S&P Capital IQ

CONTENTS

W. R. Berkley Corporation NYSE:WRB

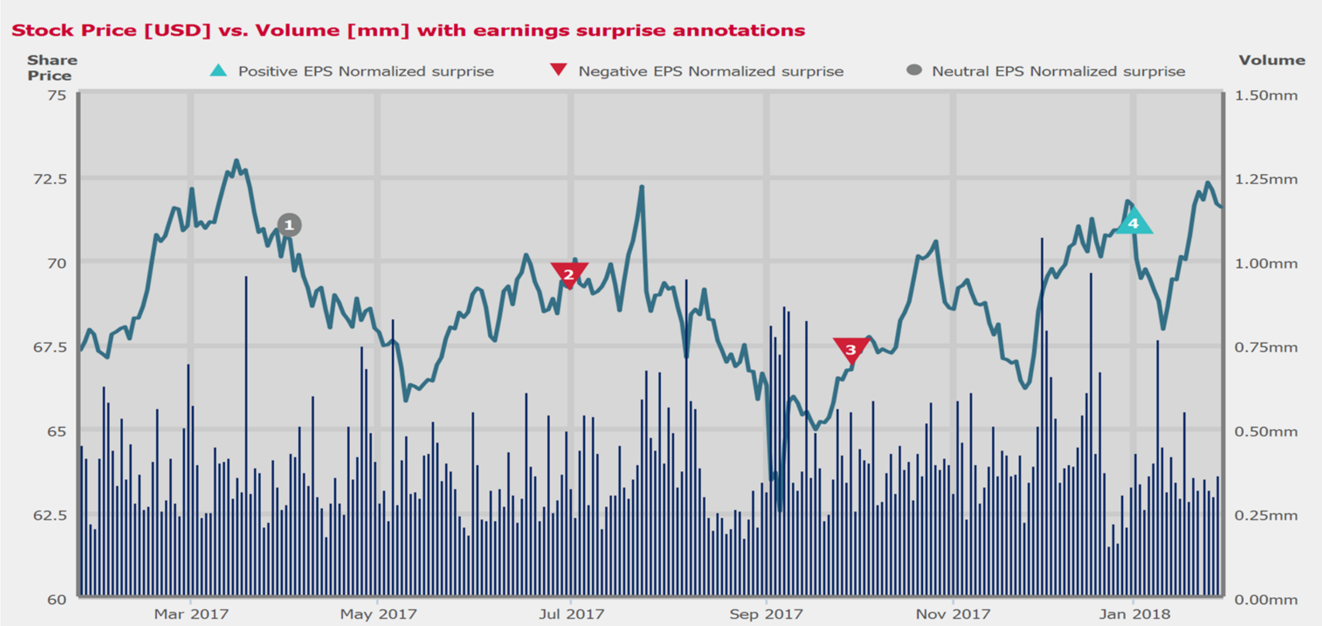
FQ1 2018 Earnings Call Transcripts

Tuesday, April 24, 2018 9:00 PM GMT

S&P Capital IQ Estimates

	-FQ1 2018-			-FQ2 2018-	-FY 2018-	-FY 2019-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.89	1.00	▲12.36	0.83	3.58	3.81
Revenue	-	-	▼(0.16 %)	-	-	-
Revenue (mm)	1569.95	1567.41	-	1583.43	6584.48	6755.30

Currency: USD
Consensus as of Apr-23-2018 9:55 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ1 2017	0.70	0.70	① 0.00 %
FQ2 2017	0.77	0.65	▼2 (15.58 %)
FQ3 2017	0.27	0.23	▼3 (14.81 %)
FQ4 2017	0.73	0.74	▲4 1.37 %

Call Participants

EXECUTIVES

Richard Mark Baio
Senior VP, CFO, Principal Accounting Officer & Treasurer

William Robert Berkley
Executive Chairman of the Board

William Robert Berkley
President, CEO & Director

ANALYSTS

Amit Kumar
The Buckingham Research Group Incorporated

Arash Soleimani
Keefe, Bruyette, & Woods, Inc., Research Division

Ian Gutterman
Balyasny Asset Management L.P.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Kai Pan
Morgan Stanley, Research Division

Unknown Analyst

Presentation

Operator

Good day, and welcome to the W.R. Berkley Corporation First Quarter 2018 Earnings Conference Call. Today's conference call is being recorded. The speaker's remarks may contain forward-looking statements. Some of the forward-looking statements can be identified by using -- of the use of forward-looking words including, without limitation, beliefs, expects or estimates. We caution you that such forward-looking statements should not be regarded as representation by us that the future plans, estimates or expectations contemplated by us will be, in fact, achieved. Please refer to our annual report on Form 10-K for the year ended December 31, 2017, and our other filings made with the SEC for a description of the businesses environment in which we operate and by the important factors that may materially affect our results. W.R. Berkley Corporation is not under any obligation and expressly disclaims any such obligation to update or alter its forward-looking statements whether as a result of new information, future events or otherwise.

I would now like to turn the call to Mr. Rob Berkley. Please go ahead, sir.

William Robert Berkley
President, CEO & Director

Brian, thank you very much and good afternoon all, and welcome to our first quarter call. Joining me on this end of the phone as in the past is our Executive Chairman, Bill Berkley; and Rich Baio, our Chief Financial Officer. And the agenda for today, again, following suit is I'm going to kick it off with a few general comments about the industry, give you a few high-level observations about our quarter and then pass it over to Rich, who will be getting into the details of the quarter. And then following his comments, we will be opening it up for questions for as long as you'd like within reason.

