S&P Global
Market Intelligence

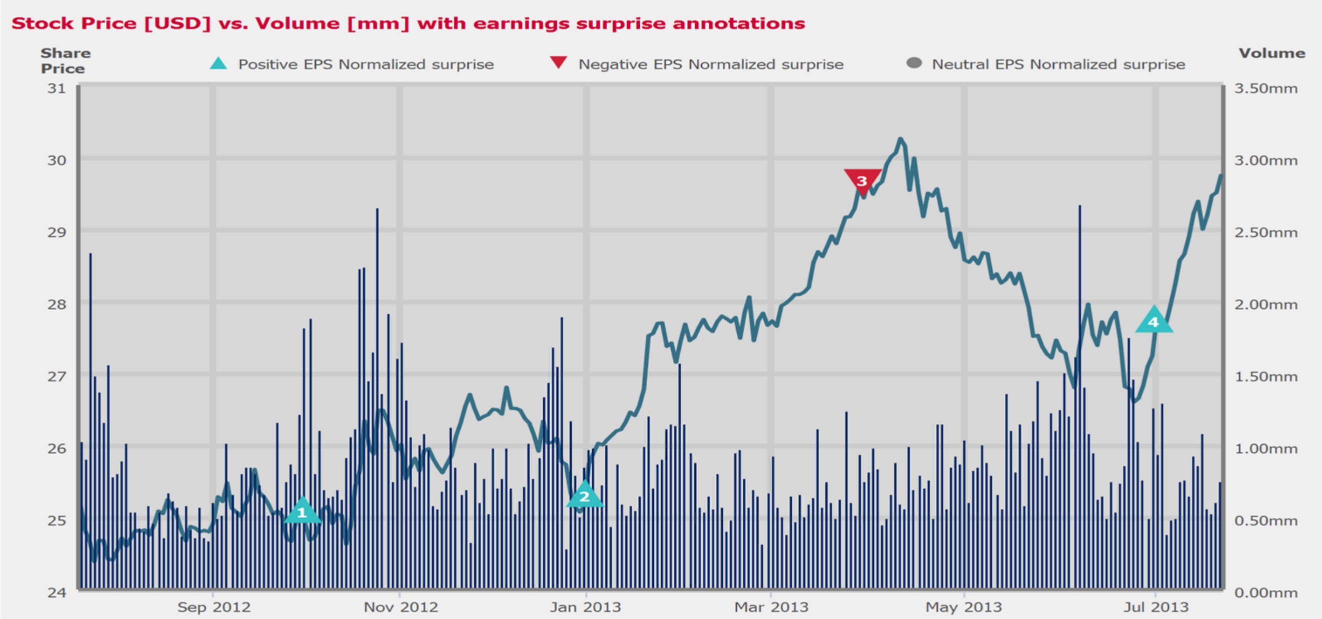
W. R. Berkley Corporation NYSE:WRB
FQ2 2013 Earnings Call Transcripts

Monday, July 22, 2013 9:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ2 2013-			-FQ3 2013-	-FY 2013-	-FY 2014-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.46	0.47	▲2.17	0.46	1.93	NA
Revenue (mm)	1512.17	1570.96	▲3.89	1546.59	6125.61	NA

Currency: USD
Consensus as of Jul-23-2013 9:15 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ3 2012	0.36	0.41	▲1 13.89 %
FQ4 2012	0.32	0.43	▲2 34.38 %
FQ1 2013	0.50	0.49	▼3 (2.00 %)
FQ2 2013	0.46	0.47	▲4 2.17 %

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Call Participants

EXECUTIVES

Eugene Ballard

William Robert Berkley
Executive Chairman of the Board

William Robert Berkley
President, CEO & Director

ANALYSTS

Amit Kumar

Gregory Locraft

Jay Cohen

Joshua Shanker

Michael Nannizzi

Scott Gregory Heleniak
RBC Capital Markets, Research Division

Vinay Misquith

Presentation

Operator

Good day, and welcome to W.R. Berkley Corporation Second Quarter 2013 Earnings Conference Call. Today's conference is being recorded.

The speakers' remarks may contain forward-looking statements. Some of the forward-looking statements can be identified by the use of forward-looking words, including, without limitation, believes, expects or estimates. We caution you that such forward-looking statements should not be regarded as representation by us that the future plans, estimates or expectations contemplated by us will be, in fact, be achieved.

Please refer to our annual report on Form 10-K for the year ended December 31, 2012, 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
Executive Chairman of the Board

Thank you very much. So we were pleased with our quarter. We think it demonstrates our lack of volatility and our ability to continue forward in this environment. And we would expect the underlying results to continue to lead the process. I'll make a lot more comments after Rob and Gene. And -- so why don't we start with Rob talking about our results? Go ahead, Rob.

