S&P Capital IQ

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W. R. Berkley Corporation NYSE:WRB

FQ2 2011 Earnings Call Transcripts

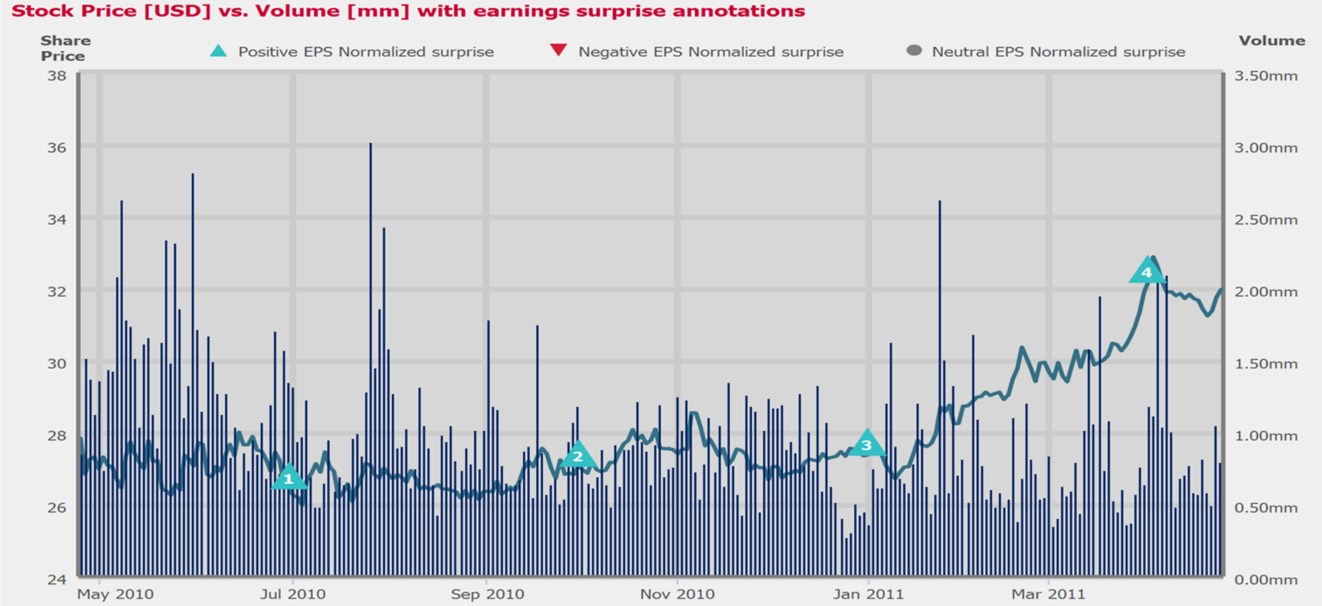
Tuesday, July 26, 2011 1:00 PM GMT

S&P Capital IQ Estimates

	-FQ2 2011-			-FQ3 2011-	-FY 2011-	-FY 2012-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.42	0.47	▲11.90	0.61	2.36	2.60
Revenue (mm)	1197.47	1270.95	▲6.14	1221.89	4835.79	5132.80

Currency: USD

Consensus as of Jul-26-2011 1:05 PM GMT



- EPS NORMALIZED -	CONSENSUS	ACTUAL	SURPRISE
FQ2 2010	0.62	0.65	▲1 4.84 %
FQ3 2010	0.66	0.66	▲2 1.52 %
FQ4 2010	0.67	0.68	▲3 1.49 %
FQ1 2011	0.65	0.66	▲4 1.54 %

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Presentation

Operator

Good day, and welcome to W.R. Berkley Corporation's Second Quarter 2011 Earnings Conference Call. Today's conference is being recorded. The speakers' remarks may contain forward-looking statements. Some of the forward-looking statements can be identified by use of forward-looking words, including without limitation, believe, expect, or estimate. 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, 2010 and our other filings made with the SEC for a description of the business environment in which we operate and the important factors that may materially affect our results. W.R. Berkley Corporation is not under any obligation and expressly disclaims any such obligation to update or alter its forward-looking statements whether as a result of new information, future events or otherwise.

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

William Robert Berkley
Founder and Executive Chairman

Thank you. Well, good morning, everyone. I was pleased with our quarter. I think that all of our expectations for the turn in the cycle and for our own operations are coming about. Certainly, things are happening a bit slower than we anticipated, and we're pretty excited about where things are going.

I'm going to let Rob talk about our operations first. Then Gene will talk about our finances. And I'll be back talking about overall the business and where we stand. So with that, Robert, please?

William Robert Berkley
Chief Executive Officer, President and Director

Thank you. Good morning, everyone. Catastrophe activity during the second quarter following on the heels of the events of the first quarter. It serves as a clear reminder of the value that the insurance industry brings to society. Additionally, the cat [catastrophe] activity over the past 6 months has provided a strong wake-up call to the industry for the need to appropriately price for the infrequent event. The recent natural disasters have compounded the pressure that the industry has already been facing. This existing pressure stems from the modest investment income, evidence of increasing frequency trend and an overall lack of underwriting discipline that has existed for the past several years.

The greatest level of competition continues to be found in accounts over $100,000. Additionally, excess cash reliance in particular, excess workers' compensation, remains under significant pressure. These longer tail lines of business are typically slower to turn given the duration of the liability and consequently, it takes more time for underwriting missteps to be recognized.

