W. R. Berkley Corporation NYSE:WRB

FQ4 2014 Earnings Call Transcripts

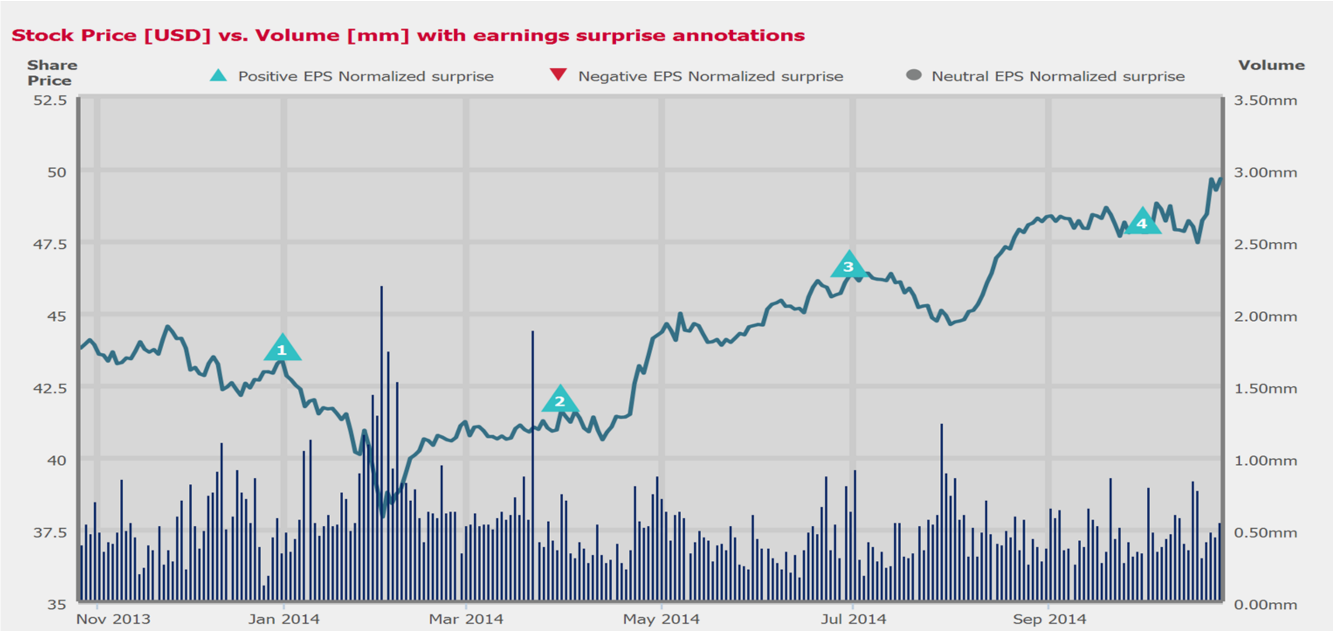
Tuesday, February 03, 2015 10:00 PM GMT

S&P Capital IQ Estimates

	-FQ4 2014-			-FQ1 2015-	-FY 2014-	
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	ACTUAL
EPS Normalized	0.82	0.73	▼(10.98 %)	0.87	3.70	3.62
Revenue (mm)	1764.05	1784.43	▲1.16	1779.75	7108.55	7128.93

Currency: USD

Consensus as of Jan-30-2015 4:52 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ4 2013	0.78	0.85	▲1 8.97 %
FQ1 2014	0.79	1.00	▲2 26.58 %
FQ2 2014	0.76	0.82	▲3 7.89 %
FQ3 2014	0.90	1.06	▲4 17.78 %

Call Participants

EXECUTIVES

Eugene G. Ballard
Executive Vice President of Finance

William Robert Berkley
Founder and Executive Chairman

William Robert Berkley
Chief Executive Officer, President and Director

ANALYSTS

Amit Kumar
Macquarie Research

Brian Robert Meredith
UBS Investment Bank, Research Division

Ian Gutterman
Balyasny Asset Management L.P.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Kai Pan
Morgan Stanley, Research Division

Kenneth G. Billingsley
Compass Point Research & Trading, LLC, Research Division

Lawrence David Greenberg
Janney Montgomery Scott LLC, Research Division

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Vinay Gerard Misquith
Evercore ISI, Research Division

Vincent M. DeAugustino
Keefe, Bruyette, & Woods, Inc., Research Division

Presentation

Operator

Good day, and welcome to the W.R. Berkley Corporation's Fourth Quarter 2014 Earnings Conference Call. Today's conference is being recorded. The speakers' remarks may contain forward-looking statements. Some of the forward-looking statements can be identified by the use of forward-looking words, including, without limitation, believes, expects or estimates. We caution you that such forward-looking statements should not be regarded as 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, 2013, and our other filings made with the SEC for the description of the business environment in which we operate and the important factors that may materially affect us -- affect our results. W.R. Berkley Corporation is not under any obligation -- 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 like to turn the call over to Mr. William R. Berkley. Please go ahead, sir.

William Robert Berkley
Founder and Executive Chairman

Thank you very much. Well, we're pleased to report that for the year, we hit our 15% target on return. In general, we think the environment's pretty good, not as good as we would like, but certainly, overall, we're pleased with where things are going.

I'm going to turn the call over to Rob for the operating results, and then, we'll follow with Gene, and then, I'll try to finish up and answer your questions. So Rob?

William Robert Berkley
Chief Executive Officer, President and Director

Thank you. Good afternoon. During the quarter, trends in the commercial lines insurance and reinsurance markets were, by and large, consistent with what we've seen over the past several quarters. The reinsurance market remains exceptionally competitive and has yet to find the floor. However, the pace of erosion, at least for the moment, seems to be slowing.