William Robert Berkley
President, CEO & Director

Okay. Thank you very much. Good afternoon. The second quarter, by and large, was a continuation of the trends that we saw in Q1. Primary comp rates continue to move up at a healthy pace. And we're pleased to see that it would appear as though the excess comp market has touched bottom and is showing early signs of improvement.

The geo market, both from a primary and excess perspective, is getting some rates, and it would appear as though the momentum is building and the umbrella market is right there along with it.

On the other hand, the professional market is a bit more of a mixed bag, depending on the class, also depending on where you are in the tower.

Primary public D&O rates continue to move up at a healthy pace. Having said that, if you're farther up in the tower and the excess space, it would seem as though things are more flat to up to plus low single digits.

Private and not-for-profit D&O are also getting some rate as the P&L[indiscernible], but then again, on the other hand, the medical space remained very competitive and perhaps increasingly competitive as is the miscellaneous D&O.

The property market, while rate is still available, best as we can tell, would seem as though the market is losing a bit of momentum. It's a bit surprising, quite frankly, that this would be the case on the heels of Sandy, as well as an active tornado season in the Midwest and, of course, the floods in Europe and Canada. Well, quite frankly, it doesn't seem like it's giving the marketplace much reason to pause.

The property market has always been one that's made us scratch our head from time to time. When the earth shakes or the wind blows, it seems as though people choose to back that out of the results. And when Mother Nature is kind to us, it seems as though people call it brilliance. The but for story or excuse presumably at some point is going to begin to get a little bit old.

Now if I can turn your attention more specifically to our results during the quarter. Rate adequacy and underwriting margin remain a paramount focus for us. We are pleased with the rate increases that we got in our insurance operations during the quarter, coming in at 6.5%. This is reasonably consistent with what we've seen over the past several quarters. More specifically, 43 of our 47 underwriting units achieved additional rates.

We were comforted by the fact that our renewal retention ratio remains at approximately 80%. This gives us a peace of mind that while we're achieving this additional rate, we are not undermining the quality of the book.

Our new business relativity metric came in at 3.6%. This is a metric that we talked about with some of you in the past. It's our effort to try and compare the rates that we're getting on new business with our renewal book. We think that this is an important metric because, obviously, you want to make sure the new business that you're adding to the portfolio, in no way, is undermining or diluting the margin in your book. And, in addition to that, obviously, new business as opposed to renewal business you know less about, so consequently, some type of surcharge would be logical and appropriate.

New business relativity metric is something that, quite frankly, we don't understand why more market participants don't focus on. There is no doubt it is not a perfect formula, but it is a meaningful data point. Our conclusion is that others must do it, they just may choose not to discuss it.

During the quarter, gross written premium was $1.617 billion, up 13% over the second quarter in 2012. As I mentioned earlier, part of that was driven by the 6.5 points of additional rate. A little bit over 6 points was due to exposure, and the balance was due to audit. All 3 segments contributed in a meaningful way. And more specifically, 39 of our 47 underwriting operations contributed to this growth.

The loss ratio on a calendar year basis for the quarter came in at a 62.8% versus a 63.7% for the corresponding period last year. We are pleased with this result, given the fact that we had $8 million more associated with cat losses during the second quarter this year.

On the topic of tax, we had a total $34 million of losses during the quarter. The lion's share of the losses stem from severe convective storm activity in the Midwest.

Gene is going to spend a bit of time on the loss ratio, as well as on an accident year basis. But I thought I would tuck in the comments that on an accident year basis, we came in at a 64.2% compared to a 66.3% for the same period last year.

And lastly, on the topic of losses, I wanted to mention that the paid loss ratio for the quarter ran at a 55.1%, which, again, is not a perfect indication but perhaps an encouraging sign as to what the portfolio is running at.

With regards to the expense ratio, we were pleased with the improvement coming in at a 33.8%. This is an improvement of 8/10 of 1%. The main driver is to the improvement, and the expense ratio is due to the building of our earned premium. As we have discussed, over time, this will be happening. We expect this to continue to improve over time, as we are able to further leverage the platform that we have heavily invested in over the past several years.

When you put all the pieces together, we ended up with a combined of a 96.6% compared to 98.2% for the second quarter last year. On an accident year basis, the improvement is similar to approximately 2% -- or 2 points, rather, excuse me.

With regard to the balance sheet, I believe our Chairman is going to be spending a bit of time talking about this, but I did want to tuck in one quick comment, and that is related to our loss reserves. We are very comfortable as an organization with our loss reserves in the aggregate. We have a large number of people that work very diligently every day to make sure that the loss reserves are appropriately managed and what they should be. Obviously, there's no substitute for time. And with the passage of time, it will become apparent how successful we have been in managing this. Having said that, the second quarter of this year represents the 26th quarter in a row of positive reserve development for the group. But perhaps that gives a bit of comfort.

