S&P Capital IQ

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W. R. Berkley Corporation NYSE:WRB

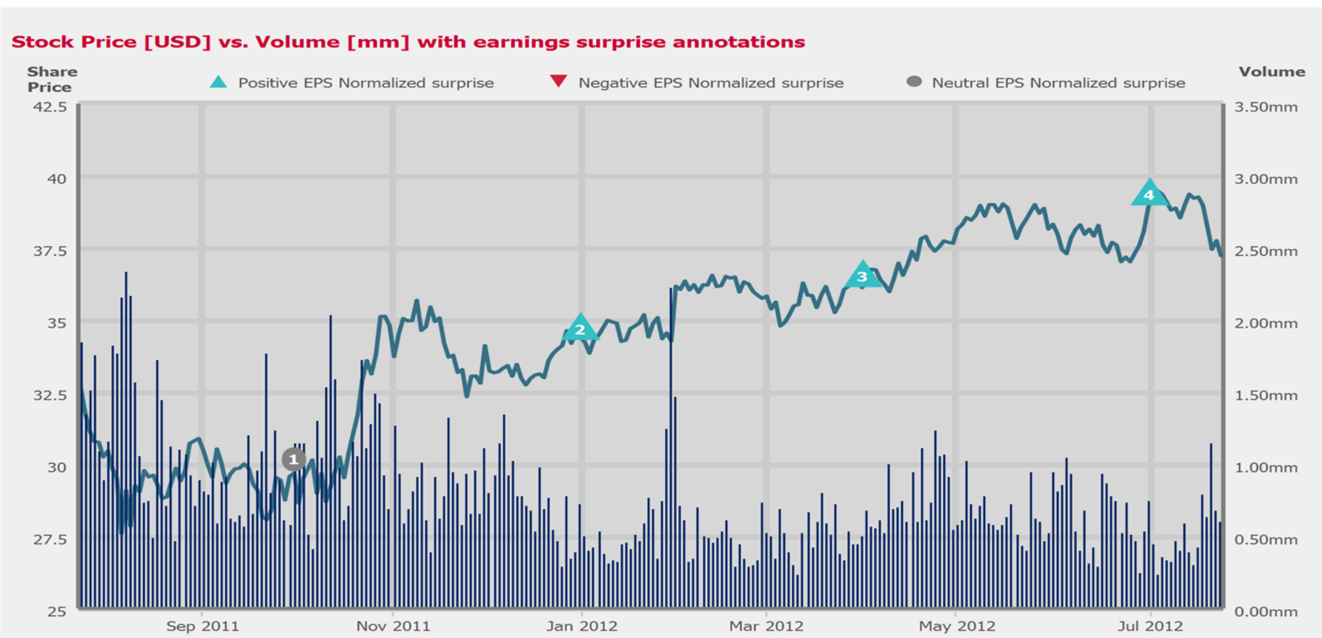
FQ3 2012 Earnings Call Transcripts

Tuesday, October 23, 2012 12:30 PM GMT

S&P Capital IQ Estimates

	-FQ3 2012-			-FQ4 2012-	-FY 2012-	-FY 2013-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.54	0.61	▲12.96	0.66	2.59	2.72
Revenue (mm)	1344.15	1420.50	▲5.68	1376.52	5366.59	5879.21

Currency: USD
Consensus as of Oct-23-2012 1:28 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ3 2011	0.44	0.44	1 0.00 %
FQ4 2011	0.50	0.58	2 16.00 %
FQ1 2012	0.67	0.73	3 8.96 %
FQ2 2012	0.61	0.65	4 6.56 %

Call Participants

EXECUTIVES

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Executive Vice President of Finance

William Robert Berkley
Chief Executive Officer, President and Director

William Robert Berkley
Founder and Executive Chairman

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Gregory Locraft
Morgan Stanley, Research Division

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Michael Steven Nannizzi
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Evercore ISI, Research Division

Presentation

Operator

Good day, and welcome to W.R. Berkley Corporation's Third Quarter 2012 Earnings Conference Call. Today's conference is being recorded.

The speakers' remarks may contain forward-looking statements. Some of the forward-looking statements can be identified by the use of forward-looking words, including, without limitation, believes, expects or estimates. We caution you that such forward-looking statements should not be regarded as a representation by us that the future plans, estimates or expectations contemplated by us, will in fact, be achieved. Please refer to our annual report on Form 10-K for the year ended December 31, 2011, 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. William R. Berkley. Please go ahead, sir.

William Robert Berkley
Founder and Executive Chairman

Good morning. We were very pleased with our quarter, more than just the quarter, all the trends we see continue to cause us to be optimistic about the balance of the year and next year. The world is not perfect. There are all kinds of things that are beyond our control, but we see nothing on the horizon that will prevent us from achieving, improving rates and continued high returns. That said, we would hope that we can achieve the kinds of returns that we've targeted as we move into the next several years.

With that, I'll turn this over to Rob to talk about our operations.

William Robert Berkley
Chief Executive Officer, President and Director

Okay. Thank you very much. Good morning, everyone. The third quarter offered further evidence that the property and casualty commercial lines market is going through a time of positive transition. Efforts among many carriers to obtain rate adequacy are becoming more widespread with every passing day. While this change in behavior is not occurring in all lines of business in perfect lockstep, there is a clear prevailing wind driving rates up.

As we have discussed in the past and it remains our belief today, the catalyst driving this change to change to be carriers' increasing sensitivity over how prior years will develop. This concern is a consequence of an industry-wide underestimation of loss trend, as well as loosening of terms and conditions combined with aggressive pricing.

Workers' compensation continues to be one of the lines of business that is experiencing the greatest change in behavior. In addition to rate increases, the accelerating growth in several states' assigned risk plans is also an important data point.

