S&P Global
Market Intelligence

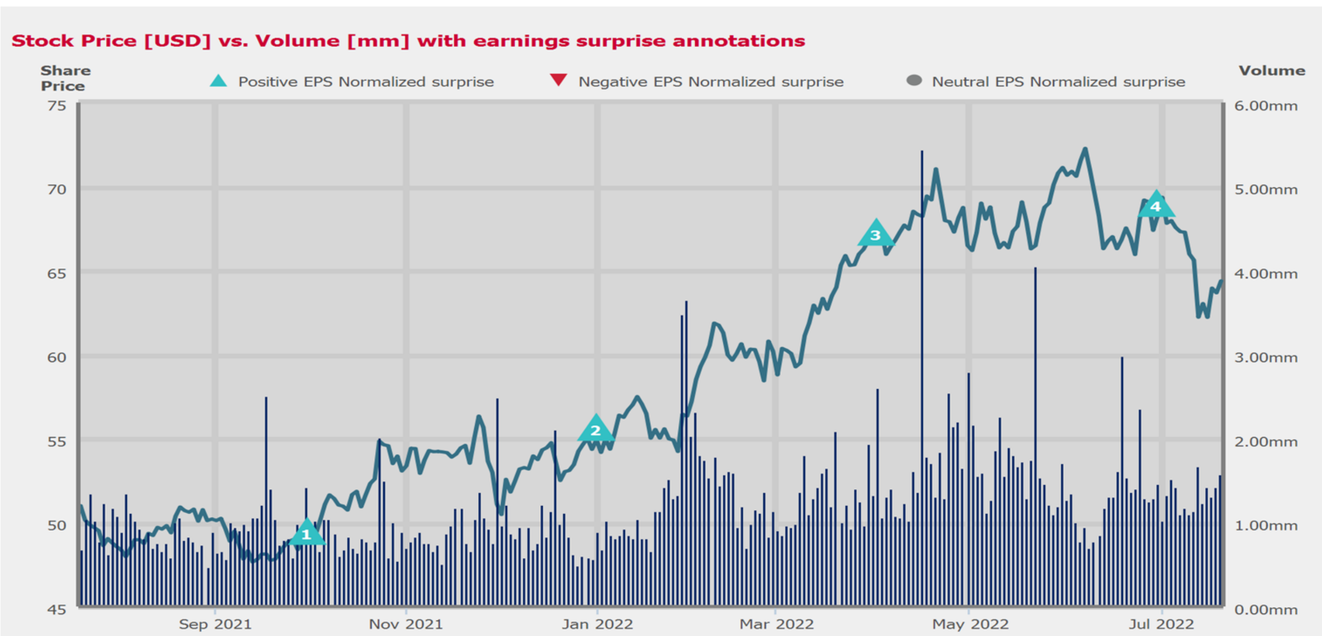
W. R. Berkley Corporation NYSE:WRB
FQ2 2022 Earnings Call Transcripts

Thursday, July 21, 2022 9:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ2 2022-			-FQ3 2022-	-FY 2022-	-FY 2023-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.85	1.12	▲31.76	0.87	3.90	NA
Revenue (mm)	2319.15	2357.16	▲1.64	2392.30	9383.82	NA

Currency: USD
Consensus as of Jul-21-2022 9:57 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ3 2021	0.63	0.88	▲1 39.68 %
FQ4 2021	0.83	1.02	▲2 22.89 %
FQ1 2022	0.94	1.10	▲3 17.02 %
FQ2 2022	0.85	1.12	▲4 31.76 %

Table of Contents

Call Participants

EXECUTIVES

Richard Mark Baio
Executive VP & CFO

William Robert Berkley
Executive Chairman of the Board

William Robert Berkley
President, CEO & Director

ANALYSTS

Alexander Scott
Goldman Sachs Group, Inc., Research Division

Brian Robert Meredith
UBS Investment Bank, Research Division

David Kenneth Motemaden
Evercore ISI Institutional Equities, Research Division

Elyse Beth Greenspan
Wells Fargo Securities, LLC, Research Division

Joshua David Shanker
BofA Securities, Research Division

Mark Douglas Hughes
Truist Securities, Inc., Research Division

Michael Wayne Phillips
Morgan Stanley, Research Division

Ryan James Tunis
Autonomous Research LLP

Yaron Joseph Kinar
Jefferies LLC, Research Division

Presentation

Operator

Good day, and welcome to W. R. Berkley Corporation Second Quarter 2022 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, 2021, 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. Rob Berkley. Please go ahead, sir.

William Robert Berkley
President, CEO & Director

Josh, thank you very much, and good afternoon to all, and thank you for joining our second quarter call. Co-hosting with me this afternoon is Bill Berkley, our Executive Chairman as well as Rich Baio, our Executive Vice President and Chief Financial Officer.

We're going to follow the usual agenda where I'm going to hand it over to Rich momentarily. He's going to run through some highlights of the quarter. Once Rich has completed his comments, I'll receive the baton back from him, offer a few thoughts on my own, and then we'll be pleased to open it up for Q&A and take the conversation anywhere participants would like to take it.

Before I hand it over to Rich, there is a one pointer or topic that I did want to flag, and it's something that we talk about with some regularity within our shop. And I don't think it's a unique observation, I'm sure everyone on the call and beyond is acutely aware of this point, but nevertheless, I think it easily falls off the radar screen as we can easily get consumed by other aspects of the industry.

