S&P Capital IQ

CONTENTS

W. R. Berkley Corporation NYSE:WRB

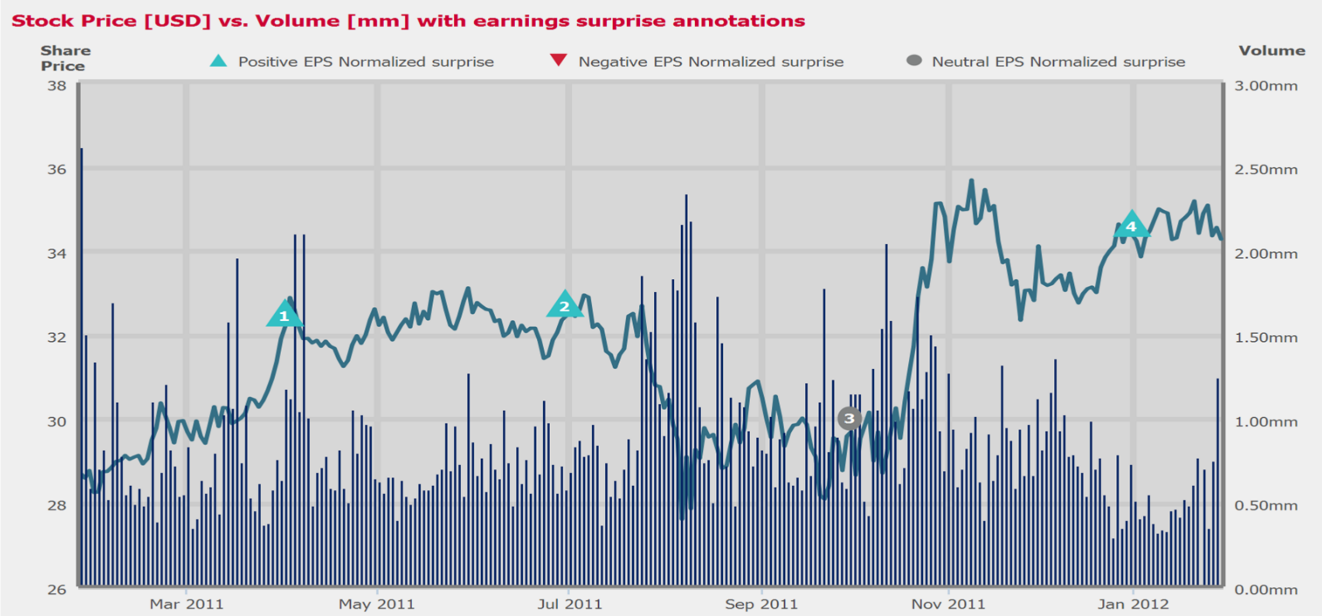
FQ1 2012 Earnings Call Transcripts

Tuesday, April 24, 2012 1:00 PM GMT

S&P Capital IQ Estimates

	-FQ1 2012-			-FQ2 2012-	-FY 2012-	-FY 2013-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.67	0.73	▲8.96	0.61	2.59	2.78
Revenue (mm)	1331.98	1378.70	▲3.51	1360.96	5482.89	5945.77

Currency: USD
Consensus as of Apr-24-2012 1:28 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ1 2011	0.65	0.66	▲1.54 %
FQ2 2011	0.42	0.47	▲11.90 %
FQ3 2011	0.44	0.44	0.00 %
FQ4 2011	0.50	0.58	▲16.00 %

Call Participants

EXECUTIVES

Eugene G. Ballard
Executive Vice President of Finance

William Robert Berkley
Chief Executive Officer, President and Director

William Robert Berkley
Founder and Executive Chairman

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Presentation

Operator

Good day, and welcome to the W.R. Berkley Corporation's First Quarter 2012 Earnings Conference Call. Today's conference is being recorded.

The speakers' remarks may contain forward-looking statements. Some of the forward-looking statements can be identified by the use of forward-looking words including, without limitation, believe, expects or estimates. We caution you that such forward-looking statements should not be regarded as representation by us, that future plans, estimates or expectations contemplated by us will in fact be achieved.

Please refer to our annual report on Form 10-K for the year ended December 31, 2011 and our other filings made with the SEC for a description of the business environment in which we operate and 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 over to Mr. William R. Berkley. Please go ahead, sir.

William Robert Berkley
Founder and Executive Chairman

Thank you very much. Good morning, everyone. We were pleased with our quarter. We were pleased with how business is going. We're glad all of you are here so you'll get the opportunity to hear about our loss reserves and so forth. We don't put it in our press release about our development and things in order to get a better audience on the call.

But with that, we'll start with Rob talking about operations, and then we'll follow with Gene talking about the financials. And then I'll talk a little bit about what's going on, and then we'll take questions. So with that, Rob, why don't you go ahead.

William Robert Berkley
Chief Executive Officer, President and Director

Okay. Thank you. Good morning. Market conditions continued to improve during the first quarter. While a cycle turn may not appear visible during any 90-day period, when one reflects back on where we were a year ago, it is clear there has been significant improvement. Evidence of this change can be seen in many ways, including the increasing number of carriers publicly announcing significant rate increases. Additionally, we are seeing many market participants adjusting their risk appetites, resulting in a gradually increasing flow of submissions into the specialty market. This increasing flow predominantly tends to be risked with poor loss experience or other complications.

Furthermore, the distribution system seems to have recognized and accepted that we are generally exiting the soft market. Consequently, they are becoming ever more successful in selling the rate increases that many carriers are requiring. Lastly, the continued accelerating growth of the state-assigned risk plan populations clearly supports the notion that market discipline is returning. Having said this, life is not perfect and that includes the insurance industry.

There are a few carriers in both the standard and specialty insurance market, as well as the reinsurance market, that don't seem to fully appreciate that things are changing. As a result of this circumstance, there is somewhat a lopsided barbell in the marketplace between those that are seeking rate adequacy and those that don't get it. Having said this, the market is turning in spite of this limited number of irresponsible companies that are serving as a hindrance, not a barrier.

