S&P Global
Market Intelligence

W. R. Berkley Corporation NYSE:WRB

FQ3 2008 Earnings Call Transcripts

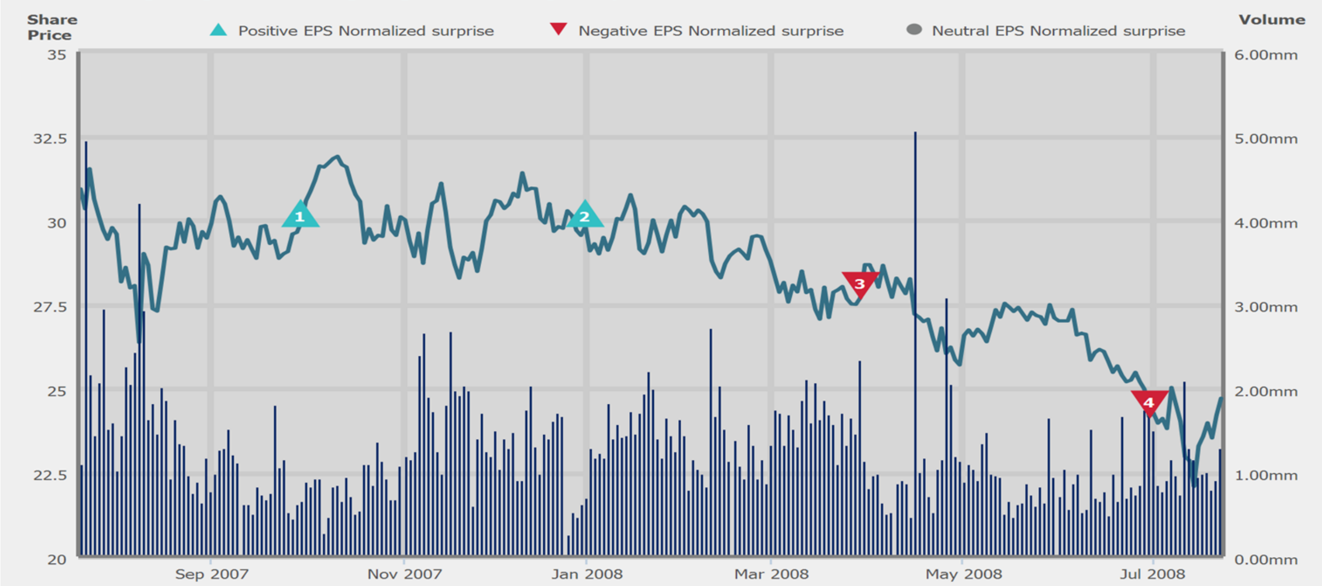
Wednesday, October 29, 2008 1:30 PM GMT

S&P Global Market Intelligence Estimates

	-FQ3 2008-			-FQ4 2008-	-FY 2008-	-FY 2009-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.71	0.73	▲2.82	0.84	3.15	3.23
Revenue	-	-	▲(13.50 %)	-	-	-
Revenue (mm)	1220.38	1055.63	-	1255.28	5058.40	4955.60

Currency: USD
Consensus as of Oct-29-2008 7:59 AM GMT

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



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ3 2007	0.91	0.93	▲1 2.20 %
FQ4 2007	0.94	0.97	▲2 3.19 %
FQ1 2008	0.91	0.83	▼3 (8.79 %)
FQ2 2008	0.84	0.77	▼4 (8.33 %)

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Call Participants

EXECUTIVES

Gene Ballard

William Berkley

ANALYSTS

Doug McGregor
RBC Capital Markets

Josh Shanker
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Kenneth Billingsley
Signal Hill

Larry Greenberg
Langen McAlenney

Meyer Shields
Stifel Nicolaus

Mike Grasher
Piper Jaffray

Presentation

Operator

Good day everyone and welcome to the W.R. Berkley Corporation third quarter 2008 earnings conference call. Today's conference is being recorded. Before we begin, we would like to note that the speaker's remarks may contain forward-looking statements. Some of the forward-looking statements can be identified by 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 report on Form 10-K for the year ended December 31st 2007 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 or 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'd now like to turn the conference over to your host, Mr. William R. Berkley. Please go ahead, sir.