And that is the macro observation or reality that this is a very unusual industry for a variety of reasons, but one of them is, this is an industry where you do not know your cost of goods sold until oftentimes many years after the transaction has actually occurred. That creates additional complexity and how one operates the business. It's less consequential when you're operating through an extended period of time where things are quite stable. But when you're in a period of time where changes abound, volatility is material, it becomes much more consequential.

Most businesses in other industries, I would suggest, the way they operate is akin to how you steer a car. You turn the wheel of a car, the wheels in the front of the car turn and the car will turn quickly. Because of what we're discussing now this reality of the timing of cost of goods sold relative to when the transaction occurs, in this industry it's different from driving a car.

In some ways, it's more like steering a boat, where the rotor is in the back of the boat as opposed to the wheels in the front of the vehicle. The difference in this industry, like a boat or a ship being steered from the back, is one needs to anticipate. One needs to not just be consumed by what has occurred yesterday, not just be preoccupied with what is immediately in front of them, but one needs to anticipate what is coming their way because of the delay in response to steering the ship. One needs to be trying to figure out what is around the next corner or over the hill.

This is something that we spend a huge amount of time working at grappling with as a team. It is one of the reasons why we have been focused on certain things for a long period of time. Whether it's social inflation or economic or financial inflation, these are 2 macro topics that we have been talking about and acting upon for several years at this stage. You can see it in our underwriting and how we have selected loss picks and how we have priced our book of business.

You can see it in our investment portfolio and how we have managed our duration. So while these types of topics have become very topical today and we hear people chatting about it, these are things that we anticipated and have been preparing for, as I suggested earlier, years. It's one of the reasons why we are so well positioned. It's not easy. It requires expertise. It requires experience. It requires discipline. It requires foresight, and it requires courage.

Fortunately, my colleagues throughout this organization have those characteristics and traits, and that, in my opinion, is the leading reason why this organization is so well positioned today and by extension, is enjoying the results that we are talking about today and anticipate we will be talking about for many, many quarters and years to come.

So with that, so much for me just keeping it short at the beginning and handing it over to Rich. Let me hand it over to Rich now, and I promise I'll be somewhat brief after he provides his thoughts and comments. Rich, if you would, please.

Richard Mark Baio
Executive VP & CFO

Of course. Thank you, Rob. I appreciate it. The company reported another strong quarter, as you saw, with operating income increasing 43% to $313 million or $1.12 per share. The key contributors include strong underwriting income driven by continued growth in premium volume, which I'll discuss in just a moment, along with improving net investment income and foreign currency gains.

We also reported net income of $179 million or $0.65 per share. Pretax underwriting income of $268 million in large part kept pace with the record first quarter, representing an increase of 32.6% over the prior year second quarter. Our year-to-date quarterly results of $543 million increased 41% over the prior year and surpassed all prior full year results with the exception of 2021, which was a record year. Despite the heightened frequency of natural catastrophes, we reported pretax cat losses of $58 million in the quarter or 2.5 loss ratio points compared with $44 million or 2.2 loss ratio points last year.

Drilling down further into our underwriting results, gross premiums written grew to a record level of almost $3.1 billion. Net premiums written grew 16.9% to a record of nearly $2.6 billion. Our decision to retain more business on a net basis can be seen by the lower session rate in the quarter and on year-to-date basis.

Net premiums written increased in all lines of business as we disclosed in the earnings release. The Insurance segment grew 16.6% to more than $2.3 billion while the Reinsurance & Monoline Excess segment increased 19.1% to almost $260 million. The overall growth is significantly coming from increased exposure. The current accident year loss ratio, excluding catastrophes, improved 0.3 loss ratio points to 58.5%.

Prior year loss reserves developed favorably by $2 million in the current year, bringing our calendar year loss ratio to 60.9%. The expense ratio continues to benefit from scaling the business as evidenced by the outpaced growth in net premiums earned relative to underwriting expenses. In addition, we continue to make investments in strategic initiatives to optimize efficiency, and as such, the expense ratio improved 1 point to 27.7% over the prior year's quarter.

In summary, the current accident year combined ratio, excluding catastrophes, improved 1.3 loss points to 86.2% compared with the second quarter of 2021 of 87.5%. The reported calendar year combined ratio was 88.6% for the current quarter compared with 89.7% for the prior year. Net investment income for the quarter was approximately $172 million. The rising interest rate environment is a key contributor to growth and income from the core portfolio of almost 30%.

On investment funds, you may recall, we report on a 1-quarter lag, and despite the decline in the equity markets in the first quarter, the investment funds performed well with a book yield of 8.3%. The transportation, real estate and energy funds led the way. The overall investment portfolio also maintained the same duration of 2.4 years and a credit quality of a AA-.

Pretax net investment losses in the quarter of $172 million is primarily attributable to the net change in unrealized losses on equity securities of $132 million, which related to sector declines in financial services, energy and metal mining and manufacturing. Stockholders' equity was $6.5 billion as of June 30, 2022. Year-to-date earnings have more than offset the change in unrealized losses on investments and currency translation adjustments, both items being components of stockholders' equity.

We returned capital to shareholders in the first 6 months of the year through regular and special dividends amounting to $182 million, of which $159 million was in the second quarter. The annualized operating return on beginning of year equity was 18.8% for the quarter and 10.8% on a net income basis.

Rob, I'll turn it back to you.