Primary workers' compensation and cat-exposed property continues to lead other lines with regards to rate increases. The reality of increasing loss costs, combined with cat activity over the past several years, has clearly caught people's attention. Additionally, the impact of recent revisions to cat models, as well as the growing consequence of lower new money rates, continues to apply added pressure.

While changing behavior may vary by territory and product line, clearly, the general trend is definitively upward. Having said this, for the moment, there are certain lines, such as excess workers' compensation and parts of the professional liability market, that remains more resistant to increased prices. Fortunately, however, it would seem as though pricing has bottomed out in even these lines and is generally no longer deteriorating.

As we have suggested in the past, there is a correlation between the duration of the tail, and the time it takes market participants to recognize a change in behavior is required. Additionally, the lack of frequency can also experience a similar delay in recognition of underwriting issues. However, even longer tail lines of business that have become exceptionally competitive can overshadow these rules of thumb. As our chairman says, even long tail lines of business can become short tail if they are sufficiently underpriced.

The company's net written premium for the quarter was $1.2 billion. This represents an increase of 11% over the corresponding period in 2011. With more than half of this -- while more of half -- excuse me, more than half of this growth came about as a result of improved rates. While all 5 of our business segments grew during the quarter, the lion's share of the increase came from our international and specialty segments.

The performance in these 2 segments continued to be driven by their exposure to strongly performing industries, as well as strongly performing economies. Additionally, some of the operations in these 2 segments are amongst the most leveraged in the group and greatly benefit from a hardened market. Finally, a significant number of younger operations -- or a significant number or our younger operations are in these 2 segments.

The group's rate monitoring for the quarter indicated an increase of approximately 6.5% over the same period in 2011. It is worth noting this is a significant increase from the 4% that was achieved in Q4 of 2011. Furthermore, it is also worth mentioning that this is the first time in several years the group has achieved rate increase on top of rate increase for corresponding periods. This is significant given it suggests we have reached a new level of momentum where it is truly beginning to build upon itself. Additionally, with our renewal retention ratio remaining at approximately 80%, it provides comforting evidence that we are not sacrificing the quality of the book while achieving improving rates.

Margin on new business also appears to be headed in the right direction. The company's new business rate relativity metric would suggest we are charging 104.2% for new versus renewal business. Put another way, with like exposures, we are charging 4.2% more for new versus renewal business. The company's general philosophy continues to be that one should be charging more for new business given the additional knowledge we have about our existing book.

Our loss ratio for the quarter was at 61.8%. While this is a similar performance to the first quarter of 2011, the result was achieved in a different manner due to varying contributions from the different operating units in the group. This result also includes $4 million in natural cat losses, in addition to $2.5 million associated with the Costa Concordia loss.

The expense ratio for the quarter was at 34.7%. While this performance was in line with our expectations, we anticipate it will improve as the year progresses. Gene will be providing more detail on this topic, along with others, shortly. In the aggregate, the company delivered a combined ratio of 96.5%. This result was achieved through the contribution of all 5 business segments generating an underwriting profit. However, when you adjust for the performance to an accident year basis, we believe the business is running in the high 90s.

We continue to have great confidence in the soundness of our balance sheet and in particular, the strength of our aggregate loss reserves. As we have explained in the past, the company reviews each of our operations reserves in a detailed manner every 90 days. This allows us timely insight into how the book is performing. We would caution observers not to leap to the conclusion that the lower level of reserve redundancies recognized in the first quarter will be the new norm going forward.

While it would be premature to declare we are in a hard market, there is undoubtedly sufficient evidence, both in our results as well as those of others in the industry, to support our view that we are clearly in a hardening market. The underwriting discipline that our organization has exercised throughout the soft market, combined with the investments we have made in new and existing platforms, will undoubtedly offer increasing returns as the trajectory of the market turn continues to steepen and accelerate.

William Robert Berkley
Founder and Executive Chairman

Thank you, Rob. Gene, you want to go through the numbers there, please?

Eugene G. Ballard
Executive Vice President of Finance

Okay, Bill. I'm going to start first with a brief summary of the impact of the change in accounting for deferred acquisition costs. I'm sure you've all heard enough of this by now, but the FASB issued new guidance that limits the deferral of acquisition costs to those costs that are directly related to the successful acquisition of new and renewal insurance contracts. We adopted this guidance on January 1, 2012, and we retrospectively restated our previously issued financial statements to reflect the change in accounting.

The impact of that change to our balance sheet at December 31 was a reduction in the DAC asset of $84 million and a reduction in our common stockholders equity of $55 million or $0.40 per share. The impact on our income statement for the first quarter of '11 was to increase underwriting expenses by $1.3 million and to increase our overall expense ratio by 0.2 point.

There's a schedule on our Investor Relations section of our website that shows the details of the impact of this change in accounting on our financial statements for each of the past 4 years. We expect this accounting change to cause some delay in the improvement and the recognition of improving expense ratios especially when business is growing and to have the opposite effect when business is shrinking. I'll cover this further when we get to the details of our expense ratio for the quarter.

Turning to our results. It was a solid quarter with respect to both underwriting and investment income. Our net premiums written, overall, up 11% to $1.2 billion. As Rob mentioned, that growth was led by the international segment, which was up 50%, with strong growth and the Asia Pacific, European and Lloyd's businesses. That was followed by 9% growth for specialty, 6% for reinsurance, 4% for regional and 1% for the alternate market segment.

The overall loss ratio was unchanged from a year ago, at 61.8%. Losses from natural catastrophes were $4 million -- that -- it doesn't include the Concordia loss -- compared with $24 million a year ago, which is an improvement of 2.1 loss ratio points. Prior year reserve releases were $25 million, down from $51 million a year ago, which is a difference of 2.9 loss ratio points. Most of the favorable reserve development in the quarter was related to the specialty and reinsurance segments and was related to accident years 2009 and prior. The 2012 accident year loss ratio, excluding cats and reserves releases, was 63.7% in the first quarter, down 0.9 point from a year ago as price increases exceeded our reserving assumptions regarding loss cost trends. In addition, our paid loss ratio was down slightly from 59.1% to 58.5%, but it's a good sign that, that's beginning to move in the right direction.

