S&P Global
Market Intelligence

Markel Corporation NYSE:MKL

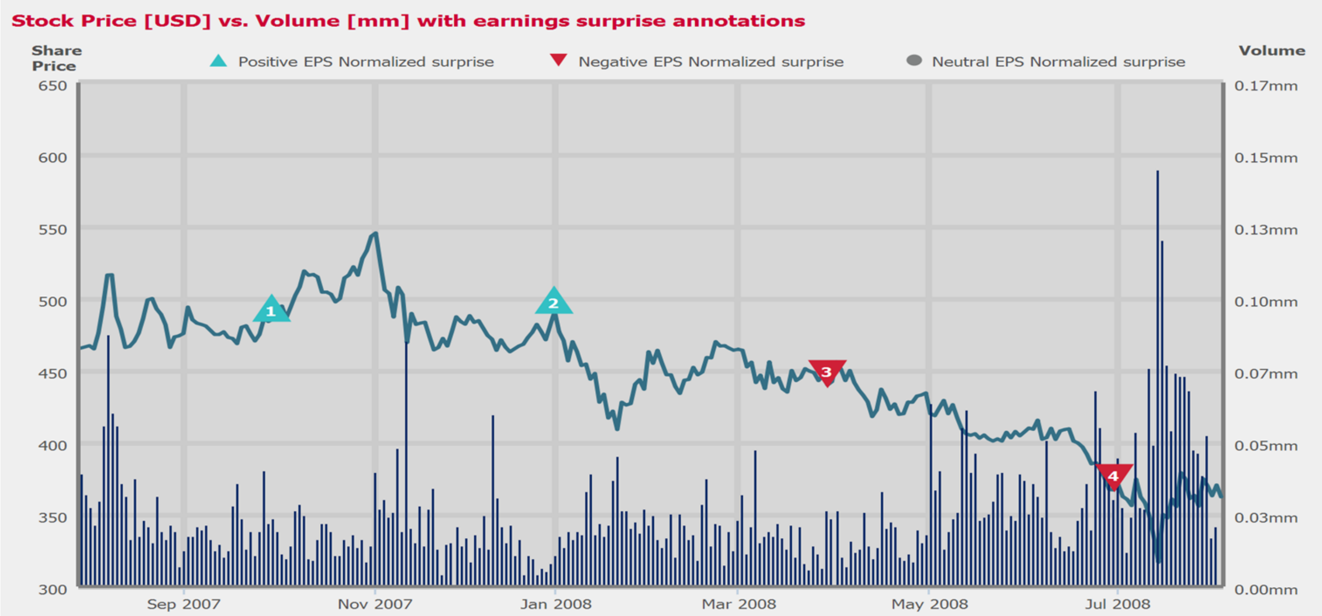
FQ3 2008 Earnings Call Transcripts

Wednesday, November 05, 2008 3:30 PM GMT

S&P Global Market Intelligence Estimates

	-FQ3 2008-			-FQ4 2008-	-FY 2008-	-FY 2009-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	(0.47)	(3.32)	NM	6.41	17.67	24.67
Revenue	-	-	1.71	-	-	-
Revenue (mm)	574.47	584.30	-	563.41	2296.06	2236.08

Currency: USD
Consensus as of Nov-05-2008 2:25 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ3 2007	8.29	9.26	11.70 %
FQ4 2007	8.60	9.77	13.60 %
FQ1 2008	7.63	7.54	(1.18 %)
FQ2 2008	7.00	6.50	(7.14 %)

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Call Participants

EXECUTIVES

Paul W. Springman

Richard R. Whitt, III

Steven A. Markel

Thomas S. Gayner

ANALYSTS

Elizabeth Malone
Keybanc Capital Markets

Jay Cohen
Merrill Lynch

John Fox
Fenimore Asset Management

Meyer Shields
Stifel Nicolaus

Unidentified Analyst

Unidentified Company Representative

Presentation

Operator

Greetings ladies and gentlemen and welcome to the Markel Corporation Third Quarter 2008 Earnings Conference Call. At this time, all participants are in a listen-only mode. A question-and-answer session will follow the formal presentation. [Operator Instructions]. As a reminder, this conference is being recorded.

It is now my pleasure to introduce your host, Mr. Steve Markel, Vice Chairman for Markel Corporation. Thank you. Mr. Markel, you may now begin.

Steven A. Markel

Fine, thank you. I'll add my welcome to the Markel third quarter earnings call. During our call today we may make forward-looking statements. Additional information about factors that could cause actual results to differ materially from those projected in the forward-looking statements is described under the caption Risk Factors and Safe Harbor and Cautionary Statements in our most recent Annual Report on Form 10-K and quarterly report on Form 10-Q.

Our quarterly report on Form 10-Q, which is filed on our website at www.markelcorp.com also provides a reconciliation to GAAP of certain non-GAAP financial measures, which we may discuss in today's call.

A program today will follow in the same format as previous calls. I'll make a few introductory comments, after which Rich Whitt, who is our Chief Financial Officer to review the numbers, Paul Springman President will follow with some operational and comments at the marketplace. Tom Gayner, our Chief Investment Officer will share some commentary on our investment activity. And then finally I'll moderate the question and answer session.

2008 is proving to be a very challenging year on many fronts. At September 30th, we were reporting our book values per share as declined 11% from year-end to $235.72 per share. Our speakers' today will get into these results and some gap. However, I'd like to start with a few comments about three important events during the quarter.

First, our underwriting results were adversely impacted by hurricane's Gustav and Ike. We ensure wind exposed property in several of our operating businesses and manage our hurricane exposures both at our product line level and in total.

The very nature of the insurance business is that we assume some volatility in our results. The vast majority of our business units, incurred losses from these hurricanes that were well within both our expectations in the level at which we can achieve very good returns on our capital.

The exceptions are a few and are very modest in size in corrected action where necessary will be taken. With out nine months combined ratio of 104% we would hope with some luck that our idea and results still might show underwriting profitability.