The casualty market and especially the excess casualty lines, are offering encouraging signs as well. Having said this, given how much underwriting discipline has eroded over the past several years, the market still has a long way to go.

On the other hand, much of the professional lines market continue to be exceptionally competitive, but it is showing early signs that things have bottomed out. The marine and aviation markets have also remained surprisingly competitive, given the level of loss activity that has occurred over the past several quarters.

The group's rate monitoring for the third quarter indicated an improvement of 7% over the third quarter in 2011. While pricing does not move at the same pace across all segments or for that matter, across all operations, our primary insurance rate improvement stood out at 7.5%.

The renewal retention ratio continues to remain at approximately 80%, providing us confidence in our pricing leverage, as well as comfort that we are not experiencing adverse selection. This represents the seventh quarter in a row where the group achieved rate increases and the third quarter in a row where we also obtained rate on rate.

Net written premium in the third quarter was $1.276 billion. This is an increase of 13.3% over the third quarter of 2011. 39 of our 45 underwriting operations grew, which allowed all 5 business segments to contribute to the group's overall growth.

The growth was driven primarily by rate at 7%, 5% of exposure and 1% audit premium. The group's loss ratio for the third quarter was 62.1, which is an improvement of 2.7 points over the third quarter last year. In addition, the expense ratio improved by 0.8 point. This gives us a combined ratio of 95.8 or a total improvement of 3.5 points over the corresponding period.

The company's progress is primarily a result of higher-earned premiums stemming from rate increases, our maturing start-up operations, as well as lower cat activity. Gene will be going into more detail on these topics shortly.

The group's balance sheet remains robust. Our reserves remain strong as demonstrated by 23 consecutive quarters with net positive reserve development. Additionally, our investment portfolio remains strong, with an average rating of AA-.

The market is turning at an increasing pace. Much of the change in behavior we are seeing today is a reaction to developments stemming from underwriting decisions made by some in the past. We expect more companies to report additional negative developments over the next few quarters.

Further, while the impact that the low interest rate environment has on the industry's economic model is widely discussed, we believe few have begun to appropriately factor this into their pricing.

Having said this, while it is unclear how hard the market will get and how quickly it will get there, it is quite apparent that we have a great deal of runway in front of us when it comes to pushing rates.

William Robert Berkley
Founder and Executive Chairman

Thanks, Rob. All right, Gene is now going to try and go through the financials, and then I'll pick up after that.

Eugene G. Ballard
Executive Vice President of Finance

Okay. Thank you, Bill. As Rob said, we had another strong quarter in terms of both revenues and underwriting profits, and we also managed to deliver a modest growth in investment income, in spite of the anticipated decline in earnings from investment funds.

Our net premiums written were almost $1.3 billion in the quarter, up $150 million or 13.3% from a year ago. The growth was led by our specialty and alternative market segments, which were up 18% and 17%, respectively. Business units that we started since 2006 grew by 34% in the quarter and now represent approximately 25% of our overall premium volume.

Changes in foreign exchange rates compared to the third quarter of last year added about 0.5 percentage point to the overall growth rate expressed in U.S. dollars.

Underwriting profits were $50 million in the quarter, that's up from $8 million a year ago and an overall combined ratio that decreased 3.5 points. 3 main reasons for that: First, the underlying accident year loss ratio before cat improved by 1.6 percentage points to 63.7, as price increases over the past 7 quarters are beginning to have a meaningful impact on both earned premiums and underwriting income. In addition, the regional segment benefited from very benign loss activity in the third period compared with a year ago.

Second, catastrophe losses were just $9 million in the quarter, that's down from $51 million a year ago, which is a further improvement of 4.1 loss ratio point.

And third, the expense ratio improved by 0.8 point to 33.7, also largely due to the impact of rate increases.

4 of our 5 business segments reported lower expense ratios on both an earned and written basis. The regional segment expense ratio was flat on an earned basis, but down 0.5 point on a written basis, that's before DAC.

That adds up to an accident year combined ratio before cat of 97.4, down 2.5 points from a year ago. In addition, we reported favorable prior-year reserve development of $28 million or 2.3 percentage points -- loss ratio points. That's down from 5.3 loss ratio points a year ago, but right in line with the reserve releases of $25 million and $30 million in the first 2 quarters of this year. Prior-year reserves developed favorably for all 5 of our business segments.

The calendar year combined ratio was reported at 95.8, down from 99.3 a year ago, with all 5 business segments reporting combined ratios under a 100. Although the specialty segments reported combined ratio was up from a year ago due to lower reserve releases, the accident year combined for specialty also improved by 2.5 points.

Investment income was $116 million, up $2 million from the third quarter of 2011. Income from our core portfolio, which includes fixed income, equities and real estate, was up $2 million to $127 million, with an annualized pretax yield of 3.7%. Income from merger arbitrage was up slightly to $2.5 million, and income from -- and investment funds reported a loss of $13 million, which includes energy-related losses of $21 million that we had already announced in our second quarter 10-Q.

The year-to-date annualized yield on the overall portfolio was 4.0%, unchanged from the year-to-date period in 2011. And on a tax equivalent basis, adjusted for the tax benefits of the municipal portfolio, the annualized return on investments was 4.6% year-to-date. We reported realized gains of $22 million in the quarter and had unrealized gains pretax of $856 million at September 30, 2012.

At the end of our quarter -- for the quarter, 85% of the portfolio was invested in cash and fixed incomes with an average duration of 3.3 years at an average credit rating of AA-.

We repurchased 2 million shares of our own stock in the quarter, which brings us to 3.3 million share repurchases year-to-date at an aggregate cost of $121 million. Our net income was $101 million in the quarter, which is an annualized return on equity of 10.2%, and we finished the quarter with book value per share of $31.81, which is an increase of $3.06 for the year-to-date period and an annualized increase of 15%.

