S&P Global
Market Intelligence

Markel Corporation NYSE:MKL

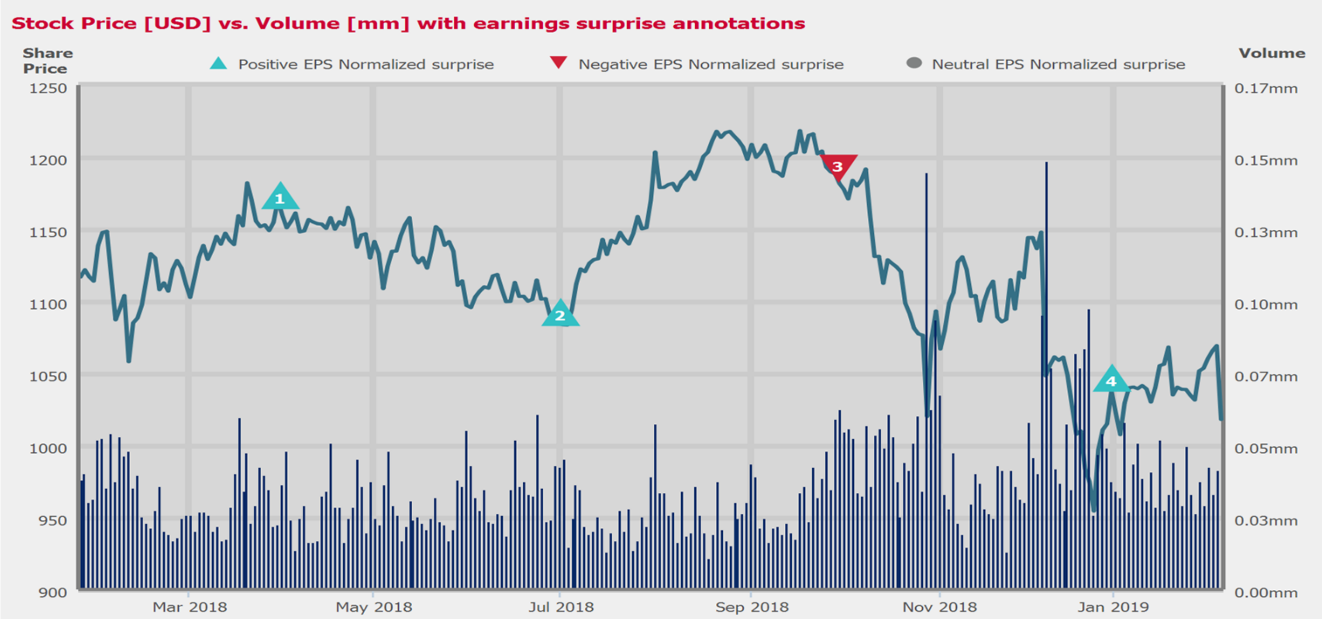
FQ4 2018 Earnings Call Transcripts

Wednesday, February 06, 2019 2:30 PM GMT

S&P Global Market Intelligence Estimates

	-FQ4 2018-			-FQ1 2019-	-FY 2018-		
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	ACTUAL	
EPS Normalized	2.00	3.67	▲83.50	9.95	27.61	28.53	
Revenue (mm)	1563.25	1042.85	▲(33.29 %)	1804.57	7362.50	6841.28	

Currency: USD
Consensus as of Feb-06-2019 12:46 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ1 2018	8.97	11.03	▲1 22.97 %
FQ2 2018	8.52	9.11	▲2 6.92 %
FQ3 2018	7.05	5.20	▼3 (26.24 %)
FQ4 2018	2.00	3.67	▲4 83.50 %

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Call Participants

EXECUTIVES

Jeremy Andrew Noble
Senior VP & CFO

Richard Reeves Whitt
Co-CEO & Director

Thomas Sinnickson Gayner
Co-CEO & Director

ANALYSTS

Jeffrey Paul Schmitt
William Blair & Company L.L.C., Research Division

John D. Fox
Fenimore Asset Management, Inc.

Mark Douglas Hughes
SunTrust Robinson Humphrey, Inc., Research Division

Scott Gregory Heleniak
RBC Capital Markets, LLC, Research Division

Will Allen

Presentation

Operator

Good morning, and welcome to the Markel Corporation Fourth Quarter 2018 Conference Call. [Operator Instructions]

During the call today, we may make forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. They are based on current assumptions and opinions concerning a variety of known and unknown risks. Actual results may differ materially from those contained in or suggested by such forward-looking statements. Additional information about factors that could cause actual results to differ materially from those projected in the forward-looking statements is included under the captions, Risk Factors and Safe Harbor and Cautionary Statement, in our most recent annual report on Form 10-K and quarterly report on Form 10-Q and earnings release on Form 8-K. We may also discuss certain non-GAAP financial measures in the call today. You may find a reconciliation to GAAP of these measures in the press release, which can be found on our website at www.markelcorp.com in the investor information section. Please note, this event is being recorded.

I would now like to turn the conference over to Tom Gayner, co-Chief Executive Officer. Please go ahead.

Thomas Sinnickson Gayner
Co-CEO & Director

Good morning. Thank you, Nicole. Welcome to the Markel Corporation Year-End 2018 Conference Call. This is Tom Gayner, the co-CEO of Markel, and that it's my pleasure, along with my co-CEO, Richie Whitt; and our CFO, Jeremy Noble, to welcome you to our year-end 2018 conference call. These calls are designed to give you a quick report on current conditions, financial results and our thoughts on the business environment for the Markel Corporation. We appreciate your long-standing partnership and interest as we continue to build your company over time, and we look forward to answering your questions at the conclusion of this call.

