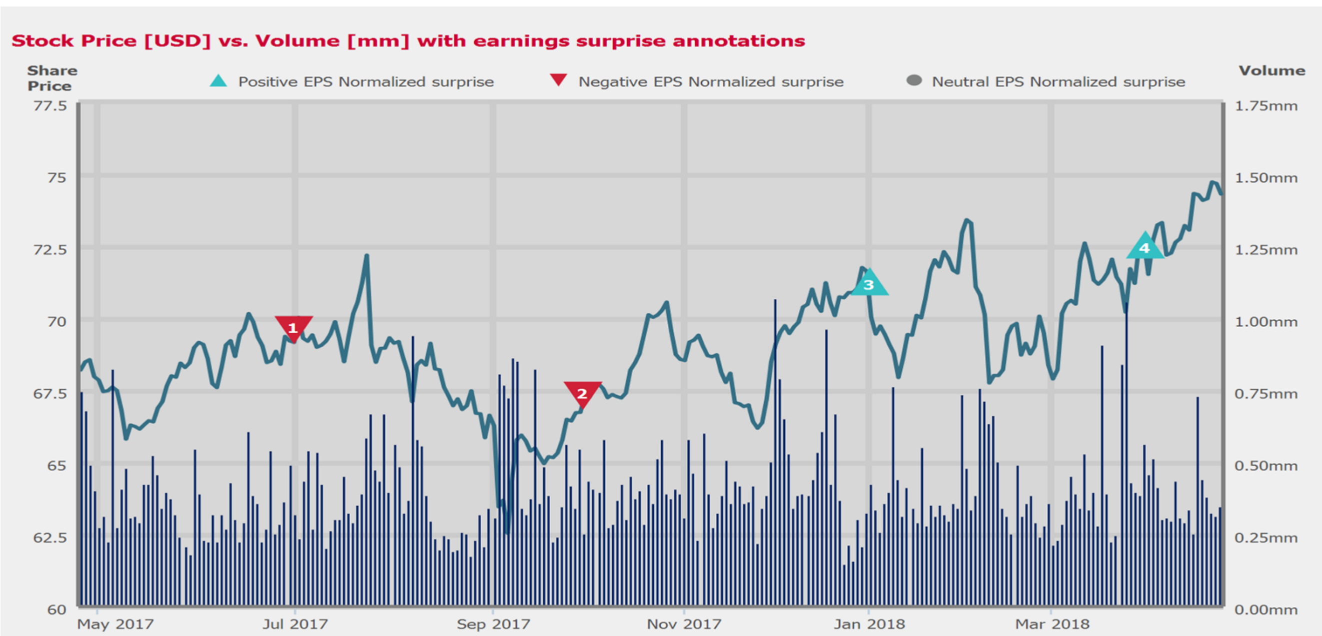
S&P Global
Market Intelligence

W. R. Berkley Corporation NYSE:WRB
FQ2 2018 Earnings Call Transcripts
Tuesday, July 24, 2018 9:00 PM GMT
S&P Global Market Intelligence Estimates

	-FQ2 2018-			-FQ3 2018-	-FY 2018-	-FY 2019-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.83	0.98	▲18.07	0.88	3.65	3.76
Revenue (mm)	1581.80	1581.05	▲(0.05 %)	1591.67	6338.68	6778.76

Currency: USD
Consensus as of Jul-18-2018 11:32 AM GMT



- EPS NORMALIZED -	CONSENSUS	ACTUAL	SURPRISE
FQ2 2017	0.77	0.65	▼1 (15.58 %)
FQ3 2017	0.27	0.23	▼2 (14.81 %)
FQ4 2017	0.73	0.74	▲3 1.37 %
FQ1 2018	0.89	1.00	▲4 12.36 %

Table of Contents

Call Participants

EXECUTIVES

Richard Mark Baio
Senior VP, CFO & Treasurer

William Robert Berkley
Executive Chairman of the Board

William Robert Berkley
President, CEO & Director

ANALYSTS

Amit Kumar
The Buckingham Research Group Incorporated

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

Brian Robert Meredith
UBS Investment Bank, Research Division

Ian Gutterman
Balyasny Asset Management L.P.

Kai Pan
Morgan Stanley, Research Division

Michael Zaremski
Crédit Suisse AG, Research Division

Yaron Joseph Kinar
Goldman Sachs Group Inc., Research Division

Presentation

Operator

Good day, and welcome to the W. R. Berkley Corporation's Second Quarter 2018 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, 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, 2017, 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. Rob Berkley. Please go ahead, sir.

William Robert Berkley
President, CEO & Director

Latif, thank you very much. And I think at this stage, your comments may be as long or longer than mine.

So thank you, all, for calling in, and welcome to our second quarter call. Joining me on this, and as usual, is Bill Berkley, our Executive Chairman; and Rich Baio, our Chief Financial Officer.

Similar to what we've done in the past, I'm going to start out with some macro comments with things that are on our mind as it relates to the industry, a couple of comments on some different product lines, and then I'll offer a few sound-bites on the quarter. And then I'll be handing it over to Rich where he will be getting into some more details on the quarter, and finally, we will be opening it up for questions. So that's the plan.

So as far as what's on our mind at a macro level, there are really 3 general topics that we wanted to discuss today. These are topics that we think are very relevant. They're not new or overly insightful, but we think they are important to the industry. And we are concerned because the industry is not known for its ability to change or to adapt.