The expense ratio was 34.7% in the quarter, unchanged from the restated expense ratio for the first quarter of '11. As I mentioned, on the new DAC policy, expenses are recognized earlier than before, which will slow the recognition of improving expense ratios somewhat. Another way that we look at expenses internally, and I know some companies actually report this in their earnings releases, is on a written basis, which compares expenses incurred during the period without any DAC deferral with business written in that period. This takes out the process of trying to reallocate expenses from one quarter to another in an attempt to match them with earned premiums. The written ratio varies a little bit more from one quarter to the next due to seasonality of premium writings, but it provides a very objective measure of the year-over-year expense trends. And on a written basis, our expense ratio was 32.7% in the first quarter of '12 -- 2012, down 0.9 point from 33.6% in the first quarter of '11.

Net investment income was $158 million, up 8% from a year ago. Income from fixed income securities, including cash, was $119 million. That represents an annualized yield of 3.9% compared with 4.1% in the first quarter of 2011. Income from investment funds was $28 million, up $16 million from a year ago, with strong earnings from energy and real estate funds. And the merger arbitrage trading account earned $6.5 million, which is an annualized yield of 8.5%. Realized gains, primarily the sale of equity securities, were $47 million in the quarter compared with $29 million a year ago, and unrealized investment gains after tax were $452 million at March 31, up from $430 million at the beginning of the year.

We have a summary of our investment portfolio on Pages 9 and 10 of the earnings release. You'll see that total invested assets were just over $15 billion at March 31, and we're up $555 million from the beginning of the year. That increase includes $350 million of proceeds from a senior debt offering that we completed in March, and of that amount, $200 million will be used to repay senior notes that are maturing in February of 2013.

So all that adds up to a very solid quarter, with net income of $135 million, an annualized return on equity of 13.7%, and an increase in our book value per share of 3.8%. Thank you.

William Robert Berkley
Founder and Executive Chairman

Thank you, Gene. So overall, we're pretty happy with the quarter. Our results are reflective of what I think are the discipline we've shown over the prior years and substantial improvement in our performance as we gain market position.

We're pleased with what we see. We measure our reserves carefully, as both Rob and Gene mentioned. We're comfortable, and in fact, our reserves, as we measure them, which is we look back at the prior 3 years earned premium and then, look at our total reserves outstanding. And we choose 3 years earned premium because that serves the duration of our loss reserves, and our reserves are at an all-time high compared to where they've been at any measuring point we've used in the prior periods. So we're pretty happy about where we stand reserve-wise.

Inevitably, our ongoing accident year loss ratio is going to improve. It's going to improve only because of price increases exceeding loss cost. So as that 4% from the fourth quarter starts to come in to earned premium and the 6.5% in the first quarter as it becomes earned, we're going to see improving results. So by the end of the year, we would expect 3% or 4% improvement in that underlying accident year loss ratio. That's setting aside all the unusual variables, you can see quarter-to-quarter in the property casualty business. But in fact, with price increases where they are, that improving loss ratio is certain to come into play.

We think that while in individual lines of business you still are seeing people compete aggressively here and there, it doesn't take long before people figure out that what they're doing is stupid. But stupidity is not limited to any one company or any one underwriter. It pops up in all markets. We just notice it more when most companies are beginning to be disciplined and understand what's going on, so the unusual behavior becomes more visible.

I think that the cyclical change is always the same. Exactly how it's implemented may well be different. But it isn't going to be a hockey stick, and it is never has been a hockey stick until some particular event happens which drives a dramatic change. It can be a hockey stick, dramatic rate increases in a particular line of business or a particular segment of the market. But overall, we're seeing good strong price increasing, and the business is moving towards profitability.

We don't think interest rates are going to dramatically move up. We think it is still one world, and the difficulties in Europe are going to impact the investment opportunities. And we think lots of the marketplace has capital embedded in Europe, so it's going to keep pressure on the overall market.

So we're excited, we think we'll have an excellent year. We would expect that we'll be able to deliver on our book value increasing by 13% to 15% for the year, and we expect that we will be able to have additional capital gains as some of the things at Berkley Capital and some of our investments will deliver realized gains in the balance of the year.

With that, Kevin, we'll be happy to take questions.

Question and Answer

Operator

[Operator Instructions] Our first question comes from Amit Kumar with Macquarie.

Amit Kumar
Macquarie Research

Just going back to your comment regarding pricing versus loss costs. Did I hear that correctly? Did you mention a 3% to 4% delta? Maybe just expand on that in terms of your thoughts on earned premium rates versus loss costs and how you got to that.

William Robert Berkley
Founder and Executive Chairman

No, don't think it was a delta. I think what I said is we would expect that by the end of the year, we would start to see an improvement in accident year loss ratio of possibly as much as 3 to 4 points. So for example, by the end of the year -- if my expectations are correct, let's just say by the end of the year you have 8% or 9% increases in your premium rates. If you have 8% or 9% and you have, let's just say, a 3% loss cost increase, part of that would come through, and then you weight it for each quarter prior to that. And I'm just saying that that's likely to give you, by the fourth quarter, a 3 or 4% increase or decline in your accident year loss ratio.

Amit Kumar
Macquarie Research

Okay. Maybe, I guess, touch upon California comp. And where do you think those trends are now as it relates to workers' compensation? Do you think rates are finally increasing loss costs?

William Robert Berkley
Founder and Executive Chairman

I'm going to let Rob talk about that.

William Robert Berkley
Chief Executive Officer, President and Director

I think the answer is trying to get your head around California loss comp loss cost is a pretty slippery slope, given that they're willing to change benefits at a drop of a hat and make it retroactive. Having said that, I think the market realizes that they have significant catching up to do. I think the rate increases that we are getting at this stage in that book are certainly keeping up with our belief as to where loss costs are going or will be over a period of time, and we are reasonably comfortable. Having said that, I think that the average pricing in the marketplace overall, they find themselves in a hole, and even the rate increases that they are trying to get today, I don't think is getting them to an underwriting profit in general.