Another subject that has come up more recently will have to do with the marketplace overall, whether the rate increases that have been achieved over the past several quarters are sustainable, whether the momentum will build, whether it will maintain or whether it will erode. When we look at the marketplace, we are convinced that, at a minimum, rate increases will remain or increase from here. When you look at the continued growth in assigned risk plans, as insurers are forced to accept the market of last resort, when you look at the commercial line space overall and the number of accounts that are leading the standard market, making their way into the specialty market and the E&S market, as the standard market narrows its appetite, it also provides further evidence that there is more tightening going on.

But putting those data points aside, there is the fundamental reality of the economic model of the industry. The lower interest rates and the impact that it's having on industry investment returns is here and coming into focus very quickly, and undoubtedly, that is putting further pressure on the marketplace to look for ways to increase underwriting margin.

We, as a group, feel very comfortable with the position of our organization. We believe we're quite well-poised to take advantage of not just the markets here in front of us today but where we see it going tomorrow.

That's about it for me.

William Robert Berkley
Executive Chairman of the Board

Okay. Thank you, Rob. Gene, do you want to talk about the numbers a bit?

Eugene Ballard

Yes, I will. Rob covered a lot of the underwriting, so I'll just add a few brief comments on that and then cover investment income.

It was a good quarter for us, again, especially in terms of our underwriting results. Underwriting profits more than doubled from a year ago, and that's due to a 12% increase in earned premiums, as well as the decline in both our loss ratio and expense ratio that Rob mentioned.

The increase in gross premium, 13%, that is made up of domestic insurance business increased by 13% as well, global reinsurance by 17% and the international insurance segment by 15% in local currency terms and 11% in U.S. dollars.

Our reinsurance costs were in line with last year with ceded premiums, excluding assigned risk business, running at about 13% of gross premiums in both years. So that leaves us with net premiums of $1.3 billion for the quarter and $2.7 billion year-to-date, both periods up 13%.

Overall combined ratio improved by 1.6 percentage points to 96.6%. On an accident year basis, before cat losses, our loss ratio declined by 2.5 points and our GAAP expense ratio by 0.8 point, with all 3 business segments reporting declines in both ratios.

The cat losses that Rob mentioned of $34 million includes $27 million from storms in the U.S., mostly in Midwest and Southwest regions, as well as $7 million from the European floods and other non-U.S. events. That gives us an accident year combined ratio, including cats, of 98.0% in the quarter, down 3 points from 100.8% a year ago.

And finally, with respect to underwriting of prior year reserve, we developed favorably by $18.5 million. That compares to $30 million in the second quarter 2012. And the favorable reserve development in '13 was concentrated in our domestic insurance segment.

Turning to investment income. Our investment income was $144 million in the quarter. It's down 11% from the prior-year period. The decline was related primarily to investment funds. Although our investment funds had a good second quarter in 2013, with an annualized return of over 11%, fund income was still down from an unusually high return of 22% in the second quarter of 2012.

Income from the rest of the portfolio was down $4 million, as lower fixed income returns were partially offset by higher returns for the merger arbitrage business. The overall annualized portfolio yield was 3.9% in the second quarter compared with 4.4% a year ago.

Realized investment gains were up $9 million in the quarter, with most of the gains coming from sales of equity securities and investment fund positions.

Unrealized investment gains were $328 million at June 30. That's down $190 million from the beginning of the year. Most of that increase occurred in the second quarter, as benchmark rates for treasuries increased by 65 basis points and quality spreads widened.

As of the end of the quarter, the portfolio remains at 81% cash and fixed income securities, with an average duration of 3.3 years and an average credit rating of AA-.

During the quarter, we repurchased 776,000 shares of our stock at an aggregate cost of $31 million. We also issued $350 million of 40-year trust-preferred securities, with a 5 5/8% coupon, and we repaid $250 million of trust-preferred securities, which had a coupon of 6 3/4%.

Our second quarter earnings include approximately $7 million of expenses related to the early debt extinguishment.

The overall effective tax rate was 27%, unchanged from a year ago, and that gives us net income of $160 million -- excuse me, $116 million, and an annualized return on equity of 10.8% for the quarter.

William Robert Berkley
Executive Chairman of the Board

Thanks, Gene. So I'm going to try and take you through a few highlights that I think are important to focus on. First of all, be sure you understand, if you may recall, the first quarter of last year, we had higher price increases than in the second quarter. It really is an aberration, having to do with the nature of what's priced when. We don't think pricing momentum has changed or gone down. June is always softer than the rest of the quarter. It's softer than the first 6 months, in general. We think it picks up. We don't see any changing in pricing momentum at this point in time. Lots of brokers are trying to push prices down. That's in their interest. It's wonderful to say. And they keep talking about how much prices have gone up.

