people who will get sick, who have not gotten sick yet, who will claim for workers' comp and those losses will come in at that point.

Q - John Fox {BIO 18976738 <GO>}

Okay. So I just wanted to be clear whether there was any in the IBNR. For Tom, can you talk about on the fixed income side? Your largest allocation is the muni bond. There is a lot in the press about the bailouts, no bailouts. All states that we live in are under stress financially, with the virus. So can you talk about how you're assessing the risks in your muni portfolio?

A - Thomas Gayner {BIO 1896932 <GO>}

Sure. Well, we're actually following the same sort of underwriting we always have. Munis to review the bidding are about 40% of the fixed income portfolio. Now, we have always operated with a position limit. So any given state can be no more than a certain percentage of the portfolio and even within those -- those purchased and portfolio limits, we don't just buy a state bond. There would be a spread of localities in jurisdictions within that state. Then the next layer of underwriting is typically by Geo and essential services like water and sewer we don't do any state financing or any of that kind of stuff. So there

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is an epic spread that we've always kept in mind with the whole portfolio. So we're the tippy top of everything we know how to do, to be as pristine credit quality as possible.

Now the reports that you're speaking of in terms of general municipal finance conditions, I would describe this is as being systemic. So it's not unique to Markel, and if you look at the presence of municipal finance within the entire structure, it's one of the things like Stein's Law. "Things that must be, will, and things that can't be won't." It is -- it is definitional to me that the structure of municipal finance has to work in order for the modern financial system to work. So as you see the central bankers and the political leaders use the phrase, "whatever it takes." That is what is happening and I believe that will continue to happen because it has to. And we're not going to speculate and be at the lower end of the curve or try to be too cute, or too close to the line of what central banks will buy or won't buy. We will be -- will be at the very tippy top of the spectrum.

Q - John Fox {BIO 18976738 <GO>}

Okay. And then let me ask a question that looks further out and is probably too optimistic for the moment, but I would think with the 60 basis point or whatever it is, 10-year treasury bond and the volatility of stock, ILS would be a phenomenal investment for the pension funds, which moves around 7% a year, and not correlated to the stock market. So, I mean, is this potentially down the road, a real opportunity for ILS, or is that too optimistic of a view given the environment?

A - Richard Whitt {BIO 7084125 <GO>}

John, that's our view exactly. We recognize the short to medium term, everything about the situation is negative on so many levels, but this just, again, proves why the ILS investment is valuable. It does, it has very, very low correlation to the rest of the market.

Q - John Fox {BIO 18976738 <GO>}

Okay. Thank you.

Operator

Our next question comes from Mark Dwelle with RBC. Please go ahead.

Q - Mark Dwelle {BIO 4211726 <GO>}

Yes, good morning. I like all the other comments. Thank you for all the disclosure. It was very thorough and very mature. First question I wanted to ask is, it was coming in the opening remarks and it's in the Q, that there was a $20 million charge within the investment income related to equity-accounted investments. Can you just provide a little bit more detail about that and what the circumstances were that produced the charge?

A - Thomas Gayner {BIO 1896932 <GO>}

Sure. Mark, this is Tom. The way that works, there is a couple of firms that we ceded over the years in terms of giving them some money to manage and normally we got some economics that the firm itself overrides from doing limited basis, but we've done a couple

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of that over the years. The way that -- in that particular charge, I believe, that we had given that firm $25 million, a number of years ago, the value of the portfolio in and of itself has gone up over time and some of the economics of the firm itself. But they had a rough first quarter. So all of the fair market decline that happened during the first quarter shows up as that specific chart. Now that being said, we're still profitable in that overall investment with that firm. It's just the profits, we have earned over this course of last several years were never isolated and labeled individually, whereas the mark to market decline in the first quarter was. So we've made money on that investment over time, but that's what drove that to be the case.

Q - Mark Dwelle {BIO 4211726 <GO>}

I see, okay, that's helpful. Within, again within the Q, there was a comment about an increase in attritional losses within workers' comp and property in the insurance business. Can you just elaborate on what you're seeing there and maybe what some of the drivers are particularly on the workers' comp side?

