S&P Capital IQ

CONTENTS



# W. R. Berkley Corporation NYSE:WRB

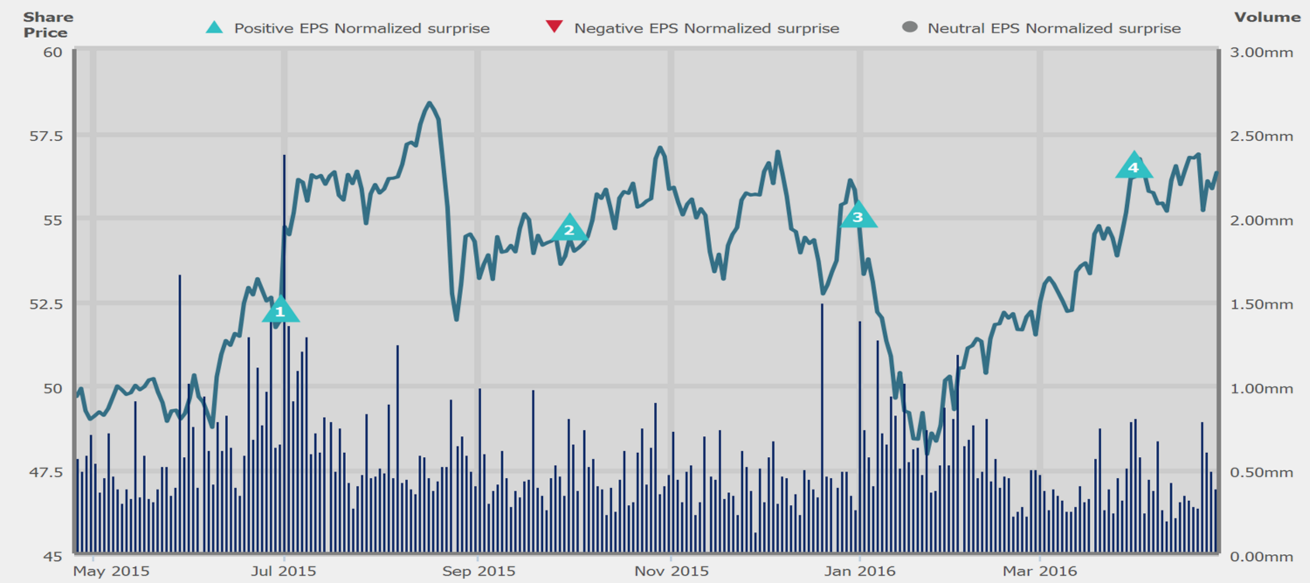
## *FQ2 2016 Earnings Call Transcripts*

Monday, July 25, 2016 9:00 PM GMT

## S&P Capital IQ Estimates

| | -FQ2 2016- | | | -FQ3 2016- | -FY 2016- | -FY 2017- |
|---|---|---|---|---|---|---|
| | CONSENSUS | ACTUAL | SURPRISE | CONSENSUS | CONSENSUS | CONSENSUS |
| **EPS Normalized** | 0.76 | 0.82 | ▲7.89 | 0.82 | 3.35 | 3.47 |
| **Revenue (mm)** | 1578.42 | 1559.79 | ▼(1.18 %) | 1595.79 | 6314.74 | 7197.90 |

Currency: USD
Consensus as of Jul-25-2016 9:57 PM GMT




| | - EPS NORMALIZED - | | |
|---|---|---|---|
| | CONSENSUS | ACTUAL | SURPRISE |
| **FQ2 2015** | 0.80 | 0.81 | ▲1 1.25 % |
| **FQ3 2015** | 0.83 | 0.91 | ▲2 9.64 % |
| **FQ4 2015** | 0.80 | 0.89 | ▲3 11.25 % |
| **FQ1 2016** | 0.85 | 0.89 | ▲4 4.71 % |

# Call Participants

## EXECUTIVES

**Richard M. Baio**
*Chief Financial Officer, Senior Vice President and Treasurer*

**William Robert Berkley**
*Chief Executive Officer, President and Director*

**William Robert Berkley**
*Founder and Executive Chairman*

## ANALYSTS

**Arash Soleimani**
*Keefe, Bruyette, & Woods, Inc., Research Division*

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**Jay Adam Cohen**
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**Joshua David Shanker**
*Deutsche Bank AG, Research Division*

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*Morgan Stanley, Research Division*

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**Michael Steven Nannizzi**
*Goldman Sachs Group Inc., Research Division*

**Ryan James Tunis**
*Crédit Suisse AG, Research Division*

# Presentation

**Operator**

Good day, and welcome to the W.R. Berkley Corporation's Second Quarter 2016 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 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, 2015, 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. W Robert Berkley. Please go ahead, sir.

**William Robert Berkley**
*Chief Executive Officer, President and Director*

Thank you, Andrea, and good afternoon, everyone. Again, welcome to our second quarter call. With me on this end of the phone, I have Bill Berkley, our Executive Chairman; Gene Ballard, our Executive Vice President; and new to the call is Rich Baio, our Senior Vice President and Chief Financial Officer. Some of you've had the opportunity to meet Rich. Others, I'm sure, will have an opportunity in the future and all of you will be hearing from him today. He's been with the organization for something more than 7 years, and the lion's share at that time he was our Vice President and Treasurer and we're delighted to have him now in the role of Chief Financial Officer.

