RLI Corp. NYSE:RLI

FQ2 2009 Earnings Call Transcripts

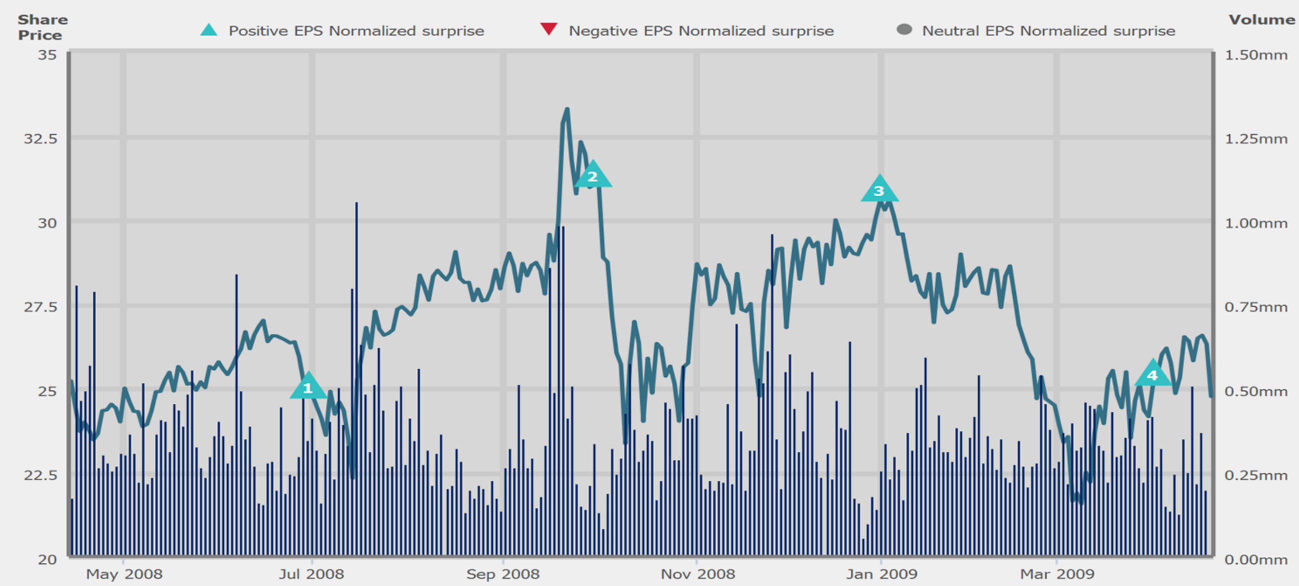
Tuesday, July 21, 2009 3:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ2 2009-			-FQ3 2009-	-FY 2009-	-FY 2010-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.52	0.66	▲26.92	0.44	1.93	1.98
Revenue	-	-	▲0.94	-	-	-
Revenue (mm)	143.39	144.74	-	141.54	548.79	574.65

Currency: USD
Consensus as of Jul-21-2009 2:42 PM GMT

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



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ2 2008	0.52	0.76	▲1 48.08 %
FQ3 2008	0.47	0.56	▲2 19.15 %
FQ4 2008	0.50	0.65	▲3 30.00 %
FQ1 2009	0.51	0.52	▲4 1.96 %

Table of Contents

Call Participants

EXECUTIVES

Joe Dondanville

John Robison

Jon Michael

Mike Stone

ANALYSTS

Bijan Moazami
FBR Capital Markets

DeForest Hinman
Walthausen & Co.

Doug Mewhirter
RBC Capital Markets

Meyer Shields
Stifel Nicolaus

Michael Nannizzi
Oppenheimer

Mike Grasher
Piper Jaffray

Ron Bobman
Capital Returns

Presentation

Jon Michael

[Starts abruptly] Joining me for today's call are Jon Michael, President and CEO of RLI Corp., Joe Dondanville, Senior Vice President and Chief Financial Officer, and Mike Stone, President And Chief Operating Officer of RLI Insurance Company.

We will conduct this call as we have in past quarters. I will give a brief review of the financial highlights and discuss the investment portfolio. Mike Stone will talk about the quarter's operations, then we will open the call to questions and Jon Michael will finish up with some closing comments.

