S&P Capital IQ

CONTENTS

W. R. Berkley Corporation NYSE:WRB

FQ4 2015 Earnings Call Transcripts

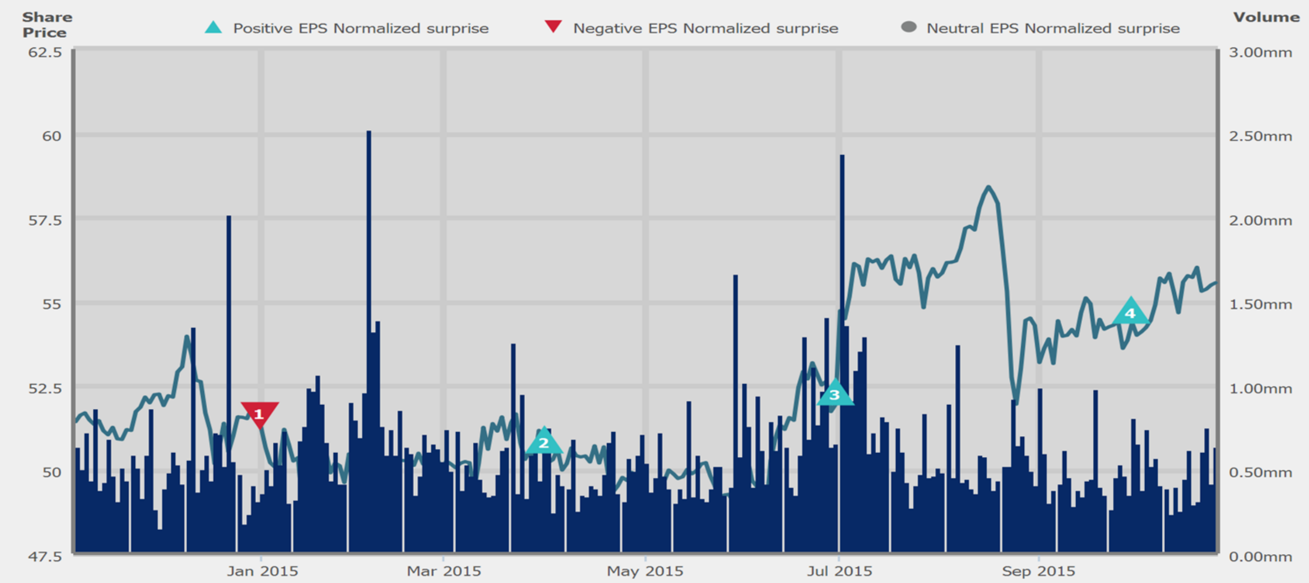
Tuesday, February 02, 2016 10:00 PM GMT

S&P Capital IQ Estimates

	-FQ4 2015-			-FQ1 2016-	-FY 2015-	
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	ACTUAL
EPS Normalized	0.80	0.89	▲11.25	0.85	3.31	3.41
Revenue (mm)	1817.63	1811.06	▼(0.36 %)	1751.15	7182.98	7206.46

Currency: USD
Consensus as of Jan-22-2016 9:45 AM GMT

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



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ4 2014	0.82	0.73	▼1 (10.98 %)
FQ1 2015	0.75	0.80	▲2 6.67 %
FQ2 2015	0.80	0.81	▲3 1.25 %
FQ3 2015	0.83	0.91	▲4 9.64 %

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

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Morgan Stanley, Research Division

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RBC Capital Markets, LLC, Research Division

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Ryan James Tunis
Crédit Suisse AG, Research Division

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Sterne Agee & Leach Inc., Research Division

Presentation

Operator

Good day, and welcome to W. R. Berkley Corporation's Fourth Quarter 2015 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 and estimates. We caution you that forward-looking statements should not be regarded as a representation by us that the future plans, estimates or expectations contemplated by us will, in fact, be achieved. Please refer to our annual report on Form 10-K for the year ended December 31, 2015, and our other filings made with the SEC for a description of the business environment in which we operate and the important factors that may materially affect our results.

W. R. Berkley Corporation is not under any obligation and expressly disclaims any such obligation to update or alter its forward-looking statements, whether as a result of new information, future events or otherwise.

I would now like to turn the call over to Mr. Robert Berkley. Please go ahead, sir.

William Robert Berkley
Chief Executive Officer, President and Director

Thank you, Bridget, and good afternoon, and welcome to our fourth quarter call. The agenda we have laid out is I'm going to start with some general comments, then we're going to hand it over to Gene to walk you through the numbers and provide some highlights and then we'll move on to the Q&A where our Chairman, Gene and I will be available to answer any questions people have.

So starting out with a couple of comments on the marketplace. By and large, market conditions were consistent with what we've seen over the past several quarters. The reinsurance marketplace remained fiercely competitive, though the pace of erosion seems to be slowing, particularly in the domestic market. We're also seeing a slowing in the entry of new alternative capital providers in the reinsurance space. And having said that, we'll have to see if that trend continues.