William Robert Berkley
Founder and Executive Chairman

Thanks, Gene. While we were pleased with the quarter, on the investment side, our duration was reduced from 3.4 to 3.3 years in the quarter, primarily as a result of the duration of our mortgages and prepayment rates in our mortgage portfolio, declining in the ordinary attritional impact of time passing by. We've chosen not to be aggressive in extending our long-term size of the investment portfolio because we are concerned that inflation is out there. Although clearly, the short-term time horizon appears to be benign. That's a balancing affect that we're concerned about. And the way to push that duration out is to go out at least at the portion of the portfolio substantially more than 10 years. And that's just not something we want to do.

The investment side also has benefited from our continuing ability to find niche opportunities, but unfortunately, they keep disappearing. A good example of those would be we were able to invest roughly

$200 million in mezzanine mortgage obligations where the collateral protection was still less than 50% loan-to-value and with a return of 6%. But as we approached the end of the third quarter, the yields on those securities declined sharply, and the current returns are more like 5%, and another niche went away as we search for more opportunities that fulfill our security and quality requirement in spite of how they may appear because of the category.

We think we can still come close to holding our existing rates to right around 4% pretax. After-tax will probably decline a little, but we're optimistic at least through the end of the year. Our cash flows, if they accelerate dramatically, would cause us to question that.

Overall, you're seeing a number of our competitors, especially the mid-sized competitors, having to face up to the reality of efficiencies in prior years. And they're coming out. We think that this is like a snowball going downhill. A number of these companies are going to have to make up for the deficiencies, they're -- then going to face issues as to their ratings and their abilities to continue on their own will diminish.

So we're very optimistic. We see more and more opportunities. We think we're being rewarded for the 5 years-plus of investment we've made in setting up new enterprises, and we expect that will allow us to grow at a time when others are just trying to hold their own.
So with that, I would be happy, Ali [ph], to turn this over to questions.

Question and Answer

Operator

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

Amit Kumar
Macquarie Research

My first question relates to capital management, with the impending fiscal cliff versus the insider ownership, can you talk about how do you view a special dividend before the year end?

William Robert Berkley
Founder and Executive Chairman

It's certainly something that we're thinking about. We're considering -- we'll probably think a decision as we head to the election. But I think that will certainly have an impact on what we do. But if, in fact, we think rates are going to change dramatically, it would take on a serious issue that we consider.

Amit Kumar
Macquarie Research

Okay. That's helpful. And the only other question I have is on pricing. You're talking about pricing going up. I'm curious and then maybe this is a bit too early, if you sort of fast forward to -- if you're in 2013, all as being equal, do you expect the rates to be up double digit at that time? Or do they sort of trend up in the next few quarters? And then in the absence of any industry event, do they start trending down?

William Robert Berkley
Founder and Executive Chairman

I think that what we're trying to get across the message to people is that with interest rates where they are, rates -- if rates go up 10% next year, you're still going to barely have adequate returns. It takes a lot of increase in rate to offset the decline in investment income. So as people's portfolios run off and the duration of portfolios are probably between 2 and 4 years, you're going to start to see people need rate just to have mid-single-digit returns at the current time. So I think that our view is you'll -- it's not double-digit, certainly very high-single digit returns by the end of next year, and we don't see them falling off.

Operator

Our next question comes from Vinay Misquith with Evercore Partners.

Vinay Gerard Misquith
Evercore ISI, Research Division

The first question is on rate increases. Now we've seen -- from your company as well as some admitted carriers out there that rates have accelerated the third quarter versus second quarter. Just curious on your perspective, what do you think are the drivers? I mean -- saw the large admitted carriers be more disciplined or do you see the smaller players also be more disciplined? And I see that within your regional business, your top line picked up, so just curious about that, too.

William Robert Berkley
Founder and Executive Chairman

I'm going to let Rob take this.

William Robert Berkley
Chief Executive Officer, President and Director

Yes, as far as the regional growth goes, that was primarily from rate, really not so much exposure count. But putting that aside, I think there are large companies and there are small companies out there that are disciplined and some that aren't disciplined. Clearly, some of the larger national carriers tend to set or have a lot of say to what the tone is of the market place. I think ultimately, what is driving the change in behavior is -- was suggested earlier in the discussion is that people are seeing things develop out from as far as prior year goes, and they're concerned as to how things look as they come into focus. And they are taking actions as it relates to that. So the rate activity that you've seen so far, again, in our opinion, is because people are observing and extrapolating how prior year is going to develop. And also, as we suggested, the level of anxiety as it relates to what was also discussed a few moments ago around the impact of investment income, I think is on people's minds. And that's probably the second shoe to drop, and it will be the catalyst for further rate increases as also suggested a few minutes ago.

Vinay Gerard Misquith
Evercore ISI, Research Division

Okay, that's helpful. The second question was on loss cost trends. Pricing is rising 6% to 7%, margins are improving about 160 basis points. Curious as to what you are booking as loss cost trends right now?

William Robert Berkley
Chief Executive Officer, President and Director

Yes, quite honestly, as you would expected there by line of business, I would suggest, though, in the aggregate for the group, it's north of 2%, probably, certainly not above 3%. And having said that we are extrapolating a bit given the rate increases that we're achieving at this stage. We've a reasonably strong degree of confidence that we are adding to underwriting margin at this stage.

Vinay Gerard Misquith
Evercore ISI, Research Division

Okay, fair enough. And then just one last question, if I may. Your expense ratio actually declined this quarter year-over-year, which is good. Do you think that you're at a point where more premiums would now add more to your leverage on the expense ratio versus the past?