Our second quarter operating earnings were $1.32 per share. Included in this quarter's earnings are $16.4 million in pretax favorable development and prior year's loss reserves. The favorable development came from our casualty book of business. The combined ratio for the second quarter was 79.5 resulting in underwriting income of roughly 25 million. Gross written premiums were down 3% versus the second quarter of 2008 and down 5% through the first six months of 2009. As we have demonstrated over time, we are an underwriting company focused on underwriting profits in hard and soft markets. We will grow when margins are acceptable and contract when we are not being compensated for the risks we are taking.

Turning to the investment portfolio, as of June 30, our overall allocation was 78% in fixed income, 12% in equities, and 10% in short-term investments. This allocation has not significantly changed from the first quarter. While the fixed income and equity markets rallied in the second quarter, we still believe the economy is fragile and have opted to slowly reinvest our cash positions. In my opinion, the first quarter exhibited an excess of pessimism while the second quarter exhibited an excess of optimism. We still have concerns over economic growth, significant deficit spending, unemployment, and the potential for inflation down the road, just to name a few. Again, we remain cautious, but have started to invest our cash balances.

We certainly benefited from the market really in the second quarter. Book value increased 7% from year-end to $35.32 per share. Many of our securities have improved significantly from the first quarter of 2009 as credit spreads tightened and equity securities posted one of the largest quarterly returns in recent history. We continue to monitor all of our holdings but believe our high-quality portfolio will continue to perform well in this challenging environment.

Within the fixed income arena, our exposure to commercial mortgage is less than 50 million, all are rated AAA and have made all contractual payments. Our exposure to credit cards and auto paper is less than 10 million and all are rated AAA. We do not own any California municipal securities and we do not own any securities rated below investment grade.

Our fixed income portfolio has an overall rating of AA with a duration of roughly 5 years. The tax equivalent book yield on our fixed income portfolio is approximately 5.3%. Investment income declined 16% for the quarter and 12% year-to-date. In addition to the lower interest rate environment, this decline is primarily due to our eliminating the more volatile asset classes, including positions in the high yield muni bond fund, REITs, preferred stocks, and the DOW Dividend Select ETF. These securities carried yields north of 7% and the proceeds are now sitting in short-term investments.

Net realized gains on investment securities were roughly 6 million this quarter. We realized approximately 12 million in investment gains from selling securities that were previously deemed other than temporarily impaired. We've recognized the tax laws but had a book value gain as these securities improved during the second quarter. These gains were offset by roughly 6 million in securities that were deemed other than temporarily impairment this quarter, the majority of which came from our equity portfolio. As of April 1, we adopted a new financial accounting standards 115-2 and 124-2. These new standards apply to fixed income securities, specifically any credit related impairment the company does not plan to sell and not likely to be required to sell is recognized in operating earnings, with the non-credit related impairment recognized in comprehensive earnings.

Based on our analysis, our fixed income portfolio is of a high credit quality and it is not probable that contractual cash flows will not be collected. The fixed income unrealized losses can primarily be attributed to changes in interest rates and not related to credit issues. As a result, this mandatory accounting change had no impact on our reporting. Our total return for the portfolio was 3.6% for the quarter with equities returning 14.1% and our fixed income reporting 2.4%. Our investment portfolio has returned 3.1% year-to-date.

Comprehensive earnings which include after-tax unrealized gains and losses from the investment portfolio were nearly 57 million for the quarter, up from 13.3 million over the same period in 2008. Shareholders equity increased to 767 million and statutory surplus stands at just under 700 million. Once again, from an investment portfolio perspective, it was a good quarter in terms of a market recovery. We are proceeding in a cautiously conservative manner making sure our portfolio remains high quality. We have started to invest our cash balances into shorter duration high-quality fixed-income securities. I would not expect to see our 12% equity allocation to significantly change in the near term.

For the operations highlights, I will now turn the call over to Mike Stone. Mike?

Mike Stone

Thanks John. Good morning everybody.

An excellent quarter by anyone's standards, remember RLI sets a very high standard, the quarter combined ratio of 79, casualty at 79.1, property at 76, surety at 88. There are no clear signs of a market change. For example, transportation, which is typically a leading indicator of casualty prices is still competitive. Having said that, we have seen some rates firming in areas of tight capacity, for example, cat exposed property and D&L. We continue to think a market change is not far away. However, with the economy mired in recession and companies continuing to report positive combined ratios, we're not there yet. Some good news in addition to a terrific combined ratio, our gross written premium was off only 3% of the quarter, with both surety and property up around 12%.

