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W. R. Berkley Corporation NYSE:WRB

FQ4 2016 Earnings Call Transcripts

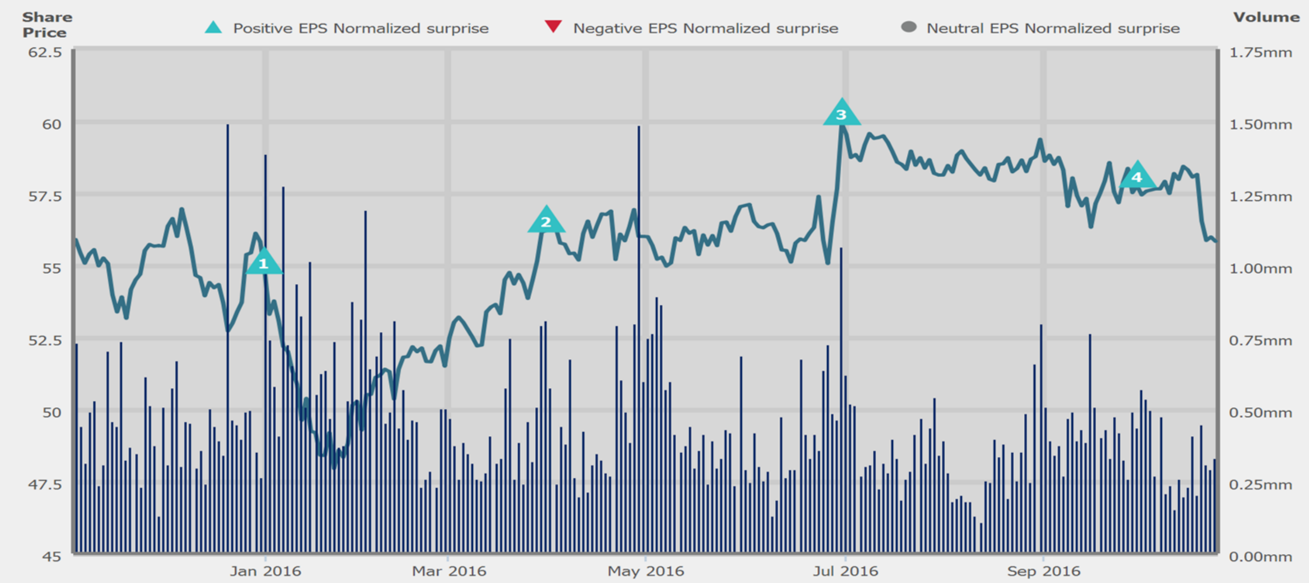
Tuesday, January 31, 2017 10:00 PM GMT

S&P Capital IQ Estimates

	-FQ4 2016-			-FQ1 2017-	-FY 2016-	
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	ACTUAL
EPS Normalized	0.80	0.82	▲2.50	0.88	3.38	3.40
Revenue (mm)	1610.70	1620.28	▲0.59	1633.10	6294.90	6293.35

Currency: USD
Consensus as of Jan-18-2017 8:00 PM GMT

Stock Price [USD] vs. Volume [mm] with earnings surprise annotations



	- EPS NORMALIZED -		
	CONSENSUS	ACTUAL	SURPRISE
FQ4 2015	0.80	0.89	▲1 11.25 %
FQ1 2016	0.85	0.89	▲2 4.71 %
FQ2 2016	0.76	0.82	▲3 7.89 %
FQ3 2016	0.84	0.88	▲4 4.76 %

Call Participants

EXECUTIVES

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

William Robert Berkley
Founder and Executive Chairman

William Robert Berkley
Chief Executive Officer, President and Director

ANALYSTS

Amit Kumar
Macquarie Research

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

Brian Robert Meredith
UBS Investment Bank, Research Division

Ian Gutterman
Balyasny Asset Management L.P.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Joshua David Shanker
Deutsche Bank AG, Research Division

Kai Pan
Morgan Stanley, Research Division

Ryan James Tunis
Crédit Suisse AG, Research Division

Presentation

Operator

Good day, and welcome to W. R. Berkley Corporation's Fourth Quarter 2016 Earnings Conference Call. Today's conference call is being recorded. The speakers' remarks may contain forward-looking statements. Some of the forward-looking statements can be identified by the use of forward-looking words, including without limitation, beliefs, 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 Jr. Please go ahead, sir.

William Robert Berkley
Chief Executive Officer, President and Director

Thank you, Andrew, and good afternoon, everyone, and welcome to our fourth quarter call. As usual, joining me on this end, we have Bill Berkley, Executive Chairman; Gene Ballard, Executive Vice President; and Rich Baio, Chief Financial Officer.

In addition to that, to be perfectly frank, we have, I don't know how many other people that seems to be well-poised and positioned to try and censor the 4 of us, but we'll see how they do.

The agenda for the call is I'm going to kick it off with some macro industry comments and I'm going to share with you some thoughts on our quarter, and following that, I'm going to hand it over to Rich, he's going to run through some of the numbers and highlights from the quarter as well. And then, over to all of you to answer any questions that you may have.

So on the macro front, it is clearly an interesting moment. In some ways, things are as expected. In other ways, it's not so clear. As far as under the category of as expected, our commercial lines insurance market continues to be incrementally more competitive. Comp is aligned, it's probably seeing the greatest level of erosion at the most rapid pace. In some ways, this isn't completely surprising given the margins that have been available there for some period of time and the action that many rating bureaus are taking across the country.