In short, 2018 was a fascinating year at Markel. We posted record revenues. Those revenues meant we served more customers with more products and services than ever. The revenues reflect our efforts to grow and expand the scope and scale of the Markel Corporation over time. Unfortunately, at the same time we're reporting record revenues, we also reported a comprehensive loss for the year. Our loss in 2018 reflects volatile equity markets and declines in our equity portfolio, especially in the fourth quarter. We also experienced mark-to-market losses in our fixed income portfolio from higher overall levels of interest rate. The cluster of challenges in 2018 also included a second year in a row of historically high catastrophe losses in the insurance industry and specific challenges at our CATCo insurance and securities operation. In each and every circumstance of challenge that I mentioned, I also believe that we learned how to better operate your company and to continue to build upon the multi-decade record of excellent financial results. We are optimistic about 2019 and beyond. At this point, I'm going to turn the call over to Jeremy Noble to give you a quick rundown on the numbers we just released. Following Jeremy, Richie Whitt will update you on our insurance operations, and then I will return to discuss our investment at Markel Ventures' operations. At that point, we will open the floor for questions. Jeremy?

Jeremy Andrew Noble
Senior VP & CFO

Thank you, Tom, and good morning, everyone. Our 2018 results included another record year of operating revenues totaling $6.8 billion, an increase of 13% over 2017. For the year, our owned premiums grew by 11% to $4.7 billion. Our revenues from our Markel Ventures affiliates increased by 43% to $1.9 billion. We reported a comprehensive loss of $376 million for the year versus comprehensive income of $1.2 billion in 2017. The compressive loss in 2018 was driven by decreases in the fair value of our fixed income and equity security portfolios, the arising interest rates during 2018 and the decline in the equity markets in the fourth quarter. Comprehensive income in 2017 included a one-time tax benefit of $340 million as a result of last year's U.S. tax reform legislation, and 2018's comprehensive loss included charges associated with our Markel CATCo operations. The unfavorable impact of these year-over-year changes was partially offset by underwriting profits of $114 million in 2018 versus underwriting losses of $207 million in 2017.

Turning to our underwriting results first. Gross written premiums within our underwriting segment was $5.8 billion for the year compared to $5.3 billion in 2017, an increase of 10%. The increase in gross premium volume was attributable to an increase in our insurance segment due to the impact from our new surety and collateral protection lines acquired in 2017, along with organic growth across several product lines. Retention of gross written premiums decreased from 84% in 2017 to 83% in 2018. This decrease was driven by lower retention on our personal lines business within the insurance segment and an increase in property catastrophe reinsurance coverage purchased in 2018 compared to 2017. Earned premiums increased 11% to $4.7 billion in 2018 due to higher written premiums in our insurance segment.

Our consolidated combined ratio for 2018 was 98 compared to 105 last year. The 2018 combined ratio included underwriting losses of $287 million or 6 points from Hurricanes Florence and Michael, Typhoon Jebi and the wildfires in California. The 2017 combined ratio included underwriting losses of $565 million or 13 points from Hurricanes Harvey, Irma, Maria, the earthquakes in Mexico and the wildfires in California. Excluding the impact of the catastrophe losses in both 2018 and 2017, our combined ratio was at 92 in both years.

Next, I'll cover the results of our Markel Ventures segment. Revenues from Markel Ventures increased $1.9 billion in 2018 compared to $1.3 billion a year ago. The increase in revenues was primarily attributable to Costa Farms, which we acquired in August 2017; and Brahmin, which we acquired in October 2018; as well as higher sales volumes in both our products and services businesses. Operating income from Markel Ventures was $77 million for 2018 compared to $115 million last year. EBITDA was $170 million for 2018 compared to $188 million last year.

In 2018, operating income and EBITDA were both impacted by expenses related to an investigation and remediation associated with the manufacture of products at one of our businesses and an impairment charge related to intangible assets in this reporting unit. Additionally, 2017 operating income and EBITDA benefited from insurance recoveries in excess of storm losses related to Hurricane Irma. These items were partially offset by the contribution to operating income and EBITDA from having a full year of operations from Costa Farms in 2018.

Next, I would like to briefly discuss the operating results from our program services division and ILS investment management operations due to their increasing contributions to our operating results. Our State National program services business, which we acquired in the fourth quarter of 2017, added $96 million in operating revenue in 2018 compared to $15 million in operating revenue in 2017. Our ILS investment management operations, which is consists of Markel CATCo and Nephila, combined to report $92 million in operating revenue in 2018 compared to $29 million in operating revenue in 2017. As a reminder, we closed on the Nephila acquisition in mid-November. The increase in operating revenue is attributed to higher year-over-year net assets under management at Markel CATCo and the Nephila acquisition in 2018.

Our ILS investment management operations are not included in a reportable segment, but are captured as part of the $144 million loss from other within the components of consolidated operating income in 2018. This loss is primarily due to certain adjustments made during the fourth quarter of 2018 and our Markel CATCo operations, which I'll discuss in more detail now.

As previously announced, effective January, 18, 2019, 2 senior executives of Markel CATCo are no longer with the company. We'd accrued $64 million of incentive and retention compensation for the 2 individuals as of September 30, 2018, all of which was reversed in the fourth quarter. Note, for the year, the reversal of this accrual in the fourth quarter results in the $35 million reduction in services and other expenses in our consolidated statement of loss and comprehensive loss for the full year of '18. During the fourth quarter of '18, we also reduced the carrying value of the goodwill and intangible assets for the Markel CATCo reporting unit to 0, which resulted in an impairment charge of $179 million. In light of governmental increase and the loss reserves reported in late 2017 and early 2018 and an entity managed by Markel CATCo and taking into consideration the departure of 2 senior executives, and certain redemption rights that are now being offered to investors and the ILS funds managed by Markel CATCo, Markel CATCo's ability to maintain or raise capital has been inversely impacted. As a result, we performed an assessment of the recoverability of goodwill and intangible assets at the Markel CATCo reporting unit as of the end of the year and determined the impairment charges necessary.