But if you look at the profitability of insurance companies, insurance companies have always made their money from investment income, and investment returns are down substantially. And, in fact, in the world we live in today, investment income for the kinds of portfolios that cautiously manage property casualty companies have -- you're going to have to see from 50 to 150 basis points decline in your portfolio as you reinvest the money because you have your highest-yielding, longest-term investments maturing or -- being pre-funded -- pre-refunded, and you have to invest that money. So the fact is you're facing serious changes in what's going off your portfolio and what you're able to invest in. The alternative is to bet on no inflation for an extended period of time, which is not something we're prepared to do, nor are most of our competitors.

Overall, we continue to have as the biggest single part of our portfolio being municipal bonds, although that is a smaller portion today than it has been, and corporates are now a bigger portion, not quite as large as municipals but a much bigger portion than they have been historically, it's purely based on maturity, yield and opportunity to invest. We continue to be modest players in the equity market and search out particularly unique investments that we think offer us good returns.

At this moment in time, we think that we'll be able to find some of those, but not enough to keep all our cash flow and our maturing portfolio fully invested. So we would expect a modest continuation in the decline in portfolio returns.

Overall, though, we're pretty pleased how things are going. We think we'll see a continuing improvement in our combined ratio in the balance of the year. As our earned premium from higher rates come through, we would expect at least another point, maybe more, maybe 2 points in combined ratio improvement, inclusive of -- part of that coming from the expense ratio. And we're pretty optimistic that it's going to end up being a good year with a really good return on our capital. We think that in spite of the brokers pounding the table, that rates have gone up enough, they're just not looking at the real cost of capital and what's happening to returns for their property casualty companies that they do business with.
With that, Sayyid, I'd be happy to take questions.

Question and Answer

Operator

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

Amit Kumar

My first question relates to the topic of pricing. Rob said that rates, I guess, will remain the same or probably increase from here. If I go back to the comments you made previously, you had said that pricing could be 8% to 10% up by year-end 2013. Are we on track? Do you still think we're on track for that? Or has that thought process changed?

William Robert Berkley
President, CEO & Director

It's Rob. I don't recall exactly the words. But what I was trying to suggest is that we think the level of rate increase that we are getting today or in the second quarter, if you like, which was 6.5%, that we believe that you will continue to see that and it is likely to build from here, which sort of ties into the comments later in my commentary that if you look at the economic model of an insurance company, much of the rate increases people have been seeking stem from their concerns having to do from loss activity. And the impact, which is even more leveraged of investment income declining, is likely to force people to raise rates even beyond what they had done to date.

William Robert Berkley
Executive Chairman of the Board

Yes. I think that his comment really tied right into what I was talking about, which is that price increases will continue at the 6.5% or higher. So I would expect what I said before is our view as well. We still are optimistic that 7%, 8%, give or take, will be the level of increases by the end of the year.

Amit Kumar

So we have gone down because as I said previously, we were -- and, again, I don't want to parse the words here, but you were thinking of 8% to 10% and then now we are...

William Robert Berkley
Executive Chairman of the Board

No, I'm being more cautious as I was at the second quarter of last year because I always am surprised that the second quarter, you may recall, my comments the second quarter of last year, I was a little cautious because the rate increases were not as much and then they came back to be in the 7s the second half of last year. So I'm a little more cautious, but no, in principle, I don't have any different feeling. You are parsing words, no offense. Does it mean 7% or 8% or 8% to 10%? The answer is the midpoint is sort of an 8% kind of rate increase. And so we are really quite optimistic.

William Robert Berkley
President, CEO & Director

And I guess we typically don't break out this level of detail, but if we look at our rate monitoring for domestic insurances, it's pretty much there right now. So the 6.5% that we shared with you includes activities outside of the United States. If we focus solely on insurance in the U.S., it's right where we're talking about it would be.

Amit Kumar

Got it. And maybe just going back to the discussion previously on a new entrant in this space. Can you sort of refresh us or maybe just talk about what impact you might be seeing from the new entrant?

William Robert Berkley
Executive Chairman of the Board

What company are you talking about?

Amit Kumar

We all know what it is. I mean, are you seeing the team or is that a matter of accounts...

William Robert Berkley
Executive Chairman of the Board

There is no new entrant in our space. That's why [indiscernible]. If you're talking about Berkshire Hathaway, they're in a lot of people's space but generally not in our space. They may come in some of our space, but our space is much more people-intensive, broker-intensive. They're not interested in our space. They have few good people writing large risks. It's not the heart of what we do. Our biggest risk is probably not big enough to be their smallest risk. Will they eventually move into areas that we do business? Could well be. But for now, they're just not in our space.

Operator

Our next question comes from Josh Shanker from Deutsche Bank.

Joshua Shanker

More of my questions for Gene. I wanted to walk through a little bit of the book value per share move between this quarter and last quarter. I assume it's obviously mostly investment losses and whatnot, but can we go to where that's happening?

Eugene Ballard

Where the investment declines are?

Joshua Shanker

Yes. Is that munis? Is that corporate? Is that across the whole book?