So inflation from our perspective, clearly, the topic of the day. I think it is the topic of the day across many industries, and the insurance industry is certainly included in that. I think for some it is the moment that people have been speculating or waiting for, for some extended period of time, and it is upon us.

Some of the obvious questions are, how much? How quickly is it going to get here? And how long will it stay? Obviously, from our perspective, there is the impact that will come along with a rising interest rate environment.

Other questions for the industry. What is the impact on loss cost going to be and ultimately reserve? And of course, as well, what is the impact going to be on investment portfolio and investment income? Having said this, we think there are a couple of other questions that one needs to be grappling with when they think about inflation and a higher interest rate environment. One of them clearly is will targeted returns be moving up with a higher benchmark? Will people be looking to think about the risk-free rate? And as a result of that, the hurdle or the delta above the risk-free rate that they should be achieving in this industry as that moving -- going to be moving up as well? And then finally, there is the question around alternative capital, which also has been discussed and considered and speculated about for an extended period of time. Is alternative capital a permanent part of this industry? Or is it something that is here during a low interest rate environment? And when you see interest rates return to a more historic level, will alternative capital withdraw as they are more easily able to achieve their targeted returns?

All important questions from our part. And ultimately, we will not have the answers other than through the passage of time. But we think they're important because the answers are exceptionally leveraged for this industry in particular.

Second thought or observation is cycle. And at the risk of stating the obvious, it is clear from our perspective that there are no longer is one cycle. And on one hand, I think that this is widely understood. At the same time, it seems as though many people, both in and outside of the industry, speak of the cycle as if it is one across all industry product lines.

From our perspective, probably a couple of decades ago, different product lines within the marketplace started to march to the beat more and more of their own drum. You can see that in the difference in what's going on in the insurance industry and the reinsurance industry. And you certainly can see that even within the insurance or reinsurance marketplace. The difference is between various lines of business, for example, the challenges of property, while on the other hand, workers' compensation for the past few years has been very attractive. So you might ask, why do we focus on this? Why do we think this is relevant? And the answer is we think it is relevant because it brings one to the idea of specialization. It is our view the reason why you're seeing product lines marching less and less in lockstep is because there is greater specialization amongst skill sets and how capital is deployed. I think this is relevant. I think it is important to bring it to people's attention because more and more people view the insurance industry as a commodity industry. And without a doubt, there are parts of the industry that certainly lends itself to that type of observation or statement.

Having said that, from our perspective there are aspects of this industry where specialization is very much alive and well. And quite frankly, specialization is the opportunity for an organization such as ours to truly differentiate itself and ultimately bring value to customers and bring value to our owners by generating excellent returns as a result of our skill set.

Let me turn to some things that are perhaps a little bit more directly related to the day to day of the industry. Reinsurance marketplace, it hasn't gotten any less painful to talk about or to operate in over the past 90 days. Quite frankly, for the life of me, after what happened in the third and a bit in the fourth quarter of '17, I can't figure out why the property market has -- property reinsurance market hasn't responded more. Some would say, I might be one of those people, that a lot of it does have to do with alternative capital that is willing to accept a lower return. They get somewhat trapped in the marketplace through the managers that manage that capital in the marketplace. And it is just looking to be deployed. And again, I'm not sure if it has the same focus around risk-adjusted return that some of the traditional players have.

As far as the casualty market, much to my surprise as I think I mentioned in the fourth quarter call, it seems to have incrementally more legs than the property market. What that really means is for accounts that have had lousy experience and the insurers are seeming to get enough leverage that they can push rates up. I'm hoping that this is the beginning of a gradual building of a groundswell, if you like. Again, we will see with time.

Switching over to the insurance market. Clearly a brighter situation from our perspective. Casualty, overall, still remains quite attractive. Workers' comp, which as we've discussed in the past has peaked, but there is still plenty of margin and certainly many territories within that marketplace. Having said that, there are parts of the comp market that I think also, as we've commented in the past, that scare the daylights out of me. Florida would be an excellent example of that.

Property on the primary or insurance front. Also a mixed bag or -- in my notes here, I wrote down the word bizarre. I do think it's absolutely bizarre for accounts that were impacted by storms in the third quarter and there were losses they certainly are seeing rate increases. For accounts that were not impacted in the third quarter but are cat exposed, the rate increase that they're getting is surprisingly modest if even that much. And ironically, sometimes noncat-exposed property is getting more of a rate increase than cat-exposed property that wasn't impacted in the third quarter. So that's why, I guess, I wrote my note, bizarre.

Professional. Still from our perspective, ripe for change. And we're pleased to see in the quarter there were some early signs that there are pieces of the professional market that are getting some traction. And again, quick comment about auto. We are pleased to see that the momentum continues to build there.

Pivoting over to our quarter. From my perspective, I think from our perspective, it would be defined or viewed as a solid quarter. I think the fact is that there was a bit of cat activity. The funny thing about cats is everyone defined taxes in their own way. If you look at the property losses that we had in the aggregate stemming from what I would define as weather related, it was not insignificant. Yet in spite of that, we still were able to achieve what I would define as a good result, to say the least. In addition to that, as far as the top line goes, you saw the 1% growth, which was an improvement from what we've seen over the past couple of quarters. But I think you need to peel a couple of layers back, and it really goes back to this idea that we grow where the margin is and we shrink where it isn't. Unfortunately, per my comments earlier, reinsurance still remains exceptionally competitive. And as a result of that, you can see that we're off considerably. On the other hand, the insurance market, we still find opportunity there. And it's meaningful. And as a result of that, the Insurance business grew more than 3%.