Let us discuss casualty. Our gross written premium down 15% in the quarter, 18% year-to-date, which with our re-underwriting of our programs operations, which were at the businesses of some $9 million or some 60% of the shortfall in casualty, about 50% year-to-date. Overall, casualty is starting to improve. Our gross written premium in GL (inaudible) was down 12% and 18% respectively as the economy affects the construction industry, which is a significant part of our GL and commercial umbrella books. Rates are off a little less than 5%, which is an improvement. Our newest product is the Design Professionals, is off to a good start and is on plan with some $2.5 million of gross written premiums year-to-date.

Property, gross written premium up 12% in the quarter, 13% year-to-date, combined ratio of 76, cat rates up around 15% and unexposed fire rates stable. We have been able to achieve moderate while keeping our overall exposures flat and improving our geographic spread, brings gross written premiums some 2% up in the quarter, 7% year-to-date. Our new property facultative reinsurance facility added some $3 million of premium in the quarter and $4.2 million year-to-date as ceding companies are buying more facultative and rates have improved.

In our surety operations, again gross written premiums up 12% in the quarter, 13% year-to-date, growth driven by miscellaneous and contract segments in the surety side and our new fidelity operations. We have invested in new teams of underwriters and broadened our geographic spread in our surety operations. We continue to be very circumspect in underwriting this segment as the economy is an important factor in underwriting results. We have been very diligent in adding underwriters and accessing new opportunities.

Our new fidelity operations which is part of the surety segment is off to a good start, with some $3 million of gross written premiums in the quarter and $5.5 million year-to-date. They are on plan as well. We are well positioned to expand in all segments as and when the economy recovers and/or pricing firms. We will as always be disciplined in our approach.

Thank you, John.

Jon Michael

Thank you, Mike. We're now ready to open the call up to questions.

Question and Answer

Operator

Thank you sir. The question and answer session will begin at this time. (Operator instructions). Please stand by for our first question. And the first question will come from DeForest Hinman with Walthausen & Co.

DeForest Hinman
Walthausen & Co.

Hi. I had a few different questions. With all the headlines around CIT, can you talk about your fixed income exposure there?

John Robison

We do not have any exposure to CIT from a fixed income or an equity standpoint at this time. We sold our CIT investment earlier in the second quarter.

DeForest Hinman
Walthausen & Co.

All right. And with realized gains we booked in the second quarter 2009, what part of the asset portfolio did those gains come from?

John Robison

The majority came from the - on the equity side, and we also during the quarter, took advantage of an opportunity to rid ourselves of some of the lower quality municipals securities. So we took some gains on the muni bond side but the majority of the gains came on equity side.

DeForest Hinman
Walthausen & Co.

Okay. And it was interesting to hear you talk about your thoughts on inflation given the budgetary deficits in the United States. And then we have disclosed our duration that we have for asset portfolio and then at the same time we talk about coming back into the market and looking for high liquid short-term fixed income products. Can you talk about where we see the portfolio duration moving to as we go forward and maybe have some of that asset portfolio roll off and then we have to look for re-investment opportunities, because it sounds a little bit like we're going to move more towards shorter term, which could also entail some more reduced level of interest income on that portfolio in the near term. Can you help me think about that going forward how you are thinking about that?

Jon Michael

When we think about duration, we do it in terms of matching with our liabilities in the portfolio. What is not included in that that five-year duration number is the cash or the short-term investments. If we were going to include that number, we would be about 4.4, 4.5. We typically targeted a range based on the liabilities of the things in our portfolio somewhere around four years to five years. As we deploy those assets I would expect it to stay within that range.

DeForest Hinman
Walthausen & Co.

Okay. That is helpful. And it seems like we have a bigger mix of muni bonds, at least compared to what we have had historically, how should I think about the tax rate moving forward with a higher muni bond allocation?

Joe Dondanville

This is Joe Dondanville. From the muni allocation, that number is going to be fairly steady. I don't think we're going to be seeing a significant increase in our muni bond portfolio but it boogies with the amount of underwriting income that we have. So in this quarter we had a fairly high amount of underwriting income which supported the higher tax rate. Last quarter because of the realized losses that we had, it offset a lot of the gains that we saw on the underwriting side. So you've got to look at the three components of earnings, the muni and the tax preferenced dividends, the underwriting gains, and then the unrealized and realized losses on the equity side, equity side primarily but a little bit on the bond side.

DeForest Hinman
Walthausen & Co.

All right. And then last question on Maui Jim, obviously as (inaudible) on products kind of been down for two, three years in a row for the summer quarter. Are we seeing a bottom or has something changed fundamentally within that sunglasses business that we should be aware of?