William Berkley

Okay, welcome. We had quite a satisfactory quarter if you didn’t look at the bad things. It is like most quarters if you overlook the things that you didn’t expect or that were bad it was a fine quarter. While Gene will go through the numbers, and I will go through some more details in a few minutes, I think that the overall view we have of the business has changed markedly in the past quarter. We’re much more optimistic about the upcoming period of time. Our forecast which has been on track with which is a marked return in end of ’09 and the first quarter of 2010 is still our position, but if anything we’re much more confident in that position and believe that it is possible that the change will take place sooner. We now see the catalysts for the change. We understand what is going on. Our own business is performing quite well. Our combined ratio is running, when you take out a reserve releases and all the external things, the ongoing rates are between 95 and 96. And we’re pretty pleased with that. That keeps our return right around the 15% level which is where we would hope we would be in spite of a lower than anticipated investment income.

We think that business continues to be okay. That is a turn to the point that prices are going down at a much slower rate and in fact on a few places prices are going up. But in general on our price monitoring reports we saw in September the price declines at measurable level of improvement compared to the prior quarters declines. Our regional businesses generally is not under as much pressure although here and there is aggressive behavior in the part of some participants. Our specialty business while still competitive, the pressure is easing a bit here and there. The reinsurance business has continued to be price sensitive but the general sense out that the lack of capacity with the changing financial markets and that is just not as much capacity there. And a lot of people are rethinking their retentions as those adverse pricing decisions they have made in the prior two years are coming home to impact their loss ratios. So overall we’re pretty optimistic. I will talk a bit more about that when Gene finishes and then we will go into questions.

So Gene, go ahead.

Gene Ballard

Thanks, Bill. In spite of a difficult quarter we have managed to report after-tax operating income was $123 million or $0.73 per share and operating ROE of 13.8% on an annualized basis.

I’m going to be begin first with a summary of the two more significant items in the quarter, which are the storm losses and investment write-downs. With respect to storms, our net losses before tax was $62 million and that compares with just $8 million in the third quarter of 2007. Losses from hurricane Ike alone were $33 million. That includes our participation in Lloyd’s syndicate, our estimate of ultimate losses from the Texas Windstorm Association as well as reinstatement premiums.

In addition to Ike, we incurred another $29 million of losses from a combination of hurricanes Gustav and Dolly and an unusually large number of wind and hailstorms in the Midwest. The breakdown of the net losses by segment was $39 million for the regional segment, $14 million for the reinsurance segment that is primarily the Lloyd's participation, and $9 million for the specialty segment.

With respect to investments we reported a net realized investment loss of $220 million in the third quarter. That loss includes $211 million of losses from Fannie and Freddie preferred stock, which we wrote down after they were placed into conservator ship by the Federal Housing Finance Agency on September 7.

Turning now back to the insurance results for the quarter, our net premiums written were $996 million that is down 12% from the prior year quarter. Again this quarter, the decrease was mostly attributable to declines in the reinsurance business, which was down 40% as well as declines in E&S lines, which were down 24%. On the other hand, regional and alternative markets were down just 4% and 6% respectively and our international segment was actually up 37% due to our new reinsurance company in Australia as well as strong growth in South America.

The reported combined ratio was 96.2% and if you look at the combined ratio excluding storms that would be 90.4%. Prior year reserve releases were $49 million in this year's third quarter compared to $18 million in the third quarter of 2007.

Our pay loss ratio including storms was 58.1% in the quarter and net loss reserves increased by $81 million to $8.2 billion at September 30th.

Operating cash flow is still strong at $375 million in the quarter and $730 million year-to-date. Our overall investment income was $153 million compared to $166 million a year ago and the investment income from the alternative investments that is the arbitrage account and the investments and partnerships and affiliates was $28 million in both periods, both this year's quarter and the quarter a year ago. But the composition was quite different. For one deals spreads widened significantly in September and as a result the arbitrage trading accounts reported a net loss of $2 million in the quarter compared with a profit of $21 million in the prior year quarter. Offsetting that however was significant improvement in investment income from affiliates, which rose to $31 million from $7 million a year ago. The improvement in earnings from affiliates was mostly due to mark-to-market gains reported by one of our external investment funds.

The core portfolio other than the arbitrage account and partnerships and affiliates, investment income declined by $13 million and that is primarily the result of lower short term interest rates as well as the impact of cash used for share repurchases.

The average annualized yield on the portfolio was 4.8% for the quarter compared to 5.2% in the third quarter of '07.

There is a summary of the carrying value of the portfolio by investment category on page nine of the release. Just a few things that I would like to point out there, one the municipals have an average credit rating of AA and that is of course without considering any credit enhancements. The mortgage securities are mostly agencies; the corporate securities are short duration high quality names. The loans receivable are all commercial mortgages and the foreign government bonds are primarily UK gilts.