So the agenda that we have laid out for you all today is I'm going to start out with a few comments about the environment. Then I'm going to offer a couple of soundbites on our quarter, and then I'll be handing it over to Rich, who is going to run through in some more detailed highlights from our numbers. And then you'll have the 4 of us at your disposal for Q&A.

So turning to the environment. Clearly, an interesting moment when you look back on the quarter. Flurry of cat activity. Nothing particularly outsized, but certainly a reminder that cats do occur. Also, continued dislocation in the marketplace amongst some very large carriers as some of them were managing through a merger or acquisition and others were just going through a meaningful structuring. And then finally, we have discontinued low-interest rate environment around the world, and it's really gotten to the point that it could almost make your eyes tear.

In spite of all that, the insurance market seems to march to a similar beat to what it did in the first quarter. The reinsurance market continues to flirt with the bottom. On the other hand, the insurance market is becoming incrementally more competitive, though it can vary greatly by product line or class.

A couple of general comments around some of the product launches in the insurance space. Properties, particularly cat-exposed properties, remain surprisingly competitive to a certain extent. My speculation would be this is as a result of the reinsurance market empowering the insurance market to be less than responsible in many situations. The professional space is very much a mixed bag. On one hand, the Fortune 5000 D&O excess market is surprisingly competitive as are parts of the medical space. Having said that, there are other components of the professional market that are exceptionally attractive and we think provide meaningful opportunity for growth where margins are attractive.

Turning to commercial auto. Certainly, a part of the market that we have discussed several times over the past few years. It seems like it is finally getting to the point that discipline is returning. We are seeing rate increases, and we are seeing the momentum begin to shift between supply and demand. On the other hand, we have the comp market, which is very much a mixed bag. As many of you are aware, workers' compensation is the largest component of the commercial line space, and there are parts of this market where the margins are exceptionally attractive. And we continue to find opportunities to grow our business, and there certainly are parts of the comp market that give one reason to pause. Probably, the market that makes one pause for the longest and scratch their head these days will be the Florida market. Fortunately, for us, we have very limited exposure to that marketplace.

The casualty market is probably the brightest bulb on the tree and, hopefully, that will continue for some period of time. And finally, the stupidity award would go to the aviation and the global marine hull market.

Turning to our quarter. By and large, it was in line with our expectations. The growth in the insurance market came from the place -- rather in our insurance segment came from the places we expected it to, led by casualty followed by professional. Again, there are some components of the professional market we continue to find very attractive. On the reinsurance front, which may have been something that caught your eyes coming out of the press release. The growth that we had there, you may be pausing and scratching your head over that, given how competitive the market is, how are we finding ways to grow. And the growth was really driven by 4 components, one, being our facultative business that distributes on a direct basis. They have a series or suite of currency products, which are effectively specialty products that are just sold on a wholesale basis. Second would be our global property fact business, which writes property fact around the world, outside of the United -- ex U.S. And this is a business that we have started last year and is getting momentum.

Additionally, we started, as we had announced last year as well, a business in South Africa, and they are getting good traction. And then finally here, back in the States, our treaty business, has been finding some niche opportunities within the structured space. The structured spaces and I believe, Gene has touched on this in the past, is a part of the market that while the potential for great underwriting margin may not be there, the way one can structure these deals, the downside is very limited. So as always, when we think about our business and included in that the reinsurance business, we start from a perspective of risk-adjusted return. And we believe the structured deals that we are able to participate in make a lot of sense when you think about the required capital charge and exposure.

Turning to the loss ratio. And again, Rich is going to get into a lot of these numbers. So I'll keep at high level. Approximately $40 million of cats. This, by and large, is in line with what our expectations were given the level of cat activity in the quarter. I think different organizations use different definitions of cat. Our definition is PCS, at least domestically. We've certainly seen some of the announcements where they come out talking about cats and weather related as well.

From our perspective, it's not unusual to see certain types of weather losses certainly in the second quarter. Rich will break that down for you a little bit more, but I believe that's 2.6 points for us on the loss ratio as a result of the cat.

On the expense front, by and large, again, sort of in line with our expectations. The insurance segment continued to show improvement as the earned premium develops or grows or builds following the written. And on the reinsurance front, the adverse impact on the expense ratio was mainly driven by the structured deals that carry a slightly higher commission. And, again, Rich is going to touch on that in more detail shortly.

Turning to the investment portfolio. Many of you saw the announcements that we made a little while ago about the sale of Aero Precision. This is a pretax gain of approximately $130 million. And we highlighted not just because the $130 million is material to the organization, but it's yet another example that demonstrates the approach that we've taken to how we manage the investment portfolio. As you've heard, our chairmen talked about for some number of years now, given the interest rate environment, we had to look for alternatives. Hence the building out of our alternative investment portfolio and gains have become a more meaningful part of our strategy. I think the guidance that we have given and we continue to believe is appropriate is approximately $25 million a quarter in gains. Having said that, that will fluctuate from time to time because the gains don't come through necessarily in such a predictable or, I should say, smooth manner.

