S&P Capital IQ

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W. R. Berkley Corporation NYSE:WRB

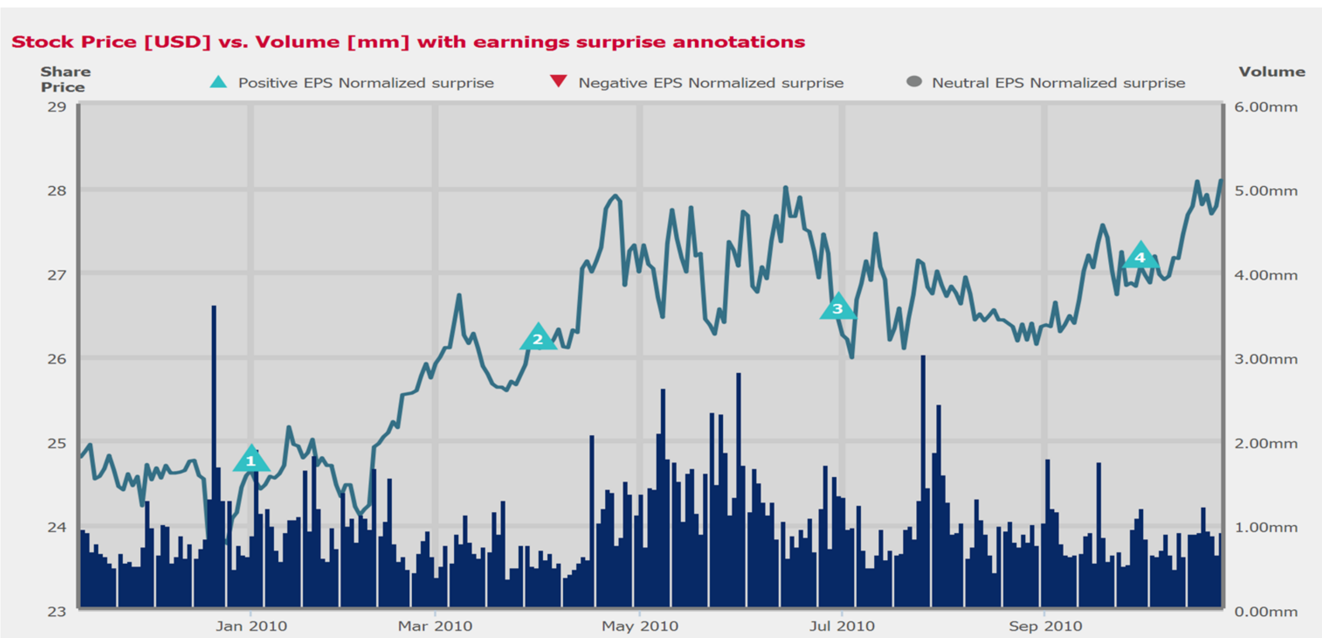
FQ4 2010 Earnings Call Transcripts

Wednesday, February 02, 2011 10:30 PM GMT

S&P Capital IQ Estimates

	-FQ4 2010-			-FQ1 2011-	-FY 2010-	
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	ACTUAL
EPS Normalized	0.67	0.68	▲1.49	0.65	2.68	2.69
Revenue (mm)	1118.26	1231.34	▲10.11	1155.10	4517.30	4724.07

Currency: USD
Consensus as of Feb-02-2011 10:09 PM GMT



	- EPS NORMALIZED -		
	CONSENSUS	ACTUAL	SURPRISE
FQ4 2009	0.67	0.71	▲5.97 %
FQ1 2010	0.65	0.70	▲7.69 %
FQ2 2010	0.62	0.65	▲4.84 %
FQ3 2010	0.66	0.66	▲1.52 %

Call Participants

EXECUTIVES

Eugene G. Ballard
Executive Vice President of Finance

Robert Berkley Jr.

William Robert Berkley
Founder and Executive Chairman

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Presentation

Operator

Good day, and welcome to W. R. Berkley Corporation's Fourth Quarter 2010 Earnings Conference Call. The speaker's remarks may contain forward-looking statements. Some of the forward-looking statements can be identified by the use of forward-looking words including without limitation, believes, expects or estimates. We caution you that such forward-looking statements should not be regarded as a representation by us that the future plans, estimates, or expectations contemplated by us will in fact be achieved.

Please refer to our annual report on Form 10-K for the year ended December 31, 2009 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

Good evening. I wish I could tell you my prognostication for the quarter was wholly accurate but I can't. It actually looked like I would be in fact telling you how accurate I was as we went into October and November, and December popped that balloon quickly when the world got more competitive. And prices, in fact, came down as everyone rushed off to meet their budgets and shoot for volume and what looked like a quarter of some, at least, significant or at least measurable price increases that seemed to be the start of the first two months of the quarter ended with very modest, probably 3/10 of a percent decrease in pricing.

We were pretty pleased with our quarter. We continue investing in opportunities around the world and in the U.S., and I'll talk about all the overview of what we're doing, and opportunities we see at the end. First, Rob will talk about our operating results.

Robert Berkley Jr.