Our property remains very competitive. To a certain extent, this behavior continues to be empowered or enabled by the reinsurance market. Professional liability, it is a very broad line with so many different classes. It's difficult to use a broad brush. Having said that, there are some parts of the professional market that are exceedingly attractive, and there are other parts where people need to be quite cautious.

Commercial auto. While it does continue down a path of improvement, from our perspective, much of that marketplace still has a way to go. Casualty remains as the bright fold for at least for the moment. And finally, the reinsurance market remains as irrational as ever from our perspective. And quite frankly, it's a bit disappointing because every now and then, you see some green shoots popping through, and in relatively short order, it would seem as though somebody comes along and stop those out.

Other thoughts beyond the immediate market conditions that I'll raise, and I'm just going to run through this pretty quickly, to the extent it strikes a node or a nerve with anyone, happy to pick it up further during the Q&A. I guess #1 would be, quite frankly, we continue to be quite surprised by what one might refer to as the resistance that the insurance industry, particularly the commercial line P&C space continues to have towards change. Specifically, the struggles around embracing analytics and technology, as well as what would seem to be a lack of recognition for the change in consumer behavior.

Another area that we are certainly paying attention to is the role of federal regulation. We've seen that on the uptick over the past several years. Clearly, it is unclear as to what the position that the new administration is going to take as it relates to federal regulation's role and involvement in the P&C space. So we'll have to see on that one, but that is something, again, that we're focused on.

Interest rates and directionally where they're headed. We have seen some movement, and certainly there's good reason to believe that we'll see them moving up from where they are today. Obviously, for some, this creates a bit of noise in their book values stemming from the impact on their bond portfolio. For organizations such as ours that have gone out of their way to manage the duration and, quite frankly, keep it somewhat short, but also have a fair amount of leverage of investment income, when you look at our economic model, we think that we're particularly well-positioned.

One more topic that I'll put out there, which is a topic that I think is getting an increasing amount of attention recently, and is near and dear to my boss' heart is the topic of tax. Clearly, there is a lot of noise or a lot of discussion around a lower corporate tax rate in this country. We, along with many others, would benefit from that. I think, the other component, which is perhaps in some ways a little less clear, is what is the impact going to be as a result of tax reform on companies in the marketplace that are not domiciled in the United States. Many companies that participated in the U.S. P&C market have benefited from being outside of the United States, and the question will be whether that benefit will continue going forward, or whether that is something that perhaps may change or be impacted by decisions and actions coming out of Washington.

Let me turn it over to the quarter. And again, I'll keep this pretty high-level. Rich is going to get you into the weeds as far as the numbers go. Top line, the growth flowed. It was really driven by a spike in competition in the fourth quarter. It's hard to say for sure, some might speculate it's as a result of many market participants trying to hit their budget. Early returns on January, and we don't have perfect visibility for January, let alone the quarter, let alone the year. From our perspective, there's a reasonable chance that we're going to see our insurance build start to recover. Having said that, as far as the reinsurance component of our business, we do not see that, quite frankly, growing in '17, and there's a better-than-average chance that we'll see it fall off further from where it is.

As I've suggested, the reinsurance market continues to be astonishingly competitive, and we are not going to view that marketplace through rose-colored glasses. Loss ratio was adversely impacted by tax. So approximately, the $237 million in the quarter. Matthew and Tennessee wildfires were the big contributors there. Again, Rich is going to give you some detail on that, that was partially offset by positive reserve development of approximately $17 million. And my understanding is that this is the 40th quarter in a row of net positive development. And I think, again, that speaks to our approach of wanting to be measured when we set our loss picks. And as they season out, then we are prepared to adjust our views.

Briefly on the expense ratio as well as corporate expenses, they did pick up in the quarter. It was not surprising to us, given some of the new initiatives. Some of which we have announced, some we have not announced at this stage. As a reminder, as far as expenses go, businesses that are in their infancy and have not started to write business, we hold those expenses at the corporate expense level. Once businesses are operational, and our definition of operational are writing business, then that will come through in the expense ratio.

And then, finally, just a quick soundbite on the investment portfolio. Terrific quarter, fired on all cylinders, both the bond portfolio, by and large weathered pretty well. In addition to that, our funds performed particularly well. And finally, one of our private equity investments, specifically HealthEquity, we recognized some gains in that position. And in addition to that, Rich is going to talk to you about some other impact on our balance sheet as a result of our holdings dipping down below 20%.

As people know, we have made efforts over the past couple of years to expand our activities in the alternative investment area. In many cases, I think, some have struggled with it from a modeling perspective because it doesn't model as easy, it's a little bit lumpier. Having said that, folks that are responsible for that part of the business have done a great job. And in spite of the fact that it's a little lumpier, clearly, the risk-adjusted returns have been great.

So I'm going to pause there. I'm going to hand it over to Rich. And again, once he's through, you have all 4 of us to answer any questions that you may have. So Rich, if you would, please?

