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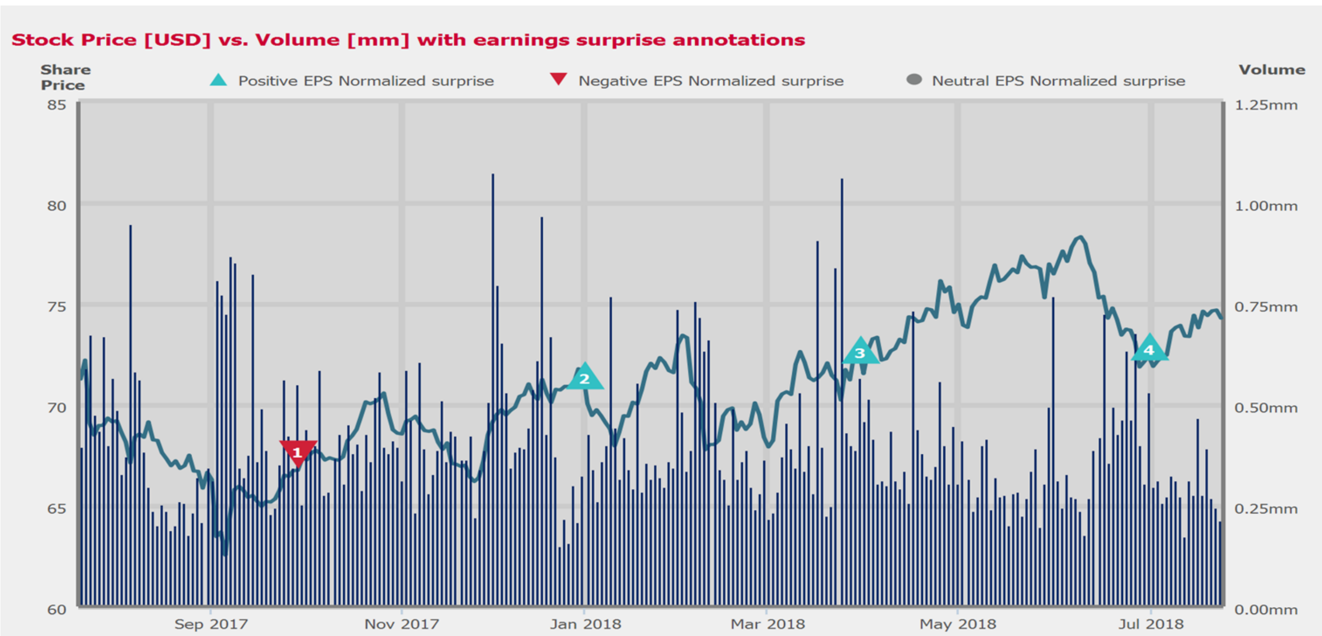
Market Intelligence

# W. R. Berkley Corporation NYSE:WRB
# FQ3 2018 Earnings Call Transcripts
## Tuesday, October 23, 2018 9:00 PM GMT
## S&P Global Market Intelligence Estimates

| | -FQ3 2018- | | | -FQ4 2018- | -FY 2018- | -FY 2019- |
|---|---|---|---|---|---|---|
| | CONSENSUS | ACTUAL | SURPRISE | CONSENSUS | CONSENSUS | CONSENSUS |
| **EPS Normalized** | 0.82 | 1.12 | ▲36.59 | 0.94 | 3.75 | 3.80 |
| **Revenue (mm)** | 1597.70 | 1603.48 | ▲0.36 | 1610.13 | 6428.72 | 6636.68 |

Currency: USD
Consensus as of Oct-22-2018 11:59 AM GMT




- EPS NORMALIZED -

| | CONSENSUS | ACTUAL | SURPRISE |
|---|---|---|---|
| **FQ3 2017** | 0.27 | 0.23 | ▼1 (14.81 %) |
| **FQ4 2017** | 0.73 | 0.74 | ▲2 1.37 % |
| **FQ1 2018** | 0.89 | 1.00 | ▲3 12.36 % |
| **FQ2 2018** | 0.83 | 0.98 | ▲4 18.07 % |

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# Call Participants

### EXECUTIVES

**Richard Mark Baio**
*Senior VP, CFO & Treasurer*

**William Robert Berkley**
*Executive Chairman of the Board*

**William Robert Berkley**
*President, CEO & Director*

### ANALYSTS

**Amit Kumar**
*The Buckingham Research Group Incorporated*

**Brian Robert Meredith**
*UBS Investment Bank, Research Division*

**Joshua David Shanker**
*Deutsche Bank AG, Research Division*

**Kai Pan**
*Morgan Stanley, Research Division*

**Meyer Shields**
*Keefe, Bruyette, & Woods, Inc., Research Division*

**Michael David Zaremski**
*Crédit Suisse AG, Research Division*

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*Goldman Sachs Group Inc., Research Division*

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# Presentation

**Operator**

Good day, and welcome to W. R. Berkley Corporation's Third Quarter 2018 Earnings Conference Call. Today's conference call 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, believes, expects or estimates. We caution you that such forward-looking statements should not be regarded as a representation by us that the 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, 2017, and our other filings made with the SEC or 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. Rob Berkley. Please go ahead, sir.