Good evening, everyone. Market conditions remained challenging during the fourth quarter. Some of the areas of most significant competition during the period included professional liability, excess workers compensation and casualty facultative reinsurance.

While the list goes on from there, these are some of the hotspots. However, it is not all doom and gloom. There is an ever increasing number of encouraging signs that change for the industry is not far off. We continue to observe an inconsistent yet growing number of carriers adjusting their underwriting behavior, however, the real potential leverage will come when the general industry-wide anxiety about inadequate rates to converts into action. And it remains our belief that this point of inflection is approaching.

Additionally, the fourth quarter provided further evidence of a strengthening U.S. economy. This trend has been validated through improved audit premiums, as well as midterm endorsements of additional units of exposure. These data points clearly indicate that the relatively recent pressure on our insurance revenues and payrolls is in fact easing. Net written premiums for the fourth quarter came in at $919 million. This is an increase of 11% over Q4 2009. The growth came predominantly from our international and specialty operations.

International growth was mainly a result of a series of strategic decisions the group made some time ago. Our investment in growing economies with sound underlying fundamentals in such regions as Austral-Asia, South America and the Nordic region of Europe are paying off.

Additionally, our Lloyd's Syndicate continues to have success in developing its presence in both a cautious and thoughtful manner. While on the topic of international, I should mention we do not envision the Australian floods in January of this year having a material impact on the group.

Increased writings amongst our specialty were by and large spread across several of the startups in this segment. Much of this traction has occurred due to our ability to provide holistic solutions to our insurers as opposed to our model line offerings. Also, several of the operations are focused on industries that have not been as adversely impacted by recent economic woes. While clearly this level of growth might, in isolation, raise a warning flag, we remain comfortable with the quality of both the risk selection as well as the pricing of the portfolio. As mentioned in the past, this confidence is achieved through the safety hands in our management team combined with our technical data and rigorous internal audit process.

The group's price monitoring indicates that rates were down less than half of 1% in the quarter while maintaining a renewal retention approaching 80%. The combined ratio for the fourth quarter was at 92.6%. Our loss ratio was at 59.8%, which includes one point of storms. Storm activity was impacted by an unusual hailstorm during the month of October, in of all places, Phoenix, Arizona.

The expense ratio was at 34.3%, which represents a modest improvement over the corresponding period last year. We would anticipate this improvement trend to continue as our earned premium, grows and consequently, we are able to leverage fixed expense base of our startups. Having said all this, we are not naive to the realities of the current situation. It is our belief the company's full year 2010 accident year combined ratio is approximately 100.

Onto reserves. Maintaining reserve equity remains a top priority for the group. We continue to believe that an appropriate level of caution in selecting loss picks is advisable. Our speculation over the past several quarters regarding a potential uptick in frequencies would appear to be well-placed. Additionally, inflation remains a wildcard as to whether it will eventually return to historic levels.

The redundancies we have recognized over the past several years may suggest the group has erred on the side of caution in selecting loss picks. However, we continue to believe a belt and suspenders approach to managing the business is appropriate given the leverage that exists in some of the unknown variables.

Undoubtedly, the market remains challenging. The combination of current rate levels, modest investment returns, threats of inflation and a shift in frequency trends has dramatically changed the landscape from what it was just a few years ago. However, these fundamentals have now become a reality that is driving industry participants to pause, and ultimately, we believe will change their behavior.

The potential double leverage of an improving U.S. economy along with a hardening insurance market is not a possibility that should be casually overlooked. However, if our speculation as to a shift in the market conditions is wrong, the company remains well-positioned to continue to deliver satisfactory returns going forward. Thank you.

William Robert Berkley
Founder and Executive Chairman

Thanks, Rob. Gene is going to review the financials, and then, I'll tie it all together hopefully.

Eugene G. Ballard
Executive Vice President of Finance

Okay. Thanks, Bill. Well, Rob already covered the change in premiums, so I'll just mention a couple of more numbers in that regard -- regarding our start-up companies, which are the new units that we started since 2006. So of the $91 million increase in overall premiums this quarter, $60 million or about 2/3 was from these recently started companies. And for all of 2010, these companies wrote $600 million, which is right at 16% of our total premiums.

With respect to underwriting results, our overall combined ratio was 94.1%, and all five of our business segments reported combined ratios under 100. We had favorable reserve development of $55 million or 5.6 loss ratio points in the quarter. That gives us favorable reserve development of $235 million for all of

2010, up from $191 million in 2009. Most of the favorable reserve development in the quarter and the full year was in the Specialty and Regional segment, and it was primarily for the five preceding accident years, more than half of it being in the other liability business.

As Rob said, on an accident year basis, that gives us a combined ratio of 100%. That's an accident year loss ratio of 66%, including two points for storms and an expense ratio of 34%. Our net loss reserves and cash flow were both down modestly in the quarter, and that's due in part to two reinsurance computations that we completed in the fourth quarter. These transactions resulted in a $79 million decrease in cash flow, a $60 million decrease in loss reserves and an insignificant book gain. Cash flow before the computation payments was running slightly ahead of net income at $139 million for the quarter.