On the international insurance front, certainly, this has remained a very competitive market, at least in the -- in the places that we participate in. Having said that, while we've seen several carriers over the past few years increasing their footprint, it would seem as though some of them are beginning to pause and perhaps, in some cases, reconsider these plans.

As it relates to the domestic insurance business, very much, as in the past, a mixed bag. Yes, marginally, in the aggregate, more competitive. Having said that, the cat-exposed property market continues to be remarkably competitive. Perhaps this is a result or an extension from what's been going on in the cat reinsurance market.

Commercial auto, while rate increases are achievable, certainly, the margins in that space continued to give us reason to pause. Having said that, on the other hand, the casualty market, the professional market and the comp market, while not across the board, has certainly offered several pockets where there's very attractive opportunity to deploy capital and generate good returns.

So having said all of this, while it does appear like it's such a natural extension of earlier quarters during '15, the fact is, over the past several months, there has been quite a bit of change, if you peel a few layers back. There's been a significant amount of M&A going on, and in addition to that, several large companies are going through some very meaningful reorganizations. As a result of that, we are seeing the potential for a lot of disruption in the P&C space. Perhaps this dislocation will actually prove to be as meaningful as some have speculated, which ultimately could generate a great opportunity for carriers like ourselves and others.

On a different note, a quick comment about the distribution. Clearly, as the marketplace is becoming more competitive for both carriers and distribution, there's a growing amount of pressure or tension between the 2 parties. Hopefully, while everyone is busy trying to find ways to maintain their margins, people will not lose sight of the ultimate goal, which is to find ways to work together to bring more demonstrable additional value to customers.

And finally, a comment on interest rates. We have had a view for sometime that interest rates would be moving up. I think our view has been modified somewhat. Not that rates will be moving up, but quite frankly, we think it may be a more gradual process than some have suggested. We will see over time. Obviously, we are reminded that in spite of the improvement in the U.S. economy, as a result of globalization, the U.S. economy is not insulated from some of the challenges that other meaningful economies around the world are facing.

A couple of soundbites on our operation before I flip it over to Gene. Certainly, the top line we thought was a reasonable growth rate. Obviously, it was somewhat impacted by FX. Having said that, when you peel a few layers back, we are growing where we think the opportunities are. And quite frankly, where we don't see the opportunities, that is where our book is shrinking.

Ultimately, we think that you can see in our press release that there are certain places where the margins are very healthy, and we are looking to increase our footprint there.

So I'm going to pause there and hand it over to Gene and let him run through the numbers.

Eugene G. Ballard
Executive Vice President of Finance

Okay. Thanks, Rob. Well, we closed the year with another solid quarter, with operating income up 18% to $115 million and operating income per share up 22% to $0.89. The improvement from over a year ago was led by higher investment income and a modest increase in underwriting profits.

Our overall net premiums written increased 3% to $1.5 billion. For the domestic segment, premiums increased 8%, with professional liability lines up 29%, worker's compensation business up another 13% and other liability lines up 9%. Partially offsetting those was an 8% decline in commercial automobile business where we continue to emphasize needed rate increases.

For the international segment, net premiums declined 11% to $185 million, due primarily to the strengthening of the U.S. dollar. In local currency terms, the decline in international premiums was 2% as growth in Canada, South America was offset by lower premiums in Europe and Australia.

And our global reinsurance premiums were down 10% to $146 million due to the impact of the continuing soft market conditions for the reinsurance business in both the U.S. and abroad.

Our pretax underwriting profits were up 7% in the quarter to $107 million, and the combined ratio improved by 0.2 point to 93.1.

For the current accident year, our pre-cat loss ratio declined 1.1 points from a year ago to 60.0, with all 3 business segments reporting accident year loss ratios between 58% and 61%.

Cat losses were just $11 million compared with $18 million a year ago. In the current quarter, there were no individual events with losses more than $2 million, and the overall cat loss ratio was just 0.7 point.

Prior year reserves developed favorably by $15 million or 1 loss ratio point with positive development for the domestic and reinsurance segments and essentially no change in reserves for the international business. That's now 36 consecutive quarters that we've reported positive reserve development.

So in total, that gives us a calendar year loss ratio of 59.8%, down a full percentage point from a year ago.

Turning to expenses. Our overall expense ratio for the quarter was 33.3% compared with 32.5% in the fourth quarter of 2014. Looking at it by segment, the domestic expense ratio increased 0.8 point to 31.2%, due primarily to higher DAC amortization. For the full year, the domestic expense ratio, which was also 31.2%, was 0.4 point below full year 2014 and right in line with our business plan. The international expense ratio increased 1.3 percentage points from a year ago to 41.5% due in part to a lower premium volume. On the other hand, the fourth quarter expense ratio of international was almost 2 points below the third quarter expense ratio as we're beginning to see the benefit of the international expense initiatives that we talked about on our last earnings call.