William Robert Berkley
Chief Executive Officer, President and Director

Yes, absolutely. This has been something that we've, at least, been trying to highlight for our folks over the past couple of years. What's happened is the written has grown, and finally, the earned is coming through and many of the businesses that are at different points in their life cycle are the startups that are transitioning out of their infancy, if you will. They are getting the critical mass, the earned premium is coming through, and you're going to be able -- you will observe the operation being able to leverage those expenses more and more over the next many quarters.

Operator

Our next question comes from Greg Locraft from Morgan Stanley.

Gregory Locraft
Morgan Stanley, Research Division

Just a follow-up on the last one. So Robert, if I was to understand you correctly, pricing up, 7% and loss trend, call it, 3%. So should we be seeing the core margins increasing by 300-plus basis points in future periods year-over-year, so call it double what we've just seen?

William Robert Berkley
Chief Executive Officer, President and Director

I think that will -- a couple of comments. First of all, I think the simple math would suggest that it's going to improve by 4%. But obviously, it takes time, as you know, Greg, for that earned premium to come through. And in addition to that, something to keep in mind, obviously, we all historically and expect we will continue to air on the side of caution as we adjust those design loss picks down. But certainly, there's -- the back of the envelope math, I would suggest is trend, 3%, rate achieved, 7% and that gives you 4%. But that will take time to come through.

William Robert Berkley
Founder and Executive Chairman

I think you also have to recognize that the past redundancies means our loss ratio picked for prior periods, as Rob suggested, may have been more than adequate. So we'll have to examine that for each year since the peak is made on a waterfall basis looking backwards. So that also could have some benefit.

William Robert Berkley
Chief Executive Officer, President and Director

Yes.

Gregory Locraft
Morgan Stanley, Research Division

Okay, okay, great. And then back to the special dividend, which was sort of an interesting question. Would you all consider adding debt to fund that? Or would it be contained within earnings? And obviously, that's pending the election, as you had mentioned over the last quarter call.

William Robert Berkley
Founder and Executive Chairman

We wouldn't have any need to add debt. We have lots of cash as a holding company. And we have lots of dividend capacity at our operating, and so it wouldn't be our plan to have that.

Gregory Locraft
Morgan Stanley, Research Division

Okay, okay. And then, shifting gears to the private equity portfolio, and I think it was the last call, you had mentioned possible monetization of $100 million or so in gains. How is that trending, and what is the use of proceeds?

William Robert Berkley
Founder and Executive Chairman

I think what I said in the press release is we would expect at least $75 million of gains in the fourth quarter. That really meant to try to be a little more specific in that issue. And that went to our thinking about all our capital management, repurchasing the stock, the special dividend. But we also have additional realized gains that we expect next year.

Gregory Locraft
Morgan Stanley, Research Division

Okay. Perfect, perfect. And then one last and I apologize for sort of rapid fire nature. But on the pricing side for the long-tail lines, this is more, I guess, for you guys just how it really works. Do you all take the embedded 4% in the portfolio? Do you take the risk-free rate? How do you think about the investment yield assumption in your models as you go out to 2, 3, 4, 5 years in your pricing model? So how does it work for Berkeley Corporation? And then, how does the competition view it from a pricing perspective?

William Robert Berkley
Chief Executive Officer, President and Director

Greg, it's Rob here. As far as pricing the business, we -- it's a bit of a -- it's a little bit of a complicated answer. But the -- I guess, the simplified version is we are very cognizant to what our new money rates are at the time. Obviously, we take into account that duration so on and so forth, but as it relates to new business that we are writing, we are focused on the new money rates and the premium that comes in, and the reserves that we set to our design pick that are associated with that business. We are focused on what type of return that money can achieve if we -- when we put it to work today.

William Robert Berkley
Founder and Executive Chairman

I think a good example of that would be what happened in our excess comp business where we effectively lost 1/3 of our business, maybe even a bit more because that -- there's a place where our pricing has literally a discount rate built-in because in those reserves, specifically, are discounted. And the discount we use reflected the current rate on long-term securities. And a number of our competitors use their average portfolio return as the discount rate. We use the current available rate for new money. So the end result of that with the 17-year duration of those loss reserves is there are prices that were substantially higher than those competitors, and we lost a lot of business to those people. But the fact is when that money flowed in, they had to invest it in the same way we did at whatever the current new money rate is. So in some areas, especially excess comp, it's a very specific impact, Greg. And other areas, it's talking to the underwriters about the profitability of the business and being cognizant of the loss ratio picks that you can have, given lower rates of return.

Gregory Locraft
Morgan Stanley, Research Division

Okay, okay, yes. Some of your competition have said exactly that, which is that they're using sort of a blended interest rate assumption, a return assumption as opposed exactly as you said, which is that you guys use new money yields. So in a way, they're seducing themselves. They think their pricing is adequate and over time, their returns just won't be there.

William Robert Berkley
Founder and Executive Chairman

In fact, it only works when you're going to sell the company. And then, the problem is someone else's.

Operator

Our next question comes from Josh Shanker of Deutsche Bank.

Joshua David Shanker
Deutsche Bank AG, Research Division

Two questions for you. The first one, I want to talk a little bit about the acceleration of rate and the deceleration of net written premium and what's going on there. And two, I want...

William Robert Berkley
Founder and Executive Chairman

Wait, wait, wait. The deceleration of net written premium?

Joshua David Shanker
Deutsche Bank AG, Research Division

Yes. You guys were doing mid-teens. I mean, it's 14% in 3Q '11, 13% in 3Q '12. I realize that's small, but given you've had a significant rate bumps since that time, you would think that net written premium growth would be accelerating at this point. And maybe even startups were writing more business, I'm sure there's a very reasonable estimation for that.

William Robert Berkley
Founder and Executive Chairman

Candidly, no, we don't -- startup is very new business. It's very -- it's quarter-to-quarter varies. We don't -- you we don't view those changes as particularly material.