Eugene Ballard

It's across the book. Munis and corporates would be the majority of it because that's where a lot of our investments are, but it's across the book, fixed income book.

Joshua Shanker

Yes. And does that mean, and maybe it's a counter for better pricing, that it's going to be difficult to grow book value in a rising and straight environment? I mean, obviously, we know that's true intuitively, but is that -- is this quarter anomalistic? Or does a 35-basis-point increase in rates eat up and then some of possibly book value growth?

William Robert Berkley
Executive Chairman of the Board

We don't believe that in a short period towards the end of the quarter, 65- or 75-basis-point change in interest rates is sort of a normal change. And we don't think it's continuing. Clearly, if we have 65- or 75-basis-point increase in rates, given the short duration of our portfolio and new cash flow, our rising investment income would very quickly offset that. And obviously, we've kept a relatively modest duration in our portfolio. So it's painful, but it's reality. There's good and there's bad. Higher investment income and your unrealized gains go down in your bond portfolio, but that's how life is sometimes.

Joshua Shanker

And on the currency translation, given -- I'm just surprised there was a...

William Robert Berkley
Executive Chairman of the Board

I'm sorry. I can't hear you.

Joshua Shanker

On the currency translation, I'm surprised there was a currency translation gain in the P&L in such a tough quarter. Maybe there's something behind it that I don't understand?

William Robert Berkley
Executive Chairman of the Board

Well, nobody gave us any credit for the fact that sterling went down at the end of last quarter. It came back in the past quarter, and that was the biggest single part of it. We have a lot of money invested in sterling.

Eugene Ballard

We also have some foreign branches that have their functional currencies, their local currency, and they have investments in U.S. dollars. And in the case of the Australian branch, for example, the U.S. dollar appreciated in that's FX gain for them.

Operator

Our next question comes from Greg Locraft from Morgan Stanley.

Gregory Locraft

Just wanted to follow up on -- I think you had mentioned the expense ratio was going to begin improving more than -- it is improving now, and we see a pickup in that in the back half. I just wanted to clarify. Did you mention that's going to be as much as 100 basis points in, say, 3Q, 4Q?

William Robert Berkley
Executive Chairman of the Board

No. No, we didn't say that.

William Robert Berkley
President, CEO & Director

I think what we said was that we were pleased that the improvement in the expense ratio was what it was. And we think that it's an example of exactly what we said would happen as the earnings continue to build and we could leverage the platform. Furthermore, it's our expectation, as that earnings continues to build, that you will see further benefit coming through.

William Robert Berkley
Executive Chairman of the Board

And the specific we said was we expected the improved loss ratio and expense ratio would end resulting in probably a couple of hundred basis point improvement in the combined ratio by the time we got to the fourth quarter.

Eugene Ballard

I'll just add that I think 0.75-point improvement in the expense ratio over 1-year period is in line with our expectation. It's not bad. Remember, you've only got sort of 10% -- sorry, 1/3 of your expenses that are going to improve because the commissions sort of stay where they are. So it's only the 12% to 13% that's left that's going to improve as a result of the earned premium increases.

Gregory Locraft

Okay, great. And then something that was in the release, I don't know if it was mentioned in the commentary, but you mentioned, I guess, some capital gains for the balance of the year. And I think in the past, you had some private equity stuff coming through. Do you anticipate more harvesting or something? Or...

William Robert Berkley
Executive Chairman of the Board

We have said to people that we expect continued capital gains in the balance of the year. We've had in excess of $50 million of capital gains so far this year. We would expect certainly some level of additional capital gains. You never can time those exactly, but there will be some certainly this year.

Gregory Locraft

Okay. So continuation there. Okay, great. And then the last is just -- more just stepping back. If you'd set out in '10 and said you get 18% cumulative pricing, here we are 3 years hence, if you just look static at the combined ratio, projected for

'13 versus '10, there's not a whole lot of improvement, a couple hundred bps, but it's not what I would have thought, plus 18%...

William Robert Berkley
Executive Chairman of the Board

The answer to your question is we think we've probably been a little cautious in examining where things are. And we would expect that more of that result will come through to the bottom line, as we are more comfortable with this lower inflation rate -- lower medical cost inflation rate particularly than we had anticipated. We have assumed a fairly higher medical inflation rate in our reserving than has, in fact, come out. So you'll see, as we have become more certain, that, that is not going to come and bite us. I think some of that 18% will become visible in our reported numbers over the next 12 to 18 months.

Eugene Ballard

The 18% is a written calculation, though, in our basis, price increase will be a little less.

Gregory Locraft

Okay. So Bill, that will be -- well, I guess, if the current medical loss trend holds, then it would come through as higher reserve releases?

William Robert Berkley
Executive Chairman of the Board

There's some improvement to come as there were some caution and concern over what would happen in all of the changes in our medical issues and health care issues. And there was caution in our part in our reserving for that part of our book of business, which is not insignificant.

