S&P Capital IQ

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Markel Corporation NYSE:MKL

FQ3 2015 Earnings Call Transcripts

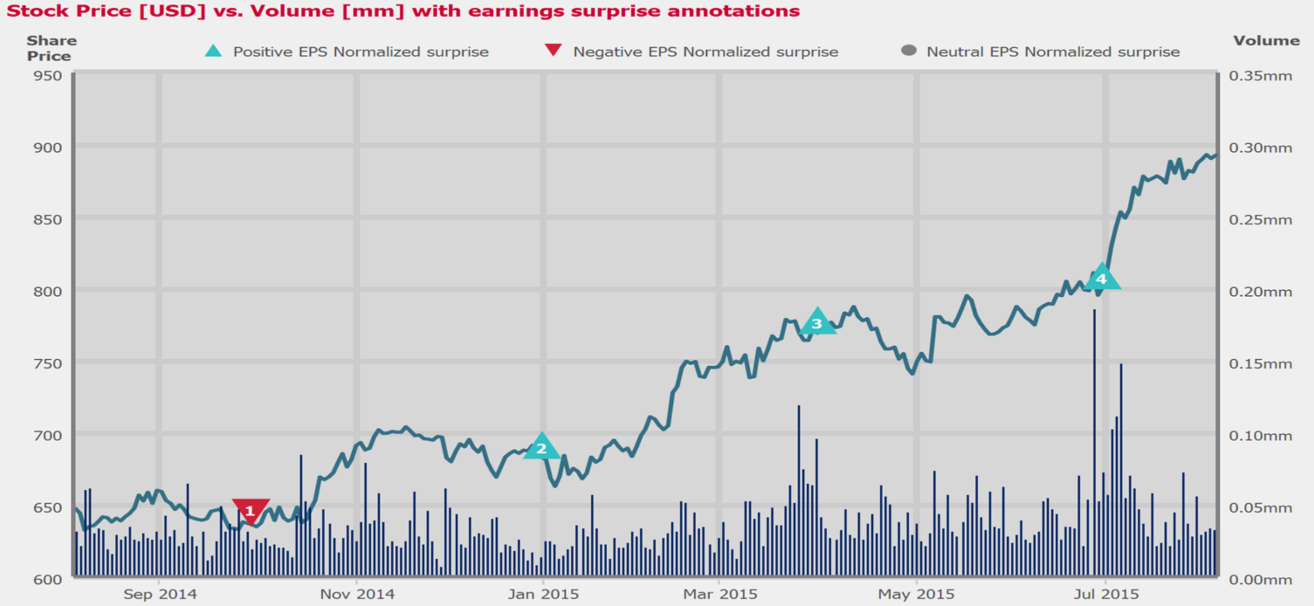
Thursday, November 05, 2015 1:00 PM GMT

S&P Capital IQ Estimates

	-FQ3 2015-			-FQ4 2015-	-FY 2015-	-FY 2016-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	6.51	7.21	▲10.75	7.12	36.46	28.38
Revenue (mm)	1300.20	1342.76	▲3.27	1295.59	5255.87	5437.72

Currency: USD
Consensus as of Oct-22-2015 9:16 PM GMT

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



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ3 2014	5.44	5.30	▼1 (2.57 %)
FQ4 2014	5.52	8.18	▲2 48.19 %
FQ1 2015	5.85	13.17	▲3 125.13 %
FQ2 2015	6.04	6.10	▲4 0.99 %

Call Participants

EXECUTIVES

Anne G. Waleski
Chief Financial Officer and Executive Vice President

Francis Michael Crowley
Vice Chairman

Richard R. Whitt
Co-Chief Executive Officer and Director

Thomas Sinnickson Gayner
Co-Chief Executive Officer and Director

ANALYSTS

David McKinley West
Davenport & Company LLC

James Davis

Jeffrey Schmitt

Mark Alan Dwelle
RBC Capital Markets, LLC, Research Division

Presentation

Operator

Good morning, and welcome to the Markel Corporation Third Quarter 2015 Earnings Conference Call. [Operator Instructions] Please note, this event is being recorded.

During the call today, we may make forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. They are based on current assumptions and opinions concerning a variety of known and unknown risks. Actual results may differ materially from those contained in or suggested by such forward-looking statements. Additional information about factors that could cause actual results to differ materially from those projected in the forward-looking statements is included under the captions risk factors and safe harbor and cautionary statement in our most recent annual report on Form 10-K and quarterly report on Form 10-Q.

We may also discuss certain non-GAAP financial measures in the call today. You may find a reconciliation to GAAP of these measures in the 10-Q, which can be found on our website at www.markelcorp.com in the Investor Information section.

The presenters today from Markel Corporation will be in the following order: Mr. Tom Gayner, President and Chief Investment Officer; Ms. Anne Waleski, Executive Vice President and Chief Financial Officer; Mr. Mike Crowley, President and Co-Chief Operating Officer; and Mr. Richie Whitt, President and Co-Chief Operating Officer.

I would now like to turn the conference over to your host, Mr. Tom Gayner. Please go ahead, sir.