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

Great. Thanks, Rob. For the fourth quarter, we reported net income of $153 million or $1.20 per share, that compares with the prior year's net income of $110 million or $0.85 per share. The growth of 39% in net income was due to an increase in realized pretax gains of $86 million, primarily from the sale of a portion of common shares in HealthEquity and to an increase of $32 million in pretax net investment income. Those increases were partially offset by a few items, including lower underwriting income, which was impacted by the cat losses, as Rob alluded to earlier. Lower income from noninsurance business is largely due to the sale of Aero Precision's operations in August this year, higher startup costs associated with the new operation. Once again, Rob had alluded to this earlier where a certain of our operations are included in the corporate expenses like Berkeley 1, or high net worth, as many of us refer to, and other yet to be announced companies. Higher interest expense due to the repositioning of our capital structure we undertook earlier in this year, which we had alluded to on some of our earlier calls. And finally, to a decline in insurance service process. Our operating income for the fourth quarter was $104 million or $0.82 per share compared with the prior year's operating earnings of $115 million or $0.89 per share.

Overall, our net premiums written increased 0.7%, slightly more than $1.5 billion. The insurance segment grew about 1% to approximately $1.4 billion, while the reinsurance segment declined 1.2% to $145 million. The growth in insurance segment was led by a 12% increase in our professional liability business, offset by a decline in commercial automobile due to continued inadequate rate environment in certain areas of this market.

For the reinsurance segment, the increase in properties net premiums written, largely offset the decline in the casualty business. As Rob referenced in his comments, the reinsurance market continues to be competitive, and we've maintained our disciplined approach of deploying capital on a risk-adjusted basis.

Our overall pretax underwriting profit decreased $24 million quarter-over-quarter from $106 million to $82 million due to higher cat losses in the current quarter. The cat losses increased $26 million over the prior year's quarter to $37 million.

The accident year loss ratio before cat losses was 60.1% compared with 60% a year ago. The cat losses represented 2.3 lost points since fourth quarter 2016 compared with 0.7 lost points in 2015. The 2 significant cat events were Hurricane Matthew and the Tennessee wildfires, as Rob referenced. They totaled $18.5 million and $15 million, respectively. Loss reserves developed favorably by $17 million, representing a $2 million increase over the same period a year ago. That gives us the calendar year loss ratio of 61.3%, an increase of 1.5 lost points from a year ago.

Our overall expense ratio for the fourth quarter was 33.6% compared to 33.3% in the fourth quarter of '15. The insurance segment expense ratio was 33%, which is an increase of 0.40 point from the fourth quarter of '15. The increase in the expense ratio for the insurance segment was due to the addition of new operations, in particular, Berkley Cyber Risk Solutions and Berkley Transactional were added to the insurance segment in the quarter. These were preannounced. We expect that these operations will develop further in the near future and begin to contribute underwriting profit for the company.

We're also expanding business in certain international geographies as well as domestic opportunities that are still early stage in development and also contributed to the elevated expense ratio. Examples include the expansion in Latin America and the Asia Pacific region.

The reinsurance segment expense ratio decreased 0.9 percentage points to 38.5%, which reflects the higher increase in earned premium relative to underwriting expenses. In pure dollar terms, the underwriting expenses increased by 10%, while net premiums earned increased by 12.7% quarter-over-quarter. This decline reflects the increased net written premium earning through from prior quarters. That brings our combined ratio to 94.9% for the fourth quarter of 2016, which compares with 93.1% from the same quarter a year ago.

Investment income increased approximately 25% or $32 million to $159 million, resulting from a few main contributors. First, income from fixed income securities was up about $8 million to $109 million, with an annualized yield of 3.2%. The most significant contributor to the growth in fixed income is the larger investment base. Second, income from the investment fund increased $27 million compared with the year-ago quarter, which was primarily attributable to investments in energy and real estate funds. And finally, earnings from loans receivable declined $4 million, resulting from the maturity in payoff of certain loans in the portfolio.

At December 31, 2016, after-tax unrealized investment gains were $427 million, representing an increase of $246 million from the beginning of the year or approximately 136%. The average rating was unchanged to AA-, and we shortened the portfolio from 3.3 years at December 2015 to 3.1 years at December 31, 2016. The overall tax rate was 33.7%, which increased primarily due to the significant net investment gains in the quarter and higher state income taxes. The realized gains in the quarter primarily related to the sale of a portion of our common shares in HealthEquity, which as a reminder, was not previously reflected in stockholders' equity. That gives us net income of $153 million and an overall return on equity of 13.3% on an annualized basis. And for comparison purposes, a pretax return on equity of 20.2%. Book value per share increased $1.17 to $41.55 in the quarter, representing an annualized increase of 11.6% and the full-year growth in book value per share of $4.34 were also 11.6%.

In the quarter, we also returned $109 million to our shareholders through special and ordinary dividend as well as repurchased approximately 575,000 shares of common stock. In addition, book value significantly grew due to the realized gains from the partial sale of shares in HealthEquity and unrealized gains on the remaining interest, which changed to an available for sale security. This growth was partially offset by a reduction in net unrealized gains in our fixed income portfolio due to the rise in interest rates during the quarter. Thank you.

William Robert Berkley
Chief Executive Officer, President and Director
Thank you, Rich. Andrew, so at this time, we'd like to open it up for questions, please.

Question and Answer

Operator

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

Kai Pan
Morgan Stanley, Research Division

The first question, Rob, I'll just follow up the tax reform. If the tax rate were to go down to, for example, 20%, how much of these sort of earnings accretion do you think will be retained? And how much do you think would be either reinvested in the business or be [indiscernible] away?