Topic number one is inflation. Certainly, it's something that we have talked about in past calls. It's certainly something that others have discussed and you can't pick up a newspaper without reading about it or turn on the news and hearing about it. Lots of questions in the industry as to where the economy is going and what does this mean for investment portfolios, what will the impact be on loss costs. Obviously, much of the focus is around financial inflation. But in addition to that, we think that, as we've discussed in past quarters, it's important to give an appropriate level of consideration to social inflation. There is growing evidence, at least from our perspective, that there is an increasing frequency of severity and severity continues to be on the rise. There is growing evidence that we are living in a more litigious environment and it is undoubtedly the case that it will have an impact on loss costs.

One of the big issues around changing loss costs and inflation that comes in different flavors is the industry has not had to deal with this reality for some extended period of time. There are many professionals in the industry that have not had to operate, or during their career, they have not had to operate during an inflationary environment. Many actuaries, many underwriters, many people in other disciplines have never had to think about this as they consider what an appropriate rate is and as they think about selection. Obviously, it's not just rate alone, it's attachment point, it's terms and conditions, it's a variety of things.

Second issue that is certainly, quite frankly, is a bit of a pet peeve of ours, has to do with property. The insurance industry has made an art out of the buck floor. When cats occur, we have this ability to back the cat losses out. But ironically, the industry doesn't seem to back the premium route. There is a reality. Hail happens every year. Tornadoes happen every year. Earthquakes, hurricanes happen certainly more often than we would like. But we cannot ignore the reality when we decide what an appropriate risk-adjusted return is. We cannot back it out of the results just because it's convenient and it tells us an answer that we would rather have. Certainly, if you use us as an example, we generated 94.9% in the quarter. As Rich will walk through the numbers with you, I would love to be able to sit here and convince myself that actually it's more of a 94% or a 93.9% if you back out the cat. And if you back out weather altogether, it's a better number than that. But that isn't reality.

I touch on this not because, again, it's a new idea, that certainly isn't a different idea. Yes, I touch on it because it goes to this idea of change. And to the extent that the industry is not willing to accept the realities of, again, it's loss costs that stem from activities that are not every day, then that is a problem and that will get in the way of us selecting and pricing appropriately.

Third area that is worth mentioning and, again, it goes to the idea of change in the industry accepting reality and doing something about it, are the inefficiencies that exist in our industry. The number of pennies on every dollar of premium that are spent on other things than claims are overwhelming. This is not a sustainable reality. The combination of acquisition costs and internal costs are not something that's deciding our opinion will be willing to accept long term. Ultimately, we as an industry have a choice. We cannot just sit here and have carriers blame distribution and distribution blame carriers. This is a riddle that will be solved by the 2 parties working together, as we have mentioned in the past. But in spite of all the chatter about this throughout the industry, it's both shocking and disappointing how little has actually changed.

I mentioned these 3 topics again for no other reason than we view them as short- to intermediate-term issues that do need to be addressed. These are issues that, if they are not addressed, the world will find a way to come up with better solutions, whether it be as it relates to the expenses, whether it be to the use of capital or whether it be to a variety of other things. We as an industry need to change.

Pivoting over to some specifics on market in general at a more granular level, maybe starting with reinsurance. Let me bifurcate that between domestic as opposed to international. On the domestic front, property remains very challenging. Having said that, we continue to be cautiously optimistic that the casualty and the professional markets are showing early modest signs of improvement. Certainly, accounts that have had severe loss activity or new accounts, there seems to be a shift in the pricing leverage where it's not completely a buyers' market. On the international or the non-U.S. front, again, property is challenging but casualty and professional actually seems to be gaining some meaningful momentum. And again, these comments are pointed at 3D. When we think about facultative, we really think in many ways that's more akin to insurance just on a wholesale basis.

Pivoting over to the insurance market. If we start with property, let me bifurcate this into 3 buckets. Cat-exposed properties that were impacted during 2017, clearly, you were seeing meaningful rate increases. Bucket number two, cat-exposed property that was not impacted in '17, you were seeing rate moving in the right direction but at a less healthy clip. And then of course, there's the nonexposed cat, which I would define as flattish.

But on the topic of property, it will be interesting to see some of the commentary that we see -- that is coming out of London, whether that is just going to be chatter and noise or whether that will convert into greater discipline in the action and the behavior.

Workers comp, clearly state rating bureaus are looking at what the results have been and they are looking -- they continue to be taking rate action. Having said that, the trends still look very good from our perspective. Not across the board, you need to use a finer brush than that. But we still feel pretty good about that, which is why if you look at our release, you'll still see, even though rates are getting more challenging in comp, we are still finding opportunities to grow.

Casualty, from our perspective, is the sweet spot today. We'll see how long that lasts. Certainly, we have our fingers crossed. Professional liability, no different than what we've been commenting on for the past several quarters, remains the area of great concern. Certainly, D&O has had its challenges. But I would suggest you can cast a broader net than that and much of the professional market over the next 12, 18, 24 months is really ripe for some type of change.

And then the last comment as far as product lines, auto. We continue to be pleased with the momentum that is building there.

A couple of quick comments, more specifically about our quarter. Rich is going to walk you through this in more detail, but we are pleased with the top line growth. You may have noticed that the insurance segment was up about 5%, which was give or take what we would have expected and certainly possible that we'll see a little bit more momentum as we go into the balance of the year. Offsetting that was reinsurance, which was down about 12%, I believe. And again, the main pressure from there was the domestic reinsurance, for the comments earlier about market conditions.