The financial markets have also experienced the hurricane this year. Our total investment returns or either loss of about 5% for the nine months. While these results are creating a bid of short-term pain, our financial position is extremely strong and we remain committed to our long-term investment strategy which includes allocating a meaningful part of our portfolio to higher quality equity securities, which we believe will generate additional returns for our shareholders over the long-term.

As the year has progressed and as the financial markets has become more distress. We've increasingly been generating cash and increasing our liquidity. In September 2008 cash and short-term investments totaled in excess of $900 million.

We're not yet ready to commit these funds to our long-term portfolio, but we are very, very bullish on the long-term prospects of the United States and our economy. The entire insurance industry is experiencing these very same of events. However, I'll not try to predict whatever everyone else might do.

But let me be very clear about what is happening at Markel. Our prices has been on downward trend for several years and while they have certainly not at a dangerously low level. We have no longer any room to reduce them further. We are increasing our prices.

Volatility of the capital markets clearly reminds us of the importance of capital and the necessity to the earn healthy return on that capital. We will continue to emphasis our underwriting standards and increase prices and we will continue to build shareholder value.

With that Ritchie, I'll ask you to jump in those specific.

Richard R. Whitt, III

Thanks Steve and good morning everybody. I'm going to stick with the format that I have used in past quarters and I will start by discussing our underwriting operation I'll follow with that with the discussion of our investment portfolio. And then I'll bring the two together with a discussion of our total results for the nine months. And again I will focus primarily on year-to-date results obviously in question... Q&A we can get into any questions you have about quarter or year-to-date results.

Many of the trends we'll be discussing are sort of competitive from our first and second quarter calls. The two biggest issues obviously affecting our nine months results as we've said are the competitive insurance market. And the unstable financial markets and their impact on our investment portfolio. In addition as Steve mentioned, we had a $115 million of losses from hurricanes Gustav and Ike in the third quarter of 2008.

So getting into it let's talk about underwriting first. Due to the increased competition through the first nine months in virtual of all our markets, gross premium volumes decreased 6% to about $1.7 billion for the first nine months of the year.

About one third of the decrease was due to exiting certain programs previously written as Markel Re, the remainder was primarily the result of the increased competition. Net written premiums were down about 4% to $1.5 billion and premium retentions were actually up slightly to 88% from 87% 2007.

I can tell you that every reinsurance treaty that comes up for renewal, we look at and look for opportunities to increase our net retentions of the business that we ride.

Earned premiums were down 5% to $1.5 billion for the first nine months, compared to 2007. Our combined ratio was 104% for the nine months of 2008 compared to 88% in 2007. This increase was the result of the following: we had a $115 million or eight points of loss from hurricane Gustav and Ike. In addition we had a higher current accident year loss ratio of 67% prior to considering the hurricane and this was due to price decreases during the year compared to 61% current accident year loss ratio in 2007.

As Paul's going to discuss shortly and as Steve mentioned we are raising rates in many of our product lines of this point. The 2008 current accident year loss ratio was partially offset by favorable prior year redundancy of about seven points on the combined ratio. This compares to favorable prior year redundancy of about eight points in 2007.

The areas that these favorable redundancy came from were primarily in excess and surplus line segment and our Markel Shand unit and our Markel Essex unit. And in the London market segment.

Also in the third quarter both years we completed our annual review of the discuss environmental expenditure as a result of that review we did increase reserves for this environment by $25 million in the third quarter of 2008 and by $34 million in the third quarter of 2007.

Here the portion of the increase in the combined ratio for the nine months was our expense ratio. Our expense ratio for the nine months increased to 36% from 35% in 2007. This was primarily due to the lower earned premiums as mentioned before resulting from competition in the markets.

Turning to our investment results, investment income decreased $221 million from $235 million in 2007. This decrease was primarily due to an unrealized loss of approximately $12 million on a credit default swap and then we talked about this is previous quarters. But in the fourth quarter of 2007 Markel sold credit pretension on the portfolio of fixed income, securities.

The presence of this contract on our balance sheet and the associated accounting treatment will add volatility to our investment income results in future periods. There is quite a bit a disclosure in our 10-Q, related to the credit default swap, and I would suggest you go there if you want additional detail around the credit default swap.

At this point, we have about $5 million of additional expenditure under the credit default swap, and at that point volatility to our financial segments will probably be pretty much over with.

Realized losses were $200 million through the first nine months of the year. This was primarily comprised of a $187 million of write-downs for other than temporary decline, and the fair value of various equity and fixed maturity securities.

The most significant write-downs for equity securities were $38 million for Citigroup, $32 million for GE, approximately $17 million each for Bank of America and International Game Technology. The most significant write-downs for bonds were $18 million for Morgan Stanley and $11 million for Casting Bank.

Unrealized gains also decreased $375 million before tax for the nine months. The decrease was roughly equal between fixed maturity and equity. Tom will obviously go into further detail in his comments. Again, I would point you to our Q, where we have quite a bit of detail around the other than temporary impairment charges, as well as just commentary on investment income and so forth.

Looking at our total results for the nine months of 2008, we reported a net loss of $26 million compared to $312 million of net income in 2007. Book value per share as Steve mentioned, decreased 11% from December of 2007, to approximately $236 per share at the end of September.

I'd like to turn to the balance sheet and cash flow statements, and make a few comments. Regarding cash flow, operating cash flows were $329 million for the first nine months of 2008, compared to operating cash flow of $383 million in 2007. The decrease is primarily due to lower premium volume for the first nine months of the year. And also, I'd like to point out at September 30th, while we are holding $742 million of cash and investments at our holding company, giving us quite a bit of financial flexibility at a holding company level.

And as Steve mentioned, on a consolidated basis throughout the year, we've been building liquidity, and at the end of the third quarter held approximately $900 million of cash and short-term investments.

