S&P Capital IQ

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W. R. Berkley Corporation NYSE:WRB

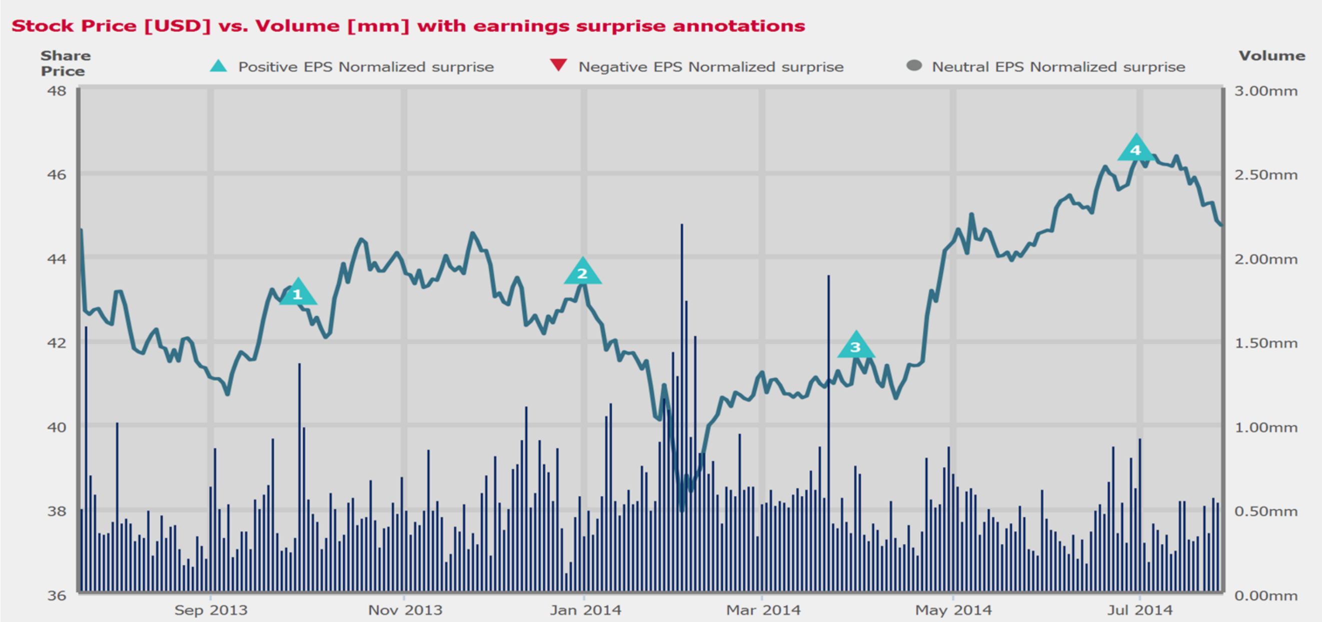
FQ3 2014 Earnings Call Transcripts

Friday, October 24, 2014 1:00 PM GMT

S&P Capital IQ Estimates

	-FQ3 2014-			-FQ4 2014-	-FY 2014-	-FY 2015-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.90	1.06	▲17.78	0.92	3.65	3.75
Revenue (mm)	1745.57	1840.60	▲5.44	1771.12	6879.99	7306.66

Currency: USD
Consensus as of Oct-24-2014 7:29 AM GMT



- EPS NORMALIZED -	CONSENSUS	ACTUAL	SURPRISE
FQ3 2013	0.73	0.77	▲1 5.48 %
FQ4 2013	0.78	0.85	▲2 8.97 %
FQ1 2014	0.79	1.00	▲3 26.58 %
FQ2 2014	0.76	0.82	▲4 7.89 %

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

Brett Horn
Morningstar Inc., Research Division

Ian Gutterman
Balyasny Asset Management L.P.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Joshua David Shanker
Deutsche Bank AG, Research Division

Kai Pan
Morgan Stanley, Research Division

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

Presentation

Operator

Good day, and welcome to W.R. Berkley Corporation's Third 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 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, 2013, 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 statement, whether as a result of new information, future events or otherwise. I would now like to turn the call over to Mr. William R. Berkley. Please go ahead, sir.

William Robert Berkley
Founder and Executive Chairman

Thank you very much. Well, we were very pleased with our quarter. We think it demonstrates our earnings capacity, and we think that, looking ahead, while there are bumps in the road, we're quite optimistic that we will continue to be able to deliver outstanding returns. I'm going to let Gene start out by talking about our financial results. Excuse me, I'll let Rob Berkley start by talking about our operating results and followed by Gene. Go ahead, Rob.

William Robert Berkley
Chief Executive Officer, President and Director

Thank you. What a relief. I thought Gene was going to take all my material. Well, good morning, everybody. Market conditions during the third quarter, by and large, followed the trends that we've seen over the past few quarters. The domestic insurance market continues to offer the greatest promise from our perspective. Casualty and workers' comp continue to stand out as particularly attractive. The non-cat-exposed property also offers some opportunity, and we are seeing the ability to get additional rate there. Having said that, cat-exposed property is a bit of a different story.