William Robert Berkley
President, CEO & Director

Okay. Great. Rich, thanks very much. That was great as always. Okay. So a couple of quick soundbites from me, and again, as promised, then we'll open it up for the Q&A. The top line continues to be very healthy. I would tell you that in the specialty space, in particular, E&S, but specialty in general, we are seeing continued strength in submissions, and we're feeling particularly good about that.

We're also seeing finally some resilience in the reinsurance market. Consequently, as you saw the growth in that segment as well. On the insurance front, jumping around here, other liability was particularly strong. Shorter tail was strong as well and commercial auto was reasonably robust. As far as what the contribution to the 17 points of growth, rate was a meaningful contributor. Ex-comp, we were at 6.8% or so.

I think it's important that people keep in mind and not confuse or decouple rate versus exposure growth. And one of the things that we've been very focused on, and I worry that some industry participants may not be as focused on, is a change in exposure, particularly in an inflationary environment is something that we pay a lot of attention to. Obviously, there's an opportunity to keep up with it through payrolls on comp, GL. As far as revenue on the property front, the appraised values that you get at the time of the underwriting and inception. But making sure that one does not fall behind is an important thing and approximately 2/3 of our policies are adjustable based on exposure. So that's a really important piece to make sure that we can keep up with inflation.

As far as strength of economy, certainly, there is a lot of sensitivity and concern. But I would tell you, as far as audit premiums at this stage, we are seeing considerable momentum on that front. Our audit premiums during the quarter were up 45% relative to the same period last year. And just on the retention front, something that I know we've discussed in the past, and we're very sensitive to not churning the book and making sure that the quality and the integrity of the book is intact as we continue to push for rate and make sure that we're getting the appropriate exposure.

Long story short, renewal retention remained just north of 80%. Loss ratio, obviously, Rich covered a bit of noise coming out of the cats. I would characterize it as frequency of modest severity and that was probably the big story behind the 2.5 points. From my perspective -- and we've heard this and we think we've talked about it in the past calls, we've heard it from some people when they look at all the rate that we've gotten. Why is it that we're not seeing the loss ratio drop even more on the current accident year.

And the simple answer is, there's a lot of unknown, and there's a lot of volatility and there are a lot of various leverage assumptions that we want to make sure we are appropriately thoughtful and measured, and we don't respond too quickly. Some people would say cautious. We would say that we're just being thoughtful and measured given the inflationary environment, both social as well as economic.

In addition to that, and we may have touched on this last quarter, we're sensitive to the backlog in the legal system. And our best estimate, which is nothing more than an estimate is that due to COVID, there's still probably an 18-month backlog in the court system. One other piece on the loss ratio, and I think I shared this with all last quarter. And for us, it's just one of many data points that we pay attention to, and perhaps, it's of interest to you all and that's the paid loss ratio. From our perspective, it is an important data point. It's not the whole story, but an important data point.

So here's a little bit of historical perspective for you again on Q2. And I'm going to give you what the paid loss ratio was going back to 2017 for Q2 as that creates as much of an apples-to-apples basis as we can, at least using shorthand. So the paid loss ratio Q2 in '17 was a 55.9. In '18, it was a 58.3. In '19, it was a 53.8. In 2020, it was 52.9. In '21, it was a 44.3. And in '22, it was 41.9. So obviously, an attractive trend. Doesn't necessarily tell the whole story, but again, from our perspective, a meaningful data point and an encouraging indicator.

Expense ratio, again, Rich touched on this. We continue to see improvement for a whole host of reasons. Certainly, lots of folks are focused on it and trying to be more efficient, but the big needle mover is just the growth in the earned premium.

And as you can see how it lags our written, there's likely more opportunity there over time. That having been said, we do have a few new operations. We'll have to see how they scale again over time.

So 88.6 reported. If you back out the cats and you do the butt forward, it's an 86.2. On an operating basis, obviously, a pretty attractive return by virtually any measure.

A couple of quick comments on the investment portfolio, and again, I think Rich summarized it well. So I'm not going to belabor the point too much here, but obviously, the duration remains notably short of where our liabilities are at 2.4 years compared to the liabilities, give or take, 4 years.

I think it's also worth noting, you're just in the early stages of seeing the opportunity for this company and its earnings power when you saw the book yield of climb from -- in the last quarter, last quarter being Q1 2.2 up to 2.6 in just a period of 90 days. And new money rate for us these days is certainly north of 4, probably 4.25, give or take.

We talked at the beginning of the call about foresight and discipline and a variety of other behaviors or traits and the importance of it. I think it has certainly been exercised on the underwriting side, but it is important to recognize how it has been also exercised on the investment side. The earnings power of this economic model going forward in a raising or increasing rate environment should not be underestimated.

It's something we've discussed in the past. I think it's something that people have an understanding for when we have the discussion, but I'm not sure if it's fully appreciated what this means for our economic model and again, the earnings power of the business as you see interest rates continue to move up.

So again, when we look forward, given the opportunities that we have before us, the flow of business coming our way continues to have significant momentum. The opportunity to make sure that we are getting the rate that we want and need continues to be there as well. And of course, the leverage that we have that is very much coming our way on the investment income side, I think all these things position us well for not just the coming quarters, but the coming years in all likelihood.
So let me pause there, Josh, if we could please open it up for questions.

Question and Answer

Operator

[Operator Instructions]

Your first question comes from Elyse Greenspan with Wells Fargo.

