W. R. Berkley Corporation NYSE:WRB

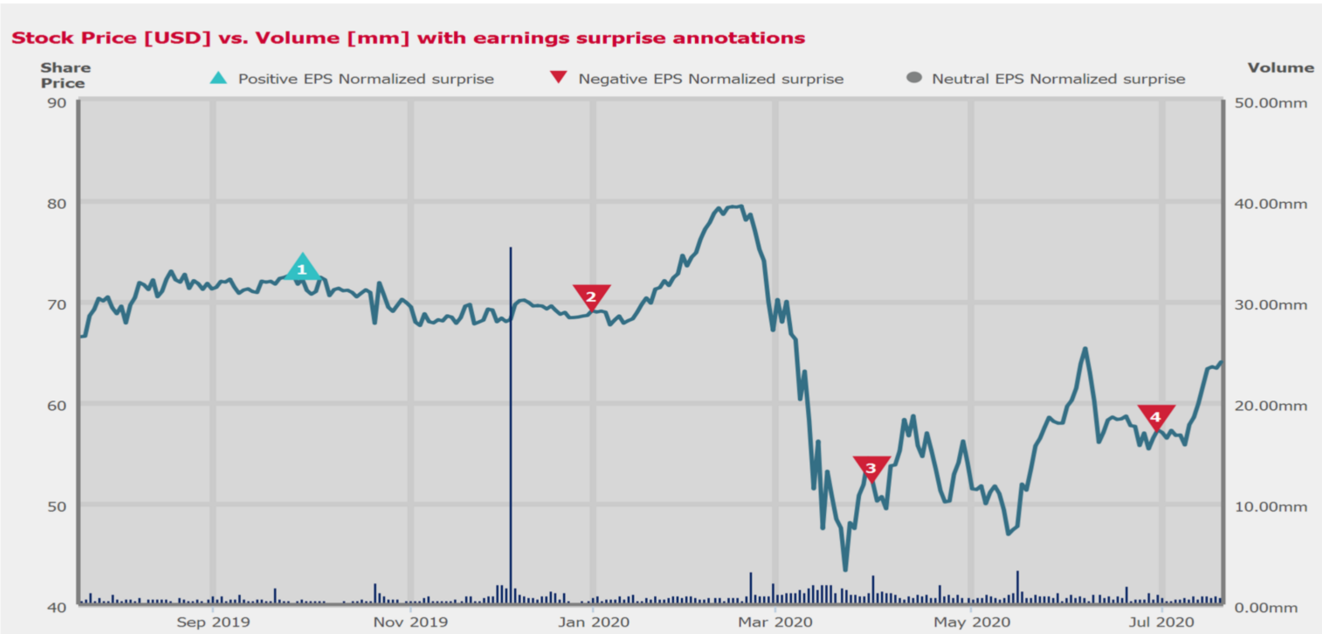
FQ2 2020 Earnings Call Transcripts

Tuesday, July 21, 2020 9:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ2 2020-			-FQ3 2020-	-FY 2020-	-FY 2021-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.09	0.06	(33.33 %)	0.71	2.32	3.04
Revenue (mm)	1750.28	1676.92	(4.19 %)	1735.90	6864.78	7331.00

Currency: USD
Consensus as of Jul-21-2020 12:31 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ3 2019	0.67	0.85	1 26.87 %
FQ4 2019	0.72	0.71	2 (1.39 %)
FQ1 2020	0.73	0.69	3 (5.48 %)
FQ2 2020	0.09	0.06	4 (33.33 %)

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Table of Contents

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Call Participants

EXECUTIVES

Richard Mark Baio
Executive VP, CFO & Treasurer

W. Robert Berkley, Jr.;President, CEO & Director

William R. Berkley
Executive Chairman of the Board

ANALYSTS

Brian Robert Meredith
UBS Investment Bank, Research Division

Joshua David Shanker
BofA Merrill Lynch, Research Division

Meyer Shields
Keefe, Bruyette, & Woods, Inc., Research Division

Michael David Zaremski
Crédit Suisse AG, Research Division

Philip Michael Stefano
Deutsche Bank AG, Research Division

Yaron Joseph Kinar
Goldman Sachs Group, Inc., Research Division

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Presentation

Operator

Good day, and welcome to W.R. Berkley Corporation's Second Quarter 2020 Earnings Conference Call. Today's conference call is being recorded.

