S&P Global
Market Intelligence

W. R. Berkley Corporation NYSE:WRB

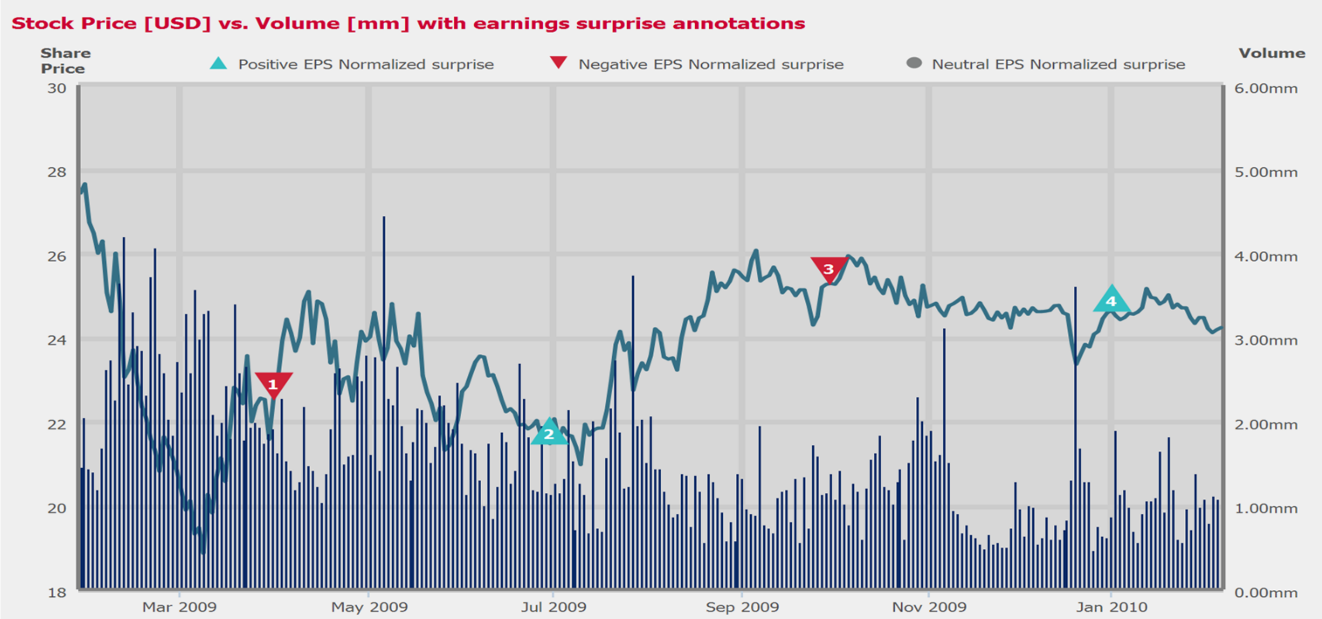
FQ1 2010 Earnings Call Transcripts

Tuesday, April 27, 2010 12:30 PM GMT

S&P Global Market Intelligence Estimates

	-FQ1 2010-			-FQ2 2010-	-FY 2010-	-FY 2011-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.65	0.70	▲7.69	0.64	2.66	2.71
Revenue	-	-	▲0.55	-	-	-
Revenue (mm)	1147.23	1153.55	-	1130.42	4542.67	4718.43

Currency: USD
Consensus as of Apr-27-2010 12:11 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ1 2009	0.28	0.25	▼1 (10.71 %)
FQ2 2009	0.58	0.60	▲2 3.45 %
FQ3 2009	0.65	0.57	▼3 (12.31 %)
FQ4 2009	0.67	0.71	▲4 5.97 %

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EXECUTIVES

Eugene Ballard

Gene Ballard

Rob Berkley

Unidentified Speaker

William Berkley

ANALYSTS

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RBC Capital Markets

Jay Cohen
Bank of America/Merrill Lynch

Josh Shanker
Deutsche Bank

Larry Greenberg
Langen McAlenney

Meyer Shields
Stifel Nicolaus

Michael Nannizzi
Oppenheimer

Mike Grasher
Piper Jaffray

Robert Berkley

Unidentified Company Representative

Vinay Misquith
Credit Suisse

Presentation

Operator

Good day and welcome to your W.R. Berkley Corporation first quarter 2010 earnings call. (Operator Instructions).