As it relates to professional liability, it is very much a mixed bag or it continues to be as we've suggested in the past. By example, D&O is very split between, what we would define as, the Fortune 1000, where that excess market is particularly competitive. Having said that, the smaller cat part of that marketplace there is opportunity for meaningful rate increase in both the primary as well as the excess.

Commercial auto continues to be a bit of a challenge. Rate increases are being achieved in the marketplace, and we expect that this is going to need to continue for an extended period of time. Adequate returns for this product line, at times, feel as though it's a carrot tied to the far end of a long stick, but I think we're getting there gradually. On the international front, it depends on the corner of the globe that you're talking about, but I would make the comment that both the U.K. and select parts of continental Europe remain exceptionally challenging. The big question mark concern from our perspective continues to be the global reinsurance market. We've talked about this over the past several quarters, and it continues to be front and center on our radar screen. The fact of the matter is the cold that the property cat market caught some time ago seems to be spreading to other part -- are continuing to spread to other parts, I should say, the reinsurance marketplace, and it would seem as though no bottom has been found yet. While benign cat season can mask some of these issues, there should be no misunderstanding the underlying challenges persist.

Turning to our organization, and how we did over the third quarter. Net written premium came in at approximately $1.525 billion. This is an increase of 7% when compared with the corresponding period of last year. The growth was driven by -- was primarily driven by our domestic insurance business, which grew at approximately 12% and was partially offset by our reinsurance segment, which was off by approximately 16%. This very much fits with our expectations given the market conditions in the reinsurance space that I mentioned earlier as well as in prior calls. Let there be no misunderstanding, we applaud our reinsurance colleagues for their underwriting discipline.

Rate increase for our insurance operations was approximately 3%, and the domestic insurance was a bit above that, and our renewal retention ratio remains at about 80%. Loss ratio for the quarter was at 60.7%, which includes approximately 1 point associated with cat. It's worth noting and Gene is going to get into this in a bit more detail that in our cat number, there are 2 aviation hull war losses that were coming out of our international segment. Expense ratio showed improvements, and we thought it was encouraging, particularly, what came out of the domestic insurance segment. This is another area that we are very focused on, and we expect that we will be able to continue to improve on what's going on with our expense ratio over the quarters to come. However, I would caution you that, on occasion, we'll need to take one step back in order to take 2 steps forward.

As it relates to the combined, it was a 93.5% on a calendar year basis. And when you adjust for a reserve development and as well as cat, we came in at a 93.4% on an accident year basis, and I would remind you that this is a -- approximately a 2-point improvement from the third quarter last year. On the topic of loss reserves, we had net $13 million of positive reserve development, and I would remind you also that this is the 31st quarter in a row of net positive reserve development. As we look forward to 2015, we remain encouraged as we continue to see our rate increases and excess of loss cost trends continue to earn through.

William Robert Berkley
Founder and Executive Chairman

Thanks, Rob. Gene, you want to pick it up?

Eugene G. Ballard
Executive Vice President of Finance

Okay. Thank you, Bill. Well, as you can see, we did have an outstanding quarter with a 46% increase in net income and annualized return on equity of 17.4%. I'll start with us a few more details on the underwriting results that Rob covered. As he said, overall premiums were up 7%. The domestic growth of 12% was led by workers' compensation, professional liability and selected short-tail lines. The international premium is up 3%, was the result of lower growth in Europe and a modest decline in South America. And in the reinsurance segment, the decline of 7 -- 16% was a result of less treaty business written in both Asia and the United States.

With respect to the underwriting results, profits -- underwriting profits were up 17% to $95 million with a combined ratio of 93.5%. Just recapping again the major components of underwriting, accident year loss ratio before cat down 1 point to 60.6%, because rate changes more than offset our loss cost assumptions, cat losses, $15 million, 1 loss ratio point, and that included $9 million from storms in the U.S. and another $6 million that Rob referred to from the aviation events in the Ukraine and Tripoli. Favorable reserve development was $13 million, primarily in the domestic segment, and overall expense ratio down 1 percentage point to 32.8%, with the domestic expense ratio down a full 2 points, as many of the expense and issues -- initiatives underway are beginning to have a stronger impact across more of our companies. If you look at those combined ratios by segment, domestic improved by 1.6 points due to improvement in both the accident year loss ratio and expense ratio, partially offset by slightly lower reserve releases. The international segment combined ratio increased 6 points due to the aviation-related cat losses that I mentioned before, as well as modest unfavorable reserve development. And the reinsurance segment combined increased by 1 point to 98.7% due to lower-earned premiums and slightly lower but still positive reserve development in the quarter.