The drivers behind this competitive market continued to be the same that they've been over the past several quarters. The alternative capital coming into the market is putting a great deal of pressure on the marketplace, overall, and traditional players are trying to rationalize how they are able to compete going forward and be able to generate a sensible return.

At the same time, we continued to see changes in the behavior amongst ceding companies. Cedings are looking for ways to buy more efficiently. They're looking to combine programs and reduce the number of treaties they buy, while simultaneously looking for ways to increase their net retentions.

As it relates to the insurance market, certainly, a very different picture, much brighter than that in the reinsurance space, though the tailwind seems to be gradually slowing. Select parts of the Worker's Compensation, GL and professional market remain very attractive, to name a few. While on the other hand, long-haul trucking, aviation and parts of the marine business continued to be a concerning puzzle.

With regards to the company's performance, net written premium was approximately $1.46 billion, up slightly more than 7% when compared with the corresponding period last year. The growth was primarily driven by our domestic insurance operations as well as select parts of our international business, though it was partially offset by our reinsurance segment, which is trying to navigate its way through, obviously, the very competitive environment that I mentioned earlier.

Rate increases for the domestic insurance business were approximately 3.1%, and at this level, we believe our margins continue to expand. It's worth mentioning as well that this rate increase was complemented by renewal retention ratio of approximately 80%.

The loss ratio for the quarter came in at 60.8%. This is an improvement from last year in spite of the challenges that our international segment faced. You may have noticed this in the press release that the international segment did have a difficult quarter and it certainly wasn't a great year.

As it relates to the quarter, there were really 2 meaningful issues that led to the outcome. One had to do with cat losses, and Gene's going to be touching on this shortly. But it really stemmed from 2 events, one in Australia and one in Mexico. The other issue was from loss development that we had coming through in our U.K. and European professional liability operations. We believe that we have our arms around the issue and are well on our way to addressing it.

The expense ratio improved during the quarter by 1 point to 32.5%. Our domestic insurance business led this improvement, coming in at almost 2 points of improvement. This was partially offset by the reinsurance segment, which saw some deterioration in their expense ratio, and this deterioration was really driven by higher commissions.

We believe that there's opportunity to improve on our group expense ratio from here, but this takes time and the hard work of many. I would remind you that this type of activity, on occasion, requires one to take 1 step back before you can take 2 steps forward.

When one puts all the pieces together, the organization achieved a combined 93.3%, which is just shy of a 2-point improvement from the corresponding period in '13. Gene's going to be touching on the highlights from the balance sheet, but I would offer one comment and that is we had net positive development for approximately $23 million in the quarter, and this represents the 32nd quarter in a row of positive development.

When one takes a step back and looks at quarter, clearly, the international segment had its challenges. But as I suggested a moment ago, I believe that we are well on our way to remedying the situation and it just takes a little bit of time for that come through in the numbers.

The reinsurance segment certainly faces its challenges as far as the marketplace that it operates in. Having said that, we believe that the discipline and knowledge and experience of our colleagues in that space would be able to continue to manage the capital effectively.

And finally, the domestic insurance business, which had a particularly strong quarter, we think is well positioned to be able to carry on into '15 with similar or improving results.

William Robert Berkley
Founder and Executive Chairman

Thanks, Rob. Gene, do you want to pick up the numbers, please?

Eugene G. Ballard
Executive Vice President of Finance

Okay, good. Thanks, Bill. Well, for the fourth quarter of 2014, we reported net income of $111 million or $0.83 per share and a return on equity of 10.2%. Although the fourth quarter underwriting results improved significantly from a year ago, those gains were offset by lower earnings from investment funds and from our service businesses. I'll briefly summarize each of those activities, starting with underwriting.

Rob covered the premiums. I'll skip to the underwriting profits. Our overall underwriting profits increased 46% to $100 million, with significant improvement in both the loss and expense ratio. The accident year loss ratio before cat loss is improved 1 point to 61%, as year-to-date rate increases of nearly 5% on an earned basis continued to well outpace loss cost trends.

Catastrophe losses were $18 million in Q4 compared with $13 million a year ago. As Bill -- as Rob said, the 2014 cat losses included international cat losses of approximately $11 million, which were due primarily to 2 events: one was a $7 million loss from a large storm in Brisbane, Australia in November; and the second was a $4 million loss from a late claim received by our Lloyd's business for Hurricane Odile, which was a Category 4 hurricane that made landfall on Mexico in mid-September.

Our prior year reserve releases continued to develop favorably with $23 million of positive development in both the fourth quarter of 2013 as well as the fourth quarter of 2014. In 2014, the domestic and reinsurance segments reported favorable development that was partially offset by prior year reserve strengthening for the international segment, primarily for professional liability business in the U.K. and Europe.

Our overall expense ratio declined by 1.2 percentage points in the fourth quarter and almost 2 percentage points for the full year. The overall expense ratio for the fourth quarter was 32.5%, which is our lowest quarterly expense ratio since early 2009.

The domestic segment expense ratio improved by 2 points, and the international ratio by 1 point. That was partially offset by a higher expense ratio for the reinsurance segment, which was up 3 points, primarily due to additional contingent commission payments on profitable reinsurance business. That gives us the combined ratio of 93.3% for the quarter, compared to 95.1% a year ago. The domestic combined ratio improved by 2 points to 90.6%, and the reinsurance combined ratio improved by 8 points to 92.5%. The international combined ratio was up 6 points due to the cat activity and loss development that I mentioned earlier.

