Q2 2011 Earnings Call

Company Participants

- Anne Waleski, VP, CFO and Treasurer
- Mike Crowley, President and Co
- Richie Whitt, President and Co
- Tom Gayner, President and Chief Investment Officer

Other Participants

- Beth Malone, Analyst
- David West, Analyst
- Jay Cohen, Analyst
- John Fox, Analyst
- Mark Hughes, Analyst
- Meyer Shields, Analyst

Presentation

Operator

Greetings and welcome to the Markel Corporation Second Quarter 2011 earnings conference 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, Tom Gayner, Chief Investment Officer for Markel Corporation. Thank you.

Mr. Gayner, you may begin.

Tom Gayner {BIO 1896932 <GO>}

Thank you. Good morning. I'm Tom Gayner. It is my pleasure to welcome you to the Markel Corporation Second Quarter conference call. Thanks for joining us.

On today's call, we will follow our normal lineup with Anne Waleski leading off with the financial results, followed by Mike Crowley and Richie Whitt with operational comments. Then I will discuss our investing and non-insurance activity. After our comments, we will all be available for your questions.

But before we begin, I am duty bound to remind you that during today's call, we may make forward-looking statements. Additional information about factors that could cause actual results to differ materially from those projected in the forward-looking statements is described under the captions, Risk Factors and Safe Harbor and Cautionary Statement in our most recent annual report on Form 10-K and quarterly report Form on 10-Q.

We may also discuss certain non-GAAP financial measures in the call today. You may find a reconciliation to GAAP of these measures on our website at www.markelcorp.com, in the Investor Information section under non-GAAP reconciliation or in our quarterly report on Form 10-Q. With that, let me turn it over to Anne.

Anne Waleski {BIO 16735457 <GO>}

Thank you, Tom. Good morning, everyone. I plan to follow the same format as in past quarters. I will focus my comments primarily on year-to-date results. I'm going to start by discussing our underwriting operations followed by a brief discussion of our investment results and bring the two together with a discussion of our total results for the six months.

Moving right into the underwriting results, gross premium volume was just under $1.2 billion for the first six months of 2011, up 18% compared to 2010. This increase was due to higher gross premium volume in the Specialty Admitted and London Insurance Market segments.

As of June 30, 2011, the Specialty Admitted segment included $110 million of gross written premiums from our FirstComp workers' compensation operation, which we acquired in late 2010. The increase in gross written premiums in the London Insurance Market segment was due in part to an increase in premiums written by Elliott Special Risks, which has now been converted from an MGA operation to a risk bearing operation.

We also saw significant increases in premium volume within our Marine and Energy division, due in part to offering larger line sizes and an improved pricing environment.

Net written premiums were approximately $1 billion, up 17% to the prior year. Retentions were down slightly at 88% compared to 89% in 2010.

Earned premiums increased 15%, primarily due to higher earned premiums in the Specialty Admitted and London market segments as a result of higher gross premium volume compared to 2010.

Our combined ratio was 107% for the first half of 2011 compared to 102% in 2010. The increase is due to a higher current accident-year loss ratio and a higher expense ratio, partially offset by more favorable development of prior-year's loss reserves compared to 2010.

The combined ratio for the first six months of 2011 included $99 million or 10 points of underwriting loss for natural catastrophes, including the US storms in the Second Quarter, and the Australian floods, the New Zealand earthquake, and the Japanese catastrophe that occurred in the First Quarter.

Our 2010 combined ratio included $17 million for 2 points of underlying loss related to the Chilean earthquake.

Favorable redundancies on prior year's loss reserves increased to $151 million or 16 points of favorable development compared to $75 million or 9 points of favorable development in 2010. The increase is primarily due to more favorable development of prior year's losses in the Excess & Surplus Lines segment.

In 2010, favorable development of prior-year losses was partially offset by unfavorable development of $63 million on a US errors and omissions program for mortgage servicing companies, as well as Italian medical malpractice coverage and Australian professional indemnity coverage for construction professionals (inaudible). All three of these programs are now in run off.

Our year-to-date 2011 expense ratio increased approximately 1.5 points to 42%. Our 2010 expense ratio benefited 1 point from two one-time benefits, a favorable arbitration settlement and an anticipated insurance recoverable.

Now, turning to our investment results, investment income was up slightly in 2011 to $134 million. Net realized investment gains was $13 million, which were flat to 2010. Unrealized gains increased $117 million before taxes in 2011 due to increases in both fixed and equity securities. Tom will go into further detail in his comments.