The speakers' remarks may contain forward-looking statements. Some of the forward-looking statements can be identified by the use of forward-looking words, including, without limitation, believes, except and estimates. We caution you that such forward-looking statements should not be regarded as a representation by us that the future plans, estimates or expectations contemplated by us will in fact be achieved. Please refer to our annual report on Form 10-K for the year ended December 31, 2019, and our other filings made with the SEC for a description of the business environment in which we operate and the important factors that may materially affect our results. W.R. Berkley Corporation is not under any obligation and expressly disclaims any such obligation to update or alter its forward-looking statements whether as a result of new information, future events or otherwise.

I would now like to turn the call over to Mr. Rob Berkley. Please go ahead, sir.

W. Robert Berkley, Jr.;President, CEO & Director

Thank you, Chantel, and good afternoon, all. Thank you for joining us for our Q2 call. We have on the phone, in addition to myself: Bill Berkley, Executive Chairman; and Rich Baio, Executive Vice President and Chief Financial Officer. We're going to follow a similar format to what we've done in the past. Rich is going to lead us through a summary around the numbers and the performance in the quarter. I am then going to offer a couple of thoughts on the heels of his comments. And then we will be opening it up for questions.

So with that, Rich, if you want to get us started, please.

Richard Mark Baio
Executive VP, CFO & Treasurer

Starting with our premium production, gross premiums written grew 2% to more than $2.1 billion despite a shrinking economy arising from the global pandemic. The growth was driven by an overall rate improvement and a comparable historic premium renewal retention ratio that Rob will be discussing shortly. Offsetting this improvement is a decline in exposures from the economic downturn as well as the strengthening of the U.S. dollar against certain foreign currencies. Net premiums written of approximately $1.7 billion was relatively unchanged from the prior year's quarter. The insurance segment decreased 2% to approximately $1.5 billion primarily due to reduced exposure and rate decline in workers' compensation as well as higher reinsurance reinstatement premiums. The Reinsurance & Monoline Excess segment grew 16.5% to about $200 million in the quarter relating to improving markets. Pretax underwriting income of $23 million was adversely impacted in the quarter due to approximately $86 million of COVID-19-related losses. This compares with $100 million for the prior year underwriting income. In addition, we reported approximately $20 million of catastrophe losses for civil unrest and $40 million for severe weather-related losses. This brought our total catastrophe losses to approximately $146 million in the quarter or 8.7 loss ratio points. COVID-19-related losses represented 5.1 of these loss ratio points. The reported loss ratio was 67.7% in the current quarter, compared with 62.4% in 2019. Prior year loss reserves developed favorably by $3 million or 0.2 loss ratio points in the current quarter. Accordingly, our current accident year loss ratio, excluding catastrophes, was 59.2% compared with 61.4% a year ago. The improvement is driven by lower non-cat property losses and a change in business mix. The expense ratio was 31%, reflecting a decrease of 0.5% compared with a year ago and the 2019 full year. As we've seen over the recent quarters, the growth in net premiums earned has outpaced the growth in underwriting expenses, which has favorably impacted the expense ratio. In addition, due to the global pandemic, expenses are considerably lower in travel and entertainment, resulting in relatively flat underwriting expenses in dollar terms quarter-over-quarter. To this end, the impact from COVID-19 may cause some variability in our expense ratio attributable to normalized operating costs and investments we make in the business. The accident year combined ratio, excluding catastrophes and COVID-19 for 2020 was 90.2% compared with 92.9% for the prior year. Net investment income decreased to $85 million primarily due to investment funds. As we mentioned last quarter, the net investment income for investment funds did not reflect the turmoil in the financial markets due to the one quarter lag. Accordingly, we are recognizing the effects of the downturn in our second quarter results, which amounted to a loss of $58 million. This decrease was evident in the energy, financial services and transportation funds. We understand that

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for modeling purposes, you may want some direction regarding net investment income for investment funds in the third quarter. We've not received any estimates yet from the investment fund managers and accordingly, are unable to provide any guidance at this time.