**William Robert Berkley**
*President, CEO & Director*

Thank you, Himani, and good afternoon all. Thank you for joining us on our third quarter call.

On this end, you also have Bill Berkley, our Executive Chairman; and Rich Baio, our Chief Financial Officer. Let me give you a quick sense of the agenda, which is similar to what we've done in the past.

I'm going to start off with a few comments or thoughts on what's going on at a macro level in the industry, offer a few soundbites on the quarter. And then I will, in short order, hand it off to Rich, who will walk you through the quarter in greater detail.

Before we jump into the agenda, let me just offer a comment on behalf of my colleagues and myself, there is somewhat of a more personal nature. The cat activity in the third quarter of this year, while not quite in some ways as severe as what we saw last year, was still very significant. And obviously, we're seeing cat activity in the fourth quarter as well.

It's easy for this activity in this industry to turn into something that's thought of as ratios and numbers, but people should not lose sight of the fact that these are people's lives. And from our perspective, we would just like to extend our thoughts and prayers to all of those that are affected. And hopefully, this does provide an opportunity for the industry to demonstrate the value it brings to society and helping it get back on its feet in affected areas.

Turning to the business of today. A couple of topics that I will refer to here and are topics that we have discussed in the past. And I would suggest they could fall under the category of how much data or perhaps how much pain is required for there to be a change in behavior. Maybe starting with the property market, particularly cat-exposed property. Yet another quarter has gone by with frequency of severity. And for all we can tell, there's not a significant change or appetite for change in behavior in the marketplace. Yes, you may be seeing incremental change, but it does seem as though the concept of risk-adjusted return, the idea that the dollars lost are real, and that this capital is entitled to return does continue to be lost on many market participants. And this idea, again, continues to be a puzzle to us, of just backing out cat losses as if they don't count really has never and continues to make no sense to us.

The other area that we and others have talked about more recently -- I think we started to talk about it 18, maybe 24 months ago, is inflation. And as we've discussed with people in the past and others have as well, it comes in 2 obvious flavors: one being financial, that seems to get a lot of attention; the one being social -- the other one, excuse me, being social, which is getting an increasing amount of attention.

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In spite of the attention, in spite of all the discussion, it is concerning to us on behalf of the industry that the dialogue and the focus did not be -- seem to be converting into action. Hopefully, that will change as we move forward. Certainly, as we have demonstrated and will continue to demonstrate, both of these points are things that we as an organization are very focused on, and we believe we are taking appropriate action as we position the business, not just today but also taking it towards tomorrow.

Let me offer a couple of quick soundbites on different product lines, again, from a marketplace perspective. Reinsurance continues to be what I would define as a relatively glim picture. I would tell you that we are able to find a few isolated green shoots in the treaty market outside of the United States. The U.S. treaty market continues to be exceptionally competitive and quite frankly concerning. I would tell you that there are early signs of possible encouragements coming out of the fac market, but I think it is premature to call it a trend.

On the insurance side, again, property, though we are seeing the market get incrementally better, it remains surprising to us in light of the cat activity that we've seen over the past year, the lack of movement. In particular, the London market seems a bit sluggish in responding as it would have historically responded to this level of cat activity. Again, also there's been a lot of chatter, but we'll have to see if that converts into a change in behavior.

I would characterize the GL market in general as steady. Workers' comp, I think there's been a lot of chatter around the action rating bureaus have taken in moving rates down. At the same time, I would caution people not to overreact to this rate activity or rate action, given the way workers' comp gets priced off of payrolls. With payrolls moving up, salaries moving up, that certainly helps keep up. And in addition to that, obviously, the frequency trend continues to be negative, which inures to the benefit of loss cost.

Professional liability, from my perspective, continues to be amongst the more concerning parts of the business. In particular, the D&O market, especially the larger D&O accounts, large law firms and certain parts of the medical market give us real reason to pause. Having said that, there are some niche opportunities within the professional space that we continue to find very attractive.

And finally, commercial auto. From my perspective, it certainly continues to improve, but one needs to be thoughtful and selective in how one participates in that market.

As it relates to our results in the quarter, again, I'm going to leave most of the details to Rich. So just a couple of comments from me. I think, overall, it was a good quarter. We were pleased with the top line growth. We are growing in the places where the margin is. In addition to that, we are pleased with the rate that we're getting. So in the insurance business, as Rich will walk you through, we grew 5%. And if you look at the rate that we're getting in our business, ex workers' comp, we're getting about 3.9% rate increase. In addition to that, our renewal retention ratio continues to run at about 80%. So even as we are pushing for rate, we think the integrity of the book is remaining well intact.

The rate that we're getting, we think, is very appropriate, just going back to that idea of inflation the we touched on early and we talked about in the past quarters. And while rate in a vacuum is not the sole remedy, it is certainly an important ingredient one needs to obviously take into account as we've also discussed in the past: terms, conditions, attachment points, et cetera, et cetera.

The loss ratio of [ over ] 63.5%, a couple of points for cats in there. By and large, again, not what we would strive for, but from our perspective, not unacceptable given the level of cat activity. Rich will talk about the incremental improvement in the expense ratio. We continue to work diligently on that. And there a lot of people very focused on it, and we think we are making progress. I would tell you, or I would caution you, it is not going to be a perfect curve or even development. There will be moments where we're able to make meaningful progress, like what you saw on the quarter. And then there will be quarters where we have to take a 0.5 step back in order to take 2 steps forward.

