Q1 2014 Earnings Call

Company Participants

- Dino Robusto, EVP, President Commercial and Specialty Lines
- John Finnegan, Chairman, President, CEO
- Paul Krump, EVP, President Personal Lines and Claims
- Ricky Spiro, EVP, CFO

Other Participants

- Amit Kumar, Analyst
- Ian Gutterman, Analyst
- Jay Cohen, Analyst
- Josh Stirling, Analyst
- Kai Pan, Analyst
- Meyer Shields, Analyst
- Michael Nannizzi, Analyst
- Vinay Misquith, Analyst

Presentation

Operator

Good day, everyone. Welcome to The Chubb Corporation's First Quarter 2014 earnings conference call. Today's call is being recorded.

Before we begin, Chubb has asked me to make the following statement. In order to help you understand Chubb, its industry, and its results, members of Chubb's management team will include in today's presentation forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. It is possible that actual results might differ from estimates and forecasts that Chubb's management team makes today. Additional information regarding factors that could cause such differences appears in Chubb's filings with the Securities and Exchange Commission.

In the prepared remarks and responses to questions during today's presentation, Chubb's management may refer to financial measures that are not derived from generally accepted accounting principles, or GAAP. Reconciliations of these non-GAAP financial measures to the most directly comparable GAAP measures and related information are provided in the press release and in the financial supplement for the First Quarter 2014, which are available on the investor section of Chubb's website at www.chubb.com.

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Now I will turn the call over to Mr. Finnegan.

John Finnegan {BIO 1735942 <GO>}

Thank you for joining us.

As we said in the press release today, Chubb produced solid results in a quarter which was adversely impacted by several factors, including cat and non-cat weather losses due to the harsh winter weather in the United States and an unusually high level of homeowners' fire losses.

We were very pleased with the continued positive rate movement in all three of our businesses, along with continued strong retention.

Our commercial businesses had particularly strong quarters. In professional liability, our combined ratio of 84.6% was as good a quarter as we have had in five years. This represented a whopping 7.8-point improvement from our First Quarter of last year. In CCI, our ex-cat combined ratio of 82.4% was our third best quarterly performance in six years.

The performance of both of these businesses benefited from the rate actions and underwriting initiatives that we've undertaken over the past few years.

Operating income per share was $1.50, compared to $2.14 in last year's First Quarter. Annualized operating ROE was 10.1% for the First Quarter of this year. The combined ratio for the First Quarter was 93.2% this year, compared to 84.6% last year. Excluding the impact of cats, the combined ratio for the First Quarter was 86.6% in 2014 versus 84% a year ago. This deterioration is more than fully accounted for by the higher ex-cat weather-related losses and homeowner fire losses in this year's First Quarter.

During the First Quarter, we had net realized investment gains of $116 million before tax, or $0.30 per share after tax. This brought our First Quarter net income per share to $1.80, resulted in an annualized ROE of 11.1%.

GAAP book value per share at March 31, 2014, was $66.36. That's a 2% increase since year-end 2013 and a 7% increase since March 31 a year ago.

Our capital position is excellent and we continue to actively repurchase our shares, as Ricky will discuss later. In addition, during the First Quarter, we increased our common stock dividend by 13.6% to $2 per share on an annualized basis. It was Chubb's 32nd consecutive annual dividend increase.

Now for more details on our operating performance, we will start with Dino, who will discuss Chubb's commercial and specialty insurance operations.

Dino Robusto {BIO 15021398 <GO>}

Thanks, John.

Chubb Commercial Insurance and Chubb Specialty Insurance both had strong performance in the First Quarter. Starting with CCI, the First Quarter combined ratio was 88.5% in 2014, compared to 81.9% in 2013.

The impact of catastrophe losses accounted for 6.1 points of the combined ratio, compared to minus 1.7 points in the year-ago First Quarter. Excluding the impact of catastrophes, CCI's First Quarter combined ratio improved from 83.6% in 2013 to 82.4% in 2014. The 82.4% is within 0.6 point of CCI's best ex-cat combined ratio in the last six years.

CCI's First Quarter net written premiums were down 1% to $1.4 billion, with flat growth in the US and down 4% outside the US, which in general continues to be a more competitive environment.

Although overall growth was down, we continued to retain our best accounts and write new business in the segments where we are the most rate adequate, while at the same time maintaining the discipline of culling accounts where we can't secure appropriate terms and conditions. The balance among these actions will vary from quarter to quarter, based on our mix of business, which in the First Quarter resulted in a small decline in overall premiums.

The slow start in the beginning of the year actually improved in March, and April is coming in even stronger than March. So, we're optimistic about stronger growth in the Second Quarter than the First Quarter, based on the quality and quantity of opportunities we are seeing in our target markets.

CCI's average US renewal rate increase in the First Quarter of 2014 was 5%, which is above our long run loss cost trends. Given the 6% to 7% increases we experienced in the US in the prior three quarters, the earned impact in the First Quarter was 6%. Outside the United States, CCI's average renewal rate increases were in the low single digits.

CCI achieved average US renewal rate increases in every line of business, and as we discussed on our prior earnings call, after three years of rate increases, much of our book is no longer in need of large rate increases. So in a number of segments, we are pushing for greater retention and more moderate rate increases, and we are writing the majority of new business in segments where we are the most rate adequate.

And the First Quarter, in the large part, reflects this strategy. CCI's First Quarter renewal retention in the US increased to 85% from 83% in the Fourth Quarter of 2013. CCI's new to loss business ratio in the US was 0.9 to 1, compared to 0.7 to 1 in the Fourth Quarter of 2013 and 0.8 to 1 in the same period last year.