Thomas Sinnickson Gayner
Co-Chief Executive Officer and Director

Thank you, Denise, and good early morning. We understand if we use rounding, there may be as many as tens of people on the call and we welcome you to our third quarter conference call for Markel. My name is Tom Gayner, and I'm joined as usual by my colleagues Anne Waleski, Mike Crowley and Richie Whitt. Anne will brief you on the financial results. Mike and Richie will discuss our insurance operations, and then I'll return with comments on our investment results and Markel Ventures. As always, we thank you for your interest and support of Markel, and we look forward to answering your questions.

With that. Anne?

Anne G. Waleski
Chief Financial Officer and Executive Vice President

Thank you, Tom, and I echo a good early morning to everyone on the call. I'm happy to report that our year-to-date underwriting results are outstanding, contributing just under $300 million to pretax profits for the first 9 months of 2015. All 3 ongoing insurance segments contributed to this result by producing a lower combined ratio compared to a year ago.

While underwriting results remained a significant contribution to shareholder value, the favorable impact from underwriting was muted by our investment results for the first 9 months which were adversely affected by volatility in the equity markets. Our total operating revenues grew 4% to $3.9 billion in $2015 from $3.8 billion in 2014. The increase was driven by higher revenues from Markel Ventures. Other revenues, which include revenues from Markel Ventures, were up 30% to $817 million from $630 million last year primarily due to our acquisition of Cottrell in July 2014.

Going back to the underwriting results, gross written premiums were $3.7 billion for the first 9 months of 2015 compared to $3.8 billion in 2014, a decrease of 3% driven by a decline within our Reinsurance segment. During 2014, we ceased writing auto insurance in the U.K. and we also decreased our nonstandard U.S. auto reinsurance business. Foreign currency exchange rates also have an unfavorable impact on the year-over-year change in gross written premiums. However, even on a constant rate of exchange, gross written premium volume declined 1%.

Market conditions continued to be very competitive especially within the property and marine and energy product lines. Consistent with our historical practices, we will not write business when we believe prevailing market rates will not support our underwriting profit targets.

Net written premiums for the first 9 months of 2015 were $3 billion, down 3% from the prior year, and our net retention was in line with the prior year at 82%. Earned premiums were $2.9 billion for 2015 and were flat to prior year. At a constant rate of exchange, earned premiums for 2015 would have increased 2% compared to the same period a year ago. During the period, we saw organic growth in several specialty division product lines within our U.S. Insurance segment, which was offset by a decline in earned premiums for the Reinsurance segment for the same reasons I just mentioned.

Our consolidated combined ratio for the first 9 months of 2015 was an 89% compared to a 97% a year ago. The decrease in the combined ratio was driven by a more favorable development on prior accident year loss reserves in 2015 compared to 2014. For the first 9 months of 2015, prior year redundancies were $459 million compared to $260 million for the same period a year ago.

As I have mentioned in prior calls, during the first quarter, we entered into an asbestos and environmental reinsurance agreement related to exposures in our U.K. book, resulting in a reduction in prior year loss reserves during the period by $36 million, which had a 1 point favorable impact to the combined ratio for the first 9 months of 2015. In addition to the impact of this reinsurance transaction, we experienced more favorable prior year loss reserve development driven by our U.S. and international Insurance segments. The more favorable development in the U.S. Insurance segment is primarily due to experiencing favorable development on our inland marine products in our Global Insurance division for 2015 compared to adverse development in 2014 as well as the impact of adverse development on our architects and engineers and brokerage excess and umbrella product lines in 2014. The more favorable development in the international segment in 2015 is driven by case reserve reductions for a small number of large general liability and professional liability claims.

Lastly, our 2014 results included $27 million of adverse development on our asbestos and environmental reserves. We completed our 2015 asbestos and environmental review in the third quarter without adjustment to health reserves.

Before moving on, I would also like to comment on the second asbestos and environmental reinsurance transaction, which we reported as a subsequent event in our Form 10-Q. Late last week, we completed a retrospective reinsurance transaction to cede a portion of our U.S. asbestos and environmental exposures. The impact to earnings, if any, resulting from a change in the estimated volatility of our consolidated net reserves for unpaid losses and loss adjustment expenses as a result of this transaction will be reflected in our fourth quarter results of operations.

While we recognize that the two 2015 ceded reinsurance transactions related to our asbestos and environmental reserves will have the short-term impact of reducing investment income, we have significantly reduced the future uncertainty around these exposures and have increased our flexibility regarding capital allocation.

Moving on to Markel Ventures. On a year-to-date basis, revenues for Markel Ventures were $784 million compared to $595 million in the same period a year ago. Net income to shareholders from Markel Ventures for the 9-month period was $14 million in 2015 compared to $16 million in 2014. EBITDA was $76 million in 2015 compared to $66 million in 2014.

The increase in revenues from our Markel Ventures operations during 2015 was primarily due to our acquisition of Cottrell in July of 2014. Additionally, we have experienced higher revenues within our other manufacturing operations due in part to higher sales volume in 2015 compared to 2014. Likewise, EBITDA from our Markel Ventures operations increased in 2015 primarily due to our acquisition of Cottrell and more favorable results within our manufacturing operations. This increase was partially offset by an increase in our estimate of the contingent consideration obligation associated with the acquisition of Cottrell.