Net investment income was $131 million, down $8 million or 5% from the prior year quarter. The decrease was attributable to the arbitrage account, which reported a profit of $3 million, down from $11 million a year ago. The average annualized yield on the rest of the portfolio was 4.1% and the average duration of the fixed income portfolio was 3.6 years at year-end. Unrealized investment gains were $516 million at year-end, that's up from $338 million at the beginning of the year. And in addition, we reported realized gains of $34 million, and income from investment funds of $5 million in the fourth quarter.

Our foreign currency losses were $8 million in the quarter, and although that's not too significant, I thought I'd explain to you why we do see this type of activity from time to time. We generally match our foreign currency denominated assets and liabilities, so FX gains and losses tend to offset one another. But for financial statement purposes, there's an anomaly where FX gains and losses on investments are reported as unrealized gains and losses on the balance sheet at least until those investments are sold, whereas FX gains and losses on liabilities are reported immediately on the income statement. So in this quarter, we had an FX loss on our Australian liabilities as a result of the strengthening of the Australian dollar in this accounting treatment.

Stock repurchases were approximately equal to our net income. Again this quarter, we bought back 4.8 million shares in the quarter and an aggregate cost of $130 million. And we purchased $17 million for all of 2010, or 11% of our outstanding shares at the beginning of the year. That gives us a net income ROE of 14.1% for the quarter and 12.5% for the full year and an increase in our book value per share of 14.3% in 2010.

William Robert Berkley
Founder and Executive Chairman

Thanks, Gene. Overall, we were pretty pleased with the quarter. I think that if you examine the details, we're probably more cautious in setting our reserve levels for the current accident year than some of our competitors. In part because we do believe the trend and frequency could adversely impact everyone's expectation for losses, and we have a bit more of a concern about inflation on some of the longer tail lines of business.

We look ahead, we do see opportunities to invest money in sort of off center kinds of investments. Example would be municipal bonds that are backed by corporate security, so we were able to buy round numbers $10 million of municipals backed by a corporate credit. The corporate credit traded for the same maturity 150 over the comparable treasury, because they were packaged as a municipal, we got the yields tax free and we got them at 450 basis points over in fact the comparable treasury yield. That was because nobody wanted to have anything that had the label of municipals on them.

So those kinds of opportunities exist, and we continue to see them. We are willing to find and buy things that people think look ugly, but when you delve through the appearance, are much higher quality securities. We continue to have a number of teams of people coming to talk to us, offering us opportunities. We look at them. We obviously have a larger share of the marketplace, covering lots of niches so there aren't as many things that are attractive. But we still continue to meet a number of outstanding people, and we're searching globally for those great teams of people where we think we can build franchise value.

At this point in time, we believe those opportunities will continue, and everything we see in the cycle are things are in fact beginning to change. There's no question about pricing. There is more discipline in lots and lots of areas, not every place. And we still, on occasion, lose business at huge discounts from what we think the adequate pricing is. But it's now unusual as opposed to everyday occurrences. And we think that most of the people we do business with, the agents and brokers, are searching for people who they know will be in business a year or two or three from now. And that's a very important thing.

So our relationships are paying off. We continue to see opportunities, and we would be surprised if the pricing changes do not continue and that 3/10 of a percent pricing decline doesn't turn into price increases. Obviously, the key element is how do we manage our business, and we wouldn't be doing anything different if prices went down 3% this year or up 3%, 5%, or 7% or 10%. The difference is we'd probably be able to write more business if prices were higher. With that, John, I'd be happy to take people's questions.

Question and Answer

Operator

[Operator Instructions] We'll take our first question coming from Ken Billingsley. [BGB Securities]

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

One of the questions -- on the pricing that you were mentioning, I know it's hard to put a number on new business, but when you talked about the pricing, is that just on renewal business or based on comparable policies that you would write?

William Robert Berkley
Founder and Executive Chairman

Our pricing metrics attempt to look at new business and make -- and look at the comparable renewal business. So it's on all business across the board, new and renewal, it's not -- the answer is price measurement in this business is not as exact as you'd like it to be because terms and conditions vary slightly. Coverages vary slightly. You may add a deductible. You may make slight changes. But to the best of our ability, it includes new and renewal business aligned to be at the same level.

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

And in your experience then, will the renewal business be holding up a little bit better based on your comments about brokers wanting to partner with someone that's going to be around? And is it the new business that is a little bit more competitive?

William Robert Berkley
Founder and Executive Chairman

According to actuaries, it's virtually the same. I would say in the marketplace, though, that people who shop every year are the price shoppers. I would probably say to you that the consistency of renewal that people have, the vast majority of that business stays with you for an extended period of time. The business that moves around is moving from one company to the next company, and it's always moving searching for a price.

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

On the Reinsurance business, can you talk about you going forward with there being capital in the marketplace, if the economy exposure units start to increase, if you have the capital on the primary side, are you going to see that maybe the reinsurance side of the business may not do as well on a hardening market if it's a slow economic recovery? Do you have any comments on that side?

William Robert Berkley
Founder and Executive Chairman

I'm not sure I understand what your question is. Could you try to...