While industry conditions remain challenging and certainly by no means are we in the throes of a hard market, there's a growing amount of evidence that would suggest we are in the early stages of a hardening market. Much of this change is coming about as many standard markets, in particular national carriers, are actively adjusting their appetite as they feel the pain resulting from overreaching during the past several underwriting years.

The greatest supporting evidence of this change is the return of pricing leverage without the sacrificing of a renewal retention. Additionally, our specialty companies are beginning to see some accounts they have not seen in years. Furthermore, in certain regions of the country, we're observing an increase in population in several assigned risk plans. Historically, this has been an early yet accurate sign of a hardening market. The modestly improving U.S. economy is also providing assistance due to fewer insurers going out of business as well as continued strengthening in audit premium.

Net written premium for the quarter was $1.06 billion. This represents an increase of 10% over the second quarter of 2010. While the main drivers of this growth continued to come from our younger operations,

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we are experiencing improving contributions from our more mature companies as the market begins to turn. The Specialty and International segments again lead the growth as we continue to benefit from those domestic industries that have not been impacted by the slowdown in the general U.S. economy as well as our presence in the international markets, whose economies continue to prosper.

The group's price monitoring report for the quarter indicated an improvement over the corresponding period in 2010 of approximately 2%. Though 2% may not be overly exciting for some, this is in fact the second quarter in a row that we have achieved an aggregate weight increase. Additionally, this represents more than twice the level of rate increase we achieved in Q1 2011. Our renewal retentions remained in the 80s, consequently prodding evidence of pricing leverage rather than adverse selection.

The loss ratio for the quarter was 66.3%, which includes 6.2 points of storms. The unusually high level of storms contributed an additional $35 million of losses beyond what we would normally anticipate in the second quarter. The lion's share of the loss activity was in our regional segment, which stem from PCS 46 in Alabama and PCS 48 in Missouri. Our expense ratio for the period was at 34.8%. This result is generally in line with our expectations given the investments we have made in starting new operations as well as where we are in the cycle. We anticipate a gradual improvement in the group's expense ratio as our earned premium continues to build, consequently, enabling us to further leverage our existing platform --

All in, we delivered a combined ratio over 101.1% for the second quarter. While this result is below our goal, we believe it is tolerable in light of the level of catastrophes during the period. Having said this, if you peel a few layers back and adjust for a normal level of cat activity as well as back out our reserve takedown, our current accident year combined ratio remains at approximately 99%. Our balance sheet remains robust, and we continue to be convinced that the strengths of our aggregate loss reserves are comfortably sufficient to allow us to manage our ways through even in unforeseen event.

Overall, there is growing evidence that the moment we have been waiting for is approaching. Though the market does not turn overnight, there are ever growing number of signs that we are headed towards an improved environment. Thank you.

William Robert Berkley
Founder and Executive Chairman

Okay, Gene, do you want to talk about the numbers a bit, please?

Eugene G. Ballard
Executive Vice President of Finance

Okay, thank you. I'll start with just a few more details on those catastrophe losses. As Rob said, the second quarter catastrophe losses were $63 million or 6.2 loss ratio points. That represents our net loss after reinsurance recoveries and reinstatement premiums and compares with $30 million or 3.1 loss ratio points in the second quarter of 2010. Losses from the tornado centered in Alabama and Missouri were $36 million in the aggregate and losses from 10 smaller but still significant tornadoes and hail storms in the quarter were another $27 million.

We had originally estimated our losses could be $60 million, $65 million for April and May. However, our actual losses turned out to be slightly less than that estimate. And fortunately the month of June was relatively benign compared with the first 2 months of the quarter. Four of our business segments reported cat losses in the quarter: $44 million for Regional, $9 million for Specialty, $7 million for Reinsurance and $3 million for International.

Partially offsetting the catastrophe losses was favorable reserve development of $35 million or 3.5 loss ratio points in the quarter. The favorable reserve development is primarily to the Specialty, Reinsurance and Regional segments and emanated from accident years 2005 to 2009.

Our underlying loss ratio excluding catastrophes and storms was 63.5 points and a 0.5 point from the prior year. The Specialty and International accident year loss ratios before catastrophes were about 2 points lower due to the combined impact of rate increases and changes in the mix of business. And that

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was partially offset by a 1 to 2-point increase in the initial loss specs for accident year 2011 for the other business segments. Our second quarter expense ratio was 34.8%, that's up 6/10 a point from the second quarter 2010 and 3/10 of a point from the first quarter of this year. There are 2 reasons for that. First, written premiums were up 10% in the quarter and only a part of the cost related to that increase goes in deferred acquisition cost. And second, we accrued higher profit commissions for the Reinsurance segment as a result of favorable reserve trends. That gives us a combined ratio including the impact of cat and reserve releases of 101.1% for the quarter compared to 94.4% in last year's second quarter. Nonetheless, our paid loss ratio decreased to 59.6% down from 64% a year ago and our net loss reserves increased by $74 million. As a result, operating cash flow was up 25% to $161 million.

I have just one other comment to add to Rob's remarks on the premium growth and that's with respect to Alternative Markets segment. You'll see that the Alternative Markets segment reported a 22% increase in gross premiums and 4% increase in net premiums. But we talked about this last quarter, that again is due to the increase in premiums on assigned risk plans that we managed for a number of states, and that business has 100% ceded to the respective assigned risk pool with no net retention for us.