With regards to other parts of the investment portfolio, again, the duration continues to shorten a little bit. We're at approximately 3 years for the fixed income portfolio and the yield is 3.2. Again, kudos to our colleagues managing the fixed income portfolio. They managed to find ways to maintain the yields while not compromising on the duration.

Again, as far as the reserves go, Rich will touch on this, but we continued to see positive reserve development. And last comment from me about numbers and I'm going to hand it off to Rich to get into a little more deeply, but on the FX gain that you saw come through about $13 million. From time to time, we've seen some people that follow the business and write on our results on a quarterly basis. They tend to focus on that, and I'm not sure if they fully appreciate the full picture. The fact is we have this gain because of our approach and our philosophy to how we manage our currency exposure. And yes, that gain came through, but we'll need to keep in mind the fact that some of our underwriting income was impacted by a weaker local currency as it gets translated back into dollars. So is it an exact push? No. But I would assure you that this is not just a one-off benefit. We have things going both ways.

So again, I'm going to pause there. I'm going to let -- leave it to Rich to run through some of the numbers with you in more detail. And once Rich is done, we'll be opening it up to questions and you have the floor with us to try and address anything we can for you. Rich?

**Richard M. Baio**
*Chief Financial Officer, Senior Vice President and Treasurer*

Great. Thanks, Rob. I appreciate it. For the second quarter, we reported operating income of $105 million or $0.82 per share, which is unchanged from the prior year's operating earnings of $105 million or $0.81 per share. As Rob alluded to, earnings reflected a slight increase in investment income and the recognition of net foreign currency gain, which were offset by a modest decline in underwriting income due to higher catastrophe-related losses. Overall, our net premiums written increased by 6.4% to more than $1.6 billion. The insurance segment premiums increased 5%, to almost $1.5 million (sic) [ billion ]. The growth was led by a 15% increase in our other liability business. In addition, professional liability was up approximately 8%, while workers' compensation, commercial automobile, property and other short-tail lines were relatively flat quarter-over-quarter. The segments increase was understated due to changes in foreign exchange rate. In original currency terms, premiums rose by 7.1% compared with the U.S. equivalent basis of 5%.

For the reinsurance segment, net premiums written increased almost 20% to $171 million. This growth continues to be driven by structured reinsurance and a few of the other items that Rob alluded to earlier in his comments. During prior calls, Gene has referenced these transactions which have very limited cat exposure and carry a lower-than-average loss ratio while being partially offset by higher profit commissions.

Our overall pretax underwriting profits -- excuse me, decreased $7 million or 8% to $79 million, primarily due to increased cat losses. The accident year loss ratio before cat losses are 60.3% compared with 60.5% a year ago and comparable to full year 2015 at 60.6%. Although our cat losses were in line with expectations, this quarter, we reported losses of $40 million or 2.6 loss points compared with $25 million or 1.6 loss points in the prior year. Loss reserves developed favorably by $16 million, representing our 38th consecutive quarter with positive development. That gives us a calendar year loss ratio of 61.8%, an increase of 1.1 loss points from a year ago.

Our overall expense ratio for the second quarter was 33.1% compared to 33.5% in the second quarter of 2015 and relative to the full year 2015 of 33.2%.

The insurance segment expense ratio was 32.3%, representing a decline of 0.7 of 1 point from the second quarter of 2015 and slightly below the full year 2015 of 32.6%. The decline in the expense ratio for the insurance segment, as Rob referenced earlier, is largely attributable to a higher increase in the earned premium relative to underwriting expenses.

The reinsurance segment expense ratio increased 1.4 percentage points to 40.1%. That increase was due primarily to the growth in the structured business, which has a higher expense ratio relative to other reinsurance business written. For comparative purposes, the structured business represented 25% and 8% of the net premiums earned in the second quarter 2016 and 2015, respectively. That brings our combined ratio to 94.9% for the second quarter 2016 compared with 94.2% for the same quarter a year ago.

Touching on the investment income and the contributors to that. Investment income increased approximately $2 million or 1% to $129 million, resulting from a few main drivers.

First, income from fixed income securities was up $3 million to $108 million with an annualized yield of 3.2%, which is unchanged from the second quarter 2015 and slightly lower than the full year 2015 of 3.3%. Second, income from the merger arbitrage account increased $3 million compared with the year-ago quarter. And finally, earnings from the investment funds declined $3 million to approximately $19 million attributable to improved energy fund results offset by a decrease in other fund income. The investment fund performance of approximately 6% on an annualized basis is in line with our target return.

At June 30, 2016, after-tax unrealized investment gains were $363 million, representing an increase of $182 million or more than 100% rise from the beginning of the year. The average rating, as Rob alluded to, was AA- unchanged, and we shortened the portfolio from 3.3 years at December 2015 to 3 years at the end of June 2016.

The overall tax rate was 31.2%, which is almost unchanged from the overall tax rate for the prior consecutive quarter as well as the full year of 2015. That gives us net income of $109 million and overall return on equity of 9.5% and for comparison purposes, a pretax return on equity of 13.8%. Also during the quarter, our book value per share increased $1.22 to $39.97, which is an increase of 12.6% on an annualized basis. Our operating cash flows remained strong with $156 million for the second quarter 2016 and almost $300 million year-to-date 2016.