And finally, the reinsurance expense ratio increased 2 percentage points to 39.4%, also due in part to lower premium volume. In addition, as I mentioned in the last couple of calls, the 2015 reinsurance expense ratio includes the impact of certain structured property trees that pay profit commissions if losses are below a stated level. And although these contracts continue to be quite profitable, they added 1.5 points to the expense ratio for the segment.

Turning to investments. Our investment income was up 12% to $128 million. Earnings from our internally managed investments, including our arbitrage trading account, were in line with prior year at $116 million at an average annualized yield of 3.1%.

Income from investment funds was $11 million in the current quarter compared to a loss of $4 million a year ago. The improvement reflects higher earnings from real estate funds as well as a foreign investment fund that was partially offset by a previously reported loss of $12 million for energy funds. For the full year, investment funds reported aggregate pretax earnings of $62 million and an average return on equity -- on investment of 5.2%.

Also in the current quarter, we reported realized gains of $13 million and recognized an other-than-temporary impairments of $21 million. The impairments are related to declines in fair value for equity investments in both the energy sector and the financial services sector.

At December 31, 2015, the average credit rating for the portfolio was AA- and the average duration was 3.3 years. With the increase in interest rates and spreads in 2015, the after-tax unrealized gains declined by $115 million to $181 million at December 31. Of course, with the subsequent decrease in rates in January, that's moved significantly back in the other direction.

Unrealized currency translation losses also increased by $125 million in 2015 as a result of the strengthening of the U.S. dollar against our holdings in non-denominated -- non-U.S.-denominated securities, including the British pound, euros, Australian and Canadian dollar. That gives us an operating income of $115 million for the quarter and an operating ROE of 10%. And for the full year, it gives us net income of $504 million, earnings per share of $3.87, 20% increase in cash flow to $881 million and a net income return on equity of 11%.

William Robert Berkley
Chief Executive Officer, President and Director

Okay. Thank you, Gene. So as you all can see, a solid quarter. We were particularly pleased with the improvements in international. Our work is not done there, but certainly, a meaningful improvement on the loss ratio front. And as Gene suggested, while perhaps the improvement is not visible on the expense front when comparing fourth quarter to fourth quarter, if you compare the fourth quarter to the third quarter, meaningful improvement there. We are not done there, more work to do, but we expect the trend to continue.

So overall, again, happy with the quarter, thought it was a good year. Additionally, because of the nature of our business, we have a fair amount of visibility as to what '16 is going to look like. And barring the unforeseen event, I think we are reasonably confident that we will be able in '16 to improve from where we were in '15.
So we will be pausing at this stage. Again, you have Chairman, Bill Berkley, Gene, and myself available to answer questions. Bridget, if you could please open it up.

Question and Answer

Operator

[Operator Instructions] Our first question is from Michael Nannizzi with Goldman Sachs.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Rob, could you talk a little bit about -- maybe a little bit more about the expense ratio in domestic. Nice growth there. It's sort of been sitting here still above 31%. We were sort of assuming that the trend line in the last couple of quarters represented would continue, just given the growth there. Can you talk a little bit about what's happening and how we should be thinking about that?

William Robert Berkley
Chief Executive Officer, President and Director

Gene, as you commented, there was a bit of a component having to do with DAC. But I think the other piece that we have there is that while we haven't made big public announcements about it, we have added, over the past couple of quarters, call it about a handful of teams to the organization. And as a result of that, we have incurred not an insignificant amount of expense, and it takes time for that earned premium to come through. Having said that, honestly, Mike, from our perspective, can -- as we've discussed in the past, can we improved from the 31%? Yes, I think maybe we can, over time, improve from the 31%, but it's unlikely that you're going to see us getting to a level that's significantly below where we are today just because of the nature of our domestic business. We are a significant specialty player, and a fair amount of that is coming through a wholesaler. We need to both address the need of a wholesaler as well as ultimately a retailer. So do I think that we were adversely impacted, and Gene had commented on this earlier, to a certain extent, by DAC? Do I think -- yes, that is clearly the case. Having said that, as our model has been for years, we tend to prefer to start businesses up. We think that's a more controlled model. But as a result of that, the earnings lag the expenses, and I think you're seeing a bit of that as well. Having -- again, having said that, I don't think you should be expecting our domestic business to pass significantly, to -- or should really get to a level materially below where we're running. Can we get down to 30%? Yes. Can we maybe get to 29%? Yes. But we'll need to see a hard market akin to like what we saw in 2003, 2004 to get there.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Got it. Okay. And then how should we be thinking about the investment funds and the income from those funds in '16, just given the sort of rough start here at the beginning of the year? Can you give us just some context for how we should be thinking about that? And do you plan to reallocate within that cluster of assets?