Turning to our investment results. Net investment income increased $434 million in 2018 compared to $406 million in 2017. The increase was driven by higher short-term investment income, primarily due to higher short-term interest rates and higher dividend income due to increased equity holding. Net investment losses included in our net loss for 2018 were $438 million compared to $5 million in 2017. The loss in 2018 was primarily due to a decrease in the fair value of equity security during the year attributed to the unfavorable market value movement and a decline in the fair value of our investments in the Markel CATCo ILS fund. We recorded net investment losses totaling $125 million for the year versus $52 million last year related to our investments in the Markel CATCo managed ILS funds. These losses resulted from decreases in the fair value of the ILS funds, which were driven by the losses associated with the 2017 catastrophe. As a reminder, effective January 1, 2018, all changes in the fair value of the equity portfolio are included in net income rather than other comprehensive income.

Net unrealized investment gains decreased $300 million during 2018, reflecting a decrease in the fair value of our fixed maturity portfolio, resulting from rising interest rates. Given our long-term focus, variability in the timing of investment gains and losses is to be expected.

Now if we take a look at our total results for the year, our effective tax rates for both 2018 and 2017 are not meaningful due to a small pretax loss in 2018 and large nonrecurring items in both '18 and '17. So instead of talking about the tax rate, I'll focus my comments today on the dollar impact, tax benefit and tax expense associated with transactions that caused our overall tax expense to differ from that what you would expect by applying the U.S. statutory tax rate to our pretax loss. First, the impact of our decision to elect to treat 2 of our U.K. subsidiaries as U.S. taxpayers beginning in 2018 resulted in a one-time deferred income tax charge of $103 million this year. Additionally, last year, we reported a one-time benefit of $340 million related to the enactment of U.S. tax reform legislation in late 2017. Excluding the 2018 nonrecurring items, our income tax expense differs from that expected by applying a 21% U.S. statutory tax rate to our pretax loss, primarily due to non-deductible losses related to our investment in Markel CATCo managed ILS fund, partially offset by the impact of tax-exempt investment income. We reported a net loss to shareholders of $128 million in 2018 compared to net income of $395 million a year ago. Comprehensive loss to shareholders in 2018 was $376 million compared to comprehensive income of $1.2 billion a year ago. Comprehensive income for the year was driven by the net loss for the year, the components of which I just discussed, along with the decline in the fair value of the fixed maturity securities at the end of 2017.

I'll close my remarks this morning with a few comments on cash flows, capital and our balance sheet. Net cash provided by operating activities was $893 million for 2018 compared to $859 million in '17. Operating cash flows for '18 have reflected higher net premium collections, lower payments for employee profit-sharing compared to 2017. 2018 also included higher claims payments, driven in part by the impact of the 2017 and 2018 catastrophe losses.

As we previously disclosed, we completed 2 acquisitions in the fourth quarter, adding Brahmin leather works to our Markel Ventures operations and Nephila Holdings to our ILS management operations. Both of these deals were funded from cash on hand. Even after considering the funds used for these acquisitions, we held $2.6 billion of invested assets at the holding company at December 31, 2018 compared to $2.7 billion at the end of last year. Total shareholders' equity stood at $9.1 billion at the end of 2018, a decrease of 4% from 2017.

And now I'll turn it over to Richie to talk more about our underwriting results.

Richard Reeves Whitt
Co-CEO & Director

Thanks, Jeremy. Good morning, everybody. Today, I'll focus my comments on our underwriting operations, and I'll also provide a brief update on our State National operations and ILS investment management operation.

So first, I'll start with the insurance segment. Gross written premiums for the quarter are up $153 million or 15% compared to the fourth quarter of 2017. On a year-to-date basis, writings are up $608 million or 15%.

Our recently acquired Markel Surety and the State National collateral protection product line added $23 million in additional premiums in the quarter and $194 million in premiums on a year-to-date basis. Premium growth for both the quarter and on a year-to-date basis, excluding these 2 new product lines, was driven by organic growth in our general liability, professional liability and personal line product.

Earned premiums for the segment are up 10% for the quarter and 14% on a year-to-date basis due to similar reasons as the gross written premium increases. The combined ratio for the insurance segment was 99% in the fourth quarter of 2018 compared to 88% for the same period a year ago. The 11 point increase in the combined ratio was largely driven by more cat events during the fourth quarter of '18 compared to the same period last year. Cat losses added 7 points to our 2018 quarter-to-date combined ratio compared to 1 point in 2017. The remaining increase in the quarter-to-date combined ratio was due to decreases in favorable development on prior accident year's losses along with the impact of higher earned premiums on the prior accident year loss ratio. The year-to-date combined ratio for the insurance segment was 94% versus 97% last year. The 3-point decrease in the combined ratio was largely driven by lower losses from cat events in 2018 compared to 2017. Cat events added 3 points to the 2018 year-to-date combined ratio compared to 8 points in 2017. The remaining change in the combined ratio was due to the unfavorable impact of growth in earned premiums on our prior year's loss ratio.

Next, I'll discuss the results of the Reinsurance segment. Gross written premiums for the quarter are up $29 million or 34% compared to the fourth quarter of '17. On a year-to-date basis, writings are down $61 million or 6%. The increase in gross written premiums for the fourth quarter of '18 was driven by higher premium volumes in our general liability and professional liability product lines due to favorable premium adjustments, new deals and renewal increases. The decrease in gross written premiums on a year-to-date basis was driven by a large specialty quota share tree, which we entered into during the first quarter of '17, that did not renew in 2018, along with a decrease in our property lines due primarily to nonrenewals.