Rich is going to walk you through the loss ratio. If you take cats and you take weather-related and you mush it altogether, it kind of gets you back to, give or take, about where we were last year. So that's flattish. Expense ratio, the 32.9% for insurance, from my perspective, not bad given the amount of specialty business we write and how much is on a wholesale basis. Having said that, we are going to keep chipping away at that. Certainly as we look to '19, we'll have to see whether we can get it done or not. But hopefully, on a written basis, we'll be able to take a point or so out of that.

Reinsurance, again, obviously, having an adverse impact. Part of the issue is ceding commissions are just out-of-whack based on historical levels. And the other piece is due to our underwriting discipline. And again, let me put a quick shout-out to our colleagues on the reinsurance front. We applaud that discipline. But the reality is, the internal costs have been moving up.

Rich will talk about the positive developments that kind of ebbs and flows quarter-to-quarter. We look very closely at our reserves at a very granular level every 90 days. This is something that we do take quite seriously.

And then the last comment I'll tell you or one of the last comments I would add is just the investment portfolio. I think that the discipline that was brought to bear in managing the portfolio over the past several years is truly bearing fruit. Rich is going to walk you through the numbers. But our colleagues have done a great job finding alternative investments with the core portfolio, managing that duration down with the expectation that interest rates would be doing what they are doing and we are starting to see the benefits. You can see that coming since you know what's happening with our book value compared to peers. You can see that and what's happening with our core investment returns as well. So again, kudos to them.

So I am going to pause there and I'm going to hand it over to Rich, let him run through some of his comments with you, all, and then we will be opening it up for questions. Rich, if you would, please.

Richard Mark Baio
Senior VP, CFO & Treasurer

Thank you, Rob. We had a solid quarter with net income increasing 65% or $71 million to $180 million for the second quarter of 2018. Our earnings improved over the year-ago quarter due to higher underwriting profit, higher net investment income and a greater amount of gains, even after the change in accounting that now requires us to include unrealized gains and losses on equity securities in the income statement.

Earnings also benefited from foreign currency gains from the strengthening U.S. dollar. In addition, our overall income tax expense decreased significantly due to the reduced U.S. tax rate of 21% versus 35% in the prior year. Pretax underwriting income increased 5.6% to $81 million compared to the year-ago quarter. Improvement was primarily attributable to higher-earned premium and lower cat losses with relatively flat underwriting expenses. Overall, net premiums written increased 3.8% to approximately $1.6 billion. For the insurance segment, premiums grew 5.2%, slightly more than $1.5 billion. The growth was led by a 12% increase in short-tail lines. In addition, we grew 7% in commercial auto and 5% in other liability while workers' compensation and professional liability were relatively flat compared with the year-ago quarter. The reinsurance segment remains competitive with continued pressure on the rate environment, as Rob was alluding to earlier. As such, our reinsurance segment decreased 12% to approximately $111 million, a reduced rate of decline from more recent quarters.

The accident year loss ratio before cats of 61.2% was slightly higher than the prior year quarter, largely due to non-cat property losses in the insurance segment. Cat losses declined from $33 million or 2.1 loss ratio points for the prior year to $14 million this quarter or 0.9 loss ratio points. We've experienced slightly higher non-cat weather-related losses in the current quarter of $15 million. This represents about 20 to 30 basis points higher than our more recent experience, but certainly within our range of expectations.

Loss reserves developed favorably in the current quarter by $7 million or 0.5 loss ratio points, compared with $21 million or 1.3 loss ratio points a year ago. Accordingly, our reported loss ratio is relatively unchanged at 61.6% quarter-over-quarter. The expense ratio of 33.3% represented a decline of 0.3% from the year-ago quarter and is relatively unchanged from the consecutive quarter. The current quarter's expense ratio is favorably impacted by the reduction in commission expense relative to the change in net premiums earned. This reduction was primarily attributable to the business mix in the insurance and reinsurance segments. This brings our combined ratio for the second quarter of 2018 to 94.9% compared with 95.1% in the prior year.

Investment income increased 14% or $19 million to $154 million. The investment income of the core portfolio increased $12 million, led by fixed income. A higher base of investment assets and rising interest rates have benefited the income statement. Investment funds increased $4 million, primarily due to lower energy fund losses compared to the year-ago quarter. We've maintained an average rating of AA- and the average duration declined slightly to 2.9 years for fixed maturity securities including cash and cash equivalents.

We reported pretax net realized and unrealized gains of $70 million due to the change in accounting for equity securities adopted in January 2018. There are now 2 components reported in this line item on the income statement. The first is pretax realized gains from the sale of investments of $124 million and second is the change in unrealized gains on equity securities of $54 million resulting from the adoption of this new accounting pronouncement. The change in unrealized gains on equity securities is not reflected in any prior year's results and therefore creates an inconsistency to these comparable periods. Had no change occurred in this treatment, our annualized pretax return on equity for the quarter would have been 4% higher.

The effective tax rate was 21.1% for the quarter. The effective tax rate differs from the U.S. federal tax rate of 21%, primarily because of tax-exempt investment income offset by foreign operations with the higher tax rate.

Stockholders' equity increased slightly from the beginning of the year. Earnings on a year-to-date basis were primarily offset by the impact of higher interest rates on unrealized gains on fixed maturity securities, currency translation losses and the return of capital. You may recall, we repurchased shares in the first quarter and gave a special dividend in the second quarter of 2018 of $0.50 per share. Our decision to maintain a shorter duration on invested assets relative to liabilities have positioned us well to minimize the impact on our balance sheet while benefiting from rising interest rates through the income statement. Our return on equity for the quarter on an annualized basis was 13.3% on net income. Thanks, Rob.