Elyse Beth Greenspan
Wells Fargo Securities, LLC, Research Division

My first question, you guys just spoke pretty positively about just submissions within, I think, you said the specialty and the E&S market. You guys have kind of flagged this 15% to 25% growth target. You obviously were there through the first half of the year. Is this something that you think is sustainable, I mean, for the rest of this year? And kind of if you have any thoughts on 2023 as well?

William Robert Berkley
President, CEO & Director

So we don't have a perfect crystal ball. All I can share with you is that there is nothing that leads us to believe that the opportunity to continue to grow the business, both based on policy count, growth and exposure in our insureds along with additional rate, we don't see that being derailed in the immediate term.

So how long will it go on for? I don't know for sure. I think one of the things, Elyse, I know we've talked about in the past, and I think it is worth noting is that we're all very sort of conditioned to think about the cycle as one across product lines. And while the realities of a cycle certainly apply to all product lines, we need to remember that product lines are not marching in lockstep these days.

So for example, it is our view that over the next 12 to 24 months, you are going to see the workers' comp market likely bottoming out and beginning to firm. And obviously, that's one of the, if not the largest, component of the commercial lines marketplace. So undoubtedly, there will be a moment where some commercial lines don't have the same buoyancy or resilience, but I would expect that you'll see other product lines firming as they are perhaps peaking or softening. So long story short, as far as specialty and E&S, there's nothing that we see in the short term derailing it. And I think that there are going to be other things such as comp that are in somewhat of an on-deck circle.

Elyse Beth Greenspan
Wells Fargo Securities, LLC, Research Division

And then just one on the capital side. You guys are trading above 2.5x book. You just mentioned again, right, that you're focusing on exposure growth. I know in the past, Berkley has shied away from acquisitions, can you just give us an update thought there? And would you guys consider a scalable acquisition to drive further topline growth?

William Robert Berkley
President, CEO & Director

So I think as you've heard my father comment in the past, and I'll echo his words that we are open to anything, but we are some people would say cautious and cheap. Others might call it disciplined. And from our perspective, one of the cornerstones of operating in the insurance industry is controlling the business. And when you buy someone else's business, you were buying somebody else's headaches and the seller typically knows more than the buyer.

We have done the occasional acquisition, but we are very careful about that. So most deals that occur, we hear about them before they are announced because we are shown the opportunity, but again, ultimately, we have a long-term view. We are focused on risk-adjusted return and controlling the business is an important part of that. And most insurance deals, quite frankly, when people look back on by and large, they probably wouldn't do them all over again if they could, and we're not looking for that experience.

Operator

Your next question comes from the line of Michael Phillips with Morgan Stanley.

Michael Wayne Phillips
Morgan Stanley, Research Division

First question is on the expense ratio. You talked about, obviously, the lag between written and earned that's going to help in the near term, but it feels like we're that part of the cycle for everybody. So I guess, I'm just kind of wondering especially with your talk on emphasis on exposure growth. It's kind of where we are today with that 27.7. Is that about the peak of improvement longer term? Near term, maybe a little bit more given the premium growth, but just kind of comments on that if you could.

William Robert Berkley
President, CEO & Director

Look, when we think about spending every dollar, every penny, we're looking at what kind of value we get for it. Can it improve from here? I guess it's possible. But for a specialty business, I think an expense ratio of 27.7 is pretty attractive. And you got to remember, a significant percentage of that is going for acquisition costs along with boards, bureaus, taxes, et cetera, et cetera.

So a limited amount of that is in our, if you will, direct internal controls. So do I think we can do better? Well, we'll have to see how it unfolds, but I think we're very pleased with the progress that we've made. And ultimately, we'll see where underwriting conditions go. The possible someday down the road, if we get into a very soft market, that number could tick up?

Yes. That having been said, to your point earlier, we have a lot of growth still like that will be coming through in the earned premium, and that will, in part, benefit the expense ratio. So I don't have a number of basis points that we're going to be able to improve from here, but I can assure you, Mike, we are very focused on it just like we are focused on every nook and cranny of what we all do as a team every day.

Michael Wayne Phillips
Morgan Stanley, Research Division

Okay. Perfect. Second question, you touched on it a little bit a second ago with comp kind of bottom out at some point and churning. I guess thinking about the venture you launched pretty recently in California. Is that a sign of just optimism in that specific market? Or is that just more in general -- I don't know if you plan maybe you can speak to that enterprise. Is that just a comp -- a California business? Or is that going to be maybe expanded out beyond that eventually?

William Robert Berkley
President, CEO & Director

Initially, the focus will be California within a particular part of the market, and certainly, over time, we are open to considering broader opportunities. For us, we -- long term, we like comp. For us, we like this part of the market, and we think the team of people that have joined us are exceptionally capable.

Operator

Your next question comes from the line of Yaron Kinar with Jefferies.

Yaron Joseph Kinar
Jefferies LLC, Research Division

I want to start with -- going to a comment in the press release, the earnings release where you say that most of our businesses are achieving or exceeding our target return on equity, and we're placing a greater emphasis on exposure growth. So should we take that to mean that with growth shifting to exposure, there's maybe less room for improvement in the underlying loss ratio going forward?

William Robert Berkley
President, CEO & Director

No. I don't think that's how I -- at least that's not how we intended it to be interpreted. I think what we're suggesting is that if you look at our portfolio, a growing percentage of it has reached or is exceeding our targeted returns and how we think about the balance between exposure growth and rate may be refined. That having been said, parts of the business that are below our targeted returns, we are still, again, very focused on making sure that the rate is adequate.