Turning to investments. Our overall investment income increased 43% to $179 million. Most of the increase was due -- was related to investment funds, which earned $59 million, up from $12 million a year ago. The increase in the investment fund earnings in the quarter was primarily related to strong returns for funds in the aircraft leasing, real estate and energy sectors. The overall yield on the portfolio excluding gains was 4.6% in the quarter, up from 3.4% a year ago. In addition, we reported realized gains of 17 --

excuse me, of $72 million, up 65%. The largest gain in the quarter was a $39 million gain that resulted from an IPO by one of our private equity investments. We report that investment under the equity method of accounting. And under that method, our share of the increase in the company's stockholders equity as a result of the IPO, which was $39 million, is reported in realized gains. However, the full market value of the stock, at its current price, is not recognized until -- and if and until the stock is sold. So at the current price, the market value of our stock exceeds the carrying value by $260 million, and that's not in the earnings or on the balance sheet.

For our overall portfolio, aggregate pretax unrealized gains were $561 million, and the average duration and credit rating were unchanged at 3.1 years and AA-. In August, we issued $350 million of 4 3/4% senior notes that mature in 2044. A portion of the proceeds from that offering will be used to repay $200 million of 5.6% senior notes that are due in May of 2015. Our effective income tax rate increased to 31% in the quarter from 29% a year ago. As I talked about on our last call, as we earn more from underwriting and from investments, other than investment income, our effective tax rate has moved closer to 35%. We repurchased 738,000 shares in the quarter and 5.6 million shares so far this year. With that, we finished the quarter with a book value per share of $37.10, up 13.1% from the beginning of the year.

William Robert Berkley
Founder and Executive Chairman
Thank you, Gene. I'd like to talk about a couple of things about our investment results, complain about the accountants and try to give you a little bit better picture of where we expect to go. As hopefully most of you remember, I've told you certainly for the past few quarters that we would anticipate, on average, $25 million or more per quarter of investment returns. That's going to be a little lumpy. It may be more one quarter, we may miss a quarter. But the fact is achieving the kinds of investments goals that we've set forward and the returns we want for our company preclude us from having high-quality fixed income securities for all of our portfolio. We still have the vast majority of our portfolio in those high-quality fixed income securities more than enough to meet all our liabilities. So we're talking about relatively modest amounts, $2 billion or $3 billion of our roughly $16.5 billion or $17 billion investment portfolio. Where we invest in the nontraditional kinds of things, we've been very successful in doing it. Part of the issue that we face is the accounting rules, which tell us where we book things, how we book things, which are not relevant from the point of view of building book value. But it seems to impact analysts more substantially than reality, and that is, if it's in operating income, people think that's good, if it's in capital gains, it doesn't count. Oftentimes, these things are the same. So we continue to build our investment portfolio in alternative kinds of things, our private equity portfolio, which is where we own large percentages of companies. A good example would be HealthEquity, which is the company Gene was speaking about, where we booked a substantial income gain. And we have an unrealized gain in the portfolio, which is not reflected any place, of $260 million, or as of probably yesterday, $285 million. But, in fact, those are the accounting rules. We carry it in our equity, and it's within our regular ordinary portfolio, our book value would increase. There are other things that are similar to that. In our real estate portfolio, we have substantial gains that aren't recognized, but again, carry a cost. It's not that these realized gains are new and they went from yesterday's value to today's value. They are reflected because of accounting rules at cost, at equity or whatever, and when, in fact, something happens that allow us to move the unrealized, unrecognized gains, it suddenly becomes visible. We think that's a very significant number, hard to get a definitive number on it, but certainly, you measure it in $5 a share or more. So we are pleased with our real investment results, but have to recognize we elected to take a course that gives returns that are less subject to building a model around them. We continue to be optimistic that there'll be opportunities to find such returns. At this point, to date, we continue to do that. And we're very pleased that -- where we are this quarter and are optimistic about the balance of the year and continue to see opportunities that we can invest in. So with that, man, I'm happy to take questions.

Question and Answer

Operator

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

Amit Kumar
Macquarie Research

Just very quickly and that color was very helpful. Some of the questions you were getting last night related to the discussion on the energy-related exposure in your investment funds, and especially as it relates to the drop-in, I guess, crude and energy pricing of 22% in Q3. How should we think about that piece and its impact in Q4 numbers?

William Robert Berkley
Founder and Executive Chairman

Well, Curran gave us a $5 million, $6 million positive in the third quarter, and my guess is it'll be breakeven to a loss in the fourth quarter. Again, it's a bumpy process, the energy markets, but they're not highly leveraged in that point of view. And our exposure to Curran has been constantly diminishing as they liquidate their assets. So it's a smaller number at the moment, so -- but I would think that would be a negative swing in next quarter.

Amit Kumar
Macquarie Research

Got it. The other question I had was, I think when Rob was talking about the expense ratio and domestic, and obviously, you pointed out the improvement, and yet, there were some cautionary language around that. Is this -- should we think about, I guess, the 31% as sort of the number we should think about for the next few quarters? Or is there more room for improvement?

William Robert Berkley
Founder and Executive Chairman

I'll let Rob answer the question.