Another quick comment, just on the top line overall. We did achieve a rate increase that we were particularly pleased with, which is in the neighborhood of 3.5%. This was more of a step than I have anticipated. I was expecting it was going to be between 2% and 3%. But we are -- I think this is just evidence that we are pushing for rate, and we are finding opportunities to achieve that rate. Again, as far as the results go, combined ratio 94.6%. The loss ratio was 61.4%. My boss commented to me, I guess he took note that it was the same in the fourth quarter and asked if we, for some reason, like that number, 61.4%. But Rich assured me that we got there a different way this time than last time. And the expense ratio, the 33.2% was, I thought, a good improvement from where we've been. And that's in spite of the fact that we moved some start-ups over from holding company expense or parent expense over into the expense ratio.

Balance sheet, starting with the reserves. And again, Rich is going to get into the details, but $12 million of positive development, which again I think is an indicator that we continue to take what we would view as a very prudent approach to how we make our initial picks, and over time we tighten them up. And we like to err a little bit on the side of caution early on. And as things come more into focus, we're willing to tighten that.

And at this stage, I'd like to begin -- Rich keeps track of the number of quarters. I don't know how many quarters, but it's a lot of quarters of positive development in a row.

A couple of other things. The investment portfolio -- and again, Rich will give you the details on this. But I did want to just tip my hat to our colleagues at Berkeley Dean that manage the portfolio. They in spite of the challenges have managed to keep the duration short at the 3 years. They've maintained the quality, and they've maintained the yield. I'm not sure how they've done it, but they've done it very well. And as a result of their skill and the skill of some others as well, we have benefited by positioning the business. So not only in the quarter with book value up, but we think that we were very well positioned as we see interest rates continue to move up to optimize.

So I will come back to you once Rich is done with his comments. Let me hand it over to him, and he'll take you through the numbers. Thank you.

Richard Mark Baio
Senior VP, CFO, Principal Accounting Officer & Treasurer

Great. Thanks, Rob. We reported net income of $166 million for the first quarter of 2018 or $1.30 per share, which is approximately $43 million higher than the prior year and represents an increase of 35%. The improvement over the year-ago quarter is primarily attributable to higher underwriting profit and net investment income. In addition, our overall income tax expense decreased significantly due to the reduced U.S. tax rate of 21% versus 35% in the prior year. As you saw from the earnings release, it is more challenging to compare our current results with prior periods. This challenge results from tax reform passed in December 2017 and accounting rules adopted in 2018 relating to equity securities. If we had followed the accounting rules for equity securities before this change, our pretax gains would have been higher by $94 million, which would have resulted in a 7-point increase in our annualized pretax return on equity. I'll explain further some of the details in just a few minutes.

Pretax underwriting income increased $17 million to $84 million this quarter. Net premiums written increased, as Rob mentioned, 1.1% to approximately $1.67 billion. The growth was led by the insurance segment, which increased 3.3% to $1.54 billion. We continue to see a competitive market in many areas of our reinsurance segment putting pressure on the rate environment. In particular, the North American assumed property and casualty business continues to shrink. This decision was driven by a marketplace that did not allow for us to achieve our risk-adjusted return. Accordingly, overall, the reinsurance premium declined 20% to approximately $122 million.

The accident year loss ratio before cats of 61.7% was largely unchanged from the year-ago quarter. Cat losses declined from $14 million or 0.9 loss ratio points for the prior year to $7 million this quarter or 0.5 loss ratio points. As many companies have defined cat losses differently, I thought it would be wise to remind you how we define cat losses. We follow PCS-identified cat losses which are based on events that cause $25 million or more in direct insured losses to property and affect a significant number of policyholders and insurers. Accordingly, we did experience, similar to others, an increase in noncat weather-related property losses, largely attributable to winter freeze, which did not meet the PCS definition as a catastrophe event. We also experienced several large fire losses during the quarter, although do not see this claims activity as a trend. Loss reserves developed favorably by $12 million or 0.8 loss points compared with $2 million or 0.2 loss points for the same period last year. You may recall that first quarter 2017 was adversely affected by the change in the Ogden discount rate in the U.K. for lump sum bodily injury claims. Accordingly, our reported loss ratio declined 1 loss ratio point to 61.4% quarter-over-quarter.

The expense ratio is relatively flat from the year-ago quarter and lower by 0.3% from the consecutive quarter. The current quarter's expense ratio was favorably impacted by the reduction in commission expense relative to the change in net premiums earned. This reduction was partially offset, as Rob had mentioned, by increased compensation expense in the full quarter of expenses for Berkley One which was moved out of corporate expenses in the fourth quarter 2017. This brings our combined ratio for the first quarter 2018 to 94.6% compared with 95.7% in the prior year.