Turning to investments. Our core investment income, that's before investment funds, was $118 million in the fourth quarter, nearly unchanged from a year ago, as the decline in -- slight decline in bond yields was offset by an increase in invested assets. The average annualized yield on the core portfolio was 3.2% in the fourth quarter compared to 3.3% a year ago.

Investment funds, on the other hand, reported an aggregate loss of $3 million compared with a profit of $22 million a year ago. The 2014 loss was primarily due to losses from energy funds and from another fund that invests in stocks. For the full year, the average return on investments for all investment funds were 12.7% in 2014, up from 8% in 2013.

Realized gains from the sale of investments were $21 million in the quarter. That's the 23rd consecutive quarter that we've reported a realized gain on investments. And at December 31, 2014, the average rating and duration of the fixed income portfolio were AA- in 3.2 years, and the aggregate unrealized gains before taxes was $471 million.

I mentioned energy from our services business, which includes both our insurance services company and our wholly-owned aviation company. They were down $4 million from the fourth quarter of 2014 -- I'm sorry, they were $4 million in the fourth quarter of 2014, excuse me. That's down $12.5 million from the fourth quarter of last year, which was our strongest quarter to date for those businesses. The decline in profits in '14 compared to '13 for those services businesses was due primarily to the timing of aircraft sales and service contracts.

Interest expense increased $4 million in the fourth quarter compared with a year ago due to the advanced issuance of $350 million of subordinated debentures in August of '12. A portion of those proceeds from that offering have been set aside to repay $200 million of senior notes that are maturing in May of 2015.

We also reported a modest foreign exchange loss of $1 million in the fourth quarter of this year, which compares to a more significant FX gain of $4 million in the fourth quarter of 2013.

In taxes, the effective tax rate was 31.8% in the fourth quarter, which is consistent with the effective tax rate throughout 2014. However, compared to a year ago, it's significantly higher. The tax rate in the fourth quarter of '13 was 25.5% and that was due to the utilization of foreign tax credits.

For the full year, that gives us net income, up 30% to $649 million, a return on equity of 15.0% and an increase in our book value per share, inclusive of the special dividend that we paid in December, of 13.5% to $36.21.

William Robert Berkley
Founder and Executive Chairman

Thank you, Gene. So I'm going to try and go over what I think are the important points about how our year was. I'll talk about the disappointments as well as the high points. The biggest disappointment were the income from funds. The worst part of it was our oil-related investments as well as 1 particular common stock fund. Unfortunately, these are -- those are bumpy. And one of the oil-related funds that we invested in will likely, in the first quarter, have an adverse impact compared to its similar quarter in the first quarter of 2014. We think, at that point, it'll be behind us. Oil prices don't have to go sky-high to have dramatic improvements, but when you choose to mark to market, which is the nature of how we mark the funds in order to give more transparency, that's just how it is.

We are offsetting the declining investment income with the growth in investable assets. You can see investable assets were up roughly $1 billion last year, and they will be up somewhere between $650 million and $1 billion in 2015, which, again, will help offset the decline in yield.

We are putting more and more money into short-term assets. We believe inflation is around the corner. We just aren't sure how far the corner is away. But in addition to the $700-odd million of cash we show, we have roughly $1 billion in other maturities, which are less than a year, but we can get a 1% yield on those maturities. So we think it's -- we're willing to go out that slightly longer distance to get up to a 1% yield.

But overall, we're still being very cautious. We don't expect to change that. Our reinvestment rates, probably 2.5%, maybe a little better. But we're mainly searching for things we can invest in that we may give up a little bit of liquidity but we can get 4% or 5% returns, but no market liquidity. High-quality securities, however, is the only thing we're looking at.

The core business, the basic insurance underwriting business continues to do well. The performance is excellent. There are a bump here and there that comes up. It's the nature of our business. We fix them. We don't hide them. We address the issues. We think we'll be able to continue to generate outstanding returns, especially given the interest rate environment. And whether we get 13%, 14%, 15% or 17%, I can't tell you at this moment in time. But we're going to still target that 15% return, and we hope we'll be able to continue to achieve that.

As far as capital management goes, we think there's lots of things happening in the industry, where opportunities to use capital, to obtain capital are available, and we're assessing those constantly. We are, and have always been, careful managers of capital, whether it's through special dividends or buying back stock. We are owners of the company. We're not theoretical owners. Therefore, we act as owners, maximizing the return for our shareholders. We will continue to do that. Nothing has changed from that point of view. When we think the best use is paying a dividend, we're going to pay a dividend. When the best opportunity is buying back stock, that's what we will do.

We've looked at acquisitions. We continue to do so. Most of them don't enhance the value to our shareholders. We're swamping our stock and the values we see in it for someone else's piece of paper that we don't think adds a similar value. We're just not anxious to buy someone else's business at a premium price. We've been able to add business. We've added $700 million of business in the past 24 months, net to us, and we've done it internally. We think we'll be able to continue to grow at a substantial rate.

So we're pleased with how things are, and we'd like it to be -- more opportunities. Many of these acquisitions of similar companies will create opportunities for us because there are people that lose their jobs and create opportunities. There are people that don't want to have the same exposure, so they don't want to double up on that exposure. We continue to believe our model is good, and we will continue to build on what we have, of course, never closing our eyes to where we are.
So with that, I'm happy to answer any questions. Nicole, [ph] We'll be glad to answer any questions.

Question and Answer

Operator

[Operator Instructions] Our first question comes from the line of Vinay Misquith of Evercore.