William Robert Berkley
President, CEO & Director
Thank you, Rich. Latif, if we could please open it up for questions then.

Question and Answer

Operator

[Operator Instructions] Our first question comes from the line of Amit Kumar of Buckingham Research.

Amit Kumar
The Buckingham Research Group Incorporated

Two quick questions and then I will requeue. The first question for you, Rob, is going back on the discussion on the loss cost trends and the underlying loss ratio. I was trying to discern if you could maybe talk about -- is the loss cost inflation trend running a bit hotter than what you expected and hence we should think differently about earned rate versus loss cost inflation? Or am I jumping ahead here?

William Robert Berkley
President, CEO & Director

Yes. I think you could be reading a little more deeply into it. The comment was meant in the broader sense. But let me take the opportunity to make some general comments. First of all, when we come up with our initial loss picks, we tend to air what I would define is on the more conservative side with the idea that as the losses season out, we will tighten those up. And that's why you -- I don't know, again, how many quarters it's been, but that's why you consistently see the positive development. We continue to take that approach. We think it's the sound and measured approach. I think that there is more inflation in the system and I think a lot of people get disproportionately focused on financial inflation and may not fully appreciate the other types of inflation that can have an impact on loss costs. When we look at what's going on, yes, there, in some cases, may be a need for rate. But one of the tricky parts, particularly perhaps for someone who's in the position or has the visibility that you have is, there are a lot of levers that one can pull and push other than rate. And whether it be attachment point, whether it be terms and conditions, whether it just be classes of business that you pivot into or pivot away from. So my point, the reason why rates was not us at all thinking that our loss picks were an issue. Actually, we continue to feel very comfortable with them. It is more making the point that there are a lot of things that are potentially changing and there are a lot of people in the industry that may not have a lot of experience with this type of change. Fortunately for us, by and large, our underwriters are very seasoned, which is typically the case in the specialty line. So there is a lot of experience, know-how, as to when you have an inflationary type environment, how do you manage that and what levers do you push and pull.

Amit Kumar
The Buckingham Research Group Incorporated

Got it. And the other question, and I will requeue after this, is I think you were talking about some of the, I guess, let's call it, the emerging perils or the perils which have been around for the past few quarters. Can you just update us on your thoughts on maybe 2 or 3 things. One is, we're seeing a bit more activity on lawsuits of -- massive amounts of lawsuits being filed against the opioid manufacturers. And secondly, the TELC issue, which is also turning out to be a bigger deal, maybe just refresh us where we are and with all of us having lived through the asbestos crisis and still having those scars.

William Robert Berkley
President, CEO & Director

Yes. Well, first of all, as far as the asbestos analogy, I think it's apples-and-oranges. And the big difference is policy limits and aggregate limits that back during the asbestos period didn't exist the way they exist today. Having said that, clearly from a social perspective, the opioid epidemic is very unnerving and it should be very concerning to all of us as a society. Unfortunately, when terrible things happen, oftentimes the way society deals with it is they say somebody's going to pay. And whether it's the manufacturers or the distributors or it's anyone else that even was within a stone's throw of the situation, they, and by extension, their carrier, there will probably be an attempt to pull them in. How this is going to play out, clearly, it is a meaningful situation that one should not shrug off. At the same time, I think it would be a mistake to suggest that this could be the next asbestos. Could it be meaningful? Yes. Is it the next asbestos? I think, likely not. And as far as TELC goes. Honestly, I was left speechless by what came out of the legal system and I think others were as well. I think some have offered some commentary on the venue. And based on historical experience, what type of judgments have come out of that venue, I'm not an attorney, I'm not a claims expert. So I can't offer a view. But I have heard some commentary around that. And again, I'm not a scientist and I have not seen the studies. So I cannot comment whether it is real or whether it is not an issue. But in any event, there will be meaningful amount of dollars both spent by the insured as well as presumably carriers on defense costs, amongst other things.

Operator

Our next question comes from the line of Kai Pan of Morgan Stanley.

Kai Pan
Morgan Stanley, Research Division

I have a few questions. First one, just follow-up on Amit's question on social inflation. I'm just wondering, can you talk a little bit more about your own professional liability book? How different is that from the general market? Are you actually -- given the trend, are you actually taking a higher initial loss pick for that line? And also, you're basically increasing pricing to respond to that inflationary trends.

William Robert Berkley
President, CEO & Director

Obviously, professional liability is a very broad universe. So to try and paint with one brush would probably not be appropriate or constructive. Certainly, we -- there are some parts of the professional liability space that we think we're in exceedingly good shape. We are very happy with the margin. And to the extent we could write more business at that margin or something approaching it, we would be pleased to do so. There are other parts of the marketplace where our view is that we will either be able to adjust what we believe is the loss pick to what we think makes sense through rate, through attachment points, through terms and conditions. And we will either find a way for that to work to our satisfaction or we will not write the business. In spite of our insurance segment growing in the quarter, you'll notice that the professional component was flattish. And if it means that we cannot get to where we need to with certain product lines, then we are happy to let the market move away from us and that part of the business will shrink.

Kai Pan
Morgan Stanley, Research Division

Great. My second question, on the investment side. The last few quarters, you've seen investment income had been growing closer to double digits or exceeding double digits. And that's quite like much better than some of your peer reporting probably mid-single digit net investment income growth. I was wondering how different is your book versus your peers and is that like high-single or low double-digit return going to be sustainable?