Investment income increased 17% or $26 million to $175 million. The investment income of the core portfolio increased approximately $13 million, led by fixed income and real estate income. Investment funds increased $14 million due to mark-to-market adjustments in real estate funds and new investments that we did not hold in the first quarter of 2017. As anticipated, energy fund performance was in line with the prior quarter. We have maintained an average rating of AA- and, as Rob alluded to, an average duration of 3 years for a fixed maturity securities, including cash and cash equivalents. We reported pretax net realized gains and pretax net unrealized gains on equity securities of $48 million. This amount reflects a change in the treatment of fair value movements on equity securities. In prior periods, these fair value changes for equity securities were reported in AOCI, component of stockholders equity. Commencing with the first quarter 2018, the fair value changes were reflected in the income statement. Accordingly, there are 2 components in the first quarter 2018 pretax gain amount. The first is pretax realized gains from the sale of investments. And secondly, the change in unrealized gains on equity securities resulting from the adoption of this new accounting pronouncement. The change in unrealized gains on equity securities is not reflected in any prior quarterly results and therefore creates an inconsistency to comparable periods in our income statement.

To put some numbers behind the quarterly comparison. We realized pretax gains on the sale of investments of $142 million in the first quarter of 2018 and $52 million in the year-ago quarter. However, due to the new rules, we reflected a reduction in the current quarter's pretax gains of $94 million for changes in unrealized gains on equity securities. Our after-tax unrealized gains reported in stockholders equity declined from $375 million to $35 million. The decline resulted primarily from the addition of the new accounting rules on equity securities, which required the transfer of after-tax unrealized gains from AOCI to retained earnings. The effective tax rate was 20.6% for the quarter. The total income tax expense reflects the reduction in the U.S. statutory tax rate from 35% to 21%. The effective tax rate differs from the U.S. federal income tax rate of 21%, primarily because of tax exempt investment income offset by foreign operations at the higher tax. Our return on equity for the quarter on an annualized basis was 12.3% on net income. Book value per share increased $0.32 to $44.85, representing an increase of just under 1%. Due to the short duration of our investment portfolio, we've not been as affected by the rise in interest rates as perhaps others and continue to see growth in book value per share. We repurchased 101,000 shares in the quarter at an average price per share of $67.31. Thank you, Rob.

William Robert Berkley
President, CEO & Director
Rich, thank you very much. And obviously in addition to your usual comments, a little bit of complexity brought to us, complements of the FASB in the quarter. So Brian, at this time, if we could please open it up for questions.

Question and Answer

Operator

[Operator Instructions] And our first question will come from the line of Amit Kumar with Buckingham Research.

Amit Kumar
The Buckingham Research Group Incorporated

Two questions. The first question is for you, Rob. You broadly covered the trends in the marketplace. I think what would be helpful is, would it be possible to maybe just go a bit deeper into some of the pricing trends you might have seen in the insurance subsegments?

William Robert Berkley
President, CEO & Director

Honestly, Amit, I think that we try and steer clear of getting into granular detail as to where we see rates going up. I try to give you a broad sense. So for example, workers' compensation, I think it's, generally speaking, widely understood that state rating bureaus and the NCCI are moving rates down, and that's impacting the product line pretty much across the board. On the other hand, I think commercial auto would be an example of where rates are going up in general. But I don't think it makes a lot of sense to start trying to get into the weeds much beyond that. But...

Amit Kumar
The Buckingham Research Group Incorporated

I guess what I was trying to understand was, obviously, there's a lot of debate on the trajectory of rates and, I guess, the slope of the rate change. And that's what I was trying to understand. If you look at the trajectory in Q1 versus Q4, if I was to take the trajectory and overlay that with the comment you guys made in the letter to shareholders, is there a greater urgency based on the change in the 10-year? Or is this a much longer-term process? I guess that's what I was trying to better ascertain.

William Robert Berkley
President, CEO & Director

I think the answer is that we are comfortable with our loss picks. And we are looking to make sure that we achieve the required rate to support those loss picks. And to the extent that there are certain parts to the book that will bear additional rate, then we will be pursuing them. So there is not a policy that we write, a treaty that we write where we think it is not going to achieve our loss pick. But to the extent that there are parts of the market that will bear more, we are going to try and take advantage of that. Do I think that all of a sudden the 10-year pops up and is flirting with 3% and all of a sudden we go down to the boiler room and try and crank up the rates? No, it doesn't work like that. At least it doesn't work like that here. Do I and, more importantly, my colleagues have a view as to where inflation is going and where loss cost is going and what our experience has been and when we put that all into a sausage maker, what kind of rate do we need? Yes, we have a view on that. In addition to that, to the extent that the market will bear more than what -- even than we think we technically need or our technical rate, then we will be looking to take advantage of that.

Amit Kumar
The Buckingham Research Group Incorporated

Got it. That's helpful. The only other question I have is you referenced NCCI. NCCI is now recommending pricing decreases coupled with the tax reform. In fact, they're making -- they're recommending different rate filings in different states, which factors in the benefit from the tax rate. So I was trying to better understand, you have a combination of NCCI pushing for rate decreases coupled with an industry already probably under competitive and pricing pressure versus the past. I mean, how should we think this thing will play out for the industry over the next few quarters?

William Robert Berkley
President, CEO & Director

So my answer, Amit, to that question would be it is still a cyclical industry. And from our perspective, the pendulum tends to swing back and forth in workers' compensation as much as any part of this marketplace. There are many parts of the comp market where we think that there is healthy margin. We think we understand the margins that are available. And depending on where the market is, we will be opening the spigot or closing the spigot. So NCCI, they have a job to do. They are charged with making rates for several of the states, and we understand that, and we respect that. And we take the data that they provide the industry and other data that we have access to as well as our own, and then we make judgment. So as I tried to touch on, maybe I wasn't clear, clearly, comp rates have peaked. But there are many markets within the broader comp market that we believe still offer attractive opportunities. How long those will last? It's hard to say. But we do not see falling off a cliff, I think that you will -- there is an opportunity that will certainly be measured in quarters.