Finally, as Rob was alluding to earlier, subsequent to our second quarter, we announced the sale of Aero Precision, an investment in our private equity portfolio. The estimated pretax gain of approximately $130 million or an after-tax gain of approximately $78 million equates to an increase in book value per share of $0.64 and 1.7 percentage points improvement on our ROE, which we would expect to reflect in our third quarter of '16.

Thank you. Rob?

**William Robert Berkley**
*Chief Executive Officer, President and Director*
Rich, thank you very much. Andrea, I think that will conclude our formal remarks. So if you could please open it up for Questions and again, you have all 4 of us here to try and answer any questions folks have.

# Question and Answer

**Operator**

[Operator Instructions] Our first question comes from the line of Kai Pan with Morgan Stanley.

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

First question on the reinsurance side, the growth. Are those one-off deals? Or do you expect those sort of like you continue to see the opportunities there?

**William Robert Berkley**
*Chief Executive Officer, President and Director*

It depends on the part of the business. As you may recall, I pointed to 4 different areas that were driving the growth. Certainly, it is our hope and expectation that our global property tax business or the business -- property tax business that's non-U.S., I think that business will continue to grow. We would expect our businesses in South -- that's focused on South Africa to continue to grow as well. The turnkey business where we offer through our direct back operation domestically, we would expect will grow. And as far as the structured deals, those tend to be one-off, while there can be renewals on those. It really depends on the season. So short answer is it's a mixed bag. I would suggest to you that this quarter the plan is some stars lined up. I don't think our expectation is this type of growth necessarily going forward.

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

So Rob, the 19% year-over-year growth, would you say the [indiscernible] business on the structured deal is like accounts from majority of it or...

**William Robert Berkley**
*Chief Executive Officer, President and Director*

I'm not suggesting that. I'm suggesting that I don't think we're going to continue to grow at 19% quarter-over-quarter.

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

Okay, that's great. And then on the insurance side, it looks like you have pretty healthy growth on the other liability lines as professional lines like, where do you see this pricing environment right now?

**William Robert Berkley**
*Chief Executive Officer, President and Director*

Where do -- I'm sorry, where do we see the -- Could you repeat where do we see what?

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

Sure. Where do you see the pricing environment right now in these lines? And also, this growth, how would that impact your sort like mix of loss ratio going forward?

**William Robert Berkley**
*Chief Executive Officer, President and Director*

Well, the other liability or what we refer to as casualty, in general, is pretty wide and diverse as is the professional space. So we're growing in places where we think the margins are attractive. So I guess, ultimately, from our perspective, we think that this will be accretive to our business and help us achieve our targeted returns.

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

Okay. And then your new business that you mentioned about the high net worth business as well as the Asia business. Could you talk more about these sort of new hires and new start-ups? And what would that impact on your expense ratio in the near term?

**William Robert Berkley**
*Chief Executive Officer, President and Director*

So just to touch on the overall expense question, and perhaps this will give a little bit of insight or color for some on the phone. When we are starting a new business, the expenses associated with starting a new business are expenses that we maintain at the holding company or corporate. Once those businesses begin to operate, which often times can take a little bit of time between when they are hired and when they actually start writing business. But once they start writing business, that's when you will start to see them participate in the overall ratios, including the expense ratio. So the 2 businesses that you are referring to that we've referenced in our release, one in the high net worth space. From our perspective, we think that, that is very much a specialty business. Many people think of the personal lines space as a commodity business, and they are certainly parts of it at our commodity business. But ultimately, we like the high net worth space because we think it is a specialty business that targets an audience where they value claim service, they value service, in general, and they're willing to pay for that value. As far as our expansion into Asia, it's a team of people, again, that are focused on the commercial specialty business. They have a great track record. They have great relationships. We don't think that this business will be overwhelming from a scale perspective anytime soon. But if we take a long-term perspective and you think about where the global economy is likely to grow over the next few decades, Asia is likely to be a big part of that. And we feel though as we manage the business and position it for the future, we need to be learning and participating in a thoughtful and forward way and the people that are managing the capital in that region on behalf of the shareholders, we think, are more than capable of doing so.

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

That's great. If I may add one last one on the $130 million pretax gain on the Aero Precision divestiture. First, 2 things on that. First is that was earnings impact going forward? And then secondly, is that sort like how do you think about to proceed? Are you going to invest in other deals like private investments or like could be used for capital management including buybacks?

**William Robert Berkley**
*Chief Executive Officer, President and Director*

The issue is when we get the money, we'll make a decision how we use this money. It's a holding company, and we'll make our own decision as we do with all the holding company funds. As to affect [ph] earnings, third quarter will close sometime at the end of July, the end of August in that period of time. It's hard to tell just what it will do. It's an ongoing basis. It will have some impact, but we also are always looking to buy things in that area and expand. So it will have an impact in the very shortest run, but we would think that in the longer term, we would expect to expand that aviation business again and restore it to its level of profitability.

**Operator**

Our next question comes from the line of Ryan Tunis from Crédit Suisse.