Jon Michael

I don't - this is Jon Michael, I don't think we're seeing a fundamental change at all. I think Maui Jim's top line is off fairly significantly but they have been able to manage their expenses very well during this period of time and still show profitability albeit not a strong as it has been. They continue to expand into other parts of the world and at the same time they are keeping their expenses really in line with the lack of growth that they have had. We expect as the economy strengthens worldwide, that company would be very well positioned to rise right with the economy and beyond that. So they have fared very well during this period.

DeForest Hinman
Walthausen & Co.

So pricing strategy hasn't changed, we haven't lost any big distribution, or anything like that?

Jon Michael

In fact, they have expanded their product line. They have added some new styles and some new technology to their product line that looks promising. We are not experts on that at all but that is what they tell us.

Joe Dondanville

Yes, their sales are down about 25%. Their expenses are down about 20%. So they don't have a complete match there but they have been able to maintain their margins on the sunglass sales. So they are not compromising with the change in pricing strategy.

DeForest Hinman
Walthausen & Co.

All right, thank you.

Operator

We will take our next question from Meyer Shields with Stifel Nicolaus.

Meyer Shields
Stifel Nicolaus

Thanks. I guess let me start with the surety segment. I understand that the fidelity product is going to have some negative impact on the net to gross but I guess I was surprised by the divergence between the net and gross rates in surety.

Mike Stone

This is Mike Stone. The - in the fidelity line, we have got a quarter share reinsurance treaty that where we keep just 15% of the premium. So as even though fidelity is a fairly small segment when you look at the - fairly small part of the segment when you look at the gross to net, it is going to affect that fairly considerably.

Joe Dondanville

Yes, it is a flip. We keep about 87% of the more traditional surety product and we keep 15% of the fidelity product. And fidelity represents about 12%, 13% of the total.

John Robison

And that is consistent with our philosophy. I think we have repeated in the past that as we bring on new teams, new products, we are going to share that risk with the partners, a reinsurance partner, and reinsurance partners, and that is what we're doing at this point. As that product matures, we get more scale, we will take on that.

Meyer Shields
Stifel Nicolaus

Okay. I just want to make sure I wasn't missing any out there. With respect to investment income and the reallocation strategy, do you think that the quarter reflects the worst of the year-over-year decline that that is going to drive? Or was it later in the quarter?

John Robison

You know it is starting to get later in the quarter. We got rid of a lot of those higher yielding securities in the third and fourth quarter.

Meyer Shields
Stifel Nicolaus

Okay. So you will see a little bit more - oh, I'm sorry…

John Robison

Yes.

Meyer Shields
Stifel Nicolaus

Okay. And last question I guess, if you look at the calendar year results in the casualty segment - I'm sorry the accident year results, coming in at about 105%, what is the current estimate of the first half 2008 accident year results, in other words, what is the level of deterioration built into that?

Jon Michael

Well, Meyer, it is Jon Michael. I don't believe there is any deterioration built into - you're talking about that accident year, first six months of 2008, there is no deterioration from that year built in.

Meyer Shields
Stifel Nicolaus

Right. I'm asking the question badly, I guess. There wouldn't be any (inaudible) there is no deterioration on accident year 2008 but there would be I guess because of rate decreases and loss cost inflation some deterioration year over year?

Jon Michael

From 2008 to 2009?

Meyer Shields
Stifel Nicolaus

Right.

Jon Michael

Probably about 5% overall without getting into the whole calculus of it. But we have take in rate declines, we take in inflation, we take in claim trends and past accident year trends, but overall probably about five is what we're estimating.

Meyer Shields
Stifel Nicolaus

Is there any concern about the accident years profitability? Casualty?

Jon Michael

Yes, of course. It is at 105, yes, of course, we're concerned about it. That is why we believe and have said so that the rest of the insurance marketplace ought to wake up and look at where we believe and I think they are seeing the profitability going. So, yes.

Meyer Shields
Stifel Nicolaus

Are you implementing rate changes?

Jon Michael

Pardon me?</TAG>

Meyer Shields
Stifel Nicolaus

I'm sorry. My phone is not great. Are you implementing rate changes on the casualty side?

Jon Michael

As the best we can, yes.