I would now like to introduce Mr. William R. Berkley. Mr. Berkley you may begin.

William Berkley

Our general counsel will now read our Safe Harbor statement.

Unidentified Speaker

The speaker's 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 the representation by us that the future plans, estimates, or expectations, contemplated by us will in fact be achieved. Please refer to our Annual Report on Form 10-K for the year ending December 31, 2009 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.

William Berkley

We are going to start by having Rob talk a little bit about our operations and Gene talk about the financials. Then I will pick up and talk a little bit about anything they left out and then talk a bit about the industry and where we see our business going. We were pleased with our quarter and generally happy with our results. So now I will turn it over to Rob. Go ahead Rob.

Rob Berkley

Thank you, good morning. In aggregate the quarter was in line with our expectations certainly by most measures the environment remains competitive and some might describe the market as two steps back, one step forward, but more recently we are encouraged to see a growing number of isolated situations where perhaps it can be described as two steps forward, and one step back.

Some of the areas that are also in the greatest level of competition continue to be as in past quarters commercial transportations, construction and product liability and a bit disappointing but a reality one could add some of the professional lines over the past quarter to that list, particularly large account D&L. The company had a good quarter, particularly given the environment, the gross premium was down to mere 2% coming at $1.126 billion.

Our price monitoring indicated that are pricing was flat and our renewal retention ratio was in the 80s. We ended up delivering a combined ratio of 94. This is made up of a loss ratio 59 and the expense ratio of 35. It’s worth noting the 59 includes $23 million of the storms as well as tax. And the expense ratio was predominantly driven by lower earned premiums as well as start up expenses with some of our younger organization.

When you go cut through all the moving pieces as far as reserves and storms and cash, our best estimate is that our current accident year is running give or take around a 100 combined. If you take a step back and you look at our history and our approach to reserving there is certainly evidence that could suggest that it is possible that, that number could improve as the year develops out.

A couple of sound bytes on the five different segments maybe cutting right through to the chase as far as the one particularly noteworthy outlier that would be our international segment. It came in with a combined ratio of a [111]. This was in part driven by an expense ratio of 44. and this was really due to some of the fact that we have a significant number of start ups in that segment including our new Lloyd's syndicate, our operations in Australia, our effort to build our business in Brazil as well as a few branches that we have created in Western Europe as part of WR Berkley, Europe, our FSA company.

Having said that, we also had some cat losses related to the Chilean earthquake to the tune of $4 million which hit our Lloyd Syndicate. Our regional segment had a very strong quarter coming into the 92.7. They incurred $15 million of storms. It's worth noting that this market place continues to be exceptionally competitive and there is a fierce tug-of-war that seems to be going on amongst a few national carriers and we are doing our best to stay out of the way of that battle.

Berkley North Pacific, our newest regional company in the North West is getting the traction that we would have hoped for. And our surety business is enjoying the early signs of improving US economy. Moving on to the regional segments, continues to be a challenging environment for our re-insurance companies. Perhaps the greatest challenge comes from our receiving partners or the company that see business to us. In an effort to support their top line, they seem to continue to buy less re-insurance. As a result of this and this reality over the past several quarters, our expense ratio has been picking up. This has also driven by our underwriting discipline. It's worth noting that we clearly recognize that there are two types of partners. There are those that try and see business to us in an effort to try and arbitrage our capital and there are some that are true partners through out the cycle. We recognize these two different groups and approach them accordingly. It's also worth mentioning that the Reinsurance Group encountered $4 million of cat losses through a relationship that they have in Lloyd, these cat expense from also the earthquake in Chile.

The alternative market was not insulated from the challenges of the environment altogether, having said that they have faired particularly well given what they are dealing with. Obviously, as traditional risk transfer solutions, quite frankly evolved to a very much buyers market, people are not interested in trying to find ways to stop insuring.

Workers compensation remains a competitive line. This level of competition though varies greatly depending on the territory. Our accident and health business is getting great traction and we are particularly pleased with the progress that's being made in the medical stop-loss case.