Looking our total results for the first six months of 2011, we reported net income to shareholders of $39 million compared to $63 million in 2010. Book value per share increased 4% to $339 per share at June 30, 2011.

The effective tax rate was 14% in 2011 compared to an effective tax rate of 31% in 2010. The decrease in 2010 is primarily due to having lower estimated income before income taxes in 2011 as compared to 2010.

Now turning to the cash flow and the balance sheet -- regarding cash flow, operating cash flows were $100 million for the six months of 2011 compared to operating cash flows of $64 million for the same period of 2010. This increase was primarily due to higher cash flows from underwriting activities at Markel International given increased premium volume.

Regarding the balance sheet, investments in cash held at the holding company were just over $1 billion at June 30 as compared to slightly less than $900 million as of December 31, 2010.

The increase is due in part to $248 million of proceeds from our issuance during the Second Quarter of unsecured senior notes with a 5.35% coupon to June 1, 2021.

At this point, I will turn it over to Mike to discuss operations.

Mike Crowley {BIO 6836605 <GO>}

Thanks, Anne. Good morning.

Second-quarter results for North American operations reflected some of the same trends we saw in the First Quarter of 2011. The rate environment was somewhat better in the Second Quarter. We saw some (technical difficulty) from property rates -- however, casualty rates remain competitive, but the decline in rates was consistent with what we experienced in the First Quarter.

The (technical difficulty) segment gross written premium, as Anne said, increase year over year in the Second Quarter for the same reasons mentioned in the First Quarter. We experienced continued growth in our equine and livestock, agriculture and accident health divisions, and FirstComp contributed an additional $51.7 million in gross written premiums.

Year-to-date gross written premium in the segment was up 77.1% over the same period in 2010 due primarily to FirstComp, where gross written premiums totaled $110 million. Excluding FirstComp, gross written premiums were up 11% for the Specialty Admitted segment in the quarter.

Other highlights for the Specialty Admitted segment included an agreement with Sallie Mae Insurance Services to provide tuition refund insurance to the college and student loan customers. We also had -- were able to gain a new Virginia K to 12 student accident program, which was previously written by Markel and was very profitable. We lost the account in 2007 and are very pleased to regain it.

The Agriculture division successfully launched a Facebook page, Markel Horse, and we already have over 600 fans. This was another entry into the social media area, testing the opportunities there for Markel.

We gained momentum on our core products of equine mortality and farm business. Mortality premium grew 13% year over year in the quarter, and farm premium growth was 19% over prior year.

At Markel American, our personal lines operation, we launched a new deductible reimbursement program in six states. And at FirstComp, we made final preparations to enter two new states, Louisiana and Alaska, and appointed 72 and 29 agencies, respectively, in those states.

We completed product training for Markel Specialty Product at FirstComp and actively began selling Markel childcare products to FirstComp's agency base.

We also have appointed over 100 FirstComp agents to date who previously did not have access to Markel's products.

In the E&S segment, the Second Quarter also showed continuing trends from the First Quarter. While overall gross written premiums declined 7% in the quarter, this shrinkage was due largely to the loss of two significant accounts.

We mentioned the loss of a book of fourth-place property business in the First Quarter. We also lost a relatively large auto account. But I want you to keep in mind that we are comfortable losing revenue when it is not profitable, or when pricing, in our opinion, becomes unreasonable.

Core regional premium for the quarter continued to increase by 2%. We're very encouraged by the continued growth in our contract binding business. Casualty binding business was up 14% and property binding business was up 21% in the quarter.

Our wholesale broker portal project is progressing and we expect to go live in the Third Quarter. We've made improvements in the look, feel, and functionality of this website and in the underwriting and pricing of our binding business. This quarter will make it much more attractive and easier for agents to do business with Markel.

Our wholesale regions also held underwriting seminars with agency personnel throughout the Second Quarter. We engaged over 500 agent representatives for product education and on-site quoting during these seminars.

Our underwriting product line leadership was also very active in the quarter. Our product line leaders are in various stages of updating and revising our quality standards and metrics. We completed the updating of the environmental product line and expect to update inland marine and casualty in the Third Quarter.

We also launched and admitted Errors and Omissions and admitted architecture and engineers products in the quarter. Numerous other product enhancements are in the works.

In summary, all of our North American operations continue to focus on increasing our interaction with our agents and brokers, product enhancements, new product and program development, and increased renewal retention. We're encouraged by the growth in several of our business segments. However, we recognize there's still much to be done, and the challenges we face from both a rate and economic standpoint still exist. I will now turn it over to Richie Whitt.