As I mentioned last quarter, a portion of the purchase consideration for Cottrell is based on our post-acquisition earnings through 2015, which we expect will exceed our initial projection. As a result, our estimated fair value of the contingent consideration increased by $27 million in 2015. The decrease in Markel Ventures net income for the first 9 months of 2015 is also a result of the contingent consideration adjustment for Cottrell.

Turning to our investment results. Net investment income for the first 9 months of 2015 was essentially flat to a year ago, coming in at $271 million. Net realized investment losses for 2015 were $3 million compared to net realized investment gains of $29 million a year ago. The net realized investment losses in 2015 were driven by a $23 million adjustment for other-than-temporary impairments attributable to equity securities. Net realized investment gains in 2014 included $4 million of other-than-temporary impairments.

Net unrealized investment gains decreased $397 million for the first 9 months of 2015 compared to an increase of $499 million for the same period last year. The declines in net unrealized investment gains this year was attributable to decreases in the fair value of our equity and fixed maturity portfolios compared to prior year-end.

Looking at our total results for the year. Our effective tax rate was 21% in 2015 compared to 25% a year ago. The decrease in the tax rate in 2015 was driven by foreign tax credits for foreign taxes paid. In previous periods, taxes paid in foreign jurisdictions were not available for use as tax credits against our U.S. provision for income taxes. In 2015, we anticipate a sufficient amount of earnings from our foreign operations will be taxable in the U.S. This will allow us to recognize the benefit of significant foreign tax credits against our U.S. provision for income taxes. A similar benefit may not be available in future years.

We reported net income to shareholders of $385 million in the first 9 months of 2015 compared to $204 million a year ago. Comprehensive income for the period was $98 million compared to $517 million a year ago. And as a result, book value per share at the end of September 2015 was $552, an increase of 1% since the end of 2014.

Finally, I'll make a couple of comments on cash flows and the balance sheet. Net cash provided by operating activities was $550 million for the first 9 months of 2015 compared to $537 million for the same period of 2014. Operating cash flows for 2015 included higher cash flows from our Markel Ventures operations partially offset by higher payments for income taxes compared to the same period of 2014.

Operating cash flows for the period was net of approximately $70 million of cash paid in connection with the first quarter 2015 asbestos and environmental reinsurance transaction that I have previously mentioned and $29 million of cash paid to complete the novation that transferred our obligations under a reinsurance contract for life and annuity benefits to a third party. Invested assets at the holding company were $1.3 billion at September 30, 2015 compared to $1.5 billion at December 31, 2014.

With that, I will turn it over to Mike to talk about the U.S. Insurance segment.

Francis Michael Crowley
Vice Chairman

Thanks, Anne. Good morning. As we've mentioned earlier, the U.S. Insurance segment comprises all direct business written on our U.S. insurance companies and includes all of the underwriting results for wholesale and specialty divisions as well as certain products written by our Global Insurance team.

Gross written premiums for the U.S. segment were $1.9 billion for the first 9 months of 2015, an increase of 1% over prior year. This increase is due to continued growth in our wholesale division casualty lines as well as our Hagerty classic car program and our workers' comp product lines, both within our specialty division. Partly offsetting this favorability are declines in our wholesale property, excess and [ph] umbrella and environmental lines. As mentioned in previous calls, we have also exited certain lines of business.

We maintained our underwriting discipline throughout the year. The U.S. Insurance segment combined ratio for the third quarter of 2015 was 90% compared to 95% for the same period a year ago. The combined ratio for the year was 89% compared to 97% for the 9 months ended September 30, 2014. The decrease in the combined ratio for the year is driven by more favorable development of prior year -- prior accident year's loss reserves as well as lower current accident year loss ratio and a lower expense ratio. Prior year losses were favorable by 2 points driven by favorable development in our Global Insurance division in 2015, primarily our inland marine product line compared to adverse development in 2014. The current accident year loss ratio benefited from lower attritional losses across each of our divisions. And finally, the decrease in our expense ratio was primarily due to higher earned premiums in our specialty division driven by the premium growth I mentioned earlier as well as lower general expenses.

The rate environment in North America remains challenging as has been the case throughout 2015. We're still achieving modest single-digit rate increases on our smaller accounts in the specialty and excess and surplus lines divisions. The large account excess property and casualty business in our global division is still under significant rate pressure. We are experiencing more opportunities in the global, professional and marine lines.

In September, a number of our Markel professionals attended the NAPSLO conference in San Diego, and we conducted over 300 individual meetings during the conference and the atmosphere was one of cautious optimism. In early October, professionals from our specialty and global divisions attended the CIAB, Council of Insurance Agents & Brokers, conference in Colorado Springs. The information garnered from numerous meetings with our agents and brokers in attendance supported our belief that there remains strong opportunity for profitable growth in our specialty E&S and certain global lines of business despite current market conditions.

During the quarter, our product line leadership made progress on several new products that will be available in 2016, and our product line leadership is also working on new filings and enhancements to aid existing products. We continue to focus on expense management and operational efficiency with the same commitment that we give to underwriting profitability. Our talent pool is as strong or stronger than it's ever been, and we're continuing to recruit bench strength wherever possible. We remain confident in our ability to continue to produce solid results through superior talent, underwriting discipline and expense management.

Richie?

Richard R. Whitt
Co-Chief Executive Officer and Director

Thanks, Mike, and good early morning to everybody. I'm just going to say, if we keep this early start time, I'm going to try to do next quarter's call from our London offices.