William Robert Berkley
Chief Executive Officer, President and Director

I think as far as the domestic goes, I would encourage you not to get fixated on the 31.1%. It can move up and down some number of basis points. Having said that, I think, over a longer period, the trend is going to be downward. A lot of it, is quite frankly, is going to be driven by a mix of business and market conditions. I think what you really have seen in the domestic business is that we've -- our earned premium continues to grow, and we have gotten to the point where we are able to further leverage our platform. So again, I wouldn't -- I would suggest that you recognize that it could go up or down a little bit. But I think, overall, there's probably more likely, over time, room for a bit more improvement than not.

Amit Kumar
Macquarie Research

Got it. That's helpful. And just a quick numbers question for Gene. Do you have the paid losses number?

Eugene G. Ballard
Executive Vice President of Finance

The paid losses or the paid loss ratio?

Amit Kumar
Macquarie Research

The paid loss number? I'll take anything.

Eugene G. Ballard
Executive Vice President of Finance

The paid loss.

William Robert Berkley
Founder and Executive Chairman

He doesn't give much, not even to me.

Eugene G. Ballard
Executive Vice President of Finance

The paid loss ratio in the quarter was 53.4%.

Operator

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

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Just a couple of questions in the domestic business. So it looks like the short-tail lines grew up a bit and comp also grew a bit. We saw some other players look like they're pulling back a little bit there. In comp, is that excess or primary? And could you give a little bit of color on the short-tail lines, please?

William Robert Berkley
Chief Executive Officer, President and Director

Sure. The growth is primarily driven by the primary comp as opposed to the excess comp. I think we had a little bit of growth in the excess comp. But, again, it was mainly primary. And that's just because, again, as we suggested in the past, Mike, we don't think that everything is rosy for comp nationwide, but we think that there are certain markets, certain classes within the comp space that are particularly attractive, and we like the returns. So we recognize that the name of the game is -- it's a cyclical business. The name of the game is to build up the iceberg as because as you can because, over time, market conditions will become less attractive. So that's what we're doing in the comp space, adding to exposure, adding to the count, again, because we like the return.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Got it. And then just on international, how should we be thinking about that? It looks like the combined is kind of sticking up in the kind of 98-ish range recently? You've had some growth. The growth kind of pulled back a little bit this quarter. How should we be thinking about the trajectory for that business? Is that an area where you expect to continue to grow? And do you want to see that? Or do you expect to see maybe the expense ratio follow the same sort of pattern that we've seen on the domestic side recently?

William Robert Berkley
Chief Executive Officer, President and Director

I think in the short run, you're going to see the growth rate slow a bit from what you've seen in past quarters. I think on the expense ratio side, clearly, we have some work to do, and we're focused on that. And as far as the loss ratio, there's still some work to be done there. Some of the businesses that make up that segment are performing particularly well. The syndicate is doing reasonably well, putting aside the 2 aviation hull war losses. Our European/U.K. insurance business, aside from our Lloyd’s operations, we have some work to do there as, I think, I mentioned a quarter or 2 ago. And we have already taken some action to get that to a better place, and we think the results of those actions will be coming through in '15.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Got it. And then just, Gene, can I ask a number's question? On other expenses, it looks like that number ticked up in the quarter. Obviously, that doesn't run through the combined ratio, but just trying to think about just overall operating income. It looks like it ticked up from about $33 million to about $42 million in the third quarter. Is that just some seasonality trend or is that just something that flipped up this quarter and last quarter? Or is that a level that we should be thinking about?

Eugene G. Ballard
Executive Vice President of Finance

Yes, so that's the parent company expenses, and then some -- any expenses that we don't allocate back to the subsidiaries. And one of those is a big portion of our incentive comp program is kept here at the parent level. So as we make more money, we accrue a little bit more for that, and that comes through in the quarter when our returns are higher. But it's unallocated expenses that we choose to paying here at the parent level.

William Robert Berkley
Founder and Executive Chairman

Got it. And that's...sorry.

William Robert Berkley
Founder and Executive Chairman

Mike, let me just be a little bit more explicit. As our return for the year is going to move over 15%, we start to have to accrue on a different level for incentive plan, which is not at all -- which is all paid for at the parent company's expense level and not allocated. So as it's become much more likely that we'll exceed that 15% return for the year, one of our long-term incentive plans required a greater accrual.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

I understand. Okay. So as time goes on and you're accruing past that threshold on a net basis, then you start accruing more incentive comp?

William Robert Berkley
Founder and Executive Chairman

Yes, except this was a catch-up for the first 3 quarters, not quite. But we weren't there. So when I say a catch-up, you make it for the year. So as soon as you're confident you're going to make it for the year, you make it. So for example, god forbid we would have a terrible fourth quarter, we would find that would be an over accrual.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Got it. And so then if I were to take that accrual piece out and look at whatever the corpus of the expenses were, other than that, is it fair to say whatever that was that didn't change much?