These decreases were partially offset by growth in our surety product line as well as higher premium growth -- gross written premium volume in our general liability, professional liability and workers' compensation product lines due to favorable premium adjustments and timing of renewals.

We have non-renewed marginal property business, where rates and/or terms did not improve sufficiently to meet our profitability targets. As mentioned previously, significant volatility in gross premium volume can be expected in our Reinsurance segment due to individually significant deals and timing of renewals on multiyear contracts.

Earned premiums for the segment increased by 3% for the quarter and decreased by 1% on the year-to-date basis for the same reasons mentioned for written premiums. The combined ratio for the Reinsurance segment was 151% in the fourth quarter of 2018 compared to 122% for the same period a year ago. The 29% increase in the combined ratio was largely driven by higher losses from cat events in 2018 compared to '17 and a slightly higher expense ratio.

Cat events added 63 points for the fourth quarter of 2018 combined ratio compared to 25 points in 2017. The increases in losses from cat events was partially offset by a lower attritional loss ratio due to lower losses in our general liability products lines as well as more favorable development on prior year loss reserves in our medical malpractice product line. The year-to-date combined ratio for the Reinsurance segment was 113% compared to 132% last year. The 19-point decrease in the combined ratio was primarily driven by lower losses from cat events compared to 2017.

Cat events added 19 points to the year-to-date 2018 combined ratio compared to 32 points last year. The Reinsurance segment's 2017 results included $85 million or 9 points on a year-to-date basis of adverse development on prior year loss reserves due to the decrease in the Ogden rate. Excluding the impact of Ogden, the segment had less favorable development in 2018 compared to 2017 due to less favorable development in our property reinsurance lines, inclusive of some adverse development in 2018 related to the 2017 cat events.

Next, I'll make a few comments about State National. Just as a reminder, the State National business is comprised of 2 primary products, a collateral protection insurance coverage, results for which are included in our insurance segment; and a fronting platform, which provides insurance licenses, rated paper and services for a fee. We refer to this business as our program services business. The program services business is almost entirely non-risk-bearing to Markel and is reported separately from our underwriting operations.

The program services business added $488 million in the quarter and $2.1 billion for the year in gross written premium, which is almost entirely ceded. The business is a fee business and contributed ceding commission fee revenue of $28 million in the quarter and $96 million for the year. These amounts are reported in services and other revenues within our operating results. We're very pleased with State National results for their first full year as part of Markel.

Now moving to insurance-linked security investment management operations. With the completion of the Nephila acquisition in November of 2018, we have significantly increased our ILS investment management operation. With Nephila and Markel CATCo, we have approximately $14.5 billion of net assets under management at the end of 2018 compared to about $3 billion of net assets under management at the end of '17. Starting with our acquisition of CATCo in 2015, State National in 2017 and most recently the Nephila acquisition in '18, we've been working very hard to build our capabilities in the insurance-linked securities and program service area. We see significant synergies possible between our insurance, reinsurance, ILS and program services businesses.

In a recent Aon publication, they stated that 2017 and 2018 were the costliest back-to-back catastrophe years on record with insured losses approaching $240 billion. This level of loss activity was an extreme challenge for the ILS market in general and for Markel CATCo in particular. Not only did Markel CATCo funds incur significant losses in 2017 and 2018, but their initial estimates for 2017 losses were too low. As we announced in early December, we received inquiries by U.S. and Bermuda authorities in the loss reserves recorded in late 2017 and 2018 at an entity managed by Markel CATCo. We're cooperating fully with these regulators. We continue to investigate these issues and have retained outside counsel to conduct an internal review. The internal review is ongoing and no conclusions have been reached. As previously announced, we have installed new management and oversight at Markel CATCo, and are providing additional resources as needed. We expect to learn from the cat events from 2017 and '18, and we've planned to adapt our Markel CATCo strategy accordingly. We remain confident in the future of ILS, and we believe ILS will be a valuable important component to Markel's overall strategy in the future.

I'll finish up with some market commentary. I would sum up market conditions at the end of 2018 as more good than bad news. We saw continued modest improvement in most insurance pricing during 2018. In fact, December rate increases were our strongest of the year. So that's the good news, and I view it as very good news considering that over 80% of our risk-bearing premiums come from insurance lines. The bad news was the property reinsurance rates continued to disappoint at the important January 1 renewals. Property reinsurance rates were inexplicably flat after a 2-year period of record catastrophe losses. We continue to push for rate increases where needed and shed reinsurance business at January 1 that did not meet our profitability requirement. I will say that all hope is not lost as the Japanese and Florida market renewals will take place in the second quarter of 2019. Both markets have handed reinsurance significant losses over the last 2 years and should rightfully be in payback mode. Our expectations are that rates should be up meaningfully for these renewals. However, if they're not, we will be reducing our writings accordingly.

I want to thank you for your time today, and now I'm going to turn it over to Tom.

Thomas Sinnickson Gayner
Co-CEO & Director

Thank you, Richie. As Jeremy reported earlier, we experienced a negative total return on our investment portfolio of 1% during 2018. Our equities declined 3.5% for the year, and we made 1.3% on our fixed income holding. Just to start, to lengthen out the time horizon a bit, and in keeping with our normal pattern of looking at results over 5-year periods, here are the 5-year numbers. In our equity portfolio, we are at 9.7% per year over the last 5 years. And in our fixed income operations, we earned 3% per year. I'm pleased with these results. Over 1 and 5 and 10 and now 30 years, we've exceeded the returns of the S&P 500 by over 100 basis points. I will happily sign up for those sorts of results for the next 30 years in a New York minute. Obviously, I'm not thrilled to report negative returns to you for 2018, but I do see them as reflecting normal and expected volatility that is the very warp and woof of financial markets. Fortunately, this is nothing new for us. We've navigated through financial markets for decades with a straightforward and consistent discipline throughout. In 2018, we stuck to our long-standing 4-part discipline of looking for: one, profitable businesses with good returns on capital, not too much leverage; with, two, management teams with equal measures of talent and integrity; with three, reinvestment opportunities and capital discipline; and four, reasonable prices. At any given point in the investment business, a true professional looks either dumber or smarter than they really are. And in 2018, that discipline produced a return of negative 3.5%. While that is better than the S&P return, it remains a negative return. We'll put 2018 in the category of times when we looked dumber than we really are. By contrast, in 2017, we earned 25.5% on our equity holdings, an amount also greater than the S&P 500 returns of that year. We'll put 2017 in the category of times when we looked smarter than we really are. Over time, the true level of intelligence or skill of an investment discipline reveals itself. And as I said earlier, we've outperformed the S&P 500 in fixed income alternatives for decades. The process worked.