Net investment income was $149 million, up 15% from $130 million in the prior year quarter. The increase was attributable to higher income from investment funds and from merger arbitrage trading. Income from investment funds was $17 million compared to $1.5 million a year ago due to strong results for both energy and real estate related funds. And merger arbitrage income was $4 million compared to $1 million a year ago. The overall annualized yield on the portfolio was 4.4%, up 50 basis points from last year's second quarter, and that represents an annualized yield of 4.1% for the core portfolio, 3.9% for the arbitrage account and 13% for investment funds.

We also reported realized gains from the sales investments of $23 million in the quarter. And at June 30 at our unrealized investment gains before tax were $600 million, and the average duration of our fixed income portfolio was 3.5 years, down from 3.6 years at the beginning of the quarter.

Finally, our net income was $83 million for the quarter, which is an annualized return on equity of 9%. And after taking into consideration the repurchase of 1.1 million shares of our stock, our book value was $27.77 at June 30, up 6% from the beginning of the year.

William Robert Berkley
Founder and Executive Chairman

Thanks, Gene. I'm quite pleased with where things are going. As I'm sure many of you recall, I expected the cycle to start to turn in the fourth quarter of last year. In fact, pricing didn't really change until the first quarter of this year. It's continuing to improve although at a somewhat slower rate. Part of that slower rate of improvement comes from this slow economic activity and the lack of the robust economic improvement. We still expect 5% plus rate improvement year-over-year by the fourth quarter. The one negative is we're also seeing this loss cost development, which is certainly gone from where it's been totally benign where you noticed the trend is changing. It's not that we're seeing explosive trend, but it's now a noticeable trend in the wrong direction. So if I were to choose a number, it might be 2% or 3% at the moment, but the signs of that trend cause you to pay attention. It's one of the things that we've tried to take into consideration when we're establishing our reserves. And looking at the adequacy of them, to be sure that we reflect those trends and maintain reserves that assumed those things continue. The one thing -- a long-term benefit of being in the industry as gain for our company is that you have to always try and look ahead for these negative things because they always appear when you least expect them.

Our businesses are gaining traction. People are thinking about why they buy insurance and who's going to be there. People are beginning to recognize expertise is really important. People are concerned about financial strength, stability. People are concerned that you have consistent approach. And brokers and agents are conscious of the fact that they need a ready market. And as people start to withdraw here and there, they step back and say, "who's going to be around? I don't serve my customer well if I have no one who wants to provide them coverage." And those thoughts are beginning to enter people's minds. It isn't a trend. It isn't where everyone is worried. But there are a number of places where people are asking those kinds of questions. And there are a number of people who were still searching for price especially on large

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risks. But as many of you remember, we've lost most of our largest risks a long time ago. So it doesn't affect us much. But in large risks, it's still a very competitive world.

I think that our International business is doing especially well. We're quite pleased with our ability to seek out opportunities, and we continue to think that there will be more opportunities that we'll be able to find in that area. The most difficult part of our business - the moment the most competitive has been our Fabricated business where the people just don't want to pay the appropriate price. And we're really pleased that our fact people have been disciplined, and we're perfectly happy to provide our expertise, but only if we think we can make money. And some people value that and are prepared to pay a fair price. But we can't offer our expertise and our capital without it, and our fact markets have suffered this market especially. And that's one of the reasons our Reinsurance area volume is down substantially. From looking at the rest of the world from our perspective, we think that we have gotten to the hurricane season. A tough hurricane season can clearly have a real impact on a lot of people who may not have the ability to buy another reinstatement, who may not in fact have the capacity to meet their liabilities. So we're here. We're well positioned. We think the world is playing out pretty much as we thought although at a slower pace. And we are starting to get the traction that we expected. So with that, Jovan, I'm happy to take questions.

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Question and Answer

Operator

[Operator Instructions] Our first question comes from Michael Nannizzi with Goldman Sachs.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Can I have one quick question on the development? It sounds like they'll give up 3.5 points, but my math would get that to about 93% on an X cat X development combined, is that right or am I doing the math wrong?

William Robert Berkley
Chief Executive Officer, President and Director

You're talking about combined ratio for the quarter? Yes, it would be, yes, about 98.5%, exactly.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Oh, so it is 98.5%. Okay, okay. Got it. And then just one question, Bill or Rob if I could on...

William Robert Berkley
Chief Executive Officer, President and Director

Wait, wait a minute.

The combined ratio without the benefit of reserve releases and without the cost of catastrophe losses, it's around 98.5%, 99%.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Okay. So 98.5%. Okay. And then just one question on International, if I could for Bill or Rob, what type of insurances is driving that growth, and is it these newer ventures primarily just further coming on line? And is there an area or, I mean without actually giving away too much, but was there an area that you focus on that you feel is continuing to allow tailwinds to grow more?

William Robert Berkley
Founder and Executive Chairman

Rob will give you the specifics but I'm going to just talk in the broadest sense, and part of it is the general economic environment. So go ahead.

William Robert Berkley
Chief Executive Officer, President and Director

Well, I think it's what was just suggested a moment ago, it's the economies that we operated in outside of the United States that enjoy the most momentum. And it's predominantly focused around commercial lines, and if you look at where we do things outside of the United States, then you look at what economies are prospering, you're going to see this. So whether it'd be Canada or Brazil or Australia or parts of Asia, those are places where we are benefiting from the macro underlying economy and our insurances are doing well and the economies have grown, so we are able to grow along with them. Our operations in Europe and specifically the U.K. as far as they have solved a little bit more of a headwind with the exception of parts of Europe that they serve such as the market like Norway, which because of their natural resources, continues to boom. And then of course, our Lloyd's operation is doing well. Part of that has to do that it's still getting traction because it's relatively young, and part of that has to do with the lines of business that it offers.