Amit Kumar
Macquarie Research

Got it. That's helpful. And I guess, one other question. Just going back to your opening comments regarding increasing flow in specialty. In terms of -- can you talk about what the pricing differential between E&S versus non-E&S entities for W.R. Berkley companies on an average?

William Robert Berkley
Chief Executive Officer, President and Director

I think the tricky part here is it's not just about if it's an individual risk or a regional company with prices versus a specialty company because it's terms, it's conditions, it's a lot of moving pieces. It's not just purely price. What I would suggest to you is this, and I'm not just speaking about our businesses but I'm speaking about the marketplace, if you will, is that, as I've suggested earlier, it's the risks that have a bit of hair on them, whether they be property or casualty. For whatever the reason may be or other issues or complications with them that they are flipping back over the wall into the specialty market and to the extent that they actually drift all the way over into the E&S market, the rate increase that that exposure would be experiencing is quite material.

William Robert Berkley
Founder and Executive Chairman

I think, Amit, you have to understand how we got here. And that is, what really gets us to a softer market is standard market rates. First, they get cut a bit, and then what happens is they loosen their underwriting standards. So they say, "Ah, we're writing all this business and not cutting rates anymore," and what they're doing is they've loosened their underwriting standards, so business that historically was in the E&S marketplace or otherwise starts to move to the standard market. Then, to add insult to injury, then they cut prices even more because they compete for the craft [ph]. So the sequence of things that happen is, first people start to raise their rates and then they figure out they can't raise their rates enough to pay for this business that never belonged in the standard market at all. And then, they tighten their standards, and it goes back. So that's how it got there, and that's how it reverses itself. And that's how the cycle moves, and the cycle moves on, so far as terms and conditions, all of a sudden. Because when you realize you can't charge enough, you just stop writing the business. So it represents the worst business in the standard market, and it's the business that they don't want to renew.

Operator

Our next question comes from Keith Walsh with Citi.

Keith F. Walsh
Citigroup Inc, Research Division

First question for Gene. You alluded to this in your commentary around the expense ratio. Maybe if you could talk about when do we start to see more leverage in that number, and then maybe if you could even talk about that number currently, excluding the startup. So are we seeing leverage there currently? And then, I've got a couple of follow-ups for Rob.

Eugene G. Ballard
Executive Vice President of Finance

Yes, well, I mean, we're already seeing in our written expense ratio the leverage come through. I think, like I said before, that calculation, that policy kind of slows that down a bit. But we're seeing it today and expect it to continue, not so much as a result of the startups anymore, but I think more so as a result of the fact that the top line is going as much as it is.

William Robert Berkley
Founder and Executive Chairman

Keith, in some ways growth now with this new DAC calculation is a penalty again. And that is you're not even recovering all your costs on a financial basis. So growth is now, once again -- especially real growth, significant growth, is no -- not only not beneficial or breakeven, it's a penalty. So the faster you grow, especially once you pass some single-digit number, it starts to have an adverse impact because you're not deferring even your real costs. So the faster we grow, the more adverse that's going to be, at least for the short run.

Keith F. Walsh
Citigroup Inc, Research Division

Okay. And then, Rob, I'm just curious. Why is the net earned premium growing faster than the gross and the net written if rate continues to improve sequentially? I would've thought the opposite.

William Robert Berkley
Founder and Executive Chairman

Could you repeat the question?

William Robert Berkley
Chief Executive Officer, President and Director

Yes, well I'm just trying to understand that, Keith. Why is the net written different than the gross written as far as growth rates?

Keith F. Walsh
Citigroup Inc, Research Division

No. The net earned is growing faster than the net written, and I would've thought the opposite if rate is improving sequentially quarter-over-quarter.

William Robert Berkley
Founder and Executive Chairman

Gene?

Eugene G. Ballard
Executive Vice President of Finance

Yes, well, I mean, the earned is a reflection of the growth not just in the quarter, but over the last 12 months of the growth rate so...

William Robert Berkley
Chief Executive Officer, President and Director

Is it reinsurance premiums over [indiscernible]?

Eugene G. Ballard
Executive Vice President of Finance

Yes, and we have some policies that are even longer than 12 months. So you can't really tie them directly to the change in the written in the quarter.

William Robert Berkley
Founder and Executive Chairman

Yes. There's nothing that's changed, if that's what you're asking, Keith. It's may be because of a reinsurance premium.

William Robert Berkley
Chief Executive Officer, President and Director

I would think reinsurance is probably the big differentiator because how we will -- as Gene suggested, obviously, the timing of the earnings coming through versus the written and how we will change our reinsurance purchasing over a period of time.

William Robert Berkley
Founder and Executive Chairman

I mean, we bought different kinds of reinsurance coverage this year, which may have had an impact on it.

Eugene G. Ballard
Executive Vice President of Finance

Yes, that, of course, will reflect the difference between written -- gross written and net written, and we have had some of that. But in terms of the earned, that's why there's a different time period that we're measuring there.

Keith F. Walsh
Citigroup Inc, Research Division

Okay. And then, just last one for Rob. In your commentary, still a few carriers don't get it. Does that imply a highly competitive market for new business? And would you expect your retention as a result of that to dip below the 80% level it's been running at?

William Robert Berkley
Chief Executive Officer, President and Director

By saying a few carriers, I guess what I'm trying to suggest is that they are the minority, and the greater marketplace, if you will, is not only has it realized or recognized action needs to be taken, but it's actually translating into their behavior. So from our perspective, you are seeing a change, and they are serving as a -- some of these folks are serving as an obstacle. As far as -- I think the reason why you're seeing renewal retention hang in there for ourselves, and presumably for some others, is because the distribution system recognizes the market is changing, and they are less inclined to try and chop business solely on price. So I think all things being equal, it's becoming a less competitive or aggressive market compared to where it was. Having said that, it can vary by line of business.