Eugene G. Ballard
Executive Vice President of Finance

There'll be some modest growth, but nothing -- not significant.

Operator

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

Joshua David Shanker
Deutsche Bank AG, Research Division

I wanted to talk to you guys about the traditional investment portfolio as opposed to the alternative investment portfolio. I noticed that your investment yield seems to have gone up about 20 bps compared to a year ago or the second quarter. Have you changed strategy on investing or what might be causing that?

William Robert Berkley
Founder and Executive Chairman

No. Just -- the answer is no. Our duration is unchanged, our quality of the portfolio is unchanged. For a period of time, we were able to invest our short-term cash and bring it down because cash flow was up, so our mix of short-term cash changed a little bit. But it was just -- it was quirky. Our returns have been going way up, and honestly, we did better than we had expected to do, and we were very pleased. But we don't think there's anything that's particularly different.

Joshua David Shanker
Deutsche Bank AG, Research Division

So if we look past the previous quarters, the run rate trend on shrinking NII in this [indiscernible] environment is more normal than the big pop you had this quarter?

William Robert Berkley
Founder and Executive Chairman

I don't know, I would say shrinking, but I would think that it would be more like flat to slightly up. I think this quarter, probably ended up being disproportionately more cash invested in the -- the cash increased again, so the return probably will move back to sort of in between where we were and where we are. So it's not -- I don't think you should think we'll get a much higher yield than we've averaged. It might be slightly higher, but this was -- I think, because of how we invested our cash, I think it was slightly better.

Joshua David Shanker
Deutsche Bank AG, Research Division

And do you have a breakdown for prior development by operating segment?

William Robert Berkley
Founder and Executive Chairman

As you know, we don not give it on this call, but it will be available afterwards.

Operator

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

Kai Pan
Morgan Stanley, Research Division

So the first question is on the investment side. Thank you for the disclosure about the substantial gain that's not on the book. I just wonder if you can quantify what's -- if you work to mark-to-market all your holdings, which occurred not in the book, like do you have estimates how much would that be as a percentage of current shareholders [indiscernible]?

William Robert Berkley
Founder and Executive Chairman

I said it will certainly be more than $5 a share.

Kai Pan
Morgan Stanley, Research Division

$5 a share. And also, just trying to understand a little bit about that investment process, basically for the nontraditional investments. So could you give a little bit more sort of colors on like what's the approach there and how do -- you're coming with these deals? The question is really to say what's the consistency of the return going forward?

William Robert Berkley
Founder and Executive Chairman

Consistency in the short run, there is none. consistency in the long run, we continue to be opportunistic searching for what we believe are good risk-adjusted returns where we aren't required to have liquidity. So we bought an office building in West Palm Beach, Florida, because someone needed to close, and there needed to be a cash closing in a very short period of time. And it was the very best office building, and to get approval to do that again, at this point in time, will take years. That would be an example.

Kai Pan
Morgan Stanley, Research Division

So these deals just come to you, or do you have a regular sort of process and like a -- basically an investment process and you've added sort of -- as such sort of opportunity arise?

William Robert Berkley
Founder and Executive Chairman

Both. We have a regular process as far as private equity things, where we have our own private equity team where things come in. We have our own real estate team that looks at these, and some things such as the real estate transaction in West Palm Beach. They come to us because someone here knows someone -- so we are sort of just out there looking.

Kai Pan
Morgan Stanley, Research Division

Great. The second question is on the reinsurance side. Given all the alternative capital, escrow asset now that there is some curious talk, primary company talking about creating internal reinsurers that potentially pull the demand from the open market. I just wonder sort of from -- your thoughts on both as a buyer and seller of reinsurance in this changing marketplace.

William Robert Berkley
Chief Executive Officer, President and Director

I think stating the obvious, it's a better moment to be a buyer than a seller. I think as far as long-term goals, it's still a bit unclear as to the permanence of this alternative capital. It hasn't fundamentally been tested from a loss perspective where a lot of the decisions and judgments, which are based on models, prove to be wrong as a result of some type of unforeseen or unfortunate event. I think in addition to that, while parts of the casualty reinsurance market have become a bit more competitive, much of the alternative capital has not necessarily found a way to effectively penetrate that market. To make a long story short, our expectation is that the reinsurance market, particularly the traditional one, is not going to go away overnight. And this is a challenging moment, and there remain opportunities to participate in the reinsurance market that are reasonably attractive. But there is no doubt that this is a competitive time.

William Robert Berkley
Founder and Executive Chairman

I think that this is an ever so alluring business appearing so predictable, but proving to be particularly unpredictable when the unforeseen event arises. Many companies, after Katrina and several other events, would have proved to be insolvent if, in fact, anyone had said, "Okay, you have to pay your claims now." And they went out and rushed and raised capital very quickly on financial statements that, at best, were questionable. I think when Rob said, they have been untested, it's a very quick period of time when these companies could be tested. Their capital accounts could be gone and not only will they be tested, but the people who purchase reinsurance from some of them will be tested. The moral commitment of participants in this business is a really important factor. And many of the people who are now playing in that industrial game don't have substantial moral commitment to our industry.