We are prepared as Steve said to take advantage of the opportunities. We believe, we will be seeing as a result of current market conditions. So at this point, I'd like to turn it over to Paul, to review our operations.

Paul W. Springman

Thanks Ritchie and good morning to all of you. You've just heard Steve and Ritchie report on our numbers from the third quarter of this year, and for the first nine months of 2008. And in a few minutes, Tom Gayner will take us through our investment results.

Today, I have an abbreviated report from our operational side. But do want to update you on three or four important items.

First, our combined operating ratio of a 124% for the quarter, and a 104% on a year-to-date basis, obviously represent unacceptable results. It underscores the importance of increased pricing, a process of which was actually started prior to the beginning of the third quarter, in a few of our select lines.

Over the last 30 to 45 days, we have met with each of our product line leaders, and have reviewed our results and pricing targets for everyone of our products, and have implemented rate increases virtually across the board.

We firmly believe that the combination of the adverse operating results being reported by the industry, as well as the turmoil in the financial markets, dictate that market pricing must rise in every sector of the business. We have moved our pricing targets up significantly, on our wind exposed business, as well as our overall property product lines.

We set individual pricing targets on all of our 75 plus specialty products, with an overall 20% return in mind. Given that uncertainty in the financial markets today, higher prices on all these products are a must for the future. So, where does that leave us in regards to the rest of the market?

Given the fact that most careers price their business 30 to 60 days in advance, most of our competitors businesses reflect moderate price erosion in the 5% to 10% range, or the majority of their businesses in the third quarter.

We believe that fourth quarter pricing will begin to level off, and that we will see moderate to significant increases beginning in early 2009. The second item I'd like to discuss today is our Texas prototype office.

During our August 5th second quarter call, I briefly mentioned that we were in the process of staffing a new Markel office, which would be located in Plano, Texas, a Northern Dallas suburb. We began assembling our team there in late July and into early August. We used the month of September to fine-tune our systems, processes, controls and internal training of our staff.

I'm pleased to report that during the first week of October, we flipped the switch and began offering all of our professional liability products through our Texas based wholesale broker partners. Shortly thereafter we added our Excess Umbrella line and latter in the month began underwriting and quoting both taxi and environmental coverage's.

Just this week, we added our Contract Mining Authority business and hand held plans and add additional products between now and year end. We have 20 plus associates on the ground in Texas, with 15 of them having previous Markel business unit experience. We have commitments from another 10 plus individuals from both inside and outside our company and should be fully staffed with 30 plus professionals by the end of this calendar year.

If early reports are any indication our presence in Dallas has been an overwhelming success. The two most difficult task that we faced each day are keeping up with the new business flow that is coming through the front door as well as managing our broker partner expectations in terms of not quite been ready with the complete Markel product offerings for all of our lines.

These are absolutely fantastic problems to face and we're delighted to address them as we begin to write business in Taxes. Our congratulations and thanks go out not only to our team there, but the dozens of Markel associates that supported our efforts in getting this operation up and running ahead of schedule.

Given our early success with our Atlas initiative which we have since renamed One Markel and our prototype office, we made the decision late last month to significantly accelerate our transition to One Markel for our entire North American Excess and Surplus Lines business units.

Our original target date for complete transition was January of 2010. We'll now begin transitioning or produce the relationships during the first quarter of 2009 with a fully operational and implementation date no later than April 1st of 2009.

Our broker partners have been unbelievably supportive and given these early positive reports in Taxes, our clients are chopping at the bid to have more products available for them in closer geographical proximity to their existing offices and operations.

Now I'd like to move across the Atlantic to our Markel International operations for just a minute.

In the latter part of the summer, we announced that effective September 1st, William Stovin would become President of Markel International, our intermediate holding company, and Jeremy Brazil will become President of Markel International Insurance Company.

Both of these gentlemen have been with Markel since we arrived on the scene in London in the early part of 2000. They will share executive and operational responsibilities for our London and international operation, and leave us well-positioned for future expansion and profitability.

Concurrent with this change Markel International's previous President, Gerry Albanese, has returned to the United States, and will be joining our Executive Team, here in Richmond.

As we further transition to a One Markel environment, Gerry will assume duties as Chief Underwriting Officer for the corporation, and will be our primary point person for our product line pricing, and product positioning for each of our lines.

I'd like to take just one moment to publicly thank Gerry for the five plus years of outstanding contribution that he made as President during his stay in London. Gerry and his team there put our business unit on the road to profitability, and at the same time designed a plan for significant global expansion for our future.

Under Gerry's watch, we have opened offices in Toronto, Madrid, Singapore, and Saco. His team has developed a model and the discipline that we will employ, as we continue to look for other global opportunities.

In conclusion, the third quarter represented a mixed bag. While business ported in the late second quarter and early part of the third, had pricing levels that continue to erode moderately, we are beginning to see a number of positive indicators that the environment for market pricing and risk selection, will definitely improve in the near future.

We are much more optimistic today about 2009, than we were 90 days ago. We are committed to underwriting profits, determined to push our pricing levels upwards in all of our lines, and have the discipline to walk away from under priced opportunities.

I look forward to your question and comments, when we get to the Q&A section in a few minutes.

Thomas S. Gayner

Thanks Paul. Good morning and thank you. As Ritchie noted in his opening remarks, total returns for the portfolio were a negative 5.1%, for the first nine months of 2008. Equities declined 12%and fixed income declined 1.7%. Additionally changes in foreign exchange subtracted 1.1% which brought the total portfolio return to a negative 5.1%.

To begin to place those results in some context our equity return of negative 12% compares with a negative 18.9 from the SMP 500. Our long-term record of solid equity return remains intact. Over the last 15 plus years of data that we keep at our finger tips, our equity investment have provided excess returns both to the SMP 500 index as well as its functional equivalent index in the bond world the at least it has been up until now layman aggregate.

I would also add the foreign exchange gains and losses should balance out economically from Markel's shareholders. As we hold the foreign exchange denominated bond to match against our foreign exchange denominated liability embedded in the insurance reserves.