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Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

So is that you're about 15% to 20% of premiums there, I mean is that -- do you feel like that's a number that you see grow? Would you want to see that get 20% to 25%, 30%? And second real quick is are all those risks written outside of the U.S. on risks that are also out so written within subs outside the U.S. on risks that are non-US?

William Robert Berkley
Founder and Executive Chairman

Yes. They are. Yes, they are. There may be one-off that doesn't, but in principle. Some of our business at Lloyd's is written like U.S. business, but all the rest is outside U.S. Then I think that I would expect that our U.S. business, which is where we've added many of our new Specialty will start to grow, and therefore while the International business will probably be somewhat of an increasing portion of our business, it will grow to be as much of an increase as you might think because we would expect our domestic business will start to grow a lot more rapidly. So I would be surprised if it got to be 20%. That -- we sort of have said that we would be really happy if our International business represents 20% of our overall, but I think that in the next couple of years, we think our U.S. business is most likely to grow substantially. So our International business is not likely to be a huge increase in its proportion.

Operator

Our next question comes from the line of Keith Walsh with Citi.

Keith F. Walsh
Citigroup Inc, Research Division

First for Rob, in your commentary, you mentioned you're getting price without sacrificing retention, I believe. It seems new business is very strong. Maybe if you could talk about how the hit rate on quoting new business has trended over the last several quarters. And then I've got a follow-up.

William Robert Berkley
Chief Executive Officer, President and Director

I didn't mean to suggest to you that the new business is particularly stronger. I was suggesting that our renewal retention is particularly strong even though we're achieving rates. The growth that we're seeing as a group at 10%, that is pretty concentrated amongst certain operating units that I tried to at least suggest in that -- with some of our newer companies in the Specialty segment as well as outside of the United States. So I don't think that newer business is plentiful across the board. I think once again, it's pretty concentrated.

Keith F. Walsh
Citigroup Inc, Research Division

Okay, very helpful. And then Bill, getting back to loss costs, where are the these loss costs specifically? Can you be a little more detailed where they're coming from? And just historical view, are higher loss costs consistent with the sluggish economy? Could just talk to that a little bit?

William Robert Berkley
Founder and Executive Chairman

I think loss costs. There are trends that actuaries have pointed to us that directionally, loss costs have turned from what's been a long-term decline to where they directionally move upward slightly, not a lot but definitely a directional change. And no, they generally don't move in a sluggish economy. On the other hand, when we were having a very good economy, they we're coming down, which isn't something one would have expected either, Keith. So I think that loss costs are seeming to move in ways that we can't predict at the moment. It's no different than inflation. We didn't have inflation when the economy was doing well mainly because effectively, Chinese low cost production was subsidizing our cost of goods here, and at the same time, inflation was being eaten up by people who were willing to invest in U.S.

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securities, which may not be a problem soon. But the fact is that I wasn't suggesting that I know. I was merely commenting of what the numbers are saying at the moment, and we're cautious. I think that if you look back at our annual report from the first month to now, we always have said what you worry about is the unforeseen event. You look at the numbers and say, "What they may be telling me that I can see out there." And I would say, we don't have any worry about inflation. It's just not happening. The economy is crumbling, but that's the unforeseen event. That's why we're not buying long-term bonds, That's why we're reserved in saying that loss costs trends based on the numbers have turned the corner and started to move on the other direction. I wish I could be more specific because I'd love to be more specific, and this is not the case of me trying to keep information for competitive reasons. This is -- I value everything that I know at the moment.

Operator

Our next question comes from the line of Mike Grasher of Piper Jaffray.

Michael Fitzgerald Grasher
Piper Jaffray Companies, Research Division

Just a couple of questions just with regard to the loss costs issue. Can you share with us in terms of -- do you believe it's driven more by the duration of claim or is it more a frequency matter?

William Robert Berkley
Chief Executive Officer, President and Director

This is Rob here. Our view at this stage is what we're seeing as a pickup in frequency. What we've had all along particularly in workers' compensation is you have these medical trends or headwind that we've been fighting for a while, and it's a societal issue, a political issue and industry issue as well. But really, the change that we're noticing most recently will have to do with frequency. It's mirroring its head in a more clear way in workers' compensation. But we are seeing signs of frequency just in the general casualty lines overall ticking up as well. But it's really comp that we're seeing the greatest level of activity.

Michael Fitzgerald Grasher
Piper Jaffray Companies, Research Division

Okay, that's helpful. And then if you look at your accident year combined ratio at 99%, would you all agree that the industry probably is tracking closer to a 107% to 110% range?

William Robert Berkley
Founder and Executive Chairman

I would actually say the industry is probably higher than that. If you'd look at the number and where the industry is in the mix of business, I would say the industry is probably closer to 110% at this point. And the reason for that is we've lost all our large accounts. Large accounts are probably doing significantly worst at this point in time. So I would think that our spread right now, between what we do in this industry, is probably at the maximum, so historically that would be sort of 10 points. When we're sort of doing average Industry business, we'd be sort of about the same, which would be 5, or 6 points. Rob would like to add.

