Q2 2014 Earnings Call

Company Participants

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

Other Participants

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

Presentation

Operator

,>> Operator Good day, everyone. Welcome to the Chubb Corporation's Second Quarter 2014 earnings conference call. Today's call is being recorded.

Before we begin, Chubb has asked me to make the following statements. 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 may 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 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 the financial supplement for the Second Quarter 2014, which are available on the Investor section of Chubb's website at, www.chubb.com.

Please note that no portion of this conference may be reproduced or rebroadcast in any form without Chubb's prior written consent. Replays of this webcast will be available through August 27, 2014. Those listening after July 24, 2014, should please note that the information and forecasts provided in this recording will not necessarily be updated and it is possible that the information will no longer be current.

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

John Finnegan {BIO 1735942 <GO>}

Thank you for joining us. Chubb produced solid results in the Second Quarter of 2014. We generated operating income per share of $1.70 and net income per share of $2.03. Our results benefited from strong premium growth of 5% X currency and our highest levels of retention for commercial and professional liability in three years. In addition, we enjoyed excellent profitability in our long-tail lines of business such as professional liability, casualty. And workers' compensation.

However, our results of the Second Quarter were adversely impacted by the performance of our short-tail property lines. We had unusually high levels of large fire losses in our commercial and personal books of property business. In addition, severe weather in the United States resulted in elevated non-catastrophe losses, as well as catastrophe losses of $0.39 per share.

The market remained stable in the Second Quarter, as evidenced by the continued increase in rates. We are pleased that we were able to secure mid-single digit increases in our US rate change metrics in all our businesses. With respect to our commercial and professional liability businesses, while the size of the increases was slightly less than in the First Quarter, we're very pleased that we're able to obtain these increases and still achieve higher levels of renewal retention.

We produced a Second Quarter combined ratio of 90% including 4.8 points of cats. Excluding cats, our combined ratio was 85.2%, compared to exceptionally low 80.9% in the Second Quarter of last year. That 80.9% last year was the best ex-cat combined ratio we've had for any quarter in the past six years.

Annualized operating ROE for the Second Quarter was 11.3%. Our annualized GAAP ROE was 12.2%. GAAP book value per share at June 30, 2014, was $68.60, an increase of 6% from the year-end 2013. Our capital position is excellent and we made good progress in our share repurchase program during the quarter.

For the first six months of 2014, we produced an income per share of $3.83 and operating income per share of $3.20. As a result of our performance in the first half, we have reduced our guidance for full year 2014 operating income per share to a range of $6.75 to $6.95, from the $7.10 to $7.40 range we provided in January. Ricky will discuss our revised guidance later. Now for more details on our operating performance we'll start with Dino who will discuss Chubb's commercial and specialty insurance operations.

Dino Robusto {BIO 15021398 <GO>}

Thanks, John. Chubb Commercial and Chubb Specialty Insurance, both had strong performance in the Second Quarter characterized by excellent underwriting results in most lines of business, particularly our long-tail line. We also had great retention, which as we stated last quarter was our focus. And a modest increase in new business, allowing us to improve our overall growth rate.

Starting with CCI, Second Quarter net written premiums were up 3% to $1.4 billion. While the commercial market is always competitive, our value-added underwriting-driven approach continues to work well. CCI's Second Quarter combined ratio was 93.3% compared to 89.9% in the corresponding quarter a year ago.

The impact of catastrophe losses accounted for 4.9 points of the combined ratio, compared to 8.1 points in the Second Quarter of 2013. Excluding the impact of catastrophes, CCI's Second Quarter combined ratio was 88.4% in 2014, compared to 81.8% in 2013. The deterioration in CCI's ex-cat combined ratio from a year ago was entirely explainable by the property and marine line of business. Our other three CCI lines performed well. And in fact, casualty and workers' comp had much better results than in the year-ago Second Quarter.

In the Second Quarter of this year, the property and marine business experienced significantly higher than usual ex-cat loss activity. This line had a combined ratio, excluding catastrophes of 97.4%, which was 34 points worse than the extremely low Second Quarter of 2013. And if we consider a longer historical perspective, this year's Second Quarter property and marine ex-cat combined ratio was about 15 points worse than our five-year average. At current earned premium levels, this equates to approximately $50 million.