Richie Whitt {BIO 7084125 <GO>}

Thanks, Mike. Good morning, everybody.

Many of the themes Mike described in the US are true on the international side as well. As a result, I'm going to keep my comments brief.

The rating environment that Mike described in the US is very similar to what we are seeing in the international market.

Cat-exposed property business is moving up. However, non-cat and casualty business continues to be very competitive. While rates in these areas appear to be flattening out, there's still abundant competition.

The Second Quarter was, again, active in terms of cat events, as Anne said. This was highlighted by the devastating US storms.

In the Second Quarter, Markel International recorded $10 million of losses on the US storms and increased reserves on the Japanese quake and tsunami by $7 million.

As I discussed on the First Quarter call, the Japanese quake and tsunami situation and was still evolving at that time. During the Second Quarter, many ceding insurance companies and direct insureds increased their initial estimated losses, and as a result, we increased our reserves by $7 million in the Second Quarter.

Losses tend to develop and settle very quickly in the Japanese market. Our information and loss reports are much better today than they were at the end of the First Quarter. And as a result, we feel we have established adequate reserves for these events. Obviously, given the magnitude of the quake and tsunami, reserves are still subject to volatility.

Gross premium volume was up 22% on the international side in the first half of the year. As Anne said, this was primarily due to Elliott Special Risks in Canada being fully integrated, and due to continued organic growth in our marine and energy book.

On the expansion front, we recently announced that we will be opening a branch office in Rotterdam, the Netherlands. We expect that this office will begin operations late in the Third Quarter.

Also during the quarter, we made a small agency acquisition in Sweden. This expands and strengthens our branch office in Stockholm. These activities are a continuation of our strategy to build a global network of branch offices producing profitable specialty business in their local markets. We're really pleased with the progress that all of our branch offices continue to make. In particular, the Elliott Special Risks team in Canada have done a terrific job renewing and developing their book of business in a really difficult Canadian insurance market.

Finally, I know we say it every quarter, but I'm going to say it again. Pricing in the property and casualty industry must have [ph] increased. 2011 is all the proof you need with insured catastrophe losses of over $60 billion in the first six months, deteriorating reserve positions and poor investment returns, especially given recent events. It's a fact -- you can't write in an underwriting loss and think you're going to make it up on volume. People are kidding themselves. At Markel, we remain disciplined and are looking for opportunities to increase pricing to more appropriate levels.

That's it for me and now I'll turn it over to Tom.

Tom Gayner {BIO 1896932 <GO>}

Thank you, Richie.

I'm pleased to report to you that we enjoyed a good first half of 2011 and our investment in industrial operations, and I look forward to your questions.

In the midst of turmoil in the daily financial markets, it's important to remember the longer-term underlying and unchanging principles we use to make decisions at Markel. As I stated last quarter and probably the quarter before that, the strategic goals of the investment department are -- number one, to protect and preserve the balance sheet through high-quality fixed income investments -- two, to allocate as much as possible to higher total return equity investments -- and three, to increase the overall earning power and financial flexibility of the Markel Corporation through the ownership of a variety of profitable businesses.

None of that changes whether the US government is rated a AAA, AA, or for those of you with long financial memories, and about questionable financial episodes and some sense of irony, B [ph] being the best [ph].

I'm happy to report that we touched all the bases during the first half, and that we continue to be on track to accomplish our strategic goals.

As to the numbers, during the first half, the total return for the investment portfolio was a positive 4.2%. Equities were up 4.5%. Fixed income was up 3.6%. And the FX effect added 0.6%.

Additionally, other revenues at Markel, which are largely those of the Markel Ventures company, were $168 million for the first half versus $77 million in the prior year, an increase of more than 100%. Markel's share of the associated EBITDA totaled $20.7 million versus $8.6 million or more than double the level in 2010. As always, the reconciliation of EBITDA to net income is available on the website.

The net of all of this is that even with the catastrophic events of the first half, we are reporting positive comprehensive income at Markel and a new record high book value per share of $338.66.

In keeping with our first strategic objective of preserving and protecting the balance sheet with a fixed income portfolio, we continue to maintain a portfolio that is high quality and short duration. Last quarter, I said that we don't seem to get paid fully for taking credit risk. This quarter, I would amend that to say we now don't think you get paid at all. And we sure don't think you get paid for taking inflation and currency risk. Consequently, our portfolio reflects those beliefs.