Vinay Gerard Misquith
Evercore ISI, Research Division

The first question is on the expense ratio that improved quite significantly this quarter. For the company as a whole, you're running at about a 33% expense ratio, where do you see it going in 2015? Do you expect the continued decline? And how much do you expect it to decline?

William Robert Berkley
Founder and Executive Chairman

All right, Rob will take that. Go ahead.

William Robert Berkley
Chief Executive Officer, President and Director

Yes, I think -- Gene, what do we show for the fourth quarter? I think we're at a 32.5%.

Eugene G. Ballard
Executive Vice President of Finance

Right, 33% for the full year, yes.

William Robert Berkley
Chief Executive Officer, President and Director

So a 33% for the full year. Our view is that there's opportunity for us to try and improve across the board. Certainly, we think that there's opportunity for us to try and improve where we are on the domestic front. We think that the expense ratio, assuming that there's not a dramatic shift in the environment, can improve a bit from there. From the 30%, we're hoping that we can drive it down to something that starts with a 2. And -- but the greater opportunity for us is on the international front. And again, while it's a smaller piece of the business, it's not going to have the same impact. But clearly, we need to be able to do something that is notably better than something that starts with a 4.

I think the one thing to keep in mind though, as it relates to the international expense ratio, the reality is they are higher distribution costs oftentimes found on the international front. So maybe to answer your question more specifically, assuming that market conditions remain as they are and we are able to maintain a level of earned premium at where we are or better, I think you will see us be able to drive that expense ratio down, over some period of time, by certainly more than 100 basis points.

William Robert Berkley
Founder and Executive Chairman

So we hope we're going to be under 32% this year.

Vinay Gerard Misquith
Evercore ISI, Research Division

That's for the company as a whole?

William Robert Berkley
Chief Executive Officer, President and Director

Yes.

Vinay Gerard Misquith

Evercore ISI, Research Division

Okay, that's helpful. Now you've grown quite significantly in 2014. So given the increase in competition, do you expect the growth to slowdown meaningfully in '15 versus '14?

William Robert Berkley
Founder and Executive Chairman

Well, first of all, the 7.2% growth, 3% roughly was rate, 4% was growth. I think that it clearly is going to be more difficult. But I don't think 4% real growth is something that we would think would be impossible to attain.

Vinay Gerard Misquith
Evercore ISI, Research Division

Okay. And just a numbers questions, maybe for Gene. Gene, the tax rate was about 31% in 2014. What's the normalized tax rate for '15 and '16?

Eugene G. Ballard
Executive Vice President of Finance

It should be in that neighborhood. I mean, the only thing that varies for us is -- the only taxable item that we have that's not a 35%, it's tax-exempt income for the most part. So what varies for us is when we have a differentiation between other sources of income and tax-exempt income. So that should be a pretty good run rate. As I said, the variation from a year ago was foreign tax credits, which can move around a bit as well. But I would say that's a good benchmark.

William Robert Berkley
Founder and Executive Chairman

And the other thing is common stock dividends, which we sort of moved out of common stocks. And if there was an opportunity to move back in that, that might change it also. So one of the issues you have is what our company, as a whole, going to do with the dividend rate and so forth.

Vinay Gerard Misquith
Evercore ISI, Research Division

Great. And then one last thing from the alternatives because if energy we have seen that weak. Should the first quarter of this year -- should the number for the alternative investments be even lower that than the minus 3.6% -- or $1 million we had in the fourth quarter?

William Robert Berkley
Founder and Executive Chairman

The only piece that we know for sure is energy. The energy partnerships will be -- could result in a -- they will not make us any money. I would think the partnerships, as a whole, we will be certainly not as good as the corresponding first quarter. We don't have the numbers at this point in time. Everything is not in. As soon as we know, we're going to do our best to give people a heads up. We were surprised about a couple of pieces of that. So we'll do our best to keep people informed. We think that the 12.7% return for the year was an okay return, but it was lumpier than we expected. But we would expect that we'll have a fine return for the year, but it could be a little lumpy.

Vinay Gerard Misquith
Evercore ISI, Research Division

Sure. But the first quarter, you expect some sort of a positive number on the alternative funds?

William Robert Berkley
Founder and Executive Chairman

I don't know the answer to that. I'll know within the next 3 weeks. But I don't know now. I'll know a lot better -- one of the things you have to understand also is a couple of those are things that are in foreign currencies. And so there's a lot of moving pieces to that. We will let you know as soon as we know.

Operator

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

Amit Kumar
Macquarie Research

Just very quickly. Maybe a follow-up on Vinay's question. Is that correlation between the energy funds and oil prices, is that like sort of a 1:1 correlation? I guess what I'm trying to ask is, if I look at the Q4 energy price, crude price change, and then sort of apply it, is that a good enough estimate? Or there are too many moving parts to make that assumption?

William Robert Berkley
Founder and Executive Chairman

No, there are a lot of moving parts. I think directionally, it's a good indication, but it's not a 1:1 kind of thing. Directionally, it's the right sense, though.

Amit Kumar
Macquarie Research

Okay, that's helpful. The other question I had was there were some comments in the opening remarks on the international professional side, and was that more of a methodology change? Or was there some sort of one-time item on, I guess, on the loss ratio side?

William Robert Berkley
Founder and Executive Chairman

The short answer, in the interest of time, and I'm happy to get into more detail, if you like, is that we had some negative development coming out of a few of the professional liability lines. And in our effort to get our arm around the situation, we did what I would define as a reasonably deep dive and look to try and make sure that we fully had our arms around it.

Amit Kumar
Macquarie Research

Got it, okay. And then just finally on capital management, I think you said that lots of things are happening, but most of them don't enhance, I guess, shareholder value. But that is...