This elevated loss activity was driven by a combination of several large fire losses and some non-cat weather-related losses. As we have pointed out in the past, property losses can fluctuate substantially in any one quarter. The Second Quarter last year was an unusually low outlier for the property and marine business with an ex-cat combined ratio of 63.1%. In fact, that was the best ex-cat combined ratio in nine and a half years. Whereas this year, the Second Quarter was an unusually high outlier. We have carefully analyzed the losses in the quarter and found no trends or issues that warrant any change in our underwriting strategy.

Partially offsetting the property results was an almost ten point improvement in the casualty combined ratio, the 85.3%, which was the best performance for casualty in 12 quarters. We also had about a 2 point improvement in workers' compensation combined ratio, an outstanding 84.5%, reinforcing our status as one of the most profitable workers' comp underwriters in the industry.

In our First Quarter conference call, we mentioned that in light of the rate increases over the past several years we were focusing on retaining profitable business and taking advantage of better priced new business and this focus favorably impacted our growth rates. While we are always looking to cull accounts where we cannot secure appropriate rates and terms and conditions, our underwriting and pricing actions over the past few years have resulted in there being fewer accounts that needed to be culled. This benefited both retention and the new to lost ratio.

Indeed, CCI's Second Quarter retention in the US increased to 87%, its highest level in ten quarters and up from 85% in the First Quarter of 2014. We achieved this 2 point increase in retention over the First Quarter while still securing average US renewal rate increases of 4%. Outside the US, CCI's average renewal rate increases continued in the low single digits.

With respect to new business, we continue to penetrate our target market segments where our unique expertise and products and services afford us the greatest opportunity to achieve our required risk-adjusted margin. CCI's new to lost ratio business in the US was 1.2 to 1 compared to 0.9 to 1 in the First Quarter of 2014.

Turning now to Chubb's specialty insurance, net written premiums were up 5% in the Second Quarter to $655 million. CSI's Second Quarter combined ratio was an outstanding 78.7% in 2014 versus 86% in 2013. For the professional liability portion of CSI, which represents the majority of the portfolio, net written premiums were up 4% to $572 million.

The combined ratio for professional liability improved to 83.2% from 91.9% in the Second Quarter of 2013 and from 84.6% in the First Quarter of 2014. The continued improvement in the combined ratio over time reflects our disciplined underwriting and culling actions, aided by our advanced analytic and predictive modeling, skillful portfolio management and the compound affect of the price increases we have achieved over the last few years.

Renewal retention for professional liability in the US in the Second Quarter improved to 88%, from 85% in the First Quarter of this year. As our rate taking and underwriting actions have earned into our renewable portfolio, as is the case with CCI, we have been increasingly focused on retaining our profitable renewal business, all the while securing a strong 6% average renewal rate increase. In markets outside the US, renewal rate increases remain consistent with prior quarters rising by low single digits.

Our new to lost business ratio for professional liability in the Second Quarter was 1.2 to 1 up from 0.9 to 1 in the First Quarter of 2014. And 0.8 to 1 in the Fourth Quarter of 2013. The steady improvement in this metric is driven both by less lost business as we focus on maintaining our profitable business, as well as our success in writing better priced new business available in the market after several years of industry rate increases and underwriting action.

One final note on our professional liability business. Several weeks ago the Supreme Court of the United States rendered its long-awaited decision in the Halliburton case. We view the ruling as a middle-of-the-road outcome and not unexpected. While it will take a long time to know the full impact, if any, on the frequency and severity of securities class actions, at this stage our perspective is that the ruling is a mild positive but should do little to change the current D&O landscape with respect to underwriting or pricing.

Turning now to the surety portion of the CSI book. Net written premiums were up 8% to $83 million. This compares to a decline of 13% in the First Quarter of 2014 and was driven by an increase in US construction activity among a few of our larger customers. Surety is a lumpy business from both a premium growth and a profitability standpoint.