For yet another quarter, it remains a matter of slack-jawed amazement to me that long-term interest rates are as low as they are given current policies and circumstances.

While we have been and continue to be early in being cautious about these risks, we do not understand and will not accept the current market offer for taking them. We think it is more important to protect the portfolio in its entirety through interest rates [ph].

As to our second agenda of allocating as much as possible to higher total return equity investments, during the quarter, we continue to methodically increase the percentage of our portfolio invested in the equities. This has been our consistent pattern for the last few years.

At June 30, the total public equity portfolio grew to $1.84 billion or 55% of our total shareholders' equity.

At the nadir of the equity markets in the First Quarter of 2009, equities comprised over 45% of our shareholders' equity. Since that time, we have been methodically and continuously investing in high-quality public equity, and the first half of 2011 continues that pattern.

While the return on fixed income and equity investments has been remarkably similar in recent years, I expect the normal historical relationship to resume, and I think we will be well served by maintaining and increasing our commitment to equities as time goes by.

High-quality equities now offer the biggest equity risk premiums since the 1950s. We think we are getting paid well against that risk and we're (technical difficulty).

Fortunately, through the aggressive actions of my insurance colleagues, who have worked tirelessly to find new products and new ways to serve our customers, as well as to the acquisition of Aspen, premium volumes are beginning to increase at Markel. With higher premium volumes and the capital strength and cash that we have around here, we are in a wonderful position to step on the gas with (technical difficulty) and accelerate our purchase of equities.

We can also do this and pick up the investment income at the same time given the dividend yields of high-quality common stocks. Given all the circumstances and current prices, expect to see us buy more stock. We also think that this is not a common view in the industry and will serve to differentiate us as time goes by.

As to our third objective of building the earning power and financial flexibility of the Markel Corporation by earning a variety of profitable businesses, we continue to be very pleased with the ongoing growth of Markel Ventures. The businesses are producing results in line with our expectations, and they are adding value to Markel.

During the Second Quarter, we purchased PartnerMD, a concierge medical practice with three offices in Virginia. We've known the principles of PartnerMD for years, and we are excited and confident about their future contributions to Markel.

With the permanent capital base at Markel provides and the changing medical landscape, we think we offer an excellent home for general practice physicians to deliver high-quality care to their patients. While the initial transaction is small, we are optimistic about the future growth and profitability at PartnerMD. We also continue to work on other transactions and we expect ongoing organic and acquisition opportunities within the growing framework of Markel Ventures.

Our portfolio and our acquisitions remain conservative. We believe in our fortress balance sheet, which enabled us to withstand the sort of catastrophic weather and natural events we experienced during the first half, and have withstood the sort of financial catastrophe that occurred in 2008, as well as the current drop in the barometer. By having the balance sheet we've built over the decades, we've been able to respond to opportunity in the insurance, investment and industrial world to build the value of your company.

We continue to see opportunities on all fronts, and I'm pleased to report to you that we have the financial and human capital, as well as the courage and creativity needed to make the most of it. With that, I would like to open the floor for questions.

Questions And Answers

Operator

(Operator Instructions). Beth Malone, Wunderlich Securities.

Q - Beth Malone {BIO 1497932 <GO>}

On the source -- you talk about the -- there was an account. At the beginning of the presentation, you talked about an account in Virginia that you had lost. There was an indication account that now you got it back, lost in 2007, got it back today. What changed or why did that move back to Markel?

A - Mike Crowley {BIO 6836605 <GO>}

I don't have the exact answer to that. My guess is that they were unhappy with the current environment and service from their current carrier.

Q - Beth Malone {BIO 1497932 <GO>}

Okay. Do you -- is this -- you pointed that out. Is this typical of what's been happening for Markel? As pricing has been so soft and you all have refused to participate, is this an indication that the market is starting to appreciate the value of Markel's services or something, and we should anticipate that this is part of all pricing getting better or the environment improving for Markel?

A - Mike Crowley {BIO 6836605 <GO>}

I think it makes sense to look at it from that standpoint to some degree. I can tell you that we are beginning to see some initial situations where business that we either declined for pricing reasons or were not able to attract for pricing reasons, is showing up in some of our submissions.

On the Specialty side just the other day, I heard of several accounts that are coming to us that are right up our alley that we think we will have an opportunity to write because of a more favorable rate environment. But I want to caution you -- I think this is just the beginning and we will see how it plays out, but we are encouraged by what we see.