William Robert Berkley
Founder and Executive Chairman

I didn't say that. I didn't say they don't enhance shareholder value.

Amit Kumar
Macquarie Research

I think you had looked at it and passed.

William Robert Berkley
Founder and Executive Chairman

Pardon me? No, I -- we said we'll continue to use capital management in order to enhance shareholder value, whether that's buying back stock, paying a special dividend or whatever, and there's lots of things going on to give us opportunities to figure ways to optimize the use of our capital.

Amit Kumar
Macquarie Research

So net-net, no change in the capital management stance versus what we have seen in the past?

William Robert Berkley
Founder and Executive Chairman

No, I don't think -- I think that there are more people doing transactions, which will give us more opportunities as our competitors try to do this. And we think that's going to be an enabler for to us to do better.

Operator

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

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

So I had a question about the expense ratio decline in domestic. Is -- what specifically was driving that? Are ceding commissions a factor, potentially, in that decline?

Eugene G. Ballard
Executive Vice President of Finance

I'm sorry, Michael, could you -- the last piece for the question, you broke up a little bit. Could you do that once more, please?

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Are ceding commissions playing a role in the expense ratio improvement year-over-year?

William Robert Berkley
Chief Executive Officer, President and Director

Ceding commissions are a component of it, I would also suggest to you that we are looking for ways to be more efficient and save dollars in how we operate the business, which is a meaningful component as well. And finally, obviously, we benefit from earned premium.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Right. Okay. Okay, yes, because it looks -- the dollar amount -- the dollar expenses are up like 5% against certainly a lot more than that on the revenue side, so I was just curious. So some cost savings and those are actions that you continue to take.

William Robert Berkley
Chief Executive Officer, President and Director

They -- I think that you should be operating with the understanding, at least, in my opinion, that we feel as though that there is opportunity for further improvement. But again, as I at least tried to suggest earlier, it's not a smooth curve. Sometimes we need to take a step back in order to take 2 steps forward. But I think that there is still opportunity for us to improve in many places. Again, the international segment is one of the more obvious places from our perspective.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Got it. Got it. And then I think you had said $24 million in net development, Rob...

William Robert Berkley
Chief Executive Officer, President and Director

$23 million.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Sorry, it looks like -- $23 million. I'm sorry, $23 million. So about 50 basis points of year-over-year margin expansion on the loss ratio purely, as we think about the expenses separately and then about 90 basis points for the full year. How should we think about from here? I mean, what's the right sort of a starting point to think about what you expect from -- or what we should expect from margins on the -- on an underlying basis from here?

William Robert Berkley
Chief Executive Officer, President and Director

Well, barring the unforeseen event, we think that it's possible they could improve from here.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Got it. Got it. And then, just lastly, if I could, just a couple of numbers questions. The insurance fees and service expenses for the fourth quarter look year-over-year kind of blipped up pretty note-worthy on a year-over-year basis. So I was just curious what was going on there, if there's something specific in the fourth quarter? And then, other expenses seem like they've been running a little bit higher than the year-over-year for the last 3 quarters or so. I'm just trying to understand if there's -- maybe there's some comp that's been running -- that's running through there, like equity comp or something, relative to the stock price, just so I can think about the forward.

William Robert Berkley
Chief Executive Officer, President and Director

Yes. Well, the service fees are -- a large part of that is we do a lot of the business with assigned risk plan. And so as we start a new business with different states, we'll see that number go up, and that's what's happening. The increase in the other expenses, part of that's due to the increase in service fees. But also, as a parent company, we have some unallocated expenses that we don't allocate back into the parent company cost, including the cost of running operation, and that goes to the -- on the other expense line. Some of that is incentive comp as well.

William Robert Berkley
Founder and Executive Chairman

And there's a lot of leverage in some of that, when we hit a 15% return, were incentive compensation. It's in -- this is as a whole, as a parent company.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Got it, okay. So we should be thinking about sort of that relative to the other costs and expenses -- the service expenses, maybe thinking about that more relative to the insurance service fees, is that fair?

William Robert Berkley
Chief Executive Officer, President and Director

That's true.

Operator

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

Lawrence David Greenberg
Janney Montgomery Scott LLC, Research Division

Just wondering how the decline in energy prices might be affecting your underwriting operations that concentrate in that sector, Berkley, oil and gas and, I think, Berkley offshore.

William Robert Berkley
Founder and Executive Chairman

I'm going to let Rob take that.

William Robert Berkley
Chief Executive Officer, President and Director

I think that at this stage, it's a little bit premature for us to be able to quantify that in a definitive manner. Having said that, it's hard to imagine that we are not going to see that coming through, as the health of the part of the economy that we service struggles a little bit more than it has in the past. We are seeing early signs of the challenges, just -- you're not seeing the same amount of investment from the operators that we have seen in the past. We certainly are seeing a slowdown as we look at the some of their receipts at this early stage. We certainly are seeing a bit of slowdown as it relates to their payrolls. So the long-term effect, how -- what the impact will be on our business, from an underwriting perspective, we don't get the same of visibility that we do on the investment side. Or certainly not as nearly as a timely manner. We do expect that there will be an impact. Having said that, we think the businesses are very well positioned and, in spite of the headwind, they'll do just fine.

Lawrence David Greenberg
Janney Montgomery Scott LLC, Research Division

So beyond maybe the top line impact, is there anything we should be thinking about from an underwriting margin standpoint?