And finally our specialty segment, which arguably is facing amongst the greatest challenges throughout the industry. The specialty market has been under a great deal of pressure over the past several quarters, mainly driven by the admitted market or the standard market, increasing its share of the overall market place. We have seen business migrating from the specialty lines into the standard market, and as that has happened we have seen an eroding of terms and conditions.

Unfortunately in the past 90 days for the first time, we have been seeing terms and conditions eroding within the specialty market. More specifically we are seeing specialty players who have gotten to the point that they can't find a way to give anymore on fine, so unfortunately what they have decided to do is cave on terms and conditions.

Historically this has been a sign of the last shoot of drop or the final straw, so while it is certainly disappointing and challenging in the short run, it is encouraging and leaving us to believe that the change in behavior is not in too distant far.

To make a long story short, our sense is that the pressure in the marketplace is building everyday, we remained focus on maintaining the appropriate level of underwriting discipline and we wait patiently for the inevitable change.

Thank you all, Gene, you want to pick up the financial?

Eugene Ballard

Okay, thanks Bill. In spite of the level of catastrophic loses and storm activity in the insurance marketplace this quarter, it was another solid quarter for us in terms of both our underwriting results and our investment performance.

Our net premiums were $984 million, which is a decrease of 4% from a year ago, although premiums were down slightly in the quarter, the rate of decline was about three points lower than it was in the preceding quarter, so we are seeing an improving trend there.

Premiums while at start of the company on a gross basis were up 39% to a 166 million and accounted for about 15% of our overall gross premium volume. While our domestic business declined by 5% through our premiums for the international segment which has a higher proportion of new businesses increased by 9%.

The overall lost ratio was 59.1, down three points from the first quarter of 2009. Favorable reserve development, increased 54 million a year ago to 62 million in the current quarter, and represented about a seven loss ratio points.

Reserves developed favorably in all five business segments with a majority of the favorable development in the specialty and regional segment.

Weather-related losses for the regional segment were $50 million, up slightly from $9 million in the prior period and losses from the earthquake in Chile were $8 million including $4 million in the re-insurance segment and 4 million in the international segment. Our paid losses decreased by $3 million from a year ago.

Our accident year combined ratio was just over a 100 if you include the cat and storm losses and about 98 without the cat and storm losses. Again Rob said, the loss estimates embedded in these combined ratios reflect our conservative approach to reserving especially for recent years that have greater uncertainty and higher risk of inflation.

The expense ratio was 35.0, that up 3.5 points from the first quarter of '09 and 6/10th of a point from the fourth quarter of '09. the current quarter expense ratio includes approximately 1 full point of incremental expenses for start-up companies that have to yet to reach sufficient scale to cover their expenses, and it also includes another point related to several large reinsurance trees with above average commission rates that are fully offset by lower loss ratios.

The overall combined ratio was 94.1 compared with 93.7 a year ago and the combined ratio was below 95 for all four of our domestic segments. The international segment combined ratio of a 111.5 includes four points from the earthquake and five points for expenses related to three new companies in that segment. Net investment income was a $139 million, that's up about a $0.5 million from a year ago. The portfolio mix is basically unchanged from year end with 89% invested in fixed-income securities 5% in our arbitrage account, 3% in equity securities and 3% in investment funds. The average duration of the fixed income portfolio was 3.7 years at March 31st, up slightly from 3.6 years at the beginning of the year.

The annualized yield on the portfolio was 4.3%, down slightly from 4.5% in the first quarter of '09. Earnings from the arbitrage account were basically unchanged from a year ago. Unrealized investment gains increased $62 million to $400 million at year end and income from investment funds was $5 million and unrealized investment gains were $6 million. That gives us an operating earnings of $0.70 per share and operating return on equity of 12.4% for the quarter. After the impact of share buybacks, we bought back 33.8 million share for about $95 million in the quarter, after the impact of those re-purchases as well as dividends our book value per share increase 3.6% to $23.80 at March 31st.

William Berkley

Thanks, Gene. Well, we continue to see signs of the market reaching its bottom, but clearly, the psychology that was required for a turn of the cycle of any dramatic proportion is not yet here. Certainly again in line in certain lines of business prices are not just firming, but prices are increasing. In general though, as Rob said, prices are flat, the declining prices while it still exits in some areas has general stopped.