So I think it would be a mistake, in my opinion, to assume that the underwriting margin is not going to -- does not have the opportunity to improve from here. I think it's just what we're trying to message is the balance between rate and growth in many product lines rate is not the primary target for us. In addition to that, when you think about our economic model, just going back to the comments earlier, I think that you're going to find that, again, there is tremendous upside leverage for us with the investment portfolio.

Yaron Joseph Kinar
Jefferies LLC, Research Division

Okay. And then in your opening comments, Rob, you talked about your interest in being thoughtful as you look at the loss picks and the loss ratio, and I recognize you're also playing a long game here and not necessarily playing for the quarter. I think what has created some confusion for at least some of us on the outside is, we also, at the same time, hear you and others talk about hundreds of basis points of potential margin that has not yet shown up in results. So I guess, from my seat, my question would be why can we find more of a middle ground where if there are -- if there's a confidence around hundreds of basis points of margin and wants to be prudent and thoughtful at the same time, why can't there be 100 basis point of margin improvement or 150 basis points of loss ratio improvement and kind of achieve both ends of that?

William Robert Berkley
President, CEO & Director

Well, I think, at least from our perspective, and obviously, everyone is entitled to their own view. But from our perspective, loss cost trend and if you choose to unpack that, particularly economic inflation as well as social inflation are exceptionally leveraged. And if you get those wrong by not a lot, it can be a real problem.

We are not interested in trying to push the business. We are not interested in trying to take any unnecessary risks. On an operating basis, we're generating a high teens return without at least as we think about it being aggressive or optimistic. We're able to do that by being measured. And given that we think about the business through a risk-adjusted return lens, we think we are generating healthy returns for shareholders without increasing the risk by declaring victory prematurely.

So we're quite comfortable with where we stand. We have a healthy respect for the unknown, and it's certainly something that we pay attention to. Obviously, as the reserves season out, we will be in a position to tighten up those picks. As we have historically, we will continue to do that, but in the early years, we're just not going to want to run the risk of moving prematurely. But in spite of that caution, we're still very proud of the results.

Operator

Your next question comes from the line of David Motemaden with Evercore.

David Kenneth Motemaden
Evercore ISI Institutional Equities, Research Division

Just a question, Rob, on the 58 5 accident year loss ratio ex-cat. Is there anything in there one-off in nature? I know that in the second quarter of last year, I believe there were a few large fire losses. Just wondering if there is anything in there one-off, whether that's positive or negative, that impacted the loss ratio this quarter?

William Robert Berkley
President, CEO & Director

We did have some property risk losses which were frustrating. The good news is, we had less than we've had in the past. I think the work that colleagues are doing on that front hasn't fully taken hold, but the progress is clearly visible. But I think the 58 5 is a reasonable number for you guys to be focused on. Rich, I don't know, do you have a different view?

Richard Mark Baio
Executive VP & CFO

I don't, Rob. That's I think spot on. I would agree.

David Kenneth Motemaden
Evercore ISI Institutional Equities, Research Division

Got it. Okay. That's clear. And then my follow-up question just on the pricing change, the move down this quarter versus last quarter. I'm wondering if you could just drill down maybe and just talk about different parts of the market, maybe where competition is picking up and also where it might be -- on the other side, maybe the market is hardening a little bit as we sort of enter into or as the inflationary environment continues.

William Robert Berkley
President, CEO & Director

Yes. So probably at this stage, not enthusiastic about unpacking where we see the best opportunities and advertising that to a broader audience. I would tell you that the rate ticking down, what I would define as incrementally, is one I would encourage people not to read too much into it in a 90-day period.

But number two, and more importantly, going back to an earlier point and what we at least attempted to articulate in the release is, when you are writing business where your returns are particularly attractive, the way you think about the balance between rate versus growth is perhaps different than it was when you didn't find the returns as attractive and rate was the priority.

So each one of the businesses in the group or by product line, by territory is thinking about the balance, and it's multidimensional, but included in that is the balance between rate versus exposure growth. And I think a big piece of what you're seeing there, again, as we try to flag earlier is, there's a lot of the marketplace that we participate in that we like the rates.

We like the margin that is available. We feel as though that through how we capture exposure change, we are effectively keeping up with economic inflation, and the rate that we're getting is more than adequate to keep up with any social inflation or stub of economic inflation. And we like it, and we're going to chase it and continue to optimize that balance.

David Kenneth Motemaden
Evercore ISI Institutional Equities, Research Division

Got it. That makes sense. If I could just follow up on that point. I just noticed professional liability growth, if I just look at net premiums written growth that decelerated a bit. Was there anything in particular going on in that line? Or just there's more and more...

William Robert Berkley
President, CEO & Director

I think there's one piece in particular that is worth noting on the professional front. The market for professional overall, we find to be very robust. The one outlier would be public D&O, and it's still healthy there. But what has happened, it's less about new competition coming in and more about a slowdown in the capital markets, particularly around IPOs and SPAC, and that's just a reality.

So that would be one of the parts of the marketplace that we participate in, where you're seeing a response to the environment, and there has been less activity on that front. And again, that's probably what's really noteworthy on the professional front. Other than that, outside of public D&O, we're seeing a lot of opportunity.