Overall, 95.9% for the quarter. Again, from our perspective, pretty good in light of the cat activity. For those of you who seem to have subscribed to the but-for model, that would translate into a 93.9%.

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On the investment portfolio, again, this was an example of us having a good foresight, in my opinion, as we thought about inflation and where interest rates are growing. We have continued to manage the duration down to the 2.9 years. Rich will give you a little bit more color on this. But at this stage, I think that is really one of the main drivers as to why we are having the effect or lack of effect on book value as we see interest rates moving up.

So I will pause there, and I'm going to let Rich get into more of the details with you all. And again, then you'll have the 3 of us for any questions. Rich, please?

**Richard Mark Baio**
*Senior VP, CFO & Treasurer*

Thanks, Rob, appreciate it. We reported net income of $162 million or $1.26 per share, unchanged from the year-ago quarter. Earnings were favorably impacted compared with the prior year by higher underwriting profit, net investment income and foreign currency gains. Offsetting these positive results were lower net investment gains, primarily attributable to the new accounting treatment on equity securities.

Overall, net premiums written increased 3.4% to approximately $1.62 billion in the third quarter of 2018. Premiums grew 5.1% to $1.5 billion in the insurance segment. The growth was led by a 9% increase in short-tail lines, followed by about 8.5% in commercial automobile and 6% in other liability.

Worker's compensation reflected a small increase, resulting from growth and exposure, as a strong economy resulted in increases in payrolls, offset by a declining rate environment, as Rob alluded to. There are pockets of opportunity in the global reinsurance market, although the North American assumed property and casualty environment remained more competitive than other areas. The team's maintained its underwriting discipline and shrunk the business when unable to write business that can achieve its targeted risk-adjusted rate of return.

Our reinsurance segment declined by 14% to $119 million, primarily driven by the soft area of the market. Pretax underwriting income was $66 million this current quarter, reflecting lower cat losses and relatively flat underwriting expenses. The growth in net premiums written of almost 3% year-to-date is earning through the income statement, contributing to improving underwriting performance.

The current accident year loss ratio before cats was 61.5%. Cat losses declined from $119 million or 7.5 loss ratio points [ in ] the prior year to $39 million this quarter or 2.4 loss ratio points. A year ago, the industry experienced catastrophe events more significant than has been seen in over a decade with hurricanes Harvey, Irma and Maria, along with the 2 earthquakes in Mexico. Albeit on a smaller scale, we were reminded again in 2018 that Mother Nature can deliver powerful storms like Hurricane Florence and Typhoon Jebi. Our losses from these storms have demonstrated that our cautious approach to underwriting global property risk is likely to continue to result into low average volatility.

Loss reserves developed favorably in the quarter and prior year quarters by $7 million or approximately 0.5 loss ratio points. Accordingly, our reported loss ratio is 63.5% for third quarter of 2018.

The expense ratio of 32.4% represents a decline of 0.2% from the year-ago quarter and was lower than the consecutive quarter of 33.3%. In dollar terms, our underwriting expense [ stayed ] relatively flat for the comparative quarters and year-to-date. As the growth in net premiums written earned through the income statement in coming quarters, we'd expect an improving expense ratio. In addition, as several new businesses reach scale, we believe their contribution will further improve the expense ratio.

We have and continue to look at ways to streamline our processes internally. Not only does this create efficiencies and strengthen our service offerings, but it also minimizes the cost of doing business. This brings our reported combined ratio for the third quarter of 2018 to 95.9%, and our accident year-combined ratio, excluding cats, to 93.9%.

Investment income increased 31% to $44 million to $186 million. The core portfolio increased approximately $50 million, led by fixed maturity securities. A higher base of invested assets and rising interest rates have benefited the income statement.

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Investment funds increased $26 million, primarily due to higher earnings from energy, aviation and real estate funds. We've also maintained an average rating of AA- and an average duration of 2.9 years for fixed maturity securities, including cash and cash equivalents.

We reported pretax net realized and unrealized gains of $22 million. Due to the change in accounting for equity securities adopted in 2018, there are now 2 components comprising pretax gains: the first is pretax realized gains from the sale of investments of $154 million; and second is the change in unrealized gains on equity securities of $132 million, resulting from the adoption of this new accounting pronouncement. The change in unrealized gains on equity securities is not reflected in any prior year's income statement results and therefore creates an inconsistency to comparable periods. Had no change occurred in this treatment, our annualized pretax return on equity for the quarter would have been approximately 10% higher.

We recognized foreign currency gains of $70 million in the current quarter, approximately $15 million of which primarily is due to the strengthening U.S. dollar relative to Argentine pesos. Beginning in July 2018, Argentina is considered hyperinflationary. Under the accounting rules, hyperinflation arises when the cumulative inflation over 3 years is equal to or greater than 100%. And accordingly, we were required to change the functional currency from Argentine peso to U.S. dollars for Argentine operations.

Effective tax rate was 21.4% for the quarter. The total income tax expense reflects the reduction in the U.S. statutory tax rate from 35% to 21%. And the effective tax rate differs from U.S. federal income tax rate of 21%, primarily because of tax-exempt investment income, offset by foreign operations with the higher tax rate.