Q - Beth Malone {BIO 1497932 <GO>}

Okay. And then, just on the top-line growth in the international, you said that the acquisition of Elliott was a big factor there. What -- exactly what kind of rate increases are you seeing on the international book? And how important is that to the growth you saw in the Second Quarter compared to a year ago in the international business?

A - Richie Whitt {BIO 7084125 <GO>}

Beth, I think the only places that we're really seeing rate increases would be cat-exposed property, and in the energy classes, some of the energy classes. Those are pretty much it.

What we are seeing, though, I think, is flattening out in some of the other areas. And Mike was talking about accounts that maybe had moved away from us a few years, that are showing back up. And we are seeing some of that in London as well. We, for example, have lost some professional accounts over the last few years, and all of a sudden they're coming back to us with a little bit better pricing and maybe unhappy with their current situation.

So, I think as Mike said, there's some positive signs out there, but to say there's much in the way of price increase in the growth that we are showing right now in London -- very little.

Elliott Special Risks is, on a yearly basis, about $100 million of premium, and so that's what we are seeing coming through our numbers through the first six months, about half that. And then, on the marine and energy side, yes, we are seeing a little bit of price increase there, but we've got some organic growth just because of some of the dynamics in that market.

Q - Beth Malone {BIO 1497932 <GO>}

Okay. And then just as I follow-on, with all the losses you guys described that you have had and the industry has experienced and the environment for the low interest rates, what do you think is the major reason that we are not seeing more of an across-the-board rate increase in the marketplace? Is this really due to the weak economy?

A - Tom Gayner {BIO 1896932 <GO>}

Beth, I think that's a lot of it. And I think also, in the 0% interest-rate regime that we're living in, the acceptable rates of return and people are willing to lay their capital out for, is extraordinarily low. Now we don't think that's why or that's really the normalized cost of capital that's out there, but I think that's the reality of what's happening on a day-to-day basis.

Q - Beth Malone {BIO 1497932 <GO>}

Okay. And then one last question to you, Tom, as the valuation in the marketplace has changed pretty dramatically over the last couple of weeks, and the outlook -- I'm not sure what the outlook is anymore in terms of economic recovery -- but do any of those factors change your appetite for the types of companies that you -- I know you have a very defined thing that you're looking for, but does this alter it at all, the kind of companies you are looking for to partner up with?

A - Tom Gayner {BIO 1896932 <GO>}

It doesn't alter what I'm looking for at all. What it alters is the ability to find what I'm looking for, because the price is lower. So I've always looked for -- they're profitable businesses run by managers with equal measures of talent and integrity that have the ability to use the capital and at fair prices. Well, the only thing that's changing is point number four there, fair prices. There's stuff on sale, and the opportunity to find those first three attributes that I've been looking for.

Q - Beth Malone {BIO 1497932 <GO>}

Now, that said, is there a limit as to how much capital you are willing to expose to that particular type of investment?

A - Tom Gayner {BIO 1896932 <GO>}

Absolutely. The shareholders' equity accountants of our stock of what the ultimate amount of capital that we can allocate that with, but there's -- we have a lot of flexibility between where we are and that ultimate number. And the reason we are putting it there is because that's where we think we will earn the best returns on capital, which has the lovely attribute of making its own capital as it goes.

Q - Beth Malone {BIO 1497932 <GO>}

Okay. All right. Well, thank you.

Operator

John Fox, Fenimore Asset Management.

Q - John Fox {BIO 18976738 <GO>}

Thank you. Good morning, everyone. First, thank you for the disclosure on the cat losses. That was very appreciated.

A - Anne Waleski {BIO 16735457 <GO>}

You're welcome.

Q - John Fox {BIO 18976738 <GO>}

Number one for Tom, what -- with some of these more recent acquisitions, can we get an update on the run rate for revenues for ventures?

A - Tom Gayner {BIO 1896932 <GO>}

Yes, I think $275 million to $300 million at the top line is the range to use.

Q - John Fox {BIO 18976738 <GO>}

All right, terrific. I don't know who this is for -- but FirstComp has $15 million year to date of I guess excess losses or reserve takeup or whatever. I guess my question is, are those actual losses or is that kind of bringing that up to the Markel standard margin of safety? And if it's the latter, where are you in that process?

A - Richie Whitt {BIO 7084125 <GO>}

It's Richie. You know, we kind of talked about probably in the Fourth Quarter call, that we expected FirstComp to be at an underwriting loss this year as we got to the Third Quarter, probably Third Quarter. Yes. We thought we'd have maybe a $30 million underwriting loss this year at FirstComp as we sort of move towards our reserving standards, as we layered our conservatism on the picks and all those sorts of things. And I think for six months, we're right on target for that.