Operator

Our next question comes from Josh Shanker with Deutsche Bank.

Joshua David Shanker
Deutsche Bank AG, Research Division

I wanted to talk a little bit -- Bill, for a couple of years, you've been concerned about the industry's reserves. When we look at competitors and peers in the industry, they still seem to be releasing a lot of reserves. Do you stand by your concerns about the industry reserve positions? And when do you think that starts to become an issue?

William Robert Berkley
Founder and Executive Chairman

The answer is I think that some people in the industry have been more aggressive than they probably would have been. And I don't know that I can tell you when that's going to happen. I think you've already seen several companies have deficiencies, and by and large, smaller companies have already had to address those. AIG had to address it and has. But my guess is there'll be more to come. But I can't tell you how soon that'll happen.

Joshua David Shanker
Deutsche Bank AG, Research Division

And do you have -- depending on the pace of loss cost trends, where we've been 1 year ago, where we are today and where we'll be in 1 year, just -- you can talk to your book or you can talk to the industry broadly, depending on how you think it's appropriate.

William Robert Berkley
Founder and Executive Chairman

I think loss cost trends are no longer totally benign. They're certainly increasing modestly. The global economic picture always has an impact on how these things happen and come down, and clearly, I think that the issues that are being faced in Europe overall will impact the economic picture every place. That being said, I think we've passed through that period in the United States, at least, with benign lost cost big picture. But I don't see anything running wild. So if you saw loss cost grow at 2% to 3%, I think that would be my expectation. Look -- and then at some point, the United States, just like the rest of the world, is going to have to face up to the ultimate issues of how do you deal with deficits that have accumulated over long time and inflation and all that goes with that. But at least, sitting here today, that's certainly more than 18 months away.

Operator

Our next question comes from Vinay Misquith with Evercore Partners.

Vinay Gerard Misquith
Evercore ISI, Research Division

The first question is on the top line. While it's strong this quarter, that seem to sequentially decline. Were there some sort of onetime items this quarter? And how do you foresee your top line over the next few quarters?

William Robert Berkley
Founder and Executive Chairman

I think, first of all, last quarter there was a particularly beneficial item that caused some of the increase. But I think that the turn in a cycle is not a nice predictable straight line. Candidly, we were more optimistic about that growth at the beginning of the quarter than we are today. We didn't know why we were surprised that it wasn't 1 point or 2 higher. But only when you sit and write numbers on a piece of paper can they be very predictable. But it's not -- I'm not trying to be cute. I don't really know precisely why and where. We had some companies that grew much faster in the first quarter than in the fourth quarter. And then, we had some that just sort of seemed to stop their growth. We had a couple of companies where, because they were disciplined in their pricing and we were really pleased they were disciplined in their pricing, they actually contracted in the first quarter. And we were okay with that. It only takes a couple of companies in a narrow marketplace and one line of business or another to make the business competitive for the short run. And that's happened in a couple of lines of business. So -- and I don't think it's a trend, and if we were in a position where we saw growth at this level, we'd probably be more aggressive in buying back our stock, for instance. But we're going to have to wait and see ourselves. We are at this turn in the cycle and at that moment in time, predicting how much you're going to grow and how much price increases are going to happen, hard to tell. We're still very positive, and we would still expect certainly growth at least the level we're at now, maybe a little more.

Vinay Gerard Misquith
Evercore ISI, Research Division

Sure. Fair enough. The follow-up is on the loss cost trends. Now you mentioned that Berkley's looking at 3% loss cost trends. Some competitors out there are saying it's about 4%. That still seems to be, I mean, not very high. How would you look at pricing in the industry going forward? And I believe you mentioned about 8% to 9% in the next few quarters. But sort of in the absence of significant spike in loss cost trends, do you still see pressures building within the system for rate increases?

William Robert Berkley
Founder and Executive Chairman

First of all, I think a couple of things. I said I feel loss cost trends were 2% to 3%. And I said by the fourth quarter, I thought price increases would be in the 8% to 9%. I don't think they're there now. I think they'll continue to get a little better. I might point out that every 1% decline in interest rates for the reinsurance business, you need 7% on price. For the standard property casualty company business, you need about 3.5%. If you've had a 150 basis point decline in interest rates over the past 2 years, maybe more, it depends who you want to use and how you want to measure and what you want to say. But just to offset interest rates, you need substantial rate increases without giving consideration to the fact that in specialty lines, prices have been coming down 25% and in standard lines, probably 15% or 17%. So yes, I think that right now, if people were to print their accident year results honestly, a lot of people would have, for company results, operating losses on a marginal basis. So yes, I do think you're going to have to have pretty significant price increases for a while before the companies get to where they're, on marginal basis, making money. You can't look backwards at your portfolio. You have to reinvest the money each day, and you have to look forward. I mean, some of the people who are going to be in the most trouble are the people who priced their underwriting margins and built them based upon their average portfolio yields as opposed to their marginal portfolio yields, and they're going to find out their companies are losing money. So I think price increases are essential for the industry just to get to breakeven.

Operator

Our next question comes from Larry Greenberg with Langen McAlenney.

Lawrence David Greenberg
Langen McAlenney

I'm just curious. With the new business pricing at 104.2% versus renewal, does that allow you to basically make loss picks consistent, new and renewal business?

William Robert Berkley
Founder and Executive Chairman

I'll let Rob answer that. I think that precision is something that we'd like to have, but I'll let Rob answer.

William Robert Berkley
Chief Executive Officer, President and Director

The answer is that what you're suggesting is what we target. And when we think about our design loss picks, and we revisit them every 90 days, we certainly contemplate what the mix and the contribution is in new to renewal business. Having said that, our approach to erring on the side of caution a bit with new business versus renewal business is not just in how we price the business, but also on how we book the business. From our perspective, as I suggested earlier, you know a whole lot more about your in-force [ph] book than you do about new business. So we look for a higher rate for new business, and we probably err a bit on the side of caution as to how we book it from a design ratio pick. Having said that, when we look at the book that has been written, we are cognizant of what percentage is new versus what is renewal as we revisit those loss picks, once again, every 90 days.