William Robert Berkley
Founder and Executive Chairman

Michael, it's Bill. I think that, first of all, the allocation of our resources, we're down to probably $100 million in total investments in our energy funds, and that's the total exposure. I think the first quarter we'll have a modest loss, probably $4 million, $5 million, $6 million from the energy funds. A number of the other funds who are -- we already have the results where a couple of real estate funds are quite positive. So the funds for the first quarter will be okay. I think that the only fund that's had real volatility, that's been surprising has really been the oil fund, and that's followed everything else in the oil industry. The rest of the funds have been reasonable. [indiscernible] And we have a wide diversity of funds. So I think that we'll continue doing the things that we do in those funds, our real estate investments and so forth.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Got it. And then if I could, I think we've -- on prior calls, we talked about the tax rate and the fact that it's relatively high compared to peers. I mean, is there -- is that an area where we can expect you're looking at potential ways to improve your efficiency there? And if so, can you just kind of let us know what you might be thinking about doing or what we might be able to see in the future?

William Robert Berkley
Chief Executive Officer, President and Director

Mike, the answer is yes. We are very conscious of it. And certainly, we, as an organization, our Chairman, in, particular, has been reasonably clear about our views as an organization. We are aware of the challenges around it compared to some of those that we compete against. And we are -- it is on our radar screen as far as our plans, certainly something again that we think a lot about. But I don't think at this stage, there's really anything to discuss beyond that. I would add, however, that we do, in our press release, provide a pretax number because we think that it's important for investors to be able to compare on an apples-to-apples basis, putting aside tax, the underlying earnings power of a business. It's not that the tax isn't real, it's not that it doesn't impact our model compared to some that we compete against. At the same time, there's often times more than one way to look at a situation.

William Robert Berkley
Founder and Executive Chairman

I think we could add something else. One of the things, when you assess short-term tax rates versus asset exposures and so forth, there are plenty of people who choose asset mixes such as municipal bonds and so forth that give you lower tax rate but don't really give you, over a long term, better returns. So I think that we try and look at overall returns. And in the short term, that can penalize us from the tax rate point of view. We think we still make the right decision. And if you take note, our percentage of our portfolio that represent by municipal bonds has gone down substantially as returns have been such that we could realize substantial gains in that part of the portfolio.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

All right. Rob, I guess, with the gap now with peers, the tax rate differential is wider, in part, because the municipal bonds aren't there as well. So, I guess, I'm just curious...

William Robert Berkley
Founder and Executive Chairman

It's also more of our peers have moved offshore.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Also fair. Also fair. Yes, so, I guess, I'm just -- I think Rob answered it, but, I guess, my question is, are you spending -- is this an area that's getting more attention as time goes on? Or is there something...

William Robert Berkley
Founder and Executive Chairman

Couldn't get more attention, Mike.

William Robert Berkley
Chief Executive Officer, President and Director

Yes. We are -- we're aware of it, Mike.

Operator

Our next question is from Kai Pan with Morgan Stanley.

Kai Pan
Morgan Stanley, Research Division

So the first question is on capital management. It looks like you didn't repurchase any shares in the quarter. I just wonder, is it because the stock price where you consider other options such as special dividends or potential growing base that either organically or inorganically?

William Robert Berkley
Chief Executive Officer, President and Director

Yes. I think the answer to that is, obviously, and quite frankly, very consistent with what I think you've heard in the past. We are conscious of trying to manage our capital effectively and in the best interest of our shareholders. We look out at our growth prospects and what we think our capital needs will be. To the extent that there is excess capital, then we will try and figure out what the optimal way to return shareholder -- value to shareholders, whether that be through a dividend or a repurchase. As far as the specifics around a special dividend or a repurchase, no different than in the past. It's not really something that we get into a lot of detail. But what I can assure you of is that capital management remains something that we are focused on in the past and continue today.

Kai Pan
Morgan Stanley, Research Division

Okay. Just a follow-up on that. Do you -- you have a pretty nice growth in terms of top line and you hired additional teams for future growth. I just wonder, would that consume part of your capital generated through your operations and going forward?

William Robert Berkley
Chief Executive Officer, President and Director

Certainly, we think that it is possible our business will grow in '16 compared to '15. And as a result of that, presumably, there would be a need for additional capital. Having said that, obviously, our growth is dependent on what market conditions are. Ultimately, we can't control the market. We can only control our actions and our activity. So again, do we think there is opportunity for growth given how we see market conditions at this stage? Yes. And as a result of that, will that create an opportunity or a situation where we will be consuming perhaps a bit more capital? Yes, that's correct.

Kai Pan
Morgan Stanley, Research Division

Okay. Second question is that you commented in your prepared remarks that you expect better returns for 2016. Just drill down a little bit on that. Given -- can you talk about the pricing environment and also investment returns and what give you confidence that you'll be able to generate better returns in the coming year?

William Robert Berkley
Chief Executive Officer, President and Director

Well, first of all, I think I suggested to you that we think that '16 will be a better year than '15. Return is certainly one of the metrics one might use. I don't think that was the metric that I used. Putting that aside, the optimism around '16 is because, as you know, our reported results, we earned that premium through. So we -- over a period of time. So we have a fair amount of visibility as to what our earned premium is going to be. We also have a fair amount of insight as to where our loss picks are running. And to -- ultimately, again, we just feel like we have that visibility. It gives us the comfort that we think '16 will be a better year. Additionally, some of the noise that came out of the international segment that we referenced earlier and have discussed on past calls, we do not anticipate that rearing its head again. In fact, we are expecting improvement from here.