Joshua David Shanker
Deutsche Bank AG, Research Division

Okay. And the second question involves, when can we really expect expense ratio to start coming down given the higher volumes?

William Robert Berkley
Founder and Executive Chairman

It's starting to come down. It will come down quarter-by-quarter.

William Robert Berkley
Chief Executive Officer, President and Director

That's the earned premium.

William Robert Berkley
Founder and Executive Chairman

You have to understand that [indiscernible] your earned premium, that takes 5 quarters. The other thing you have to remember is the whole change in that calculation doesn't give you the benefits of growth until it's converged to earn premium. So this whole new accounting change, in fact, effectively penalizes you for growth. So we're going to -- it's going to come down slower for us than it will be for companies that might not be growing this quickly.

Eugene G. Ballard
Executive Vice President of Finance

On a written basis, one of the things we've talked about when the dispatch [ph] pronounce [ph] the first came out is we also look at the decline in expense ratio on a written basis and for us, quarter-to-quarter last year this year, it's down 1.4% point. And it's down 0.8 points on earned basis. So that gap will close and in addition, as we continue to grow, it'll be that much better.

William Robert Berkley
Founder and Executive Chairman

These are earned premium where it's going to -- we're still seeing growth in our premium, and that's going to make that continue to decline. We would expect there'll be substantial declines in that over the next, certainly, at least 5 quarters that are baked in already.

Operator

Our next question comes from Michael Nannizzi of Goldman Sachs.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

So one question I had was on the $75 million gains. Was that specifically related to the private equity portfolio? Or is that related to the more -- or is part of that related to the more traditional fixed income book?

William Robert Berkley
Founder and Executive Chairman

We're just leaving it as it's -- generally we're just letting people know that, that's what we're going to have. And we're -- the answer is we have -- we expect it to be probably private equity, but there's a lot of places that there are gains in the portfolio that will be realized.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

So the question is, if you're selling fixed income to sort of how...

William Robert Berkley
Founder and Executive Chairman

It's not fixed income.

Gregory Locraft
Morgan Stanley, Research Division

Okay. It's not fixed income, okay, so we shouldn't interpret the press release commentary to imply that you're kind of harvesting some gains on the fixed income side?

William Robert Berkley
Founder and Executive Chairman

No.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Okay, got it. Great, okay. I was -- and then -- but you talked in the past about this notion of fear, greed turning to fear when inflection pricing inflection points happen. How would you fit that to the environment that you're seeing right now?

William Robert Berkley
Founder and Executive Chairman

I think it really happened company by company. When people stop seeing redundancies in the reserves and start to see deficiencies, when people stopped seeing those cushions that they had now for many quarters, I think that you've seen it happen in a number of companies. I think there were over 30 companies had deficiencies last year. I think that the fact is that as people who think they then fixed their problem of deficiencies by putting up money, find out, oh my goodness, another quarter and we look at our reserves and there's another deficiency, people start to afraid, and when they start to get afraid, they push on price, they get more disciplined on terms and conditions. I think you're going to see that in a lot of people who were aggressive in writing workers' compensation, especially on California places, where people didn't know what they were doing and thought this was such an easy thing. And I think there's a lot of lines of business that are like that. I think you'll see a number of people in the overall. That was a line of business that was so easy and they've managed to make a mess of it and it's not really a very longtail lines, so they're finding out quickly. So I think that's what happens with fear. You think you fixed your problem, you said, oh it's behind us, we fixed the deficiency. And then, the deficiency comes up again.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

All right. And then, just one last one maybe for Rob, if it's okay. You made a comment about rate and exposures and translating that to the top line. If we were to look at the regional segment, I'm just curious, like, if rates overall were up 7% or 7.5%, where does the regional segment fall in that spectrum? And what is the rate versus exposure on the U.S. regional business?

William Robert Berkley
Chief Executive Officer, President and Director

Mike, just want to make sure that -- as it relates to the question, as far as the regional piece goes, you'd like to understand what the relationship is between rate versus exposure versus other premium so on and so forth?

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Yes.

William Robert Berkley
Chief Executive Officer, President and Director

Yes, typically, we don't break that out by segment. Having said that, what I can tell you, the simple math is that it is again, it's really all rate and plus a little bit and exposure is not -- it's flat, quite frankly.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Okay. So it's mostly rate and exposures -- and on a relative attractiveness in terms of the rate gains you're seeing, versus loss just in absolute terms in the regional segment versus the other areas or the other segment. And I realized it's a broad question because there are a lot of businesses that roll up into each of them, but are you seeing more or less opportunity for rate in the regional segment versus the others?

William Robert Berkley
Chief Executive Officer, President and Director

I think certainly, from our perspective, we're quite pleased that with the rate that we're achieving in the regional group. So we don't have any reservations about the rate that we're achieving in the regional group, I guess to make a long story short. Are they outperforming other segments, so to speak? They're doing a little bit than some, they're not doing quite, as well as a couple of others. But the rates that they're getting there without a doubt clearly, they are adding to underwriting margin. We're very comfortable with both the pace that they are moving as far as achieving more rate.

Operator

Our next question comes from Meyer Shields of Stifel, Nicolaus.

Meyer Shields
Stifel, Nicolaus & Company, Incorporated, Research Division

Rob, in your introductory comments you said you think that current rate changes stem more from reserve problems than from interest rate recognition. And I'm wondering, what is it that you're seeing that makes you think that it's the reserve issue and not the yields impacting current behavior?

William Robert Berkley
Chief Executive Officer, President and Director

Quite frankly, it's more anecdotal. But my sense is from this listening with people in the marketplace and you hear what their focus is and what is really in the immediate term on their mind and what they're trying to address, it's pretty apparent that they are focused on how they see prior years developing. There's a lot of discussion around quite frankly, the impact that investment income is going to have. But quite frankly and in our opinion, if they're really focused on investment income as well, there would be a more sense of urgency in getting even more rate than they are.