So, things are going basically as we expected. Actually, maybe things are going a little bit better than we expected because we are starting to see a little bit of price move in the workers' comp market, and God knows it needs it, so we're hopeful.

Q - John Fox {BIO 18976738 <GO>}

Okay. So that run rate really is going to continue this year.

A - Richie Whitt {BIO 7084125 <GO>}

Yes. Yes. So we're right on target there.

Q - John Fox {BIO 18976738 <GO>}

Okay. And then Richie, while have you, I think you are the international guy. Could you talk about the $10 million in the marine/energy? You put it in the cat table, but were they really cats? What were the nature of those losses?

A - Richie Whitt {BIO 7084125 <GO>}

They're energy losses basically. You know, we are growing our marine and energy books significantly. We're probably going to write rough numbers, $250 million of marine and energy this year, so that book is getting substantial. As you know, John, we keep as much of it as we possibly can, so we have a reinsurance program where we keep pretty much I would say about $10 million at the bottom of the program. So we had two relatively sizable losses. In the book -- a $250 million book of business can take a few of those hits, but these were fairly early in the year. So, we have -- they're not really cat. They're really just large losses, and we're going to expect to have a few of those a year on a $250 million book. And we will see how the rest of the year plays out.

Q - John Fox {BIO 18976738 <GO>}

And what's the catalyst for that loss? Obviously, we have like a BP-type event, which is kind of a one-off. What --?

A - Richie Whitt {BIO 7084125 <GO>}

One was an offshore oil platform that sustained some serious damage. The other one was a pipeline spill where there's some cleanup costs and obviously fixing of the pipeline and various things like that. So two pretty big losses to the market, and we participated on those.

Q - John Fox {BIO 18976738 <GO>}

Okay. And then I think this is for Anne. The June debt offering -- what are your plans for the proceeds?

A - Anne Waleski {BIO 16735457 <GO>}

Well, right now, the proceeds we are -- I think we've said in the offering they are for general corporate purposes and potentially acquisitions. We're generally viewing them as increasing our flexibility to take action where we see opportunities, so for instance, if we had an opportunity, which I don't think we do at the moment, to buy back some of the 2013, we would exercise that option. If we had an M&A opportunity that we thought was really interesting, we could use it for that. So right now it's really just increasing our flexibility to do any number of things.

Q - John Fox {BIO 18976738 <GO>}

And the 2013, is there a call feature or why can't you repurchase them?

A - Anne Waleski {BIO 16735457 <GO>}

I just don't think that the purchase prices on them right now are very attractive. We can repurchase them. I just don't think we will at the moment.

Q - John Fox {BIO 18976738 <GO>}

Okay. Terrific. Thanks, everybody.

A - Tom Gayner {BIO 1896932 <GO>}

Thank you.

A - Anne Waleski {BIO 16735457 <GO>}

Thank you.

Operator

Mark Hughes, SunTrust Robinson Humphrey.

Q - Mark Hughes {BIO 1506147 <GO>}

Thank you, very much. The favorable development in the excess and surplus, anymore detail you can provide, what the specific lines benefit is in this case?

A - Mike Crowley {BIO 6836605 <GO>}

It was pretty much a core business in our binding, property, casualty business.

A - Tom Gayner {BIO 1896932 <GO>}

Primarily professional liability, right?

A - Anne Waleski {BIO 16735457 <GO>}

Yes, primarily professional and products liability, and it was within the 2006 to 2009 accident years.

A - Mike Crowley {BIO 6836605 <GO>}

Oh you were -- oh, I was thinking about the rate increases. Sorry.

Q - Mark Hughes {BIO 1506147 <GO>}

Yes, that's helpful. Thank you. And then the expenses in the Specialty Admitted and the London segment were fairly low this quarter. Would you expect that to be sustained or is it just a little random variation?

A - Anne Waleski {BIO 16735457 <GO>}

I think part of that, if you are looking at the expense ratios being driven by the increase in earned premium, as well as FirstComp has a slightly lower expense ratio within Specialty Admitted.

Q - Mark Hughes {BIO 1506147 <GO>}

Right. So assuming the earned premium trends hold up and the expense ratios should continue to be a little more modest?

A - Anne Waleski {BIO 16735457 <GO>}

I think you can assume that, yes.

A - Mike Crowley {BIO 6836605 <GO>}

God willing.

Q - Mark Hughes {BIO 1506147 <GO>}

Thank you.