William Robert Berkley
President, CEO & Director

Yes. well, we don't spend an exorbitant amount of time studying what other's portfolio composition is. We spend a lot of time trying to figure out what our portfolio should be. I think back to the comment earlier around the decisions that were made some time ago around duration, we are benefiting from that. And quite frankly, one of the things that was also done is we started to put some money into some floating rate and we're benefiting from that. So the cash has given us a better return. Some of the floating rate stuff is helping in our duration. Having been short, it allows us to put money out at higher rates.

Kai Pan
Morgan Stanley, Research Division

If I may have last one on capital management. If you look at year-to-date, your capital return is about less than 30% over the net income for the 6 -- first 6 months. The question there is: number one, is that

-- is there a potential for increase to the payout; number two, is there sort of like a preference between share buybacks versus special dividends?

William Robert Berkley
President, CEO & Director

So I'll give you my two cents and then I'll hand it over to my boss, who also is in charge of buybacks and dividends amongst other things. My view is that, as has been suggested in the past by myself and by others, that we are interested in having the optimal amount of capital. At this stage between the underwriting profits as well as the gains that are coming through in the investment portfolio, particularly out of the alternative component to the investment portfolio, we are generating more capital than we can use. Having said that, every day we look at what we think our prospects are, what the opportunities are and where our capital is and we decide how much capital is available to return to shareholders and whatever we conclude as the most efficient manner. But I'll pause there and...

William Robert Berkley
Executive Chairman of the Board

The long and the short of it is, our first choice is always to use our capital to grow our business and to expand our business and find opportunities. After that, we look at the alternative uses, being the buying back of securities, stock or bonds and the return we get vis-à-vis what we assess as the current value or just simply paying out dividends. It's a real-time decision we make and we don't have a plan per se that says this is what we'll do when. However, I would say if there's anybody who wants to sell a big block of stock, we certainly hope they call us.

Operator

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

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

I just had a couple of quick questions. In terms of Irma loss creep, obviously, that's -- we've seen some headlines about that. I was just curious to what extent you think that could have any impact on subsequent reinsurance renewals from a pricing perspective?

William Robert Berkley
President, CEO & Director

Sorry. Could you repeat at least the second half, if not the whole question? Again, you were -- a little bit of breaking up out there.

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

Oh, sure. I was just curious. We've seen some headlines around Irma loss creep. And when you look at the June 1 renewals, it's particularly surprising that those were flat when you look at how much the losses have developed. So I was curious if...

William Robert Berkley
President, CEO & Director

Well, we're not a large property cat writer as an organization. So there are probably others that are more suited to comment than I. Having said that, that won't keep me from commenting. I was surprised at the 7 1s. But I was even more surprised back at 1 1. I thought after what you saw happen in the third quarter and what you saw happen in the fourth quarter, I didn't think it was possible that the cat reinsurance market was going to be flat to, sort of, I don't know, up 5, if you will. And again, I don't understand that part of the market as well as some. But as I suggested in the past, and I think others have suggested in the past, when it comes to property cat, you just have this tsunami of alternative capital that I think is keeping a lid on the marketplace's ability to turn as it has historically. I think that, again, it's one of the reasons why some of the lines of business that are not -- that are places that alternative capital does not participate in are showing signs that they are more poised for more of a historical turn.

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

And in terms of the commercial auto growth you had, how much of that was rate versus exposure?

William Robert Berkley
President, CEO & Director

I don't have those details at my fingertips. And quite frankly, generally speaking, we don't break it up by product line. But certainly, I would tell you, a meaningful amount of it’s rate. The one little insight on the rate front that we would share with you is where the group overall ex comp was about 3% or so, is my recollection. And my recollection is that comp for the quarter was off about 3 points, which incidentally was a lot better than we had expected on the comp.

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

Right. Okay. And then just lastly...

William Robert Berkley
President, CEO & Director

The auto, I don't remember the number.

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

Okay. And my last question was on the non-cat weather losses, the $15 million. Was that consistent with 2Q '17?

Richard Mark Baio
Senior VP, CFO & Treasurer

It's Rich. It's slightly higher on an earned premium basis. It's about 20 basis points, as I mentioned earlier. But it's a few million dollar difference.

Operator

Our next question comes from Mike Zaremski of Crédit Suisse.

Michael Zaremski
Crédit Suisse AG, Research Division

Rob, you mentioned trying to shave a point off the primary insurance expense ratio over the next, let's call it, 6 quarters or so. Maybe you can offer more color on the playbook there. Is it business mix or you guys are more bullish about premium growth? Or should I just simply shave off a point in our models?

William Robert Berkley
President, CEO & Director

Well, that's up to you what you choose to do. But my view is that I think that you are going to see our insurance business grow. I think it will take a little time for that to come through in the earned premium. In addition to that, we are looking long and hard in the mirror for ways that we can benefit from efficiencies and how we operate without undermining our model or our philosophy. So long story short, we think that there's a growing amount of evidence that we'll be able to write more and hopefully spend less.

Michael Zaremski
Crédit Suisse AG, Research Division

Okay, that helps. And related to the corporate other costs and expenses [were up 10%]. Is that more tied to net income, which obviously has been very strong?