William Robert Berkley
Founder and Executive Chairman

I think we talked to people everyplace from agents to presidents of companies and the thinking and the concentration is inadequate underwriting margins. And no one talks about the impact of lower investment income. It's just not a topic that's in the front of people's dialogue or in the front of their mind.

Meyer Shields
Stifel, Nicolaus & Company, Incorporated, Research Division

Okay, that's very helpful. Bill, are you seeing any of the same trends in terms of -- reserve problems driving rate increases on the international front?

William Robert Berkley
Founder and Executive Chairman

I think that we would suggest that it's not as easy at this point for us to see those trends internationally, the same information and the same format is not available for us to look at. I think that there's certainly are a number of global companies that have similar problems. So I would suggest that a number of the larger global companies have reserve problems. But in some of those cases, bigger problem for some of those companies would be balance sheet problems related to asset makeup. So we think the issues exist on a global basis. Some of them because of reserve shortfalls and some of them because they're carrying values of investment assets, which are probably now reflective of the real market.

Meyer Shields
Stifel, Nicolaus & Company, Incorporated, Research Division

Okay. And last question, I guess, probably for Gene. Can you give us a sense as the overall percentage exposure to property, I don't know if I got that from the quarter, but it has in the recent past. Can you give us a sense about what the cat load is for the pricing that you're using?

Eugene G. Ballard
Executive Vice President of Finance

What the cat load?

Drew Woodbury
Morningstar Inc., Research Division

Yes, the cat free load.

William Robert Berkley
Founder and Executive Chairman

I guess, before Gene tackles the question, one piece maybe that I would add is I think it would be a mischaracterization to suggest that we have dramatically increased our cat -- property cat exposure. In fact, what we have done is increased some of our exposure to some of the shorter tail lines of business. But property cat is not something that we have increased our focus on. Gene?

Eugene G. Ballard
Executive Vice President of Finance

Yes, I don't really have a number I could give you. It depends on what line, what part of the business you're talking about and it's a pretty complicated exercise to figure out what cat load goes into each policy in each line of business. We don't have like an overall cat load for the book.

William Robert Berkley
Founder and Executive Chairman

The fact is, what we do is we examine our book of business. We examine total load -- total insured values, assess the cat value by area, by store, by line of business and then protect ourselves accordingly. But we are -- even though we are now writing, as Rob said, more short-term business, even the property business that we're writing is not cat exposed particularly.

Operator

Our next question comes from Jay Cohen of Bank of America Merrill Lynch.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

First, a numbers question, I guess for Gene. Gene, can you give us a more precise breakdown on the investment income with some of the other ways you typically break it out in the queue? Real estate and equity securities?

Eugene G. Ballard
Executive Vice President of Finance

In terms of their yields or -- the returns, Jay, are not changed so much from where they've been in those lines of business. I mean overall ...

Jay Adam Cohen
BofA Merrill Lynch, Research Division

I was thinking the numbers for the quarter, what the...

Eugene G. Ballard
Executive Vice President of Finance

Even for the quarter, I mean the core portfolio was up, which are those 3 pieces, it's up a couple of million dollars. And there's no movement within any of those categories you mentioned significantly one way or the other.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

It looks like then that the fixed income portion was up from the first half into the third quarter?

Eugene G. Ballard
Executive Vice President of Finance

The fixed income was up from when?

Jay Adam Cohen
BofA Merrill Lynch, Research Division

From the first half run rate, it looked like it improved in the third quarter.

Eugene G. Ballard
Executive Vice President of Finance

No, I think it's very, very stable. The core portfolio for that 3.7 around that. That's on tax equivalent basis, pretax, but not on a tax equivalent basis.

We've had some cash flow, our investment portfolio has grown. So we're seeing a bit more investment income come through, but the yield has been pretty flat.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Okay. Second question, I guess, when you're looking at price increases versus claims inflation, obviously, driving margin improvement, I assume that's on the renewal book of business, that 7% price increase? But if your renewal is -- retention is 80%, then clearly, obviously, a lot of this premium is new business as well, does that...

William Robert Berkley
Chief Executive Officer, President and Director

That is accurate, but our renewal business actually, as we said, is about 7%. Then we do a new to renewal pricing relativity, which we're actually getting a bit more on our new business than our renewal business, if you will. I think we're getting about 3.5 more on new versus renewal.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

I guess your new business then would not necessarily detract from the margin improvement that you expect on the renewal book?

William Robert Berkley
Chief Executive Officer, President and Director

Now, please understand, it's a bit of a process to make sure that we're getting apples-to-apples, new versus renewal. But our best estimate is in fact, we are getting higher rates on our new business than our renewal business. And quite frankly, when you take a step back and you think about it, it's kind of logical.

You know more about your renewal book than your new business, so you should want to surcharge the new business. I know that we're a bit of an outlier based on what we see our -- many of our competitors are doing in the marketplace. But that is our philosophy and that is coming through in our results.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Yes, that makes sense. I guess it's harder to attract new business if you're getting even better price for that business, it's attract that business from someone else. But obviously, you're able to do it.

William Robert Berkley
Chief Executive Officer, President and Director

Certainly, it does not make it any easier. Having said that, when you're focused on long-term underwriting margin, we think it makes sense.

William Robert Berkley
Founder and Executive Chairman

And frequently, the business that we find that is most attractive to us is people who had an unpleasant claims experience with someone else. They then value the person they do business with.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Got it. And then, the last question is, with the reserve developments for the industry, you certainly see these isolated incidents of reserve -- adverse development. I mean, look at Meadowbrook this past quarter, and there's a bunch of those, they seem to be different companies every quarter practically. And if you look at some of the larger companies, public companies anyway, that favorable development has continued to be an important source of earnings, including you guys. Do you need to see bigger companies essentially face more pressure on reserves to get a more dramatic turn in pricing?