**Ryan James Tunis**
*Crédit Suisse AG, Research Division*

I guess my questions are just a little bit more on the structured deal and reinsurance. I think, Rob, said, first of all the, the margins are a little bit lower, but the risk-rewards are a little bit better. In other words, there's less downside. What would you say the target combined ratio is on the structured deals that you've been doing?

**William Robert Berkley**
*Chief Executive Officer, President and Director*

So that's just not something that we're going to get into on the call. I would tell you that we're not going to deploy capital unless we think it's a reasonable risk-adjusted return. But how we price individual transactions, that's just not typically something that we would get into that level of detail. What I would tell you is that while the upside may not be as attractive as some other activities, the downside is very limited. And the commission, the ceding commission is on a sliding scale. And again, I have mentioned earlier when we look at the capital exposed, we think it justifies the utilization of the capital. But as far as the details, I'm not sure if that would really make sense to our shareholders to get into that level [indiscernible].

**Ryan James Tunis**
*Crédit Suisse AG, Research Division*

Sure, sure, that's fair. But I guess, just from an accounting standpoint, I think I heard that 25% of your earned premium this quarter within reinsurance was coming from these deals. And I think you also said that they tend to be one-off. So maybe just looking for some visibility over the next few quarters on to the extent you don't do any more of these sort of where we should see the combined ratio and reinsurance even out, I guess, maybe the right way to put it?

**William Robert Berkley**
*Chief Executive Officer, President and Director*

Yes. I think the way you might want to think about this -- but, first of all, this isn't just like some flurry of deals that we've done in the last 90 days, while this perhaps spiked up a little bit. That, in part, is because we've reduced our participation in some of what one might define as the more traditional components of the market. So the structured component is standing out a bit more. But from our perspective, from a combined ratio normalized for cats and perhaps the loss ratio getting incrementally better, I think, if you look back to where we've been over the past few quarters, it's probably not a bad data point.

**Operator**

Our next question comes from the line of Michael Nannizzi with Goldman Sachs.

**Michael Steven Nannizzi**
*Goldman Sachs Group Inc., Research Division*

A couple of questions for you on the Aero Precision sale, Bill. I guess that was a one piece of Aero Precision, and it looked like it was just maybe one region of that business. I'm just trying to get an idea, is it possible to understand, whether on a percentage of revenue basis or percentage of something basis, percentage of profit basis, what was the contribution of the business that was sold?

**William Robert Berkley**
*Founder and Executive Chairman*

It was the bigger -- it was the largest single part of Greenwich Aero, but it wasn't all of Greenwich Aero. And we acquired Greenwich Precision -- Aero Precision rather, I think, 3 years ago. And we'll reinvest some part of that money and expanding into other kinds of specific areas that offer us other opportunities in the aviation field. We think we have expertise in areas having to do with the aviation business. So we have continued to look. But it had a varying percentage of the business that has not been a business that has consistently had earnings that are highly predictable quarter-to-quarter.

**Michael Steven Nannizzi**
*Goldman Sachs Group Inc., Research Division*

And did you give the proceeds number from that transaction? I don't know if we have the gain number, but I don't know...

**William Robert Berkley**
*Chief Executive Officer, President and Director*

Yes -- no, we didn't.

**Michael Steven Nannizzi**
*Goldman Sachs Group Inc., Research Division*

Okay. And then I know you guys, Rob, picked up some debt in the quarter. Was just curious, I mean, the financial leverage is a bit higher than it's been, starting to get picked up a little bit a couple of years ago when you guys prefunded some debt. Just wanted to understand how we should think about that? I mean, you got a couple of issues coming due in, I think, '18 or '19. I was just trying to get an idea, is this where you expect or you plan to be running your leverage? And is there a reason why you've chosen to take that up?

**William Robert Berkley**
*Chief Executive Officer, President and Director*

Richard, go ahead.

**Richard M. Baio**
*Chief Financial Officer, Senior Vice President and Treasurer*

Sure. So as you pointed out, we do have some maturities coming due in 2019 and 2020. In light of the interest rate environment, our expectations was to try and take advantage of the loan coupons that one could benefit from. And so as we evaluated our capital stack, we determined that it would be more efficient to have hybrid capital on -- in our overall debt and hybrid structure. And so to that end, we effectively are pre-funding, recognizing that the leverage ratio is a little bit elevated from where we would like it to be. I think we target kind of 32% to 33% over the short term.

**Michael Steven Nannizzi**
*Goldman Sachs Group Inc., Research Division*

Okay.

**William Robert Berkley**
*Chief Executive Officer, President and Director*

So Mike, we like the trust preferred instruments. We like the duration given there's a lot of flexibility. We like the 5-year call option. And it's hard to know when interest rates are going to be moving up, but it seemed like a reasonable window. And is there a little bit of short-term cost? Yes, there is. But as Rich suggested, it's an opportunity to pre-fund, and obviously, rating agencies are comfortable with this.

**Michael Steven Nannizzi**
*Goldman Sachs Group Inc., Research Division*

Right, okay. And then just one quick one on expenses. So when we back out the FX, it looks like the other expenses were a bit higher and then relatively shorter to my estimates the expense ratio overall, especially in insurance, it's a bit lower. So is some of that sort of the expense initiative that you're talking about with regard to these new sort of businesses that you're talking?