Competition is continuing however for the largest risks and we see it sporadically especially in the closing periods of every quarter where people are trying to make budgets and getting aggressive. The other thing we see is people occasionally are starting to have to pay the piper for their prior year's poor judgment. So we are starting to see some people not only not having any redundancies to release but have deficiencies that they have to deal with and we expect that that's is going to continue.

The overall environment is still not positive. people haven't face up to the fact that today the industry is probably in general at 110 combined ratio in an accident year basis, even the best companies in the industry are at a 98 to 100 on an accident year basis.

There are number of good companies still have significant redundancies, but you still have to look at that 110 best companies just under a 100 and the current level of investment income which is delivering for the average company a zero rate of return and for good companies 10% at best, we are optimistic that the cycle is still going to turn, we expect it to turn by the end of the year. we think you will start see price increases as people approach the end of the year, do their budgets for next year and have to look realistically at where things are and our general view is unchanged about price increases of substantial amount in the fourth quarter.

We believe that there continue to be opportunities to right business where customers recognize they buy insurance in order to get claims paid and what's been unsaid here is a number of the most aggressive competitors are behaving in ways that historically this industry has found unacceptable under being more difficult payments and claims and more aggressive in resisting their claims responsibilities. We think both the agents, brokers and ultimate customers are going to migrate towards those companies to take their responsibilities more seriously and to understand people buy insurance to take claims and get them paid.

So we are optimistic that we'll continue to be able to hold our own, expand our position. There continued to be people talking to us because we find that our opportunistic approach to be in growing to expand even in this difficult environment offers traction to people who are experienced and like our disciplined style.
With that, I'd turn this over to question's Mary.

Question and Answer

Operator

(Operator Instructions). Our first question comes from Mike Grasher from Piper Jaffray.

Mike Grasher
Piper Jaffray

First quarter, just following up on your comment there at the end about the opportunities that your are finding. Can you talk to despite the environment that we are in, how is it that you are able to find these new opportunities? And really grow this start up?

William Berkley

This is still a people business Mike and relationships still exist, novelty and expertise is really the grounding of this business and while its not easy to build a large business. There is a core of relationships that go with people who have expertise and knowledge and if you can attract those people you are always able to build the starting point of good business. We haven't been able to make a number of those businesses grow as much as we'd like, but we think by getting outstanding people, we are able to get traction pretty quickly.

Not only as quickly as we like them. But its still, as I said, it's a people business and that represents the reason we have been able to do this.

Mike Grasher
Piper Jaffray

Okay. And then how much does the idea of joining Team Berkley sort of incentivize those people on the outside?

William Berkley

The person who they usually talk to first is Rob and when I let Rob talk and then he is more modest than I am, so after he talks then I'll probably tell you my less modest point of view.

Rob Berkley

I think that certainly for many people we offered attractive alternative perhaps where they currently are or other alternatives, because of our general approach to the business that is reasonably decentralized and we are great believes that the folks that are closest to the frontline are the ones are in a position to make the best decisions, but consequently we empower them and give them the authority.

So, I guess long story short, I think people find our organization attractive yes because of our financial strength, but the real reason is because we have a track record that allows that would suggest that people given the authority and the economy to run those business as opposed to being exposed to being micro managed by some giant centralized home office.

William Berkley

I think a good example is our budgeting process, we don't direct goals as the volumes or anything else our budgets come from each operating unit who then tell us what they think they can do and we have a dialogue about it, as opposed to us telling them what we expect.

Many people who come here for the first time are shocked that we actually do what we say. But our segments are manageable, there's one person between Rob and I and the operating units that the Senior Vice President who is not a long line to get through if there's not a lots of ways that you are prevented from talking to anyone of this organizations so, it's a very few tiers of people and easy to work in and focused on getting the job done. We like to say we are outcome focused, not process focused and there aren't many companies that have our resources that are still able to do that

Mike Grasher
Piper Jaffray

Okay. That's helpful. Thanks for the insight there. And one final question just around your comments with the industry accident you are probably somewhere around a 110. Can you talk to more specific lines of business that maybe you are above that 110? And those are maybe below. I guess more importantly, those that are above?