Kai Pan
Morgan Stanley, Research Division

Okay, lastly, on capital management, and it seems like you have a very strong earnings year-to-date and buybacks slowing down a little bit. So just wonder your thoughts on buybacks going forward or any thoughts on special dividend?

William Robert Berkley
Founder and Executive Chairman

One of the things we face is the opportunity to buy back stock when we're blacked out because our lawyers say we're taking a risk. When there's opportunities, we're trying to constantly measure our capital, our alternatives, the regular dividends, special dividends and buying back stock. But as you and everyone knows, when we talk about myself and other senior management in the company, everyone is concerned about capital usage, and we'll be very conscious of all those things, and we are examining all those options.

Operator

Our next question comes from the line of Vinay Misquith of Evercore.

Vinay Gerard Misquith
Evercore ISI, Research Division

Several small questions. First, thanks for the $5 number of unrealized gains. So is that an after-tax number, Bill?

William Robert Berkley
Founder and Executive Chairman

It was an estimated number to give people a magnitude picture of what it could be. I'm really trying to give people an idea. I would tell you that it probably is, but it's an estimate. Don't buy. And as I said, it shouldn't be modeled, and it can't be modeled. It's a number to give people a sense of without their..

Vinay Gerard Misquith
Evercore ISI, Research Division

Yes. No, no, that's fair enough. But I think that's really helpful. Second question was pricing versus loss trend, and I believe Rob said that you have some ways to go on the international side, where you can actually reduce the combined ratio. So given that pricing and loss trends are now roughly flattish and may be going the other way, but that may be offset by some margin improvement in international. Do you still think that you can keep margins flat? Or do you think that the combined ratio is going to take up next year?

William Robert Berkley
Chief Executive Officer, President and Director

Did you want to? Would you like to...

William Robert Berkley
Founder and Executive Chairman

Rather you talk, and then I can comment on what you say.

William Robert Berkley
Chief Executive Officer, President and Director

So I think, obviously, we're in the throes of our planning process, but when we look out the front windshield, our expectation is that for 2015, we should be able to, certainly, keep up with trend, if not exceed it in general. In addition to that, we think that there will be some further benefit coming through in the expense ratio, particularly, on the international front. So all things being equal, I think the reported numbers, barring unforeseen events, should probably hang in there or improve next year. And on a policy year basis, I think there is certainly room for us to do as well, if not better.

William Robert Berkley

Founder and Executive Chairman

Yes, I am more optimistic. I think that, in fact, we're going to -- as premiums get earned, we will see continued improvement from the past 12 months' rate increases.

Vinay Gerard Misquith
Evercore ISI, Research Division

Okay, that's helpful. And just wanted to have a clarification on the yield on the fixed income. I mean, I thought that the dollars of fixed income earnings this quarter was about $120 million. That was about $107 million, $108 million in prior quarters. So there seems to be a jump this quarter. So were there some onetime items in there?

William Robert Berkley
Founder and Executive Chairman

Well, there are various things, but you got to remember, our cash flow was almost $400 million also. So there was a big amount of cash flow also that accounted for part of it. But the fact is that I think that there were -- every quarter, there are various changes, things that happen in -- we have 52 operating units. We have lots of bundles of securities. The general view I would have is our core portfolio will have a slightly better trend than it had in the prior quarters, but you shouldn't think we will do a lot better than we did before.

William Robert Berkley
Chief Executive Officer, President and Director

I can just give another reference to that. Our yield on the fixed income portfolio for all of last year was 3.6%. And it's 3.6% in the third quarter this year. It was slightly lower in the first 2 quarters, but it's back around where it's been from the last 4 quarters.

Vinay Gerard Misquith
Evercore ISI, Research Division

Okay. So I just want to be sure that there was nothing sort of untoward this quarter, and this quarter is, maybe, the base for the run rate for the future?

William Robert Berkley
Founder and Executive Chairman

I think that this quarter had a couple of quirks in it to make it slightly better, but not an overwhelming number.

Vinay Gerard Misquith
Evercore ISI, Research Division

Okay. And the last thing if I may, the pace of reserve releases has slowed a little bit this quarter. Just curious as to what's happening there.

William Robert Berkley
Founder and Executive Chairman

The answer is, over time, as pricing is, reserve releases get more modest, they should get more modest. And the fact is, as you saw, we've already had 3 or 4 companies have -- adverse reserve releases. And so we're pretty pleased our reserve position is very comfortable, and I think that everyone has been slowed by a few of our very large competitors with huge reserve releases. It's never been an issue with us.

Operator

Our next question comes from the line of Brett Horn of Morningstar.