The investments gains and losses are reported explicitly. The roughly corresponding and offsetting gains and losses of matching insurance liabilities are recorded as part of the reserve heading process and sure is a part of the underwriting.

One accounting item that I will point out is that we've recorded another than temporary decline in our investment portfolios of roughly $95 million during the third quarter. More than half of this amount comes from the lower market price of our holdings and equities such as GE, International Game Technology, Marryat and other companies where we can to be optimistic about their long-term prospect despite their recent price decline.

Do not own complicated or exotic securities. They're transparent and easily priced. While we may not like the price we see at the closing bell, we have always included all our market prices in our calculation of book value. We've also always emphasized book value and the comprehensive income that equates to the change in book value.

Current accounting practice is a one way street. Where unrealized losses show up in net income when market prices decline in the way we'd experienced in 2008. Any subsequent gains in the market prices or things like GE will not slow through the net income unless they are actually sold and the gains become realized.

All gains and losses however, realized and unrealized will continue to be reflecting in our book value per share and we remains focused on building that value to the best of our ability.

The last time Markel our calendar year, when investment returns were negative in both our fixed income and equity portfolio was 1994. In that year, book value per share declined from $27.83 to $25.71, a decline of 7.6%. As a 97% combined ratio and underwriting profitability weren't enough to offset the difficult investment environment, partially rising interest rates from that year.

I think it is worth pointing out though that in 1994 the book value declined 7.6% from $27.83 to $25.71. Our news today is that so far in 2008, book value is down 11.1% from $255.42 year-end to $235.72 at the end of the third quarter.

The book value per share is up nearly tenfold over that timeframe. If I could sign up right now for another tenfold increase in the book value per share of Markel over the next 14 years, I would happily do so immediately.

By the way, as we are all certainly aware of the credit crisis environment we face today, and the challenges of secure energy slide, the last 14 years were not exactly trouble free. Among the issues that came to my mind quickly as I considered the past 14 years, were items like the Asian currency crisis of 1997, the Russian currency crisis of '98, the collapse of the long-term capital management, when we should have all learned the lesson that Warren Buffet spoke recently about, I beware of key securing models.

The building bust of the dotcoms, Y2K issues or concerns ranging from getting stuck on the elevator all way have having planes fall out of the sky, and major human catastrophes such as the 9/11 terrorist attack, the wars in Afghanistan and Iraq, terrible tsunami in Malaysia, ongoing and continually attractable troubles in Africa and elsewhere, and Hurricane Katrina are among others.

While some may look at that list, could be afraid to get out of bed in the morning. I think one can also look that list and think about the amazing resilience of the human spirit. And our ability to overcome with themes like interminable problems.

At some point in the not too distant future, I believe that we will look back on our current issues, and think about them in the same way that we can now dispassion revisit, the litany of the last 14 years. There are gullible features human existed. Despite that list and the new troubles yet to come, progress continues its unrelenting upward path.

I think it's also worth noting that over those 14 years of book value growth at Markel, our fundamental investment approach has not changed at all. Our fixed income department has charged with the responsibility of hacking this share. We hold fixed income investments to more than cover our liabilities to our policy holders and we match our duration in currency to earn a spread while we owe the funds.

Doral credit analysis and we own planes in our balanced portfolio of corporate municipal and government aided stock. While we experienced some losses in 2008 in this portfolio even with our conservative approach our main confident in the basic soundness discipline.

We learned some lessons about hissing leverage and the necessity of parity and transparency in financial statements and we will modify our fixed income approach somewhat to take advantage of the lessons we learned.

Our fourth quarter equity investment approach of investing in profitable businesses with good returns on capital earnest and talented management with reinvestment opportunities in capital discipline at fair prices also remained unchanged in the 14 years since we had the last cluster of event such we face today. I'll also add that I'm increasingly optimistic about prospected equity returns.

This decade so far has produced the lowest equity market results since the 1930. Financial headwinds are still to forecast of ongoing below a minimal returns for U.S. economy. I respectfully disagree with that outlook for several reasons.

First, we're starting from meaningfully lower equity evaluation than we have a decade ago. Second our system is encouraging itself of excess debt each and everyday. Third as I observed my children go out to college they and their friends are talking about things like alternative energy and alternative fuels rather than future carriers of investment bank.

Reasonable and non reluctant assumptions of that earnings and dividends of high quality global businesses to get equity investors down, we look forward to better returns in the next decades than what was seen in recent years.

Additionally the events in property and casualty insurance world of natural catastrophe such as Hurricane Ike and Gustav and unnatural catastrophe such as subprime mortgages, EDOs, EDOs squre, derivative is gone wild and so many other unsound pieces of financial engineering that continue to ride problems in industry capital base should produce formal pricing and positive cash in flows for Markel.

While we're naturally disciplined with any negative results we've protected the balance sheet of Markel to what I believe is the once in generation storm of physical and financial catastrophe our company have greater liquidity than in anytime in its history with cash and short-term investments available $900 million at September 30, our debt stands at a low of roughly 20% of total capital, and we have the financial strength and flexibility, to respond to better insurance markets and a disciplined and way.

Better insurance prices and a target rich investment environment, could produce a cluster of debt that should be the exact through books, of what was experienced so far in 2008. I'm optimistic about our chances to jump [ph] such circumstances, and I look forward to questions in the Q&A period. For that, let me turn over to Steve.

Steven A. Markel

Thank you, Tom, and Ritchie and Paul. While the quarter in 2008 have been a challenge, we are very confident of our ability to earn consistent underwriting profits, and superior returns on investments, to build shareholder value.

With that, I'd like to open the floor to your questions.
Question And Answer

Question and Answer

Operator

Thank you. Ladies and gentlemen we'll now be conducting the question-and-answer session. [Operator Instructions]. Our first question is coming from John Fox with Fenimore Asset Management. Please state your question.