Also want to point out as we mentioned in our prerelease that we do not invest in CDOs CLOs, never been a party to a credit default swap and don't engage in securities lending.

At September 30th, the net after-tax unrealized losses were $155 million or 1.2% of the total portfolio. We repurchased 1.9 million shares of our stock in the quarter at a cost of $44 million and that brings our year-to-date share repurchases to 19.4 million shares. The financial effect of those repurchases which were made at prices above stated book value was to reduce book value per share by $0.90.

Our ending book value per share at September 30th was $18.81 down $0.99 from the beginning of the year.

William Berkley

Thank you, Gene. So basically, let me just quickly go through the real story of our businesses. Our regional business is general flat; prices are down slightly less than 5% this year. A little less competition currently then there was again sporadically in a few places in a few companies more aggressive, especially those companies who are particularly concerned about cash flow are out there trying to aggressively write business.

Our specialty business continues to see standard markets entering into the business as well as some aggressive competition from less well rated, less established competitors, where they are searching for opportunities to get into the business. We have actually seen business loss to people where the prices they have quoted a 100% loss ratio or more. We just aren't sure that people understand what they're doing but that is the nature of the bottom of the cycle. We continue to see that.

In the reinsurance business, it is not only been price decline but terms and conditions especially for some of the largest buyers of reinsurance where they're just tried to bring [ph] in terms and conditions, take away the rights to audit claims. They basically forced reinsurers to say we want you to pay you pay, you have no question, you have no rights and you have no ability to verify. And our own experience has shown that without those capacities in many cases it doesn't do particularly well and some of these same way companies tend to give us the worst results. So that volume is down substantially. We have lots of capacity to do more business. We think that capital will be very well rewarded for sitting on the sidelines because the capacity in the reinsurance business has been hurt substantially by the debacle in the securities market. So sidecars and a lot of these vehicles have been eliminated and we think we'll stay on the side, no pun intended for this next cycle at least for a while and watch the participants have had their capital cutback.

So we think we'll be able to take advantage of that more quickly. Overall, alternative market business continues to do all right. We still see opportunities, lots of that business is built on relationships although we do see a number of people who have captives, who are facing restrains of the current economic climate and their investment portfolio is under stress and are going to be looking for more reinsurance and more solutions, which will give us a real advantage.

So we're pretty optimistic about the change, our overseas business, the UK, is more competitive than we expected it to be. Australia has been a great advantage. We have domestic and insurance business in Australia and that is led by an excellent management team. It got off to a great start in what we think is the right time which is the middle of this year. And while in the short run increased our expense ratio because we had very little earned premium, they have done a great job getting it going and our Latin American business is doing quite well and we have been pretty well protected in all these cases currency wise although not totaling protected.

The reason we're optimistic is because we have had a lot of experience and the management team which has been around a long time. And last market cycles started to change really at the very end of 99 where you started to see prices start to move up slightly and then in the end of 2000 you had Reliance and Frontier effectively go out of business and then you began to see dramatic price increases followed by the unfortunate events of 9/11 with just the accelerated that trend.

While Reliance and Frontier were small companies today we have a number of large companies who are under great stress. Clearly AIG is under stress. Other companies have other problems because of the capital markets.

The pricing cycle has effectively brought people to where it is likely the underwriting results for 2009 are going to result in the industry combined in the area of 110, could even be worse and very poor investment results, which in our view means the industry will have a net operating loss, investment income, underwriting losses. When the industry has a net operating loss with at least several of the very largest players suffering capital problems and stress with the lack of excess capital sidecars and excess companies on the side not available. Capital markets reasonably close to the industry because of where we're. We think this is going to be an excellent opportunity. We think those catalysts for change are here. We would expect, again our formal position is still the very end of 2009, the first quarter of 2010 but there are a lot of things out there that tell us it could easily happen sooner.

So we're sitting here looking at opportunities. We have seen a number. We have hired a couple of teams of people and we continue to talk to people and look at opportunities. The pricing of things that are for sale is much more attractive although most of the things are still not of an interest to us that we continue to see what we think are exciting opportunities and we expect by the end of 2009 we will fully utilize our capital, although at that point we expect to be generating enough capital to allow us to have plenty of growth.

We have great reinsurance partners who have supported us and have made money doing business with us and we continue to expect to use them to participate with us in this anticipated growth.
So with that now, we will take questions please.

Question and Answer

Operator

(Operator instructions) And we will take our first question with Josh Shanker with Citi. Please go ahead sir.