William Robert Berkley
President, CEO & Director

Yes, I mean, there's really a couple of big pieces there. One of them was what I would define as costs associated with GDPR and getting ourselves to where we need to be. A lot of that was in the quarter, which was frustrating but reality. There's probably a little bit more of that to spill over into the third quarter. And I'm not sure it was New York Part 500, and whatever everyone else comes up with, what that's going to be, but one-timeish, if you will. Then the other big piece, and again Rich can give you some more detail if you'd like, but I would just label it incentive compensation associated with some of these meaningful gains and the higher returns that we've been able to generate for shareholders which -- and obviously there are some expenses associated with that as it relates to remuneration. But those 2 pieces are probably the 2 big buckets. There are some other stuff in there, but they're the 2 big pieces.

Michael Zaremski
Crédit Suisse AG, Research Division

Okay, that's good. And then one final one as a follow-up to Kai's question. So far, the yield I think was definitely higher than most people thought, at least assumed in their models. And my understanding from your commentary is that it does sound like that's kind of a good base yield to work off of, all else equal, in terms of interest rates as we look forward.

William Robert Berkley
President, CEO & Director

Yes. The short answer is yes. I think the benefit of why we're getting a bit more or less than some folks may have expected is because they didn't appreciate fully our ability to shift gears. And again, that goes back to the benefit of the shorter duration so we could shift gears quickly. And as things started to move in the direction we expected, that uptick is really coming through. So the 3 7 is a real number, a good number. How much better it will get, we'll have to see where rates go. But certainly, things are unfolding as we had hoped for and expected.

Operator

Our next question comes from the line of Yaron Kinar of Goldman Sachs.

Yaron Joseph Kinar
Goldman Sachs Group Inc., Research Division

I have 2 questions. First, with regards to the accident year loss ratio. So the non-cat weather drove about half of the year-over-year deterioration. Can you talk a little bit about what drove the other half?

Richard Mark Baio
Senior VP, CFO & Treasurer

It had to do with the property losses that I had alluded to earlier. We did have some fire activity in the insurance segment that was slightly elevated relative to the prior year.

Yaron Joseph Kinar
Goldman Sachs Group Inc., Research Division

Okay. So…

William Robert Berkley
President, CEO & Director

It is -- go ahead, I'm sorry.

Yaron Joseph Kinar
Goldman Sachs Group Inc., Research Division

No, please.

William Robert Berkley
President, CEO & Director

I was just going to say, property is something that we're paying close attention to. I think as you can see with our exposure is to cats of all shapes and sizes, we tend to -- it tends to be pretty benign for us. We certainly are looking at our property book to make sure that we are as pleased with that as we are with our approach to cat management. And as we've looked at these exposures and we've looked at these losses and peeled the few layers back, by and large, we're looking at the risk. And we're saying that if we could do it all over again, we'll write the business. Unfortunately, sometimes, sawmills burn down.

Yaron Joseph Kinar
Goldman Sachs Group Inc., Research Division

Yes, understood. And then my second question, hey, Rob, I hear the frustration concern coming from you about industry trends and the slow reaction from the industry. But I guess the 3 topics that you've noted aren't necessarily new. And I'm just curious, what would get the industry to really change its behavior here? And while the changes may be slow to come, how do you actually accelerate the growth in premiums in that environment?

William Robert Berkley
President, CEO & Director

So I completely agree with you that there was nothing novel or new or particularly insightful with the 3 topics that I raised from our perspective. Unfortunately, history would suggest that not only is the industry slow to change but they only really start to change when they feel pain. We certainly have seen that in pricing cycles and perhaps we will see that with other types of change in behavior. Ultimately, there's probably not enough pain in some ways at this stage to change the behavior. Having said that, we are very conscious of the realities of the changing environment. We are very happy to do business in the traditional manner. At the same time, we're conscious of the fact that ultimately the customer is king and we need to be in a position to do business any way the customer chooses to.

Operator

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

Ian Gutterman
Balyasny Asset Management L.P.

My first question, I guess, this is probably for Rich. The -- that new accounting on the unrealized equity, I know you don't like it, that's okay. I was more curious why it was negative this quarter. It looked like about $15 million negative. I would have thought HQY looked to have a great quarter. So I thought it would have been a positive. Was there some asset class -- not asset class, but a sector you were overweight that did poorly or something with one security? I was just kind of curious.

Richard Mark Baio
Senior VP, CFO & Treasurer

I think this is one of our frustrations, quite honestly, as well. The accounting does really muddy the waters here quite a bit. So what effectively wound up happening, you might recall when companies adopted this at the beginning of this year, is that they had to reclass their unrealized gains and losses that they had at the -- effectively, at the year-end of '17 from AOCI, a component of stockholders' equity, into retained earnings. And so to the extent you sell any of those securities in the 2018 year, because that is already reflected in retained earnings, you can't duplicate that recognition of income. And so as a result of that, we sold, to your point, a fair amount of shares in HealthEquity in the second quarter. And as a result of that, we can't reflect those realized gains a second time. So that's why that $54 million that you're referencing is a negative number because that's been reflected in retained earnings already. The second piece is, and there are 2 moving parts to it because the $54 million is a net number in terms of the movement in the unrealized gains. And that would be any movements that have been transpired in the second quarter relative to what you had in the first quarter. So if we had a movement in an existing equity security that we still owned as of the end of second quarter, you'll see that effect also embedded in that $54 million number.

Ian Gutterman
Balyasny Asset Management L.P.

Okay, I was thinking it was all the latter. So that makes perfect sense, that's helpful.

William Robert Berkley
President, CEO & Director

No, it doesn't make perfect sense. It's totally irrelevant and misleads an investor.