Kai Pan
Morgan Stanley, Research Division

Okay. That's great. Lastly, if I may, on the investment side, can you give an update -- in the past, I think you talked about this before, Bill, about some -- the investment, actually, you mark it at sort of the book value rather than mark-to-market value. Given all the market movements, so what's your estimate in term of book value per share?

William Robert Berkley
Founder and Executive Chairman

It's come down a lot. How much, my guess is it's probably come down $150 million from where it was. So it's probably come down significantly. On the other hand, candidly, a couple of the pieces of real estate seem to have better values than we expected based on some transactions that have taken place. But clearly, the market has gone down. And certainly, at least the HealthEquity where we're a big shareholder is down from where it was by, let's just say a round numbers, $150 million. As of now -- as of the end of the year, it was substantially less than that, but I'm marking it to today's price.

Kai Pan
Morgan Stanley, Research Division

Great. Where do you -- Bill, where do you see investment opportunities? Because given the track records the past few years, actually, a lot of book value gains have been coming from these harvesting gains as well as these investments. And given the market condition, do you think that opportunity becoming less going forward or you're still finding areas that could provide additional returns?

William Robert Berkley
Founder and Executive Chairman

There are always better opportunities when everyone else thinks there are none. So we're really quite optimistic. And we see numerous opportunities where people are more concerned or need financing because we buy things without debt, without financing and we could go in and do a transaction without needing any financing, any contingency based on things we know and understand. So we continue to see great opportunities.

Operator

Our next question is Ryan Tunis with Crédit Suisse.

Ryan James Tunis
Crédit Suisse AG, Research Division

My first question is, I guess, going back to Rob's prepared remarks on interest rates. And it sounded like a modification of the view there that the interest rates still rise but more gradually. Just wondering, practically speaking, if that has an impact on any of your investment philosophy or how you're thinking about trends.

William Robert Berkley
Founder and Executive Chairman

I think that the answer to that really is that we were just trying to indicate that, clearly, deficit spending ultimately is going to bring about higher interest rates in our view. But as long as governments continue to find ways to defer paying the piper, that's not going to happen. And it seems like they've been able to find ways for a long time. So our expectation of increasing interest rates is just not happening. We thought rates would be up 100 basis points this year. We think it's probably not so likely.

William Robert Berkley
Chief Executive Officer, President and Director

This year being '16.

William Robert Berkley
Founder and Executive Chairman

This year being '16. And we're just -- we're in a quandary. We sit it here and say, "What and who is going to do what? And is inflation, in fact, going to take hold as we anticipate?" So we're trying to be more cautious and not, in fact, sit here and wait. So I think we're just taking a little more cautious stance.

Ryan James Tunis
Crédit Suisse AG, Research Division

Okay. But no change to your -- I guess, your view of trend given the lack of inflation? Or just thoughts on how you might deploy the short-term portion of your investment portfolio.

William Robert Berkley
Founder and Executive Chairman

Our short-term portion of investment is something we continually try to find creative ways where we don't need as much liquidity as we have. So are there things we can do where we give up instant liquidity but maintain that AA, AAA quality of risk? So we're willing to give up instant liquidity and have 3 months liquidity to get a little bit better yield. But the fact is, in the past 30 days or so, 5-year treasury is down by 50 basis points. That's a hell of a change. And people who close their eyes to those changes are naïve. That's a huge change. And if you look at our cash flow, we generate $700 million, $800 million, $900 million a year of cash flow. That makes a difference in how we invest our money, and we're shooting for a 3-year duration. So we're just constantly trying to figure out how and what do we do. And the cornerstone for our operation for our short-term money is we have lots of liquidity. We can give up our short-term instant liquidity, but we can't and aren't willing to give up the quality of our portfolio.

William Robert Berkley
Chief Executive Officer, President and Director

And as far as the picks around loss trend, as we've discussed with some in the past, we tend to err on the

[Audio Gap]

and mature, then we will recognize the fact that we took a very measured approach to begin with. But certainly, if inflation continues to be as benign for the foreseeable future, as it's been over the past several years, we, as an organization, from the reserve perspective, we view that as a plus.

Operator

Our next question is from Vinay Misquith with Sterne Agee.

Vinay Gerard Misquith
Sterne Agee & Leach Inc., Research Division

The first question is the accident year loss ratio, x cats. We saw that at about 60.0% this quarter. This was about 100 basis points better than last quarter and the year-ago quarter. Just wondering what's happening with that.

William Robert Berkley
Chief Executive Officer, President and Director

Gene, would you like to comment or would you like me to?

Eugene G. Ballard
Executive Vice President of Finance

Well, the 1 observation I was going to make is, as we get towards the end of the year, obviously, we learn more information as the year goes along, and by the time we get to the end of the year, we've got a pretty good idea of where it's going to land. We might be a little cautious towards the beginning of the year and we firm that up.