Operator

And our next question will come from the line of Arash Soleimani with KBW.

Arash Soleimani
Keefe, Bruyette, & Woods, Inc., Research Division

So just first question, is $25 million a quarter still the right run rate for 2018 on the realized gains?

William Robert Berkley
President, CEO & Director

I think that, that is a reasonable way to think about it. Obviously, as discussed in the past, it can be lumpy. And we have lots of things in the hopper or the pipeline. But from our perspective, we think that, that is still a reasonable placeholder.

Arash Soleimani
Keefe, Bruyette, & Woods, Inc., Research Division

Okay. And then maybe just follow-up on that, for Rich. The performance fees associated with the gains, which line items do those show up in? And do they impact the segments or just corporate?

Richard Mark Baio
Senior VP, CFO, Principal Accounting Officer & Treasurer

It just impacts corporate. So when we were at one point reporting operating earnings, you may recall that we had adjusted for those net performance compensation-related items. And now that we don't report operating earnings because we're managing it on a total return basis, we wanted to make certain that The Street was still calculating things factoring that in. And so you'll see there's $4 million associated with that.

Arash Soleimani
Keefe, Bruyette, & Woods, Inc., Research Division

Okay. So just corporate, no segment impact, okay. And the other question I had. So if you, I mean, if you factor in the 70 basis points of noncat weather, I guess, just starting there, what was noncat weather last year? Is that 70 basis points consistent year-over-year? Or was that -- was it higher this quarter than it was in 1Q '17?

William Robert Berkley
President, CEO & Director

It's about the same.

Arash Soleimani
Keefe, Bruyette, & Woods, Inc., Research Division

It's about the same. Okay. Okay. And this 3.5% rate increase you mentioned, where was that in the book?

William Robert Berkley
President, CEO & Director

It was in different pockets of the book. And again, we don't generally get into the details of where we're getting rate by product line or by operating unit. But I would tell you that if you think back to some of the comments I made about where there are opportunities in the marketplace, that's a really good indicator as to where we're seeing rate.

Arash Soleimani
Keefe, Bruyette, & Woods, Inc., Research Division

Okay. Well, I guess, I was asking was the 3.5% on average across a certain point like on the insurance...

William Robert Berkley
President, CEO & Director

That was for the group overall.

Arash Soleimani
Keefe, Bruyette, & Woods, Inc., Research Division

Okay, across both segments consolidated you're saying 3.5%?

William Robert Berkley
President, CEO & Director

Correct. Correct.

Arash Soleimani
Keefe, Bruyette, & Woods, Inc., Research Division

Okay. Okay. And maybe just a follow-up to Amit's question a bit. But on the rate increases, I mean, do you view those as sustainable? Do you think they'll lose some steam throughout the year?

William Robert Berkley
President, CEO & Director

I think that sometimes people get a little bit hung up on a 90-day period just because that's how the calendar falls. I think at this stage we are looking for rate in many pockets of the business, and our expectation is that it's going sort of float between 2% and 4%, if I were to speculate.

Operator

And our next question will come from the line of Kai Pan with Morgan Stanley.

Kai Pan
Morgan Stanley, Research Division

My first question is on the core margin, underlying margin. If you take out the cat that's well reserved beneath it, it looks like it's flattish year-over-year in terms of underlying quarter [combined] ratio. Given the pricing environment, do you think you'd get enough pricing to offset the loss cost trend? You'll be able to maintain or improve the margin going forward?

William Robert Berkley
President, CEO & Director

The answer is we expect the margin should improve a bit from here. I know that it's easier to calculate it when you start trying to use rate increases. But I would tell you that the bigger opportunity for us is some of the adjustments that we're actually making to the portfolio overall, certain classes of business that we are deemphasizing, other parts of the business that we are expanding. And that on its own, I think will have a meaningful impact on the financial results. And what we are able to do on rate, I think, will be helpful. But that is secondary to the pivoting of the portfolio. One of the pluses of our organization, and you've heard -- I've talked about it in the past probably forever, my father certainly talked about it in the past as well, and that is because of our decentralized structure we're able to be particularly nimble and take advantage of opportunities and actually get visibility into the business at a very granular level. And that's helpful on multiple levels.

Kai Pan
Morgan Stanley, Research Division

That's great. I think you mentioned about sort of one competitive advantage here, how W.R. Berkley has been the decentralized structure. And I'm wondering like -- because when the company is sort of like many years ago, when you have several start-up companies and now you have more than 50. I just wondered, are you coming to the point you have to centralized somehow, like in terms of infrastructure or like -- or becoming unmanageable?

William Robert Berkley
President, CEO & Director

Well, I think we -- certainly our view that it's not unmanageable. Hopefully, it's your view as well. As far as opportunity for efficiency, that is something that we as an organization pay close attention to. We're very sensitive to, on one hand, ensuring that what looks good on a whiteboard and the opportunity to combine or centralize like other carriers do that may have value. At the same time, we do not want that to overshadow, quite frankly, our ability to be local and to be responsive to the marketplace and for the people that are close to the distribution and the customers to have authority. So it is certainly something that we have been looking at. We continue to actively look at. But I don't think that you're going to see us overnight turn into a model that you may see a typical national carrier operate with. At the same time, we are conscious of the cost, and we are willing to consider opportunities for efficiency.