Ian Gutterman
Balyasny Asset Management L.P.

I shouldn't say the rule makes sense. I was saying Rich's explanation makes sense.

William Robert Berkley
President, CEO & Director

Fine.

Ian Gutterman
Balyasny Asset Management L.P.

So Rob, if I can go back to the social inflation question, I guess from a couple of angles. One is, I agree 100% with everything you said. And some other companies are talking somewhat similarly. Yet what's interesting is we're not seeing people saying I can't grow GL anymore because I'm worried about the litigation environment or I'm not going to grow D&O or I'm raising my picks. You know what I mean? It feels like there's a [indiscernible] if everyone thinking it's a [prong] for the industry or not for them. And so how...

William Robert Berkley
President, CEO & Director

Yes. So we're all [indiscernible]

Ian Gutterman
Balyasny Asset Management L.P.

Right, right.

William Robert Berkley
President, CEO & Director

But I think this is not a unique or new type of situation for the insurance industry, right? I mean, we're famous for always having to learn things the hard way and we spend much of our lives looking in the windshield -- rather, the rearview mirror, as opposed to the windshield. We come up with pricing based on historical data, as opposed to, yes, taking the historical data and then applying what we see coming our way. So I think that it's really hard for people seemingly to extrapolate from the historical data and apply what they know today. We certainly are doing it. I can tell you, in our organization, we think the combination of the 3 points of rate that we talked about ex comp, along with how we are pivoting the portfolio from a selection attachment point and terms and conditions' perspective, is going to bode well for us. Honestly, if all we're doing is sitting there and trying to get another couple of points of rate, I don't think that would be enough. I think, again, it's those other levers that you need to use. And I think it's one of the benefits of our structure that we're able to see the marketplace at a much more granular level, which allows us to bob and weave at a, I think, little more effectively. So ultimately, the pain -- the early pain turns into chatter and eventually the chatter converts into action. And when you look at our organization, I think one of the things that we've done reasonably well over time, whether it be on the underwriting side or the investment side, is we are looking out the front windshield, we are extrapolating -- what does that mean -- we need to do today and we are not willing to trade off tomorrow just to fluff up today.

Ian Gutterman
Balyasny Asset Management L.P.

Understood, understood. Can I ask, when you say moving attachments, does that mean moving higher?

William Robert Berkley
President, CEO & Director

Oftentimes, yes. So ultimately, what -- so depending on the tower and where you attach or what the coverages may be. So again, I think that one of the challenges for folks, just particularly when they're operating from a bit of a distance, is they just do the simple math because that's all they have to work with. They say, "Okay, I think the loss pick is this. I think trend is that and you're getting this much rate and that gives you my answer." The problem is there are other very leveraged variables that can be introduced which are what I'm referring to.

Ian Gutterman
Balyasny Asset Management L.P.

No, I agree with that, I agree with that. I guess what I was thinking about is if we're worried about frequency of severity, doesn't moving up mean you just get less premium for a loss that's now more likely to reach you than maybe -- you know what I'm saying? If you're going to get the loss anyway, why not get more premium [indiscernible] in that pie.

William Robert Berkley
President, CEO & Director

Well, I guess that's making the assumption that you go all the way up in the tower. So what we're suggesting is that oftentimes when you're in an excess layer, you have a certain expectation as to what the loss activity is going to be. And ultimately, to the extent that you see maybe the average claim, if you will, moving up in size, maybe you want to move up in the tower. So again, it's kind of like the whole terms and conditions discussion as well that it's how you build the box.

Ian Gutterman
Balyasny Asset Management L.P.

I was going to say, the last one on that point is, are you buying more reinsurance to bring essentially net retentions down or net limit per insured or things like that?

William Robert Berkley
President, CEO & Director

Look, we are a gross line underwriter as an organization and we're mindful of our relationships with our reinsurers. Undoubtedly, we have a certain appetite for volatility amongst other things. And as a result of that, and again in a very transparent way, we pay a premium to our reinsurers to help us manage to our risk appetite. But we are not an organization that is looking to arbitrage people who are supposed to be our partners.

Operator

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

Brian Robert Meredith
UBS Investment Bank, Research Division

Quickly, just the health care professional liability book that you guys have. What are you seeing with loss trend there? I've heard that there's an adverse trend happening in that business?

William Robert Berkley

President, CEO & Director

Honestly, Brian, generally speaking, we just avoid getting into that level of granularity. We got 54 different businesses and trying to get into the minutiae. But I would tell you, just in general, when we talk about professional liability as a space and areas that look hot to us, health care would certainly be included in that and hospital professional liability would certainly be on the list.

Brian Robert Meredith
UBS Investment Bank, Research Division

Great. And then last question here, Rob. Could you give us an update on Berkley One and how that's rolling out? And what are you seeing in that market? Has it been challenging to get in there? Are there good opportunities?

William Robert Berkley
President, CEO & Director

Look, we -- it's been very well received in the states that they are in so far. As I've commented in the past, the rollout process, both from a regulatory perspective as well as an IT perspective, certainly doesn't come easy. I think some people have tried to jump in and they're playing the non-admitted route and that's just not the approach that we're taking. We are building this thing with a long-term perspective. We're building it, as they say, to last. We're building it the right way and to want to make sure that we have an offering that, in spite of the fact that the business is somewhat in its infancy, it has a platform and a service offering that can compete with any one of any scale. And I think we have achieved that, which is why I believe it's being well received by distribution and customers, really, to the point that the people running that business are going to have to, at some point, decide how long they're going to let the queue be of people who want to do business with them or when they say, "We can only have so many partners." I think they've already selected to begin with. But there's a lot of demand, if you will, for the appointment.