It is important to remember we have never relied solely on rate to achieve our historically excellent results. As more and more of our book approaches rate adequacy and rate increases moderate, we will continue to target growing our profit by remaining vigilant in our underwriting and management of our mix of business across our broad set of products and customer segments. It is this the legacy of underwriting expertise that allowed us to build an enviable book of business, which we expect will enable us to maintain strong performance relative to the industry in any market.

Moving to Chubb Specialty Insurance, net written premiums were down 1% in the First Quarter to $624 million. CSI's First Quarter combined ratio was 88.9% in 2014 versus 87.4% in 2013. For the professional liability portion of CSI, which represents the lion's share of the portfolio, net written premiums were up 1%, to $552 million.

Similar to CCI, the marketplace outside the US continues to be more competitive than in the US, with premiums down 2% outside the US, but up 2% in the US.

The combined ratio for professional liability improved almost 8 points to 84.6% from 92.4% in the year-ago quarter. That 84.6% is the best combined ratio that professional liability has produced in the last 10 quarters.

We are very pleased with the 7% average renewal rate increase we achieved for professional lines in the US in the First Quarter of 2014, as we continued to drive greater profitability. The First Quarter of 2014 was the 10th consecutive quarter of professional liability renewal rate increases in the US and the seventh consecutive quarter that professional liability rate increases ranged from 7% to 9%.

Each of our professional liability lines of business in the United States achieved renewal rate increases in the First Quarter. As in CCI, we continue to differentiate our rate and retention action based on the performance of each line of business and each policy.

In markets outside the US, average renewal rate increases for professional liability in the First Quarter were consistent with the Fourth Quarter 2013, rising by low single digits. Renewal retention for professional liability in the US in the First Quarter was 85%, up 1 point from the Fourth Quarter 2013 and up 4 points from the First Quarter of 2013.

Retention was the highest for our best-performing segments and lowest for our worst performing, again improving the overall quality of our book of business.

The new to loss business ratio for professional liability in the First Quarter was 0.9 to 1, up from 0.8 to 1 in the Fourth Quarter of 2013, which continues the slow but steady improvement in that metric since the First Quarter of 2013 as more of the new business we target is meeting our demanding underwriting standards.

Turning to the surety portion of our CSI book, net written premiums in the First Quarter were down 13% to $72 million, also impacted by the competitive marketplace outside the US. The combined ratio for surety was 122.9%. The unusually high combined ratio was driven by one large loss in the current accident year from an insured outside the United States that was primarily engaged in mining construction services, whose business failed due to several problem contracts he inherited as the result of an acquisition.

As we have stated in previous earnings calls, results can be lumpy in the surety business, as the presence or absence of a large loss can have a significant impact, especially on one quarter's results. The last time surety had an unprofitable quarter was back in 2008. Our aggregate loss ratio since 2005 is under 15%, so clearly, our surety business has been very profitable and remains attractive to us.

And with that, I will turn it over to Paul, who will review our personal lines and corporate wide claim results.

Paul Krump {BIO 5211397 <GO>}

Thanks, Dino.

Chubb's personal insurance net written premiums increased 3% to $1 billion and CPI produced a combined ratio of 101.8%, compared to 87% in the corresponding quarter of last year.

CPI's profitability was adversely affected by the severe winter weather, resulting in both increased cat and non-cat losses, as well as several large fire losses. The impact of catastrophes on CPI's First Quarter combined ratio was 11.2 points in 2014, compared to 3.9 points in the First Quarter a year ago. On an ex-cat basis, CPI's combined ratio was 90.6% in the First Quarter, compared to 83.1% in the First Quarter of 2013.

Homeowners' premiums grew 4% in the First Quarter. The combined ratio was 104.9%, compared to 82.5% in the corresponding quarter last year. Cat losses accounted for 17.9 points of the homeowners' combined ratio in the First Quarter of 2014, compared to 6.1 points in the First Quarter of 2013.

Due to the unprecedented cold snap, some of the homes of our targeted high net worth customers experienced costly interior damage, especially from burst pipes and ice damage.

Excluding the impact of catastrophes, the 2014 First Quarter homeowners' combined ratio was 87%, compared to 76.4% in the same period a year ago. This 10.6-point difference is more than accounted for by the First Quarter's unusual non-cat weather-related losses and an increase in the impact of large fire losses.

As I mentioned, the severe winter resulted in an elevated level of non-cat weather-related losses compared to last year's mild winter. Non-cat weather-related losses accounted for about 14 points of our homeowners' combined ratio in the First Quarter of this year, which is 9 points higher than in the First Quarter of 2013.

In addition, we experienced an uptick in home fires. For perspective on how the First Quarter 2014 fire loss impact stacks up, it was 4.5 points higher than in the First Quarter of 2013.

To summarize, when one compares the homeowners' ex-cat loss ratios of the First Quarter of 2014 and the First Quarter of 2013, this year's elevated non-cat weather-related losses added 9 points and the impact of fire losses added about 4.5 points. Together, these 13.5 additional points of losses in the First Quarter of 2014 more than account for the 10.6 points of year-over-year deterioration in the homeowners' ex-cat loss ratio.

During the First Quarter of 2014, we achieved an average homeowners' renewal rate and exposure increase of 7% in the United States, the same as in the First Quarter of 2013. Our pricing momentum remains strong, and this is our fourth year of homeowners' renewal rate and exposure increases.