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

If the economy rebounds and your exposure units increase and you have the opportunity to write more business, will primary companies continue to hold on to more of their business as opposed to utilizing reinsurers going forward? And will that impact your Reinsurance business?

William Robert Berkley
Founder and Executive Chairman

Our Reinsurance business is not really an across-the-board reinsurance business, we do business with smaller, specialized companies where we have relationships. And by and large, I don't think it will particularly impact us as much. We're particularly well-capitalized. I think the most interesting thing that's going to happen is. In fact, smaller, high-quality companies are going to need reinsurance more as the market changes, and I think it probably will give us the kind of customers we do business with, really a competitive advantage. I would add, I think across the board, for the very large reinsurers, your statement is likely to be more true.

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

You said your focus is more on some of the smaller insurers that will not have as much access to capital?

William Robert Berkley
Founder and Executive Chairman

I think that our average reinsured is a company with less than $1 billion of surplus, and it's a company that buys reinsurance because it's a necessary part of their financial strategy.

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

And any comments on why there has been, on an LTM basis, that the premiums have declined there? Is that a focus of the pricing?

William Robert Berkley
Founder and Executive Chairman

Are you talking about our Reinsurance business?

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

Yes.

Robert Berkley Jr.

The reason why the premiums have declined is because, well really two fold. One, quite frankly, the reinsurance market, believe it or not, has actually become more competitive over the last 12 months, and so consequently, we're willing to walk away from business is if we think that we are not going to get an adequate rate for our capacity. And secondly, obviously there are many ceding companies out there that are looking for ways to bolster their top line and one of the easy ways to do that is to increase your retention.

William Robert Berkley
Founder and Executive Chairman

I would add a third piece to that is we really enforced our view that reinsurance is a partnership venture and that really means a number of very large companies who don't view reinsurance in that way, don't fit as places where we should use our capital.

Operator

We'll take our next question coming from Josh Shanker. [Deutsche Bank]

Joshua David Shanker
Deutsche Bank AG, Research Division

Bill, I know that you're a pretty smart buyer of reinsurance, and you're also a player in the Australian market. So given that you maybe don't have a dog in that fight maybe you can tell us what's going on with the losses there in the first quarter.

William Robert Berkley
Founder and Executive Chairman

First, I should say that my lawyer's looking at me carefully now, Josh. First, we do not have big losses. We're not a property writer, and we think we have quite modest losses from the floods. And we expect at least in the ordinary course, to have reasonably modest losses from the cycle. And although obviously, that's an event we have not heard any information about. But as a matter of what business we do, we're not a property writer. And the reason we're not a property writer is because lots of parts of the world have extremely low prices for property exposures and the reason for that is because the exposure and consistency of laws for U.S. wind and English-European wind was such that companies try to diversify their capital exposures, so they try to write global exposures, and the prices for those global exposures have become very low. So when we look and enter the Australian market, everybody thought the kind of limits we were prepared and could afford to put down made no sense because people bought wind protection, cat protection of $1 billion, $2 billion, $3 billion, $5 billion of protection. And we look at our company, we're talking about putting maybe a $10 million line down, maybe a $20 million line down. It just doesn't make any sense in that marketplace. So there are lots of places in the world, Australia being one, where the scale of the property reinsurance market for catastrophes was huge but prices were relatively low. And the requirements to play were very, very high. We would expect the losses to be quite substantial, and I think it's going to be a very significant loss. How much it'll change the market? I think the floods alone would've had an impact on the market but not be what I call dramatically market changing. I think that the cyclone, in addition, could have real adverse impact to Sydney. And it could really make quite a difference, the magnitude of the reinsured losses is certainly going to be in the multi-billions of dollars.

Joshua David Shanker
Deutsche Bank AG, Research Division

How many events are we talking about here?

William Robert Berkley
Founder and Executive Chairman

I'm not an expert at defining events, but I think it would have to be at least two.

Operator

And we'll take our next question coming from Vinay Misquith. [Crédit Suisse]

Vinay Gerard Misquith
Crédit Suisse AG, Research Division

Your accident year loss ratio has stayed very favorable for the last three years, and it's been relatively flat. Should we start to see an uptick in that for next year? That's for 2011 now since pricing has been flat and your comments on frequency and severity trends.

William Robert Berkley
Founder and Executive Chairman

First, we didn't say anything about severity trends. We said something about frequency trends. At least, I listen to what I say. The fact is that our accident year loss ratio was conservative compared to all of my competitors. In fact, I actually must say we really look like we're pretty crummy underwriters compared to everyone we compete with. So I'm not sure I would think that we get significantly worse because I think we've tried to take into consideration those trends, which means we're always looking ahead. If we were to see severe inflation start to develop, yes, you'd be correct. But because of how we have our loss picks, which is a waterfall process, we always have somewhat of a cushion because going back four or five years, we were more cautious than we thought we were. And that caution, even though we tried to weed it out as we see those years develop, it takes time because you don't want to be so aggressive that you overstep. We've done that. The only advantage of being old is you've seen it happen before, and I promise you it's probably the only advantage. So we're not going to make that mistake again. So I can't tell you that our accident year loss ratio will get worse. I think we've been a little more cautious than we might have been. So I wouldn't reach that conclusion. I wouldn't discount it either. It's not an unreasonable thing to think, but we've had a lot of favorable development. And my guess is that those past loss year picks may still result in the more recent years being more cautious than they should've been.