**William Robert Berkley**
*Chief Executive Officer, President and Director*

Yes, that's right, Mike. As you recall, over the past, call it 12 months or so, we've started quite a number of new operations. Some of them stand-alone, some of them in an incubator that will get folded into an existing operation. And as I mentioned earlier, we tend to put the expenses prior to operational into the overall expense. So for example, the high net worth as well as Asia, that's coming through the corporate expense. And there are a couple of other bits and pieces that are just in their infancy that are in there as well.

**Michael Steven Nannizzi**
*Goldman Sachs Group Inc., Research Division*

Got it. Okay. So -- and so then when we look at the expense ratio, excluding those, so we could expect to see more expense coming through that line as you're building, and then...

**William Robert Berkley**
*Chief Executive Officer, President and Director*

Right. I mean, it's almost like an incubator, if you will. And once they leave the incubator, then it shows up in the expense ratio. So you'll see it spike in the corporate then you're going to see it evolve over to the expense ratio. And then as they hit maturity or the earn gets some level of critical mass, you'll see that expense ratio start to come down as that earn turns off.

**Michael Steven Nannizzi**
*Goldman Sachs Group Inc., Research Division*

Got it, okay. And then when we look at the segment, then that 60 basis point year-over-year improvement in insurance in the expense ratio, which is reflecting the continuing businesses that we should be -- that level of expense is reasonable for the way that you're going to be accounting for that business on a go forward, at least as a starting point?

**William Robert Berkley**
*Chief Executive Officer, President and Director*

Look, I think it's a reasonable number to start with. But obviously, as we move -- as businesses mature and they go -- and they are up and operational, then it's going to flop over and hit the expense ratio, and it might move it up. So as things make their way down the assembly line, if the numbers are showing up in different areas, if you will, whether it's corporate expense or expense ratio. The improvement that you saw in the expense ratio this quarter consistent with some of the things that we've chatted about in the past on these calls is the result of the maturing of some of the operations in that earned premium growing. So again, as we're starting new operations and they migrate from corporate expense into the expense ratio, you'll see that expense ratio go up and down.

**Michael Steven Nannizzi**
*Goldman Sachs Group Inc., Research Division*

Got it. Okay. And last question, just on these new initiatives. Do you expect the natural expense ratio for the businesses you're starting to meet different at maturity than the remainder of your business?

**William Robert Berkley**
*Chief Executive Officer, President and Director*

Some of the businesses will take more time to mature than others. But ultimately speaking, we believe long term that our expense ratio is certainly will be in the low 30s. And we're going to keep track and push on that in a sensible way to the extent we can push that further.

**Operator**

Our next question comes from the line of Arash Soleimani with KBW.

**Arash Soleimani**
*Keefe, Bruyette, & Woods, Inc., Research Division*

A couple of questions here. I think that the high net worth business was described by one of your competitors as being $8 billion to $10 billion currently in annual premium, but having the potential to hit $30 billion to $40 billion. Just curious if you would describe that market similarly

**William Robert Berkley**
*Chief Executive Officer, President and Director*

Well, I think that people can define that market in a variety of different ways. And if can to talk to 10 different carriers, they'll probably tell you 10 different definitions as to where the high net worth market starts. I also think it depends on the territory, whether you're talking about the U.S. or whether you're talking about global. And I think it also depends that you're just talking about auto and homeowners or are you including fine art, jewelers, block et cetera, et cetera. So like many things in life and certainly this industry, definition is key. But we do believe that it is a meaningful market where there is not only dislocation but there is, quite frankly, enough scale that there's opportunity for multiple carriers to play and find different ways to bring value to customers.

**Arash Soleimani**
*Keefe, Bruyette, & Woods, Inc., Research Division*

Can you just remind us the business mix changes that are helping the core loss ratio?

**William Robert Berkley**
*Chief Executive Officer, President and Director*

The business mix changes that are helping the core loss ratio, generally speaking, we will disclose some things in the Q, but we're not -- we don't really get into the specifics as to what the margins are by product line and that level of granularity. What I would suggest is if you -- I know it's a bit monotonous, but if you go back and hear our comments from today and in the past as to where we think the best margins are, that's usually where the improvement is coming from.

**Arash Soleimani**
*Keefe, Bruyette, & Woods, Inc., Research Division*

Okay. And lastly, can you mention any impact, if any at all, that you expect from Brexit on your business?

**William Robert Berkley**
*Chief Executive Officer, President and Director*

Well, I have a couple of thoughts, but in addition to title of Chairman around here is also Chief Economist, so I'm going to leave that to our Chairman to reflect on.

**William Robert Berkley**
*Founder and Executive Chairman*

First of all, we, in fact, had set up a company in Liechtenstein well in advance being cautious and wanting to take no chances. So we are equipped to do business in the EU in the domicile other than the U.K. So from a legal point of view, it won't have an impact on us if we did that some time ago. Clearly, the [indiscernible] space in the London market continues to be there. We don't see it disappearing. So we think London will continue to be the center of the insurance business in that part of the world. And from a regulatory point of view, we think we can protect ourselves. So we don't really see a major change or a significant impact.