Personal auto premiums declined 2% and the combined ratio was 101.4%, compared to 94% in the First Quarter of 2013. Worldwide auto growth was down in the quarter as we experienced a negative impact from foreign currency translation, as well as slower growth in our Brazilian operation due to targeted rate action. Auto growth in the US remained strong at 5%, driven by renewal rate and exposure increases.

US in-force count was up slightly as well versus the First Quarter of 2013. The auto combined ratio in the quarter was adversely affected by challenging winter driving conditions in many parts of the United States, including flooding in an affluent section of Palm Beach County, Florida, in mid-January. All told, the unusual winter weather resulted in about 3 points of auto losses in the quarter.

Policy retention in the US in the First Quarter was 90% for homeowners and 89% for auto, both of which are essentially unchanged from the Fourth Quarter of 2013.

In other personal, which includes our accident, personal excess liability, and yacht line, premiums were up 3% and the combined ratio improved to 92.4% from 94% in the First Quarter a year ago.

Turning now to claims corporate wide, in the First Quarter of 2014 we had cat losses of $199 million before tax, or 6.6 points on the combined ratio. This reflected about $206 million of losses from seven cat events in the United States and one event outside of the United States, partially offset by about a $7 million decrease in our estimated losses from catastrophes which occurred in prior years.

The US events included two catastrophes that occurred in early January of this year, for which we provided a preliminary loss estimate at the time of our last earnings conference call. Our current estimate for those events remains in line with our earlier estimate and they accounted for the bulk of the overall catastrophe impact in the quarter. Of the total First Quarter catastrophe losses, 60% were attributable to CPI and 40% to CCI.

Now I will turn it over to Ricky, who will review our financial results in more detail.

Ricky Spiro {BIO 15061279 <GO>}

Thanks, Paul.

As usual, I will discuss our financial results for the quarter, and I will also provide an update on the April 1 renewal of our major property reinsurance program.

Looking first at our operating results, underwriting income was $208 million in the quarter. Property and casualty investment income after tax was down 4% to $277 million, due once again to lower reinvestment rates in both our domestic and international fixed maturity portfolio.

Net income was higher than operating income in the quarter, due to net realized investment gains before tax of $116 million, or $0.30 per share after tax. For comparison, in the First Quarter of 2013 we had net realized investment gains before tax of $138 million, or $0.34 per share after tax. In both quarters, $0.14 per share of the net realized investment gains came from alternative investments.

As a reminder, unlike some of our competitors, we do not include our share of the change in the net equity of our alternative investments in property and casualty investment income. We include it in net realized investment gains and losses.

Unrealized depreciation[ph] before tax at March 31 was $2.2 billion, compared to $1.9 billion at year-end 2013. The total carrying value of our consolidated investment portfolio was $42.9 billion as of March 31, 2014. The composition of our portfolio remains largely unchanged from the prior quarter. The average duration of our fixed maturity portfolio is 3.9 years and the average credit rating is AA-3.

We continue to have excellent liquidity at the holding company. At March 31, our holding company portfolio had $2 billion of investment, including approximately $830 million of short-term investments. Book value per share under GAAP at March 31 was $66.36, compared to $64.83 at year-end 2013. Adjusted book value per share, which we calculate with the available-for-sale fixed maturities at amortized costs, was $62.39, compared to $61.86 at 2013 year-end.

As for loss reserves, we estimate that we had favorable development in the First Quarter of 2014 on prior-year reserves by SBU as follows. In CPI, we had approximately $5 million. CCI had $90 million, CSI had $65 million, and reinsurance assumed had zero, bringing our total favorable development to approximately $160 million for the quarter. This represents a favorable impact on the First Quarter combined ratio of almost 5.5 points overall.

For comparison, in the First Quarter of 2013 we had about $190 million of favorable development for the Company overall, including $5 million in CPI, $125 million in CCI, $55 million in CSI, and $5 million in reinsurance assumed. The favorable impact on the combined ratio in the First Quarter of 2013 was about 6 points.

For the First Quarter of 2014, our ex-cat accident-year combined ratio was 91.7%, compared to 90.2% in last year's First Quarter. During the First Quarter of 2014, our loss reserves increased by $26 million, including an increase of $40 million for the insurance business and a decrease of $14 million for the reinsurance assumed business, which is in runoff. The overall increase in reserves reflects an increase of $57 million related to catastrophes, and the impact of currency translation on loss reserves during the quarter resulted in a decrease in reserves of about $25 million.

Turning to capital management, we repurchased 4.7 million shares at an aggregate cost of $409 million during the quarter. The average cost of our repurchases in the quarter was $86.73 per share. At the end of the First Quarter, we had $1.2 billion available for share repurchases under our current authorization, and as we said on our last earnings call, we expect to complete this program by the end of January 2015.

In February, as John mentioned, our Board raised the quarterly common stock dividend by 14% to $0.50 per share, or $2 on an annual basis. This was our 32nd consecutive annual dividend increase, a continued indication of our consistent performance and financial strength.

I would now like to say a few words about our reinsurance program. On April 1, we renewed our major property treaties, including our North American cat treaty, our non-US cat treaty, and our commercial property for risk treaty. We renewed these programs with a similar limit structure to what we had in 2013, but with expanded coverage and improved terms and conditions.

The reinsurance market was orderly and there was plenty of capacity to meet our needs in each treaty. As you might expect, we are an attractive cedent. We achieved double-digit price decreases on all three property treaties that we renewed, and the aggregate cost of these three treaties will be meaningfully lower than last year.

In addition, in March we successfully completed our sixth catastrophe bond offering, East Lane VI, to replace a maturing cat bond. The transaction was very well received by the market, and this enabled us to increase the existing limit from $225 million to $270 million and expand the perils covered relative to the expiring arrangement at attractive pricing.