Stockholders' equity increased slightly quarter-over-quarter and from the beginning of the year. The combination of lower unrealized gains on fixed maturity securities due to rising interest rates and the return of capital offset much of the earnings in the quarter and year-to-date.

Fortunately, our early decision to maintain a short duration on our fixed maturity portfolio has positioned us well to minimize the adverse impact on the balance sheet while benefit from rising interest rates through the income statement.

We also returned capital to investors of $79 million in the quarter. And finally, our return on equity for the quarter on an annualized basis was 12% on net income.

Thanks, Rob.

**William Robert Berkley**
*President, CEO & Director*
Great, Rich. Thank you very much. Himani, now we would be pleased to open it up for questions.

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# Question and Answer

**Operator**

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

**Amit Kumar**
*The Buckingham Research Group Incorporated*

Just a couple of quick questions. The first question I had for you, Rob, was I was trying to tie your commentary on pricing of 3.9% with your frustration with the industry behavior regarding what they are doing. Is that -- does that mean that we should anticipate a continued upward trajectory in WRB's pricing? Or am I simplifying the thought process too much?

**William Robert Berkley**
*President, CEO & Director*

Well, look, from our perspective, I think it's pretty clear that in many lines of business, loss costs are moving up. Workers' comp may be one of the few phenomenon where we are seeing certain components of the loss cost, particularly the frequency trends being negative, which, again, inures the benefit. But overall, when you look at the level of financial inflation in the broader system and if you look at the level of social inflation that there's a growing evidence around, we think that there are lots of ways to affect rate. Again, one is the price you charge. One is terms and conditions, attachment points, deductible, et cetera, et cetera. Our view is that given the level of inflation that is in the system and that presents itself in many different ways, one needs to be taking appropriate action. So yes, when we talk about 3.9% of rate, that is just what's driven -- being driven by the pricing. We are doing other things as well, which we think will impact the margin.

**Amit Kumar**
*The Buckingham Research Group Incorporated*

Got it. That's actually very helpful. The other question I had was going back to the broader discussion on expense ratio. And I know Rich made some comments, and there were some comments -- specific comments in the press release. I know in the past, we have talked about, I guess, a 1% to 2% number. Are we still on track for that? Or could we even end up doing better than that?

**William Robert Berkley**
*President, CEO & Director*

Well, I don't want to get ahead of ourselves. I think as we've commented in the past, we are running at a 33-something pretty consistently. We are looking to take a point off that over time consistently. And once we have gotten to that new level, then we will look to see are there opportunities for us to improve from there. But again, I would caution you and others, please keep in mind that occasionally we need to make certain types of investments in order to position ourselves to improve, which could come at a cost.

**Amit Kumar**
*The Buckingham Research Group Incorporated*

Got it. That's helpful. And maybe just sneak one more quickly, and I'll stop. Do you have any early indications what your Hurricane Michael exposure might be?

**William Robert Berkley**
*President, CEO & Director*

Are we getting some loss notices? Yes, of course, we are, as I presume others are in the marketplace. But I think it would be really premature for us to begin to even speculate as to what that's going to be. Having said that, as you know and as we continue to demonstrate, we manage volatility in what we believe is a thoughtful and measured manner. And given our comments around property pricing, particularly cat-exposed property, we tend to underwrite that certainly compared to the average, the norm or our peers.

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**Operator**

And our next question comes from Kai Pan with Morgan Stanley.

**Kai Pan**
*Morgan Stanley, Research Division*

Just to follow up Amit's question on rates as well as the inflation. If you balance these 2, the rate increasing as well as you have inflation trends, will you be able to maintain the underwriting margin going forward? Or you can -- actually, the rate increase itself outpace the loss inflation, that you can have some improvements on it?

**William Robert Berkley**
*President, CEO & Director*

Our expectation between the rate that we are looking to achieve and we've been able to achieve so far as well as some of the other underwriting actions that we've taken, we believe that, ultimately, it will inure to the benefit of the margin, and you will see margin enhancement on the underwriting side.

**Kai Pan**
*Morgan Stanley, Research Division*

Okay. That's great. And then just follow up on workers' compensation-like commentary. You see negative frequency trend. What we heard from some other competitors talking about the increasing frequency. Is something sort of different your business, your writing versus the others?

**William Robert Berkley**
*President, CEO & Director*

Well, I'm not familiar with the others' book of business. I can only react to our portfolio, and I would suggest that you might give a call to the folks over at NCCI. They put together some, what I would define as very helpful broad data on the industry. And I think that might give you some further insight, and I would expect that would dovetail with our comment.

**Kai Pan**
*Morgan Stanley, Research Division*

Okay. That's good. And then on the investment side, looks like the alternative fund -- so the fund returns have been more than sort of like last few quarters, like you cited energy and real estate funds. Are there any early indication for the fourth quarter results because I remember those result probably lagging the market internal reporting.

**William Robert Berkley**
*President, CEO & Director*

Yes. Much of what's in there we book on a quarterly lag. Having said that, I think it's a little bit early for us to really point you in a direction. I think Karen has given some historical guidance in the past, and we have as well, I think, somewhere between $15 million to $20 million a quarter. And -- but again, as -- if you look back over the history, there's a fair amount of volatility in that it's a very different animal than the fixed income portfolio.