Meyer Shields
Stifel Nicolaus

Okay. I get it. I'm sorry. I am being…

Jon Michael

Mike, do you want to…

Mike Stone

Yes. Meyer, it is Mike Stone. I think when you look at our casualty trend, you will see that our premium is down, it has been down over the last number of quarters, and that is because we are careful about how we are underwriting in this rate environment. We believe - we underwriters believe that our performance will be better than predicted but underwriters always believe that the results are going to be better than predicted. We think that the rate of rate change is lessening and I think in our biggest line, our largest line, GL, rates were off about less than 5% this quarter, which is an improvement, but they are still off. And but we have done fairly profitable in that line over the past number of years. We think we have been underwriting that carefully. Like I said, we expect that to be better than the actuaries think but then again they are the actuaries, and so we will be cautious, disciplined as we approach this, but the trend is what it is. And the next moment has been down, but you will see that we have reduced our volume as well.

Joe Dondanville

And Meyer, I think we believe our 2009 accident year combined ratio - or 2008 combined ratio is somewhere around 98, 99. So about five points higher.

Meyer Shields

Stifel Nicolaus

Okay. That is very thorough. Thank you very much.

Operator

We will hear next from Mike Grasher with Piper Jaffray.

Jon Michael

Hi, Mike.

Mike Grasher
Piper Jaffray

Hi.

Jon Michael

Take it off mute.

Operator

I apologize. Wait a second while I remove you from the queue. Mr. Grasher, if you could please press star one one more time? I am sorry. Please go ahead.

Mike Grasher
Piper Jaffray

It's okay. Congratulations on the quarter, gentlemen. Just a couple of questions. AM Best certainly affirming the A+ rating during the quarter and mentioning superior capitalization as part of their commentary, how much excess capital do you have right now?

Joe Dondanville

Mike, this is Joe Dondanville. I think if you were to look at the Best adequacy ratios, we're probably somewhere around that hundred million dollar level.

Mike Grasher
Piper Jaffray

Okay. With that hundred million, would you be inclined to I guess reengage the share repurchase?

Joe Dondanville

Well, that is going to be one of the things we look at in the second half. We would also want to make sure that we are well on our way to an economic recovery. We don't want to see any continuous setbacks that we have seen in the second quarter, but second quarter is just kind of the start and we are somewhat cautious about what the second half is going to bring but if we see some opportunities to put that money to use that is what we would rather use it as opposed to buy back shares.

Mike Grasher
Piper Jaffray

Okay. And I assume that would imply some M&A opportunities that maybe would come along?

Joe Dondanville

If something does come along, we are certainly open to it.

Mike Grasher
Piper Jaffray

Okay. And then can you speak to what you have seen on that front?

Mike Stone

Hi, it is Mike Stone. Let me answer part of that. We have added a number of products, we have added a number of underwriters, we have increased our geographic spread over the past year. We are positioned for a market turn. We don't have to do M&A to run our gross written premium up quite a bit over the next year or so assuming that the economy recovers, or assuming that the insurance market pricing firms. So we don't have to do an M&A to use that capital fairly quickly if we get some change. If we don't get any change, yes, that is a different question.

Mike Grasher
Piper Jaffray

Yes, okay. Fair enough. And then final question, just wanted your comments around inflation, what are you sort of assuming in terms of inflation over the next couple of years, or how are you intertwining that into the assumptions within the reserving policy?

Jon Michael

Well, when we talk about inflation, we talk about - this is Jon.

Mike Grasher
Piper Jaffray

Yes, Jon.

Jon Michael

We talk about inflation that includes inflation for the traditional economy but then in addition to that, we talk about claims inflation, which includes increased or decreased jury awards, general expansion of coverages that may occur through - within the within the legal system or through the regulatory system. We also talk about medical inflation which is much higher than the general economic inflation and so our reserving process includes dependent upon the duration of the product, what kind of product it is, it goes away from a low of about 4% estimated and that would be for a product that maybe has a fairly short duration type life and up to as high as 12% dependant on the duration of the product and the type of product. So I can't - again I am not an actuary but I just know what those numbers are.

Mike Grasher
Piper Jaffray

Okay. And those numbers, have they changed, and if so how much have they changed over the past six months?

Jon Michael

Over the last six months, they have probably gone up slightly, but not anything that - we are not estimating any kind of hyperinflation if that is what you're asking. And over the last couple of years, they have risen probably moderately, I would say. So I believe we are seeing a slight increase in what our actuaries are seeing. Of course, they are looking at a rear view mirror and then trying to forecast the future and looking at economic trends and the like.

Mike Grasher
Piper Jaffray

Understood. Thank you.

Operator

(Operator instructions). We will hear next from Ron Bobman with Capital Returns.