Josh Shanker
Citi

Thank you, good morning. My first question involves the (inaudible) lines market; obviously Lexington is a big player there. In terms of how wholesalers look in the marketplace. What is the prospect for some programs that are associated with Lexington to look for sponsorship among other E&S players?

William Berkley

First I should understand and be sure you understand my general counsel is looking at me right now and reminding me and handing me a note that said, remember your first amendment rights are curtailed by the relatively important aspect of insurance regulators who say you have to be careful what you say about other companies.

Josh Shanker
Citi

Absolutely (inaudible) so talk to me about process. I am more interested in process.

William Berkley

I just want everybody to understand I'm trying to be careful. I think that in general people always are concerned with uncertainty. Uncertainty is out there and AIG is the biggest excess and surplus lines rider in the business. It houses some of the most talented people in the business. Brokers, agents, and their employees are all facing uncertainty. Nothing new for anyone. And what is happening is everyone is trying to assess how that plays out what happens and how do we hedge our best. So everybody is looking around and trying to figure out what to do and I think that the process is AIG has some unique capacities that no one else has and everybody is out there trying to assess how can I hedge my bet, what can I do. And that is the process that is going on and as the leverage of AIG's advance increases and the uncertainty increases, people get more anxious and they look around and try to figure out what to do and I think that that clearly - that is a pressure point that is not going to go away and if anything is likely to increase.

Josh Shanker
Citi

But taking AIG out of the commission is as though we don't stumble on things. If I'm a wholesaler and work for myself, to some extent, but use another company for capital support. Am I early in the process of looking for a new partner or am I - is this the stickier times of business or when let be sticky kind of business?

William Berkley

I think that there are issues of capacity. There are issues of when the business renews. I think that most people are sitting there and saying le we wait for a renewal. Let me examine what are my options, where can I get the capacity. If you are a broker you're going to look at where do you get paid what commissions. I think that most people are looking to diversify their exposure and ensure they are going to have everything back as they did in AIG. AIG was the unassailable star of our business for so many years and I think it takes a long time before people recognize and see what happened and I mean that in the kindest away. I think people are still adjusting to all this and trying to figure out what does it mean and where does it take you. Though you know, I think you're seeing people search for ways to diversify their risk right now and trying to find ways to offset that risk. And in some places they can find alternatives and in others they can't. And then they make a decision do they do things in a different way than they have for the past ten years using AIG's capacities et cetera.

Josh Shanker
Citi

Okay, sort of the answer. I will take it. The question going back to 2003, are you writing at about twice the premium surplus you are writing today? Is it possible for Berkley given all the rating agency changes over the past few years, given the changes in the marketplace in general, even if things got favorable and where can Berkley really get to on a premium surplus bases. I realize that it is a mistaken sort of metric to use but all we have.

William Berkley

I think first of all the rating agencies have gotten smarter. I think they're a little more - I make fun of the rating agencies all the time because I think they use models to much and but they have gotten smarter. First of all, the rating agencies always looking at you relative to the industry. And so when the industry starts to move up a little bit the rating agencies are going to move up a little bit, not a lot but a little bit. So I think that we have a little better chance of capacity. Second of all I think the rating agencies look at quality of reserves, quality of business diversification. We all have much more positive things going then we did five or six years ago or much more diversified. We have much stronger reserves. We are in much better shape. That having being said I think when we wrote at a higher premium surplus it was always with a commitment to the rating agencies that we were coming down. We're understood where we needed to get to and it was sort of a blip and it was all - and we showed them it was all because of price increase not because of exposure increase. So let me give you an example if the double our prices and our exposure units stayed the same, I don't think the rating agency they would start to yell and be unhappy. But I don't think it would be a disaster with the rating agencies if we could give them statistical backup because they are naïve. If we show them policy count was the same, exposure was the same, and it was merely premium that changed because we charged more that would not be a disaster. So I think they are smarter about price changes and these things than we think.

That having been said if we assume to three to one and couldn't demonstrate that it was primarily a price increase we would have hell of a problem. On the other end if there was 70% price increase, 30% volume increase and if we were writing at two to one and they could see earning a lot of money and that coming down to 1.5 to 1 and so on I think they'll be more flexible and understanding if that is mainly driven by price increase and modestly by that. I think the other thing is we think we have good relationship with reinsurers. We have lots of other avenues for capital. So we think we can certainly manage that issue for a while. We think that if there is a significant jump in that premium surplus it would be for a year or 18 months. It wouldn't be for a long period of time. They would jump up and then trend down mainly because our earning power is so high. I think that if you put back the development from prior years our returns on capital are pretty awesome. And I think that if anything returns are likely to improve much more rapidly in this cycle than the last.