In our Markel Ventures operations, we reported revenues of $1.9 billion versus $1.3 billion a year ago. We also reported EBITDA of $170 million compared to $188 million a year ago. On the surface, this doesn't jump off the page as a spectacular result, but I'd like to suggest that it's meaningfully better than what it looks like at first glance. First, in 2017, EBITDA benefited from certain insurance recoveries related to Hurricane Irma, which pulled some earnings into the 2017 number, a bit ahead of what would've occurred otherwise. In 2018, the effects of purchase accounting and first full year ownership circumstances, which includes tax adjustments, the payment of better-than-expected earnouts and certain one-time charges at other Markel Ventures units, all went through the 2018 EBITDA calculation. I've spoken in the past of my expectation that the Markel Ventures portfolio would normally produce EBITDA margins in the low to mid-teens. In 2019, if our operations performed at the same level they did in 2018 economically, we will earn and report EBITDA in that range since we will have burned off a good chunk of purchase accounting-related charges by that point.

One other data point that might be helpful is also to view Markel Ventures in the similar 5-year time period as we do throughout Markel. Almost each and every year, I find myself writing in the annual report or speaking in these conference calls about accounting and how it is important to sort and sift through the first pass of presentation to gain more understanding about the underlying economic performance of Markel Ventures. The good news is that we're long-term around here. And in the long-term, the effects of purchase accounting diminish over time and burn off. On a completely unadjusted, no comment, no color commentary basis, 5 years ago, Markel Ventures reported revenues of $683 million and EBITDA of $77 million. In 2018, we reported revenues of $1.9 billion and EBITDA of $170 million. Have we made some mistakes along the way? Are there things we need to get better at? The answer is absolutely yes. We're making mistakes, and we'll learn. And in aggregate, the results indicate that the process at Markel Ventures is working. We follow the same discipline at Markel Ventures as we do in our equity process. We look for profitable business, good returns on capital and not too much leverage, with management teams of equal measures of talent and integrity, with reinvestment opportunities in capital discipline at reasonable price. Just as with the case with our equity results, the long-term record of this approach has created immense value for Markel over time. Just as is the case with our equity results, it does not happen in a straight line or in smooth, year-by-year progressions. The 5-year view of our insurance, investment and ventures operations begins to set things at the same focal point as the one we use to run the business. We hope you are pleased with the 5-year results, understanding of the year-to-year variability and volatility and as excited and enthusiastic as we are to apply what we've learned for the next 5 years. Thanks for your interest and partnership. And with that, we look forward to your questions.

Question and Answer

Operator

[Operator Instructions] Our first question comes from Mark Hughes of SunTrust.

Mark Douglas Hughes
SunTrust Robinson Humphrey, Inc., Research Division

Could you talk about the redemption rights? You mentioned that there's opportunity for investors in the ILS fund to presumably redeem some capital. Where are we in that process? How much is exposed to that process? And at this point, does it impact your own capital?

Richard Reeves Whitt
Co-CEO & Director

Okay. Mark, this is Richie. Yes. Given those circumstances at Markel CATCo, we felt it was appropriate to offer investors a special redemption right, which they can exercise by March 31. The likelihood is most of the investors will wait until March -- or close to March 31 to exercise their option. And my expectation is just given the uncertainty that we mentioned in terms of the decisions we made around accounting, I would expect most investors to exercise their option that we've given them at March 31. But we'll obviously -- we're in contact with the investors. We're talking to them. We're providing them updates and we'll see what they decide to do. In terms of impact to Markel's capital, no impact to Markel's capital. Obviously, if investors redeem, what we are able to do in terms of investing for the 2020 year would be impacted by their decision.

Mark Douglas Hughes
SunTrust Robinson Humphrey, Inc., Research Division

And then is there a magnitude -- it sounds like you think most will exercise, how many potentially could exercise. Or how much capital is involved?

Richard Reeves Whitt
Co-CEO & Director

It's everything in the product fund. The public fund board needs to take its own decisions in terms of what they want to do, in terms of the public fund. But it would be all the capital in the private fund, which is roughly, what, 85% of -- I don't have an exact number. But it's a significant amount of the capital. If I put myself in the shoes of investors, they've received an option, there is quite a bit of uncertainty. They have the ability later in the year, if the uncertainty is resolved, to come back in if they'd like. So that would be my expectation.

Mark Douglas Hughes
SunTrust Robinson Humphrey, Inc., Research Division

And then of the $14.5 billion, how much of that was Nephila?

Richard Reeves Whitt
Co-CEO & Director

About $11.5 billion roughly.

Mark Douglas Hughes
SunTrust Robinson Humphrey, Inc., Research Division

So is that -- if I'm thinking about it properly, the majority of the balance would be open to redemption. Is that right?

Richard Reeves Whitt
Co-CEO & Director

Yes, I think that's a very fair statement.