**Operator**

Our next question comes from the line of Larry Greenberg with Janney.

**Lawrence David Greenberg**
*Janney Montgomery Scott LLC, Research Division*

I guess, this is just a modeling question, but can you tell us what percentage of the investee revenues was represented by Aero? And then is there a kind of a new normalized run rate for the investment funds line that we should be thinking about?

**William Robert Berkley**
*Chief Executive Officer, President and Director*

Yes. Rich, do you have any comments, estimates, or...

**Richard M. Baio**
*Chief Financial Officer, Senior Vice President and Treasurer*

I would just say that the -- as it relates to the investment funds, there is a fair amount of variability as we've seen over the quarter. So I don't know that that's something we can really predict or provide guidance for.

**William Robert Berkley**
*Founder and Executive Chairman*

Yes, I mean, it changes substantially quarter to quarter. And it's not -- it doesn't model particularly well.

**Lawrence David Greenberg**
*Janney Montgomery Scott LLC, Research Division*

And the Aero as a percent of total investee revenues?

**William Robert Berkley**
*Founder and Executive Chairman*

The answer is -- I can't tell you, but if you call Rich Baio up tomorrow, we can give you the answer to that. I don't know offhand.

**Operator**

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

**Jay Adam Cohen**
*BofA Merrill Lynch, Research Division*

A couple of questions. First, the buyback activity. I guess, given the accelerating top line growth and also given the added debt, is it reasonable to expect buybacks to be fairly close to nil in the near term?

**William Robert Berkley**
*Chief Executive Officer, President and Director*

Jay, I think, first of all, the trust preferred that we issued, while it looks like debt, as far as our room in our basket, we get equity credit for that. So just wanted to clarify that. In addition to that, while certainly, the growth is there at this stage, we are generating a fair amount of capital. And we think that we're well positioned to have, over the coming quarters, barring the unforeseen event, flexibility as it relates to special dividends, repurchase of debt or repurchase of equity or stock. As you've heard from our Chairman in the past, our approach to returning capital to shareholders varies, and it all depends on what we think is the most appropriate at that moment in time. But we do think that there will be capital in all likelihood available to return to shareholders over the next several quarters.

**Jay Adam Cohen**
*BofA Merrill Lynch, Research Division*

That's great. That's helpful, Rob. Second question, you talked about some of the pricing trends that you're seeing. I'm wondering if you could talk about what you're seeing from a claims standpoint. And I guess, to highlight one line of business, workers' compensation, specifically, what you're seeing from a claims standpoint there?

**William Robert Berkley**
*Chief Executive Officer, President and Director*

Generally speaking, we continue to be pleased with the frequency trends there. There are some outliers. I referenced Florida earlier as a place that, personally scares the daylight out of me as you may be aware. They are basic -- what they are doing -- basically, what they are doing is retroactively, they are changing the benefits and fees. And as a result of that, what people thought their loss cost were, those are changing. So the idea of loss cost and what people had thought they were when they priced the business may not prove to be reality.

**Jay Adam Cohen**
*BofA Merrill Lynch, Research Division*

That's on workers' comp, but any other lines of business where the claims trends are surprising to you at all?

**William Robert Berkley**
*Chief Executive Officer, President and Director*

There's nothing that's outstanding, but I think as we've commented in the past, we continue to see potentially early signs of an uptick amongst the plaintiff bar and how well organized and focused they are and has, again, come through in the comp line and we're seeing early, early signs that it may present itself and other lines. Certainly not at the point that anyone should hit the panic button, but from our perspective, it's something we're paying attention to.

**Operator**

Our next question comes from the line of Ian Gutterman with Balyasny.

**Ian Gutterman**
*Balyasny Asset Management L.P.*

Actually, can I ask you still on that last answer about the Florida comp? I just want to make sure I've understood my reading of the issue. Can you just give me a sense -- I know obviously a lot of the concern is on the new business. But my understanding is it also applies to any sort of open inventory essentially of unclosed claims. Can you just give a general sense of somewhere in workers' comp in the state of Florida, how much of their essentially back reserves might be exposed to this?

**William Robert Berkley**
*Chief Executive Officer, President and Director*

Yes. Honestly, I'm not the Florida comp guru. There are other people who could opine on this. We do not have a lot of exposure there. I think we have a whopping $5 million or so of premium. So it's not a big deal for us. But what I have heard -- and again, don't go on this please, check it out yourself, but it is retroactive. It is on claims that are open, and I've heard some commentary where there are some people that are actually trying to open old claims. So this could potentially be quite meaningful. Again, I am not the expert. I would encourage you to talk to others and, quite frankly, a great resource is an NCCI.

**Ian Gutterman**
*Balyasny Asset Management L.P.*

Exactly, exactly. Great. And then just most of my other questions were answered. I guess, just one thing to pile of the aviation questions. I think the reason people are asking so much is just it's a hard line to model, as you guys say. And just, it would be unfortunate if you were to miss next quarter or Q4 or whatever it is for something you could disclose in advance on the aviation. So if there's any color, maybe you can put in the Q that will help us model, that would be much appreciated.