Kai Pan
Morgan Stanley, Research Division

That's great. My last question on the investment side. And looks like you've been guiding $100 million each year on realized gains. But you did more than that in the quarter as well as the last couple of years as well. It's maybe a question for Bill is that is the market condition like you guys feel like more opportunity to harvest the gains so that we would see more to come?

William Robert Berkley
Executive Chairman of the Board

I think that we told people $25 million a quarter because they wanted a number to put in their model. And we felt comfortable giving that number out with a fairly high degree of conviction. And yes, you're correct. This is an opportunity for us to harvest some gains. It's a good environment. And we would expect that will continue for a while. $25 million was a placeholder to let people use models to forecast our results. Yes, we had more than that in the first quarter. And I would expect that while we might have more or less in the second quarter or the third quarter, we'll have more than $100 million by a significant amount we would expect by the end of the year. But again, it's meant as a placeholder so people can come up with a forecast. But it would be disappointing if this year we didn't do substantially more.

Operator

And our next question will come from the line of [Mike Baremski] with Crédit Suisse.

Unknown Analyst

You mentioned -- you started out in your remarks saying inflation is here. Maybe you can talk about trends or anything you're seeing in the corporate liability arena. I'm a novice, but there's been securities litigation decision by the U.S. Supreme Court that keeps flashing across my screen is just one example.

William Robert Berkley
President, CEO & Director

Look, from our perspective, when we -- some -- I don't know, if it was a year ago, 18 months ago or 9 months ago, but we for some period of time have been beating the drum that we are seeing early evidence that there is inflation coming out of the legal system in the rulings or the awards. And we are just seeing inflation, quite frankly, and perhaps a little bit of a spike of severity and maybe a frequency, if you will, of severity as well. So we are paying close attention to that. And obviously, on the other front, we all understand what's going on with just general economic inflation and their impact on the industry and the cost of settling claims in the future.

Unknown Analyst

Okay, that's helpful. And next as a follow-up to the earlier question about the NCCI prescribing rates. And I think there's other states where there -- maybe it's not the NCCI, but they're still kind of something else that's not free market based. Are you able to approximate what percentage of your book is, I guess, free market-based competition versus these prescribing authorities? And I guess also, which -- what do you prefer?

William Robert Berkley
President, CEO & Director

Well, I -- basically, every state has a rating bureau. So as far as writing primary comp, if you will, there is, if you will, a framework that is prescribed by a rating bureau that works in collaboration, if you like, with the insurance department and other stakeholders.

Unknown Analyst

Okay, so there's...

William Robert Berkley
President, CEO & Director

I don't know if you're referring to occupational accident or something else.

Unknown Analyst

No. You see a lot of headlines come out all the time and I'm not -- I'm -- and some of them talk about there not being inflation in that line. That's why they are even lowering the rates. So I've always been a little confused, and I think other people are confused...

William Robert Berkley
President, CEO & Director

I think it's pretty widely understood that medical inflation has been here and real for an extended period of time. I think as far as comp goes really since the financial crisis people have been particularly surprised with the trend around frequency. And that has persisted or continued until recently. Whether it continues going forward, I think there are a lot of questions around that, particularly in a tight labor market. When you get people working overtime, you get people taking jobs that they are not as well trained for. Oftentimes, that's when people get injured on the job. So we'll have to see if that frequency trend continues.

Unknown Analyst

Okay. And if I could sneak one last one in. On the duration of the investment portfolio on the fixed income side, I looked back a number of years, and it doesn't seem like it's ever been much over in the 3s. I guess, what would get you to increase duration? Would it just be simply spreads coming out a lot? How -- are any changes in place?

William Robert Berkley
President, CEO & Director

I think ultimately if you see the 10-year as a benchmark moving up to a 4-plus percent you're probably going to see our colleagues actively thinking about it this the moment to start looking a little bit longer term. But look, the duration of our liabilities is roughly 4 years. They've created a collar for -- we've created a collar for ourselves that we're generally speaking, while there's an occasional exception, not going to be more than 1 year less than that or 1 year longer than that. But look, interest rates have been pretty low for a long time. As you see them move up, as we expect, they are going to move up, you're going to see us take the position that we're willing to extend duration.

Operator

And our next question will come from the line of Jay Cohen with Bank of America Merrill Lynch.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Mike, actually, asked my question. So thank you.

Operator

Our next question will come from the line of Ian Gutterman with Balyasny.

Ian Gutterman
Balyasny Asset Management L.P.

I just had a few things to clarify, I guess. Rob, first when you talk about rates up 3-plus percent, is that including exposure? Or is there exposure growth on top of that?

William Robert Berkley
President, CEO & Director

No. That's rate, rate, rate. That's not price, that's rate. So that is dollar collected for unit of exposure, if you like.

Ian Gutterman
Balyasny Asset Management L.P.

That's right. I just want to make sure. So with the exposure, which I assume is growing, you're kind of getting apples-to-apples, call it, mid-single-digits growth, and yet the net premium growth all in is only 1%. So are you -- is retention coming down? Is new business coming down? I'm just sort of wondering what the offset is?

William Robert Berkley
President, CEO & Director

It really depends on the posture of the business. Both Rich and I have commented on the challenges in the reinsurance segment, for example, where I think the overall segment was down 22% -- to around 20%. I think the domestic treaty reinsurance operation was down more than 40% in the quarter. So we have 53 operating units. Some are growing, some are shrinking at any moment in time. Some are gaining rates. Some are, quite frankly, willing to give up rate. So there are a lot of moving pieces. Overall, I would tell you that between what we're doing with the portfolio as far as repositioning it, shedding some business, building it in other areas and achieving overall rates, from our perspective our math both at a micro level as well as a macro level, we -- our margin is improving.