Operator

Your next question comes from the line of Mark Hughes with Truist.

Mark Douglas Hughes
Truist Securities, Inc., Research Division

On the economy, you mentioned that the audit premiums are looking quite strong. It doesn't sound like you're seeing any sort of issues. Why is that relative to a lot of the chatter out there about the looming recession and slowdowns in end markets? Is it just your positioning? Will you see it later than others? Just a little comment there would be helpful.

William Robert Berkley
President, CEO & Director

Well, I think a lot of people are -- when they talk about the economy and weakness in the economy, I'm not sure it's necessarily here and now. I think it's people anticipating what the interest rate environment is going to do to the economy.

So while -- so from our perspective, our insurers, they seem to be doing quite well. Businesses are growing. Sales are robust. Payrolls are going up. And quite frankly, inflation seems to be driving a lot of it, too.

So if you think about workers' comp, just as an example, payrolls are going up because of wage inflation. If you think about the local store on Main Street, maybe they're selling more, but part of that is being driven by they're charging more for their products. And of course, on the property front, we all know what has happened with values.

So again, from our perspective on the audit front, we're not seeing our insurers at least at this stage in any type of financial apparel. And we are seeing their businesses grow partly due to health in the economy, but probably even more so as of late due to inflation and prices and wages going up and values.

Mark Douglas Hughes
Truist Securities, Inc., Research Division

Understood. And then the ceded premium has been declining. Will that continue? And how low can that go?

William Robert Berkley
President, CEO & Director

Well, ultimately, from our perspective, we have a view as to how our business will perform. We have some reinsurers that are clearly our partner throughout the cycle, and there are other reinsurers where they look to try and arbitrage us. From our perspective, we understand cost of capital, and we believe we understand the margin that's in our business, and we will operate accordingly.

As far as we're somewhat uniquely positioned because we are not a heavy cat player. We, generally speaking, do not write large limits business. Well, we do write some, but just as a data point that we have shared with some folks in the past, insurance -- types of -- insurance where you can legally have a limit, 90% of our policies have a limit of $2 million or less.

So as a result of that, we're just not as dependent on the reinsurance market because we're relatively cat light, and we're not a big limits player. So we will partner with people that are true partners, and we are not inclined to be arbitraged by those that are looking to do such.

Operator

Your next question comes from the line of Alex Scott with Goldman Sachs.

Alexander Scott
Goldman Sachs Group, Inc., Research Division

So the first question I had is just on capacity to grow. And just thinking through premium growth has been really strong in 2021, it's continued to be strong. I mean what you're saying about exposure growth and when we think about rates still positive, and there's a lot of things driving pretty heavy premium growth here.

I mean is there any way we should be thinking about the underwriting leverage of the business? And how much higher can that go? What kind of capital capacity do you have here to take growth to the next level, just given that, that seems to be the focus?

William Robert Berkley
President, CEO & Director

So I would tell you that we are very comfortable with our capital position and our ability to continue to write all of the well-priced business that we see out there. So we do not see today or anticipate tomorrow capital being a constraint. In addition to that -- I probably should have mentioned it earlier, Alex, one of the benefits to the approach that we have taken with the investment portfolio is, well, we are not completely insulated on the book value front from what has happened with interest rates and by extension, what's happened to book value.

We are far more well positioned than many of our peers. And the rating agencies, certainly one of the ways they look at capital strength is on a relative basis. So when you see some of our peers facing challenges with their bond portfolio, perhaps, those are not the type of severe challenges that we have to deal with fortunately for us. So again, just overall capital, we feel like we're in a pretty good place. In general, we feel like it's not going to constrain our growth, and we think the health and soundness of our capital is really well positioned given the duration of the portfolio and the quality of the portfolio.

Alexander Scott
Goldman Sachs Group, Inc., Research Division

Got it. And that actually leads into sort of the next question I was going to ask you, which is about the duration of that portfolio. I mean any updated views on sort of the mismatch you're running a little bit between assets and liabilities, and how you think about that going forward?

William Robert Berkley
President, CEO & Director

So my two cents, and then I'm going to flip it over to my boss to comment on. Obviously, we are short of where our liabilities are. That was a deliberate decision, and it's proven, at least at this stage, to be a very good one. As we continue to see rates move up, I think you'll see us look at taking the duration out. I don't think it's going to happen overnight, but I think you're going to see us gradually step into the water. I think the faster rates move up, the more aggressively you'll see us step into the water. So that would be my two cents. Mr. Chairman, do you want to offer an additional view?

William Robert Berkley
Executive Chairman of the Board

My only additional comment would be, in spite of where the world is, where interest rates are, the Fed has no choice but to raise rates to deal with inflation. We're going to see rates higher. I don't know if it's going to be 300 basis points higher, 200 basis points higher or 500 basis points higher, but substantially higher.

And we think in our sweet spot, which is the duration we ought to have, we'll get more than our fair share of that. So we would expect that will give us at least several hundred million dollars on a comparable basis of additional investment income. So we're quite optimistic, and we're not in a rush to push our duration out further.

Operator

Your next question comes from the line of Ryan Tunis with Autonomous Research.

Ryan James Tunis
Autonomous Research LLP

My first question was just, I guess, when we think about your headline rate number, and I guess, trying to compare them to others. To what extent is your relatively lower exposure to short tail lines, perhaps at this point or reason why you might have a lower headline rate number?