Today, I'm going to focus my comments on our underwriting results for the first 9 months of 2015 for both the International Insurance and Reinsurance segments. Both segments continue to produce outstanding underwriting results through the third quarter of this year.

First, I'll start with International Insurance segments, which includes business written by our Markel International division as well as certain products written by our Global Insurance division. For the year, gross written premiums declined just over 1% to $912 million. The year-to-date combined ratio was 87% compared to 95% in the prior year.

The decrease in premium writings is primarily due to the continued impact of the strong U.S. dollar. Excluding currency impacts, gross written premium volume actually increased 4% for the year due to continued growth in our professional liability product lines in both divisions as well as growth across multiple product lines in the Markel International division.

The lower segment combined ratio was driven by more favorable prior year takedowns partially offset by a higher expense ratio. Prior year losses were favorably -- favorable by 12 points driven by higher redundancies in the Markel International division across multiple product lines. We also experienced stable development in our Global Insurance division, which had slight adverse development through 9 months in 2014. The expense ratio has increased nearly 4 points due to higher profit-sharing cost, higher general expenses and lower earned premium this year.

Next, I'll discuss the results of the Reinsurance segment, which includes treaty reinsurance programs written by our Global Reinsurance division as well as that written by our Markel International division. Gross written premiums for this segment decreased 12% for the year to $876 million, down from $1 billion a year ago. The segment is also seeing the effect of the strong U.S. dollar and excluding currency impacts, the decline for the year was 9%.

As we've disclosed and talked about a number of times, at the end of last year, we made the decision to cease writing U.K. motor reinsurance business and to take smaller line sizes in our nonstandard auto U.S. book. This is now -- you're now seeing this show up in the year-over-year comparisons of gross written premium volume.

The combined ratio for the Reinsurance segment was 92% compared to 97% last year. The reduction in the combined ratio was driven by a 7-point decrease in our loss ratio partially offset by a higher expense ratio. The decline in loss ratio is comprised of the lower current accident year loss ratio due to lower property losses in 2015 as well as more favorable development on prior year's loss reserves across both divisions. The increase in the expense ratio is due to higher commissions and lower earned premiums this year.

Just a few operational comments. When it comes to discussing competition, I'm starting to feel a little like a broken record each quarter on the earnings call. As Mike and Anne discussed, market conditions remain extremely competitive and that's very little change from what we reported to you in the first and second quarter of this year.

Speculation has now started in earnest on what's going to happen with rates on the January 1 renewals. Our expectation is that without some sort of catalyst, pressures on rates are going to continue. As a result, underwriting discipline is going to become even more important as we enter 2016.

I would also like to mention that we continue to make good progress towards closing our previously announced CATCo transaction, and we expect to close in the next several weeks. To refresh everyone's memory, CATCo is an insurance-linked securities asset manager and currently manages $2.7 billion of retrocessional and traditional reinsurance portfolios for clients around the world. CATCo's business generates management and performance fee income on its assets under management. We expect a smooth and efficient transition of the CATCo business into Markel, and we've already started planning how our reinsurance operations and CATCo will collaborate going forward to bring our entire suite of traditional reinsurance and ILS products to our cedent clients.

With that, I'd like to turn it over to Tom to discuss investments and ventures.

Thomas Sinnickson Gayner
Co-Chief Executive Officer and Director

Thank you, Richie. The good news at Markel is that we enjoy a set of what I would call structural advantages as we continue to build the long-term value of this company. And they are as follows: First, we operate a successful insurance business with a long-term record of underwriting profitability. Second, we operate a high-quality and low-cost investment operation that amplifies the returns generated from the Insurance business. And third, we have a diverse set of majority-owned industrial and service businesses in the form of Markel Ventures that increasingly contributes to our overall results. Prospectively, we can and we will allocate capital among those opportunities in search of the best long-term results.

It's always the most fun when we can discuss each of those components when all of the cylinders are firing. The reality, though, is that's not always the case, and that is the circumstances so far in 2015. The good news is that even without all cylinders firing, we made modest but forward economic progress.

The cylinder that didn't fire in the first 9 months is our investment operation. Our overall investment returns for the first 9 months were a negative 0.3% in local currency terms and a negative 1.2% after the foreign exchange effects. Equities were down 5.3%, and fixed income earned a positive return of 1.3%.

If I had only one word to describe all of our investment operations, it would be quality. In fixed income, that's relatively easy to quantify and describe. 97% of our holdings are rated A or better. We also do our own credit work in addition to that of the rating agencies, and I'm happy to report to you that our quality is as high as we know how to make it.

In our equity operations, we maintain a similar discipline and focus on quality. Equities are not rated in the same way as bonds and as such, I don't have a statistic to cite which would correlate to quality. I can assure you, though, that we underwrite each and every equity security we purchase with thoughtfulness and a desire to own durable, long-lasting, profitable businesses. In a world with increasing regulatory change, that job is getting harder rather than easier, but we remain dedicated to our long-standing commitment to this effort and I'm optimistic that our discipline will continue to serve us well.