Operator

Meyer Shields, Stifel Nicolaus.

Q - Meyer Shields {BIO 4281064 <GO>}

Good morning, everyone. If we take out the primary development and the significant catastrophic losses, we still saw a 4 or 5percentage point increase in the loss ratio for Excess & Surplus and Specialty Admitted. I was wondering if you could talk to that a little.

A - Anne Waleski {BIO 16735457 <GO>}

Meyer, what I can tell you at a high level is some of that is related to mix of business. Michael alluded to some of the accounts that have moved on, so there's some mix of business in that. There's the addition of Aspen within specialty, which is adding to that. And then there -- admit there were those large losses that we talked about that Richie just covered.

Q - Meyer Shields {BIO 4281064 <GO>}

Okay.

A - Tom Gayner {BIO 1896932 <GO>}

One other point that's worth adding, Meyer, is we've consistently stated (inaudible) for decades on what (inaudible) when we try to reserve on day one when we write the business at a level that's more likely to be (inaudible) than deficient [ph]. So the fact that you are seeing stable reserve development issues, we see people ex that out all the time, but they -- you ex it out in 2011 and 2010 and 2009, and 2008 and 2007 and 2006, it's the sort of thing that we try to have a consistent practice here at Markel rather than extraordinarily so.

Q - Meyer Shields {BIO 4281064 <GO>}

No, I understand that. I've always assumed that. I was just wondering about the sequential change from the First Quarter to the Second Quarter of 2011.

With respect to the hunt for (inaudible) agents that you said are budgeted [ph] for Markel, is that for all Markel products then?

A - Mike Crowley {BIO 6836605 <GO>}

No -- it would just be for our specialty -- some of our specialty products like child care, social services, and some things where we expect to see some duplication in terms of the kind of (inaudible) business that FirstComp is writing.

I think I said in the First Quarter that we had gone through all of FirstComp's agents and identified about 400 agents where we thought there was opportunity to cross sell Markel products. We've now point appointed about 100 of those.

Q - Meyer Shields {BIO 4281064 <GO>}

Okay, but that's for very specific products. It's not the entire portfolio.

A - Mike Crowley {BIO 6836605 <GO>}

Right.

Q - Meyer Shields {BIO 4281064 <GO>}

Okay. And last question for Tom if I can. Will you look at I guess where we're seeing incremental investments obvious with the equity portfolios growing a little bit. We're also seeing foreign governments and short-term investments grow very rapidly. Is that just timing or is there something particularly attractive there?

A - Tom Gayner {BIO 1896932 <GO>}

That would be some reflection of (inaudible) business overseas. And just like we match the insurance liabilities in the US against largely US based securities, when we write business overseas, we tend to match that in a local currency investment of some sort so that we don't take currency risk from the balance sheet.

Q - Meyer Shields {BIO 4281064 <GO>}

Okay, so is the way you are addressing that through government-issued securities of those equities?

A - Mike Crowley {BIO 6836605 <GO>}

Largely -- but there's some equities that we own. And that gets into nomenclature as well because you know, for instance, it's no secret that we own Biagio. Well Biagio shows up on the statements as a UK-based company, but North America is their largest market, so it's a little bit tap the issue [ph] when we describe that as an international company.

Similarly, we also (inaudible) Caterpillar Tractor who has done more business overseas than in the US for decades. That shows up as a US-based investment, but I would largely describe their (inaudible) as more outside the borders of the than inside.

A - Richie Whitt {BIO 7084125 <GO>}

Meyer, also keep in mind, you know we had the debt offering in the Second Quarter, and obviously we haven't gotten around to allocating that out to the portfolio yet. So until that happens, you put it in fairly short-term treasuries and money funds and various things like that. And as Tom said, we are fairly measured in how we do things. So over time, we will reallocate that into the longer portfolio or to Markel Ventures or to equities.

Q - Meyer Shields {BIO 4281064 <GO>}

Okay. That's very helpful. Thank you, all.

Operator

Jay Cohen, Bank of America, Merrill Lynch.

Q - Jay Cohen {BIO 1498813 <GO>}

Thank you, -- a couple of questions. First is, on the Ventures business, you had talked about, Tom, what you thought a normalized level of revenue would be. On the bottom line, the income sequentially jumped up. Obviously you've been adding to that business. Should we look at this quarter as a fairly normalized earnings contribution as well? Is there anything unusual in that number that either helped or detracted from the number?