John Fox
Fenimore Asset Management

Hi, good morning everyone. So I have number of questions. First, if we given monitoring was going on the life insurance business, which you may, or may not have, a lot issues there with investment losses, and product guarantees, and that type of things which I know you don't have. But you certainly have a investment portfolio, and the rating agencies seem to be changing the bar.

And I am just curious... how do you guys think about if we sustain further investment losses in this point, where your capital position would be like? How would that allow you to take advantages of I guess, the hardening market into '09? And how do you handicap to rating agencies might change the bar? So if you can just kind of comment on that area?

Steven A. Markel

Yes John, I'll take a shot at it. And when I think the economic and the dynamic between our light businesses and TNC businesses are very different, and I think a large part of the life problems are on the assets side. And again, we don't invest I don't think in any life companies and we certainly don't operate and it like businesses. So we've a few steps removed from that. But our fixed income is definite portfolio was never structured to be a 5% or 6% guaranteed yield in our life contract or annuity or variable annuity, and so we didn't try to structure exotic assets to match them.

I think also this is a global outside of my area expertise but I think historically, like companies does not been maybe as disciplined in marking those assets to appropriate valuation of accounts we would like and because of sort of level two and level three type assets that are in those portfolios, they are probably much greater stressed in time to determine what is an appropriate right valuation and whether or not is an impairment whether it's temporary or some otherwise.

In terms of Markel capital position is, I don't think it ever have been any stronger as we pointed out diffusion liquidity today, our premium volume has been flat for three or four years. And if the rest of market does not increasing prices our risk will down in somewhere in the next quarter or two as we increase prices regardless of what others do, we continue to operate with underwriting profitability and have a very, very strong balance sheet. So I don't sense that we have any particular financial stresses whatsoever.

John Fox
Fenimore Asset Management

Yes, I guess my question was really about the rating agencies and whether are they changing how they're measure you and if there's further investment losses in the system and I agree my color very strong have you getting any noise in the rating agencies or anything of that nature?

Steven A. Markel

I'll be honest with this, John I don't talk to them at all. So I'll let somebody else.

John Fox
Fenimore Asset Management

Okay. That's good.

Richard R. Whitt, III

John this is Ritchie.

Steven A. Markel

We don't have to talk to rating agencies.

Richard R. Whitt, III

Yes, the things I guess, I can say is obviously evolved if things keep dropping, if you drop another 30% or 40% from here, in terms of the whole system. But realistically we have very strong capital position and speak that we have a lot of liquidity as a holding company and on a consolidated basis. We were recently upgraded this year by SMP annuity to bring this to a BBB last level our team is departing. So we're BBB flat now from all three of the rating agencies.

So, clearly we and everybody else will be having a lots of discussions with the rating agencies because there they have a heightened sense of awareness at this point because of what's going on in the market.

John Fox
Fenimore Asset Management

Sure.

Richard R. Whitt, III

In terms of them being particularly concerned about Markel absolutely not and if the markets were to go down a bit more, we have the capital to deal with that, for system collapses nobody hasn't see it where with all the deal with that.

John Fox
Fenimore Asset Management

Right, I understand that obviously. And then for Steve, I was interested in your opening comment about, if I interpret this correct, possibly writing at a 100 for the year. I'm looking at year-to-date underwriting loss with obviously with the hurricanes and stuffs et cetera. So, could you just expand on that a little bit? It would obviously require a pretty good combined ratio here at the end of the year?

Steven A. Markel

Yes, I think I mean there are couple that Ritchie pointed out some of those. They are usual events or additional charges in the third quarter.

John Fox
Fenimore Asset Management

Right.

Steven A. Markel

In addition to the hurricane, there was... I think we did our as practiced [ph] in environmental review which added a few buck than we had, a little bit of bad news in one of those product lines that we discontinued a year or two ago.

So I think with the normal quarter added to those kinds of events, it's not unrealistic that we could end the year at 99%. We also, I think we're reasonably conservative on our hurricane estimates. There is no certainty of how that will evolve in the next couple of months, there is still a lot of work to be done through set some of the damages. But early indications are that we may have a small bit of redundancy there as well.

And so I think we're it's very realistic. But I shouldn't realistic, it's very possible that we'll end the year at something less than a hundred. And the contract I'll sign put it in. was that in terms of the signing

Markel's ability to absorb it faster bit. Our standard has been that we want to have every year less than a 100% of that ratio. And have the 92 that Gustav and Ike are such that we pushed into the limit. And we may have gone over that limit modestly. But I don't think so yet, or I'm not certain yet.

John Fox
Fenimore Asset Management

Okay.

Steven A. Markel

Although I wish intended to sort of gaze the size of our ability and willingness to absorb a hurricane loss, obviously in return for thinking that we were quite enough premiums in the year. But they're not at loss to just start getting in that activity and on each product line we do evaluate and measure that.

John Fox
Fenimore Asset Management

Okay. Thank you.

Operator

Our next question is coming from Beth Malone with KeyBanc Capital Markets. Please state your question.

Elizabeth Malone
Keybanc Capital Markets

Hi, thank you. Good morning. You talked about pricing, putting us in pricing increases, and being pretty disciplined throughout your market. Is the market itself in general there is some very undisciplined competitors still out there in the marketplace that may not follow that pricing trend. So should we... what do you anticipate for the top-line, if you raised rates missed it half the underwriting, but are we going to see it meaningful shrinking of the business as the consequence.

Steven A. Markel

Yes. From that result I want you to understand and certainly all of our associates understand. If we need to increase prices on a particular downside was 15% we should do so because it's the right think to do with that respect to what any of our competitors do.

In the last quarter I cover volume result of five points I think. It would not at we one do in fact I would prefer is than all 10 points if the margin would had improve. And I will be trilled for that if we get our price increases to awarded and of course those people did achieve that goal, with that regard to the volume.