Ron Bobman
Capital Returns

Hi. Good morning. And congrats on a great quarter. I had a question. I think I read during the quarter that one of the cat modelers in their quake model made some meaningful changes to I think it is the California sort of quake loss estimate or that ensure I guess using the model would incur. And if I my recollection is right, would that have - do you perceive that having any impact on either A, the quake risk that you sell, or the type or the amount of structure of the reinsurance you buy to protect that book? Thanks a lot.

Mike Stone

Yes, this is Mike Stone. I think the one of the models is as recalibrated and cat quake is down from a model perspective. There are a number of fairly widely used models, the others are not, not yet anyway. So I would suspect that right now that one model change probably won't the market. If the other models come out with similar changes or comparable changes, relative changes, because they're all different, but if there are relative changes in that direction, you might see some price movement in quake. Certainly, the reinsurers typically use a wide range of models, some proprietary. I doubt that this one model change will have a significant impact on pricing.

Ron Bobman
Capital Returns

Okay. And do you know if the other modelers are in the process of running - or sort of running refinements or I guess just in the ordinary course of constantly doing that and you wouldn't be aware of anything extraordinary being withdrawn?

Jon Michael

As Mike said, I do know that one of the other modelers is preparing a version change. Well, when that becomes available, we don't know yet, it's moved a couple of times, we suspect that there will be some movement, probably downward on cat quake, but that is just a suspicion at the moment.

Ron Bobman
Capital Returns

Okay, thanks. And continued good luck.

Jon Michael

Thank you.

Operator

We will take our next question from Bijan Moazami with FBR Capital Markets.

Bijan Moazami
FBR Capital Markets

Good morning, everyone. Just wanted to recap some of what you have said in a conference call and try to have a better understanding in terms of what is the strategy of the company because I'm a little bit confused. On one hand, on the investment side, you are accumulating massive amount of cash, you're shortening the portfolio duration. From an underwriting perspective, you don't appear to be way too excited about the dynamic of the market. You are sitting with almost $100 million of excess cash on the balance sheet.

You had a cash flow which is twice as much as your operating income, which by the way it is really good, which basically means you are accumulating statutory capital at a very rapid pace. You are not going any share buyback right now which brings the question of what are you planning to do? Do you think that the market is going to improve any further than that? Do you really see a lot of opportunities to be making acquisitions? I'm a little bit confused and I was wondering if you could help me out understanding what the strategy is.

Jon Michael

Well, Bijan, as you know strategy doesn't take place in a quarter or even six months. It takes place over a whole cycle. Yes, today, we do have excess capital, and we intend to use that excess capital and if we can't and you know probably better than anybody else if we cannot use that excess capital, we will give it back to the shareholders. So we intend to use it if we can. If we can't, we will give it back. That is our strategy. Are we anticipating a turn in the marketplace? Well, we can be hopeful that there will be a turn in the marketplace. And if that doesn't occur, and we cannot find places to deploy this capital through M&A or through other teams of underwriters, that we have already have been deploying, then we will give it back to shareholders.

Bijan Moazami
FBR Capital Markets

I don't want to be pushy on this topic but what is the product that is missing that you know and that you have an interest in getting into?

Jon Michael

Go ahead.

Mike Stone

Bijan, it is Mike Stone. The - again obviously there is - we are still a fairly small company I believe. Last time I looked there is a whole host of products that we aren't in. Which of those products make sense, fit with our model? I'd suggest to you that there are a number of them. I will just lead with one. We started Design Professionals last year. We believe most of our peer companies in the specialty space have a much larger professional practice that we do. We would be interested in that. We are not - we do not have anything on the radar but one of the things that we think about. So I think a short answer to your question is we're still small. There is a bunch of products that we aren't in, that we could be in, if we found the right people. And it really does start with that, the right people, and we haven't found them yet.

Bijan Moazami
FBR Capital Markets

Okay. One last question on the property business, you have been growing that book pretty nicely. First, how much of that growth comes from the DIC? And secondly, because the reinsurance rates are growing up so much faster than the primary rates, if the margin in that business holding on accident year basis?

Joe Dondanville

Yes, it has. I think we have seen some favorable loss trends that has offset the amount of exposures that we have is down. I guess that might also address your other comment about your strategy. If you seeing any improvement in the economy where we have exposures in the trucking area and the contractors area, it is not necessarily a policy count problem. It is the revenue base problem or miles driven problem that as we the economy picking up, we will see more revenues from contractors and more miles, and we will see an improvement in the business that we write from that perspective as well.