A - Richard Whitt {BIO 7084125 <GO>}

Hold on, just one second, on reinsurance?

Q - Mark Dwelle {BIO 4211726 <GO>}

I thought it was in the insurance segment. But maybe, maybe my notes are confused.

A - Richard Whitt {BIO 7084125 <GO>}

Yeah, well, maybe I'll try it a little more generally, because we're struggling to find what that reference was in the Q, but it's interesting Mark. Obviously, there's been a lot of discussion of social inflation. And we certainly are seeing some signs of that in our numbers as well. It's probably -- we're seeing a bit less of it on the insurance side than on the reinsurance side, it takes longer to get to reinsurance. So I think those comments would have been related to our reinsurance entity -- our reinsurance business and would have been around some of our workers' compensation business there and some of our casualty, professional business there. So we have seen, we have seen the impact of social inflation on the reinsurance side, and we're seeing it some on the insurance side, but nowhere near as much. Also interesting to us and again very early days, our claim activity is down. Our traditional claim activity is down in the first quarter of 2020 compared to 2019. Only a couple of those weeks were impacted by the COVID-19 situation. So we're still assessing that, but that, hopefully that helps you out a little bit.

A - Thomas Gayner {BIO 1896932 <GO>}

The market share amount, it's more weighted towards property and workers' comp with regards to attrition. And actually another part about workers' comp, a little bit of mix in the portfolio between where we're writing quota shares or access a lost contract. They can have slightly different attritional there. So I wouldn't read too much into that comment with regard to that moving the attritional loss ratio from a reinsurance workers' comp standpoint.

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Q - Mark Dwelle {BIO 4211726 <GO>}

Okay. And then the last question that I had was you, Richie, in your remarks you alluded to the probability of higher litigation expense in defending your various contracts particularly for BI or probably for just about everything? That's been reflected or that is being reflected in the loss picks that you selected in Q1 or is that something that you're still awaiting development on before -- before making that type of an adjustment?

A - Richard Whitt {BIO 7084125 <GO>}

Yes, I would say it's more implicit than explicit in terms of the numbers that we have put up, but I mean, we very much -- I mean -- and here's the reality. I mean the economics that are at stake. The economic damages that had been done by the situation are just so large. People have incentive to attempt to recover that even if their coverage was not granted. So we just simply expect given the size of the economic damage, the political backdrop, the emotion involved. There is going to be more litigation, and so, we are preparing for that. That is implicit to the numbers as we go forward, and probably be more explicit to the numbers.

Q - Mark Dwelle {BIO 4211726 <GO>}

Got it. Thanks for the answers. Appreciate it.

Operator

(Operator Instructions). Our next question is a follow-up from Phil Stefano with Deutsche Bank. Please go ahead.

Q - Phil Stefano {BIO 18965951 <GO>}

Yes, thanks. I was hoping you could just help us think about how the rating agencies are viewing the debt ratios, especially in the context of tangible equity, current cash levels, and maybe potentially the depressed outlook for earnings as we think about moving forward?

A - Jeremy Noble {BIO 20687803 <GO>}

Yes. So it's Jeremy. I'm not going to speak how the rating agencies or maybe generally looking at it across the board, but certainly specific to Markel. I mean, from a from a debt level standpoint at a 27% leverage ratio. That's well within our target range and certainly well within what the rating agencies are comfortable with. It won't come as a surprise and we certainly are in discussions in previous year earnings in the release, as we would typically for our quarter with significant events. So we've been speaking to each of the rating agencies. Because we have been acquisitive over time right to point out that they will look at varying degrees, the level of goodwill and intangibles to shareholders equity. But again, I would say, while we're at the higher end of the range of kind of what they look at, there is a lot of qualitative considerations that go into that as well when they look at the underlying businesses in the earnings and cash flow streams from those businesses so nothing on that front. I think right now it's specifically of note.