Vinay Gerard Misquith
Crédit Suisse AG, Research Division

You mentioned about frequency trends, if you could just elaborate on that, that would be helpful.

William Robert Berkley
Founder and Executive Chairman

I'm going to -- Rob talk about that. Go ahead, Rob.

Robert Berkley Jr.

Without getting into too much detail, we're seeing early signs of frequency having, in all likelihood, bottomed out for the casualty line. I'm not talking about comp. I'm not talking about property. I'm talking purely certain casualty lines we are seeing, once again, frequency what appears though has bottomed out and it's starting to move up. While it's not racing-up, it's certainly a shift in direction from what we've seen in the past several years.

William Robert Berkley
Founder and Executive Chairman

I think that goes with the prior question also. I think that we weren't as optimistic about declining frequency as a number of our competitors, and they proved to be right and we were too cautious. We now see those things changing, and again, we may be a little ahead of the curve, but there's no question, directionally about that change.

Vinay Gerard Misquith
Crédit Suisse AG, Research Division

On the expense ratio, this year, that was 34% roughly, do you think with higher on premiums next year that it could go to roughly the 33% that it was in 2009?

William Robert Berkley
Founder and Executive Chairman

The answer is we can't give you a single number just like we can't tell you what a good number is. We've always had the view that having the best people in this business gives you a huge competitive advantage. And if at any year or two your expense ratio was out of line, we were prepared to live with that. I think as the cycle turns, the expense ratio will go down dramatically because a big part of that cushion expense ratio is additional operating units that haven't been fully utilized, then achieve scale with the number of people we have. We think with the numbers of people we have, we can really grow dramatically without any, really, consequential increase in our overhead. But I would hesitate to choose a number at this point. I'll feel a lot better after I have another quarter or six months under our belts. This is that moment where things are starting to fluctuate, and you're starting to see some of those changes but the changes aren't here I was early in my prediction, my facts were all right but people's state of mind and my facts weren't aligned.

Operator

We'll take our next question coming from Jay Cohen. [BofA Merrill Lynch]

Jay Adam Cohen
BofA Merrill Lynch, Research Division

The first is, the Alternative Markets business, the premium growth jumps around quite a bit quarter-over-quarter, can you talk a little bit about what's happened there and what drove the growth in this particular quarter?

William Robert Berkley
Founder and Executive Chairman

There's some things that are happening there, couple of different things. There's some accounting things, and then there's some business things. So I'm going to let Rob talk about the business things, and then Gene will talk about some of the accounting things. And then I'll probably just try to screw things up totally. Go ahead, Rob.

Robert Berkley Jr.

Jay, I think the simple answer to your question is the growth in the quarter was predominantly coming out of our A&H business and that was really the major driver in that segment.

Eugene G. Ballard
Executive Vice President of Finance

And the only thing I would add to the accounting change, Jay, if you're looking at net written, you're going to see the growth that Rob's talking about and where it came from. It looks to be a little bit higher on a gross basis and that's because I think we may have talked about this before, we write this, we service this assigned risk plan business and part of the way that's done is you actually put it in your paper and then reinsure it back to these NCCI pool so it goes in and out on a gross basis. And we had been writing some of that business on regional paper, so some of it was on the Regional segment. We've been moving it over to the Alternative Market segment because that's where the servicing is done. So you're seeing some of that business move out of the Regional segment and into the Alternative Market segment. It's not business that we keep net.

William Robert Berkley
Founder and Executive Chairman

So there's a lot of noise because of this change in where we write the business but in fact, none of that sticks with us, it's all business for assigned risk plans that come in and go out. It comes in on a gross basis and it goes out. And then the real growth that you're seeing is the Accident Health business, which is mainly Stop Loss business and it's in the A&H business.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

As I look at 2011, presuming that the A&H business has gained a little bit of traction, should we see kind of another up year? Not wanting any details as far as how much up, but would you expect that premium to be up in 2011?

Robert Berkley Jr.

Jay, I think obviously our expectations are that, that business is going to continue to grow and develop over a period of time. There are no guarantees as to what the market is going to be tomorrow. Assuming that the market continues to cooperate, we will try and find ways to grow that business.

William Robert Berkley
Founder and Executive Chairman

We've got some terrific new people there, and we think that's a good opportunity for us.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

The second question was on exposure growth. You're, I guess, the third company I've heard that suggested things look like they're bottoming and beginning to improve from an exposure standpoint. I guess my question is, is that good? If the price per unit of risk is inadequate or hasn't budged much, does growing exposures help or is it in fact possibly a negative?

Robert Berkley Jr.

I think the answer is that if you're getting an adequate rate and you're making a decent margin, exposure growth and assuming you're actually charging for that additional exposure growth, it's a good thing. If you're underpricing the business and not making a reasonable margin, and you think you're going to make it up on volume, you're probably going to be disappointed with the outcome.