Under this new arrangement, we purchased fully collateralized multiyear coverage to supplement our reinsurance program for the perils of named storm, including hurricane and tropical storm, earthquake, winter storm, and severe thunderstorm in the northeast US, running from Virginia to Maine.

In terms of pricing, we attained the lowest pricing ever achieved on a cat bond with US hurricane risk.

Similar to our previous cat bonds, we have an indemnity-based trigger, which means that our right to collect is based on our actually incurred losses, as opposed to industry or indexed based losses. We like the diversification that these cat bond arrangements bring to our overall reinsurance program, especially in our peak zone. Importantly, they provide us with a cost-effective fully collateralized alternative to traditional reinsurance, with pricing locked in for several years.

And now, I will turn it back to John.

John Finnegan {BIO 1735942 <GO>}

As you can see, First Quarter results were a mixed bag. A strong underlying performance was offset, to a large degree, by the impact of higher cat, non-cat weather-related losses, and unusually high homeowner fire losses.

The adverse effect of these factors is reflected in our operating income per share for the First Quarter of $1.50, which was $0.64 per share less than the $2.14 per share we earned in the First Quarter of 2013. Of this $0.64 per share differential, $0.45 per share was attributable to higher cats in this year's First Quarter. The remaining $0.19 per share difference was more than accounted for by the $0.23 per share aggregate negative impact of higher non-cat weather-related losses, $0.15 per share, and homeowner fire losses, $0.08 per share, in the First Quarter of 2014. Bear in mind that we also had this large surety loss, which accounted for approximately $0.10 per share this quarter.

Cat/non-cat weather-related losses and homeowners' fire losses had the most pronounced adverse effect on the profitability of personal lines in the First Quarter of this year. The deterioration in the personal lines combined ratio versus the First Quarter of last year was more than totally attributable to these factors, which can swing significantly from quarter to quarter. As we have said before, we have enjoyed benign loss experience with respect to non-cat weather and large homeowner fires for a number of years, and as indicated on our January call, our guidance for this year contemplated some reversion to the mean in 2014, and we certainly got it in the First Quarter.

While nothing is for sure, we think it is reasonable to expect lower levels of non-cat related weather and fire losses during the balance of this year.

Turning to our commercial businesses, we feel good about a number of positive developments in the First Quarter. Professional liability First Quarter combined ratio improved almost 8 points from the First Quarter of last year. It was the eighth consecutive quarter in which our combined ratio in professional liability improved.

Moreover, our accident-year loss ratio was about 66%, 4 points better than last year's First Quarter. Our ex-cat CCI combined ratio of 82.4% was 1.2 points better than the First Quarter of last year, 2 points better than last year's full-year combined ratio, and better than any full-year combined ratio in recent memory.

We're also pleased that in all three of our business units, we continued to obtain mid-single digit renewal rate increases in the US in the First Quarter of this year. Commercial, we have now enjoyed mid to high single-digit renewal rate increases for 10 consecutive quarters. Also in professional liability, we have now enjoyed eight quarters of mid to high single-digit renewal increases. And in personal lines, the homeowners' line of business has enjoyed nine quarters of mid to high single-digit renewal increases.

Meanwhile, we continue to enjoy strong renewal retention in all of our business units.

Finally, with respect to capital management, we returned $533 million to our shareholders in the First Quarter, through $409 million of share repurchases and $124 million in cash dividends.

And with that, I will open the line to your questions.

Questions And Answers

Operator

(Operator Instructions) Amit Kumar, Macquarie.

Q - Amit Kumar {BIO 15025799 <GO>}

Two quick questions. First of all, just going back to the discussion on the fire losses, can you expand on the nature of these fire losses? And was there some sort of a geographic concentration to these fire losses?

A - John Finnegan {BIO 1735942 <GO>}

I think the quick and dirty answer is no geographic concentration, and most of fire losses from quarter to quarter are a matter of good fortune or bad fortune. No pattern, really.

Q - Amit Kumar {BIO 15025799 <GO>}

Okay, got it, okay, so it was just more of an aberration than anything else.

A - John Finnegan {BIO 1735942 <GO>}

You know, we were aberrational on the low side for a few quarters, and this was a little bit on the high side, so we've been talking about a little reversion to the mean. Yes, hopefully, it will revert back down a little bit. But yes, we have had a good run, though.

Q - Amit Kumar {BIO 15025799 <GO>}

Got it. I got the point. The second question I have is -- and this relates to CCI, I think a comment was made that you have gotten good rate increases for some time, and hence, based on the book of business, that level of rate increases, it diminishes going forward. If you were to fast forward, let's say, to end of 2014, how do you foresee the rate versus loss cost accretion[ph] to shape up?

A - Dino Robusto {BIO 15021398 <GO>}

What I can say is we look at April. Pricing in April appears to be in line with what we saw in the First Quarter. But I can't predict what the rest of the year is going to bring.

What I can tell you is that we continue to differentiate our rate increases by account, based on the underwriting merits and the performance of each of the accounts, and you know, there's a meaningful difference in the average rate changes we get. And so, and we're going to continue to execute that strategy.

One thing on loss cost trends to keep in mind, obviously, you've got the benefits of the lag, earned impact of the prior quarters' higher rate increases, and those all play forward for a couple of quarters. But I can't really predict what's going to happen to rates by the end of the year.

Q - Amit Kumar {BIO 15025799 <GO>}

Okay, so all is somewhat of a steady state right now?

A - Dino Robusto {BIO 15021398 <GO>}

Yes, what we saw essentially in April.