William Robert Berkley
Founder and Executive Chairman

Yes, yes, I think what really happens is big companies are able to hide the problem for a longer period of time, which I think is happening. And then, I think what really occurs is some individual, big company reaches the dam, if you will, and then everyone else, okay, let's just get it over with. So I think that there are a lot of companies -- and by the way, I don't think companies are short. Monumental amounts where they're in jeopardy of survival. But I think what it does is it points out that their pricing is inadequate. And I think that the hiding of shortfalls is a reflection of their operating statements that their pricing is inadequate, not they're in danger of insolvency. I think the middle sized and smaller companies have insolvency issues. The bigger companies shortfalls are just -- they're not facing the issues or getting their prices to be adequate. So -- and I think the moment the first one of those big companies that bites that bullet, I think you're going to start to see a bunch of others follow through.

Operator

Our next question comes from Kenneth Billingsley of BGB Securities.

Kenneth G. Billingsley
BGB Securities, Inc., Research Division

Just a couple of questions. One, for Gene, could you give us year-to-date reserve release numbers again by quarter?

Eugene G. Ballard
Executive Vice President of Finance

Year-to-date by quarter, it was -- so we had $25 million in the first quarter, $30 million in the second quarter and $28 million in the third quarter. All those total $83 million year-to-date.

Kenneth G. Billingsley
BGB Securities, Inc., Research Division

I appreciate that. And I realized there's a talk extensively about reserve releases and the way it compares to the market. And just add to that, it seems like a lot of the increases that we're seeing outside of you is a lot of this 2009 to 2011 accident years. And I know that your mix of business may not overlay exactly with where some of these other people are taking some of these increases. But could you just talk about, I mean what's different in your observations that your reserve estimates obviously were subtly different? It seems like some of these guys are taking the charges we're growing pretty heavily in '09 and '10 when you weren't. But obviously, 2011 seems to be creating problems for some of the players out there? And that's where you did start to grow, not necessarily in those direct segments that they maybe -- could you just talk about your observations and why you may not feel you're going to run into some of the same issues at least for that 2011 accident year?

William Robert Berkley
Founder and Executive Chairman

Yes, I mean I think that by and large, we don't expect problems in our current accident year in essence because of how we establish reserves, that there -- if you look at '09, '10, '11, they proved as you look at them, they prove to be more than adequate. And we expect that will continue. I think the people who have found themselves deficient ended up being aggressive in lines of business that we're most competitive, and they generally follow the old saying that the grass is always greener. And as they grew or expanded dramatically in lines of business where they had no experience, no knowledge and no basis data. And I think that the surest thing to do is to find the company without any experienced personnel, and that's the kind of thing where they're looking for trouble. We think that the nature of how we've chosen to grow, which is don't choose a line of business you want to get into, find a great team of people is for exactly that reason. We're not interested in getting into a great line of business, we're interested in having great people that will allow us to get into a line of business.

Kenneth G. Billingsley
BGB Securities, Inc., Research Division

And the last question on this. It seems that some of the industry was releasing reserves from more recent years, a lot sooner than they had in prior decades in years, much more quicker to release reserves that were only 1.5 to 2 years developed. Are you seeing in that as maybe in some of the issue as well not only were they aggressive, but then they still thought they did well and now they're having to fill that hole? And where are your reserve releases coming from? Are they back-end loaded? Are they in the 2009 to 2011, I know they're more heavily weighted to '10 and '11?

Eugene G. Ballard
Executive Vice President of Finance

They're in a more recent years, I'd say '08, '09, '10, '11 is really green. But remember, we're only talking about $28 million in the aggregate. So there's any 1 year where you're aren’t seeing anything that meaningful.

William Robert Berkley
Founder and Executive Chairman

It's a very small percentage of our reserves, especially relative to a number of our competitors.

Kenneth G. Billingsley
BGB Securities, Inc., Research Division

Sure. But were you shocked to see that some of the competitors were releasing more sizable amounts in comparison to their total reserves from these more later years?

William Robert Berkley
Chief Executive Officer, President and Director

It's Rob -- sorry, it's Rob here. I think fundamentally, as we've referenced for a couple of years now on several of these calls, we observe what that others do, but we can't crawl inside of their minds and don't know what's going on specifically in their organizations. What we can tell you is that we feel as though it is appropriate, prudent to take a cautious approach to both pricing, setting reserves and then, to the extent that there is reserve development in a positive direction, recognizing that in a thoughtful and controlled manner, controlled in the sense of making sure that you have a clear understanding as to what the outcome is going to be. From our perspective, as we have also suggested in the past on these calls, there are some folks that we feel as though have been more optimistic in their loss pick than we would have been. And a lot of that stems from their assumptions around certain bits and pieces that go on to trend, whether it be medical trend, whether it be inflation, whether it be assumptions that people make around investment income as we discussed earlier on this call. So we have an approach, we have a philosophy where we are interested in being cautious early on. As more data becomes available, that outcome will come more into focus. And we will adjust reserves appropriately. But what other people do, what it appears, they've been more optimistic in their assumptions and quicker to release than we had been, perhaps in some cases. But again, we're focused on what we do, we're not preoccupied with what others do.