Gregory Locraft

Understood. Will it come through as a reserve release or as an accident year?

William Robert Berkley
Executive Chairman of the Board

No, no, no. Come on.

Operator

Our next question comes from Vinay Misquith from Evercore Partners.

Vinay Misquith

The first question would be the impact actually of Berkshire. We know that they don't play in the same lines of business that you guys play, but just curious on the overall market impact. Do you think that your competitors would now seek to write smaller business? And how hard is that going to be for them to do that?

William Robert Berkley
Executive Chairman of the Board

First of all, the skills and distribution required to write the kind of business we do is really quite different than what they do. Second of all, Berkshire is going to write at a profit. My friend, [Mr. James], is absolutely determined to get his share of the market, but not, I emphasize not, at any cost. He's going to write the business where he thinks he can make money. And nobody should be afraid of that competition. He's going to give good service, give good capacity. And he's going to want to share the market, and he's going to do it through those basis. But he's not going to be a price cutter. Some people have entered the business to buy their share. I think Berkshire, by and large, is going to try and do it in other ways using their capacity, their credit and their ability to put large lines down. But I don't think most of the people we compete with have the market position or the underwriters to move down to write smaller risks. Eventually, could that be a problem? Of course. Eventually, they all can write personal lines, too, and then you should worry about State Farm and Allstate. But for now, I think they're going to have a battle. And I think it's more likely that some of the non-Berkshire companies may decide to cut price to hold onto market. But I don't think Berkshire is going to be a market leader in pricing. I think they're going to be -- try to be a market leader in capacity and quick answers because that's something they have.

Vinay Misquith

Yes. Fair enough. I mean, my concern was more about the non-Berkshire companies than the Berkshire companies.

William Robert Berkley
Executive Chairman of the Board

I'm not really worried there. A bunch of them that compete in that area, they don't compete with us. And it takes a huge amount of infrastructure and lots of people and lots of systems to write the kinds of business we write. It just isn't the same thing.

Vinay Misquith

Okay, that's helpful. The second question is on the top line growth in the domestic insurance. We've seen the gross written premiums sort of slow down over the last 3 quarters. Just curious what's happening there. And do you expect to continue to slow down for the near term?

William Robert Berkley
Executive Chairman of the Board

Rob?

William Robert Berkley
President, CEO & Director

I think that we have seen -- we have seen a little bit of a slowdown. Having said that, there's nothing, as far as market conditions go that lead us to believe that you're going to see the growth slow down altogether. Obviously, we're getting healthy rate, which on its own is going to help drive the growth. And as we've seen margins get to the point that we find particularly attractive, we'll be working very hard to try and add policy count, and we, as a group, are all on board with that idea. I think part of the slowdown in the growth has to do with some of the startup companies. As we've discussed with you and others in the past, when the companies first started in their infancy, there's a fair bit of low-hanging fruit that they're able to grab because of prior relationships, and then they have to work through it every day like everyone else. I think some of that low-hanging fruit is gone, and now we're out there chopping away just like everybody else, trying to build a business in an intelligent way. I think the big driver of growth is going to be how much rates move up and when we start to see more and more parts of the marketplace get to the point that we think the margin that's available is particularly attractive, and then we will be opening up the spigot even wider.

William Robert Berkley
Executive Chairman of the Board

But putting all that aside, our goal has always been a focus on profitability, and that's going to continue to be the case. We like to grow as much as we can, but it's always a goal of profitability first.

Vinay Misquith

Okay, that's helpful. Just one numbers question. For the net investment income on the core portfolio, can you give us a breakdown between the fixed income, real estate and equities, please, if you have the number?

Eugene Ballard

What we've disclosed in the release is the arbitrage return and the fund return in then the core portfolio. I don't have a further breakdown for that for the rest of the portfolio here, but we'll have some more of that in the 10-Q. And you're welcome to call.

Operator

Our next question comes from Michael Nannizzi from Goldman Sachs.

Michael Nannizzi

I just have one question, first off. I saw a lift in reinsurance premiums in the quarter. It's a little bit more than we expected. Could you just talk about, first off, maybe, what drove the change for you? And second, if you could just give a little context on what you're seeing in that market. I'm assuming most of that is casualty reinsurance business. But if you could just give us a little context that would be great.

William Robert Berkley
Executive Chairman of the Board

Rob?

William Robert Berkley
President, CEO & Director

Yes. First, the lift in the reinsurance, that was primarily coming as a result of growth in our reinsurance activities outside the U.S. And probably, the lion's share of that growth outside of the U.S. from the reinsurance segment was coming from our European operations as it's getting up and running.

Michael Nannizzi

Got it. Okay. And then as far as your growth, otherwise, I mean, are you growing in areas where you're seeing exposure growth in areas where you're seeing the most rate? Or how should we think about what's driving top line growth, whether it's in that reinsurance segment or elsewhere? Is it rate or...