Tactically, after several years where we let the duration of the fixed income portfolio decrease due to our concern about the possibility of higher overall levels of interest rates, we now are at the point where we expect to keep our duration from coming in any more. Including cash and short-term holdings, the overall duration at the end of the third quarter stood at slightly less than 4 years. A normal number for us would be between 4 and 5 depending on the nature of our insurance reserves. So as you can see, we are, as we have been, a bit short of that duration target. We will work to try to keep the duration between the 4- and 5-year bandwidth as we reinvest maturities and cash flows.

On the equity side, our allocation as a percentage of Markel's total shareholder's equity, equity securities, stands at 54% on September 30 compared to 55% at year-end 2014. Historically, this number has ranged between roughly 50% and 80% over the last 25 years. That allocation is a residual of our views on finding specific investment opportunities which meet our 4-part thought process as well as our overall view of our insurance operation opportunities and the overall investment markets.

As you can see, we've got some dry powder in our balance sheet. I think the option value of having quickly available capital to deploy as opportunities present themselves is a big advantage for Markel going forward. I would also add that we incur very little in the way of opportunity cost in doing so given the low overall level of yields and investment returns all along the curve.

Additionally, I think it's worth pointing out that at cost, our equity portfolio has a dividend yield of over 3%. In short, we're getting the yields we would get on fixed income and the upside of owning equity securities in the current environment. While that number is based on historical costs, it isn't too hard to pencil out similar dynamics for the equities we're buying today. Oftentimes, current dividend yields roughly equal what we could get on high-quality fixed income securities. One or two dividend increases starts to open up a gap in our favor over time.

At Markel Ventures, we're enjoying a very solid year overall. Revenues advanced $784 million from $594 million a year ago. As we spoke about in the second quarter, we have the very high-class problem that one of our recent acquisitions is doing better than we projected at the time of purchase. As such, the earn-out payments associated with that deal are higher than we first forecast. We are accounting for that payment as an expense item in 2015 rather than capitalizing those costs. This item will be fully accounted for this year. We are reporting EBITDA for Markel Ventures as $76 million versus $66 million a year ago. If you adjust for this one item, the run rate for EBITDA would be in excess of $100 million for the first 9 months of the year.

Within Markel Ventures, some of our businesses tend to correlate quite highly with the overall level of the U.S. economy. We've had a very good year in those businesses. We understand the basic cyclicality inherent in those operations, and we fully expect their results will fluctuate over time. That said, we are very happy with the returns on capital being generated by these companies over reasonable time periods, and we'd be delighted to own more of these kinds of businesses.

While we would like to own more Markel Ventures-type businesses, it seems that the rest of the world would like to do so as well. As such, we've regularly encountered pricing that goes beyond what we think we should pay and we've remained disciplined and on the sidelines so far in 2015. We continue to actively engage in many discussions, and I'm confident that we'll productively deploy capital on certain special circumstances as well as in a more favorable overall pricing environment in the future.

Meanwhile, we continue to learn from and support our successful managers of these operations. We also continue to look for ongoing opportunities to improve across each and every company within Markel Ventures. We'll never stop doing so.

As I said at the beginning of my comments, we enjoy a unique set of structural advantages at Markel. In a rapidly changing world, our first and foremost advantage remains our unchanging, deeply-rooted culture as described by the words of the Markel Style, first penned in 1986. Your management team and all the people of this organization looks forward to meeting the challenges of building on our worldwide set of insurance, investment and industrial and service opportunities. And now we will welcome the chance to answer any questions.
With that, Denise?

Question and Answer

Operator

[Operator Instructions] Your first question this morning will come from Jeff Schmitt of William Blair.

Jeffrey Schmitt

With the CATCo acquisition closing, I guess, at the end of the year here, is there still an appetite for M&A in '16? Or what are your thoughts on that?

Richard R. Whitt
Co-Chief Executive Officer and Director

I'll take that one and you guys kick in any time. Jeff, we've been acquisitive over the years, and Tom was talking about the current environment right now. There's certainly companies out there that we think would be nice strategic fits with Markel. But the problem seems to be right now, a lot of other people seem to think those companies would be great strategic fits as well. So the things we look for when we -- when we're doing acquisitions, the culture has to be a fit. That's number one, needs to be a good strategic fit, a good reason for it. And then obviously, it's got to be at a fair price, and that's probably the one we're having the most trouble with right now.

Thomas Sinnickson Gayner
Co-Chief Executive Officer and Director

Yes, I'll add -- I completely concur with Richie's comments, and we're hunting all the time. And sometimes, frankly, we get surprised by the opportunity we come across just as much as you are. So we know about it a little bit before you do, but we'll keep hunting them and we'll keep you posted.

Jeffrey Schmitt

Okay. And then on the pricing front, with pricing remaining pretty difficult here, are you seeing any of the standard writers move in, in some of the E&S lines more than usual? Or...

Francis Michael Crowley
Vice Chairman

Yes, Jeff, this is Mike. I've been in this business for -- this is now my fifth decade. And whenever you have the pricing situation we have today, you're going to have the standard carriers moving into the E&S space. I think the advantage that we have is that we have not one insurance division, not just an insurance division, but we have our U.S. specialty business, we have our global business and we have the international business. So market conditions are competitive. But as I mentioned in my comments, on the smaller U.S.-based business, we're still getting modest rate increases. But certainly, in this type of environment, we are going to see the standard carriers move in, but they'll also move out as they have in the past.