In addition, a combination of the low interest rate environment and the defensive position we've taken to enhance our liquidity and shorten our duration to 2.4 years has resulted in lower net investment income in the current quarter for fixed maturity securities. You'll note that our cash and cash equivalent position has increased to almost $2.7 billion as of second quarter-end or 13% of net invested assets. We believe this is prudent given the uncertainty in the financial markets and the economy. The fixed maturity investment portfolio, including cash and cash equivalents, maintained a high credit quality of AA- and reported a significant recovery in after-tax unrealized gains in the quarter. From the first quarter of 2020, the total after tax unrealized gain in stockholders' equity improved from an after-tax unrealized loss of $110 million to an after-tax unrealized gain of $209 million. Pretax net investment gains in the quarter of $78 million primarily attributable to the change in unrealized gains on equity securities of $62 million and a reduction in the allowance for expected credit losses on investments of $16 million. The change in fair value on equity securities is largely driven by Fannie and Freddie preferred stock. The favorable change in the allowance for expected credit losses is driven by the improved prices on foreign government bonds.

Our net income in the quarter is $71 million or $0.38 per share. Stockholders' equity was approximately $5.8 billion at the end of the quarter, an increase of more than $300 million after share repurchases and dividends of $117 million. The company repurchased approximately 2 million shares for $96 million at an average price per share of $49.29. As a result, book value per share increased 7.7% before share repurchases and dividends. The company had strong cash flow from operations in the quarter of $427 million, which benefited under the Care Act from the deferral of tax payments until July 15. The liquidity is strong at the holding company with more than $1.5 billion in cash and liquid investments.

At this point, I'll turn it back to Rob.

W. Robert Berkley, Jr.;President, CEO & Director

Thanks, Rich. That was great. So a couple of quick comments from me. Clearly, a challenging moment for all of us on many different levels. Everyone is appropriately very focused on COVID-19. Having said that, I think we're all struggling with the reality that there are more questions than there are answers. Hopefully, that will not be the case in the future. Hopefully, the behavior of many people will change, and that will help us bring the situation more under control. And hopefully, a pharmaceutical solution is not too far in the distance.

Having said that, while, again, COVID-19 is the topic du jour, I think it's important that we not lose sight of some of the other realities or factors that are impacting the industry and by extension our business. If one thinks back to last year, there was a growing groundswell of a firming market. You could probably see it before 2019, but during '19, it very much came into focus. We saw it accelerate throughout the year, and we saw it continue to accelerate into 2020, very evident in Q1. The evidence of this was demonstrated at least in part by business leaving the standard market, make its way to the specialty market and, in particular, the E&S market. We saw rate increases that we, as an industry, have not seen in some number of years, and we could see a reduction in capacity that various carriers were offering. All of these things were being driven, in our opinion, by 2 major factors: one, being a low interest rate environment and the knock-on effect for what that means for investment income; and number two, loss cost trend in part driven to -- actually, to a great extent, driven by social inflation, which have been benign for an extended period of time. And then, in our opinion, crept up on the industry when it was least suspecting it, and it has proven to be much more of an issue. These drivers that I just referenced remain alive and well. And quite frankly, I would suggest, if you thought during 2019, interest rates were low, then you must think that they are really low today. And if in 2019, you were worrying about loss cost trend and inflation -- social inflation, then you probably should be worrying more about it today than you were then. One needs to be careful that the current circumstance stemming from COVID-19 does not overshadow the underlying issues that are driving loss cost trend because we expect that this will just be a brief hiatus.

Today, we continue to see business exiting the standard line, making its way to the E&S market and the specialty market overall. We continue to see a reduction in capacity being offered. And we're certainly seeing the leverage moving back towards those that are selling the product and in part, we are seeing that demonstrated by the rate increases that are coming through. And as we referenced in our release, we got 13 points of rate in the quarter. It's worth noting that the rate increases came through without our renewal retention ratio coming unfastened. Our renewal retention ratio continues to be consistent with what it's been for not just many quarters, but many years sort of hovering between, I would say, approximately 80%.

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In addition to that, another data point that we've shared with you all in the past is our new business relativity metric, where we measure the rate that we are getting on new business compared to our renewal business. For the quarter, it came in at 1.084%. What does that mean? That means we are getting 8.4% more rate on new business than our renewal business, and that is something that we look for and expect because you know more about your renewal book than new business. These factors have allowed us to maintain a top line. While we have not been able to grow at the same rate that we did in Q1 or that when we were doing our planning, we thought we would be growing in Q2. We were still able to maintain a top line. And in addition to that, I would add that when we do see an economy that begins to open up again and recover, which hopefully is in the foreseeable future, it is likely that, that will have a very meaningful positive effect on our top line when you combine growth in the overall economy with what we are able to achieve on the rate front, along with business making its way into the specialty market.