Vinay Gerard Misquith
Sterne Agee & Leach Inc., Research Division

Okay, that's fair enough. And should we expect that could deteriorate slightly next year given the fact that pricing is likely not keeping trend with loss cost?

William Robert Berkley
Chief Executive Officer, President and Director

I'm sorry, you were breaking up a little bit. Would you mind repeating the question?

Vinay Gerard Misquith
Sterne Agee & Leach Inc., Research Division

Sure. Sorry. So should we expect the accident year loss ratio, x cats, to deteriorate slightly in '16 versus '15 given that pricing is not keeping trend with loss cost trends?

William Robert Berkley
Chief Executive Officer, President and Director

I wouldn't suggest that you not lead to that conclusion. First of all, that would be -- you would be making an assumption that our portfolio is not changing and the mix of business isn't changing for starters, which would be the wrong assumption. In addition to that, again, trying to figure out how far I can go here, we feel very comfortable with our loss picks, and it's certainly possible that there will continue to be good news to come.

William Robert Berkley
Founder and Executive Chairman

See, he made the mistake. He let the lawyer sit next to him. I never sit next to a lawyer.

William Robert Berkley
Chief Executive Officer, President and Director

I tried to answer your question without answering it. Hopefully you got it.

Vinay Gerard Misquith
Sterne Agee & Leach Inc., Research Division

I think I got the answer. Okay.

William Robert Berkley
Chief Executive Officer, President and Director

Thank you. What else can we share with you?

Vinay Gerard Misquith
Sterne Agee & Leach Inc., Research Division

Yes, the follow-up is on the net investment income. I mean, that was much, much better than what we thought, especially on the fixed income side on the core portfolio. How did it increase much quarter-over-quarter and year-over-year?

William Robert Berkley
Founder and Executive Chairman

It was pretty much what we thought it would be. We -- I know -- maybe with the cash flow, but, I mean, it was pretty much in line with what our expectations were.

Eugene G. Ballard
Executive Vice President of Finance

Yes, it was.

William Robert Berkley
Founder and Executive Chairman

I mean, I think -- I looked at it and compared it to our expectations and it was insignificantly different. So maybe if you can chat with Karen about your forecast with that, but it was right on with what we gave. It was not significantly different than our forecast.

Vinay Gerard Misquith
Sterne Agee & Leach Inc., Research Division

Okay, that's helpful. And then one last thing, if I may. You said that there are some opportunities in the market because of what's happening with some competitors. Those competitors are large competitors. Just curious if you're seeing some opportunities in your space, too.

William Robert Berkley
Chief Executive Officer, President and Director

So let me offer a couple of soundbites, and I suspect my boss has a view to share as well. I think for -- there are several opportunities that have come into focus from our perspective. Some of those opportunities we have capitalized on. Some of those we have explored and decided not to pursue. Some of those opportunities we continue to explore. The fact of the matter is, by and large, whenever there's a meaningful merger or acquisition, that creates a degree of overlap or uncertainty or potential dislocation that impacts both the people within the organization and it also can honestly impact people outside of the organization such as the distribution system and customers. So we certainly have seen opportunities as a result of the M&A activity. We expect we will see more. In addition to that, as you and others are aware, just like we're aware, there are some very meaningful organizations in the P&C space that seem to be going through a process of looking in the mirror and making some significant changes. As a result of that, that is creating some uncertainty, confusion and ultimately, potentially opportunity as well for organizations like ourselves for both talent and business. So all things being equal, from our perspective, we do think that there are some opportunities that we've been able to capitalize on and we think that there will be more to come. From our perspective, as we've suggested to some in the past, insurance business is fundamentally 2 things: it's capital and it's people. We believe capital is evermore a commodity and people are what makes the difference. So the opportunity to attract talented people from other organizations is certainly something that we are focused on.

Operator

Our next question is from Josh Shanker with Deutsche Bank.

Joshua David Shanker
Deutsche Bank AG, Research Division

So if you improve the international business, I'm wondering if you can drill down a little bit into maybe what lines of business need fixing and how you measure success and, ultimately, whether you think you have a core competency in international markets the way you do in the domestic markets.

William Robert Berkley
Chief Executive Officer, President and Director

A couple of questions there, so let me try and take them one at a time. First of all, we do believe that everything is not perfect, every plate is not spinning perfectly. But we think we are well on our way down the path to a better place. I appreciate the comment, but I don't think everything in the domestic markets here we have running perfectly either. As far as core competencies go, we do not necessarily take the same approach that other organizations take, particularly very large multinationals. We have no desire to be in every market around the world. We have a desire to participate in markets or niches within markets where we are able to compete based on expertise. Obviously, there are some places where we have not succeeded in doing that and some of the results and some of the discussion that we shared with you in the past. Having said that, we -- as I suggested, we believe that we are well on our way to remedy that. So quite frankly, I think our strategy outside of the United States is not dissimilar to our strategy in the United States. We are not trying to be the global all things to all people. We are trying to find niche opportunities in other markets where it makes sense outside the United States to achieve reasonable risk-adjusted returns in several markets that we participate in. Latin America would be an example. I think we have achieved that consistently for more than a decade. I believe we are doing that through our Lloyd's operation as well. Having said that, some of the activity in Canada -- rather, excuse me, in continental Europe has not proven to work out as well, but again, we think that we are getting that sorted.