Lawrence David Greenberg
Langen McAlenney

Okay, great. That's helpful. And then, with regard to your comment on the reserves, the favorable reserve development for the quarter and that we shouldn't assume that the drop this quarter is indicative of anything in the future, was there anything unusual in that? Or is it just to suggest that one quarter doesn't make a trend?

William Robert Berkley
Founder and Executive Chairman

I think we're trying to get across a message, and the message is, which I followed up on when I made the comment, that our reserves relative to the average 3-years earned premium is at its high level -- or higher actually than they've ever been. And they've gotten higher in each successive year for the past 5, in spite of reserve releases, and that no one should think that the amount of reserve releases was indicative, in some way or another, of our concern about reserve positions. We do a review. We conclude where we think we are, but we didn't want people to get the wrong impression. And frequently, people think that the amount of reserves you release is a reflection on your reserve position. I now think I can speak for our company, as well as a number of others. I don't think it necessarily is. Some companies who are deficient still release reserves. They even may release record amounts of reserves. It doesn't change the fact that they're deficient, it's just that they're more anxious to show better earnings. Some companies that are redundant are cautious in what they release, and they may be getting more and more redundant. I think investors tend to read too much in about reserve releases reflecting upon a company's overall reserve position.

Lawrence David Greenberg
Langen McAlenney

Great. And then, finally, just reading between the lines, Bill. I mean, I know you're talking about kind of a gradual uptick in pricing this year, still relatively moderate loss cost growth. But I sense that you still believe, at some point in time, this is going to turn into a more traditional hard market. Is that an accurate description?

William Robert Berkley
Founder and Executive Chairman

Hard markets always starts this way, and then something happens. Something happens because someone cheated more than they thought they were and gets into dire financial difficulties. I mean, it happened to AIG, but AIG got bailed out by the government. I mean, look at all the billions of dollars of deficiencies they had to make up for. And we don't know if that's done or not. They do have very honest guys running the business now, and I'm sure they will get there. But the fact is, none of us know where and what is sitting out there. And all I can tell you is that every time we go into the beginnings of an upward cycle, it takes people a long time to get through paying for their past sins. And usually, someone doesn't have the ability to make it through. I don't know who that's going to be, and I can't tell you for sure. But there certainly are lots of issues and risk to that situation. And I think that you can have other kinds of problems out there. We certainly don't know who might be impacted by the European issues and the financial issues in the European banks. Lots of the capital that supports the overall industry is based in Europe. So I think there a lot of uncertainties. I think the fact is profitability increases were very dramatically -- with 8% or 9% price increases in this year and with the same next year, you see dramatic increases in return on capital. Return on capital in the high-double digits certainly for us -- excuse me, high teens. And certainly, the second year of 8% or 9% price increases, our returns would be in the 20s. But I can't tell you any more than that. But yes, I do think prices will continue to go up, and I think that those price increases will get to be more substantial. Just like today, a few companies can restrain price increases by their aggressive behavior. Those few companies end up going broke. I mean, it's what happened with Reliance and Frontier. They cost a lot of people a lot of money because they restrained prices in a couple of areas. And then, they went broke, and then, literally in one month, prices in commercial transportation in October of 2000 went up 28% on average. So that will happen. There will be a couple of what I would call smaller to midsize companies who will go out of business.

Operator

Our next question comes from Michael Nannizzi with Goldman Sachs.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

First question, I guess. So if we back out the international segment, trying to understand what happened to exposure trends relative to the pricing change. I'm assuming -- and this may not be right, but I'm assuming that price change outside of international in your segments was better than the pricing change in international. And just one follow-up.

William Robert Berkley
Founder and Executive Chairman

Mike, we typically don't get into the detail of the pricing, so to speak, by segments. I would tell you, though, that the international segment, while rate played a component, it had more to do with additional units, if you will, of exposure driving the growth there, as opposed to some of the other segments where rate played a more significant component in the growth.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Right, got you. So if that's just sort of -- if we back out the international entirely and we just focus on everything excluding that, I think net written premiums were up just under 5%. And so if the 6.5% price change that you saw year-over-year, then -- I'm just trying to figure out how to think about what happened to exposures, whether it's regional or specialty given those are the bigger of the remaining segments.

William Robert Berkley
Founder and Executive Chairman

Say that -- I want to make sure I'm following you. Gene was sending me piece of paper, which was of not much help.

Michael Steven Nannizzi

Goldman Sachs Group Inc., Research Division

Sure. So if I take -- if we take the consolidated results and we take out international written premiums, if my math is right, written -- net written premiums were up 4.7%, excluding international. And you said that in international, more of the growth was exposures, not rate. So I'm assuming that that 6.5% is probably just fair as a starting point for the business outside of international. So it looks like if rates were up -- if you wrote $100 of business last year and then you lost some and then you wrote some new business, you're getting 6.5% rate on the business you kept. I'm just trying to understand why the exposure line actually increased less than the rate change. So 4.7% versus 6.5%, I guess, is my question.

William Robert Berkley
Founder and Executive Chairman

First of all, I think you have to break out a little more and it's a longer question than we can answer here. But a big part of that is impacted by alternative markets, which grew at a very low rate, barely grew at all. And that was because of one particular area that in fact declined because of how our competitor priced their business, and we had substantial decline in premium in that one area. So when you take that out, I think that's probably a little misleading. So for example, specialty grew at roughly 9%. It's a lot more complicated than we can answer on this call. But I think your underlying assumption is like adding up how many dogs do you have if you have 17 animals. It's hard to give you an answer that will make sense. But I think that in the specialty business -- and by the way, you also have to weight it by amount of premium, and it's not just adding up the pieces. So I think that the answer would be that the units of exposure in the alternative markets declined and -- despite an increase in the specialty business, but price increases still drove most of it. And as I said, I'm sure if you want to go through the details of it, we can try to do that, and Gene will go through it with you, Michael, later on. But it's not something you can sort of aggregate, just sort of add up. It's a fairly detailed thing. I think it's one of those cases where the mathematical conclusion is correct, but I think it doesn't give you the correct aggregate conclusion because, as I say, the biggest section of specialty, prices were up 8.8% and units exposure were up slightly.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Got it. I'll follow up later. And then, just one question about some of the new businesses, whether in specialty or international. Did you add any new teams or new platforms during the quarter? And in terms of the capacity of folks that you've brought online, I guess, particularly in international where we've seen the most growth, what sort of percentage of the business that they were writing before they came online here are they writing now? Just to kind of get an idea of pipeline of potential business there.