**Kai Pan**
*Morgan Stanley, Research Division*

Okay. Last one, if I may, is on the sort of realized gain and losses. In the past, you be always guiding $100 million a year. So far, you did $420 million in 3 quarters. So how should we expect going forward? Is that going to be less because you've already realized a lot? Or is the current trends going to continue?

**William Robert Berkley**
*President, CEO & Director*

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We continue to guide people towards the -- $25 million a quarter is the right plug, if you will, for your model. At the same time, as we have been quite emphatic, the nature of the type of investments and how it gets realized, there's going to be a good deal of volatility. We've had a couple of good years. I would suggest you not make the assumption that, that means that we have gone through all of the opportunity to monetize. I would tell you that the pipeline is both deep and broad. At the same time, the timing of one that gets realized could easily vary by some number of quarters. So again, my suggestion to you is that you continue to use the $25 million at the -- per quarter. At the same time, from our perspective, while it may not help you, the nature is there will be volatility in that.

**Kai Pan**
*Morgan Stanley, Research Division*

Okay. I was hoping Bill can make some comments on what asset classes you'll write for, sort of harvest in term of valuation?

**William Robert Berkley**
*President, CEO & Director*

Well, I would suggest you give Bill a call. [indiscernible] I don't think he's doing that with a broad audience.

**William Robert Berkley**
*Executive Chairman of the Board*

I think the long and the short of it is it's really an opportunistic decision. When an opportunity comes along, we'll harvest one asset or another. And it really is truly opportunistic. And I think that will continue to be where we are.

**Operator**

[Operator Instructions] Our next question comes from Mike Zaremski with Crédit Suisse.

**Michael David Zaremski**
*Crédit Suisse AG, Research Division*

A follow-up on Kai's question, and Rob, your remarks on workers' comp. So if we take into account the important nuance you brought up about payrolls and wage increases helping and then frequencies staying negative. And we mesh that with pricing, which is negative, are margins staying steady? Or are they just deteriorating but deteriorating off of excellent levels? Just trying to get directionally where that line's going.

**William Robert Berkley**
*President, CEO & Director*

Yes. The thoughts that I would share with you are the following. I think it varies greatly by territory, it varies greatly by class. So I would be reluctant to use such a broad brush for really what requires a fine brush to provide a specific an answer as you're looking for. I would tell you that if -- there are clearly parts of the market, not the whole market, but there are parts of the market that we find very attractive still in spite of what's been happening with the action coming out of the rating bureaus, which is why you see us continuing to grow the line of business as articulated in the release.

**Michael David Zaremski**
*Crédit Suisse AG, Research Division*

Okay. That's fair. And I know that's a very nuanced by state. My next question is regarding the catastrophe load. It seems like it's continually a little below investors' expectations. I know you guys emphasize volatility management. So portfolio mix has changed a good deal over the last 10 decades. And honestly, I'm just taking the 10-year average. So just curious whether maybe I shouldn't be taking 10-year average?

**Richard Mark Baio**

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*Senior VP, CFO & Treasurer*

I'm sorry. We missed the last part of it. We were preoccupied with the 10 decades, and I turned to my boss...

**William Robert Berkley**
*President, CEO & Director*

No, I think that it would be appropriate to think that when you see cat activity, you should expect the experience on a relative basis for our organization to be relatively benign. The growth that [ may be ] referring to in the product line exhibit that -- Rich, I think you've thrown into the release, is really driven by what I would define as non-property short-tail lines. So examples of that -- not limited to this, but examples of that would be surety as well as A&H. But look, we have had and continue to have the view that this business is all about risk-adjusted return. If and when there is an opportunity that we believe that the risk-adjusted return makes sense in a property cat space, we are prepared to play that game. But we believe that when you think about risk, one needs to factor in volatility. So until you see a dramatic shift, and it would have to be very dramatic, then you will continue to see us be underrated in some of the cat-exposed lines. And to the extent that rates get attractive, then we certainly will be sharing with you and other stakeholders to the extent our appetite has changed and why. But we are not going to do anything that we don't think we get paid appropriately for the risk.

**Michael David Zaremski**
*Crédit Suisse AG, Research Division*

Okay. Okay, great. And if I can throw one last one in, the -- you mentioned in the prepared remarks as well, the real estate portion of the investment portfolio has grown by more than a couple of points since year-end. How do you think about the total return opportunity in that portfolio? And just curious, do higher interest rates make it -- make the opportunity to harvest maybe less promising over time?

**William Robert Berkley**
*Executive Chairman of the Board*

No. First of all, we generally don't use leverage in our real estate portfolio. So it hasn't really had much impact on us. Our real estate portfolio, I think we have one building that we've agreed to put one mortgage on, but that's the total sum of our historic mortgages. So it doesn't really have much impact on us. Number two, we're developing projects. So the increase in our investment in real estate is we finished a building in London. It's something like 60-something percent rented up, maybe even 70%, I don't know exactly as of the moment. And we have buildings in Washington that are just finishing up. And we have finished in 100% leased building in New York City. So what you've seen is our completion of buildings and renting them up, not new projects starting.

**Operator**

And our next question comes from Joshua Shanker with Deutsche Bank.