William Robert Berkley
Chief Executive Officer, President and Director

Yes. I mean, one comment that I would like to add is that if you look at the commercial lines base, and the largest line in commercial lines is workers' compensation. According to the NCCI, 2010 combined ratio ran at -- it was somewhere between 110% and 115%. I believe it actually was a 115% combined ratio for the accident year. So that on its own as the largest commercial line is probably forging at a direction that things are running hot.

Michael Fitzgerald Grasher
Piper Jaffray Companies, Research Division

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Okay, very good. And then with regard to workers' comp in the pricing environment there, obviously driven by the states, but relative to the class of risk, what are your experience there in terms of the change in the pricing dynamics?

William Robert Berkley
Founder and Executive Chairman

You mean pricing dynamics today?

Michael Fitzgerald Grasher
Piper Jaffray Companies, Research Division

Yes, relative to the class of risk that the workers' comp would be -- the exposure would be to.

William Robert Berkley
Chief Executive Officer, President and Director

Generally speaking, we don't get to the specifics of class of business within our line of businesses as to what we see going on, and we don't necessarily get so granular to telling the specifics as to what in file within class is within the line. But what I can tell you is that we're seeing certainly encouraging signs in the primary, if you will, or comp market as opposed to the excess comp market, which seems to be a very different circumstance where there doesn't seem to be any noteworthy disciplines entering that part.

William Robert Berkley
Founder and Executive Chairman

Yes, I mean in the excess comp market, people are making incredibly optimistic statements or assessments as to what they think future interest rates should be used to discount their loss specs. So we're having people use 5% and 6% discount rates on establishing loss reserves for excess comp as opposed to the current interest rates on 30-year treasuries or anything even shorter. So with the excess comp, it's still incredibly competitive.

William Robert Berkley
Chief Executive Officer, President and Director

I should add as far as primary comp goes, the market does not march in locked step. It really depends on the territory, if you will how the market is shifting.

Operator

Our next question comes from the line of Josh Shanker with Deutsche Bank.

Joshua David Shanker
Deutsche Bank AG, Research Division

I'm starting to keep on this loss cost thing and I realize I'm splitting hairs a little bit. But if your rate is up 2% and loss cost are up 2% to 3%, is it, right now at this moment, loss costs are exceeding rate or are they about the same, where are we right now?

William Robert Berkley
Founder and Executive Chairman

I think you're trying to be more precise about loss cost than I can be. And loss costs aren't something we can measure especially because the loss cost trends are based on frequency, and it's literally one quarter. Were as for pricing, we have quarter-to-quarter measures with a lot of consistency. Those numbers have some level of accuracy. And loss costs as I said, it's sort of a -- you're looking at the trend and the directional changes without really telling people. And I would say that we're gaining a little, we're losing a little. I know I'm not excited about pricing because loss costs are actually going the wrong way. So I would still say we're net-price positive, but it's not significant, and I'm concerned about loss cost directionally. But you're asking for precision, Josh, where I don't have any yet and I'm trying to tell people who follow

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our company about why we're a little more cautious in our reserving, why we're little more cautious about how good the pricing is.

Joshua David Shanker
Deutsche Bank AG, Research Division

It's totally understandable. Can you give a little detail on the excess workers' comp market that you already did? At least if you listen to a lot of primary layer of comp writers, they're talking about rate increases, and the Broker's Survey seemed to confirm that. But obviously, and one of the primers that these loss costs are rising at workers comp, they took a small charge in it. What's going on the excess market and how does pricing compare in that competitive marketplace?

William Robert Berkley
Chief Executive Officer, President and Director

Josh, it's Rob. The excess market while the -- the primary comp market and the excess comp market, while they may be to a certain extent, certainly the same underlying exposure, if you will, in many cases the same customer base. The fact of the matter is that the markets do not march in lockstep at all. Clearly, there are regions within the United States where the comp market is beginning to turn in our opinion. Having said that, once again, it is our view that the excess comp market has yet to show any signs of turning and it remains a very competitive segment of the industry.

Joshua David Shanker
Deutsche Bank AG, Research Division

Along those lines, the -- if people say that primary is up to 1%, do you have a sort of idea how you can get about pricing the excess market rate -- the rate move at this point?

William Robert Berkley
Chief Executive Officer, President and Director

The answer is that we're seeing many -- without getting overly specific, we are seeing many competitors in the excess comp space operate in a more aggressive way today than they did yesterday.

William Robert Berkley
Founder and Executive Chairman

I think also the customers in the excess comp market are widely varying. It's a very long tail line of business. And there are some modestly aggressive well-established companies and then there a new people who are wildly aggressive. So I think it's a very wide range of competitors. Some will think it looks so attractive because you get to hold the money a long time, and some were just making what I define as irrational but judgments as to interest rates returns. So from our point of view, I think prices are just inaccurate when you compound interest rates at 2 points higher for 17 years, which is the average duration of excess comp. That's a lot of money in pricing.

Operator

Our next question comes from the line of Bob Farnam with KBW.

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

Let's talk about the new ventures. Is there -- how much additional momentum should we see from the new ventures? I'm trying to get an idea of what -- how much capacity is being used for the new ventures thus far?

William Robert Berkley
Founder and Executive Chairman

When you mean additional capacity, I'm trying to understand what -- what are you trying to answer, Bob?

Robert Edward Farnam

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

You're getting pretty solid growth from the new ventures. I'm trying to figure out will that continue or will it grow even more?