A - Tom Gayner {BIO 1896932 <GO>}

No, I think it's way too early in the history of Markel Ventures to annualize per [ph] quarter. The businesses are doing well, but as you might suspect from having known Markel for a long time, we are not running them in 90 day sprint increments. We are thinking about the long-term economics. I mean obviously with the way they are doing, expect more of the same, but that doesn't come out in a 90-day increment.

Q - Jay Cohen {BIO 1498813 <GO>}

Got it -- no, that's fair.

And then, a numbers question -- as we looked at operating earnings, so excluding realized -- net realized gains, it looks like the tax rate on the operating earnings in the Second Quarter is relatively low, and I'm wondering if there's anything distorting that.

A - Tom Gayner {BIO 1896932 <GO>}

It -- Jay, that's just going to be the fact that pretax is dropping, but we have a pretty static allocation to muni tax-exempt bonds. So that permanent item, that tax-exempt amount, becomes a larger percentage of the pretax and that goes against operations.

A - Anne Waleski {BIO 16735457 <GO>}

It's also that we have a lower rate on the foreign operations in that.

Q - Jay Cohen {BIO 1498813 <GO>}

Got it. That does explain it. And then if I could squeeze one more in for Tom Gayner, Tom, I wouldn't mind if you would reflect a little bit on this action by S&P, and specifically, what it might mean for your muni portfolio going forward.

A - Tom Gayner {BIO 1896932 <GO>}

Well, I don't think that it really is a surprise to the marketplace. Quite frankly, (inaudible) of the last 48 hours or so, so I don't think it makes any difference at all. (technical difficulty) in terms of the muni part of the question, from Richmond, Virginia, I happen to note that the Commonwealth of Virginia is in surplus this year as it was last year. And I think there's something like 36 AAA-rated counties in the country, and we are calling you from one of them. And another one of them is (inaudible).

So when you look at the state and municipal level of finance, actually it looks better than the federal government, partly because they operate on a shorter leash and they have a balanced budget requirement, so I feel pretty good about the munis.

And one other point that I noted to our board is if you look for instance in the news flow, the City of Atlanta, as an example, switched over to retirement plan of a 401k-style plan from a defined benefit plan. That's not a bastion of conservativism when we look at the Atlanta City government. So the fact that the reality was they needed to change to keep the doors open, they did, and you are seeing states and municipalities make tougher, harder, and I would argue, better decisions than what's done at the federal level.

Q - Jay Cohen {BIO 1498813 <GO>}

Sounds like a very sane view. Nice to hear something that sounds sane these days. Thank you.

Operator

(Operator Instructions). David West, Davenport & Company.

Q - David West {BIO 1838548 <GO>}

Good morning. Returning back to be expense questions a little bit, I wonder if there are any comments relative to the One Markel initiatives or are those pretty much winding down?

A - Anne Waleski {BIO 16735457 <GO>}

I don't know that we had much in the way of comments relative to One Markel. As we have talked about in prior calls, the actual move to the regional model is now finished and implemented and working as we had hoped, and we're getting good feedback from our distribution partners on how that is working relative to some of the IT initiatives that we were working on.

Relative to that specifically this year, the data warehouse and the broker portal. Broker portal is in a beta test state at this point and data warehouse is moving along as we anticipated, perhaps slightly slower than we anticipated, but going to deliver the results we had hoped for. So I don't know that there is too much to talk about in the expense ratio other than normal run rate expenses from those IT projects.

A - Tom Gayner {BIO 1896932 <GO>}

Yes. And I think we think this is the last big year to spend on those, David. Next year I think it's just sort of run rate, sort of IT investment, the things you have to do to keep your IT competitive with the rest of the market.

Q - David West {BIO 1838548 <GO>}

Very good. And then Tom, kind of returning back to the Markel Ventures, is there any particular seasonality in the patterns of revenues and profits that you can see right now with your portfolio?

A - Tom Gayner {BIO 1896932 <GO>}

Well, they each do have some seasonality associated with them, but as that business grows and the spread widens, different ones will be on different seasons, so I don't think we're going to see pronounced seasonality out of those sets of businesses. I guess with PartnerMD, we might see a bump in the cold and the flu season, but stay tuned on that.

Q - David West {BIO 1838548 <GO>}

Okay. Thanks very much.

Operator

Thank you. Mr. Gayner, there are no further questions at this time. I would like to turn the floor back over to you for any closing comments.

A - Tom Gayner {BIO 1896932 <GO>}

Thanks so much for joining us. We are available as always, and we appreciate your loyalty and support. And we will talk to you soon. Thanks. Bye bye.

Operator

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