Now my believe is that in good time the marketplace will also get more prices and we'll see our volume increase, I also believe that our share of the market with some of the problems going on in the industry really increase.

But it's and what we can control is the underwriting discipline on each and every account and we can do our very, very best job to get out in front of our agents and our clients in still Markel and provide a quality services and quality product that we offer our clients in this there is no reason why this business shouldn't be able to grow very, very significantly. But the first step is to do the right job underwriting and the right job of charging the right price, the rest we'll talk also.

Elizabeth Malone
Keybanc Capital Markets

Okay. Could you comment on what you thinks going on, with a native competitor with AIG where do you think there's going to continue to be a major factor in the marketplace or do you see in not few just in future than their competitor capability if they manage.

Steven A. Markel

I think the safest and smartest thing to do is not to throw any oil or gasoline on that fire. It's burning pretty good all by itself, we don't any help from there.

Elizabeth Malone
Keybanc Capital Markets

Okay, fair enough. And for Tom could you mentioned that you were going to look at changing carrier strategies potentially given market conditions? Is there an overall seeing that you are going to focus on or is there going to be change in the kind of investments you make in the market or the kind of company you invest with?

Thomas S. Gayner

No on the equity side I really don't anticipate any change at all. The comments that I made is that on the fixed income side, I think we learned some lessons I could recall my comments exactly about the net necessity and transparency and clarity in financial statements and some of the additional things you think about when you're doing credit analysis work in the corporate volume area. So that's really the area that's under the microscope.

Elizabeth Malone
Keybanc Capital Markets

Okay. And just, I know you provide a lot of detail in your 10-Q on the credit to cost front. But as you've always transpired to have very clear and simple investments that are easy to understand. Is the credit default go up fall into that category?

Richard R. Whitt, III

Yes, I'll take the responsibility for that. At the fall of last year, when the storms started coming, credits spreads and pricing, went out a bunch. Now clearly, they've since gone out a lot more than what we had ever anticipated or thought or had seen before.

We thought in the fall of last year that we were being paid appropriately, for the risk that we were taking. The credit fall swaps in Markel, consisted of credits that we had already had in our portfolio. We had already done credit analysis work. Everybody here involved in credit analysis looked at each of those credits, and we netted the list of names, and we essentially made the decision that we thought those institutions were not going to go bankrupt.

Clearly, there is a long list of institutions that do not exist today, that existed a year ago and that explains a 100% of losses in the credit default swab, we didn't see it. We lost unfortunately, we did one. And then we stopped, and we have not done another.

I would also add in the discussion of the pricing, some hands in insurance over used to rate online, for a $50 million total notional exposure, we were paid $30 million of cash, right upfront. So, that's 60% rate online. And given our comfort with the underlying names in the portfolio, we thought that was a good risk reward decision. It has proven to be incorrect, we declined a less and we're moving on.

Elizabeth Malone
Keybanc Capital Markets

Okay. Thank you.

Operator

Our next question is coming from Jay Cohen with Merrill Lynch. Please state your question.

Jay Cohen
Merrill Lynch

Yes, thank you. Regarding the price increases, first of all I was kind of encouraged to hear your early definitive statements. What we've been from others is where pricing should be moving up.

But I haven't heard anyone say it is simply in the directly as you that we are raising prices. And that's what I hope to hear from others, I'm encouraged to hear you guys talking about it. Not surprised given your history.

Had you started that process yet, and if so, what has been the reaction of your distribution partners, when you go to them with the price increase, have they been accepting to hear about price decrease what you say?

Steven A. Markel

I'll let Paul deal with that. The first answer is yes, we've started it already. And yes, we don't want there to be any ambiguity, in what we intend to do. And that's true not only for communicating to you and other shareholders. But also internally.

Richard R. Whitt, III

I'm happy to comment on that Jay, there were a couple of product lines even before the beginning of the third quarter that we started move pricing up, our international holders just being one example and our domestic architects and engineers business being sequent for different reasons and some opportunistic and some just because the targets needed to moved up. But post of the two storms and post a lot of the noise around the financial turmoil we've set down with each of our 23 or 24 product line leaders and really reviewed where are from a result standpoint over the last several years.

What we've done in terms of pricing in particular over the last 36 months, putting all in mind that each of our products over period of time need to return that 20% to the cooperation and we have systematically put in place price increase targets for virtually everyone of our product lines across the Board and that 65 to 75 of these specialty products.

As I commented in my remarks where does this leave us in regards to the competition quiet frankly and we're probably out of step with most of the rest of the market taking a wait and see position but candidly this is one parade we don't mind being out in front.

We think somebody has to be the pricing leader, someone has to say that the prices have to go up and we do have the discipline to walk away from business when we can get our price terms and conditions.

Early indication would be that in a lot of products where we maybe targeting a 5% or 10% or 15% increase, previously the market place was doing a 5%, 10%, or 20% decrease and now maybe the marketplace has come up to at least flat. And we believe before you start be able to significantly sell increases you've got at least stop the decreases.

So we're encouraged that the rest of the market is at least beginning to level of in pricing. And I firmly believe that from the first of the year and end of the first quarter you're going to see some increases and vast majority of alliance and significant, significant increases in some other products.

Another elements our pricing models is that we do use an internal capital allocation category each products has underwriting targets for their lost ratio or combine ratio. And one of the elements tat go into the model is interest rate assumptions because while the underwriter don't directly participate in our investing returns the model don't take consideration are both the various products generally. And clearly our interest rate forecast for those internal debt to application models is lower than it was a year ago. And that's also an important element that drive prices up.

Jay Cohen
Merrill Lynch

Great. And I appreciate those comments. I also hope your competition is listening to this call as well. The second question, if you look at your combined ratio, you take out the favorable development, and you take out the catastrophe effect, it looks like for the quarter it's about a 106 combined ratio. And you take out the development for the past two quarters, you are running more 101.