Brett Horn
Morningstar Inc., Research Division

Yes, I wanted to ask a follow-up question on the previous question on the expense ratio in the domestic lines. I appreciate your comment that it will potentially pick up here in the very near term, but it sounds like you're positive about the longer-term direction. Obviously, we've got more active in those lines, and presumably, you're scaling your cost there. I guess my question is to you see a positive longer-term trend, do you need to see the pricing picture get even better? Or is it -- would just a status quo situation allow you to continue to leverage that cost?

William Robert Berkley
Chief Executive Officer, President and Director

I'm pausing because I'm trying to figure out how to answer the question without getting myself in a corner or splitting hairs. So I think the answer to the question is, for the domestic insurance business, we think, give or take a certain number of basis points, we can do a little bit better over time as our earned premium continues to grow reflecting the recent growth that we talked about earlier. I think that, that is not necessarily perfectly smooth or perfectly predictable, and it can ebb and flow by quarter. What I can tell you is that all of my colleagues, both domestically as well as outside of the United States, are focused on our expense ratio overall as a group, and are determined to make sure that we are spending what we need to spend and not spending more than we need to spend. So will the 31.1% come down x number of basis points? Yes, I think it's possible that it could get a little bit better from here over time. A lot of that's going to be driven, quite frankly, by mix of business as well, and to a certain extent, the type of reinsurance we're buying. But I think the areas of low-hanging fruit are probably in the international segment over the next 6 to 12 months.

Operator

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

Jay Adam Cohen
BofA Merrill Lynch, Research Division

A couple of questions. I guess, first on the reinsurance side. One thing we do notice is that you retain the bulk of your reinsurance premiums, your net gross really hasn't changed. In fact, it has gone up a little bit. Given the softness in the reinsurance industry, have you explored and could there be an opportunity to buy some retro from people that want to sell it too cheaply, potentially?

William Robert Berkley
Chief Executive Officer, President and Director

Jay, I think, probably, the best way for us to answer that is we're cognizant of the market, we are cognizant of the various types of pools of capital that are out there that seem to have an unquenchable thirst to participate in this marketplace, and we have in the past and continue to explore and consider whether there are alternatives to using our shareholders capital that would make more sense.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Got it, got it.

William Robert Berkley
Chief Executive Officer, President and Director

I was after a nonanswer answer.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Yes, it's kind of what -- it's a reasonable nonanswer though. So it's okay. The other question was on HealthEquity. You obviously gave us the numbers for its market value in excess of cost. When we think about...

William Robert Berkley

Founder and Executive Chairman

By the way, that's in excess of our book cost. We have a real cost to 0 at this point.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Got it. So carrying value, let's say. When we think about the economic value, forgetting accounting, is that something we should tax-adjust anyway? Or is that an after-tax number?

William Robert Berkley
Founder and Executive Chairman

No, that's a pretax number. We think -- we elected not to sell any stock because we think it's an outstanding company. But I think that we have not tax-adjusted it.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

But eventually, when you do sell it, obviously, there would be -- will be a tax bill?

William Robert Berkley
Founder and Executive Chairman

Yes, unless it was -- yes, the answer is, yes.

Operator

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

Lawrence David Greenberg
Janney Montgomery Scott LLC, Research Division

Just one quick one related to HealthEquity. So they declared a dividend, I think, the day before the IPO, and you guys got $17.5 million. Is that included in the gain that you reported? Or is that something that you might report on a lag basis?

William Robert Berkley
Chief Executive Officer, President and Director

No, that's taken into account.

William Robert Berkley
Founder and Executive Chairman

That reduced our cost basis, and then the increase in book value took it up. So it's my frustration with the accounting treatment. Larry, trying-- I've finally gotten old enough that I could tell the accountants they're wrong, but I wouldn't convince them they're wrong. It all appears as -- in the gains.

Operator

Our next question is a follow-up from the line of Amit Kumar of Macquarie.

Amit Kumar
Macquarie Research

Just one quick follow-up on the investment funds. I guess, the other question we were getting was the discussion on the merger RFPs of your investment portfolio. There has been a lot of chatter in the news regarding down winding of some deals and -- apart from the tax discussion. Do you get the sense that you will see some impact from all that is going on in the merger RFP space in your Q4 numbers? Or is that somewhat of -- somewhat unaffected?

William Robert Berkley

Founder and Executive Chairman

So you're asking me to tell you what already has happened, right?

Amit Kumar
Macquarie Research

Yes.

William Robert Berkley
Founder and Executive Chairman

And the answer is, no, we do not get particularly adversely impacted. So that goes under the forecasting what already happened, exemption under our -- go ahead.

Operator

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

Ian Gutterman
Balyasny Asset Management L.P.

Bill, I was hoping, or Rob, I was hoping one of you could expand a little bit more on just about market competition and how it might affect your future growth plans. And, I guess, I'm thinking specifically you mentioned internationals, maybe you can expand upon what you're seeing there in London and so forth. But also, are we seeing competitors that maybe 6 months or a year ago, what has been focused more on improving their own books, trying to be more aggressive for new business? Or are we seeing more E&S business return to stay in markets, things like that?