Operator

We'll take our next question from Meyer Shields. [Stifel, Nicolaus]

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

Bill, you mentioned, and I think that you said for years that you view reinsurance with a partnership so you don't shop around for cheaper reinsurance...

William Robert Berkley
Founder and Executive Chairman

No. We have partners and we have shoppers. So there's a big chunk of our core business where we look for partnerships for long-term then there's opportunistic things that you buy because the market's soft so there's layers. I think when we sell reinsurance, we're interested in finding the partnership relationships, not the opportunistic ones.

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

When you talk about how it's becoming less common to lose business, does not have any commodity/ratio implications? I know in personal auto, the expectation that business will season favorably. I don't know if we can extrapolate from that to your casualty line.

William Robert Berkley
Founder and Executive Chairman

I think that by and large the stability in the business improves the outcome because you understand the business you're writing. You understand what it is and experience with customers lets you better tailor the product. It's especially true in the specialty area where you better understand the exposures. So I would say that longer relationships result in better results. So the answer is in the long run, the higher the retention, the better your combined ratio should be or the better your loss ratio should be.

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

Gene, do I understand the FX impact is saying that there is a $0.03 hit to -- on an accounting basis but not on an economic basis?

Eugene G. Ballard
Executive Vice President of Finance

Yes, right. So that $0.03, $8 million went to the income statement and we do have assets in Australian dollars that appreciated as a result of the strengthening of the Australian dollar and that went through equity into unrealized gains.

William Robert Berkley
Founder and Executive Chairman

In essence, unrealized gains and losses offset the loss of the $0.03. And if we went the other way, we'd show the $0.03 gain, and we'd have an unrealized loss. But you know accounting rules are such that they don't always enhance one's ability to understand what's going on in the business. This is the case here. We match our currency for the most part in the cheapest way we can, which is in the investment portfolio. So we have $10 million of liability in x currency, we'll try to have $10 million of assets invested in that currency. The consequence, however, from a financial point of view is that it comes through our income statement if it's up or down, and it goes into our balance sheet so in the other way, so it's not matched in how it appears.

Operator

Our next question is coming from Bob Farnam. [Keefe, Bruyette, & Woods]

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

The regional expense ratio went up a bit, about a point and I'm wondering if that's related to the shift in the Assigned Risk business from there to the alternative markets?

William Robert Berkley
Founder and Executive Chairman

No. I think it's just that our premiums were down.

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

And maybe a question for Rob, with the excess worker's comp competition being up, is that competition from existing carriers, or is it from new that are coming into that market?

Robert Berkley Jr.

Predominantly from existing carriers but the greatest level of competition is coming from an isolated number of carriers, some that have been in the marketplace for many years and others who have entered more recently and they would not appear as though they have the command of the subject matter that they might.

William Robert Berkley
Founder and Executive Chairman

You have to understand about this business, because it's a long tail. There's only one critical assumption here, and that critical assumption is how you want to assume your interest rate. So you make optimistic assumptions about returns and you can justify almost any price at all. We think that, that's always a danger and this is a line of business that many companies have come and gone.

Operator

Our next question is coming from Michael Nannizzi. [Goldman Sachs]

Michael Nannizzi
Oppenheimer

Just a question about the new business, could you talk a little bit about whether or not that increase is coming from either more exposures on existing policies, new policies to customers that maybe just had one or two coverage types? Or how much is completely new business?

Robert Berkley Jr.

It's a mix of both. Many of the startups they do not have a large portfolio to begin with, even though it's building. So it's actually a combination of all the categories. It is our efforts to offer, as I suggested earlier, a multi-line solution as opposed to a mono-line solution to some of these customers, in addition to that, it certainly is the businesses -- getting more traction. Reforging those relationships that they may have had at prior organizations, and there certainly is a renewal book for as many of these company at this stage that continues to build.

Michael Nannizzi
Oppenheimer

And when you think about the producers that are producing that business, relative to their old books wherever they were before, is that new business to them or is it really kind of as you say like new business to you just because they are resetting those relationships?

Robert Berkley Jr.

I think typically what it is, is a group of people that have a long-standing relationships with both insureds as well as the distribution system and they have a following if you like and some percentage of the business that they may have had at prior employer would seek out the opportunity of doing business with them again mainly because it still is some what of a people business and relationships make a difference.

Michael Nannizzi
Oppenheimer

I just have one question on investment income and the arbitrage accounts. Where would you like to see those accounts or that segment of the portfolio generate returns, and where do you think that can get? And do you expect that you'll continue to keep your allocation to that business in this environment?