Q - Amit Kumar {BIO 15025799 <GO>}

Got it, okay, that's all I have. Thanks for the answers and good luck for the future.

Operator

Josh Stirling, Sanford Bernstein.

Q - Josh Stirling {BIO 17463087 <GO>}

Thank you for taking the call. So I appreciate all the commentary on pricing, and it sounds like you guys think you are about adequate, and obviously record earnings, so it was probably good confirmation of that. The question is if you think about the industry structurally, you guys -- you have visibility to the way people actually act. We're just trying to respond to earnings calls and things.

What do you think happens when the rest of the industry isn't adequate? Are we going to maintain pricing stability more or less like around the rate of inflation, like theoretically the new rationality should lead people to do? Or when you talk about things like double-digit declines in reinsurance pricing, do you think we will see a real softening cycle if you look out six months or a year and you are doing your planning and you are thinking about the people you are actually competing with?

A - John Finnegan {BIO 1735942 <GO>}

I think for one thing, the industry is a good deal from price adequate. I think in some lines, we are getting the price adequate, and I would say in professional liability, for example, we have made great strides and we are probably running a steady-state 95, if you look at normalized expense account -- expense ratio. But that's still not really price adequate over a longer term with current interest rates.

I would guess the industry on a current accident-year basis, fully loaded for caps to current investment rates, the industry itself is probably running high single digits, at best. There are some of our competitors that are running like us, running low double digits, but that's still not quite where people want to be. So I think there's a ways to go.

There's a lot of people can speculate on how the market will react as we go down the road. I really don't have any great insight. I think we are all taking a wait-and-see. Reinsurance is interesting, but for now, it's a benefit to us. As to whether it will be a detriment down the road, just hard to say.

Q - Josh Stirling {BIO 17463087 <GO>}

That's fair. If I could ask another question, so I was surprised to see you guys shrinking internationally this quarter. I didn't -- I realized I didn't know that much, honestly, about your international businesses. But it is a 30-year book and we don't talk that much about it. I'm wondering if you can give just some color on what's going on, and big picture, the growth opportunities internationally, and how you guys are able to leverage the global -- leverage Chubb as a global brand? Thank you.

A - John Finnegan {BIO 1735942 <GO>}

Paul, you can answer. I will start off, it's more like a quarter of our business, not a third.

A - Paul Krump {BIO 5211397 <GO>}

Yes, I would say, Josh, this is Paul, it's about 25%. It depends on the line of business. In the personal lines space, it is right around 25%.

And we have had some very good opportunities for growth. What you saw, and we saw it mostly in our auto, because Brazil is a very large automobile market for us, and we took some rate action. I think Dino has mentioned that on previous calls. So we have been surgically improving the book of business there. So we had about flat policy in-force count in Brazil, but when it translated into US dollars, it came back about -- down about 10%.

If I go over to the accident and health business, another area that is more disproportionately outside the United States, it's almost the inverse, about 70% outside the United States, 30% inside the United States. We have been enjoying some very nice growth there and we have been writing both employer groups and some affinity groups, so things like travel accident for credit card holders outside the United States.

A - Dino Robusto {BIO 15021398 <GO>}

And on commercial, as we have been indicating over some of the prior calls, and we said it today, too, we got a lot less rate historically overseas. It's just a much more competitive marketplace, in particular, places like Europe, and clearly we're not going to chase any unprofitable business. We maintain a disciplined approach.

And so, we have seen a little bit less growth recently. Over time, though, we still see good potential and we expect that the underpricing will eventually catch up in the marketplace, and we will continue to be a player outside the United States.

Q - Josh Stirling {BIO 17463087 <GO>}

Great, thanks for the time.

Operator

Kai Pan, Morgan Stanley.

Q - Kai Pan {BIO 18669701 <GO>}

Thank you for taking my call. First question on the 150 basis-point deterioration in terms of your underlying combined ratio year over year. How much of that is attributable to this non-cat weather and the large fire losses, and also the surety loss?

A - John Finnegan {BIO 1735942 <GO>}

I would say about 200 basis points are attributable to non-cat weather and fire losses, so it's more that accounts for the total deterioration, and the surety loss will be another 1 point.

Q - Kai Pan {BIO 18669701 <GO>}

Another 1 point, okay.

A - Dino Robusto {BIO 15021398 <GO>}

And then, the fire losses were probably another 1 point as well.

Q - Kai Pan {BIO 18669701 <GO>}

Okay. So, as we -- the rate of increase actually is slowing down, and if inflation keep the same as it is right now, at what point we would no longer see the underlying margin expansion?

A - John Finnegan {BIO 1735942 <GO>}

I think part of the thing is that it is a little bit complicated, like most[ph] say. Margin expansion is a long-term projection that doesn't take into account quarter-to-quarter variations. We saw a significant variation this quarter. But just looking at it, you could do a mathematics and say it is a 1.5 points or 2 points. Now we still have an earned premium as we move forward in terms of margin expansion.

But also, remember, as rates come down, our book has improved, so whether you call that a lower loss cost trend line or a more immediate impact to loss costs right now, there is a benefit. You need 10 points if you have nothing but a lousy book, and when you prune that book, you don't need 10 point anymore. You need less points.

I don't know that you can just as easily just look at -- given what a book is, let's compare it to 4 points and say, is it 1 point or 2 higher? It is cutting it pretty close. I think right now we are getting margin expansion, but again, we have a better book, so we would expect a little bit less rate as we move forward.

Q - Kai Pan {BIO 18669701 <GO>}

Okay, thank you. Lastly, on the reinsurance costs, you mentioned that meaningful lower reinsurance costs. Would that flow directly into the bottom line or are you going to pass some of it on to consumers?