Ian Gutterman
Balyasny Asset Management L.P.

For sure. For sure. Okay. So moving on, just to get back to reinsurance. Just -- I understand the challenges there. And shrinking makes a lot of sense. So I just want to -- as far as the numbers in the quarter, you put the 107 combined with a very minimal amount of cat. I know you don't like to talk about reserve development by segment until the Q, but if I can ask it this way, is it reasonable to think there is may be 5 or 10 points of adverse development or something maybe a little bit larger than normal and that's why we're seeing that combined ratio there?

William Robert Berkley

President, CEO & Director

I think probably the best thing to do, again, because we just don't really talk about reserve development by segment, is why don't you -- if you want to give Karen a call offline, and she can try and give you a little bit more color. But for the most part, we try not to start getting into that level of weeds or detail on the call.

Ian Gutterman
Balyasny Asset Management L.P.

Understood. Okay. Fair enough. I thought I'd try. The expense ratio. So I just want to make -- I -- as you said, I expected the Berkley One expenses to move into the insurance line this quarter. I guess what threw me -- and maybe my math is wrong because I was doing it quickly. But it seemed like your unallocated expenses actually went up about $10 million. I guess I thought they would have been flat to down with the Berkley One coming out. Is there something else in there this quarter? Or did I do my math bad?

Richard Mark Baio
Senior VP, CFO, Principal Accounting Officer & Treasurer

When you say the unallocated expenses, are you talking about the corporate expenses?

William Robert Berkley
President, CEO & Director

The corporate expenses?

Ian Gutterman
Balyasny Asset Management L.P.

Yes. The corporate, right. The corporate expenses, not in the combined ratio.

William Robert Berkley
President, CEO & Director

It was down compared to the fourth quarter by about $4 million.

Richard Mark Baio
Senior VP, CFO, Principal Accounting Officer & Treasurer

Yes. $4.5 million it was down from fourth quarter.

Ian Gutterman
Balyasny Asset Management L.P.

Okay. I must have done it...

William Robert Berkley
President, CEO & Director

So I think one of the trickiest things with some of these numbers is the way we presented in the release we're showing you first quarter versus first quarter, which it's not that that's not relevant. It is relevant. But with some of the things, we probably should give you a reminder as to what the fourth quarter looked like as well.

Ian Gutterman
Balyasny Asset Management L.P.

Fair enough. Fair enough. Fair enough. And then I think just [last December ones], do you have the [page handy]?

Richard Mark Baio
Senior VP, CFO, Principal Accounting Officer & Treasurer

Paid loss ratio?

William Robert Berkley
President, CEO & Director

Otherwise, I'll wait for the Q on that too.

Ian Gutterman
Balyasny Asset Management L.P.

Yes. The pay loss ratio, yes.

Richard Mark Baio
Senior VP, CFO, Principal Accounting Officer & Treasurer

It's 58.8%.

William Robert Berkley
President, CEO & Director

And that's up a little bit about 3 points or so. And a lot of that, quite frankly, had to do with claims stemming from the third quarter in particular as well as other property claims. For us, just to -- since you gave me the window, I'm going to take it. For us, the claims are -- nobody likes claims. At the same time from our perspective, it creates a great opportunity. And we go out of our way, our colleagues in the claims areas departments go out of their way to try and get people their money in a timely way. So what really pushed that up was certainly some claims from the third quarter but also some of the claims that occurred during the first quarter associated with some of the cats and some of the what I would -- as Rich defined it, the noncat weather-related property losses.

Ian Gutterman
Balyasny Asset Management L.P.

Got it. And if I can ask just one broader question that I don't think came up yet was since the last call we have seen sort of another wave of M&A in this sector. I was wondering if you had any thoughts you'd like to share or just observations about what it means, and are we in for another wave. And how does that affect Berkley either positively, negatively or neutral?

William Robert Berkley
President, CEO & Director

Well, I'll give you my two cents, and then I'll hand it over to my boss. My two cents is that there's been a fair amount of consolidation. I think there are parts of the insurance marketplace that are viewed as particularly attractive. In some of those more attractive areas, there's less and less real estate available, if you like. And we'll have to see what unfolds. But from our perspective, consolidation creates opportunity for us as an organization not just to attract talent but also to attract relationships and insureds. Because our ability to provide predictability, continuity and consistency to the marketplace is perhaps very meaningful or even more meaningful when other organizations are disruptive or distracted by internal activity.

William Robert Berkley
Executive Chairman of the Board

I think that I would add that the quality and culture really determines an insurance company's success. All things being equal, that you have the financial capacity to meet your obligations. Just as we were more than happy to pay our claims as rapidly as we were reasonably able to because we felt that's why people buy insurance, we wouldn't want to do anything that would have an adverse impact on the culture or the quality of our enterprise. And while we look at many opportunities, it's hard to find things that we think would be a good and useful way to spend our capital that would approach the value of returning it to our shareholders. There's lots of things in the marketplace. There are many companies that are out there looking for ways to find new homes. And we look at most of them. And it's just hard to find things that we think are additive and create value for our shareholders.

Ian Gutterman
Balyasny Asset Management L.P.

Got it. Do you have any -- do you view that's as coincidence or not that we've seen a pickup in offshore sales since the tax law passed?