William Robert Berkley
Chief Executive Officer, President and Director

I don't think so. I think that we believe the underwriting decisions are very sound, depending on how difficult that part of the economy gets for what period of time. That may, for some period, have a negative impact, at some point, on our expense ratio, which we're more than prepared to deal with if the businesses begin to shrink, and that's fine, as we've demonstrated in the past through other challenging times. But overall, the underwriting appetite and the underwriting discipline does not ebb and flow. It is constant. And we're not particularly concerned about it. But again, it's maybe a top line phenomenon, which will impact the expense ratio, but that's about it.

Lawrence David Greenberg
Janney Montgomery Scott LLC, Research Division

And then, Bill, I'm just curious on your case for the reemergence of inflation at some point. And would you -- so maybe what's the basis for that case? And then, would you extrapolate that to impact industry loss trends?

William Robert Berkley
Founder and Executive Chairman

I think, ultimately, there are issues that are old and common sense, which says the government keeps printing money. More money will eventually convert into inflation. The complexity that we are adding is we now have a global economy, with people bringing money into the dollar, with interest rates overseas basically going to negative, even 20 basis points is more attractive here than it is when you're paying 20 basis points to deposit your money. So I just think it's eventually going to come about. We're starting to see pressure on wages here. I -- if I was more certain about it, we'd have a lot more cash because it's still only 10% of our portfolio where we're short. I think that it's a judgment backed -- that's the direction we're going, and the duration of our portfolio is somewhat shorter than the duration of our liabilities but modestly shorter. It's 3.2 years compared to, say, 3.5, 3.6 years, again, 10% or 12% shorter. This is not a business where we make big bets because we think we're brilliant. It's -- we hedge. Would we go a little shorter, maybe. But right now, we're cautious. We're looking for things to do, that those less liquid assets will give us inflation protection. We're just being cautious because we see inflation as a major uncertainty that's sitting out there.

Lawrence David Greenberg
Janney Montgomery Scott LLC, Research Division

And you would -- and would you think that loss trends kind of follow the traditional inflation impact?

William Robert Berkley
Founder and Executive Chairman

Right now, loss trends are totally benign and they're -- our assumption of sort of loss trends at 2%, give or take, maybe 3%, are -- if anything, we're probably overestimating for the moment. But I don't see anything that's going to dramatically change that. And, clearly, the question is how things heat up? When do they heat up? What causes it to heat up? How's that going to interact with the Affordable Care Act and, certainly, medical cost are a big part of it. I think that people will have to build models that have to make estimates have to make some assumptions. Our assumption is we think a step in one direction and try to hedge a little bit. Our hedges -- we think there's a possibility of inflation. We're assuming there's more inflation than in fact appears at the moment. But we'll have to change our view, if inflation starts to pick up. We'll have to go with the other thing

[Audio Gap]

and it'll protect us, more than in fact, the levels of inflation.

Operator

Our next question comes from the line of Vincent DeAugustino of CBW.

Vincent M. DeAugustino
Keefe, Bruyette, & Woods, Inc., Research Division

It's Vincent DeAugustino of KBW. Bill, just your last point kind of segues into my question here and it's on the strong dollar. And so aside from any currency trend

[Audio Gap]

I'm wondering if we should think about any exposure to whether it'd be trade credit or any other line

[Audio Gap]

actually raise claim incidents?

William Robert Berkley
Founder and Executive Chairman

We have negligible exposure to trade credit. I mean, the answer is we don't write trade credit in any consequential way. We probably have some peripheral trade exposure. And some -- we end up having exposure in everything, some way, someplace, somehow, even though we're not supposed to. So we'd probably have a bit here or some place. But we don't write trade credit. I think that we'll -- the interesting thing is the dollar strength causes us to mark our assets to market. And while we mark our liabilities to market, we don't get a full credit for all those liabilities. So we've got some benefits at the moment, where we've hedged our credit exposures as far as currency goes. And we don't get the benefits on our balance sheet of those hedges. So if there's anything, the strong dollar -- our balance sheet is probably a positive at the moment. I think from an economic point of view, clearly, a strong balance sheet will have a more negative point of -- on our balance sheet, not directly, but indirectly on the economy. So it's something we need to be concerned about.

Vincent M. DeAugustino
Keefe, Bruyette, & Woods, Inc., Research Division

Okay, good color. And then, on the workers comp front, you guys have talked about -- the term was building up the iceberg, with returns being a little bit more acceptable. Now we've covered similar comments from some of the competitors in the space. And I'm just curious if kind of the pace of building that iceberg has been impaired by any incremental competition in that workers comp arena or if it's still business as usual there?

William Robert Berkley
Chief Executive Officer, President and Director

This is Rob. I think the answer is that clearly workers' compensation is a bit more competitive than it was 12 months ago. Having said that, the business that we're writing, we're still very confident that it is achieving or exceeding the targeted return that was referenced earlier. So yes, the market is more competitive, but we don't think that it's gotten to the point that it's not still attractive. I think it's important to note that once you're not painting with too broad of a brush, there are parts of the market within the comp universe that are exceedingly attractive and there are other parts of the market which one should tread very carefully. So I think we, as an industry, tend to talk about the comp market as one. But quite frankly, it's really a bunch of micromarkets all under the banner of comp, both depending on exposure as well as territory.

Vincent M. DeAugustino
Keefe, Bruyette, & Woods, Inc., Research Division

Okay, good to hear. And then just one last one for me. So Bill, it's a big picture question for you. On the reinsurance side, it seems like the premise here has become "bigger is better"

[Audio Gap]

benefits the industry

[Audio Gap]

the same issues that we're dealing with today.