A - Ricky Spiro {BIO 15061279 <GO>}

Again, I think as John said, for now we're going to benefit from those lower costs. Whether or not we incorporated that into pricing as we go forward, time will tell.

A - John Finnegan {BIO 1735942 <GO>}

You think -- order of magnitude, you're thinking $30 million, $40 million, $50 million on a full $1 billion book, so it's not a major driver of the pricing decision.

Q - Kai Pan {BIO 18669701 <GO>}

Thank you, so much.

Operator

Vinay Misquith, Evercore.

Q - Vinay Misquith {BIO 6989856 <GO>}

For the higher fire losses and the non-cat weather, that is about 3 points year-over-year change. Just curious, how much of it was higher on a normalized basis for this quarter? So -- because last year, I believe, you had a below average number.

A - Ricky Spiro {BIO 15061279 <GO>}

Yes, give us one sec. So if you look over a five-year average for First Quarter for non-cat weather-related losses, and this is excluding the current First Quarter, so that the five years prior, we had about 7 points on average of non-cat weather-related losses in our First Quarter.

The same comparable number, if you look at fire losses, would have been about 8 points. I'm sorry -- yes, 8 points. And again, those numbers are on homeowners' loss ratio, not on the overall Company.

A - John Finnegan {BIO 1735942 <GO>}

And remember, you would expect that the First Quarter of a year would have a little bit higher non-cat related weather than most of the other quarters, right? Fire would be different, but non-cat related weather is more of a First Quarter weighting.

Q - Vinay Misquith {BIO 6989856 <GO>}

Sure. So for the non-cat weather, it was 7 points, on average, versus I think this quarter was 14 points, you said?

A - John Finnegan {BIO 1735942 <GO>}

Yes.

A - Ricky Spiro {BIO 15061279 <GO>}

Yes.

Q - Vinay Misquith {BIO 6989856 <GO>}

Right, and on the fire, the normalized is 8 versus -- so, was it 9 for this quarter?

A - John Finnegan {BIO 1735942 <GO>}

Paul.

A - Paul Krump {BIO 5211397 <GO>}

Yes.

Q - Vinay Misquith {BIO 6989856 <GO>}

Okay, that's helpful. Secondly, on the auto combined ratio, that also seemed to be high. I believe you mentioned 3 points or something. If you could just help me understand that, it would be helpful. Thanks.

A - John Finnegan {BIO 1735942 <GO>}

Sure, you're talking about the personal auto?

Q - Vinay Misquith {BIO 6989856 <GO>}

Yes, correct.

A - John Finnegan {BIO 1735942 <GO>}

Okay, what you have in the personal auto was the 3 points of the adverse weather that was hitting it. I mentioned as well we had experienced some profitability issues in Brazil. We have been taking action there. We feel like we are addressing that very adequately through our surgical underwriting action and specific rate taking by tier.

And I would just caution you to remember that we have a very small auto book in our portfolio, so it doesn't take much to move the overall combined ratio.

We have enjoyed good rate and exposure increases of 5 points in that book of business, and our US book has grown at 5%. So that is really the story behind auto on the personal lines front.

Q - Vinay Misquith {BIO 6989856 <GO>}

Fair enough. And just one last follow-up, so looking at the reduction in the pace of rate increases and the increase in the retention and the new to loss business, it seems that there is a modest improvement. But curious on your perspective as to how you look at the risk/reward tradeoff between taking less rate versus growing the book, because the book doesn't seem to be growing right now.

A - Dino Robusto {BIO 15021398 <GO>}

As I indicated a little bit earlier, after multiple years of rate-on-rate increases, plus given the fact that we have been culling the lowest performing parts of our book and managing our mix of business, increasingly we are focused on retaining our best accounts, and also, those kinds of rate increases have impacted some of the new business opportunities.

And so, we are looking at increasing the retention and going after a little bit more new business, which we saw. It didn't really manifest itself in total in the aggregate, as I indicated. Outside US was still a little bit more competitive, so our growth was down there, and there was a couple of additional factors affecting some of the growth on the US side.

Our exposure decrease was actually 2 points, and that was a function of the fact that we were reducing our participation on certain accounts to manage our aggregation, so that had a dampening effect on what you are seeing in terms of the higher retention and a little bit more new business. But directionally, clearly, we are interested in retaining more of our accounts and we see some good opportunities going forward. And so, as I indicated earlier, a little bit more optimistic that the growth will look a little better in the Second Quarter.

Q - Vinay Misquith {BIO 6989856 <GO>}

Okay, thank you.

Operator

Michael Nannizzi, Goldman Sachs.

Q - Michael Nannizzi {BIO 15198493 <GO>}

I guess one question I had was, obviously, reinsurance is very inexpensive for the market and for you in particular. Why not -- but the homeowners' book shrank, and obviously there were some issues on the homeowners' book that were specific to the quarter. But why not grow that book of business if you are able to get very good rate, you're comfortable with the risk profile, and you can buy inexpensive protection?

A - Paul Krump {BIO 5211397 <GO>}

First of all, Mike, this is Paul. And homeowners grew at 4% in the quarter. So, we felt pretty good about that.

I would tell you that we do look at reinsurance. Occasionally, we look at it opportunistically in the homeowners' front. It depends on the geography. It depends on the customer.

But when we most often step into the fact market is where we are looking at the ultrahigh net worth, the family office type exposures where they have properties all over the globe, often times in places like Florida, and that's where we use reinsurance the most often on a facultative basis in the homeowners' world. Dino, I don't know if you want to add anything?