Let me give you a little more granularity on a couple of lines of business and how we see the pricing and the competitive nature. I think as it's widely understood, the property market rates continue to move up. The larger the account, generally speaking, the more the rates are moving up. Similar story on the GL front. I would tell you that the excess and umbrella market very much stands out. And quite frankly, both of these product lines need the rate that they are getting and probably more. Professional liability, it's a very broad spectrum. I would tell you, virtually all components of the professional space, we are seeing rates moving up. Public D&O, particularly on the large accounts, continues to stand out. And we have gotten to the point where we are getting rate on rate in a meaningful way. And I, again, would suggest that the industry needs every last penny. As it relates to workers' compensation, which has been marching to the beat of its own drum, most other commercial lines products, we have been seeing some level of rate for some number of quarters, comp has been moving in a different direction. We are seeing early signs that workers' compensation pricing may be in the early stages of bottoming out. And I would not be surprised as we make our way into 2021, if you started to see a change in trend and rates actually start to move up at some point next year. Lastly, the reinsurance market, clearly, has been waiting, give or take, I don't know, call it, 1.5 decades for perhaps the moment that is upon us. Things are firming. We'll have to see how much discipline really returns to that market. As we see that disciplined return, you will see us grow our reinsurance division more and more and certainly, it may have an impact on how much business we choose to seed to the marketplace.

Rich did a nice job, as always, covering the loss ratio, I just want to tack on a couple of quick observations around that. One, as it relates to COVID, the number, both that we put aside for COVID in Q1 and now in Q2, when you total that up, approximately 75% is sitting in IBNR or approximately 1/4 is either paid or cased with lion's share of it available for incurred, but not reported. I'd also make the comment around a topic that has been widely discussed, and that is what is the impact, at least in the short run, of COVID-19 on loss activity? I don't think anyone knows with certainty what it is going to be when the dust settles, but certain -- without a doubt, there are product lines that have found themselves in a situation where frequency is considerably down. Shouldn't be a surprise to any of us, given people sheltering in place and the slowdown in the economy. Having said that, it is our expectation that when the economy opens back up, you will see frequency return to a more normal level. I should also mention on this front as a result of what we're seeing with frequency, our actual versus expected continues to run more benign or the actual has proven to be less than the expected as far as loss activity in many lines. Most of those lines are longer tail in nature, few are shorter tail. Shorter tail, for example, auto physical damage or property, as Rich referenced in his comments. The line's share of our business is on design loss ratios. So even when we have a reduction in loss activity, specifically stemming from a reduction in frequency, that is not reflected in our reported numbers because we, again, book the business on a design loss ratio, which we hold for some period of time as those reserves season out.

Pivoting over to the expenses. Rich covered this well, I would just offer the observation as far as the expense ratio benefiting in the quarter, I would tell you that, give or take, probably 75% of the improvement comes from higher earned premium with the balance coming from, we just don't have people getting on trains, buses, planes or staying in hotels. And obviously, there are some savings associated with that. My opinion is that it's fair to assume that the company continues in a normalized number running somewhere between 31% and 32%. I'm not going to belabor the discussion around the investment portfolio, again, Rich covered that, but I would offer a couple of thoughts briefly. The investment portfolio is something that we view very clearly through a lens that we think about as risk-adjusted return. There is a huge amount of uncertainty in the world today. And from our perspective, we have reached the conclusion, I should say, that it is better to take a defensive posture. We have had a duration that has been shortening for some period of time. And we have, quite frankly, not seen much of a reason, given where rates are, to take that back out, so there is a limit. And as far as quality goes, we have gone from what I would define as a moderate AA- to a very strong AA-. I was chatting with a colleague earlier today, half of our portfolio can get reduced by a notch, and we will remain a AA-.