Josh Shanker
Citi

And one final question I apologize, with regards to those rating agencies do you have a relatively clean balance sheet compared to some of the more in peril peers? Did they view to your best guestimation the unreleased losses in a similar way that you view your unrealized losses?

William Berkley

As far as we know, we have got very recent reviews. We have had nobody has any problem and one of the things that. The variability on some of these things is so enormous you know on the 20th of October the world went to hell with municipals and now the world is fine with municipals. I think there was 110 basis points more in the municipal bond market. If we were there to mark that to market on the 20th of October and mark it back to market now, it would be pretty dramatic you know. On the other hand we only have a 3.5-year duration of our investment portfolio, which is costing us money but minimizes that stuff. So, I think that there we also still have some unrecognized and unrecorded gains on our balance sheet that we are working on and trying to find a way to recognize.

Josh Shanker
Citi

Very good. I understand you are talking about the (inaudible). All right, very good and thank you Bill.

William Berkley

Thank you.

Operator

And we will take our next question with Mike Grasher with Piper Jaffray. Please go ahead.

Mike Grasher
Piper Jaffray

Good morning Bill. Just a quick question here, a follow up I guess to your discussion around premium surplus I guess. How do you balance the I guess, you have catalysts out there on the horizon, yet here in the short run, could you and you see these opportunities, could you still involve yourself with share repurchase or get back engaged in that share repurchase?

William Berkley

I think that if the stock traded down to the book value range we would have to seriously think about it, but I think at this point we see some pretty exciting opportunities. We're hired two teams of people. One we announced yesterday for our offshore business and we hired a team to do E&L business. We also started a group in Canada, where were hired a fellow, who had built the specialty book of business in Canada and we are looking at a couple of other things where transactions are at our global value. So, we are going to talk about getting very attractive returns and build the business. So, you know, I think I have had the consistent position that if we can build the business and effectively get better returns than buying our own stock back, we would do that. If our own stock starts to sell at book value or less, we would probably go back to seriously considering that. And the one piece that is there now that wasn't there is that the capital markets are much more uncertain although we have been informed that we have access to the capital markets. That access is less certain and the price is less certain. So, if you are desperate you always have access at least in our position but the price maybe dear.

Mike Grasher
Piper Jaffray

Understood and then moving on to a different topic. I guess if you could speak to any concerns you may have on the outcome of the election one way or the other and just as a secondary question to that more specifically around regulation of the insurance industry from a Federal or state level.

William Berkley

There are three pieces there I will comment on. Number one, we're of the belief that the government and industry need to work together for a rational outcome. We're intermediary trying to balance out and spread risk and our goal is to have a reward as acting as the buffer and we think that is in the government and in the consumers' who buy insurance best interest. Predictability is what insurance does best in. So, we think that either President who is elected is fine. We are particularly pleased that the Mr. Obama has come out with a certainty of supporting our tax on non-U.S. insurers. So that is a positive. Mr. McCain has been less certain. That would be a plus. I think that given our new direction in the government it is more likely that there'll be some national insurance regulator of some type. I think one of the problems they had in dealing with AIG, how to deal with AIG when you had state regulators, the Federal government, the Federal Reserve, the FDIC. I think those conflicts made dealing with AIG a more complicated thing. I think the government suddenly realized that. I think that Berkley as well as a number of other well capitalized insurers are opposed to property casualty companies participating in the TARP program. We don't think we need it and we don't think that for the most part the insurance industry needs the participation of the TARP plan, and those companies that are seeking participation are seeking it primarily because of liquidity issues that could be dealt with the falling in securities as opposed to capital infusions. So we're not in favor of TARP at all, for the insurance industry at least.

Mike Grasher
Piper Jaffray

Okay thanks for those comments. And then just a final question for Gene, a numbers question, in terms of the new businesses or the new startups that were on the books at January 1, how much have they contributed to the total premium production for the year?

Gene Ballard

Businesses that we started -

William Berkley

That were started prior to January 1.

Mike Grasher
Piper Jaffray

Yes.

Gene Ballard

(inaudible) our businesses for several years.

Mike Grasher
Piper Jaffray

So within the past year.

William Berkley

Something less than $40 million for the quarter.

Gene Ballard

And that is just a really new startup not the start ups.

William Berkley

Right Mike that is the recent startups, not the older startups. Well having startups are a continuing process for us.