A - Dino Robusto {BIO 15021398 <GO>}

We don't have any new overall strategy to increase our reinsurance prices, but clearly as thoughtful underwriters, we're always looking to maximize our risk/return trade-off, and lower reinsurance pricing could potentially offer us that on certain accounts and we will clearly look at that.

Q - Michael Nannizzi {BIO 15198493 <GO>}

Got it. And then maybe, if I could, Paul, on the comp book, can you comment just a bit on where that is right now on an underlying loss or combined ratio basis, and whether or not you are continuing to get rate there at the same level as previously or where that is factoring relative to loss trend? Thanks.

A - Dino Robusto {BIO 15021398 <GO>}

So the work comp, it continues to be very profitable for us. The rate increases for comp have declined from the higher levels that we saw in 2011 and 2012. But we continue to see some really good performance in it. Our growth was down a little bit this quarter, but in general, we are very optimistic about our comp portfolio. It's been historically very profitable, and we continue to see it as an opportunity going forward.

Q - Michael Nannizzi {BIO 15198493 <GO>}

So, where are you writing that business now? Can you tell us?

A - Dino Robusto {BIO 15021398 <GO>}

The combined ratio in the quarter for our commercial workers' comp was an 84.

Q - Michael Nannizzi {BIO 15198493 <GO>}

On an underwriting basis?

A - Dino Robusto {BIO 15021398 <GO>}

Yes.

A - Ricky Spiro {BIO 15061279 <GO>}

No, no, no, calendar year.

Q - Michael Nannizzi {BIO 15198493 <GO>}

Okay. Okay, so is there any -- I guess my question is, whether it is comp or other business, obviously you have your levels of profitability that you're willing to write business, and we can't see it at the segment level because we just don't have this disclosure. But is there -- is it -- are you seeing in the market competitors that are looking to get -- to frankly start to get more competitive and pick up your business if your threshold for profitability is higher than theirs?

Because if you are running an 84 at comp, you are probably writing it as a 74 on an underlying basis. Or -- no, I guess that's not[ph]. But it's clearly very profitable. Are other people willing to write that business at less profitable levels because they can clip the coupon on the investing side and maybe give you more competition, whether it's there or whether it's in other books?

A - Dino Robusto {BIO 15021398 <GO>}

Just in terms of the competitive side of it, as we have always indicated, right, we write our workers' comp -- our work comp portfolio in parallel with other coverages in our target niches, and it's attractive business.

It's been historically profitable, but our retentions have stayed historically very high, and clearly based on our value proposition, we can keep the business that we want on comp, based on all the other lines that we are writing. And to your question about where we are writing it, we are writing it across the US in line with our target market strategy.

A - Paul Krump {BIO 5211397 <GO>}

Mike, I would just add that as underwriters, we put our business into -- we tier it all the time. It's rare that we lose a customer just on a couple of points of price.

So, we know which ones are performing exceedingly well and which ones are not performing so well. So we put them into different cohorts, and our underwriters are trained to know when to back away and when to let an account go and when to hang on to one.

A - Dino Robusto {BIO 15021398 <GO>}

I think at 84, it was a very good quarter for workers' comp.

Q - Michael Nannizzi {BIO 15198493 <GO>}

Of course. Absolutely. Great, thank you very much.

Operator

Jay Cohen, Bank of America.

Q - Jay Cohen {BIO 1498813 <GO>}

A couple questions. You had mentioned, in the property reinsurance treaties, getting better terms and conditions. I am wondering if you could give us a bit more detail on that.

And then, the second question, might as well ask it, in CCI, did you have a similar experience with non-cat weather as you did in personal lines, or was that -- would you consider that to be fairly normal?

A - Dino Robusto {BIO 15021398 <GO>}

You want to answer it?

A - Ricky Spiro {BIO 15061279 <GO>}

Jay, it's Ricky. I'll start with the first question on reinsurance, and then Dino will take the non-cat weather.

So, in -- I will give you one example. The biggest change that we were able to achieve was with the definition of a single occurrence for a key peril. So as you probably know, within cat treaties a single occurrence for specific perils is based on the number of hours from the beginning of an occurrence to the end of an occurrence. And all the losses that fall within the hours caused for a given peril are covered as a single loss occurrence.

Generally speaking, longer hours causes are better for the ceding company, so you have more time in which to cover losses that occur as part of an event.

So with that as background, I will give you just one specific example. In our North American cat treaty for the peril of hurricane and tropical storm, our expiring hours cause was 96 hours, or four days, and our new hours cause is 168 hours, or seven days, so a meaningful increase in the length of time that we can put losses for a specific event.

And that sort of thing happened for almost all the perils in each of our major treaties, so a very positive development for us.

A - Dino Robusto {BIO 15021398 <GO>}

Then on the non-cat weather, it's clearly much more of a personal lines issue for us. In most cases, a weather event that could trigger large commercial losses is probably going to be designated a catastrophe, and in fact, in the First Quarter of 2014, we did not have any large non-cat weather-related property losses.

Q - Jay Cohen {BIO 1498813 <GO>}

Got it. If I could squeeze one more, it's a yes or no question. You talked about having some favorable development in the cat line. Was that also -- did that also show up in the favorable development that you talked about overall?

A - Ricky Spiro {BIO 15061279 <GO>}

Yes, it did. It was about 0.2 points of development related to that. So you don't double count, if you're trying to get to, say, our accident-year ex-cat combined ratio, you got to deduct about 0.2 points from the overall favorable development number.

Q - Jay Cohen {BIO 1498813 <GO>}

That's helpful. Thanks, Ricky.