Joshua David Shanker
Deutsche Bank AG, Research Division

By premium, if you were to divide it into the 80-20 rule, are 80% of the returns by premium very attractive and 20% are providing problems? Or how should we think about it?

William Robert Berkley
Chief Executive Officer, President and Director

I think the way I would suggest that you think about it is, as I suggested earlier, Josh, there were a couple of places that we zigged when we should have zagged, and we think that we are well on our way to having that sorted out. I would hesitate to try and start putting percentages on it because I don't have it down to the decimal point.

William Robert Berkley
Founder and Executive Chairman

There's a better person in charge now, Josh, so he'll get it cleaned up.

Operator

Our next question is from Jay Cohen with Bank of America.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Rob, in your prepared remarks, you mentioned that in 2016, you're looking for improvement. And you really didn't mention a metric. I guess, the earlier assumption was it was ROE. I mean, one of that, I guess, headwinds you see is catastrophe losses were relatively low this year, lowest in 7 or 8 years. So with that headwind, I mean, you look at things like combined ratio. Is it hard to improve upon where you were?

William Robert Berkley
Chief Executive Officer, President and Director

I think -- again, here we go with the forward-looking statements. I think our view is that based on what we know today, which is imperfect, and I highlight imperfect, we think that there is a reasonably good chance, significantly better than average, that we will be able to improve our top line as well as our loss ratio. Additionally, we think that there is good reason to believe that we will be able to improve our expense ratio. Having said that, going back to some of the comments earlier, given some of the dislocation in the market, we will be prepared to sacrifice our expense ratio in the short run in order to invest in new operations as we have done historically.

Operator

Our next question is from Mark Dwelle with RBC Capital Markets.

Mark Alan Dwelle
RBC Capital Markets, LLC, Research Division

A couple of questions. First on the service fee revenue. That declined a fair bit in the quarter, at least in percentage basis, and that's sort of contrary to the trend. Is there something that rolled off there or ran off there that caused that reversal?

Eugene G. Ballard
Executive Vice President of Finance

Well, that fee-based business is -- most of it is related to one of our companies that manages assigned risk plans on behalf of various states. So there's some variability in that business from one year to the next and depending on what states come on or drop off.

William Robert Berkley
Chief Executive Officer, President and Director

So in other words, a, first of all, as the population of these pools grow and shrink, you have that variable. But even more so, these are contracts that we enter, and they tend to be for a few years at a time. And they come up for bid every certain number of years. And again, sometimes they're rolling on, sometimes they're rolling off. So that's what creates a bit of the volatility as some of those contracts roll off. Ultimately -- sorry, excuse me?

Mark Alan Dwelle
RBC Capital Markets, LLC, Research Division

No, go ahead.

William Robert Berkley
Chief Executive Officer, President and Director

I was just going to say, as we've discussed in the past, obviously, the size of those pools tends to ebb and flow with market conditions. The pools are shrinking a bit at this stage as the traditional market is accepting more of the risk and the risk is not spilling over into the market of last resort.

Mark Alan Dwelle
RBC Capital Markets, LLC, Research Division

Okay. On commercial auto, I guess, I was truly surprised at how quickly the level of premiums there had reversed. That had been kind of generally growing, albeit slightly, for most of the year, and then this quarter seemed to mark a fairly sharp contrast. I've heard from competitors sort of mixed views on commercial auto and just wondering if you could share a little more detail about how you're thinking about the sector and maybe more specifically, what types of pricing challenges you're facing there.

William Robert Berkley
Chief Executive Officer, President and Director

Sure. Well, generally speaking, as we've been discussing, I guess -- or it's probably not this quarter, it's maybe a couple of years at this stage. We found that commercial auto space overall to be particularly challenged, long and intermediate haul trucking probably standing out. In particular, though, the overall space is not an easy one. Our activity in the commercial auto space has been shrinking for some number of years. It may not be visible in some of the things that you see because the fact of the matter is, you see the amount of premium we're writing, you don't see our exposures going down. So our exposure count has gone down and has been going down dramatically for some period of time, and it probably in the fourth quarter just accelerated further. The amount of premium that we are collecting is not reducing at the same pace because of the rate increases that we are achieving. So I think that's why I would encourage you not to leap to any conclusion just based on some of the numbers that we are publishing. Again, our exposure count toward the power units that we are writing is going down at a far more quick pace than the numbers that you are seeing and it's just the rate increases that are mitigating that to an extent.

Operator

Our next question is from Ian Gutterman with Balyasny.

Ian Gutterman
Balyasny Asset Management L.P.