William Robert Berkley
Chief Executive Officer, President and Director

The answer is I guess we need to define the environment, Bob. Are we talking -- assuming there's no turn in the market even though it is our belief that the market is in the early stages of turning but for purposes of discussion, let's assume that there is no turn in the market. It is our expectation that you will see some reasonable level of growth certainly for the balance of this year. Having said that as we get into 2012, if we do not see a turning in the market and we do not add additional new ventures to the group, I think while I would not suggest we will plateau or shrink, I think it is likely that we will -- our growth rate would slow. Having said that, I think our expectation is you are going to -- we are in the process of returning market, and we would the growth rate to continue well into next year.

William Robert Berkley
Founder and Executive Chairman

Yes. I think that the critical elements here have to do with both the economy and the insurance marketplace. So at this point, our best judgment is growth continues as it is, maybe even accelerating. However, it's a lot of uncertainty and there's no question with the economy on edge like it is, you can't feel good about where all that takes us for the moment and therefore we'd be stepping in the wrong direction. If we continued our expectations unchanged as we feel a bit less certain about economic activity.

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

Fair enough. And a question on any change in terms and conditions, I don't know how that terms and conditions have held up over the past couple of years but are you seeing them starting to tighten? Or are they still deteriorating?

William Robert Berkley
Chief Executive Officer, President and Director

It's Rob again. As far as terms and conditions go, the places that you're seeing have tightened a little bit. It's just that when you see business migrate from the standard market into the specialty or nonstandard markets, inherently in that transfer or shift, you're going to see terms tighten up. We're seeing a bit of that but not an overwhelming amount of that. Other -- putting that aside, we're not seeing a tightening of terms in a significant way from where it has been recently.

William Robert Berkley
Founder and Executive Chairman

I think, by the way, I would add, Bob, a little to that. That's part of the reason we've been losing business in our specialty business, specialty places like the Admiral is, because we haven't been willing to change our terms and conditions, and we've lost business because of it.

Operator

And so our next question comes from Meyer Shields with Stifel, Nicolaus.

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

I was hoping that we could get, I guess this is for Gene, the reserve releases and reinstatement premiums by segment?

William Robert Berkley
Founder and Executive Chairman

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The reserve releases, we normally don't talk about that on the call. We'll have that in our 10-Q.

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

I guess, with regards to the quarterly results, did the natural catastrophes that you incurred have any impact on acquisition expense? In other words, basically, do the dilution compensation change because of the outside level of catastrophic loss.

Eugene G. Ballard
Executive Vice President of Finance

No.

William Robert Berkley
Founder and Executive Chairman

No.

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

Okay and then I guess, one big picture I was hoping to run by Bill. Is it too early to tell how good this market will ultimately get? I mean, you've -- given your expectations in this [indiscernible].

William Robert Berkley
Founder and Executive Chairman

I think honestly, the biggest issue that's sitting out here is the economy as a whole and where we all stand. I think that we're going to have a gradual -- I mean, every cycle changes gradually until some events take place, whether it's 9-11 or Reliance and Frontier going broke. If we were to have 2 severe hurricanes, you change this market dramatically because reinsurance capacity would disappear because there are a number of people who have no capacity to buy reinstatements who are in the reinsurance business. They use there one reinstatement after what's out there already. And there is not a market for it and therefore that would change the market dramatically. It's clear that if you look at Katrina, a number of reinsurers, in fact, really went bankrupt but they forgot to tell anybody and investors put a lot of money in. Between the time they decided to tell people, they were bankrupt and the time they raised the money. Somehow, they forgot. I think that there's a lots of stuff out there and I think that we sit here and wait for the unforeseen event and hope that it hurts our competitors and doesn't hurt us because we hopefully are prepared for it, and we go forward. But I think that based on pricing, and pricing alone, you need 15% increases in the average price, 20% increases in the average price. And even then the return on capital and industry will be probably only 8% after-tax. That's based on where I see the combined ratio now for the industry. Now there are lots of companies that are doing better than that, and there are plenty that are doing worse. So if I were to give you a forecast, I would say that by the end of 2012, we'll get 5% this year and will need 10% more next year, and then maybe even a little more by the -- certainly by the rate of change by the end of next year needs to be higher.

Operator

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

Jay Adam Cohen
BofA Merrill Lynch, Research Division

I got a couple of questions. The first is you mentioned in the specialty business, the accident near loss ratio X cats improved by a couple of points. And I guess, I'm assuming that the earned price impact is still either flat or negative and you mentioned claims is beginning to go up. I know the business mix is changing, maybe that's a big part of it but if you could explain that? And then the second question, I'm wondering, Bill, if you can comment on the debate now about the debt ceiling and how you see it playing out?

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William Robert Berkley
Founder and Executive Chairman

First of all, I think that the comments sort of are pretty straightforward about the specialty lines business. I mean, I think that business is increasing volume. It's increasing mainly from new businesses and the pricing is up a little bit. That's one of the places where we've had some positive impact on pricing.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

I guess, I just wouldn't expect the earned effect of those price increases at this point to be outpacing your loss costs, especially when you say your loss costs seem to be increasing. Maybe it's just too modest at this point.