Mike Grasher
Piper Jaffray

Understood.

William Berkley

Okay.

Operator

And we will take our next question with Meyer Shields with Stifel Nicolaus. Please go ahead sir.

Meyer Shields
Stifel Nicolaus

Thanks good morning everybody.

William Berkley

Good morning.

Meyer Shields
Stifel Nicolaus

If I can play of that question, is there any relationship between how long you have had a unit up and running and the amount of business they would lose in a soft market?

William Berkley

It is interesting, when companies start up they generally are more selective. They get business from people who they know from business they wrote, they know the pricing. They don't lose much business because by and large the business they get is not price sensitive and is relationship driven for the most part. Some of the new businesses get almost nothing for the first year. And some jump off to an extraordinary start in the first six months. So the answer is most of the new businesses don't lose business at the start because the business they get is either built on relationships or built on some particular area of expertise that they develop. And we didn't have that many new ones that were started prior to say the year 2006 peak. Most of them started after that. And most of them get to a particularly big size that it is the current sequential amount.

Meyer Shields
Stifel Nicolaus

Very helpful. Is it safe to infer from your remarks that you are expecting a market turn in reinsurance earlier than broader insurance?

William Berkley

Yes. I think that this year end that you're going to start to see a change in the reinsurance marketplace. I don't think, I think in property catastrophe business, you'll see it at this year-end. I think it has already been announced that for instance, (inaudible) is getting out of the property cat business. I think sidecars and a lot of the securities that everyone said was the future of reinsurance business were impacted by the current market. So I think that a lot of that stuff is already being impacted at the moment. So I think that the reinsurance market is going to start to do better sooner. I think on the property side will have a better year in 2008 and the entire industry will start to do better as we go into 2009. I think that the other piece that will be a little different than the last cycle. The last cycle was led by the primary business turning before the reinsurance cycle. The cycle before was led by the reinsurance business. I think you're going to have the reinsurance business leaving this but compounded by the lack of capital in the primary business. I mean there is a real possibility this is going to be a very dramatic change. That is not a prediction that is merely the hypothesis of a possibility.

Meyer Shields
Stifel Nicolaus

Okay, one question on that if I can and then I'll pass the torch. One of the issues that is obscure was I guess (inaudible) increases in the past and the fact that some insurance companies have intentionally or otherwise (inaudible) losses do you expect that to be a factor in '08 or '09.

William Berkley

I think there is two issues that you have to look at. I think first of all a lot of companies have brought down redundancies from prior years more quickly than they have and others cyclical changes. So I think you saw people trying to bring down redundancies because they showed redundancies up on the balance sheet. They made assumptions that may have been a little optimistic about inflation. So they brought reserves down that came through their income statements. So I think there is a not as much left as redundancies for most companies. And the second thing is that in the financial climate we're in today most people are going to be a little more cognizant of the concerns of wanting to get their numbers right. The fear of (inaudible) in this climate is pretty severe. You know, we spent a lot of time thinking should we pay preannounce this. What should we do and we never liked to preannounce anything because you're sort of guessing. You don't really have every number tied together. Yet, we're sort of back to the position to preannounce with not as exact a numbers as you would like. And that is again a function that the insurance world is cognizant of investors more than they have ever been. So I think most companies are going to do their best to try and get it right. That is always outlier but I think most companies are going to try to get it reasonably right. There is a couple that may not do that.

Meyer Shields
Stifel Nicolaus

Thank you so much.

Operator

And we will take our next question with you Doug McGregor RBC Capital Markets. Please go ahead.

Doug McGregor
RBC Capital Markets

Hi, good morning. Most of my substantial questions have been answered except two number related ones. First Gene, how was that your $122.7 million of operating income, and then you said about $162.7 million of diluted shares, and that to about $0.75 operating income per share. Is that - am I missing something?

Gene Ballard

Well, we are using a 100, and for the operating income we are using our diluted shares of $168 million. I think for the income statement we are using basic shares because we had a net loss. So that would be anti-dilutive to use the diluted shares, but on the operating income you will see that on page 8 of the news release, I think, in a footnote there we mentioned that we use the diluted shares of 168 million (inaudible).

William Berkley

There is some kind of crazy accounting rules that we had to use for taxes and for the diluted shares and stuff because of the tax rules and the loss for the quarter that sort of mess up some of those calculations and I am happy for you to give them a hard time I did already.

Doug McGregor
RBC Capital Markets

Okay actually I see on the footnote now. Thanks for pointing that out. And the second question little more general, the - you the overall available reserve development with that concentrated in any particular business line or is it reasonably spread out.