Bijan Moazami
FBR Capital Markets

Thank you.

Operator

Thank you. And we have a follow up question we will hear from Meyer Shields.</TAG>

Meyer Shields
Stifel Nicolaus

Thanks. Have another follow-up on the property side, how do you distinguish between sort of fundamental underwriting profitability on one hand and maybe the catastrophic provisions on the other hand when there weren't any catastrophic losses?

Jon Michael

Well, when there are - Jon Michael answering this, when there aren't catastrophic losses, there are no losses to report, that is an obvious thing. I guess if you're asking if our profile of risk has either increased or decreased, I think over the years, it has decreased significantly from cat, and so our diversification of our insurance portfolio is far less cat oriented today than it ever has been, and we continue to reduce that exposure to catastrophe.

Meyer Shields
Stifel Nicolaus

Okay. So the catastrophic provision as a percentage of premiums has been coming down?

Jon Michael

Yes, it is coming down. It is.

Meyer Shields
Stifel Nicolaus

Okay.

Jon Michael

And so, overall as a percentage of our overall premiums, our cat exposure is a lot less than what it has been in years past.

Joe Dondanville

And we monitor the results of the property by the different types of coverage that we write. So we look at the fire coverage as separate from the cat coverage.

Jon Michael

Yes. We're looking at - we are looking at for example wind in Florida, and wind in other areas for profitability of that book given the normalized loss cost. We're looking at our exposures to earthquake by measuring exposure units, not just say PML or anything like that. We're looking at actual exposure. So it is quite a bit more sophisticated than just posting GAAP results.

Mike Stone

Okay, thank you.

Operator

Okay. We will hear next from Michael Nannizzi with Oppenheimer.</TAG>

Michael Nannizzi
Oppenheimer

Thanks. Thank you for taking my question. Just had a question about lost development in the quarter. I know I think you guys do your full reserve studies in the second, third and fourth quarters, just wanted to understand a little bit about the process you undertook in the first quarter and coming up with the release and if you could talk a little bit about which books and which accident years were the beneficiaries of the reserve releases and I have one follow-up, thanks.

Joe Dondanville

Okay. This is Joe Dondanville. You are correct, we do studies on three of the fourth quarters, but in the - for every quarter we do an evaluation of the actual reported losses versus expected reported losses, and that is also a driver of the overall results because the loss reserve studies are in arrears, but we also look at what has happened in that current quarter. So if we see a significant improvement in the reported numbers versus expected, that will cause reserve changes as well, both positive and negative.

Now, the reserve releases that we had in the second quarter, we have had just about half of it come in out of the 2008 year, favorable results on our personal umbrella and our trucking business, which is short sale. And the rest of it goes anywhere from 2001 to 2007 looking at the casualty lines and then we have also had some adverse development that goes back to prior to 2001. So it is across the board when we get into the comprehensive reserve study that we conduct.

Michael Nannizzi
Oppenheimer

Great, thanks. And just in the casualty line I noticed that the expenses ticked up a little bit, is there anything specific related to it?

Joe Dondanville

Well, it will typically pick up when we have favorable reserve releases. That additional income will drive bonus programs that will cause us to pay more out in those programs.

Michael Nannizzi
Oppenheimer

I see, I see. Okay. And just if I could one last one, just a more philosophical question. It is your casualty, if customers that purchase casualty insurance are in this market kind of whether they're pulling back limits or raising deductibles to kind of the dial in their exposures, are you - first of all, are you still seeing that activity on the casualty side? And second on the property side, is that a behavior that you're seeing, or because it is a less discretionary coverage, are you seeing not less on that side? And thank you again for taking my questions.

Mike Stone

It is Mike Stone. On the casualty side, certainly we see people buying less limits still. And with less commercial umbrella cover, less personal umbrella cover. On the property site. And I think you are correct, except you'll see less people buying quake for example, or where they are able not to buy if there is not some bank that is forcing them to. And certainly they will raise deductibles on the property side as well if it gives them the appropriate amount of relief. So you see buying habits change on all lines in this marketplace.

Michael Nannizzi
Oppenheimer

Great, thank you.