William Robert Berkley
Chief Executive Officer, President and Director

No different than how we manage our capital account. When people have asked about our approach to repurchasing stock or dividends or so on, we try and look at what our needs are to operate the business, what our needs for capital are. Ultimately, with this additional earnings, then the question is do we need to hold on to it, or do we need to give it back, or is there an opportunity to return it to shareholders. So I think, we're hoping that we have the problem where we have a lower tax rate and we have more earnings to either grow the business or return to shareholders.

Kai Pan
Morgan Stanley, Research Division

Okay. And then, the following question is really on your core loss ratio as well as expense ratio. Given the sort of you said the market becoming even more competitive. What's the inflation trend? Do you think that these underlying loss ratio will maintain at current levels? Or could there be some deterioration? And on the expense side, looks like this quarter is higher than the prior 3 quarters in 2016. Shall we sort of looking forward to be kind of looking full-year basis? Or do you think the current run rate is a good number for 2017?

William Robert Berkley
Chief Executive Officer, President and Director

Yes. So the 2 pieces there, let me touch on the loss pick first. So as far as the loss ratio or the margins, I think, on an apples-to-apples basis in the industry, certainly, for much of it, rates are going down. Having said that, I think, the 1 variable that you didn't touch on, which we are very focused on every day at every level, is selection. So I don't envision, generally speaking, that just because we are seeing some, what I would say, modest incremental growth in rate pressure, that one should naturally just assume that will straightly translate to a higher loss pick because, again, we are constantly combing through our book and making sure that we are optimizing. And many of the things that we are working on internally, I think, could more than offset anything you see happening with rate. As far as the expense ratio goes, as Rich commented, I offered a thought on as well, a lot of it has to do with what we have in the hopper and what we have in the incubator, and those are the big drivers as far as where the expense ratio came in for the quarter and the impact on corporate expenses. So obviously, for example, as Rich mentioned, Berkley One, our entry into high net worth, that is a meaningful component to corporate expense. Some of the other growth or new initiatives that Rich had mentioned that are already up and going, those are having a significant impact on our expense ratio. So what I would tell you is that I think it's possible that by the end of, or towards the end of this year, it's possible that you will see our corporate expenses coming down and maybe our expense ratio itself will be treading water or it might even pick up ever so modestly from here. So again, I appreciate what you're trying to do in the complexities and trying to get your head around the -- in the lack of visibility, but this is all driven by new initiatives that we think are going to bring value to shareholders over time.

Operator

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

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

Just on the -- back to the expense ratio. I know you mentioned that things that are in the incubator won't directly impact the expense ratio. I guess, when high net worth does go live, what type of expense ratio impact should we expect at that point?

William Robert Berkley
Chief Executive Officer, President and Director

The answer is that we haven't really published it. At this stage, the impact, we'll have to see, but it certainly would raise it. At the same time, we don't know some of the businesses that are already sort of under the category of expense ratio, how they will be maturing. Our expectation is that many of the younger businesses or businesses that are operational but in their infancy will have gotten some traction, their earned premium will be kicking in, so that would be moving the expense ratio down. But if you're looking for a specific dollar amount or number of basis points that high net worth is going to have on the expense ratio, that's not something that we have to share today.

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

Okay. That's helpful. My other question, obviously, interest rates still have a way to go up. But as they do go higher, does your investment appetite or does your investment strategy change from where it is today, just given that you've obviously gone more into the capital gains-oriented approach now that interest rates are low?

William Robert Berkley
Founder and Executive Chairman

This is Bill. The answer is we have gone into cap gains, which was a very limited amount of our portfolio. And we don't buy things to own forever for the most part, although there may be some things that we own forever, and we make decisions based on the environment and our examination of how we look ahead. So that will depend on not just interest rates, but inflation and uncertainty. So for example, we moved more money into the real estate marketplace when real estate was not particularly attractive, we may choose to be less involved in real estate. We move into certain industrial areas when that was unattractive, we may be less or more. So it's a judgment we're constantly making. At this point in time, we think inflation is going to be modest and interest rates are going to go up modestly, and we'll continue to try and find opportunities that are attractive. But industrial opportunities will become more attractive if interest rates and taxes go down. So obviously, that's the offset there. So bottom line is we will probably continue with our current balance, may move our nontraditional bond portfolio a little bit. But we do expect tax rates to go down a little, and interest rates to go up a little, and inflation to move up a little, which would mean we're not likely to increase our fixed income investments, we're likely to keep short of the balance we have.

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

And my last question, just kind of an extension of Kai's question on taxes. So I guess, to what extent would you expect your underwriters' appetite to change, and that if are they evaluated on pretax underwriting income? Or they get evaluated on an after-tax basis? Sort of what extent do tax rate changes make them more aggressive?

William Robert Berkley
Chief Executive Officer, President and Director

So from my perspective, and I believe my boss' perspective, first of all, underwriters, we are focused on making a reasonable risk-adjusted return and they are focused on making an underwriting profit. And we, collectively with the management team of each operation, figure out what the right level of margin or underwriting profit is. As far as the impact on tax and that changing our targets, I think, it's more likely than not it's going to be actually turning that on its head. I think, what there's a real possibility is you're going to see companies that are based outside of the United States that all of a sudden find themselves paying a higher tax rate than they have historically are then to examine what their underwriting margin is and whether they need more underwriting margin in order to make their economic model work because their tax benefit is eroded or eliminated.