William Robert Berkley
Founder and Executive Chairman

The answer is we've had a consistent good return in that business based on our investable assets. There's no question in the past couple of years there's been more volatility. When I talk to the guy who runs it for us, and I complain to him about more volatility, he said to me, "Well it's not fair for me to say." Then he said, "The problem is you all extrapolated, when I have a good month and make x, you then tell me I should make x every month. But if you look at what I do over a year it's pretty consistent." And he's right. And He's met the bogey we generally set. He only gets rewarded if we get -- based on how much we do over the risk free rate of return plus the bogey. So we've been able to do that. It's a very liquid portfolio. We have lots of liquidity. I think that if we had just an overwhelming number of opportunities that gave us great returns we would probably face the decision of how are we doing there. Right now, I can't find returns that give us anything approaching what we get in the arbitrage account. So, from our point of view we got 6%, 7%, 8% a year over a long time, and there were years where we got 15%, 18%, 20% a year. So for us it's a good return. We're happy with what they do. We've known them. They've been with us for more than 20 years. We value that consistency, that relationship, and how they do. So it's not something we have to worry right now because I'm not overwhelmed with wonderful investment opportunities, Michael.

Michael Nannizzi
Oppenheimer

Broader, in the line to you and I think Rob you had mentioned, lines that are very competitive and others that are maybe more attractive. In the competitive ones, what has to happen for pricing to improve there? Is it loss trend, or capital, or is it just that some people have to decide at some point that they shouldn't be writing the business or they can't really write the business? What's the pass in those overly competitive markets to get to what you would consider to be adequate pricing?

Robert Berkley Jr.

I think the answer is what needs to occur is losses. The losses from poor decisions that have been made are going to have to come through and whether they actually are fully experienced or the actuarial analysis just points in that direction of reality. Ones that comes into focus, people will become scared and their behavior will change. Now, whether they will elect to take a different approach and how they price and select risks or whether they will choose to withdraw altogether, my ability to predict is no better than anyone else's. Oftentimes, it depends how deep a hole they have dug themselves in, if it's deep enough, they may throw their hands up and run away from it altogether. If they just injured themselves modestly, they may decide to try and find ways to adjust and carry on.

William Robert Berkley
Founder and Executive Chairman

I think that one of the things, Michael, that everyone has to recognize that those fundamental things that change business behavior are fear and greed. And pricing models change when fear overcomes greed. Fear overcomes greed is the point in time where you can't hide in this case from reality. So be it pricing trends, be it paid losses, be it someone going bankrupt. When Reliance and Frontier went bankrupt, everyone else who was competing with them said is, "There could be me." And everyone decided they better change their behavior or they would be them. And I think that's what you really talked about. So my guess is that we've got a few people out there, some of them of some size that are way too aggressive. And then there's a lot of companies who are doing okay, whether they're doing us well as they say or not, they're not going to go out of business, but the management is going to say, "You know, it's not worth it anymore. I'm going to have to do something different." But in the meantime, you've got to get to that point where you're afraid your results will be so bad that, that overcomes your desire just to grow and write more business because the risk is too much. So whether it's declining surplus, operating losses, a lack of investment opportunities, whatever, that fear has to enter the psyche of the management of the enterprise.

Operator

And our next question is coming from Amit Kumar. [Macquarie Research]

Amit Kumar
Macquarie Research

You talked about Australia, can you sort of talk about the other hotspot in terms of Egypt and Middle East? I mean it's too early, but does this sort of alter buyer behavior and does this even end up becoming a big deal for the marketplace?

William Robert Berkley
Founder and Executive Chairman

It's rare that I hesitate to talk about almost anything. I think that it's very hard to say what this all means. I think there are some really fine companies and businesses in that whole territory. I think the lack of stability and uncertainty is very great. I just don't think it's -- I certainly am in a position to foretell what's going to happen. It's a part of the world that's undergoing change, and I think it's hard to predict where and how that change comes out. And we have to sit back and from our point of view, sort of sit and wait and see. And I think in all likelihood, things will get more difficult before they get better.

Amit Kumar
Macquarie Research

Do you have any exposure through Lloyd's to the Middle East?

William Robert Berkley
Founder and Executive Chairman

I'm sure we have some, but we don't think there'd be anything -- nothing consequential.

Amit Kumar
Macquarie Research

Going back to the growth in your international book, obviously we've seen meaningful double-digit growth over the past three or four quarters, and I know you mentioned Australia and Nordic regions and South America. Does that growth sort of taper off as we head further into 2011, 2012? Or do you think that it's such a big enough market that growth can be sustained going forward?

Robert Berkley Jr.

It is unlikely that the growth rate that we have seen in this quarter will continue on for an extended period of time. Having said that, obviously, when you're operating in economies that on their own have a great deal of momentum, you benefit from participating.

William Robert Berkley

Founder and Executive Chairman

I think you also have to remember when you're small, to start with. You don't have to add a lot of business to have a significant percentage growth. So those businesses aren't giant businesses. And while in some markets, there's significant for the marketplace, overall, when examining the marketplace, we're not that large a participant.

Amit Kumar
Macquarie Research

Just on your comment on the buyback, I think you mentioned the buyback equal to the income in the quarter, just based on your comments regarding the pricing, perhaps getting modestly better than what it was previously, do you think it changes your view on capital management going forward? Or it sort of stayed the same in the near future?