Mark Douglas Hughes
SunTrust Robinson Humphrey, Inc., Research Division

Okay. The -- just more of a small board question, but professional liability. I, think you've -- you talked about growth there in the maybe both reinsurance and in the insurance segment. Anything there that is catching your eye? Any dislocation in that market? I'm thinking medical professional in particular.

Richard Reeves Whitt
Co-CEO & Director

Medical professional continues to be challenging, probably amongst the professional lines, that's still one of the more challenging areas. I think it's -- I think what we're seeing primarily is I mentioned sort of modest rate increases. We're starting to or we saw throughout '18 modest rate increases in professional. We're a big writer of professional, both insurance and reinsurance. And I think relative to other areas that we could deploy capital and write business, we think professional is becoming more attractive. So nothing really kind of stands out to me in particular, just the kind of gradual improvement that we've seen in the pricing environment and the risk-reward around professional business.

Mark Douglas Hughes
SunTrust Robinson Humphrey, Inc., Research Division

So within that medical professional is a laggard perhaps?

Richard Reeves Whitt
Co-CEO & Director

I'm sorry. Say that again.

Mark Douglas Hughes
SunTrust Robinson Humphrey, Inc., Research Division

Within that, looking at professional liability, would you say medical professional, I used the word, laggard, but still one of the more challenging areas, I think, with what you said?

Richard Reeves Whitt
Co-CEO & Director

Yes, yes, I think it is. I mean, that's an area that's been, over time, really good to us, but it has -- had -- it's been very competitive over the last few years. And for whatever reason, it has been slower to react to the losses that have incurred over the last few years. And I would -- yes, I would say the pricing movement has lagged some of the other professional lines.

Operator

Our next question comes from Jeff Schmitt of William Blair.

Jeffrey Paul Schmitt
William Blair & Company L.L.C., Research Division

Could you discuss maybe just kind of broadly what you're seeing for commercial loss trends in the U.S.?

Richard Reeves Whitt
Co-CEO & Director

Well, loss trends, I mean, we are -- we all have -- we stay wary of inflation and, in particular, when it comes to insurance claims inflation. For quite a while, inflation has been pretty tame. It's been under control. And as a result of that, claims inflation has also been fairly tame and under control. And I think the entire industry has really benefited from that. We continue to remain wary of that, and I do think we are starting to see some signs of claim trend ticking up, and I think we've seen some signs of severity of losses ticking up. Now that can be inflation or socioeconomic issues, legal issues. But I think we're seeing some tick-up in both of those, and we're trying to build that into the pricing that we think we need to hit our return goals on those products.

Jeffrey Paul Schmitt
William Blair & Company L.L.C., Research Division

Okay. And just thinking about AIG and Lloyds kind of polling back in E&S space, can you maybe discuss what you're seeing there, where there's opportunities for Markel?

Richard Reeves Whitt
Co-CEO & Director

Well, E&S is an area that actually -- I mean, that's kind of really where Markel started, cut its teeth, and it's still a very big part of our business. So the E&S wholesale market has been a really good market for us the last few years. We grew nicely in 2017, and then on top, again, in 2018 off of that already nice growth that we saw in '17. So that's been a real positive, I think, in terms of our businesses in the last couple of years. Now whether that's a result of whatever AIG is doing or the things they're doing at Lloyds to address the lower-performing lines, I'm sure that has some impact, but that's probably not all of it. Certainly some of the factors, but not the only factor.

Operator

Our next question comes from John Fox of Fenimore Asset Management.

John D. Fox
Fenimore Asset Management, Inc.

I have a number of questions. First for Jeremy. That was an excellent description of the tax rate of the last 2 years. Do we have an estimate of what it'll be going forward?

Jeremy Andrew Noble
Senior VP & CFO

Yes. John, thanks for the question. If you think about -- to the extent you can think about, predict kind of a normalized amount of pretax income, think about taking statutory tax rate and that we would come in slightly lower than that, predominantly because it's sort of tax-exempt investment income. I caution you, because as we talked about, that variability, particularly mark-to-market equities through our pretax income can create some variability, with the extent to which those permanent differences like tax-exempt investment income, move the rate. But generally, what you haven't seen in the last couple of years, we should come in slightly lower than the U.S. statutory tax rate.

John D. Fox
Fenimore Asset Management, Inc.

Okay, great. And then in the -- the investment management business had revenue in the quarter of $39 million. And then I thought I heard you say because of that accrual of CATCo, there's a $35 million reduction of expenses in the quarter?

Jeremy Andrew Noble
Senior VP & CFO

Actually, year-to-date the benefit would be about a $35 million reduction in the quarter if that amount was $65 million.

John D. Fox
Fenimore Asset Management, Inc.

Got it, okay. And should we think about that line item growing as the asset balance has gone from 3 to 14]? Is that like a traditional asset management business, where there's a fee income in the revenue part, and then whatever the margin is, it falls out. Is that the right way to think about it?

Richard Reeves Whitt

Co-CEO & Director

I think so, John, yes.

John D. Fox
Fenimore Asset Management, Inc.

Okay. And then, Richie, expanding on CATCo. What are the risks to book value going forward? I mean you did take a goodwill charge. I mean, if there's an awful scenario here ann CATCo, let's say, just kind of goes out of business, is there a potential for further goodwill? And then I think you have $58 million invested in the funds. That obviously could make money or go down. So can you just kind of, going forward, put some size on the risk in CATCo at this point?

Richard Reeves Whitt
Co-CEO & Director

Sure. Well, I think you did a good job of it, John. Obviously, at this point, we've written off all the goodwill and intangibles related to CATCo. So if we get to the other side of the challenges we currently face, and we don't have -- we're not able to continue the business, there's no more goodwill or intangible hits to take. We have our investment. We have our investment in CATCo, which has been hit hard, obviously, by the losses -- the cat losses in 2017 and 2018 that started out at $200 million-plus range and is down $58 million that you mentioned. That just comes down to how 2017 and 2018 developed. And obviously, we invested in the 2019 year, so we'll see what 2019 holds in terms of cat activity. But -- and then there is, obviously, ongoing cost of the business on a reduced asset base. We'll see how that works out. And then legal contingencies, we'll have to see how those things play out.