William Robert Berkley
Founder and Executive Chairman

I think what I was trying to say is lost costs are giving us signs, and signs give us concern because they've changed directionally and we always have taken the view, I shouldn't say always. But certainly for the more than the past 10 years, we've taken the view that you don't do better than everybody else by retrospective analysis. You do better than everybody else by looking for signs that give you a directional point of view. So we got a little bit cautious. We can always become less cautious if 3 or 6 or 9 months down the road we were too cautious. For the moment, we'd rather be a little more cautious. As to the debt ceiling, a chuckle about our President who voted against raising the debt limit along with every other Democrat on a number of occasions. It's just a little worse. And he pointed out that we had 17 votes to increase the debt limit for Ronald Reagan, which tells you that Congress only gave Ronald Reagan a little bit at a time, but this President doesn't want a little bit at a time. Look it's a terrible problem. We've become so politicized that no one seems to put our nation's interests first. Individually, you talked to these people, I think congressmen, senators are really extraordinary people who are devoted to our country and then they all get together and they're worried more about reelection, and it's unfortunate. I think it's a serious issue. I'm optimistic that we will get at least some temporary solution. It is a philosophic breakdown of the 2 extremes in our nation and not much from the middle which says, hey, get this off. No one's talking about the fact that every other nation restricts health care costs through restricting funding. Every other nation restricts their expenditures by controlling how much they spend. I don't mind about taxes, if they want to raise taxes, some, that's fine. But the fact is, it has to be rational taxes and it has to let our country be a competitive force in the world, which we're becoming less and less of. But right now, we need to snap to and act like a single country that's sophisticated and intelligent and that means we should get together and ask something and have a plan for how we're going to resolve this. And if it were Warren Buffett and a great idea that said, if we have a deficit more than a certain amount then no one in Congress should be allowed to stand for reelection. I think that was a wonderful solution.

Operator

Our next question comes from Brian Meredith with UBS.

Brian Robert Meredith
UBS Investment Bank, Research Division

Bill, I just want to follow on a Jay's question for a second there. If the U.S. credit rating is downgraded from a AAA to AA+, what would be the implications for the property casualty industry and also on W. R. Berkley? Specifically, I mean, you do have some municipal bonds, some probably AAA-rated, what are your thoughts on that?

William Robert Berkley
Founder and Executive Chairman

First of all, we have a relatively -- our duration is now long and we haven't been tempted to go out and buy yield by going out long or buy yield by getting lower quality securities. So I don't think that, that's really going to be a significant issue for us. We have lots of liquidity and its kept in places that we won't

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be restricted from having all that liquidity. I think that the issue will be the same severely issue we all face, and that is today, America and treasure securities are the reserve currency of the world, and it's an unquestioned issue and all of our securities are priced off of that. I think it will raise the issue about the quality of Wall Street but from a real day-to-day operating point of view, since what comes in every day is more than what goes out everyday, it shouldn't have any consequence. And while in the very short run, there might be a slight hiccup. I don't think it's going to be a consequential one. There aren't very many AAA securities. And I just don't imagine it would have a very significant impact.

Brian Robert Meredith
UBS Investment Bank, Research Division

And then for Rob, are we seeing any impact at all from RMS 11 on some pricing in the industry yet on the primary side?

William Robert Berkley
Chief Executive Officer, President and Director

As you know, I think we're certainly seeing it in the reinsurance marketplace and you're seeing attempts of folks to try and push rates on the primary side but it's really -- it's not material at this stage in our opinion and certainly not significantly material as far as changing market conditions or rates for property. But we'll see as the year progresses and rating agencies take more of a position as it relates to RMS 11.

Operator

Our next question comes from Scott Frost with Bank of America.

R. Scott Frost
BofA Merrill Lynch, Research Division

I was wondering if you could touch on any governing exposures to European credits, specifically peripherals. I saw the foreign government agency exposure, but I was curious about your corporate portfolio, if you have any credits in the Euro zone that you're worried about?

Eugene G. Ballard
Executive Vice President of Finance

No, we've basically don't. Most of our credits are really -- the answer is no. We don't. We have none that we're concerned about at all and most of our non-US credits are Australia, Canada, U.K. and Brazil.

Operator

Our next question is a follow-up from Michael Nannizzi with Goldman Sachs.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Just if I could, one question on -- you've mentioned the faculty of the market is tight, is that on the property cat side or is that just general faculty?

William Robert Berkley
Founder and Executive Chairman

No, not tight. It's very soft. Yes, it's very soft. And it's soft on both, less soft on the property side than on the casualty side. The casualty side is very soft because the problem is on the facultative business, you price it independently of the originating price. So if you charge a rate of 2% and the facultative people think the rate should be 6%, they charge -- they give you a quote of 6% for whatever they're taking, which may leave you nothing for your primary business. So you say I can't buy it. I can't afford to, I don't get paid anything for what I retain. So that's the problem. On the property side, frequently, people get the property quote before they make their primary property quote so they take it into consideration.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

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I see. And then, so what would have to have happened on the property side, I mean for you to -- or would you -- is there something that could happen on the property side that would cause you to take more property cat risk or is that just something that you don't want to do?

William Robert Berkley
Founder and Executive Chairman

I think we're prepared to take more property cat risk, but not domestic property cat risks. We think on a global basis, we'll consider it. But we're not going to do it domestically, we have plenty of property cat exposure on a primary basis. So on a Reinsurance basis, we wouldn't take it any -- we wouldn't take it domestically at all.

Operator

Our next question comes from Gregory Locraft with Morgan Stanley.

Gregory Locraft
Morgan Stanley, Research Division

I wanted to just better understand, I'm sort of having a hard time modeling the investment fund side of the equation, and I know roughly half the portfolio is in real estate and about a quarter is in energy. Should we -- what would you do if you were in our shoes to try to get a handle as to the -- modeling that? Obviously, it's going to be somewhat lumpy but any help would be appreciated in terms of how you think about it.