William Robert Berkley
President, CEO & Director

Well, I mean, clearly, property cat is one of the product lines that is getting the most robust amount of rate. And I would suggest to you, it's probably one of the product lines, whether it's insurance or reinsurance, that has been most underpriced for an extended period of time. And I think that there's a lot of industry results to support that.

Again, I think a lot of it really -- and I think -- I'm not sure I've articulated it particularly well, Ryan, but a lot of it has to do with rate adequacy. And once you believe that your rate adequate or better, then it turns into how do you think about the balance between pushing harder on rate versus growing the iceberg.

So I agree with your point that because we are not a giant property cat writer, and I think we need to draw the distinction between cat-exposed property and traditional risk. You're maybe not seeing the same level of rate increase, but you're also in a lot of the market that we participate in. To begin with, you didn't see the same level of inadequacy in rates. I mean you got to remember, we've been pushing for rate for several years now at this stage. I think we were earlier than some and we paid the price for that on the volume front, but I mean it's several years now where we're getting rate on rate. Rich, it's going to be, what, 3 years?

Richard Mark Baio
Executive VP & CFO

Yes. I think back to 2018, Rob.

William Robert Berkley
President, CEO & Director

A little bit more.

Ryan James Tunis
Autonomous Research LLP

Got you. And then on, I guess, the bottom on the workers' comp market, that's interesting. Is that a -- little more detail on that. Is that loss cost driven? Or is that just from the erosion of pricing over time?

William Robert Berkley
President, CEO & Director

No, I think loss -- I think it's both, to be perfectly frank. I think the pricing has been eroding for an extended period of time. And in addition to that, I think you're going to start to see severity become more and more of an issue.

And I think the realities of medical inflation which have been somewhat benign for some period of time, I think that's going to change. I think you're going to be seeing medical inflation take off, and a lot of it has been sort of historically focused around pharma. And I think it's not just going to be pharma, I think it's going to be other aspects of medical inflation. I mean if you look at health care providers, big hospital systems or large groups, they are bleeding out of their ears, many of them, and something is going to have to change.

So when the day is all done, there's going to be a moment of reckoning between the providers and the payers, and ultimately, the workers' comp market is not completely insulated from that. I think that there's early signs if you chat with the people at NCCI that they are starting to see, in the more recent years, issues around severity trend.

And they are starting to recognize the current accident years can only be supported so much by positive development coming out of prior years. In addition to that, my understanding is that the WCIRB out on the West Coast had a view that rates should be moving up, give or take, call it, I think it was 7% or so. And that got shut down by the insurance department out there. So there's growing tension there as well.

So Ryan, I can't call it to the day, the week, the month or even the quarter, but there's a growing level of evidence that the music is slowing. That party is going to come to an end. It was likely prolonged by COVID because of the holiday around frequency and that has sort of allowed it to continue on for some time. But I think 24 months or so, maybe less, people are going to have to start to wake up and address it. I think the industry is probably running well over 100 at this stage as far as comp.

Operator

Your next question comes from the line of Brian Meredith with UBS.

Brian Robert Meredith
UBS Investment Bank, Research Division

A couple of ones here and I think some for Bill here. First, I'm just curious, on the investment funds. Obviously, a terrific result. This quarter, you seem pretty optimistic about some good performance here through remainder of 2022, despite what many would consider a very challenging investment environment. Just curious if you can kind of give us a little breakdown as to why that is, why you're pretty optimistic about it for the remainder of the year?

William Robert Berkley
President, CEO & Director

Are you talking about specifically the funds? Or are you expecting...

Brian Robert Meredith
UBS Investment Bank, Research Division

So not investment funds. Exactly the funds.

William Robert Berkley

President, CEO & Director

The funds. So from our perspective, we think they've been reasonably resilient, as you can see. Please keep in mind that we booked it on a quarterly lag. So we don't have perfect visibility as to what Q3 will look like at this stage. Will it be as healthy and robust as it's been in the first half of the year, we'll have to see with time. We don't have that visibility yet, but we do not anticipate it being a big problem for us either based on our casual conversations with those that are managing the money.

Brian Robert Meredith
UBS Investment Bank, Research Division

Got you. And then I guess another question. I'm just curious from a macro perspective. It's been since the '70s since we've been in the stagflationary environment, and it looks like we may be going into one. Just curious, and Bill might know this, how did the industry kind of perform in a stagflationary environment? What are the kind of consequences in the playbook. And does it really matter that much for commercial insurers?

William Robert Berkley
Executive Chairman of the Board

Well, I think the issue, yes, stagflation is really an issue of how do you reserve your clients and how do you price your product and the mix of business you're in. So some companies do really well and some do really badly. And we saw a number of companies effectively go out of business, and others prosper and with the acquirer.

So I think that it's a mixed bag of companies who paid attention to their numbers did quite well and possibly, companies who chose not to, defaulted. A great example would be Chubb at Hospice and AIG made some bad decisions, and they defaulted. I think there's a whole mix of companies, some did wells, some did not do so well.

But going forward, I think that it's going to be a much greater differentiation based on both the lines of business you're in and the particular opportunities that are out there. And my point of view, I generally see greater opportunities, but also substantial punishment for the companies that don't pay attention to the changing environment. And I think the environment is going to continue to save at a more rapid pace.

Operator

Your next question comes from the line of Josh Shanker with Bank of America.