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Q - Phil Stefano {BIO 18965951 <GO>}

Okay. I noticed in the Q that there was a conversation around no goodwill or intangible impairment. Maybe you could just give us some thoughts about how that process worked and businesses that feel as though they may be most susceptible to some form of impairment just as we think about, particularly in the Ventures business maybe the impact of the economic environment moving forward?

A - Jeremy Noble {BIO 20687803 <GO>}

Yes, sure. Again, Jeremy. First of all, I think you will have seen and observed there's a lot of cautionary language that we put into the Q and we're trying to be very clear of the things that could respond relative to levels of uncertainty that exists specifically in the period. We have a meaningful amount of goodwill and that's because we've been acquisitive over the years. We looked at all of our reporting units and ultimately we determined that it was not more likely than not that the fair value or-- it wasn't more like not the fair value exceeded the carrying value for each of our reporting units and we didn't feel yet at the end of March but there was really a triggering event. So we realized significantly on qualitative considerations in sensitivity analysis looking at the last time we had done valuations of the various reporting years and we felt pretty comfortable at this stage. We flagged the fact that there is a tremendous amount of uncertainty so the longer the economic shut down goes on the more impactful that is over a sustained period to our businesses. It's reasonable to think that there could be a possibility that those valuations would be called into question. That's something that we would be prepared at. We will be prepared to look at over time. I would say in part because we've conducted a number of acquisitions recently. Those are places we will look at very carefully-- most carefully because there has been less time since the point that we did the original valuations of those businesses. There is quite a bit of disclosure in the Q that we'll lay out some of those key considerations and assumptions and how we think about as accounting requirements.

Q - Phil Stefano {BIO 18965951 <GO>}

Got it. Thank you.

Operator

Our next question comes from Rob Goff [ph] of Wells Fargo. Please go ahead.

Q - Unidentified Participant

Hi, thanks very much. Just to follow-up on the goodwill and intangible question. I think I know the answer to this but just looking for confirmation here. None of the goodwill or intangibles being reviewed or held as an admitted asset with the insurance companies?

A - Thomas Gayner {BIO 1896932 <GO>}

That's correct.

Q - Unidentified Participant

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Okay, great. Then the Q also mentioned that the Ventures businesses could look to potentially increased borrowings to help get through this period of time. We're certainly seeing that across the board within various other industries. Could you remind us again how much the insurance companies have loaned into the Ventures business? Have those balances increased since the end of the quarter and are there any regulatory or internally mandated limits on how much the insurance companies can lend into these entities.

A - Thomas Gayner {BIO 1896932 <GO>}

I'll let Jeremy chime in but basically from the bottom-up point of view, the businesses themselves, they can operate with relatively low levels of debt. There is some of those companies that have no debt at all. They would have normal working capital lines with banks that they would work with given that the normal flows of their business but part of the language in the case was just given the uncertainty and the array of credit options that were being placed out there in the marketplace that it was appropriate to add the language that they might avail themselves to some of those things. As of yet, they have not.

A - Jeremy Noble {BIO 20687803 <GO>}

The amount of debt with the insurance subs has not moved meaningfully since the end of the year. I think that number is actually disclosed out in our footnotes in the 10-K so I don't want to quote that to you right now. Then with regards to limits in place, there are limits in place and we have to say, both internally and then in conjunction with what we've agreed from the state rules with regards to each of our domestic insurance companies. So there are limits to when that makes good economic sense and complies to the regulatory requirements.

Q - Unidentified Participant

That's helpful. Then last one for me for Tom. Did you mention Tom, how much has the mark on the equity portfolio changed since the end of the quarter?

A - Thomas Gayner {BIO 1896932 <GO>}

We've not released that number out but obviously so far in April price has been going up.

Q - Unidentified Participant

Okay. Great, thanks very much.

Operator

This concludes our question-and-answer session. I would like to turn the conference back over to Tom Gayner for any closing remarks.

A - Thomas Gayner {BIO 1896932 <GO>}

Thank you very much for joining us. We look forward to connecting with you next quarter. Be well, thank you.

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Operator

The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.

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