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I think this brings us to one last point that I'd like to make, and then I promise we'll get on to your questions. When we think about the business, including the investment portfolio, we think about it as owners. We don't think about it as people that collect the paycheck every 2 weeks. We think about it with a long-term view and a sense of obligation and commitment as if we, as a team, 6,500 of us, own this business. We think about risk-adjusted return. We think about the uncertainties there are in the world, and we have made an active decision that this is a moment that we are willing to pay the price for taking a defensive posture and for having flexibility given the unknown.

So let me pause there and, Chantel, if we could please open it up for questions.

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Question and Answer

Operator

[Operator Instructions] Our first question comes from Phil Stefano with Deutsche Bank.

Philip Michael Stefano
Deutsche Bank AG, Research Division

Yes. And I guess, the attritional loss ratio, particularly on the insurance business side, felt like it had a nice improvement. In my mind, part of the rationale may have been the slower frequency that we've seen on the heels of the economic slowdown given COVID. And it feels like, Rob, in your prepared remarks, that wasn't the case. And it sounds like most of the...

W. Robert Berkley, Jr.;President, CEO & Director

Actually, the way I would characterize it that there certainly was some benefit as a result of the slowdown. But please, again, understand that much of the difference in actual versus expected or things -- or the reduction in frequency does not come through in our reported numbers. So you will see the impact on the auto physical damage front of fewer cars, trucks, et cetera, on the road, but you're not going to see that on the auto liability. You will see that, again, on the property, but you're not going to see that on the comp or the GL, et cetera. So in Rich's comments, he referenced that one of the contributing factors was non-cat property. And it was, quite frankly, in my opinion, there are a couple of different reasons within the non-cat property that we had this result. One of them has to do with some re-underwriting that we've been doing over some period of time, and that has come through. But I would tell you that -- go ahead.

Philip Michael Stefano
Deutsche Bank AG, Research Division

Is there any way you can help us kind of conceptualize the frequency benefit versus price versus trend? And I think the third metric that you had mentioned was a mix of business.

W. Robert Berkley, Jr.;President, CEO & Director

So I would tell you that there are a couple of things at work here. First of all, I think we all have a sense that frequency for many product lines is down considerably given the environment. Number two, I think the other piece that should not go unnoticed is that the rate increases that we have been getting for some period of time now that are no longer just on a written basis but are hitting our earned, are meaningful. And I think if you look at our mix of business, which we disclose in lots of public information and you can get a bit of a glimpse into that in the release, I forget which page it is, but where we show the mix of business, you can see the different product lines and how much of our portfolio would fall under shorter tail products, where that would be coming through in our P&L now versus longer tail that would be on a design loss ratio where you would not see an impact of any consequence on a reported basis.

Philip Michael Stefano
Deutsche Bank AG, Research Division

Got it. Okay. And just one more for me. It felt like if we think back a couple of years ago, interest rates were heading lower. There was reinvestment pressures for the portfolios. But it didn't have an impact to pricing. Does it feel like reinvestment rates -- has something changed? Has rates just dropped below a point where they are now a lever to pricing, I guess?

W. Robert Berkley, Jr.;President, CEO & Director

Well, I think clearly, rates are notably lower now than they were after the financial crisis or the Great Recession or whatever you'd like to label it. They're extraordinarily low. In addition to that, we clearly have a federal reserve and counterparts around the world that seem very determined to manage interest rates for at least the moment, at least as long as they can. And finally, you got to remember that an insurance company, ultimately, it takes time for that book yield to come down as the new money gets invested at lower rates. So from my perspective, I think we're hitting new lows as far as interest rates. And I think ultimately, it will take a little bit of time, but we're starting to see the early stages of it actually having an impact where it's going to hit investment income. But that takes time because it's the new money.

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Operator

Your next question comes from Mike Zaremski with Crédit Suisse.

Michael David Zaremski
Crédit Suisse AG, Research Division

First question. Regarding the COVID-related losses, and I appreciate the stat on 75% IBNR, just curious if there's any more color you can offer on the newly available information or legal developments that arose, so we can kind of better understand whether there's potential for that to persist in a meaningful way in the back half of the year?