Joshua David Shanker
BofA Securities, Research Division

I appreciate you want to keep the secret sauce in the company and totally makes sense. People always ask you what your loss cost trend is, what your inflation assumption is. You'll be qualitative about it, not quantitative.

But can you talk about when you're out there searching for business, how big is the gap do you think between what your inflationary assumptions are and what your competitors are? Now some people are obviously very disciplined like yourself, but how wide is that variance do you think when you're out there speaking for pricing, I guess, between what smart people and less smart people are doing?

William Robert Berkley
President, CEO & Director

So Josh, I think it's a hard one to answer because it varies by product line and level of competition. And in addition to that, not going to be a wise ask, but competitors aren't really inviting us to their rate-making meetings. So knowing how they make their rates and come up with it, we're not really privy to. I would tell you that it's surprising to me, quite frankly, and I think we may have touched on this last time, but I apologize if it's repetitive.

But there's a real divide these days between what I would define as standard market, that being national carriers and super regionals have an appetite for, versus what they don't have an appetite for. If they don't have an appetite for it, there seems to be more meaningful discipline in the specialty and the E&S market, and that's really attractive.

I have been surprised that many national carriers and large regional carriers have been willing to be exceptionally competitive on what remains within their strike zone or their appetite. So again, I can't speak specifically to how they're thinking about loss trend and what their view is on this or that, but I can tell you that it is a very bifurcated world as far as level of competition between what is still within the appetite of the standard market and what falls outside.

Joshua David Shanker
BofA Securities, Research Division

Okay. I'll unpack that and work with it as I can. And then I guess a question for the Chairman. Look, I have a model going pretty far back, but not as far back as yours. When we talk about lengthening, what is the longest duration, or I guess, relative duration to liabilities that Berkley has ever been willing to run?

William Robert Berkley
Executive Chairman of the Board

Well, I think that the answer is, duration is unlimited exposure and it's not one we would ever consider taking. Whereas shorter durations let you reset your mistakes more quickly and with more specific challenges. So if you count your integration's through the years is shorter than the portfolio duration, you know what your exposure is. Whereas if your duration is 3 years longer than your portfolio -- that gives you a different kind of risk. So I would guess, the answer is, we have never been consequentially longer a year or 2, maybe 3 on the long side. And when we have been such, we've been such because we think the world is paying way too much in interest rates for the current interest rate picture.

So today, it would be a different story. We don't -- we think the pricing for interest rates is such that it's unlikely that get a lot of exposure. People paying a lot too much as far as rates, and I think that that's maybe even worse because at the moment, it's really an issue where you're confronting an environment where current interest rates are significantly in excess of the current market. So we have never, as far as I remember, really gambled on interest rates substantially in excess of our forecasted duration.

And the answer is, we've never been long side, doesn't suit our general conservative nature. So yes, you in fact have caught one of the views that we have primarily, and that is, you don't get rewarded for taking a long-term debt, interest returns being in excess of the return on your duration. By the way, I would be happy if somebody has the idea when it come up with that because that would be a hell of that.

William Robert Berkley
President, CEO & Director

Sorry, Josh, did you have another question for us?

Operator

Your next question comes from the line of Michael Phillips with Morgan Stanley.

Michael Wayne Phillips
Morgan Stanley, Research Division

I just had 1 follow-up. You mentioned earlier in a question about your small mistakes in loss picks could result in kind of big ramifications. And I guess I'm curious, were you specifically referring to you or the industry? And if you, is that just because of your exposure to excess layers and your...

William Robert Berkley
President, CEO & Director

No. I think that's just a reality of this industry. If you look at anyone when you think of their economic model in this industry and you sort of unpack what are the drivers in a loss ratio and the leverage and certain assumptions that go into coming up with the loss ratio, some of them can be very leveraged, such as how do you think about economic inflation? What do you think social inflation means? And those numbers don't need to be adjusted very much for there to be a heck of a ripple effect.

Michael Wayne Phillips
Morgan Stanley, Research Division

Okay. Make sense. So I just want to make sure I didn't -- if you're specifically thinking of your own.

William Robert Berkley

President, CEO & Director

No, it wasn't pointed at us. I think it's just a reality for the industry, but obviously, the longer the tail, the more potential there is for leverage.

Michael Wayne Phillips
Morgan Stanley, Research Division

Sure. Okay. And then if I could, your high net worth book, I haven't heard much about that yet. We've heard a lot of severity issues on traditional homeowners companies, and any thoughts you could share there on what you're seeing?

William Robert Berkley
President, CEO & Director

Business continues to do exceptionally well, and it's clearly considered a very attractive alternative to some of the more traditional or long-standing names in the marketplace, some of which perhaps have lost sight of their value proposition. And fortunately, for us, we have colleagues that are doing a great job building that business and have a laser focus on what the value proposition is that audience or customer base is looking for and that's being recognized.

Operator

Yes, there are no further questions at this time. I'll turn the call back to Mr. Rob Berkley for any closing remarks.

William Robert Berkley
President, CEO & Director

Okay. Josh, thank you very much, and we appreciate all that participated, you finding time to visit with us today. Clearly, a strong quarter which is obviously very encouraging, but perhaps even more encouraging is, there's clear evidence that the momentum continues to be there in a meaningful way on the underwriting side and a particularly noteworthy way as it's building on the investment side. So we will look forward to connecting with you all in 90 days. Thank you again for your participation, and have a good evening.

Operator
This concludes today's conference call. You may now disconnect.