William Berkley

It is more in the specialty lines than any place else, but it was reasonably - it was spread out, mainly in the specialty.

Doug McGregor
RBC Capital Markets

Okay thanks a lot. That's all my questions.

Operator

And we will take our next question with Larry Greenberg with Langen McAlenney. Please go ahead.

Larry Greenberg
Langen McAlenney

Thanks very much and good morning. You touched some of my questions too, but I was wondering if you could just discuss loss trends and whether you are seeing anything more recently that is out of line with what you had been seeing and perhaps touch on how you think the macroeconomic environment might impact some of those trends going forward?

William Berkley

No I think there is - I think there is three things I would say. Number one, I think that this in this kind of economic climate it is a little easier to settle things and even if you are moving towards slightly more inflation, you usually have an easier time to settle losses. I think that the macro environment does give you some concern. You have to be careful with agents and ensure that you get paid, and I think other than that it does not have a big effect at the moment.

Larry Greenberg
Langen McAlenney

What if I said that the outlook was towards deflation.

William Berkley

If you said the outlook would be for deflation, then we probably have very, very redundant reserves and then I would guess that it would in fact have a huge amount of positive leverage on our balance sheet.

Larry Greenberg
Langen McAlenney

Thank you.

Operator

And we will take our next question with Keith Billingsley with Signal Hill. Please go ahead sir.

Kenneth Billingsley
Signal Hill

It is Kenneth Billingsley, just a - I have a question on you're talking about essentially the capital and the industry, and I thought you did a pretty good walk through why you think rates could stabilize into '09 beginning in 2010, but the capital impact of write downs have done little to change underwriting leverage at many insures in this quarter. Are you expecting to see further write downs since October 1st and also mainly for the industry and as well as for yourself.

William Berkley

First of all I think that it is important to understand that I started by saying a couple of things that in addition to the public issues with AIG, a number of other particular insures have the financial statements quite strained. But again, as I warned you my first amendment rights are somewhat restricted I have been told.

Kenneth Billingsley
Signal Hill

I understand.

William Berkley

Let me just finish - so there are a couple of very specific, but remember those couple of specifics where large companies having an enormous impact when this cycle turned in 1999-2000 it was (inaudible) companies Reliance and Frontier. Here AIG alone is 10% of the commercial lines market, 20% of the specialty market, the E&S market. Plus there are some others that have real restraints. So you have that piece and in addition to that piece you have all these sidecars and other vehicles that were funded by investment people who have different issues, not industry people and you then have to put that together with the industry that is not earning money and have had some markdown of capital. It is not that they are in trouble, but the marginal people who are these several big companies that have capital issues and the peripheral people who solve those capital problems, all coming together and then the pressure of reinsures I think is going to drive the cycle much harder than people think.

Kenneth Billingsley
Signal Hill

With the economy in the face of the pressure it is under, would you not expect to see either a cutback in coverage by customers as prices go up because these cannot afford it, similar to we saw post 9/11 as well as primary companies just increase their retentions.

William Berkley

Yes. But that may happen to some extent and you also noticed post 9/11 the industry had amongst its best periods of times ever. So, I think that yes that is true, but people still more than ever need to buy insurance because they cannot accept or risk the volatility of uncertainty.

Kenneth Billingsley
Signal Hill

It just seems on their calls this quarter have been share leading higher rates, but no one has seen it in their own numbers as a whole nor are they proposing that they are going to be the leaders to raise rates. I suspect that you guys are not going to be the first ones to raise your rates, would that be correct?

William Berkley

Well I wouldn't say that. No. Not only wouldn't I say that, I would say that in some areas we have already raised rates and I think that I said last quarter and the quarter before I thought the turn in the cycle would come at the end of '09, the first quarter of '10. You can look up our conference call and we said exactly the same thing. All that's happening now is the specific facts that are going to make that a catalyst, but ultimately rates change when you have a zero return or a negative return, and that's what's going to happen in my view in '09, but prices aren't going to change particularly much right now. It's going to be - we're at least 6 months away from that price changing happening and we're probably three quarters away before we see any real dramatic price changes. But it's going to start to happen. I think what I am saying and I have said for some period of time and now there are some others that are saying it also is that the catalysts are all here, prices are going to begin to change, and yes in fact we have started to change our pricing.

Kenneth Billingsley
Signal Hill

Very good. Thank you.