William Robert Berkley
Executive Chairman of the Board

No. We write very little property cat in our reinsurance portfolio. That's not something that we choose to focus on. We write a little bit of it but not in a big way, hence, that's why you consistently see us underwrite it as far as natural catastrophe as when you look at what our results are compared to most organizations of our scale. So that's by design. The growth, as I suggested earlier, is mainly -- or it's more than half at this stage coming as a result of rate. And then where we find attractive margins, that's where we are trying to expand the business from an account or exposure perspective as well. Those opportunities present themselves, Mike, both domestically, as well as outside of the U.S., both in the casualty lines, as well as some of the property-like shorter tail lines.

Michael Nannizzi

Great. And then I think you also alluded, too, a bit in your comments, Rob, the amount of your business, and forgetting reinsurance, obviously, but the amount of your business that is syndicated business, so primary access versus just Berkley writing in a whole risk policy.

William Robert Berkley
President, CEO & Director

Yes. I don't have the specific number off the cuff, but I would suggest to you that the lion's share of what we do is, from a policy count perspective, is where we write the whole risk. So, for example, approximately close to 90% of our policy count are policies that have a limit or capacity of $2 million or less, so don't hold me exactly to those numbers, but it's pretty close. So when the comment was made earlier that we play in a different part of the universe than many of these other commercial markets, that hopefully puts it in perspective.

William Robert Berkley
Executive Chairman of the Board

And, by the way, you can extend that there's probably 98% of our policy count that's $5 million or less. So it doesn't -- it's really very small number of policies that are out there and compete where the Berkshires and the AIGs, for the most part, compete.

Michael Nannizzi

Got it. Got it. And then just one last one, just on the balance sheet a bit here. So debt to cap, if my count is right, it's about 33%. So that's up a little bit from some new debt and then the negative impact of AOCI and then, I guess, the buybacks. That's a relatively high level for you. If I look back historically, I think it was higher last year. It was close to that level last year. But if I remember right, you guys have prefunded some debt at the beginning of '12 that was set to mature later in the year. How should we think about that, I mean, in terms of propensity for buybacks or the potential impact of further negative marks if rates continue to rise? Where are you comfortable with that number being? And...

William Robert Berkley
Executive Chairman of the Board

We're at the high end now. I think that we wouldn't want to go consequentially more than this. If we went to 34%, would it be all right? It was -- because of market bonds to market, that's consequential risk we take. But, in general, the stock buyback came. It was a reflection of our capital gains that we realized outside of our ordinary income stream, and that's sort of how we look at buybacks at the moment. We think our capital base is sort of at the leverage point where we're okay, but we would expect it to start to come down. But everything also depends on the level of risk at any moment in time. We actually see the risk in the business at the moment declining because we see opportunities that will present themselves. So we think our underwriting margins will expand. So our returns will go up, so therefore, the risk relative to leverage compared to returns will be better. By the way, that ratio, I think, is closer to 32% to 33% at the moment. And our goal is to sort of move it down from there closer to the 30% level or...

Michael Nannizzi

Got it. I mean, I guess, the question will be, I mean, if rates do continue to go up, I mean, I would imagine that we'll continue to see that mark-to-market come through for you and for others. Do you weigh that less? Or did the rating agencies or whoever you're kind of -- you want to make sure is satisfied with that, is that a factor that you'll kind of take into consideration separately? Or is that kind of all baked into your hope to kind of -- or expectation to kind of have that quotient gravitate lower?

William Robert Berkley
Executive Chairman of the Board

Everything is baked in, because if it wasn't, we wouldn't be doing our job. That said, we have a relatively short duration portfolio. It's 3.2, 3.3 years. And that's after our various mortgage portfolios' durations moving up a little, with everything else moving down. And they moved up because as interest rates move up, the duration on those things could extend. So we think we're in pretty good shape. We have pretty good cash flow, not great cash flow. We think cash flow is going to pick up. So we think that the duration is moving down. And therefore, automatically, as we move towards the end of the year, that duration is going to come down, our cash position to reinvest at higher rates, assuming rates really move up significantly. But honestly, we're worried about inflation less today than we were yesterday. And we think the positive impacts on inflation in our business would be much greater than the negative impact on inflation on our bond portfolio. Historically, this is a business that has done much better in inflationary times than otherwise. So yes, we have that concern, and we certainly have that worry. But if we start to earn the kinds of money we expect, we can certainly handle any impact of the decline to bond portfolio without any worry at all.

Operator

Our next question comes Scott Heleniak from RBC Capital Markets.

Scott Gregory Heleniak
RBC Capital Markets, Research Division

You guys formed a new unit in the quarter. Obviously, you're optimistic about the market. But are you seeing a lot of opportunity to add new units in 2014, assuming market conditions are kind of standing where they are? Or is that mostly just going to be kind of a ramp of the existing units that you've had in place for the past few years?