William Robert Berkley
Founder and Executive Chairman

What I want to be sure is that we don't get short of capital and the one thing we've seen in the past two years is that capital markets aren't as predictable as we thought they were at least a couple of years ago. So while we would like to buyback stock and buyback stock as aggressively as we can, we want to be sure we maintain enough powder that we can grow for a year or 18 months or two years without the need to raise additional capital. So we're not quite as aggressive as we might be. Historically, when the cycle turns, you've always been able to raise capital at attractive prices. So on a historic basis, I probably should be more aggressive in buying back stock. But I've been in this business a long time and I've never seen what happened in capital markets in the past couple of years so I don't want to base my life on those long-term histories, and we've made a commitment to our marketplace that when business is well priced, we will never turn it down. So we're going to continue to use whatever we earn to buyback stock and maintain our capital ratios where we have lots of flexibility. And we want to be sure that's the case, and that may be slightly more cautious than I should be, but when you're my age and you see things you never saw before, you at least have a good enough memory to last you for a couple of years.

Operator

We'll take our next question from Scott Ross [ph].

Analyst

Just to clarify, I want to make sure I heard you correctly on the Australian exposure, are you saying that you expect Cyclone Yasi coupled with the previous flooding to have a real adverse impact on the industry but do your business profile neither is expected to affect your results in 2011, is that accurate?

William Robert Berkley
Founder and Executive Chairman

What I said is, I don't think it will have a material impact on our results.

Operator

And our next question is from Brian Meredith. [UBS]

Brian Robert Meredith
UBS Investment Bank, Research Division

Talking about the whole capital management situation and trying to be conservative with leverage, typically, you said the high-end debt to cap 35%, how close do you really want to get to that, I guess you're on 32% right now?

William Robert Berkley
Founder and Executive Chairman

We are at 32% including preferred. I think it would be unusual for us to take on anymore debt than we have now. Unusual is a funny word because we're at an environment that things happen. I think that our capital count is better than most people thought at year-end, and I would expect we'll continue to have positive surprises for people. We think our balance sheet is conservative. But that being said, I don't think we're going to push that hedge any further, unless some unusual thing happens that would cause us to reconsider. I think we've got about as much leverage as we're planning to have at the moment.

Operator

We'll take our next question from Michael Grasher.

Michael Fitzgerald Grasher
Piper Jaffray Companies, Research Division

Follow-up from previous questions just on the improving exposure units, can you highlight particular lines of business that's occurring in or that maybe occurring in? And then also, if it's related to any particular region of the country.

William Robert Berkley
Founder and Executive Chairman

It really isn't, Michael. I think that the point we were trying to make is unlike prior periods, the general economy's improvement is resulting in positive ordered premiums, is resulting in additional premiums for policy, and new business. So it's not any one place here or there. It's not anything that's dramatic. It's just generally across, and by the way, the additional units of exposure, it's a small number. It's between 1% and 2%. So it's not something that's going to knock your socks off. I wish it would, but it isn't.

Operator

And our next question is from Jay Cohen. [BofA Merrill Lynch]

Jay Adam Cohen
BofA Merrill Lynch, Research Division

When you talked about the higher frequency that you're seeing, I shouldn't say higher, the stabilization of frequency, does that make you rethink the loss picks? Or did you already account for that in your loss picks anyways? Or it doesn't necessarily make you change those picks?

William Robert Berkley
Founder and Executive Chairman

As I said, I think we already took into -- take into consideration, the trend of flattening our increasing loss picks. It's already built-in. That probably is one of the reasons we have higher accident year loss ratios, because we already anticipated that.

Operator

And our next question is from Vinay Misquith. [Crédit Suisse]

Vinay Gerard Misquith
Crédit Suisse AG, Research Division

Just wondering what the dollar amount of your net investment income from fixed maturities securities were this quarter?

William Robert Berkley
Founder and Executive Chairman

Somebody is going to look in the sheet of paper, because I don't have all that off the top of my head. I think it was $131 million.

Eugene G. Ballard

Executive Vice President of Finance

Well, just fixed income alone is $128 million.

Vinay Gerard Misquith
Crédit Suisse AG, Research Division

And I'm just curious why that increased so dramatically from last quarter when I think it was $123 million?

Eugene G. Ballard
Executive Vice President of Finance

Yes, there is an increase there. I think the average. I'd have to double-check you may want to give me a call and get back to you. It may have to do with reallocation of the investments to some extent, but I don't have that right offhand.

Operator

And we have one final question at the moment coming from Meyer Shields. [Stifel, Nicolaus]

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

I was just hoping to throw in a couple of questions on the segments. I was wondering whether Gene could break down the $55 million reserves development?

William Robert Berkley
Founder and Executive Chairman

We basically do that, if you want those details you could give Gene a buzz either later tonight or in the morning.

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

Is there any significance to the fact that we're seeing a divergence of command ratios by segments more than we've seen on the past few quarters?

Eugene G. Ballard
Executive Vice President of Finance

I think more than anything else, it just happens to be where the development happens to come. If not the underlying accident year loss ratios, x storms, are much more stable than what you'd see on a reported basis.

Operator

And at the moment, I'm showing no further question.

William Robert Berkley
Founder and Executive Chairman

Thank you all very much. I appreciate your spending some of your evening time listening. I know you'll be busy tomorrow. So have a good evening. Thank you.

Operator
Ladies and gentlemen, this does conclude your conference. You may now disconnect, and have a great day.