Operator

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

Joshua David Shanker
Deutsche Bank AG, Research Division

I want to talk a little about the commercial auto market. I see premiums pull back. It's obviously probably the place where you're getting the best rate. So can you talk a little bit about where rate is and how much volume you're losing, I guess? And I assume this is intentionally. And why now, maybe this is a time to grow in commercial auto given that there's pricing there?

William Robert Berkley
Chief Executive Officer, President and Director

So I think there were a couple of questions in there, Josh, so if I missed a couple of them, just let me know. First of all, it is true that our business has shrunk in the commercial auto space. And I would suggest to you that from an exposure perspective, we shrunk even more than it appears in the release because you got to remember, we're getting significant rate increases and we're still shrinking, so that's perhaps an indicator to you as to actually the exposure is down even more than you might think at first blush. As far as the market goes, and apologies if I gave the wrong impression, our view is that it has finally touched bottom and it is moving in the right direction. We certainly do not believe that by and large, the commercial auto space is a hard market or anything approaching that. Having said that, it is one of the few lines where it seems like rate increases are outpacing trend as opposed to some other lines of business where rate increases are treading water with trend, or maybe in some cases, the product line is losing altitude. So from my perspective and, I think, my colleagues' perspective, it is by and large, for primary commercial auto, better than it was yesterday, but not attractive enough from our perspective that we want to open up the spigot yet, and we'll have to see if it gets to that point. Quite frankly, we saw a lot of momentum in the commercial auto space as far as people willing to push for rate up until December, and then we look at December and we were surprised by the level of competition that seem to step back into the market. So we are cautiously optimistic. What didn't I answer?

Joshua David Shanker
Deutsche Bank AG, Research Division

Has the market maximized its sense of pain over that market yet?

William Robert Berkley
Chief Executive Officer, President and Director

I don't know the answer to that. I can't speak for others, but it would seem as though if we've -- I can't put myself in other people's shoes, Josh, I don't know what's going through other people's minds. Clearly, there -- for much of '16, there seems to be a recognition that things need to tighten up, people needed more rate. And hopefully, that will continue to '17, but we'll have to see what happens.

Joshua David Shanker
Deutsche Bank AG, Research Division

And the exposure that you are losing, is that because it's being bit away, or that's because you're walking away?

William Robert Berkley
Chief Executive Officer, President and Director

Both. Oftentimes, they go hand-in-hand. We say this is the rate we need and somebody else will come along and do it for something materially less. Sometimes, we'll look at the exposure and we say we just don't like the exposure period.

Operator

Our next question comes from the line of Amit Kumar from Macquarie.

Amit Kumar
Macquarie Research

Maybe just a couple of question. First of all, just going back to the discussion on U.S. corporate tax rate. I guess, what we're trying to figure out is if the tax rate goes down, does the benefit get computed away based on your comments regarding the competition? And I guess, what you're saying is it might be a more blended outcome. Is that a fair way to look at it? Or how should we be thinking about that?

William Robert Berkley
Chief Executive Officer, President and Director

Well, I'm going to yield to our Chairman here who has strong views on the topic.

William Robert Berkley
Founder and Executive Chairman

I think the answer is we believe we have a President and a legislature who's very conscious of the fact that we shouldn't have a tax law that gives preference to non-U.S. entities, and that is what the insurance law -- tax laws do at the present time. So 2 companies who write U.S. business, 1 offshore and 1 domestic, the company offshore pays substantially less to no tax. So we think that will benefit us because we think this President and this legislature will recognize that sometime over the next 12 months and level the playing field. So that will not lower -- likely, that part will not lower our tax, but will raise the tax of our competition. The overall, U.S. tax rate, we think, will go down, which will benefit us. So we would expect there'll be probably a continuing same amount of competition at a lower tax rate.

Amit Kumar
Macquarie Research

Yes. So Bill, if I go back, in the past, you were involved with -- there was a coalition for a domestic insurance industry, then there was a, I think, a council for competitive insurance rates. I'm curious...

William Robert Berkley
Founder and Executive Chairman

Right.

Amit Kumar
Macquarie Research

Will you be playing a similar role this time around?

William Robert Berkley
Founder and Executive Chairman

Well, we continue to have an American coalition for competitive insurance rates, and this group of American domestic companies continue to work hard to seek legislative solution to having level taxes, and we're confident that is something that the current administration and the current Congress is much more receptive to than in the recent past. Those jobs, those people and that capital paying a fair rate of tax to the U.S. is the objective. So yes, I expect that we will continue, I will continue, and we think we have substantial support in the United States property and casualty industry who will work with us in this process.

Amit Kumar
Macquarie Research

Got it. And then, the only -- the final question, I will make this quick. Just going back to the discussion on Berkley One. Obviously, we're now getting close to the launch date in the second half of 2017, and I know we have talked a lot about this in, I guess, May or June 2016 when this was being set up. Now that this is clearer, closer to being launched, how should we think about sort of the mid and the short-term and the long-term opportunities? Should we as outsiders expect an immediate ramp-up for the product? Or is there sort of it's like a slow slope, which will last for few quarters before the premiums are more apparent to us?