W. Robert Berkley, Jr.;President, CEO & Director

So the work that we have done, and obviously, we're in a much better position to try and get our arms around it now than we were when we were talking to you, give or take, 90 days ago. But given the work we have done, by and large, we are assuming that this is going to be more under control by, call it, the end of this year, early next year. And the -- as far as the activity, again, there hasn't been a huge amount. There's not a lot paid, let -- or for that matter, in case reserves, the line's share of it is just sitting there in IBNR. And it's just our best estimates as to what we think the impact could be. From our perspective so far, workers' compensation has not proven to be a big issue and neither has casualty. The challenge has more been in the shorter tail lines. And probably some -- I don't have the numbers in front of me, but I would say the biggest component of that is event cancellation.

Michael David Zaremski
Crédit Suisse AG, Research Division

Okay. Understood. That's helpful. Moving to the top line growth conversation, it feels like what you're trying to say is that clearly, your fortunes will be tied to the economy. Hopefully, the economy improves. Although there seems to be some other variables, the comps declined by 20% year-over-year. So anything else we should be thinking about in terms of 2Q being the nadir versus ongoing choppiness?

W. Robert Berkley, Jr.;President, CEO & Director

Yes. So the way we think about it is that the opportunity to make sure that we have rate adequacy continues to be there, and you can see that in the rate that we are getting. We are an underwriting shop and rate adequacies, the be-all-and-end-all, when we see it in certain product lines where the rate is not what we think it needs to be, i.e., in certain parts of the workers' comp market, we're prepared to let the business go with the understanding it'll be back someday when we find the rates to be more acceptable. The broad point that I was trying to suggest earlier in the call was, we are able to maintain our top line because we're seeing the flow of business coming in to the specialty E&S market. We're able to maintain our top line because we are getting meaningful rate increases and in spite of the challenges that everyone faces, including us, none of us are completely insulated from what's going on in the economy and society in general, those factors are helping to offset those challenges. And in addition to that, if you subscribe as we do, this will be, over time, brought under control. A lot of the fundamentals will remain in place, the economy will recover and it is likely to bode very well for how this business could grow, in addition to that, what it may mean for margins.

Michael David Zaremski
Crédit Suisse AG, Research Division

Okay. Understood. And I guess, finally, we saw that you continued to buy back some stock during the quarter. Any thoughts on the stocks, somewhat recovered? Any thoughts on whether you still view the stock as being attractive from a buyback perspective?

W. Robert Berkley, Jr.;President, CEO & Director

So I appreciate the question, but we're not going to answer that the way you want us to. But I'm happy to pause, my boss is on the phone, he's the one who's more focused on that than me. Are you there?

William R. Berkley
Executive Chairman of the Board

I'm here. And of course, we always think the stock is attractive. It's attractive today. However, we are always looking at uses of our capital, what we can do with it, how buying back stock impacts everything having to do with our shareholders.

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We don't have a single rule. We -- our average price in the first quarter was different than in the second quarter. It's the judgments we make and how we see the opportunities, so we don't really have a single rule. And if there's an opportunity that we think at that moment in time is to buy stock at an attractive price, we'll do so. But we don't really have a rule per se.

Operator

Our next question comes from Yaron Kinar with Goldman Sachs.

Yaron Joseph Kinar
Goldman Sachs Group, Inc., Research Division

My first question just goes to better understanding IBNR. What I did not realize in the first quarter was that there are some definitional differences there. And just want to make sure I understand how you're thinking about it. So when we talk about incurred but not reported, do you also include losses for events that have not yet occurred, but you think have a high probability of occurring?

W. Robert Berkley, Jr.;President, CEO & Director

We have looked at -- so I appreciate the question, and let me try and clarify it. We look at our portfolio, we look at our exposures, we think about how it will be affected by COVID. And that's how we came up with our number. So some of it is events or losses that have not even occurred, but the exposure is out there, and we think that there's a possibility that there could be a loss associated with the exposure.

Yaron Joseph Kinar
Goldman Sachs Group, Inc., Research Division

Okay. And is that mainly for short-tail lines? Or is that also for longer tail lines...

W. Robert Berkley, Jr.;President, CEO & Director

We have looked at the full portfolio.

Yaron Joseph Kinar
Goldman Sachs Group, Inc., Research Division

Okay. And then my second question, a bit more broad, conceptual, on social inflation. Can you maybe talk about how it's manifesting itself today, it doesn't seem like it's COVID-related, given that you're expecting more of the losses to come from short-tail lines. So where -- or how is it playing out in the current environment?