Thomas Sinnickson Gayner
Co-Chief Executive Officer and Director

One editorial comment to that. Obviously, the investment side was the toughest part of the house for us, but we breathe the same air as everybody else. The investment operation -- environment that we're operating in is the same that every insurance company is. So while everything is competitive, I don't think anybody's under the delusion that they can operate on a sloppy fashion on the underwriting side and make it up on investments. So the nature and tone of competition and where that bar is set in terms of underwriting profitability is lower this time around than what it would've been in previous cycles. So that's somewhat good news. It's hard to get the volumes, and we have to compete for every piece of business that we have. But I think everybody is competing in a more disciplined fashion than they were in previous cycles, and that's a function of both the lower level of investment returns and better underwriting data and technology that gives people better insight into what the cost of what they're writing are.

Operator

The next question will come from Mark Dwelle of RBC Capital Markets.

Mark Alan Dwelle
RBC Capital Markets, LLC, Research Division

Just a few questions. Let me start with CATCo. Richie, maybe if -- it seems like that's a little bit less typical of a normal Markel acquisition. Maybe you could just talk a little bit about how that fits in, what some of the ambitions you might have for it. And then I guess the other question I have related to CATCo, is that going to be folded into the international unit? Or is it going to be picked up as one of the other segments?

Richard R. Whitt
Co-Chief Executive Officer and Director

Sure. Well, first, I'll take the easy one first. Markel CATCo, as it will be called when going forward, we're going to set that -- since it is a little bit different as you recognized, Mark, it's going to sit alongside our Reinsurance division. And we expect Tony Belisle, who is going to be running CATCo for us, and Jed Rhoads, who runs our Reinsurance division, those 2 teams are going to be working very closely together because we think there's a lot of synergies, a lot of opportunities to collaborate across those 2 platforms. So they'll sit beside each other in that array of product set we hope to make available to our cedent clients. You did mention, it's a little bit different than what we've done before, and the reality is the insurance market's a little bit different than what it was 5 or 10 years ago. Insurance-linked security business, alternative capital as people called it initially, it's just simply capital now, has been coming into our market over the last 5, 10 years. And that trend is going to continue, quite honestly, and it's going to continue to become more and more meaningful. We got a small taste of that with our purchase of Alterra with their New Point facility that they have had for quite a long time before the acquisition. And Jed Rhoads and myself, we talked about the fact we felt like we needed to be more meaningful in that ILS space going forward, and CATCo provided us that opportunity. And like I said, we really view that as kind of extending our product set across the reinsurance space, both traditional and ILS. And then going forward, we hope to develop new products, and that could potentially mean moving into the different areas of insurance as opposed to just reinsurance.

Thomas Sinnickson Gayner
Co-Chief Executive Officer and Director

And Mark, I'll add one editorial comment here, too. And while you correctly categorized this as being different than what we've been doing to date, frankly, that's typical of almost every deal we've ever done. Part of the reason to do the acquisitions we've done over our 30-year history as a public company is to learn, to expand, to recognize that the world keeps changing. And we pick up people and skills and talents and opportunities that we didn't have internally, and I think that is an absolutely typical and recurring feature of Markel's and will continue to be.

Mark Alan Dwelle
RBC Capital Markets, LLC, Research Division

Just to follow up on some of that. To characterize CATCo, is the skill set here, is this an underwriting skill set? Or is this more of a brokerage and asset management or placement type of skill set? I guess I'm trying to be clear on which bit of the house you're bringing to bear in making this ultimately successful.

Richard R. Whitt
Co-Chief Executive Officer and Director

Well, there's really 2 skill sets. The one that in my mind is the preeminent skill set is the underwriting, and that's where we spend a tremendous amount of time was understanding and getting comfortable with the underwriting that CATCo does and we believe they do a fantastic job of underwriting the business. So it's a skill set we're very familiar with. We are underwriters at heart at Markel. The ILS combines 2 skill sets. It brings that underwriting skill set to the table along with raising funds. It's a fund manager. So the other skill set and one that Tony and his team possesses is the ability to go out and explain the story that CATCo has and the skill set that they have to investors such that they are willing to invest in the funds. So it is a bit of a hybrid and it's a model, quite honestly, that we're going to see more and more in our industry.

Mark Alan Dwelle
RBC Capital Markets, LLC, Research Division

Okay. That's helpful on that. Let me ask a second question, changing gears to the tax rate. You've documented throughout the year kind of the pluses and minuses on that. I guess, this quarter, this was primarily a true-up to get to now that you can have some better visibility of full year results to kind of true your full year provision into that 21-odd percent full year rate?

Anne G. Waleski
Chief Financial Officer and Executive Vice President

That's right.

Mark Alan Dwelle
RBC Capital Markets, LLC, Research Division

Is that...

Anne G. Waleski
Chief Financial Officer and Executive Vice President

It's just a mechanic to get there.

Mark Alan Dwelle
RBC Capital Markets, LLC, Research Division

Right. So all else equal, would it make sense that the fourth quarter number would be somewhere in that same ballpark?

Anne G. Waleski
Chief Financial Officer and Executive Vice President

Should be. I think...

Mark Alan Dwelle
RBC Capital Markets, LLC, Research Division

But then some -- go ahead.