John D. Fox
Fenimore Asset Management, Inc.

Right, sure. Okay. And then my last question is more of a strategic one for you and Tom. I'll use Tom's 5-year, long-term timeframe, which the Reinsurance business is writing close to a $200 million underwriting loss. And Richie, you gave an excellent description of the market, where we had 2 back-to-back record cat years, but really, very little increase in rate in the marketplace for a variety of reasons. So strategically, is this a business that you like less, you like more? Where does it fit in? And given the expansion also in the ILS market, is it a business where you can make a Markel-type return? And are you thinking about that?

Richard Reeves Whitt
Co-CEO & Director

Sure. There's a lot to unwrap there, John.

John D. Fox
Fenimore Asset Management, Inc.

There is.

Richard Reeves Whitt
Co-CEO & Director

The first thing I'd say is if 2017, 2018 level of catastrophe activity were to continue, nobody's business model works that writes property, just period end of statement. Everything's going to have to change if that level of activity continues. We found ourselves in this place once before, not that long ago, after 2004 and 2005, when we had multiple events in back-to-back years, Katrina, Rita, Wilma in the 2005 year, and we were all asking the same question. And so the question is going to be, where -- does this level continue? Do we end up somewhere in between? Do we go back to the old ways you'd go a number of years of light cat activity? Nobody can answer that. And you've got the additional question of global warming or climate change or whatever you want to call it. The bottom line is, over or the last 2 years, as we've seen what's happened, we've been reducing our property writings. We're writing less property today than we were at the beginning of 2017. We're going to probably write less property in 2019 if pricing doesn't get better quickly. So we and everybody else will continue to back away from property risk unless the risk-reward equation gets back into an appropriate balance. So we're not going to knee-jerk. We're going to adjust, as we always do, sort of gradually, but we're not going to knowingly continue to take losses on a product line.

John D. Fox
Fenimore Asset Management, Inc.

Yes, sure. And you mentioned 2004. There were 4 Florida hurricanes, and then there wasn't one for a decade or so, I think so.

Richard Reeves Whitt
Co-CEO & Director

Yes. So who knows? But we're adjusting. We've adjusted each year as this has been going on. And we'll continue to adjust in '19, and we will not knowingly write business at a loss.

Thomas Sinnickson Gayner
Co-CEO & Director

John, this is Tom. I have nothing further to add.

Operator

Our next question comes from Will Allen of KBW.

Will Allen

I just had some questions regarding Nephila, particularly if you could help me on the performance in 2018. You just mentioned that they have $11.5 billion of AUM currently. I believe that's down from the $12.3 billion at closing. And then also, I think they peaked at $12.5 billion in August. So can you just explain the decline in $1 billion of AUM there? Could you also talk about whether they -- how their performance was and whether there was any urban loss deterioration and how you think of that in the context of what happened to CATCo? I have a few other questions relating to Nephila, but let's start there.

Jeremy Andrew Noble
Senior VP & CFO

All right. All right. Let's start there. Thanks, Will. First of all, it's probably good to understand Nephila is in a very different space to CATCo in the ILS market. CATCo is a very niche business writing retro, and not only writing retro, but writing a very specific product, a pillared product. So they're in the retro space of the ILS market. Nephila is in the reinsurance space. They write virtually no retro, and they writing more -- all the time, they're writing more insurance. So they're a reinsurance and insurance business, whereas CATCo is a retro business. The decrease in AUM is going to be largely due to losses in 2018. They -- the redemption activity was not out of the ordinary. There were also people coming into the funds. So I don't know the exact number or the exact net, whether it was a net redemption or a net increase, but it was relatively modest. Most of that reduction in AUM or NAV is going to be due to losses in 2018. Because they write reinsurance and insurance and they're closer to the risk, their losses were smaller than CATCo, and also more predictable. So I don't think they've had the same issues with loss creep that CATCo had. All reinsures had cat -- had creep issues with Irma and some of the other storms, certainly not to the extent that CATCo saw, and they had small losses for 2018, but I would say, within expectations, given the type of year that '18 and '17 were. So they fared and they did a good job. Frank, Greg and that team, they are -- I truly believe they are in the best in the business, and they've been doing it for 20 years. And that experience and knowledge of ILS has really shown through in terms of their performance in '17 and '18. They'll be the first to tell you, it's not what they want to do. They want to produce for their investors. But I think given all the challenges of 2017 and 2018, they came through it very well.

Will Allen

I would just link to that, I guess, and, I guess, linked to CATCo, but could you give us an assessment of how to think about the goodwill that you paid for Nephila? Obviously, KKR and Man Group did very well on their investment. And -- but obviously, during that period, they had good results and increased their AUMs significantly.

And then as moderately linked to that, the one thing I was surprised by in the results last night was actually the amount of compensation that the individuals at CATCo had been receiving. Can you give us an idea of how much of the economics of Nephila were recurring to the team there versus shareholders?