Operator

(Operator instructions) We will take our next question with Meyer Shields with Stifel Nicolaus. Please go ahead.

Meyer Shields
Stifel Nicolaus

Thanks. I just had a couple of quick follow ups. One, could you sort of outline which accident years contributed to the reserve releases this quarter?

William Berkley

I think you have to chat with Gene about that. You know, you start to get into where and what sort of you wouldn't mind chatting with Gene after the call.

Meyer Shields
Stifel Nicolaus

No, no problem at all. A couple of quarters I guess ago, you talked about your expectations for the different investment segments. I was wondering if you could update us in terms of what you're thinking for the arbitrage et cetera, I guess in the back quarter of 2008-2009.

William Berkley

Our arbitrage account has been mainly cash for a fairly extended period of time. That's why it didn't lose hardly any money. I think we've lost a little bit of money and prior to that was because of the restrictions on short-selling and other things. But our big arbitrage account which is Milton Partners continued to run a very conservative book of business and it was - it did an outstanding job, they didn't make money and nobody likes not to make money, but basically they had about 60% cash and I think that we had - actually I apologize, I said I would just direct it for the quarter actually it was in September, but we've lost money for the quarter, actually made money, but the outside advantage, we had lost money and our in-house arbitrage was mainly was and is mainly cash. So we continue to have lots (inaudible) what they do and I think that clearly that's the vast majority of our external money. I think that the - you know relatively modest amounts of other things. I think that yields clearly have come down. The yield curve is steepening. We have with a 3.5 year average duration, which is well under what our duration of our loss reserves are. We have capacity to extend that. Right now we are investing money basically in AAA Securities, basically at a 3 to 5-year duration, primarily 3 years, which is giving us adjusted pre-tax returns of 5.5%. We can get up to about 6.5 over the last 5 years and we still have pretty good positive cash flow which is being invested only in those fixed income areas for now.

Meyer Shields
Stifel Nicolaus

Okay. That is very helpful. And I guess one last question. When we look at some of the new units that have been formed recently, we're starting to see I guess - or let me assess are you starting to get comfortable with a property risk to a larger account D&O compared to the smaller casualty focus that you've had historically.

William Berkley

I think that we've always tried to find great people. We've built our business on great people. We think that we continue to believe that small to middle size casualty business is our sweet spot and the place we would like to continue to build our business. It's what we like, but when a couple of great teams became available, we felt that just great teams don't come around very often. The reason we haven't been in the property business very often is because I learned about the insurance business and reinsurance business 35 years ago. And I learned a different language than everybody runs their business today and I am only comfortable with my old fashion language. And my old fashion language is called underwrite to an AML. AML is absolute maximum loss. So the only kinds of property exposures we're going to ever get in is where we can underwrite to an AML or an absolute maximum loss. So the kinds of things that we will be doing when you see us getting in the property business is getting in businesses where the underwriting teams have a philosophy that matches with mine and my sons, which is you always need to know how much you can lose in the worst possible scenario, because the worst possible scenario always occurs when you can least afford it. That allows you to buy quarter share reinsurance and excess reinsurance with defined limits. It allows reinsures to do business for you with much more comfort because they understand what their exposures are and how it is and what they are getting paid for taking those exposures. So we haven't changed our view, it's just the kinds of people that are attractive to us, having been around, and when they get around we haven't been able to hire them for any reason particularly, and now we suddenly we found a couple. So that was really exciting to us. It goes along with our view of always know the risk you're taking and if you wanted to know our (inaudible), it is that three letters, AML. Most everybody else in the property insurance business and reinsurance business underwrites what they call PML, probable maximum loss. I was a statistical major. I actually understand that PML means probable not absolute. Therefore, you might be wrong and you can go broke. So therefore, that is why we're looking and doing these things because we love the idea of underwriters who know what risk management is about.

Meyer Shields
Stifel Nicolaus

Okay. Thank you very much.

Operator

And that conclude our question and answer session. I would like to turn it back over to management for any additional or closing remarks.

William Berkley

Okay. Well, we thank you all. As I said we really see now more clearly than ever that the cycle is beginning to turn. We're quite optimistic. It's not here now. It's beginning. It takes five quarters before any change comes into to be fully reflected. So even if it's the third quarter when things change, it's five quarters from then. So it's really the end of 2010 when it's a 100% reflective. But that really means 2010 could easily be quite a good year, and we think that it will be very visible in the second half of 2009. Thank you all very much. Have a great day.

Operator

Once again, ladies and gentlemen, this would conclude today's conference. We thank you for your participation. You may now disconnect.