**Joshua David Shanker**
*Deutsche Bank AG, Research Division*

Excellent quarter. Good job. I would love to talk to you guys a little about your personal lines foray and understand if there's a new business penalty associated with acquiring business? And what that happens over time? And given some travelers' remarks, and we had this big fire out in California, what is the appetite long term for that kind of business? Obviously, you're looking for specialty business but trying to understand your overall appetite.

**William Robert Berkley**
*President, CEO & Director*

Josh, let me just repeat the question back to you to make sure I got it correct if you don't mind. So were you -- well, were you asking about Berkley One, our personal lines business or just in general, our exposure to cat? Or I just want to make sure I have it...

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**Joshua David Shanker**
*Deutsche Bank AG, Research Division*

So Berkley One and how it relates to exposure to cat.

**William Robert Berkley**
*President, CEO & Director*

Okay. So...

**Joshua David Shanker**
*Deutsche Bank AG, Research Division*

And also if there's -- and if there's a new business penalty as you grow.

**William Robert Berkley**
*President, CEO & Director*

Okay. So for starters, if -- when you say new business penalty, what does that mean exactly? I want...

**Joshua David Shanker**
*Deutsche Bank AG, Research Division*

I mean, in the past, certainly, Bill has said that you -- unlike a lot of companies, you like to write new business at a better margin than business that's already on your books. So you understand the nature of the business on your books. But taking on new business, most companies say, "Look, we don't know that business as well." So oftentimes, it contains losses and a loss profile that's in excess of -- we might have expected. I guess that's what I mean, yes.

**William Robert Berkley**
*President, CEO & Director*

Okay. I appreciate the clarity. So maybe this is as far as that piece right off the bat. We do not burn our way into the market, maybe to put a slightly finer point on it, whether that be due to selection or pricing or whatever. Our colleagues that are running the business are true professionals and not do they -- not only do they have the technical expertise, but we have a shared set of values out of respect for the capital that our various stakeholders provide us. So is it possible at any given one-off risk that we could be cheaper than competitor C? Yes, it's certainly possible, but it's also possible on the next 3 quotes that we would be less competitive than competitor C or competitor A or competitor B. So to make a long story short, no, I do not believe that we are burning our way into the market. And philosophically, I don't think the folks that are running that part of the business on behalf of the shareholders subscribe to that at all. As far as our overall approach to cat and exposures such as wildfire, it certainly is something that we have a high sensitivity to. We measure our exposure in our aggregates very carefully. We have some very skilled people in our ERM department, making sure that we understand what we have out there. We have a clear view around what our risk appetite is as an organization. And then ultimately, we will find partners that are looking to deploy capacity in the reinsurance market to help us manage whatever exposure is beyond what our appetite may be. So long story short, Berkley One has not changed our philosophy in general or our risk appetite.

**Joshua David Shanker**
*Deutsche Bank AG, Research Division*

And do you have any way of framing in a 5-year sort of view how big Berkley One could be?

**William Robert Berkley**
*President, CEO & Director*

Do I -- how big? I think Berkley One 5 years from now is going to be very meaningful to our organization. I think it is meaningful today because of the contribution that colleagues are making in building that and developing our franchise. And I think that, that will only broaden from here as the financial contribution becomes something that will move the needle in a meaningful way for the group.

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**Operator**

And our next question comes from Meyer Shields with KBW.

**Meyer Shields**
*Keefe, Bruyette, & Woods, Inc., Research Division*

Rob, in your prepared comments, you talk about terms and conditions. Is there a market trend right now where terms and conditions are an area of competition in insurance?

**William Robert Berkley**
*President, CEO & Director*

I think that there's -- certainly are pockets of the market where you see standard market appetite expanding. And consequently, you'll see a relaxing of terms and conditions. And I think that there's some meaningful parts of the market that are moving in the other direction where you're seeing a tightening of terms and conditions as well, and you're seeing business exit the standard market. So again, I'm not trying to be difficult, but it really varies depending on what part -- what pocket, excuse me, of the market you're referring to. But I referenced the terms, conditions, attachment point, deductible, et cetera because people tend to get very focused on did your rate move up, how much did it move down, how much? And those are really important things. And certainly, our rate monitor tries to capture some of that, but I would tell you that I don't think any rate monitor fully is able -- excuse me, is able to fully capture change in terms, conditions, et cetera.

**Meyer Shields**
*Keefe, Bruyette, & Woods, Inc., Research Division*

No, that's helpful. That makes a lot of sense. Within the frequent -- I'm sorry, within the general liability lines, you've talked about social inflation for a while. Is that trend accelerating? Or is it just sort of worse than it had been but at the same level?

**William Robert Berkley**
*President, CEO & Director*

I think it's like a lot of things. It's very difficult to determine that over a short period of time. I think, clearly, as we get a few more quarters under our belt, it will become more evident. But I would tell you, we have a little bit of data, but I think the growing [ depth ] field within our organization is that you're seeing a resurgence in activity and effort in the plaintiff bar. You've obviously seen some very large awards coming out of juries. And oftentimes, when you see these large numbers, that tends to set the bar for what other awards may be as a new reality. So again, I don't feel as though anyone has enough evidence or data at this stage to be able to point to you definitively in a direction. But I think there is a growing amount of data that would support there is good reason to have concern around the social inflation idea.

**Operator**

And our next question comes from Brian Meredith with UBS.