William Robert Berkley
President, CEO & Director

Scott, this is Rob. From my perspective, I think in all likelihood, you're going to see a fair bit of organic growth through existing operations over the next several quarters. As far as new operations, we certainly are constantly talking to people. We try and be selective. It's hard to know exactly what opportunities will present themselves tomorrow or not. So it's difficult to speculate as to whether we'll be starting many or few or no new operations next year. But certainly, we've continued to be out there and open to discussions. But many of them, certainly, we would expect there will be meaningful growth coming from the already established companies.

William Robert Berkley
Executive Chairman of the Board

I think, Scott, it's more likely, given that we see it, is that we're going to find groups of people or pieces that we would add to where we are or what we're doing as opposed to whole new units. We have lots of units that can expand and find opportunities to do things. So I don't think you're going to see as many new units, if any, over the next 12 to 18 months. But we may add groups of people who fit into one of our other businesses. So you shouldn't take that we're not going to be out there seeking and talking to teams of people. So it just looks likely there'll be new units.

Scott Gregory Heleniak
RBC Capital Markets, Research Division

Okay. Sure. That's helpful. And then just a quick question on the revenue from the wholly owned investees. That's been up quite a bit year-over-year for this year. Just wondering if there's -- is there a lot of seasonality in that line? I know it's mostly private -- I think private equity aviation investments. Is that a good run rate to use?

William Robert Berkley
Executive Chairman of the Board

It is. The aviation business made an acquisition, and it's running at a much higher rate than it did last year. So I think that third quarter is a good -- second quarter, rather, is a good indication of how it's going to run through the balance of the year.

Scott Gregory Heleniak
RBC Capital Markets, Research Division

All right. And then just a last question, just on the investment portfolio. Do you expect to see -- obviously, you don't know what the market is going to do, but do you expect to see corporates kind of continue to move up as a percent of portfolio as munis then move down as a percent of portfolio, which is I guess what we've seen in the last year and a half?

William Robert Berkley
Executive Chairman of the Board

In fact, recently, it went the other way of, let's just say, in the past 30 days, we probably invested $150 million, $175 million. $100 million, $125 million went to munis versus $50 million into corporates because that was the relative attractiveness. It was wonderful. Detroit declared bankruptcy, and suddenly, the whole municipal market was terrible for a short time. And people redeemed their municipal bond mutual funds, and there were opportunities. So we're an opportunistic investor. I think that, overall, at one point, we had over 50% of our portfolio in munis. We're not going to get there. But as far as the balance going between, let's just say, 28% and 35% in the municipal market, that's a function of opportunistic investments.

Scott Gregory Heleniak
RBC Capital Markets, Research Division

Okay. And did you have any exposure to the Detroit bankruptcy on the muni side?

William Robert Berkley
Executive Chairman of the Board

No. And, by the way, I sort of chuckled a little about everyone talking about the $18 billion Detroit disaster, but I think only $1 billion or $1.5 billion of that were municipal bonds, the rest is the pension funds. So it wasn't quite as big a disaster for the municipal market as people thought.

Operator

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

Jay Cohen

A couple of questions. The first one was just numbers one that I missed. The share buybacks in the quarter, I know, was modest. What was the number of shares?

Eugene Ballard

776,000.

Jay Cohen

And the total price, Gene?

Eugene Ballard

$31 million.

Jay Cohen

Okay. And then, separately, I guess the one line of business in the U.S. that kind of jumps out as far as growth goes is other liability, and that can mean so many different things to different companies. I'm wondering if you can give us a little bit of insight into what's driving the growth in that line of business.

William Robert Berkley
President, CEO & Director

E&S.

Jay Cohen

And what class is the business, Rob?

William Robert Berkley
President, CEO & Director

Yes. Really, Jay, it's across the board. It's across the board. There is certainly some in the professional space, as well as some in the excess and umbrella space as well.

Jay Cohen

You've suggested that you're seeing a shift into E&S from standard markets. Can you quantify at all what your submission activity looks like in your E&S businesses?

William Robert Berkley
President, CEO & Director

I don't have specific metrics to share with you on this call, but certainly, we are seeing signs of a growing number of submissions coming our way. But unfortunately, I'm sorry, I don't have any specific metrics to share with you at the moment.

Operator

I'm showing no further questions at this time. I'd like to hand the conference back over for any closing remarks.

William Robert Berkley
Executive Chairman of the Board

Okay. Well, we thank you, all. We are exceedingly optimistic. We think our numbers have been cautiously presented. We've been a little more pessimistic than seems appropriate about our medical inflation. And we expect that as we're more and more comfortable with where those numbers come out, I expect that it will result in more positive outcomes for the balance of the year and into next year. Thank you, all, very much. Have a great evening.

Operator
Ladies and gentlemen, thank you for participating in today's conference. This concludes the program. You may all disconnect. And have a wonderful day.