William Robert Berkley
Chief Executive Officer, President and Director

The answer is that it is going to be a gradual build as the business rolls out, and it will build momentum over some number of quarters. As we suggested in the past, we think, over time, it can become a meaningful part of the business, but this is not a situation where one just flips a switch, so to speak, and all of a sudden, a large business pops out of a box. So there will be a ramp up period of time as it scales and that will take quarters, and ultimately, years as it grows and develops out.

Operator

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

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Let's see, several questions. Rob, you had mentioned an increase over the past several years in federal regulation. We generally think of this industry as being state regulated. I'm wondering, are there any regulatory issues at the federal level that have been burdensome that may potentially go away or go down with the new administration?

William Robert Berkley
Chief Executive Officer, President and Director

Jay, from my perspective, I think that ultimately is just a question for the industry to try and to figure out who its regulator is or who they are, who its master is to a certain extent, and who sets the rules, and that's fine. I think, over the past several years, as [indiscernible] got some momentum, there were certain situations, such as equivalency, that popped up that created a little bit of confusion for market participants as to who was doing what, as to what would be managed at a state level/by the NAIC and what was the roles for Washington. Obviously, with the new administration, we'll have to see what the view is as to, again, the role that Washington should play in the property and casualty insurance industry.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Got it. Next question, given the rise in interest rates, I'm wondering if you can tell us what your new money yield is relative to your portfolio yield at this point?

William Robert Berkley
Founder and Executive Chairman

The new money yield is still probably 50 basis points under our average portfolio yield. So even now, our new money is not going to give us where we are. But that's also in part because we're keeping a short duration. If we were more confident about inflation and interest rates and we pushed our duration out to the longer side of our liability duration, it'd be closer to a match than it is right now. But right now, keeping with that 3, 3.75-year duration, we're still coming up short. The offsetting feature to that is both our capital gains and our increasing size of the portfolio, which is giving us more investment income.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

That's really helpful. And the last question, I guess, back on the tax side, maybe a potential benefit for your reinsurance business, but if you as companies are going to be -- obviously, buy a reinsurance from offshore entities. Do you see the border adjustment playing a role and possibly making it more expensive to buy from offshore reinsurance companies for, again, domestic insurance companies?

William Robert Berkley
Founder and Executive Chairman

First of all, Jay, I don't think anyone at this point knows what the tax posture is going to be. I think, if you go to a border adjustment plan, the most likely event, in our opinion, would be most of the major foreign insurers, reinsurers would open U.S. subsidiaries, and that would take care of the problem. The U.S. represents, give or take, 40% of the property and casualty business, and I think that would probably be the real outcome. But I think we're a long way at this point from knowing what the tax equalization structure will be for these kinds of things.

Operator

Our next question comes from the line of Brian Meredith from UBS.

Brian Robert Meredith
UBS Investment Bank, Research Division

A couple of questions here for you. Rob, just given your comments about the competitive reinsurance environment, particularly on the casualty side, are you seeing any opportunities to cede more business Away? Other companies, I think, are starting to do that.

William Robert Berkley
Chief Executive Officer, President and Director

We certainly are acutely aware from the perspective of ceding how competitive the market is. So we are conscious of that as far as the specifics around our reinsurance purchasing strategy, rather. That's, generally speaking, not details that we get into. But we are aware of the market conditions and we try and take advantage of that. At the same time, we're conscious of the fact that these reinsurers are our partners, and we are not looking to treat them as anything other than a partner.

Brian Robert Meredith
UBS Investment Bank, Research Division

Got you. I was just wondering if there was an opportunity to help your expense ratio as you grow out some of these businesses with reinsurance.

William Robert Berkley
Chief Executive Officer, President and Director

No, it's certainly something that we look at. Having said that, some of the -- the ceding commissions are attractive, but we think the businesses that we're building and growing, we think they're pretty attractive, too, but we do look at quota share structures to try and give us a little bit of relief.

Brian Robert Meredith
UBS Investment Bank, Research Division

Great. And the next question is for you and Bill. One, just can you talk a little bit more what you're seeing with respect to loss cost inflation? And two, the reason I bring it up, we've seen more and more companies buying these adverse loss reserve development covers, which I seem to remember, was starting to happen back in the late 1990s. Maybe your perspective on that?

William Robert Berkley
Chief Executive Officer, President and Director

Well, my two cents is, well, it's kind of funny, Brian, that you bring it up because the 2 of us were just chatting about that the other day as to are these signs of something else to come. Clearly, if you look at the accident year loss ratios, there are a lot of challenges that exist in the market. We have and continue to believe that there are a lot of pain that just hasn't come into focus potentially. And if you actually backed out or normalized for cat activity and people stopped living off of prior year development, which eventually it would seem as all they're going to need to, there are a lot of issues. If you -- so do I think that is going to turn into a situation like the late '90s and 2000? No. But do I think that there are some organizations that got a little ahead of themselves? Yes. And I think that there is some pain, and some of those companies that have some pain, I don't think that there's a lot of patience for volatility amongst their shareholders.

Brian Robert Meredith
UBS Investment Bank, Research Division

Got you. And then, last question for you. Back on tax, but more from a market perspective, do you think if we do get a reduction in the U.S. income tax rate, that some if not all of that will ultimately be computed away with respect to price?