Operator

[Operator Instructions] Our next question is a follow-up from Amit Kumar of Buckingham Research.

Amit Kumar
The Buckingham Research Group Incorporated

Two quick follow-ups, I'll make this quick. Number one, you have a decent sized commercial auto book. Recently, there has been renewed press discussion and in fact hedge funds have gotten into litigation financing and they're targeting commercial auto and personal auto to some extent. Is that something which is sort of discernible in the numbers? Or is that more noise than anything else?

William Robert Berkley
President, CEO & Director

Look, I think litigation funding is, and I think we may have talked about this a little bit last quarter, is certainly somewhat of a concern, I think, to the industry. They are sophisticated and they have a lot of money, and that's, again, a reality that when people think about loss cost going forward, probably needs to get factored into. As it relates to the auto space, my thought that I would share with you is I think you are likely to see us write over the next several quarters. We are going to be writing more of that, not less of that. As the rates continue to move up and once we feel as though it's in the green zone, you'll see us open up the spigot quite a bit. It seems to be moving in that direction. So the loss costs are falling into place. I think the industry got caught flat-footed for a while, but the industry's catching up.

Amit Kumar
The Buckingham Research Group Incorporated

That's a fair point. And final question from my side is a broader question. The question is on, I guess, a new topic of tariffs and how will that impact the economic growth and any change in buyer behavior. Obviously, everyone has benefited from the economic recovery seen in the past few years. Are you sort of thinking differently in terms of how tariffs will sort of play into top line and bottom line? Or we still have some other time to think about it?

William Robert Berkley
President, CEO & Director

It's clearly something that we think about, both on the underwriting side and even more so on the investment portfolio side. But why don't I -- you've probably heard my voice more than enough today, I'll pause there and hand it over to our chief economist.

William Robert Berkley
Executive Chairman of the Board

So I think that the long and the short of it is, I think there's lots going on with these tariffs that are going to impact consumer pricing, that's going to impact manufacturing. There's lots of stuff that's going to happen. But I think it's premature at this moment to conclude what's going to happen. I think the whole issue of the global economy is one that you have to worry about: interest rates, slowing down of the economy. But I think you just have to be cautious before you jump. For the moment, I think America is relatively better off. But you can be sure the consumers will not be happy if all those Chinese goods start to cost more. There's a lot more to the whole process going on, lots of negotiation. We're not jumping to any conclusions. I think in the natural sense, this may well slow the economy down a bit more, but it's not going to have a particularly adverse impact on the insurance business.

Operator

And we have a follow-up from Kai Pan of Morgan Stanley.

Kai Pan
Morgan Stanley, Research Division

I have 2 as well. Number one is that, Rob, you mentioned property pricing is probably the most challenging. Yet if you look at the premium growth of the short-tail lines, actually grew faster among your lines. Could you clarify that?

William Robert Berkley
President, CEO & Director

Yes. I think that a lot of the growth that you're seeing in the premium under the short-tail lines is actually A&H.

Kai Pan
Morgan Stanley, Research Division

Okay, that's perfect. And then last one. You mentioned the inefficiency in the system. I just wonder, could you give us some example that either the industry or you can do to improve that.

William Robert Berkley
President, CEO & Director

Well, I think that some of it's going to come out with -- come about as a result of technology. I think that when you look at the inefficiencies that exist between the consumer and actually a policy getting issued when you look at the inefficiencies between a claim occurring and actually the person receiving their funds that they're entitled to, the number of hands, the multiple entry of information, the path that the payments go through, it's just terribly inefficient. And if you look at other parts of financial services or if you look at other industries in general, you're going to be hard-pressed to find the level of operational inefficiency that exists both within carriers as well as distribution. And quite frankly, while it's a little bit of a third rail, you're going to be hard-pressed to find a part of financial services where the customers paying this number of pennies on the dollar for access to the product. So I think there are a lot of examples where it's not just access that's being provided. There's true value and service and expertise. But there are a lot of situations where it is just access. And that's not just a distribution issue, that's a carrier issue where we need to find ways to work together to be able to do all of these things more efficiently.

Operator

And at this time, I'd like to turn the call back over to Mr. Rob Berkley for any closing remarks. Sir?

William Robert Berkley
President, CEO & Director

Okay, Latif, thank you very much for your assistance and certainly thank you to all who called in and for the questions as well. From our perspective, it was very much a strong quarter. The underwriting was what we would have expected, perhaps a little bit better. I think it demonstrates how our ability to pivot the portfolio regardless of the market is sound and it's a real asset, which again, we believe in part we benefit from our structure which allows us to do that more effectively. In addition to that, clearly, as people saw the action that we took on the investment portfolio and what the return was on the core portfolio ticking up, those actions that were taken earlier on, those are paying dividends as well. And then when we look forward to the balance of the year, we see a lot of opportunity certainly as our hope and expectation that our insurance business will continue to grow. To what extent we're able to accelerate it from here, we'll have to see. We are increasingly bullish about the reinsurance business outside of the United States and we are cautiously optimistic about where the reinsurance market domestically will be going. So all things being equal, again, we think it's a good quarter and we are very much looking forward to the balance of the year and onto '19. Thank you, again.

Operator
Ladies and gentlemen, this concludes today's conference. Thank you for your participation and have a wonderful day.