Anne G. Waleski
Chief Financial Officer and Executive Vice President

Sorry. Go ahead, Mark.

Mark Alan Dwelle
RBC Capital Markets, LLC, Research Division

Well, I was just going to say then, and then but still no view yet on next year as to whether there's any likelihood that this credit will carry forward into '16 outlook?

Anne G. Waleski
Chief Financial Officer and Executive Vice President

So I don't believe today that the credit will carry forward, but it's hard to know for sure. We would likely think next year would be more typical in the mid- to high-20s from a tax rate. The real story on the tax rate this year is higher pretax income than we projected, which is a good news story that results in tax rate sort of bouncing around.

Mark Alan Dwelle
RBC Capital Markets, LLC, Research Division

Okay. And then a third question I had related to the new asbestos and environmental retro that you did. To the extent that ultimately produces any gains or losses, I think you mentioned there was a $10 million-odd gain -- or loss, rather, on the initial transaction before any revisitation of reserve setting. Is that going to show up in the other segment? Or is that going to be in one of the North American segments?

Anne G. Waleski
Chief Financial Officer and Executive Vice President

It should show up in the other segment.

Operator

[Operator Instructions] Your next question will come from James Davis of Silver Point Capital.

James Davis

The 15% compound book value growth track record is what caused us to take a look at the company. And as we've been doing our diligence, we've noticed some changes in the company that suggest the book value growth is likely to be meaningfully lower in the future. But we wanted to get your thoughts to make sure we're thinking about this the right way. The 2 big changes that seem to have taken place at the company are, first, investment leverage has declined meaningfully. 10 to 20 years ago, investments were about 4x your book value, but today, this is only about half that, 2.1x your book value. And second, investment yields have declined meaningfully. 10 to 20 years, portfolio yields were in the 5% range versus 2.2% today. So our math suggests these 2 factors combine to create a pretax ROE drag of about 15% relative to previous periods, making it tough to get to double-digit ROE without a significant rally in the equity market. And we seem to be seeing this play out this year as a relatively minor hiccup in the equity markets has resulted in a flat book value growth for the year. Are we missing something? Or have these changes made historical returns very tough to meet going forward?

Thomas Sinnickson Gayner
Co-Chief Executive Officer and Director

Yes, this is Tom. I'll try to take those. Compared to 10 or 20 years ago, I think you're correct. I mean, the amount of premium leverage we can get relative to our equity capital here is lower. Now, specifically what we can do in the face of that is that we can increase the allocation to higher total return securities because the reason we would have a fixed income portfolio is predominantly to overcollateralize the insurance liabilities and the claim spends that we expect to make. So if we have less leverage and we're writing less business, what that means is we can allocate a higher percentages of portfolio to equities where we would expect to pick up higher return. The second what you mentioned is lower overall investment yields. I would agree with that. I would also suggest that the higher yields occurred during a period of higher inflation. So nominal yields are lower, but real yields have not decreased as much. So nominally, it's a lower return environment; that's correct. But in the real sense, if we make high single digit, low double-digit returns in a 0 interest rate world, both the nominal yields and the inflation circumstance that we face, that will be a spectacular economic outcome, and we're optimistic about our ability to do so.

James Davis

Okay. Got it. That makes sense. And then with the equities, as you mentioned previously on the call, you're currently at kind of 54% of book value versus the historical range of 50% to 80%. So in terms of the opportunity to increase to higher return assets, we're not sort of seeing that right now. Is there an intention to increase that allocation to try to make up for that difference is the first question. Then I guess on the second question, it makes perfect sense, lower inflation, lower nominal yields. I guess, are we right to think that, that just translates into lower nominal ROEs as well going forward relative to what we've seen in the past?

Thomas Sinnickson Gayner
Co-Chief Executive Officer and Director

Yes, I mean, that's the math of lower nominal ROEs. But in real terms, as I've said, we're going to try to do the best we can. In real terms, we've generated excellent returns for a long time and hope we have the formula in place to continue to do so. In terms of additional allocations to the equity portfolio, whisper some good ideas to me after the call and we'll put it to work, but as far as the acquisition question, we work all day every day looking for things. At the moment, we're driving down the road tapping the brakes a little bit just as a function of being picky about what we buy. But as we see things, and we hunt for them every day, we do have the capital to put money into the equity portfolio and we would love to do so when we see it.

James Davis

Makes perfect sense. And so did I hear correctly that in the current environment, the view is like kind of high single moving into the low double digit would be a great outcome?

Thomas Sinnickson Gayner
Co-Chief Executive Officer and Director

Yes, we don't make forward looking forecasts or any expectations of that sort. But when you pencil out the math that you did, I don't think you're doing that incorrectly.

James Davis

Got it. And then just final question. We've always admired the discipline at the company, and like you said, there's a lot of headwinds in the market right now. The investment leverage and rates which we talked about, like you pointed out, pricing's weakening, equity markets are a little more difficult, trading in elevated multiples on above-trend margins. The private acquisitions are certainly tougher given the prices out there today. And in terms of your core business, like you said, accretive acquisitions are tougher. It seems like there's an M&A premium kind of built into everything that's trading out there. Are -- is the right way to think about Markel right now that it's a tough environment, you reduced leverage, you're kind of retrenching and will have a period of lower returns. But as the market change, there will be the ability to pay more often -- to play more often and move to higher returns at some point in the future?