William Robert Berkley
Chief Executive Officer, President and Director

I think it would be fair to characterize maybe to bifurcate between domestic, and then we can talk about any markets outside of the United States that we participate in and that we wish to. But on the domestic front, I think it is fair to say that the market is a bit more competitive now than it was 12, 18, 24 months ago. Having said that, we do believe that we are still able to achieve rates that are a bit above, what we believe, loss cost trend to be. Having said that, it's an interesting moment because the level of competition seems to ebb and flow by the months. So for example, we found July to be particularly competitive, August was a bit competitive, September was a little bit less competitive. And, actually, October was very encouraging for many of our companies in the group. And again, this is domestically. So it's up and down. Clearly, some of it is driven by competitors, perhaps, trying to make their budgets at certain times of the year. But I think we're pretty comfortable that, by and large, the market conditions that we have seen in the third quarter will certainly continue into the first half of '15 if not beyond. As it relates to the U.K. market, I think you had referenced also, I could say, it's an exceptionally competitive place. You got a lot of very skilled people managing a lot of capital within a couple of blocks of one another, and as a result of that, you get a very competitive marketplace. In addition to that, much of the business they write is cat-prone, and short-tailed. So when things don't go the wrong way, people end up feeling pretty good about themselves, and sometimes, that euphoria from the shorter-tail lines of business can appropriately or inappropriately spill over into the longer-tail lines of business. And as a result of that, you get a very competitive market. That's been the case for some period of time, and it is our expectation, at some point, you're going to have to see that change, particularly, for some of the casualty lines.

Ian Gutterman
Balyasny Asset Management L.P.

Got it. So internationally, obviously, more difficult. In the U.S., there is a comment and it doesn't sound like it's -- guys, seem it always does in some accounts, but as an overall theme, it's not impacting your ability to grow in the areas you want to grow in then?

William Robert Berkley
Chief Executive Officer, President and Director

We are comfortable with the U.S. insurance market. We think, again, a bit more challenged than it was 12, 24 months ago, but we still think it is a good opportunity as opposed to the reinsurance market, which is facing more of the headwind on a global basis. And the international insurance market, obviously, it varies by territory. But as we suggested, U.K./parts of Europe are also facing a bit of headwind.

Operator

[Operator Instructions] Our next question is a follow-up from the line of Josh Shanker of Deutsche Bank.

Joshua David Shanker
Deutsche Bank AG, Research Division

Yes, Bill, sorry, to belabor things on this cash in the quarter, just trying to understand a little bit better. If you receive a lot of cash in the quarter and reinvestment at the current market, doesn't that depress the overall yield to portfolio? I guess, I just need a little education on how that works.

William Robert Berkley
Founder and Executive Chairman

I'm sure you can talk to Gene after the call.

Joshua David Shanker
Deutsche Bank AG, Research Division

Okay. Then next question. So I was trying to answer it for myself, and I noticed over time that there's been a concerted effort to decline the percentage of the portfolio investment in municipal bonds, which means the bonds, of course, have a lower yield than the traditional fixed income corporates. Is that going on? And why -- if, maybe, we think that tax rates are risk to rise, or maybe they're not risk to rise, why is the strategy the company is trying to own less munis over time?

William Robert Berkley
Founder and Executive Chairman

In the area that we invest, the relative yields on municipals are not as attractive. And the reason our tax rate is going up is because we are having substantial realized gains, which are fully taxable. So the investment income is a smaller percentage of our overall income. But if you look at the relative yields, on an after-tax basis, municipals are particularly rich in the 5 years or under.

Operator

Our next question is a follow-up from the line of Jay Cohen of Bank of America.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

I'm looking at the international segment, and if I build in a little bit of adverse development, low single-digit numbers, millions of dollars, it looks like the accident year loss ratio in that segment, ex-cats, jumped up quite a bit from a year ago and even quite a bit from the first half. I'm wondering, are there any other non-cat large losses in that segment and/or what drove the presumed increase?

Eugene G. Ballard
Executive Vice President of Finance

No, there's no -- nothing else in there. But we did raise our lost pick as we saw some of that on a favorable development come through, so we raised our loss pick and there was a bit of catch up because they came through in the quarter. And the expense ratio was slightly higher as well.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

I was just talking on the loss ratio. So on that loss ratio then, Gene, for a reasonable run rate numbers, should I look at, maybe, the first 9 months of the year as kind of what you suspect that business is producing.

Eugene G. Ballard
Executive Vice President of Finance

I think that would be pretty accurate.

Operator

And I'm showing no further questions. I'd like to turn the conference back over to management for any closing remarks.

William Robert Berkley
Founder and Executive Chairman

Okay. Well, thank you, all, very much. We're really quite pleased with the quarter and quite optimistic with the balance of the year. I wish you all a very happy Halloween.

Operator
Ladies and gentlemen, thank you for your attendance in today's conference. This does conclude the program, and you may all disconnect. Have a great rest of your day.