William Robert Berkley
Chief Executive Officer, President and Director

No. I think, quite frankly, at this stage, it could go the other way, Brian, at least. And I can't speak to the whole market. But I can tell you, from our perspective, the number of competitors that we're in the ring with every day that are based outside of the United States, it's a significant percentage of the population. So a lowered tax rate for us and a higher tax rate for them, I think, is just going to force them again to really focus on their underwriting results and their core economic model. And quite frankly, I think, if anything, it's possible that could be a double positive for our shareholders.

William Robert Berkley
Founder and Executive Chairman

And Brian, it's Bill. I think, if you look historically as tax rates have changed, just like portfolios when change, companies haven't change their underwriting strategies when the taxes have changed. They've continued underwriting either brilliantly or terribly, but not because they haven't changed their attitudes because of taxes.

Operator

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

Ian Gutterman
Balyasny Asset Management L.P.

My questions were largely covered, but maybe if I'd just clarify a couple of things. Bill, just to clarify on offshore tax, I guess, how I read the bills that are -- the various bills that are out there, it's very unclear how financial firms will be treated in things like a border tax and some of the other proposals. I guess, what gives you confidence something will be done about offshore financial companies as opposed to just foreign manufacturing and retailers and things like that? It seems some people think that financials would be excluded from some of the stuff and maybe not a whole lot changes, unless we get a remake of the neo bill.

William Robert Berkley
Chief Executive Officer, President and Director

Well, I think that, certainly, there are lots of people, especially those people located in the Bermuda and Ireland and other places, that would like to put forth a view that, that's the case. I think that if you look at what the administration has put forth is they don't want U.S. business enterprises to be at a competitive disadvantage because you are located from a legal enterprise structure offshore. There is no enterprise that would be more suited to their concerns as a property and casualty insurance business. We have been able to persuade almost everyone we see, although one never knows where the world goes, and we believe that it's obvious the U.S. would not have written their tax law to benefit non-U.S. insurers. So we think, whether they include all financial companies or not all financial companies, we believe it is most likely that property and casualty insurance companies will be included in any bill that's put forth because it's so obviously designed in the current status to give non-U.S. companies a benefit and a competitive advantage. All you have to do is look at where all the money, the finance, the companies that are located in Bermuda and Ireland and wherever, the money all came from the U.S., goes offshore and then they pay no tax on the United States business that they bring over there.

Ian Gutterman
Balyasny Asset Management L.P.

I definitely agree. I just didn't know if Congress understood it is, I guess, what I was trying to ask.

William Robert Berkley
Chief Executive Officer, President and Director

I believe they do, and I think we have more people in support of the neo bill. But whether it's to border adjustment or the neo bill, we think that this administration understands that it's billions of dollars of revenue that would come and how it's introduced could in fact been maybe even tens of billions of dollars.

Ian Gutterman
Balyasny Asset Management L.P.

Understood. And then, how does it -- the other place I'm trying to understand how it would affect would be Lloyd's. And I guess, not so much on the tax rate being all that different post to reform, but just, again, if we do have a border adjustment, a lot of Lloyd's business obviously emanates in the U.S., what happens to Lloyd's in that environment throughout the U.S. risks they rate?

William Robert Berkley
Chief Executive Officer, President and Director

I cannot give you the answer because I don't know. I don't know how the border adjustment's tax rules would work. And in fact, Lloyd's has a U.S. trust fund that is really a very special entity. So while Lloyd's might have businesses that emanates in the U.S., in many ways, Lloyd's business goes into the U.S. trust fund. So Lloyd's might, in fact, not be stuck in the same problems of everybody else. But I don't know the answer, that was purely a hypothetical issue.

Ian Gutterman
Balyasny Asset Management L.P.

Okay. I understood. And then, just lastly, the other thing that's been going around, I mean, obviously, this administration is against -- is very protectionist. But China, I think, has come out and advocated against Chinese firms buying U.S. firms without sort of extra clearance. Does it feel like some of the M&A maybe starts to slow down, at least the foreign buyers starts to slow down because our President doesn't want it and the Chinese don't seem to want it and you're taking out a major source of buyers?

William Robert Berkley
Founder and Executive Chairman

I'm going to give a brief comment, and then Rob, who's been much more involved, they'll give you a better comment. And that is regulations and oversight of these things, having been around now for a long time, has rarely changed the direction, the economic factors dictate. So I think, everyone may have a view for the short term, but it won't change the dynamics of the economies. Rob?

William Robert Berkley
Chief Executive Officer, President and Director

I agree. I was out for a better answer.

Operator

We have a question from the line of Ryan Tunis from Crédit Suisse.

Ryan James Tunis

Crédit Suisse AG, Research Division

Just a few to clean it up, I guess. The first one, just in the insurance segment. If you guys can help us a little bit more just to understand what drove the slowdown in premium growth there? I mean, was it more new -- through new business opportunities, retention? And I guess, along those lines, is there a way to quantify the negative impact of rate?

William Robert Berkley
Chief Executive Officer, President and Director

Well, A couple of things. First of all, the renewal retention ratio, give or take, was hanging around where it's been. I think, it was just a tick shy of 80% for the group overall, but it was sort of in that neighborhood. What might be helpful, what page is this, Rich, in the release? We break out the growth -- on Page 5 -- I'm sorry, 6. You'll see at the top by line of business, which will probably give you a little bit of insight as to where it's growing. And by and large, it's -- new business is tough to come by, there are a lot of people out there with a pretty big appetite, and they want to grow and they seem to be doing -- well into doing it at thrice levels, it just don't make a whole lot of sense to us.