William Berkley

I don't really. As you know, having listened to our calls before, we don't get into discussions about the individual lines of business on these calls.

Mike Grasher
Piper Jaffray

Not within your own company, but just within the industry.

William Berkley

It's just as dangerous for me to do that, so I'm going to pass Mike.

Operator

Our next question comes from Doug McGregor from RBC Capital Markets.

Doug McGregor
RBC Capital Markets

Just a couple of quick questions. First, I guess maybe Gene. Was there any Forex impact, adverse or favorable under international business for you?

Gene Ballard

A modest amount about $5 million in the quarter if they stay favorable gain.

Doug McGregor
RBC Capital Markets

$5 million favorable, that will be in premiums mainly?

Gene Ballard

No, it's normally when we' will have an overseas operation that has invested in a currency other than its own functional currency.

Doug McGregor
RBC Capital Markets

Okay, that make sense. I guess the second question would be more of overall capital management question. Obviously you are pretty aggressive with your buyback this quarter. You indicated that a general appetite for buybacks given the current conditions. Could you remind me first of all what your current authorization is,a dollar or share amount?

William Berkley

It's about 11.5 million shares, it's not stated in the dollar amount. It's 11.5 million shares

Doug McGregor
RBC Capital Markets

I would assume that you saw the appetite to buyback as current conditions would hold?

William Berkley

We don't even tell people when and how and where we determine what to buy a stock back, that's not something we just play out, we bought back shares and at times we do and times we don't. We are interested in buying back stock when we think it's good for our shareholders and that maybe today or may not be today but we think it's not something we just play out. It gives us less of an advantage for our shareholders if we tell the people on the other side the transaction what our plans are.

Operator

Our next question comes from Michael Nannizzi from Oppenheimer

Michael Nannizzi
Oppenheimer

On investment income, is that number a little light relative to last quarter, as a result of the buybacks which look like it occurred mostly in early part of the quarter?

William Berkley

I think the buybacks due to occur in the very early part of the quarter. I think the investment income is basically flat. It's not light I think that in part being quite as a function of, you're always running a race especially when we have older higher yielding paper coming off and investing in that current interest rate. So, it's a foot race to maintain our yield.

Michael Nannizzi
Oppenheimer

On the net investment funds, can you talk a little about the $4.7 million there, that includes the mortgages and if I heard you right, can you just kind of talk about that line relative to that last quarter?

William Berkley

What you mean, what makes up them?

Michael Nannizzi
Oppenheimer

Yes, what’s the number relative to kind of where we were we were last quarter there. I just wanted to understand.

William Berkley

It’s basically what you, it is not much change really it is evaluation changes, some oil and gas funds that we have in Canada or which is probably the biggest single piece, then it is real estate. We have two real estate funds.

Gene Ballard

The balances is basically unchanged from its been, it’s about $400 million total investment in affiliates and funds </TAG>

Michael Nannizzi
Oppenheimer

You mentioned our qualitative matters as far as your service profile, claims paying and these other aspects of your business that differentiate you from others. Are you seeing that get equal footing or more footing now relative to just pricing and could you talk about whether or not that behavior or physiological change happened prior to the last cycle turn.

William Berkley

One of the things that I’ve tried to talk to people about is the state of mind that really drives the cycle change because it’s not just the reported numbers, it’s when the fear of the business doing badly and the real results ending up being much worse than the reported results that cause people to act and as people start to see those adverse trends, there are some companies that choose to tighten up their claims paying procedures and their behavior in the field gets more difficult.

Those companies always end up suffering. So, I think that the independent agent recognizes that. The independent agent then starts to move away from those companies that they see behaving in an arbitrary way. So, we have benefited in general and cyclical turn as large companies and small also, but primarily large companies get being tougher with claims and agents decide that's not something they can deal with. So we have benefited by that and in the last cycle the same thing happened.

Operator

Our next question comes from Meyer Shields from Stifel Nicolaus.

Meyer Shields
Stifel Nicolaus

Will I was hoping you could give some insight into the margin appreciation within the healthy-owned investees? Is there something that we should expect that along with an economic recovery?