William Robert Berkley
Founder and Executive Chairman

It is -- I mean, I'm sure, Greg, that Gene will happy to go through with you, but it's not very easy to model over a short-term basis because first of all, oil prices are volatile and as to the real estate, that is more predictable. And Gene can go through it with you, we don't mark our real estate to market, so that's a bit more predictable. But to the energy funds, it's a volatility in the marketplace for oil and energy-related things. But I'm sure that I'm happy just to -- Gene, Gene will go through with as much detail as you want, but it's very hard quarter to quarter to build a model for him.

Gregory Locraft
Morgan Stanley, Research Division

So I guess, Gene, should we just follow up offline then?

William Robert Berkley
Founder and Executive Chairman

Yes, just give Gene a call offline and he'll go through with as much detail as today.

Eugene G. Ballard
Executive Vice President of Finance

I'd be glad to. I'd still say it's hard to predict, but we can go through kind of what we have.

Gregory Locraft
Morgan Stanley, Research Division

With regards to real estate, do you have visibility? Like, do you sit in the third quarter and have an understanding as to what the fourth quarter is somewhat looking like for that part of the portfolio?

Eugene G. Ballard
Executive Vice President of Finance

To a degree, we've booked these funds on a lag basis, a one quarter lag basis. So we talk to them all the time, but we don't really have their actual earnings until the subsequent quarter.

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Gregory Locraft
Morgan Stanley, Research Division

And then another question, just shifting gears a bit on the reserving side, the reserve releases dropped from the 4, 8 and 12 quarter averages, and I guess how does that tie to your loss cost commentary. Did you all change anything?

William Robert Berkley
Founder and Executive Chairman

The answer is as I've said we began a bit more cautious, so we see how loss costs develop further.

Gregory Locraft
Morgan Stanley, Research Division

So that is a sustainable, I mean, that -- the trend which you've called out, you've actually reflected in your reserving that resulted in less releases and therefore that probably becomes the new level that we should be assuming.

William Robert Berkley
Founder and Executive Chairman

I wouldn't say we've changed trend. I would say that we've said, let's understand this a little better. Let's see where that take -- it's better in any quarter to be cautious and get your pudding and understand the knowledge you have than to continue blindly moving ahead. So I would've said that we're just examining everything. So I don't think we've directionally changed anything except to say, let's be sure we understand what's going on, doesn't change it. It's better to be cautious at the moment. There's so many uncertainties out there, caution is better. We think we'll have a better understanding at the end of the next quarter and we may revert to back where we were, we may stay where we are, we may get more cautious. It's a constant reevaluation. Now our job is not to be the same. Our job is to use our best judgment each quarter.

Operator

Next in line, we have Amit Kumar with Macquarie.

Amit Kumar
Macquarie Research

Just one quick question in regards to capital management. This quarter, we had a modest buyback and I'm wondering, based on where the stock is trading, should we expect that going forward or has there been any change in the capital management philosophy here?

William Robert Berkley
Founder and Executive Chairman

Mr. Kumar, have I ever told anybody what I'm going to do about buying back stock? The answer is that it's always a balance between what we see our needs for capital and the price of the stock at any moment in time, and we'll have to make that judgment, and then we do each day, and where and how we see things coming along. But for the moment, our views haven't changed but they didn't change in the first quarter, we didn't buy stock.

Operator

And next in line, we have Meyer Shields with Stifel, Nicolaus.

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

I just had 2 difficult questions, if I can. One, Bill or Rob, are the early signs of an uptick in workers' compensation frequency, are you seeing anything like that in medical malpractice?

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William Robert Berkley
Founder and Executive Chairman

Well, I think the difference is medical malpractice has been an incredibly profitable line of business, far more profitable than we would've expected. And while it's been competitive, workers' compensation never got to the levels of profitability you got from workers compensation. And it was just never as profitable as malpractice. I think that malpractice business is seeming to be getting a little more stable at the moment, but there's not any dramatic increase in pricing happening.

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

And the liability of property's business, the one right now, is it about 60%-40%?

William Robert Berkley
Founder and Executive Chairman

No, we're still probably, I would've said, 7 -- 75%-25%, and that's down from probably -- we're probably, 80 plus casualty. Three years ago, we were probably 82%, 83% casualty, 4 years ago, and today we're probably 75% casualty.

Operator

And next in line, we have Kenneth Billingsley with BGB Securities.

Kenneth G. Billingsley
BGB Securities, Inc., Research Division

Just a quick question for Gene, looking at the diluted share count for the second quarter, it went up from the first quarter despite the rollover of 1 million share buyback. Could you just talk about what else is going on in that line?

Eugene G. Ballard
Executive Vice President of Finance

Yes, a lot of that just has to do with the timing of when share transaction take place. So we did have some stock exercises and option exercises in the first quarter that took place late in the quarter. So it came through on a full quarterly basis in the second quarter and some of the buybacks by the same token in the second quarter came in later and didn't get reflected. So it's really just more of the timing of those transactions.

Operator

And sir, I'm showing no further questions at this time.

William Robert Berkley
Founder and Executive Chairman

Okay. Well, thank you all very much. We are concerned about the economy, concerned about Washington but enthusiastic about our business and the position we're in going forward. So thank you, all very much and have a great rest of the summer.

Operator
Ladies and gentlemen, thank you for your participation in today's conference. This concludes the program. You may all disconnect. Everyone have a great day.

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