William Robert Berkley
Founder and Executive Chairman

I think, you should understand, a lot of people have budgets and run their business by budgets, which is not really how we run our business. So you get to the fourth quarter and people aren't going to meet their budgets and aren't going to get their incentive compensation. So that always happens in the fourth quarter, you get people seeing more aggression.

Ryan James Tunis
Crédit Suisse AG, Research Division

Understood. So maybe the fourth quarter growth rate isn't necessarily run ratable in the first half of this year?

William Robert Berkley
Chief Executive Officer, President and Director

Yes. As I suggested earlier, we'll have to see. Tell us what the competitive environment is going to be for '17 and we can tell you what we think the top line is going to look like. Having said that, again, as we touched on earlier, we don't have perfect visibility into January. And even if we did, that's not a perfect proxy for the first quarter or the year, but early returns in January were encouraging for the insurance business. As it relates to the reinsurance business, as we suggested, that's a pretty tough environment. We are being very selective, as we have been, and we will continue to be going forward. And I think, there's a better-than-average chance you're going to see that business shrink in Q1 of '17, and there's a good chance you'll see it shrink for the whole year.

Ryan James Tunis
Crédit Suisse AG, Research Division

Okay. And then, I guess, just thinking about catastrophes, I mean, obviously, there've been some pretty well-known events. But last few quarters, you guys have been hit a little bit more on cats than you would have been expected historically. I noticed that property reinsurance premiums have been up full year. Is there anything about your cat profile as we look into '17 that you'd say is different than it was potentially headed into this year?

William Robert Berkley
Chief Executive Officer, President and Director

No. When we look at our portfolio, it hasn't shifted. We haven't become more inclined to accept cat risk on a net basis. I think, what's really happened is the series of events, they've kind of, from our perspective, been in the no man's land zone, if you like. And what I mean by that is they were big enough to be aggravating and noised, but not big enough to meaningfully go into our reinsurance structure. Though in some cases, touched it, it hasn't really been a big enough event that is a notable industry event, and again, piercing through to all the towers that we buy.

Ryan James Tunis
Crédit Suisse AG, Research Division

Okay. And then, just one last one, maybe for Bill, on capital management looking out into '17. Is there anything, I guess, kind of about this no man's land with tax reform that makes you want to take a pause in terms of managing capital? Or is there any way that we should think about the mix being different in '17 versus '16?

William Robert Berkley
Founder and Executive Chairman

I think that you saw we paid a 2 $0.50 dividends last year, special dividends instead of $1 special dividends. It's because we're trying to get a better assessment, and the world is changing ever more rapidly and there's more uncertainty. We'll continue to be cautious trying to assess where it goes and we'll continue to search for opportunities. And we're going to make those judgments as the cost of capital is balanced with what we can do with the money and what the price of our stock is. And we are truly a company that's run with what we think is the best interest of our shareholders. And we make those judgments everyday just as though we own the whole company and we were thinking about in those terms. And so I don't think we're going to make a change or a strategic reconsideration. Every day, we get up and we say, what can we do that we think is best for our shareholders. And that's how we manage the business. And I expect it will continue that way, and Rob's feelings are exactly the same as is every senior officer here because every one of our people are 60%, 70%, 90%, 100% of their net worth is tied up in the ownership of W.R. Berkley stock.

Operator

[Operator Instructions] I'm seeing no other questioners in the queue at this time, so I'd like to turn the call back over to management for closing comments.

William Robert Berkley
Chief Executive Officer, President and Director

Okay. Thank you, Andrew, and thank you to everyone for calling in. From our perspective, it was a good quarter. Obviously, the top line, while it slowed down a little bit, in our opinion, certainly, the insurance business where our margins are more attractive at this stage than the reinsurance business. We think, you're going to see potentially an uptick in the growth in '17 from what we saw in the fourth quarter. Having said that, we'll have to see how much of that is offset by the reinsurance operation. When the day is all done, we are very focused on risk-adjusted return and underwriting margin, and if it means that margin isn't there, we are prepared to shrink the business. I think, the other piece that's worth mentioning also is we continue with the focus around total return for shareholders, and that's very much included in our approach on the investment front. They're, from our perspective, a means -- there is, rather, I should say, from our perspective, a meaningful pipeline of other gains that we will be harvesting. And as we take those gains and we have some visibility into how that's going to unfold over the next few quarters, we again think that, that is going to have a meaningful impact on the result of the organization. And in addition to that, while the gains are coming through, we continue to plant seeds and create new opportunities which we think will create gains in a more distant future.

And lastly, we went through the laundry list of macro issues, in particular, I think, the tax question has a lot of people's attention. While no one knows with great certainty exactly how that's going to play out, again, as we discussed earlier, clearly, a lower corporate tax rate in this country will work to our benefit and by extension to our shareholders' benefit. But in addition to that, I think, it would be a mistake for anyone to gloss over or brush off the potential impact for companies that are based outside of the United States and at least the apparent focus of the current administration to, as was suggested earlier, level the playing field.

So again, thank you for calling in, and we look forward to speaking with you in about 90 days. Good night.

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