William Berkley

No, the answer, that's all, (inaudible) that Credit Arrow [ph] continues to do better. It's a business. I don't think the margins are going to get better. It's an industrial company if you will, they are doing better and I don't think that will continue to have a significant increase in the margins. It's a little more volatile quarter to quarter. I think they're doing fine and it's giving us a good return on our investment, but I think you have started to see a significantly better economy before they would be really be benefiting. And I don't think you've seen it yet.

Meyer Shields
Stifel Nicolaus

And you talked a little bit about professional liability in (inaudible) price I think. Do you expect the recent Goldman Sachs news changed that?

William Berkley

Sorry, could you repeat the question?

Meyer Shields
Stifel Nicolaus

I'm sorry. I was asking whether the recent Goldman Sachs user charges is likely to impact pricing for specialized D&O.

William Berkley

Unfortunately not. We don't think that the Goldman situation is all of a sudden going to dramatically change the appetite or the environment for a large account D&L. I think that you are going to see a series of significant SEC claims that will provide the required wake up call. I think what we're seeing right now is the greatest level of competition particularly on some of the lower layers as some of the folks that have been in the market place for some period of time playing some of the higher access layers or looking for ways over the past call it 12 months to elbow their way up to the table and perhaps become the next AIG, so we will see with the time whether that works out or no, to your specific question, it is unlikely in our opinion that Goldman situation on its own will drive a change in market behavior.

Gene Ballard

And some of those people actually may become the next AIG without the government's assistance. That's wishful thinking unfortunately I am afraid, but I think that the only loss that we see that could change a particular segment might be the drilling of rig loss in the Gulf where the loss is going to be very large loss, it was the kind of loss that no one anticipated, very high quality, partners operating it, in everyway, technologically advanced rig. Big loss, not storm related, not the kind of loss you would expect in a market that wasn't at the peak of competitiveness, but was certainly competitive. That's the kind of loss that might have an impact on the margin, but generally speaking one loss or one issue like Goldman Sachs would not have an impact on the market.

Operator

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

Jay Cohen
Bank of America/Merrill Lynch

Can you discuss the amount of shares you’ve bought back to date in the second quarter?

William Berkley

First of all, no of course I can’t discuss what I have done in the second quarter. Because then I would be saying something that I have little enough to say Jay, what would I say of the second quarter call if I told you know.

Jay Cohen
Bank of America/Merrill Lynch

Quartet to date, just give us a taste for it.

William Berkley

No, I can’t do, my lawyer is sitting here is waving his finger at me saying, lets not talk about it I am sorry.

Jay Cohen
Bank of America/Merrill Lynch

All right because of the company actually did mention this one but let’s go to other question.

William Berkley

I have a lawyer who is bigger than me what can I say.

Jay Cohen
Bank of America/Merrill Lynch

Rob, you had mentioned you are seeing some sings of terms and conditions loosening up. I am wondering how widespread that is?

Rob Berkley

I think that how widespread it is kind of hard to articulate that, you know Jay I think as we have discussed in the past on these calls and I think other occasions as well. We have seen terms and conditions loosening or an extended period of time as I suggested that business migrated from the non-standard or non-admitted/specialty market into the standard or admitted market. That just happens naturally, but what we are seeing now and it seems to be becoming more widespread, is an erosion of terms and conditions that are being offered within the specialty market. And I guess our only conclusion is to wire a speculation as to why folks are doing it, is because they finally realize that they hit the wall with pricing. So in an effort to attract business, well what they are doing is since they can’t give any to more up on price front. They are just giving it up on terms and conditions.

How wide spread is it, I don’t have a metric that I can share with you but certainly it is not something that we saw in a significant way in ’09 or prior, it is something that has come somewhat out of the blue in Q1 of 2010 and I think that you would find that if you went back to sort of 99 - 2000 it is perhaps a page out of Berkley book, as I also suggested earlier. The good news is that when you get aggressive with pricing that takes a little bit of time to come home to roost. Often times when you start playing with terms and conditions as it has been suggested in the past that's one way to take long tier business and make it short tier business.

Jay Cohen
Bank of America/Merrill Lynch

Thanks Rob, last question on the claim side can you give us some flavor for what newly arising claims are looking like from a frequency standpoint, actually weather of course?