William Robert Berkley
Chief Executive Officer, President and Director

Mike, we added one new team, and they're going to be focusing on the public entity space. And at this stage, they have not even begun to write business or there's nothing that's been bound. We expect that to be happening later this quarter. So there has been no impact from what we did as far as starting new businesses in the first quarter and on the income statement. We do think that, over time, it will be a meaningful contributor to the group. But certainly, at this stage, there's been no impact.

Operator

Our next question comes from Doug Mewhirter with RBC Capital Markets.

Douglas Robert Mewhirter
RBC Capital Markets, LLC, Research Division

Most of my questions have been answered. Just 2 quick question. First, I noticed, if my calculations are right, your investee -- your wholly-owned investees reported a pre-tax loss. Is that, I guess, a seasonal swing? Or is there any particular issues?

William Robert Berkley

Founder and Executive Chairman

Just a seasonal swing. They expect to meet their budget for the year.

Douglas Robert Mewhirter
RBC Capital Markets, LLC, Research Division

Okay. My second and last question. You talked about how the primary workers' comp rates have been going up industry-wide, although lost costs have been kind of unpredictable as well. But you said that excess workers' comp isn't following and you talked about how there's still some competition in your alternative markets. Why do you think there's a disconnect? And do you think that that log jam would eventually break loose this year, or would it -- do you think it'll take a while? Going up through to the excess market, I mean.

William Robert Berkley
Chief Executive Officer, President and Director

I think what you're really seeing is just the, as we have suggested earlier, the difference in tail or duration of tail as we had suggested earlier. Excess comp has a much longer tail than primary comp. And as a result of that, it takes a bit more time from insurance carriers or market participants, if you like, to recognize that we have -- that they have an issue. So I do expect that you will see a shift in excess comp, and as we also suggested earlier, it's probably, give or take, bottoming out. But there is a bit of a lag or a delay before the reality comes into focus, and you'll see the same type of momentum building on the excess comp line that you are seeing in primary comp.

Operator

Our next question comes from Meyer Shields with Stifel, Nicolaus.

Meyer Shields
Stifel, Nicolaus & Company, Incorporated, Research Division

Two quick questions, if I can. First for Rob, when you, I guess, cautioned us not to extrapolate too much from the first quarter's reserve releases, were you saying that $25 million is lower or higher than the expected run rate?

William Robert Berkley
Chief Executive Officer, President and Director

I think I was trying to suggest to you that I wouldn't hang my hat that that is the number or the level going forward. I think it would be very problematic if I answered your question more specifically.

Meyer Shields
Stifel, Nicolaus & Company, Incorporated, Research Division

Well, the second question -- I'm sorry.

William Robert Berkley
Founder and Executive Chairman

I think if you put that together with what I said, you should have the answer, which is our aggregate reserves have never been stronger.

Meyer Shields
Stifel, Nicolaus & Company, Incorporated, Research Division

Right. So that's why I was -- they think -- I think I misinterpreted Rob the first time that's why I was asking. In general, Bill, when you think about the mix between property and casualty, it looks like you're a little bit more heavily focused on the property side than historically. Is that a reflection of rates or a change in approach because the larger company can afford a little bit more volatility?

William Robert Berkley

Founder and Executive Chairman

I think there are several things that are happening. First of all, with interest rates down, the difference in expected returns for short-tail lines, and I don't mean property lines, but short-tail lines, is changed because you're now no longer getting the benefit of that higher investment return on longer-tail reserves. So on marginal business that we write new business now, the improved return from casualty business is less than on shorter-tail lines of business. So yes, we have shifted, whereas longer tail lines of business used to represent, let's just say, between 85% and 87% of our business, today, it probably represents 82% of our business. Still very predominantly casualty-focused, very predominantly long-tailed, but yes, consciously a decision that says we're willing to shift. Number two, pricing on some of those lines of business have gotten much more attractive. And number three, some of those specialty lines, in fact, do have some volatility that when we were a lot smaller company, we couldn't take, and now we could afford to take it. Things like marine business where we can afford to have an adequate -- enough to make money on the line of business. So all of the above that you mentioned.

Operator

Our next question comes from Jay Cohen with Bank of America.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Just one question to something you guys have talked about, and that was in the quarter, the underlying cost ratio was better than a year ago. I guess, as I thought about it, I suspected that the earned premium for the first quarter still reflected obviously business written last year when price increases did not keep basic claims inflation. So while I think you're right, you'll certainly should see improvement later in the year, I was surprised to see in the first quarter. Anything else going on there?

William Robert Berkley
Chief Executive Officer, President and Director

Jay, there are a couple of things going on there, but probably the most noteworthy would have to do with a pretty benign first quarter as it relates to property losses. And obviously, that drops right through. So relative to what our expectations would be for property loss activity in Q1 versus what it turned out to be, things were a little bit better. And while there were a couple of different moving pieces, I would suggest that the lack of property loss activity was the leading contributor.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

That was my second question. That's great [ph].

William Robert Berkley
Founder and Executive Chairman

But overall, I think the trend loss costs, again, were less than 4%, probably slightly less than the 3% of the second quarter -- of the third quarter rather. So there's a slight benefit from those price increases in the third and fourth quarter of last year.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Got it. And then, on the fixed income portfolio, can you talk about the difference between the new money yields and the expiring yields or your book yields, I should say?