**William Robert Berkley**
*Chief Executive Officer, President and Director*

It's hard to give you an answer when we don't know it.

**Ian Gutterman**
*Balyasny Asset Management L.P.*

No, I understood, I understood. I just --

**William Robert Berkley**
*Chief Executive Officer, President and Director*

Part of it is we don't lose the earnings till we close. We don't know the date that we close. So that's a starter for why we don't know the answer. So there's lots of reasons. We're not avoiding the answer, we just don't know it. Giving the wrong answer generally gets people a lot more unhappy.

**Operator**

Our next question comes from the line of Jamie Inglis with Philo Smith.

**James Inglis**
*Philo Smith & Co.*

Rob, I just started the call. With the company sort of in interesting times and I'm trying to get a sense of where you think we are? Meaning, if you look back over 10 years, you guys have had ROE of 14%, you've had book value per share growth, nicely double digits. What to you is the most important metric? And what do you think about your ability to achieve that over the next 10 years?

**William Robert Berkley**
*Chief Executive Officer, President and Director*

Okay. I think, ultimately, we believe our model has worked well. And we think the fundamentals of that model will continue to serve us well, and that is really a focus on expertise and a focus on parts of the market where expertise that are the great differentiators. And we continue to do that as we build out new operations, and we continue to invest from the perspective in our existing operations and bringing in new talent. So clearly, there are a lot of variables, a lot of questions as to how the business will operate over the next 10 years, and that ranges from predictive modeling to analytics to how product in many parts of the marketplace will be distributed. And the list goes on from there, but fundamentally, we choose to participate in parts of the market that are not easily commoditized. We want to participate in parts of the market, where it's people and expertise that makes the difference. And we believe that approach has served us well, and we believe it is applicable going forward.

**James Inglis**
*Philo Smith & Co.*

Can you speak to the question about sort of metrics and what do you think is the most important things to you?

**William Robert Berkley**
*Chief Executive Officer, President and Director*

We focus on risk-adjusted returns. All returns are not created equally, and we try and evaluate the risk that we're taking on and whether an appropriate return is associated with that. Ultimately, we are focused, obviously, going hand in hand with risk-adjusted return, ROE.

**Operator**

[Operator Instructions] Our next question comes from the line of Josh Shanker with Deutsche Bank.

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

Can we talk a little bit -- election season is coming up, about what you think the chances are for Bipartisan Tax Reform?

**William Robert Berkley**
*Chief Executive Officer, President and Director*

You know what, in addition to being Chairman, our Chief Economist, he's also our Chief Lobbyist. So I'm going to yield to him on that one as well.

**William Robert Berkley**
*Founder and Executive Chairman*

Tax reform. I don't know who's going to be elected President. Probably, either of the above would be a good outcome. I have no idea whether we're going to get tax reform or not. I think that the reality is that the tax system is not working, not just for the insurance industry, but for lots of parts of corporate America and how people behave or what people do. Will we get tax reform? We sure should. We need it. I spent last time in Washington as I become less enthusiastic about something happening. Last week, I spent time with a lobbyist and talked about it. He was more optimistic because as they don't have much choice. So I'm slightly more positive than I was 2 years ago, but you surely can't bet on it.

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

And what about in the U.K.? I heard the rumblings of that U.K. taxes might come down maybe benefiting Lloyd's and whatnot in order to compete with the EU.

**William Robert Berkley**
*Founder and Executive Chairman*

They're talking about lowering the tax rate in the U.K. from 25% to 20%, but they -- I think they're talking about a lot of things in the U.K. They haven't yet turned in their resignation from the EU, and we don't know what's going to happen there. So I think there's a lot of uncertainty. We don't -- I'm just sort of trying to keep our company in a position so we have the optimal level of flexibility. It's why we have an EU domicile company as well as U.K. domicile company. We're just trying to sit here to be sure we can do the best for our shareholders for the best return. It's why we're investing in different kinds of things in fixed income securities because we couldn't get great returns that way. And we're just trying to be as nimble as possible and so we feel like we have some way to judge the future, and it's pretty comfortable.

**Operator**

And our next question is a follow-up from the line of Kai Pan with Morgan Stanley.

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

Just a number question. The $60 million [ph] reserve release that can you put it down into the insurance and reinsurance segment?

**William Robert Berkley**
*Chief Executive Officer, President and Director*

Yes. Generally speaking, we don't get into that detail in the call. It will be in the Q as it is -- as it has been in the past.

**Operator**

I'm showing no further questions at this time. I would now like to turn the call over to Mr. W. Robert Berkley for any further remarks.

**William Robert Berkley**
*Chief Executive Officer, President and Director*

Okay. Andrea, thank you very much, and thank you to all that dialed in. Again, from our perspective, we think the business is particularly well positioned. We think the investment that we've made over the past few years and continue to think today are going to serve us very well over the foreseeable future. And as a result of our structure and the people that make up the organization, we are able to find opportunities and, for that, more specifically, very attractive opportunities to make good risk-adjusted returns when others that have a more traditional structure and perhaps are not as nimble are not able to identify these type of opportunities as easily as we believe we can. So again, thank you for calling in, and we look forward to speaking with you in about 90 days.

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