And so... and I know mentioned with several product lines, you had mystery behind this cap. But looks like about a 5 point increase. First of all, is that you guys seeing at the same way, and then secondly what's behind that increase consecutively?

Steven A. Markel

Jay, I am not and without maybe we can call to talk after the call. But one thing I am not sure, if you're picking up or not, is investors charge, which is about $25 million. So I don't know if that's giving the way you are doing your math, I don't know if that's ending up in your current exiting year or coming out.

Jay Cohen
Merrill Lynch

I think, I'm taking it out. I'm just taking good 19 of net, net 19 of favorable development that I am just taking out.

Steven A. Markel

Yes. That sounds a little high to me. But we can look at it after the call. And one thing I can't say is we're obviously continuing to establish margin on safety on the current estimate year as we always have in the past. And so clearly, that continues to be there. We have had tick up in the expense ratios. So that will pick the some of it, that's about a 1% increase. We did have couple of lines of business, that didn't behave quite the way we would like in the fourth... in the third quarter. We had some prop areas, of property other than catastrophe, just sort of normal property losses that were figure then we would like to see. And so that might be driving it a little bit.

But I think we are still comfortable that we're pricing the business, to make an underwriting profit. Obviously, we have to establish the margin to save beyond top of that, and we've had some other things going on in the quarter as well.

But I think your point is very valid Jay. And the margins have shrunk with the decline prices over time, while in the aggregate we might be equivalent over with our run rate is it, 99 or 101. The more important thing is that our run rate needs to get down into the low 90s, not the high 90s. We need to earn the kinds of margins adjusted our capital and insurance industry. That does not exist today. We need to increase prices significantly, to generate the kind of returns we're entitled to earn. Capital is king today, and we got to earn good returns on it. And the first thing that need that is it has to go up.

Unidentified Analyst

Very rational. Thanks for the comment.

Operator

Your next question is coming from Meyer Shields with Stifel Nicolaus. Please state your question.

Meyer Shields
Stifel Nicolaus

Thanks. Good morning. Let me start with much of comments I can. I think this on few comments and your comments it's not that your not quite ready to punch into equity and, waiting for?

Unidentified Company Representative

Meyer, what I really like is this both tells in the short-term lineup and the two barrels in SMP the investment ideas and opportunities that are out there and I do think that they are out there. And point number two is the permanent insurance market, because the net dynamic that it happened in Markel over the years and that I think is on the horizon, when the insurance business is taken profitable and hard and has a lot of money coming in for that to happen at the same time when equity prices are very attracted, we would be deploying a lot of money indirectly.

Meantime if you say capital is changed, preserving liquidity, preserving the quarter's balance sheet that we've had as our mentality really for the last year and half of though has been very important because the of the real familiar to finish first be most first finish. And we've got the balance sheet in place and we need to protect that first and foremost that we can take advantage of both in short and the investment markets.

Meyer Shields
Stifel Nicolaus

Okay. That's helpful. And I think, I guess one of the characteristics of our insurance market is that businesses sort of marginally specialty like moves from the standard carriers to the specialty carriers, is that should we except that happen if we see rate declines next year or is it sort of different enough hard market that you anticipate in the tax components available or likely?

Steven A. Markel

Well from my experience Meyer I would say that every hard market, soft market cycle has different characteristics and we have seen over the last 24 to 36 months a lot of grey area business except the Excess and Surplus Lines marketplace and find this way back to the standard market and that's just part of the normal as it flow in the cyclical nature of the business.

What we're beginning to see already right now just over the last 60 days is that when you had carriers previously putting down $25 and $50 million lines on large Excess and Umbrella placements or large property or cover something's like that and the brokers and their clients are starting to say perhaps move maybe... I'll have five carriers each putting down $10 million rather than two carriers putting down $25 million alliance. And when you get back to layering such as that in another itself, the market pricing will push, will push the average cost north. So we're encouraged by that.

We haven't really seen any change other than a blip on the radar screen in the middle of September, in terms of our new business offerings. Our new business submission count has been off significantly all year, but usually that just means more people shopping not necessarily more people buying.

Richard R. Whitt, III

I think Meyer, it is fair to say that the bar that we write the profit $5,000 are still being flat tracked as restaurants in the standard market. And so, we've not seen those comeback yet. But, you can make an underwriting profit writing bars of a $1000 in the standard markets. So, it's a matter of time.

Meyer Shields
Stifel Nicolaus

Okay. No that helped. And I guess the last one, I think historically I think your preference has been to acquire companies that are sort bruised. Are more than nothing on your growth yet?

Steven A. Markel

There are plenty of bruises out there. And I think we get our fair share look at most of them. I don't think there's any transactions that are ready for announcement today, and I wouldn't want to imply or to judge that something is going to happen at any special point to time. That's sort of a very opportunistic kind of circumstance.

My guess would be that the impact of what we've seen in the financial markets, and the impact of what's going on in the underwriting markets, that we will see some significant opportunities in the profit cash over the next several financial quarters.

Richard R. Whitt, III

As the operator said at the beginning of the call, we're in a listen-only mode.

Meyer Shields
Stifel Nicolaus

Got it. Thank you very much.

Operator

Our next question is coming from Chuck Acer with Acer Capital Management [ph]. Please state your question.

Unidentified Analyst

Hi, thanks. Three, four quick questions, thinking about this tarp [ph] around as its moving past banks and financial institutions, and maybe the life insurance. Have you all considered what would be... what would likely be your position if they wanted to shove money into you or others in your space, and putting you either advantage to disadvantage relative to other players, or is it just a crazy idea?

Steven A. Markel

Well Chuck, it's sort of an interesting, because investment in a local bank or Markel Corporation, is in fact a bank holding company. And as a bank holding company, under the definition I think I have seen it, we are on list of thought eligible. I guess in industries or several preferred stock. At this point in time, I don't it would add much value to our balance sheet. So, it's not something that Markel Corp is currently pursuing and --

Unidentified Analyst

But, you haven't been exposed to the issue of if you're going to take this?