**Brian Robert Meredith**
*UBS Investment Bank, Research Division*

Actually, that was kind of my question there, but Rob, let me just follow up on the social inflation a little bit here. I'm just -- what do you think's going to be driving it here going forward? And if you look at, obviously, the court system right now, we're back to kind of a balance federal appellate court [ system ] as far as Republican to Democratic-appointed judges, we've obviously got a favorable Supreme Court. How do you think that impacts things here going forward?

**William Robert Berkley**
*President, CEO & Director*

I think the pendulum tends to swing back and forth as we've observed, but I think there's a delay. And I think we've expressed the view in the past, and it continues to be our view, Brian, that part of the

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resurgence in the plaintiff bar and perhaps some of what you see coming out of juries is a reflection of the environment over the past -- the 8 years that we had Washington really very much influenced through more of a Democrat lens. I suspect if you roll the movie forward over time, you'll see the pendulum swing back the other way, but there's clearly a delay.

**Brian Robert Meredith**
*UBS Investment Bank, Research Division*

Got it. It makes a lot of sense. And then certainly, Rob, I'm just curios, you made the comment that you're still seeing some favorable frequency on workers' compensation insurance. Can you tell us what drive that they kind of pop back up the other way?

**William Robert Berkley**
*President, CEO & Director*

So again, I don't know if anyone can scientifically if you will or mathematically prove exactly what has driven this relatively benign environment for an extended period of time, even though there's data that would suggest it has to do with safer workforce, medical cost as well and a variety of other things. I would suggest that perhaps the -- one of the larger concerns that we have that could send it sailing back in the other direction, putting aside what people have been trying to do on as far as managing cost, would be a very, very tight workforce like one that we're seeing today, sub-4%. What ends up happening when you have an environment like that oftentimes, Brian, is you get people in jobs that they have not received an appropriate level of training for, that oftentimes can lead to accident and injury. You also get people working overtime, and oftentimes, people get a degree of fatigue that can lead to accident and injury. So my crystal ball is pretty much as foggy as anyone else's, but that certainly is one of the things that when we lock ourselves in a room together and try and figure out where things are going, that's one of the thoughts that we kick around.

**Operator**

And our next question comes from Ryan Tunis with Autonomous Research.

**Ryan James Tunis**
*Autonomous Research LLP*

I just had -- I had a couple on underwriting and then one on expenses. I guess, on the underwriting side, just how would you characterize this quarter in terms of like man-made losses? Short-tail stuff that's non-cat. Was -- did that help the loss ratio, or was it that hurt a little more than it's been?

**William Robert Berkley**
*President, CEO & Director*

I think it was kind of just right up the middle, by and large. I would say -- so I think the improvements that we've been talking about that you'll see with time are going to come as a result of rate and changes that we are making on the underwriting front as far as not just pricing again but -- and not just terms and conditions but selection as well.

**Ryan James Tunis**
*Autonomous Research LLP*

And -- actually, that was my follow-up. So on the stuff outside of rate, the terms and conditions, the risk selection, I know in the past you talked about moving up an attachment point. Philosophically, does that change -- is that going to change the volatility of your results at all? Are you more like you could have lumpy quarters if you're higher up? Or I mean, are you -- I mean, is there any offset, do you think, in terms of -- obviously, that's going to help margins, but is there any caution about what that might do for a volatility standpoint or anything else?

**William Robert Berkley**
*President, CEO & Director*

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Yes. Again, as we suggested under the lens of volatility, risk-adjusted return, we're focusing on property cat in the comments earlier. Volatility in general is something that we are very sensitive to. I would caution you not to make the leap that, in some cases where we adjust attachment point, that, that would have a dramatic impact on the type of volatility we have in our portfolio. I would also remind you that the lion's share of the business that we write is not large account or even in an excess tower. The vast majority of the business we write is relatively small-limit business. So I think, as a data point, more than 85% of our policies have a limit of $2 million or less. So when you think about that in the context, we are not a big excess market, and we are not a subscription market in a big way. The lion's share of what we do, we write the whole individual account.

**Ryan James Tunis**
*Autonomous Research LLP*

Got it. And then on the expense side, I'm not exactly sure what's been happening with the ratio there in reinsurance, but it looks like one place where you made a lot of improvement has been in reinsurance. Looks like you have kind of a low 40s selling and operating expense run rate now, and that was up towards 60 just over a year ago. Just some color, I guess, on what you're -- what are some of the changes you're making there and...

**William Robert Berkley**
*President, CEO & Director*

Yes. There was -- we had a shift in the portfolio, and I'm going to give you my 2 seconds, then Rich can give you a little bit more color. Rich, that was my heads up. It's about to come over to you.

**Richard Mark Baio**
*Senior VP, CFO & Treasurer*

Fair enough.

**William Robert Berkley**
*President, CEO & Director*

What's happened is we had several structured deals there where the loss ratio had a corridor or a cap on it, if you will, and the commission was on a sliding scale. The commissions were particularly high. We -- The colleagues running the business decided pursuing those in general did not make a lot of sense going forward. Commissions came down. Scale of the business came down. Internals went up. I'm done. You.