William Robert Berkley
President, CEO & Director

I think that pre-tax reform, post-tax reform, there are some businesses that are trying to look long and hard in the mirror and evaluate what is their business model, what is their offering, what is their value added, what is the differentiator. I think there are some businesses that were formed and set out to be in one part of the market. That got tough, and they thought it would just be easy to get involved in another part of the market. And I think it's proven to be disappointing and frustrating for them that maybe it's not quite so easy. And as a result of not being able to find a greener pasture, I think they're being forced to grapple with what should their future be.

Operator

[Operator Instructions] And we have a follow-up question coming from the line of Kai Pan with Morgan Stanley.

Kai Pan
Morgan Stanley, Research Division

There are 2 of them. Number one is that your best fund returned $40 million for the quarter. My understanding is that you have lacked -- that sort of performance lacked by a quarter. So do you have preliminary indication for the second quarter investment fund returns?

William Robert Berkley
President, CEO & Director

We have some visibility into that. But generally speaking, we don't get into a lot of details. Part of that -- the piece of the funds that historically has given us a fair amount of volatility would be some of the energy-related funds. And again, I think that's sort of flattish from where it's been or neutral. But again, if you'd like some more detail, I suggest that you reach out to Karen, and she'll give you as much color as the law allows.

Kai Pan
Morgan Stanley, Research Division

I will. And lastly, just follow-up on Ian's question in a different sort of direction. Your reinsurance business it's less than 10% of overall premiums, and the combined ratio have been above 100% for the last couple of years. So if you step back, what do you think is the strategic value of the business to overall W.R. Berkley? And do you -- have you think sort of about -- sort of either divesting or scale up that business?

William Robert Berkley
President, CEO & Director

Look, we view the reinsurance business no differently than any other part of our business. Let me be very clear. From our perspective, it is a core activity for us as a group. And we applaud our colleagues that are managing the capital in that part of the business for not sliding down the slippery slope that in our opinion others in the market are. Fact of the matter is our expense ratio is probably, I don't know, 6 to 8 points above some of the midsized competitors and probably 10 points above or more than some of the large competitors. When the market condition shift, change, improve from where they are today, you will see that this business scale up as our colleagues see that there is an opportunity to deploy capital. Fundamentally, we believe long term in the reinsurance business. We do not view it the same way some of our competitors do. We have no interest in just being stupid capital that gets arbitrage at the convenience or [seasonal]. We have a great deal of interest in being partners with those that value us beyond just capacity. So to put a -- hopefully, a fine point on it for you, we are committed to the business. We are frustrated, all of us as a team collectively. At the same time, we believe that at some point the market will come about. There certainly are parts of the business that it's questionable what its future will be, such as property cat. But that is a part of the market that we participate in, in a very selective manner in particular. Did I answer your question?

Kai Pan
Morgan Stanley, Research Division

Thank you so much for your thoughts.

Operator

And we have a follow-up question coming from the line of Arash Soleimani with KBW.

Arash Soleimani
Keefe, Bruyette, & Woods, Inc., Research Division

I just wanted to follow up on Berkley One and see -- is there any more detail you can provide there in terms of the continued rollout? I know there were 2 states, I think, you mentioned last time you are planning for.

William Robert Berkley
President, CEO & Director

Yes. At this stage, we're in 3 states, and we expect that we are going to be in a -- our expectation, our plan is that we will be in another 8 states by the end of the year. The reality is we can run as fast as we like, but we can only make insurance departments move as fast as they want to move. So we will be prepared. It is a matter of whether the insurance departments move at what type of pace. But our colleagues that are running that part of the business are successfully managing the heavy lift of building this platform out and I think are building healthy and constructive relationships with the insurance department. And again, I don't know if it will be 8 or not, but it'll be considerably more than the 3 that we are currently in.

Arash Soleimani
Keefe, Bruyette, & Woods, Inc., Research Division

And Rich, did you say that the expense ratio uptick from Berkley One was fully offset by the commission expense reduction?

Richard Mark Baio
Senior VP, CFO, Principal Accounting Officer & Treasurer

Yes.

Arash Soleimani
Keefe, Bruyette, & Woods, Inc., Research Division

And can you remind me what drove the commissions reduction again?

Richard Mark Baio
Senior VP, CFO, Principal Accounting Officer & Treasurer

Part of it is with regards to the business mix that Rob was alluding to earlier.

Operator

And I'm showing no further questions via the phone lines. So now I'd like to hand the call back over to Mr. Rob Berkley for some closing comments and some remarks.

William Robert Berkley
President, CEO & Director

Yes. Thank you, Brian. And thank you all for your time today. Again from our perspective, a very solid quarter. I think some of the news that you're hearing from others would suggest that our approach to managing volatility, particularly around the property lines, we were able to demonstrate that again. Looking forward, we see quite a bit of opportunity. Obviously, we can't control the market. But we can control what we do, and many of the parts of the markets that we have a meaningful presence we think are providing significant opportunity. I think the growth that you saw in the insurance segment, quite frankly, is what we had alluded to in the fourth quarter. And I think there is a better-than-average chance as we make our way through '18 there will be more growth coming out of the insurance segment. And on the other hand, the reinsurance market, which is -- at least parts of it showing signs of bottoming out and maybe some green shoots, we remain with dry powder ready to work with [seasons] when the opportunities present themselves. So again, thank you for your time, and we will talk to you in 90 days.

Operator

Ladies and gentlemen, thank you for your participation on today's conference. This does conclude our program, and we may all disconnect. Everybody, have a wonderful day.