William Robert Berkley
Founder and Executive Chairman

Well, first of all, we have been pretty cautious about reinvesting. In the past 45 days, you could, at any year, get anywhere from 240 to 197, and we have been cautious in what we've done, though so we have more cash than we've ever had. I shouldn't say ever had. Where we have more cash than usual. We have, I think, $1.4 billion of cash, give or take. So I would say a couple of things were doing, Jay. Number one, we're looking to try to buy highly protective mezzanine mortgages, where we can get 5% or 6%, that has sort of a 3- to 4-year duration, 5-year at most, that will help us offset by lower yields on our fixed income marketable securities. So I'd say overall, we're sort of investing at the between 3.75 and 4.25. So we don't -- we think it's going to have a slightly adverse impact. We hope that's going to be offset by common stock dividend yields, which we've invested probably $400 million in common stocks based on dividend yields and attractiveness for what we think will be gains. Not what I call a dynamic stock portfolio, but a conservative one. And in addition, finding these particularly small niche things that we've -- we bought some housing bonds that give us tax credits. That will give us effectively a 7% or 8% yield, but it doesn't appear in the investment income. It's going to appear in a lower tax rate. So for now, we think we're okay, still sort of maintaining this, give or take, 4% bogey on our yield. But I will say, my -- I'm very comfortable about the market changing. There's no doubt in my mind about pricing increases and where they're going. My biggest concern is the harder the market turns and the greater our cash flow, will we be able to keep finding niches to invest in and opportunities to invest in at the current portfolio level. And I think that certainly, the situation we're seeing Europe, which is the populist movement not to face fact of economic discipline, fiscal discipline is an issue we're going to face here, too. And if we don't, we're going to have inflation, and with inflation, you don't want to lock in higher rates for longer terms, which we've actually not done.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Got it. And then, one last quick question, I guess for Gene. Can we assume that the catastrophe losses were all in the regional segment?

Eugene G. Ballard
Executive Vice President of Finance

That's right.

Operator

Our next question comes from Rob Farnam with KBW.

Robert Edward Farnam
Keefe, Bruyette, & Woods, Inc., Research Division

On the excess workers' comp piece. So with AIG pulling back in that space, do you -- have you seen any changes thus far? And is that -- do you see that as a good opportunity to have that market change more quickly?

William Robert Berkley
Founder and Executive Chairman

AIG has reduced their relative competitive position before. They had gotten more sensible. Their pulling back was certainly helpful. There is one company that we think was a very aggressive pricing business. They didn't price their discount on their investment yields. In excess comp, the average duration of the portfolio is probably 17 or 18 years and its enormous impact with rate, interest rate assumptions, and they base their discount on their average portfolio yields, not based on current marginal interest rates. Because of that, their prices were from 20% to 40% less than ours. And that's the one place in our industry where we lost business, substantial business. That company is in the process of being sold, so hopefully the new owners will get sensible.

Operator

Our next question comes from Samir Khare with Capital Returns Management.

Samir Khare
Capital Returns Management, LLC

I just wanted to ask about the 4.2% higher price increase you're achieving, higher than your renewal business. How does that compare to the pricing for these 2 buckets trended over, say, like the past 4 quarters? And could you also comment on what the bound versus quoted trend has been doing in the same time period for the new business?

William Robert Berkley
Chief Executive Officer, President and Director

Let me answer the first one, and then I will -- and then if you could ask the second piece, I didn't catch the whole thing. Relatively speaking, within a certain number of basis points, the delta between new versus renewal has been pretty consistent over the past several quarters, so that is not a new phenomenon. We just decided to start to bring that to people's attention because it's -- well a, we think it's relevant and b, it's surprised us how the industry, in general, doesn't really seem to talk about new pricing. They tend to focus only on renewal pricing, which we didn't feel is appropriate. So the short answer is that it's been pretty consistent.

Samir Khare
Capital Returns Management, LLC

Okay. And the second question was actually just how is your bound versus quoted metric has been trending in your new business in, say, the same time period, let's say 4 quarters?

William Robert Berkley
Chief Executive Officer, President and Director

As far as those ratios by the group or by segment or by operating unit, that's just not stuff that we typically get into. I would tell you that new business is a bit more competitive today than it was in prior quarters. At the same time, we are finding opportunities. And that -- and it has, once again, it's become perhaps a bit more competitive for new business. And that's more, I think, a reflection on a change in the attitude of the distribution system as much as anything.

Operator

Our next question comes from Dan Johnson with Citadel.

Daniel B. Johnson
Citadel LLC

Surprising, almost all of them answered. Maybe just one question. As you move from more into mortgages on the asset side, you gave some good statistics there. But what sort of a loss assumptions do you use in sorts of assets relative to what you might be using when you think about corporate investments?

William Robert Berkley
Founder and Executive Chairman

The mortgages we're buying are all less than 50% DAC to value. So we're not really using anything with significant leverage and we're all -- the mortgages we're buying have relatively short duration. So the things we're using is -- quite frankly, we don't think there's any consequential risk of loss. We're not in the open market. We're not buying just stuff in the marketplace.

Daniel B. Johnson
Citadel LLC

Do you have a team underwriting these, or are you buying products from others?

William Robert Berkley
Founder and Executive Chairman

I'm not going to talk about the specifics. We've had relationships with people who've done this for a while.

Operator

I'm not showing any further questions at this time. I'd like to turn the conference back over to the host for closing comments.

William Robert Berkley
Founder and Executive Chairman

Well, thank you, all, very much. We're very enthusiastic, and while clearly, we felt we would grow more this quarter than we did, I think one of the things that happens in the cycle is turning the distribution part of our business is sort of sitting and adjusting to price increase environment and they're not out chopping their business. That also means until some of the companies start to set higher standards for terms and conditions, there's not as much business out loose [ph]. So I think that's not going to start to change more dramatically. I think right now, we would expect price increases to continue and to accelerate somewhat. And as I said, by the end of the year, we'd expect 8% or 9%, maybe even a little better, and we'd expect our growth to get somewhat better than it was in the first quarter.

So thank you, all, very much. Have a great day.

Operator
Ladies and gentlemen, this does conclude today's presentation. You may now disconnect, and have a wonderful day.