**Richard Mark Baio**
*Senior VP, CFO & Treasurer*

I think that's a fair summary, Rob. I -- the other point that I would add is that as we see on the commission side, as you're pointing out, a reduction. The fixed costs are obviously down a little bit as well. And that reduction is not enough to counter the effect of the earned premium reduction that we're seeing coming through quarter-over-quarter. So it's really just a reflection of that fixed and variable cost proportion to the earned premium.

**Ryan James Tunis**
*Autonomous Research LLP*

And I guess, just keeping it here on expenses for a second, but Rob, you did -- it did kind of sound like you were cautioning toward run rating this level of expenses this quarter going forward. [indiscernible]

**William Robert Berkley**
*President, CEO & Director*

If that was the message that I sent to you and others or if I left you with that impression, what I'm suggesting is this. We've been running at a 33-something give or take more often than not for a while. We've expressed a desire to take a point off of that. And once we get that accomplished, we will be as a group looking to see other opportunities to improve from there. I would suggest, I guess, additional comments where I would just remind people that in order to make this progress, occasionally, one has

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to take 0.5 step back in order to take 2 steps forward. So I am not suggesting to you -- I'm not -- in any way, shape or form what your assumption should be, the -- that assumption is your assumption. But I am telling you that I think some of the progress that we have been looking to make was visible in the quarter. At the same time, we do have other initiatives that could move it back in the other direction temporarily.

**Operator**

And our next question comes from Yaron Kinar with Goldman Sachs.

**Yaron Joseph Kinar**
*Goldman Sachs Group Inc., Research Division*

Rob, in your prepared comments, you expressed some frustration over the way the industry is behaving right now. And I guess my question to you would be, are your expectations of the industry different than what the industry has done over time? Namely, we're seeing net investment income improve, interest rates rise. We're -- We haven't quite seen losses emerge at any significant scale just yet. Industry capacity remains abundant. I think you guys have been in this industry way longer than I've looked at it. But in your experience, have you seen the industry raise rates in such an environment?

**William Robert Berkley**
*President, CEO & Director*

So I am going to yield to my boss who has a -- decades more experience than I do, and I think he can give you a better perspective than I.

**William Robert Berkley**
*Executive Chairman of the Board*

I don't like being referred to as decades. But that -- the long and short of it is, I think you have different sources of capital that are responding to losses in different ways than this industry has historically responded. So yes, it is different than it was, primarily because the capital is in this industry for marginal returns over and above their investment returns, there are lots of it. And people are looking at their investment returns in a different way. I think that, that's going all change, and it will at some point, when the capacity losses are large enough that it impacts people who find that the unforeseen event is greater than the actuarially protected result. And that will happen. We just don't know exactly when. We've had periods of time where we've had 3 and 4 100-year events in a period of 5 or 7 years. And that's the kind of thing that can dramatically change the outcome. Sandy wasn't even a hurricane. Imagine if it was a hurricane. Imagine if a '38 kind of hurricane came across where it did last time, the losses on Long Island and Rhode Island alone would be bigger than any storm we have seen. So I think that you aren't seeing people react because they're relying 100% on the predicted modeled result. And if you've been in the business long enough, you know predictive modeled results are only averages based on statistics, they're not perfect. And I think this business has become much more predicted and modeled. So I don't think it -- I do think it is behaving in a different way at the moment, but we'll see whether that's justified or not.

**Yaron Joseph Kinar**
*Goldman Sachs Group Inc., Research Division*

Got it. And then, I guess, the other question, Rob, in your prepared comments, you also talked about D&O, particularly for large accounts, as being an area that seems especially concerning right now. We've all seen the data around frequency picking up and defense cost being up. Is there anything else that is driving your concern there, specifically for large accounts? And on top of that, do you see the private market, the smaller market as an area that could be a port in the storm if the trends that you're seeing in large public do indeed go through?

**William Robert Berkley**
*President, CEO & Director*

Again, from our perspective, the D&O space in general is pretty competitive. As far as opportunities or niches within the D&O space, we prefer not to get into where we see the pockets of opportunity. But again, the large accounts -- and we all read about the loss activity. If you pick up The Wall Street Journal,

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you can't help but stumble across it. There's been a fair amount of loss activity. There's been a frequency of severity, if you will, and that's not uncommon for the D&O space. I think the problem is that the market has been very competitive for an extended period of time, and I'm not sure if there is an appropriate level of premium to be able to endure the level of loss activity. And again, I think that's particularly noteworthy in what I would define as the Fortune 5000.

**Operator**

This concludes today's Q&A session. I would now like to turn the call back over to Mr. Rob Berkley for closing remarks.

**William Robert Berkley**
*President, CEO & Director*

Okay. Thank you very much. We appreciate you all calling in. From our perspective again, it was a solid quarter. It was an opportunity for us to demonstrate how we manage risk and return, particularly in this quarter under the lens of property cat. We spent a good deal of time focused on a lot of things in how we manage the business, but we try not to spend our lives being upset for what's in the rearview mirror but actually looking out the front windshield. Hence, how we have been positioning the investment portfolio for an extended period of time as well as the actions that we've been taking on the underwriting side.

We think there are clearly opportunities in the marketplace, and we are pleased with the strength and the stability of our platform. So thank you all again for calling in, and we look forward to talking about another successful quarter with you in 90 days.

**Operator**
Ladies and gentlemen, thank you for participating in today's conference. This does conclude the program. You may all disconnect. Everyone, have a great day.

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