William Robert Berkley
Founder and Executive Chairman

I think that the discussion we have briefly about discounts and long tail lines, really goes to the heart of this complicated question on how it would impact income statement. We lost 35% of our business because we priced using the discount rate of marginal return versus average portfolio return. They look like they were brilliant. They grew a lot, and as that developed over the years and they had to reinvest the money at lower marginal returns, they will pay for that mispricing over a number of years. It all goes to the pricing you set. So if you set high pricing, you may show bigger or lesser price increases and it just makes you more or less redundancies. Again, goes to the price you initially set. It's one of the reasons we think we're in a better competitive position because we've been more disciplined in prices we originally set, at least we think we have been.

Operator

Our next question comes from Larry Greenberg of Langen McAlenney.

Lawrence David Greenberg
Langen McAlenney

And just staying on the topic of reserves. I'm just wondering if you could give us any color on how your workers' comp business is developing? And more interested on the primary side, but maybe some differentiation between primary and excess?

William Robert Berkley
Chief Executive Officer, President and Director

As far as the development goes, typically, on these calls, we don't get into a lot of granularity by line of business or by operation, so to speak. Having said that, there's nothing that we see as it relates to our workers' comp reserve either on an excess basis or a primary basis that give us any reason to pause. We have been pushing very hard for rate for an extended period of time. We have a great sensitivity to trend, particularly medical trend. And we certainly are not blind or naïve to local states comp benefits rates and what's going on there. We've paid a lot of attention to that. So many of our comp-related businesses or comp-focused business, if you will, have been shrinking over the past several years. There are others that had what seemingly is an unquenchable thirst for premium as presumably everyone on the call understands at this stage, appetites had changed. And we are seeing more opportunity going forward hopefully. But to your specific question, as it relates to our reserves in both primary and excess comp, we feel that we are on firm ground.

Operator

[Operator Instructions] Our next question is a follow-up from Michael Nannizzi of Goldman Sachs.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

But in the alternative segment, I just wanted to understand, what drove the increase in premiums? I know in prior quarters, there were some, I believe, I may be mistaken, but there are some reclassification of some premiums out of alternatives or in alternatives or something. But I'm just trying to understand what is driving that? Is it primary or...

William Robert Berkley
Founder and Executive Chairman

On a growth basis?

William Robert Berkley
Chief Executive Officer, President and Director

Yes, on a growth basis or a net basis, Mike?

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

I mean think it's kind of both, I think, so net, you're up about 18% growth, it looks like maybe it's about the same, maybe a little bit less?

Eugene G. Ballard
Executive Vice President of Finance

You're talking about the quarter or the year-to-date period now?

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Just the quarter. I mean, you're up 20% in the second quarter year-over-year and then, 17% net year-over-year in the third quarter. And probably just curious, I mean it looked like primary comp was a big driver in the second quarter, we don't have that data now. But I'm just trying to understand what...

Eugene G. Ballard
Executive Vice President of Finance

The main reason there is we've got one -- a couple of startups that have done particularly well. One in the accident health business, and one in the workers' comp business.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Okay. So A&H would roll up into the other piece then?

William Robert Berkley
Chief Executive Officer, President and Director

Yes, I mean part of it also has to do with, quite frankly, just what the trend assumption is then, how much rate that we're getting and what we need to get as far as rates keep up with loss trends. So for example, some of these lines of business that because of the exposure to medical trend that fall into the alternatives market. We're pushing for more rate there because we got to keep up with medical trend and then some. So the thing we're getting medical trend is a big issue. We could have 16%, 17% rate increases.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

I see, I see, okay. Is that kind of where you expect the third quarter kind of indicative of where you think there's -- there are no kind of one-offs there? I mean, you've got...

Eugene G. Ballard
Executive Vice President of Finance

There's nothing unusual there.

Operator

Our next question comes from Meyer Shields of Stifel, Nicolaus.

Meyer Shields
Stifel, Nicolaus & Company, Incorporated, Research Division

This sort of a relatively rapid slowdown in the International segments closer to premium growth. And it looks like the base wasn't all that different from the base in the second quarter. So I'm wondering if you could talk about why that growth is slowing down a little bit?

William Robert Berkley
Chief Executive Officer, President and Director

Yes, Meyer. It's Rob here. I think, certainly, a lot of it has to do with some of the startup operations having, I wouldn't say plateau, but the growth rate is not what it had been in the past. And so that's really the part of the biggest piece of it, if you will. And having said that, there is some -- a little bit of seasonality to it. So do I think that you're going to see a slowdown so to speak further beyond what we've seen? Not necessarily. But I don't think that you're necessarily going to see the pace of growth that you've seen over the past several quarters at some point that, that curve may not flatten out, but it's not going to be quite as steep as it has been as we have also suggested in past discussions.

William Robert Berkley
Founder and Executive Chairman

You've also seen some currency issue.

Operator

Our next question comes from Howard Flinker from Flinker & Company.

Howard Flinker

What did you pay for the 2 million shares you bought in the quarter?

William Robert Berkley
Founder and Executive Chairman

Our number is $37.

Operator

And I'm showing no further questions at this time. And I'd like to turn the conference back over to Mr. William Berkley for any closing remarks.

William Robert Berkley
Founder and Executive Chairman

Thank you very much. We're very enthusiastic. We think that you all -- as we've tried to signal people, the quarters are moving as we expected. We would expect our expense ratio to continue moving downward. We'd expect the loss ratio to move downward also as increased pricing moves through our earned premium, increasing levels. So we're very optimistic about our fourth quarter.

The one issue had nobody raised, that I want to point out is, as we invest our money in other things other than fixed income securities, you're not going to see that income come through what everyone calls operating income. It's going to be lumpier. We think it's just as good for our shareholders as having income from bond, and we think in this bond market, with fixed income returns are definitively less than even our modest inflation levels. That's a better thing to do for our shareholders.

So thank you all very much. We look forward to our year-end call and having great results. Thank you.

Operator

Ladies and gentlemen, this does conclude today's conference. You may all disconnect, and have a wonderful day.