William Berkley

I don't think there has been a particular change in our claims either frequency or severity. There is nothing we [talked]. I think in general we would say that we have been more conservative in our claims reserving for a number of years having found ourselves short in 2001 to a greater extent than we ever anticipated. I think that embedded in our claims process is a much higher level of conservatism which continues and redundancies continue to develop and the fact is there is nothing that causes us to see inflation trends or anything else that's directionally changing where claims are going we are pretty benign.

Operator

Our next question comes from Vinay Misquith from Credit Suisse.

Vinay Misquith
Credit Suisse

On the margin for the business, the [accident] in your loss ratio extent seems to be slightly better than the fourth quarter and significantly better than 2009. Could you help us understand what's driving the improvement? Is it business mix or is it your view that lost core strength are not as high as you had anticipated originally?

William Berkley

I think that it's a couple of things, I think there is some change in the business mix as Gene mentioned for instance in the re-insurance area. Our expense ratio went up because we wrote some property business, non-cat related property business that we knew ahead of time or to have a lower loss ratio with a higher expense ratio. So that accounted for part of it. I think another piece of it was we recognized that we will probably more conservative than we should have been in establishing our loss to extend a number of areas and we are trying to get a more precise handle as we look at it line-by-line. And I think that finally, some of the areas of business have proved to be more positive results than we expected.

Vinay Misquith
Credit Suisse

That's great. And the third question is your exposure towards the Transocean rig if you could just give us a sense of what do you have any re-insurance on that and what your exposure would be?

William Berkley

The long and short of it our net including everything, including re-instatement premium was something just low $5 million. And we in fact will probably pay that claim this week and it was well within what we expect that's the business we have anticipated loss ratio and its well within the numbers we have.

Operator

Our next question comes from Josh Shanker from Deutsche Bank.

Josh Shanker
Deutsche Bank

I was curious about the composition of the favorable development by acts in euro lines and if you can give any color to that?

William Berkley

You know we don't talk about that, on the phone you are welcome to talk to Gene.

Josh Shanker
Deutsche Bank

Okay, lets talk about the industry in terms of a 100% for the quality players, a 110% for the industry usually I think of the market risk property versus casualty running at a higher combined. Are you just talking about lines that you are participating in or the industry broadly speaking?

William Berkley

Josh, I think what we are referring to is commercial lines ex-property cat.

Josh Shanker
Deutsche Bank

Okay, and is property running around the same as casualties.

William Berkley

Well. I think what we are doing is we are looking at commercial lines in the aggregate ex-property cat we are not at this stage looking to have break it out the casualty or the property or the CMP versus it so that's I think that's a general view when we do our homework as to where we think the industry is running.

Josh Shanker
Deutsche Bank

Okay very good. And finally you spoke in the first conference call about potentially a 15% ROE for the year do you still think that's achievable?

William Berkley

Yes. It's a really simple thing by the way, if you would take out our unforeseen storm losses, our net income would have given us about a 14.8% return as of 13.5 net income, I know if that wasn't talked about operating income. I talked about net income because we've moved our gains and a fair portion of that to where it's not in our operating income. But I still think that we will do that. Yeah.

Operator

<TAG>(Operator Instructions). Our next question comes from Larry Greenberg from Langen McAlenney.

Larry Greenberg
Langen McAlenney

Rob you highlighted on the re-insurance side having partners and then dealing with arbitragers and I am just curious. Are you seeing anything unusual in that breakdown seg.

Robert Berkley

No, I think quite frankly you know just to make sure that we are on the same pace what I suggested, certainly meant to suggest are there are two types of partners, those that are opportunistic and want to use as one of its convenience for them. And those that are truly our partners throughout the cycle.

And as far as the split between the two, obviously in a challenging market. Those that are opportunistic were not able to find ways to do as much as with them as we came in a hard market. Those that are truly our partners throughout the cycle. We value those relationships greatly and we continue on with them through second [sem]. So, I guess to answer your question yes it becomes more waited in a soft market. Towards those that are partners throughout the cycle as opposed to those that are trying [game up].