William Robert Berkley
Founder and Executive Chairman

I think that the people who will benefit will be the

[Audio Gap]

will be better. I think there are some companies that are too small to be competitive, I think can't get along with $1 billion or $2 billion of capital. But I think $4 billion or $5 billion of capital is probably okay. My best judgment is it's just fewer people for the government to look at who don't pay taxes. It just makes it easier.

Operator

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

Kai Pan
Morgan Stanley, Research Division

First question is on the pricing side. You said the rate increase stands around 3%. That's roughly the same last quarter. So can you talk a little bit more about the competitive dynamics in the marketplace? Do you see the pricing deceleration will be orderly in 2015 and next year? Or there's potentially going down quicker than what we're seeing right now?

William Robert Berkley
Chief Executive Officer, President and Director

I don't think there's anything orderly about what we're seeing today, to tell you the truth. I think it's a pretty mixed bag. Again, we end up talking about rate increases. But we are covering a pretty broad spectrum of different types of insurance here and there's some that are getting tremendous increases still at the stage, and there are others that are -- quite frankly, we're willing to accept rate reductions because we believe in the margin in the business. I think, ultimately, what should we expect going forward, in part, is a result of some factors that are out of our control. Part of it being how aggressive will the reinsurance market get from here and are they going to empower irresponsible behavior in the insurance space. So I don't really know, to tell you the truth, how orderly it'll be. But we certainly, at this stage, don't see anything in the marketplace that would lead us to believe that anything is going to fall off the table.

Kai Pan
Morgan Stanley, Research Division

Great. Then secondly, on your CD professional line in your international book. You mentioned that there are some issues there. Could you detail a little bit on that? And also, have we seen the worst already, sort of taken care of? Or there could be some -- continue some issue to be addressed for a period of time?

William Robert Berkley
Chief Executive Officer, President and Director

Yes. Well, the issue was stemming from our professional liability that we rolled out in the U.K. and a bit out of Europe. And to make a long story short, the issue was that the business performed less well than what we had anticipated and, in fact, it performed poorly. As it relates to going forward, as I suggested, I think that we have done a reasonably rigorous examination of the portfolio. And while I can't guarantee everything, I am very much inclined to believe that we have our arms around it, and that we have taken the action that is required. So it is possible that there can be some additional modest noise coming out over the next quarter or 2? Yes, of course, it's possible. But do I think that it would be to be anything to the extent that we saw in the fourth quarter? I would be both very disappointed and surprised.

Kai Pan
Morgan Stanley, Research Division

Great. Lastly, on your own reinsurance book, like you see significant decline because probably your pricing discipline is account for like about 10% of your overall business. I just wonder, like what do you think about the size of the book? And in the current marketplace, does that put you at a disadvantage in terms of getting business or getting favorable terms and conditions?

William Robert Berkley
Chief Executive Officer, President and Director

No. I don't think that the size of the book, at this stage, in any way, marginalizes our ability to be effective in the marketplace. I think the fact is that we have strong relationships with all the brokers. We have strong relationships with the ceding companies. And quite frankly, I think the quality ceding companies that we have long-term relationships with, they both appreciate and respect our underwriting discipline, and our relationships are alive and well. So from our perspective, we think that the people that manage the reinsurance business are very capable. They know what they're doing and they're doing just what we would want them to do.

Operator

And our next question comes from the line of Brian Meredith of UBS.

Brian Robert Meredith
UBS Investment Bank, Research Division

I have 2 bigger picture questions. One of them, back on the reinsurance book. Rob, though, I'm just curious, clearly the cyclical pressure is going on right now in the reinsurance market from excess capital, et cetera, et cetera, but do you believe this is a market that's got secular pressures as well because of the alternative capital and maybe the way that reinsurance buyers think about purchasing decisions now?

William Robert Berkley
Chief Executive Officer, President and Director

I don't -- the world is changing, okay? The world is changing from every aspect, and there's lots of capital searching for predictable returns. And the returns will not be as unpredictable as those people think.

We've had a wonderful run of low-cap activity, and we've had some people who look like they're brilliant. And I think that as long as that continues, there'll be lots of cat capacity. In the meantime, I think that it'll continue with there being low cat activity and low interest rates because the marginal return you can get, if you have a portfolio of fixed income securities, the marginal returns from taking a flyer in the reinsurance business is pretty significant. So if you have a $10 billion pension fund, it's probably something that we think that makes sense to take a flyer and you'd have $10 billion pension fund. You expose $300 million and you can get a marginal return of a consequential amount when you're used to getting only 1% return.

Brian Robert Meredith
UBS Investment Bank, Research Division

Got you. And I'm just curious, were you able to take advantage of the increasingly competitive reinsurance market that -- the one where [indiscernible] with your own the programs? And kind of what your thoughts there? We had a point where the arbitrage is available in areas.

William Robert Berkley
Chief Executive Officer, President and Director

Brian, it's Rob. As it relates to our own ceded activities, of course, we are cognizant of what's going on in the reinsurance market. And we're trying to make sure that we take that into account in our buying habits and to ensure that we are managing the capital appropriately for the shareholders. So yes, we have benefited from the current reinsurance market. At the same time, we have not -- we've been conscious of not overreaching and turning our back on our long-term partners because we think that one needs to strike the balance between being opportunistic but also, recognizing one's partnership with those that has gone back for many years and will hopefully to continue on for many years.

Brian Robert Meredith
UBS Investment Bank, Research Division

Great. And then, just last question, Rob. Are you seeing any increased appetite from the standard commercial markets maybe dipping down in the E&S market at this point?