W. Robert Berkley, Jr.;President, CEO & Director

Well, I think in some ways, it is COVID-related, and I think you're going to see it potentially in the professional liability space. An example of that would be with EPLI would be certainly 1 specific example. I think there is a reality that we have an emboldened plaintiff bar. And we have an environment in society overall that is more empathetic for the moment to the plaintiff bar. And that is a reality, whether one likes it or not. And the insurance industry needs to recognize that and adapt appropriately.

Yaron Joseph Kinar
Goldman Sachs Group, Inc., Research Division

So is that also reflected in, for example, business interruption claims?

W. Robert Berkley, Jr.;President, CEO & Director

Well, I think that we have an aggressive plaintiff bar. And as I think we may have touched on in the last call, certainly, they have viewed business interruption as an opportunity. I think perhaps, it's a plaintiff-friendly environment overall. I don't think that judges are willing to just completely turn their back on the words in a contract or a policy, which is why you have seen many of the rulings, though it is still early, come out suggesting that physical damage is required in order to trigger business interruption. And in spite of the efforts so far to suggest the presence or possible presence of COVID-19 being physical damage. Most of the judges that I'm aware of have not subscribed to that view.

Operator

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Our next question comes from Meyer Shields with Keefe, Bruyette, & Woods.

Meyer Shields
Keefe, Bruyette, & Woods, Inc., Research Division

Rob, I want to go a little bit deeper into what you just talked about with the exposure for lines like EPLI to increase COVID-related losses. I appreciate the fact that there's no -- that you're not booking lower loss picks for lines of business where claim counts were down, frequency was down in the second quarter. Are there any increased provisions for lines where now the reality has changed? And maybe social inflation, et cetera, makes things worse?

W. Robert Berkley, Jr.;President, CEO & Director

We -- every 90 days, we look at our loss picks. And we look at the data, and we try and assess whether we feel as though we are in a good place. Our general philosophy is that we want to try and air a little bit on the side of caution, recognizing all the unknowns. And as those reserves season out, we will tighten up that pick. We don't always get it right, but we certainly try. And when we get it wrong, we're not shy about acknowledging it and trying to address it. So as far as the specifics of what we're doing with our picks by product line, that's generally speaking, just not something that we get into at that level of granularity.

Meyer Shields
Keefe, Bruyette, & Woods, Inc., Research Division

Okay. Fair enough. Maybe a different question. In the past, I think we've worked or I've worked under the premise that economic inflection points take 3 to 6 months to actually impact written premium volumes. Does that make sense? Does that make sense in the current environment? Can we expect maybe if -- we're seeing if recovery continues right now that exposure units have already bottomed?

W. Robert Berkley, Jr.;President, CEO & Director

I think one of the tricky parts is it really have things bottomed out as far as the recovery, if you talk to people in New York, they might say, yes, if you talk to people in Florida or Texas or Arizona or parts of California, I don't think that they would say yes. So ultimately, we -- in the New York area, we had our experience. Hopefully, we won't have another, but we should not lose sight of what the recent circumstances in other regions of the country are facing, and for that matter, parts of the world. So my opinion is that, it would seem as we saw things looking better in June than they did in May. And May was maybe less ugly than April. And certainly, early returns for July were encouraging, but we'll have to see. So I'm a little bit guarded to suggest that things are recovering. As far as the lead time, it can be a couple of months, yes.

Operator

[Operator Instructions] Our next question comes from Brian Meredith with UBS.

Brian Robert Meredith
UBS Investment Bank, Research Division

A couple of questions for you. Just one, could you talk a little bit about what's going on with terms and conditions right now and what the industry is doing? And related to that, specifically, is there anything you're doing to protect yourself from, call it, third-party liability claims, and you just mentioned EPLI stuff as we kind of look forward and people go back to work and economy, those kind of things?

W. Robert Berkley, Jr.;President, CEO & Director

Yes. So as far as what are we doing to protect ourselves? We are actively looking at our policy wordings. And we are looking to make sure that the policy wordings appropriately address things such as communicable disease and related types of exposures. There are some exposures where we're very focused on making sure that communicable disease is excluded. There are some situations where we use a much finer brush than that. But we've been -- actually been a bit surprised that the broader market has not been more active in trying to make sure that they are managing their exposure to communicable disease in general and in particular, COVID. I think people were so consumed by what was going on with business interruption, they haven't thought through what does it mean for the liability market, both casualty as well as professional. And I think that that's something that the industry needs to be more actively grappling with because there is real exposure there, to your point, as things open back up. As far as what do we see happening with wordings, certainly, we are seeing policy wordings tighten up, just the mere fact that business is making its way from the standard market to

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the specialty or the E&S market, I think is a leading indicator that policy wordings are tightening up and coverage that is being provided is contracting a bit. So that -- I hope I answered your question or questions.