John Robison

Michael, on the liability lines, the biggest factor is economic activity. When as Joe mentioned, when construction projects are down, when contractors get their revenues cut by 25% or 30% or 40%, then our premium levels are going to track that fairly consistently with that particular contractor. So the book overall which that general liability book which is largely driven by contractors, a high percentage of it, perhaps as high as 60% of that book, at one period of time was contractors. And as that economic activity gets reduced, our premium volume will get reduced as well. And as Joe mentioned on transportation side, it is dependent on some people call it power units. We do our rating based on miles driven, we think that is a better driver of it, but when economic activity is down, there are fewer trucks on the road. So that is going to drive premiums down. But writing habit do change. On the property site, they are buying less limits, especially for earthquake as prices have gone up and deductibles will go up too.

Michael Nannizzi
Oppenheimer

Right. Thank you very much for that. Just if I could one quick follow-up, I mean on the property - so casualty clearly there is a very tight walk across from the economy, and the commercial equity overall. Is there a similar kind of macro trend that impacts the property line to the same degree or is it just a more diluted impact of the economy on the property side?

Jon Michael

Well I think we are in the specialty business and so in a strange way we might get more opportunities as buildings become vacant and move over from an admitted product to a non-admitted or surplus lines product. So in that strange way you get more fire type opportunities. But I think behaviors on the property site are driven largely by what the banks require coverages to be and what the customer can afford to pay for insurance because you don't necessarily see the same type of reduction obviously. Building values would be down and so one would expect that the premiums would be down and that is true. But perhaps not as we don't see it as (inaudible) we do on the liability side.

Michael Nannizzi
Oppenheimer

Great. Sorry to hog so much time. Thanks again for answering all those questions.

Operator

And we do have one more caller in the queue. We will hear from Doug Mewhirter with RBC Capital Markets.

Doug Mewhirter
RBC Capital Markets

Hi, good morning. I just wanted to - first question, just a quick follow-up on the previous caller's question, regarding how it relates to the competitive environment in the economy, I realized that you know rates are determined part by underwriter behavior and rising loss ratios can change behavior. But do you think that rising loss ratios aren't really sufficient to really turn rates around and you really need some sort of upturn in economic activity to drive demand to really, really push the market, I guess particularly on the casualty side?

Joe Dondanville

Well, I think there are two different things. You have got the economy which is the external environment with which we are playing and then you have the insurance marketplace and the amount of deployed capital in the insurance marketplace and currently worldwide and especially in this country we are over capitalized. And that is in all probability why we haven't seen any turn in the market because certainly at 105 combined ratio that we're predicting for the accident year, and I think any other company that is writing the same kind of business that we are writing, perhaps should be predicting those same type of ratios. We should see price firming or at least price stabilization and although as Mike mentioned, it is down just 5% or less than 5% probably for the quarter, we haven't really seen that bottom yet. But we're getting pretty close. So I don't know if that answered your question but there are different factors that affect the insurance marketplace and the rate environment that we live in.

Doug Mewhirter
RBC Capital Markets

Thanks for that. My last question is regarding the new teams you brought on board, what do you think the - I know you don't really target or budget premiums, you look more like underwriting profit, but based on the past, the underwriting team's past books of business or the size or their contacts, people you may have brought onboard in the last six months, how much I guess premium capacity do those teams might have that are above and beyond the current books they are writing right now in very round numbers?

Joe Dondanville

I guess - you are right, we don't, we don't predict that. We don't give that kind of forward-looking information. We wouldn't have hired them if we don't think they have the ability to generate a profitable book of business that would impact the company's bottom line, I would just tell you that. So I can't give you numbers.

Doug Mewhirter
RBC Capital Markets

Okay, thanks a lot. That is all my questions.

Operator

At this point, we have no further callers in the queue. (Operator instructions). If there are no further questions, I will now turn the conference back to Mr. Jonathan Michael.

Jon Michael

Thanks, great questions everybody. An outstanding quarter given the economy and the relative soft insurance marketplace. Our gross premiums were off just 3% for the quarter and just over 5% year-to-date, really a remarkable achievement, given the lack of economic activity this last six months. Even more noteworthy is that our combined ratio for the quarter was sub 80 and year-to-date 83.7. These ratios were obviously aided by the reserve releases that we talked about, but even without those releases, the underwriting result was very, very good indeed. Our assets are solid, we are fairly flush with cash, and have a solid capital base to build on. We continue to look for new opportunities and stand ready to take advantage when we deem it appropriate. Thanks for listening. We look forward to talking to you next quarter.

Operator
Ladies and gentlemen, if you wish to access the replay for this call, you may do so by dialing 1-888-203-1112 with an ID number of 9947260. This concludes our conference for today. Thank you all for participating and have a nice day. All parties may disconnect.