Richard Reeves Whitt
Co-CEO & Director

Sure, I'll do my best. In terms of how to think about the goodwill on Nephila, I mean, we were -- we're basically buying the future stream of operating cash flows. So Nephila is a fee business. It's an asset manager. And you think of it -- in terms of thinking about it, I think you think about it in terms of a multiple of EBITDAs, which you're willing to pay for that future stream of cash flows. I think we paid a fair multiple of the future of what we think the future stream of cash flows will be to the selling shareholders. We're not -- there's no question ILS has now been challenged 2 years in a row. Everybody was questioning the resiliency of the ILS market after '17, and then '18 is another bad year. And so additional questions come about. I am not so much concerned about 2019 or 2020 in terms of ILS. We're thinking more -- much more about the next 5 and the next 10 years, and that's how we think about the goodwill that we paid for Nephila when we bought it. We're thinking about the next 10 and 20 years and what that looks like, and we think it's a very bright future for ILS. The comp -- going to your compensation question. In the CATCo deal, we deferred a significant portion of the proceeds for the deal over the next 3 to 5 years. And so that is why it was about 1/3 of the proceed or 1/3 of the value of the deal was deferred in the CATCo deal. And so that's why that number is so large. It is because of roughly 1/3 of the purchase price was deferred, and it was divided between performance and basically stay bonuses. So that's the reason there. We took a different approach with Nephila, and a big chunk of it was not deferred, but to achieve alignment with investors. The selling share -- the selling management, Frank, Greg and team, took a big chunk of their proceeds and invested them side-by-side with the investors in the Nephila funds. And they wanted to do that to show alignment and support of the investors in Nephila, and we were very glad to -- that they wanted to do that. And so we agreed that a big chunk of their proceeds now sits in the funds alongside the investors.

Operator

Our next question comes from Scott Heleniak of RBC Capital Markets.

Scott Gregory Heleniak
RBC Capital Markets, LLC, Research Division

Just the reinsurance growth was really strong this quarter. And I know you mentioned it was professional and general liability. Just wondering if that was -- was that driven by a large treaty or 2? Or did you see that kind of across the board? And do you still expect to see sort of pockets of growth in reinsurance and those liability lines this year even if pricing doesn't improve a whole lot? And just on the liability side, I know property is obviously a different story.

Richard Reeves Whitt
Co-CEO & Director

Yes. Nothing sticks out to me, I'll be honest, like we try to always caution timing. These are big contracts in relationship to the size of the overall portfolio. So it doesn't -- it only takes one or the timing on one contract to slip or speed up, and all of a sudden you're talking about big increases or decreases quarter-to-quarter. We are clearly focusing more on professional and liability because we -- as I think I said earlier, we see rates moving in a positive direction on those 2 lines, and we view the relative pricing adequacy of those as being better than what we're seeing in property and in some other areas. So we definitely are more interested in those areas, but I don't -- if we don't see continued progress in terms of rates, we're not going to put our foot to the gas on casualty or professional. I just think, relative to other areas, they look a little more attractive to us right now. But it's not a, let's go out and write all we can. There's still some work to be done in professional and casualty.

Scott Gregory Heleniak
RBC Capital Markets, LLC, Research Division

Okay. And then on the property side, what kind of rate increases would you want to see to, I guess, get more interested in some of that property business at 401 and 6:1. And obviously, flats aren't good enough, but even low single digit seems like not much of a help. Would you want to see 5% to 10% rate increases? Or what are your thoughts on how much pricing has to move to become more interested?

Richard Reeves Whitt
Co-CEO & Director

I'm probably not the expert there. I'd want to leave that to my -- to Jed Rhoads and the guys who run our reinsurance operations. If I had to guess, what they would tell you is it would depend on the season, and I don't think single digits gets it done. I think teens is probably needed for people who have had relatively decent performance, and something much better than teens is probably needed for people who really need to pay back losses that they've handed to us over the last couple of years. So -- but to get more specific than that, I think I'd have to ask the team to get involved. There's probably a little more art. There's art and science in that, I guess, I'd say.

Scott Gregory Heleniak
RBC Capital Markets, LLC, Research Division

No, that's a helpful answer. I appreciate that. And then, I guess, the last question. I don't know if you gave this up, but was -- how much of the one-time costs that you had from CATCo investigation that were in expenses? And anything else unusual that impacted expense ratio in the quarter?

Jeremy Andrew Noble
Senior VP & CFO

Yes. Scott, it's Jeremy. We didn't disclose any figure with regards to those ongoing expenses, but they're not significant in the period. And really nothing else you will see in the expense ratio. It's pretty consistent period-on-period across the piece. So there's not much that I just want to point to there.

Richard Reeves Whitt
Co-CEO & Director

I'll just add to my answer because Jed Rhoads just sent me something to point out that we -- he wanted to point out that we did some new transactional liability business in the liability space. That's an area that we have been growing in. And so that's part of the reason for the growth in liability. And I was pretty close on the -- on my answer to price increases. He'd like to see high single digits to the 10% range in Japan, and he needs double digits, mid-teens and up in Florida is what he'd like to see.

Operator

Our next question, and is a follow-up, from Jeff Schmitt of William Blair.

Jeffrey Paul Schmitt
William Blair & Company L.L.C., Research Division

Just wanted to follow up real quick on CATCo. Does Markel have to reinsure any CATCo's losses if investors redeem? I mean, could you be on the hook for anything there?

Richard Reeves Whitt
Co-CEO & Director

We do not reinsure CATCo. CATCo purchases some protections on their own. And obviously, those would be available to the extent they're triggered. But Markel does not provide any reinsurance to Markel CATCo funds.

Jeffrey Paul Schmitt
William Blair & Company L.L.C., Research Division

Okay, okay. And then excess capital at holdco, could you give us a sense on where that stands after the deals and the writedowns?

Jeremy Andrew Noble
Senior VP & CFO

I don't know so much about excess capital. But at the end of the year, we had sort of $2.6 billion of invested assets at the holding company after having funded the transaction in the fourth quarter.

Operator

This concludes our question-and-answer session. I would like to turn the conference back over to Tom Gayner for any closing remarks.

Thomas Sinnickson Gayner
Co-CEO & Director

Thank you very much for joining us. We look forward to connecting with you next quarter. Thank you. Bye-bye.

Operator
The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.