Brian Robert Meredith
UBS Investment Bank, Research Division

Yes. That's very helpful. And then my second question, Rob, conceptually thinking about this. AA corporate bond yields, we see you're kind of looking at AA corporate bond yields as kind of your new money yield right now that you're looking at, it's the lowest it's been since I've been working, right? So as I look at where we are right now, is the pricing environment adequate enough to, I guess, one, earn a double-digit return on equity? Or even two, just earn your equity cost of capital at this point?

W. Robert Berkley, Jr.;President, CEO & Director

We think with the rate increases that we are getting...

Brian Robert Meredith
UBS Investment Bank, Research Division

That the market is getting, yes.

W. Robert Berkley, Jr.;President, CEO & Director

Yes. And again, I can't speak for others. I don't know their business, their portfolio, but for us, with the rate increases that we're getting today, we certainly think we are comfortably above our cost of capital. And I -- based on my math, we are comfortably in the double-digit space as far as return goes. But there is no doubt we need that rate. The comments that I made earlier about the impact of this low interest rate environment and what it means for investment income and what it means for the industry's economic model, that is real, and we are very focused on it.

Operator

Your next question comes from Josh Shanker with Bank of America.

Joshua David Shanker
BofA Merrill Lynch, Research Division

So just a couple of questions, more investment related than insurance related, I guess, I see that you're moving the money to cash and you're shortening the portfolio. Should we expect that the 2Q traditional investment portfolio result is a good indicator of where the future is going to be until you decide to redeploy that cash again?

W. Robert Berkley, Jr.;President, CEO & Director

Sorry, Josh, could you ask the second part of the question again? You broke up a little bit. I beg your pardon.

Joshua David Shanker
BofA Merrill Lynch, Research Division

I'm sorry. Should we assume that the 2Q result for traditional investment income is sort of a good guidepost to think about until you decide to redeploy the cash that you're stock holding right now?

W. Robert Berkley, Jr.;President, CEO & Director

Yes. Obviously, putting aside funds as far as the core portfolio.

Joshua David Shanker
BofA Merrill Lynch, Research Division

Yes. And can you just talk a little bit about the results in the arbitrage portfolio for the quarter?

W. Robert Berkley, Jr.;President, CEO & Director

They had a particularly strong quarter. Part of it was some of their traditional activities. Part of it has to do with some activities they participate in, surrounding specs.

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Joshua David Shanker
BofA Merrill Lynch, Research Division

And that as onetime in nature, the $58 million loss in LP, we shouldn't expect, there's a change in how you're deploying and that could continue into the future?

W. Robert Berkley, Jr.;President, CEO & Director

As much as I wish it was a new normal, I don't think you should assume that's the case.

Joshua David Shanker
BofA Merrill Lynch, Research Division

Okay. And can you -- just we don't get the number, can we know what the reinsurance recoverable was for the quarter?

W. Robert Berkley, Jr.;President, CEO & Director

I honestly, I don't have that in front of me, but either Rich or Karen will make that available. They'll both follow-up with you, if you don't mind.

Joshua David Shanker
BofA Merrill Lynch, Research Division

No problem. Fantastic. And good luck and be safe.

Operator

There are no further questions at this time. I will now turn the call back over to Mr. Rob Berkley for closing remarks.

W. Robert Berkley, Jr.;President, CEO & Director

Okay. Thank you, Chantel, and thank you all for dialing in. Obviously, challenging times and a fair amount of uncertainty. But hopefully, from our discussion today, you have a sense for how the business is well positioned. From our perspective, we are well positioned in order to weather the circumstances that we are navigating through. Even more so, we are well positioned to take advantage of a market when we come out the other side of the tunnel. So I think that is all for us. We will look forward to speaking with you in 90 days. Thank you again, Chantel. Have a good night.

Operator
This concludes today's conference call. You may now disconnect.

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