Francis Michael Crowley
Vice Chairman

Let me split that, and I think Richie alluded to this a bit in his discussion of CATCo. It's always tough. Markets are always competitive. So I don't think there's anything new about that than what has been the case during all of the time that the record you speak so kindly of, of looks great, it's always tough. But break capital into 2 forms; there's financial capital and there's intellectual capital. Financial capital is what a lot of people have a lot of. I mean, there's a lot of money flashing around everything, and that leads to the comments about insurance industry pricing acquisition pricing, things of that nature. But the intellectual capital, that's scarce, and that's where the returns really can be generated. So just as like Richie was talking about the creativity behind the folks at CATCo and what they're doing, a good portion of the returns they generate is because they thought of stuff. They were creative and they applied intellectual capital. That is similarly the case in the Markel Ventures operations. We're looking at businesses that have the markets they have and have the customers they have because they creatively have found a way to take care of their customers. And they tend to operate in markets that are not distorted by big gobs of financial capital. Similarly, you look at the historical set of businesses that Markel underwrites in our insurance world, we need expertise. We need creativity. We need people who know what they are doing in different and unique lines of business. And there's really nothing about that, that changes. And I think creativity and intellectual capital will always be able to earn a return.

[Audio Gap]

Richard R. Whitt
Co-Chief Executive Officer and Director

And the principles of those industries don't necessarily sell to the highest price. We were successful in some of those acquisitions because the principles were looking for a long-term place and a good fit for their employees and for themselves and for patient [ph] capital for long term to continue doing what they were doing rather than have be gobbled up and chopped up and stripped and flipped and whatever. So I think those opportunities still exist and will present

[Audio Gap]

James Davis

We compete against the same gobs of capital, so we understand exactly what you're going through. Appreciate answering the questions. I guess, our last thought is just when we look at the current valuation of the stock, it seems like the market is expecting the same future returns as what they've seen in the past in terms of the stock trading at 1.5x book value. And that's kind of the root of the questions. We think of that -- the franchise is very valuable, the opportunity is very valuable. We're just trying to figure out right now kind of what price makes sense?

Francis Michael Crowley
Vice Chairman

And we don't comment on valuation, but we thank you for your interest and your questions.

Operator

Your next question will come from David West of Davenport & Company.

David McKinley West
Davenport & Company LLC

Mike, question for you. I guess, my grasp on time is not real good, but you've been in the workers' comp business now at least 3 or 4 years. Could you talk or give a little more color about pricing trends in workers' comp? And also, are you making underwriting profits in that line of business now?

Francis Michael Crowley
Vice Chairman

The answer is yes. That's a tremendous success story. When we acquired FirstComp, I guess, it was 2010, they -- there was work to be done there and the environment was tough. Their geographical mix of business or the other mix of business was not what we thought was the right path for the future. And Matt Parker, who now heads our specialty division, and Chad Bertucci, who's now running FirstComp, and the entire team there have absolutely executed on a plan that has been perfect in terms of the restructuring of the business geographically, product line, pricing-wise. The pressure on the pricing there is not as significant as it is in other lines right now. And yes, they are making underwriting profits. They have their expense ratio well under control as well as anybody in our business, and we couldn't be more pleased with the plan that they executed over a span of 2 or 3 years and where they are today.

David McKinley West
Davenport & Company LLC

Okay. Great. I think in Anne's comments, when you talked about the impairments taken this quarter, it was, I think, mostly on the equity side of things.

Anne G. Waleski
Chief Financial Officer and Executive Vice President

That's right [ph].

David McKinley West
Davenport & Company LLC

Could you provide some color on that? Was that a mechanical process? Or did 1 or 2 securities particularly, you think, warrant the impairment charge?

Francis Michael Crowley
Vice Chairman

Yes, David, there's a mechanical process that triggers the reviews. That is consistent. We've been doing it that way for quite some time. Half of that came from energy securities

[Audio Gap]

and oil prices.

[Audio Gap]

To hearken back to the earlier comment I made about quality, Exxon is our largest position, and Schlumberger is our second largest in the energy world. Those are last men standing in that entire food chain that exists. And then point of fact, you already see it happening with Schlumberger. I mean, they have the balance sheet to be able to acquire things during very tough markets. So we make sure that we invest with people that we think make it to the other side and not only make it to the other side, but are better off by the time you get there. So we don't have what I would consider speculative energy positions. Exxon and Schlumberger would account for, I don't know, 80% or 90% of the total amount we have in energy, so I'll fight with those guys.

David McKinley West
Davenport & Company LLC

Very good. Lastly, on Cottrell incremental compensation. Does that agreement -- is that accrual just through the end of this year? Does it carry on into 2017 at all?

Thomas Sinnickson Gayner
Co-Chief Executive Officer and Director

No. It's done in 2015.

Operator

And at this time, we will conclude the question-and-answer session. I would like to turn the conference back over to Tom Gayner for his closing remarks.

Thomas Sinnickson Gayner
Co-Chief Executive Officer and Director

Thank you very much. We'll chat with you next quarter. Take care.

Operator
Ladies and gentlemen, the conference has now concluded. We thank you for attending today's presentation. You may now disconnect.