Operator

Meyer Shields, KBW.

Q - Meyer Shields {BIO 4281064 <GO>}

Just with regard to the weather, does that have any favorable impact on workers' compensation because there is less activity going on outside? Is that at all relevant?

A - John Finnegan {BIO 1735942 <GO>}

It's a good question. I guess we have never thought of it that way before.

A - Dino Robusto {BIO 15021398 <GO>}

I don't think we have an answer to that. (multiple speakers) -- data points to give you.

Q - Meyer Shields {BIO 4281064 <GO>}

Okay, I am not trying to take anything away from the 84.

A - John Finnegan {BIO 1735942 <GO>}

I think, A, it's a good question. B, it stumped us. And C, I can assure you it wouldn't be material to the 84, I'm sure. Yes.

Q - Meyer Shields {BIO 4281064 <GO>}

Okay, that's the part that matters.

Second, with regard to the culling, I am not sure how to quantify this question, but can you compare how much of your book now is in the underperforming tiers compared to what a reasonable long-term target is?

A - Dino Robusto {BIO 15021398 <GO>}

I can't really quantify it exactly for you. What I can clearly tell you is that a lot more of our accounts in our book is rate adequate, and which is why you saw a little bit of the slight moderation in the rate. We are still getting, though, some strong differentiation.

One thing maybe as a data point that I can give you, if you look at distribution of the increases, in the US about 20% of our CCI book got greater than 10% rate increases, whereas in our professional liability, it was roughly a quarter of the book that got over 10%. In terms of price reductions, less than 10% of our book got rate decreases for both our commercial lines and professional liability lines, but clearly over time, we have less and less of the need for the larger rate increases.

Q - Meyer Shields {BIO 4281064 <GO>}

Okay, no, that's very helpful. And is there any difference in terms of loss cost trends outside of the US and inside?

A - Ricky Spiro {BIO 15061279 <GO>}

The lines of business roughly the same, I would say. It's roughly the same.

A - Paul Krump {BIO 5211397 <GO>}

Yes, I would agree.

Q - Meyer Shields {BIO 4281064 <GO>}

Okay, fantastic. Thank you, very much.

Operator

(Operator Instructions) Ian Gutterman, BAM Investments.

Q - Ian Gutterman {BIO 3106649 <GO>}

I just had a couple of questions on reserves. The first one, in CPI, the $5 million[ph] releases, I know that's the same as last year, but most quarters, that's 20, 30, 40 favorable. Was there anything that was less than usual in CPI?

A - Ricky Spiro {BIO 15061279 <GO>}

No, really, it's hard to say. Every quarter is different, as you know. Most of it came from personal other, and then there was a small piece that came from homeowners due to what we were talking about earlier, the favorable prior-year cats, and personal auto was a little bit adverse.

Q - Ian Gutterman {BIO 3106649 <GO>}

Okay, so there was less releases from home than usual, though, it sounds like?

A - Ricky Spiro {BIO 15061279 <GO>}

Yes.

Q - Ian Gutterman {BIO 3106649 <GO>}

Okay, and then the other one, this is a little bit more technical, but on D&O reserves, going through your Schedule P, the other liability claims made, my analysis, and I think several of the analysts on the sell-side published similar analyses that seem to show that, say, starting in 2010 through 2013, those accident years don't look to be reserved as well as the older years. At the same time, obviously, you guys have discussed over the past couple of years running hot in the lines that are more frequency-type lines that arguably would cause paids to happen sooner than if we looked at the historical paid pattern.

So I was wondering if you had any insights into why we are seeing that pattern where it seems like the reserves aren't as strong as we're used to seeing them for your professional lines?

A - Ricky Spiro {BIO 15061279 <GO>}

Sure. Well, obviously, as you point at it, if you aggregate what is shown in Part 2 of Schedule P for our individual writing companies, the average development in the other liability claims made for two of the accident years, that being 2011 and 2012, were slightly adverse, about $4 million adverse in 2012 and about $9 million adverse in 2011.

So when you say that they are developing adversely, that is really hardly any change at all.

The other thing I would say is there are naturally many moving parts within an aggregated line of business like this, so parsing movement this small and its contributing elements is inherently problematic. But as you point out, we have talked on prior earnings calls about, for example, some of the issues we have had with the employment practice liability line, and so part of the adverse development you are seeing is related to that.

Going forward, I would say these accident years are still green and we will see how they will develop over time, but we set our year-end reserves at what we believe are appropriate levels, and you guys can draw your own conclusions.

Q - Ian Gutterman {BIO 3106649 <GO>}

If I can just clarify a little bit, I am not so much worried that they developed adverse initially. It was more looking at the initial paids relative to incurred in the early years versus older early years, and the initial IBNR versus other years' IBNRs. Would that be -- it seems like there is maybe a tale that is changing. And it is obviously hard for us outside, given some of the points you raised, to disembowel that, I guess. Is there any suggestions you can give us on what appropriate adjustments might be that might give us a better answer?

A - Ricky Spiro {BIO 15061279 <GO>}

Yes, again, it's hard to point to anything specific. There have been some mix changes that may have some impact there, but nothing on a philosophical basis that I would point out.

Q - Ian Gutterman {BIO 3106649 <GO>}

Okay. Great. That's all I have for tonight. Thanks.

Operator

It appears there are no further questions at this time. Mr. Finnegan, I would like to turn the conference back to you for any additional or closing remarks.

A - John Finnegan {BIO 1735942 <GO>}

Thank you, very much for joining us. Have a good evening.

Operator

This concludes today's conference and thank you for your participation.