Gene, first, do you have the paid loss ratio for the quarter?

Eugene G. Ballard

Executive Vice President of Finance

Yes, I do. That would be 55.8%.

Ian Gutterman
Balyasny Asset Management L.P.

Great.

Eugene G. Ballard
Executive Vice President of Finance

And it's 50 -- it's right in line where it's been in the mid-50s pretty much for the year.

Ian Gutterman
Balyasny Asset Management L.P.

Got it, got it. Rob, in your opening comments, you mentioned a slowdown in alternative capital entering the reinsurance market. I guess, I was wondering, is that something that we should take that may affect your ability to execute something in the space? Or is that more just a broad market comment?

William Robert Berkley
Chief Executive Officer, President and Director

Yes, I think it's just a general observation about the reinsurance marketplace. Clearly, the entry of a meaningful amount of alternative capital over the past several years has put a meaningful amount of pressure on the reinsurance marketplace and specifically on the traditional players. And the pressure is still there, but it doesn't seem like it continues to flow in at the same pace.

Ian Gutterman
Balyasny Asset Management L.P.

Got it. Great. And then just finally on the investment impairments, the $20 million or so. Was that something that -- is that one of those mechanical adjustments where the equities are down 20% for a certain duration that they have to be marked or just something different?

William Robert Berkley
Founder and Executive Chairman

The answer is -- exactly right. It was already mark-to-market on the balance sheet. And once it's more than 12 months, you have to run it through the income statement. It's a really stupid rule.

Ian Gutterman
Balyasny Asset Management L.P.

It is a stupid rule.

William Robert Berkley
Founder and Executive Chairman

Because, by the way, once you run it through the income statement, if it goes back up the next day, you don't get to run it in the income statement when it goes back up. So it's dumb.

Ian Gutterman
Balyasny Asset Management L.P.

Exactly. It is a bad rule. I just was curious that it was bad enough something that you chose to impair based on a deal of something. And then is it reasonable to assume that if -- with the markets stay where they are for the rest of the quarter, they'll probably be a little bit more this next quarter because they'll have more things sort of tripping at 20%?

William Robert Berkley
Founder and Executive Chairman

There may be some other, but it's not a constant.

Ian Gutterman
Balyasny Asset Management L.P.

Not significant. Okay, great. Okay.

Operator

And our last question is from Brian Meredith with UBS.

Brian Robert Meredith
UBS Investment Bank, Research Division

Rob, I'm wondering if you could talk a little bit about what your exposure is on the underwriting side to the energy sector. In the U.S., you've made some efforts to grow in that area the last couple of years. Anything that we should kind of be thinking about or anything on your radar screen as far as potential loss activity coming out of that area?

William Robert Berkley
Chief Executive Officer, President and Director

Yes, good memory, Brian. We have expanded a bit into the energy space and it's something that we've chatted about with you all in the past. Just to put it in perspective, from an underwriting perspective, the -- our exposure to oil and gas is less than 5% of our premium. It's closer to -- I think it's about 3.5% was the last time I had a look. So is it something we care about? Sure, it's something we care about. But is it something that's going to dramatically derail the organization as that sector is under pressure? No, we don't think it. Forget about dramatical. We don't think it really is going to even be a blip for us. And as far as the loss activity goes, we've seen no evidence to date that it is going to create an issue for our -- the text that we are using.

Brian Robert Meredith
UBS Investment Bank, Research Division

Great. And then next question. I'm just curious, any thoughts about increasing your reinsurance buy as we look into 2016, given -- I'm hearing a lot more about multiyear deals coming in place and just attractive reinsurance pricing.

William Robert Berkley
Chief Executive Officer, President and Director

Certainly, we are in touch with the reinsurance market. By and large, it is a better moment to be a buyer than a seller. From our perspective, we try and view the reinsurance market as a place where we can partner with long-term partners. We do not look to arbitrage our partners. At the same time, we are not naïve to the market conditions and the opportunity that generates for our shareholders. So as far as the specifics around our reinsurance-buying strategy, Brian, that's just not something we tend to really get into in this type of forum. But I would suggest we -- we're not trying to abuse anyone but we are not naïve to market conditions.

Operator

And I'm not showing any further questions. I'll now turn the call back over to Mr. Berkeley for closing remarks.

William Robert Berkley
Chief Executive Officer, President and Director

Okay, Bridget, thank you very much, and thank you, all, for calling in. As we've suggested earlier, we think both the quarter and the year were a solid showing. We continue to be very focused on generating what we believe are solid returns. And again, our view is that the return on equity that we should be able to achieve in the future is something that we're very focused on. And it is our view that we will be able to improve '16 when compared to '15. So again, we think the market offers meaningful opportunity. We think some of the challenges that we faced in '15 are behind us and we are enthusiastic about what is ahead. Thank you, all, for joining us, and have a good evening.

Operator

Ladies and gentlemen, thank you for participating in today's conference. This does conclude the program. You may all disconnect. Everyone, have a great day.