Steven A. Markel

No, right now, there is no intent to take a brief. We are on behalf of or in conjunction with the community bank we own, are involved with the discussions that whether or not they should after them.

Unidentified Analyst

Okay.

Steven A. Markel

That decision has not been made yet.

Unidentified Analyst

Great, quickly you answered a question about AIG. Somebody had mentioned that maybe not on this call, but did mention that they were being particularly fierce competitor in today's market, in order to preserve brand and franchise.

Do you see that as a consequence of the turmoil there, and how it affects your ability to achieve price increases and so on, in places that you'd like to be.

Richard R. Whitt, III

Well, I think the comment I made before is, we probably have quite not appropriate got through [ph], oil and gas on that file. But I don't think we are going to loose many Markel renewals. But we have a good relationship with the client over a long period of time, through a company like AIG being particularly competitive.

What I am hearing in the marketplace is they're extreme aggressiveness it really relates to hanging on to there renewals.

Unidentified Analyst

Right, Okay.

Richard R. Whitt, III

And the vast majority of their business, is in product lines where they're putting out $500 million or $50 million or $25 million, and when those are not things that we particularly have a strong interest in.

Unidentified Analyst

Okay.

Steven A. Markel

When they get down into the smaller account area. We would love to compete with them. And my guess is that they're spending all their energy on their big accounts. And so, I don't... I'm... with really 15% more and the clients is looking at it the long-term, I am not particularly worried about competition with them.

Unidentified Analyst

Great. Couple of questions and your equity holdings today as a percent of shareholders equity is what?

Thomas S. Gayner

We're at about 60%.

Unidentified Analyst

And so that's about the lowest we've been in how long Tom?

Thomas S. Gayner

Lowest it ever got was right after the Markel International acquisition at 50%, 51%. And this would be the second lowest in the modern era.

Unidentified Analyst

I suppose with your sense of humor, its okay to pass on the will rogers [ph] notion about your investment, got your changes in investment philosophy [ph].

Thomas S. Gayner

Yes, that does not change. We're more interested in the return of our money than the return on our money.

Unidentified Analyst

Well, I was thinking about, the one about buy stocks, if they go up and if they don't go up--

Thomas S. Gayner

Let's talk of it offline. There is no reason to share that information if you'd like [indiscernible].

Unidentified Analyst

Then just real quickly, the last question was about deals in the marketplace. And it seems to me that as it relates to what we call your gearing ratio, or your quarter one, are now less than three to one structure. You can get it back to the four to one target area, only through two things either through deals or strong pricing environment?

And, if you're in fact, if we lucky enough that we're headed into a stronger pricing environment, I suppose that to some degree of means, do deals, or at least the aggressions the size at which you might be tempted. Is that accurate, or is that fuzzy thinking?

Steven A. Markel

No, that's very, very accurate. And we clearly, we prefer to generate the growth internally. But we're still open for looking at opportunities. And particularly, in today's environment, having teams of people, and that's a very productive way, I think the Markel doors are wide open, to smart folks, with good ideas, they can bring business ideas underwriting, profit ideas in Markel. And so, we'll get placed, the people wanted to build their career. We're looking for hiring good people.

Unidentified Analyst

Thanks so much.

Operator

[Operator Instructions]. Our next question is a follow-up from John Fox with Fenimore Asset Management please state your question.

John Fox
Fenimore Asset Management

Hi, I had a question for Tom. Tom if you could just describe kind tone of the fixed income market, obviously October was horrible it's may through the quarter and into little bit early here in November. Do you see things getting thing the same if you could just seeing in fixed income.

Thomas S. Gayner

Well, I can't give the answer to your question. That's pretty ugly out there.

John Fox
Fenimore Asset Management

Do you see any improvement or have all the same.

Thomas S. Gayner

What I would say is that rate of decline we seem to have stop and just to improve the nature where nobody would... after NC&B product the bank done to long time ago, NC&B for no catch from nobody, and the markets were deep closing up like that for a while. We are starting to see a little bit of fall and the ability to transact and that would be the first step towards returning towards normality.

John Fox
Fenimore Asset Management

Okay. Thank you.

Operator

Our next question is coming from Mayer Shields with Stifel Nicolaus. Please state your question.

Meyer Shields
Stifel Nicolaus

Thanks a follow-up for Paul, if I can. If does you see rental offices at all basically local Texas business?

Paul W. Springman

At this point it is Meyer we have roughly five dozen wholesale producer relationships in Texas and our concentration, the first 90 days will be on those broker partner relationships that we were already in place. As we get closer to the end of year, we will expand to the surrounding states like Louisiana, Oklahoma and then ultimately the Mid South office we'll have roughly 10 to 12 states, they will be responsible for.

In the meantime, we'll continue to prospect for new relationships and try to work on better penetration through the existing once.

Meyer Shields
Stifel Nicolaus

Okay. That is all, there is no risk going of with cannibalizing other product line?

Richard R. Whitt, III

That is not all new business. They have inherited roughly $75 million to $85 million of existing business with existing Markel relationships that has being transferred under their watch to plain and in addition to that they're charged with responsibilities are producing them.

Meyer Shields
Stifel Nicolaus

Okay. Thank you for the clarification.

Richard R. Whitt, III

Our deal the Markel organization that we are talking that is to create regional offices that provide all Markel products, all Markel wholesale products through those regional office distribution systems. So, Texas regional office will provide all Markel products to all the wholesale relationships in that region ultimately, currently as we've practiced we'll be expanding as well.

Meyer Shields
Stifel Nicolaus

Okay. That's great. Thank you.

Steven A. Markel

Ladies and gentlemen we appreciate your long-term support of shareholders with Markel. We wish you a very good day and if you have any further questions or comments don't hesitate to give us a call.

Operator
Ladies and gentlemen this does conclude today teleconference. You may disconnect your lines at this time. And we thank you for your participation. .