Larry Greenberg
Langen McAlenney

Okay, but you are not seeing any of the more of the traditional relational partnerships and moving into to the other camp of trying to game the system?

William Berkley

I think that the answer is in a soft market there is enough pressure for everyone to go around. Having said that we have partners that are built on long-standing relationship, we understand what our role is, we understand what their role, they understand what our role is and there is a mutual understanding that the relationship needs to be rewarding for both parties.

So, is there a bit of fraying around the edges then certainly there is some relationships that we sort of question a little bit here and there. But I would suggest that the core of that group is well intact and we are pleased to have the opportunity to support them and be their partner.

Unidentified Company Representative

In many ways that relationship is no different than it is doing business with large insurance. We don't write very many if any Fortune 500 companies because they have finance capital and again there is a capital arbitrage. We are happy to write insurance for people who want to buy protection from volatility, protection from loss. We are not interested in writing if you will risk arbitrage in the insurance business because frequently the insured knows more than we do about the frequency or likelihood of loss.

Larry Greenberg
Langen McAlenney

Bill, I mean if I could summarize your position on the marketplace it sounds like on the one hand you think that the industry is at a 110 accident year and that's clearly an impetus to change pricing. On the other hand there is spectrum, there is still lot of redundancies out there and that probably is going to mute things to some degree.

I mean, can you just elaborate on the issue of redundancies in the industry and maybe you've got some historical perspective on this?

William Berkley

Why don't we start by saying pricing levels based on our analysis are roughly at the kind of levels they were in 2000. Inflation has driven costs higher than that and investment income is substantially lower than that. So the industry is doing worse. So you have to put that in the context of what we're talking about. But the past five years have been extremely profitable years and a number of companies, not even intentionally but almost in spite of themselves have found themselves to be extremely conservative in prior years reserving because business was much better than they anticipated.

And as those loss years develop, they are finding redundancies and the redundancies are proving to be far more than they had anticipated. The companies that are in that position are not evenly spread. Companies that reported results in the low to mid 80s are unlikely to have great redundancies.

Companies that reported high 80s, low 90s are likely to have more redundancies than companies that reported somewhat higher results will probably continue to have redundancies. So all companies are not going to be created equal with the amount of redundancies they have to bring down, and it varies by lines of business, the shorter the power lines of business, the less redundancy or likely to have because they will have a merged more quickly. So companies that are like private passenger automobile are not going to continue to have big redundancies in all likelihood. Companies that have property business are not going to have accumulated big redundancies, its going to sort of washout catastrophe business, where they have shown great results virtually immediately after you didn't have many cats.

Companies that had significant casualty business will have longer or at least a possibility of longer tail and accumulated longer redundancies that will take time to be released.

So it's going to be different for every company but the third in the cycle is going to come about when people start to recognize the reality of where pricing is and that they need to do it and do something about it. And you know we are running at a 97 - 99 or a 100 I can't tell you, but I can tell you that our current action year is not great and while as compared to the world, we are doing alright, we are not where we want to be and historically if you'd look at our chart we do 8 - 10 points better than our better competitors and more than 10 points better than the industry as a whole.

So, we'll have to see how that comes out and when do people major players starts to say we can't live with prices at this level. But to make that decision you have to be willing to lose business. And that's a hard thing for an insurance company executive to say, that we are prepared to have our insurance volumes go down and either fire people or have a bad expense ratio.

So it's that state of mind that the long term pain of more loses is something I just can't do with, and when Rob talked about terms and conditions. Frequently changing terms and conditions changes how quickly losses get reported. Because you had coverage's that allow people to report things that otherwise might not be reported. So it accelerates the reporting and thus reduces the tail on specialty business.

So that's the best I can do to tell you that we are bunch of irrational people with a huge marketplace that respond to our emotions more than the economic reality.

William Berkley

Okay, I thank you all very much. There are lots of signs that there are people who are recognizing this issue as they start to see things happening that surprise them. I would expect our prognostication's timing is not going to be off much if its off that will be by a little, but we still anticipate the fourth quarter, people will start to look at those changes and react. So, thank you all very much. Have a great day.

Operator

Ladies and gentlemen, this does conclude today's program, you may now disconnect and have a wonderful day.