William Robert Berkley
Chief Executive Officer, President and Director

It's really, quite frankly, hasn't become a huge issue, so far, based on what we've seen. I mean, who knows what we'll see in the next, call it 90 days or throughout '15. But the competition that we're seeing from some of the standard market, to the extent that it's there and that's serious and visible, it's really more our regional companies that have seen it and, certainly, our mono-line comp companies have seen the national carriers sort of reawaken in the comp space, having stepped away over the past several years.

Operator

Our next question comes from the line of Ken Billingsley of Compass Point.

Kenneth G. Billingsley
Compass Point Research & Trading, LLC, Research Division

I just -- I'd like to follow up on the reinsurance purchases for yourself. It looks like the net to gross appears relatively flat. So are -- you said you're not looking, obviously, to take advantage of your reinsurance partners, but does -- are you getting more coverage than may be even better, in terms of conditions for the same price? How...

William Robert Berkley
Founder and Executive Chairman

I think the best way I could answer that -- because we generally speak and don't make it a practice to get into the nooks and crannies of the coverage that we buy. I think that from our perspective, we believe that the average rate that we pay for reinsurance today is less than it was in the past. So in other words, the premium that we are ceding may look similar to you, but as I think you are alluding to a moment ago, I don't think you should assume that the coverage is one and the same.

Kenneth G. Billingsley
Compass Point Research & Trading, LLC, Research Division

And then the last question I have is, at the end of the year, you guys pulled back on stock buyback, and I know you did pay a special dividend. Was that -- one of the reasons was because you were paying a special dividend that you pulled back on stock buyback? And then, the second part of that is, how much more room do you have for existing repurchase authorizations this year?

William Robert Berkley
Founder and Executive Chairman

We have lots of authorization, and I never comment on why we buy back or don't buy back or whatever. But we have lots of room on the authorization. And it's just a constant judgment we make based on the price of the stock, use of capital. I mean, one of the problems we face is we think we're way overcapitalized, but the rating agencies don't. So if you look at the history of our companies, we are more than generously capitalized because we don't have the volatility of many of our competitors. But rating agencies look at average capital employed. And as everyone, we hope, is more and more overcapitalized, the standard goes up. So we continue to search for opportunities and ways to return capital to our shareholders in an effective way that still meets all of the guide lines the rating agencies require. And we'll continue to that. But we -- to do the best for our shareholders, it would not be to tell people how we do it or what we're going to do.

Kenneth G. Billingsley
Compass Point Research & Trading, LLC, Research Division

And last question I have is regarding your service fee income, I know you had mentioned that a large part of the increase was assigned risk plans and new business starts in new states. So could -- should we assume that service fee income will remain at these elevated levels going forward?

William Robert Berkley
Founder and Executive Chairman

Mr. Ballard?

Eugene G. Ballard
Executive Vice President of Finance

Yes. For the short -- in the near-term future, yes. I mean, all these contracts typically have a life of a few years, give or take, around 3 years, while there are some exceptions. And those are constantly being put out to bid and rolling on or rolling off.

Operator

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

Jay Adam Cohen
BofA Merrill Lynch, Research Division

My questions were answered.

Operator

And our last question comes from the line of Ian Gutterman of Balyasny.

Ian Gutterman
Balyasny Asset Management L.P.

Gene, first, do you have the -- can you tell us how much in dollars the average [indiscernible] was in the international for the quarter?

Eugene G. Ballard
Executive Vice President of Finance

We haven't disclosed that yet. We'll have that in our 10-K.

Ian Gutterman
Balyasny Asset Management L.P.

Okay. Could you just give us like a ballpark or an [indiscernible] point? Just trying to get a rough a sense of how significant that was.

Eugene G. Ballard
Executive Vice President of Finance

I think you got to wait.

Ian Gutterman
Balyasny Asset Management L.P.

Okay, no problem. And then, Bill, on the energy side, I was looking through some of the disclosures. I think your 10-K shows about $150 million in the energy funds. As I go through your Schedule D, there's a -- 1 private equity firm, where you have multiple investments that add up to pretty close to that $150 million.

William Robert Berkley
Founder and Executive Chairman

It is all one investment, funds. We have 3 tranches.

Ian Gutterman
Balyasny Asset Management L.P.

Okay, and it looks like that investment firm, from what I see, is based in Canada and a lot of their investments, from what I found, are in Canadian oil sands. Is that accurate and, if so, how comfortable are you with that, given they seem to be sort of marginal capacity and the Saudis are talking about trying to put them out of business?

William Robert Berkley
Founder and Executive Chairman

Well, first of all, you made a lot of different statements in that comment. And I haven't yet talked to the -- well, the king of Saudi Arabia hasn't told me his plans. Number two, they're not really in oil sands, per se. They're first fund, when we met them, was oil and sands, and that fund is almost fully paid out. And their other -- their subsequent funds was in the Gulf, North Africa, all over, several of them being very low-cost oil. But the fact is the oil prices are down 50%. Even if they're the most brilliant people in the world, the value of what they got has gone down a lot.

Ian Gutterman
Balyasny Asset Management L.P.

Okay, got it. And just from a -- you mentioned, obviously, some pressure on Q1. I assume these are reported with the 1Q lag, and I noticed some of their investments are public. But for the private, how do -- do you have a sense of how they mark those? I know a lot of times, private equity markets tend to sort of lag public markets.

William Robert Berkley
Founder and Executive Chairman

I really -- I can't give you an answer -- I don't see it because I don't know. We do our best to be sure it reflects the fair market value of the securities or the entity.

Operator

I'm showing no further questions at this time.

William Robert Berkley
Founder and Executive Chairman

Thank you, all, very much. Have a great night.

Operator
Ladies and gentlemen, thank you for participating in today's conference. That does conclude today's program. You may all disconnect. Have a great day, everyone.