The combined ratio was 45.3% compared to 42.1% in the Second Quarter of 2013. Despite the occasional large loss, our expertise in customer selection, underwriting and portfolio diversification, has enabled us to achieve outstanding long-term results in our surety line making this business very attractive to us.

In conclusion, the results of the Second Quarter demonstrate the continued success of our long-standing commercial and specialty underwriting strategy. In any one quarter, the profile of accounts that are up for renewal can vary and as we have noted in the past, the change in premium growth from one quarter to another is sometimes attributable more to the renewal or non-renewal of a few large accounts than to any underlying trend.

Nevertheless, we are confident that our underwriters will continue to manage the rate retention dynamic, in order to strive for the optimal balance based on the underwriting characteristics of each insured. It is this commitment to underwriting discipline, along with building strong relationships with the best agents and brokers in the industry. And providing our customers with unparalleled claims service that should enable us to continue to grow our business profitably over time.

And now I will turn it over to Paul who will review our results for CPI and corporate-wide claims.

Paul Krump {BIO 5211397 <GO>}

Thanks, Dino. Considering the elevated level of homeowners losses, Chubb personal insurance turned in a very good quarter. CPI's net written premiums increased 5% to $1.2 billion. And CPI produced a combined ratio of 92.7% compared to 89.6% in the corresponding quarter last year. The impact of catastrophes on CPI's Second Quarter combined ratio was 7.5percentage points in 2014. In the Second Quarter a year ago, the cat impact on CPI's combined ratio was 12.7 points. On an ex-cat basis, CPI's combined ratio was 85.2% in the Second Quarter of 2014, compared to 76.9% in the Second Quarter of 2013.

Homeowners premiums grew 4% in the quarter and the combined ratio was 92.2%, compared to 86.9% in the corresponding quarter last year. Cat losses accounted for 12.1 points of the homeowners' combined ratio in the Second Quarter of 2014, compared to 20.1 points in the Second Quarter of 2013. Excluding the impact of catastrophes, the 2014 Second Quarter homeowners combined ratio was 80.1%, compared to an extraordinary 66.8% in the same period a year ago, which was the lowest homeowners ex-cat combined ratio of any quarter in the previous eight years.

As in the First Quarter of this year, CPI experienced an elevated level of homeowners fire losses in the Second Quarter. For comparison, US fire losses in the Second Quarter of

2014 accounted for 13 points of the overall worldwide homeowners loss ratio, versus only 5 points in the Second Quarter of 2013. In addition, the effective US non-cat weather-related losses contributed about 2 points more of the loss ratio than in the corresponding quarter of 2013. Together, the impact of US fire and non-cat weather related losses accounted for 10 points of the year-over-year Second Quarter ex-cat combined ratio delta for homeowners.

Looking at our average combined impact of US fire non-cat weather; related losses on homeowners over the past five years, the impact in the Second Quarter this year was about 6 points worse than the average. At current earned premium levels this equates to about $40 million. Fire and weather losses do not occur in a linear fashion. We believe our book is well underwritten and that the losses will average out over time.

Homeowners rate and exposure premium increases totaled 7% in the US in the Second Quarter, the same as what we achieved in the First Quarter of this year, as well as in the Second Quarter of 2013. Apart from the dollar impact of rate taking, we continue to implement greater pricing sophistication as our ability to match price to specific risks improves, thus enhancing the quality of our portfolio. The use of sophisticated analytics is also helping us retain more of our best customers. We believe this suite of enhanced tools will continue to drive profitable growth in the years to come.

Personal auto premium growth was flat for the quarter, auto premiums increased in the US and decreased outside the US driven by currency fluctuations. The combined ratio was 95.6%, compared to 95.3% in the Second Quarter of 2013. Policy retention in the US in the Second Quarter was 90% for homeowners and 89% for auto, both of which were essentially unchanged from the First Quarter of 2014.

In other personal, which includes our accident, personal excess liability. And yacht lines, premiums increased 10%. And the combined ratio was 93.1%, compared to 93.3% in the Second Quarter a year ago. Growth was driven by accidents and personal excess.

Turning now to corporate-wide claims. Catastrophe losses for the Second Quarter totaled $146 million before tax. There were 13 cat events in the United States and two in Canada. The events included wind, flood and hail. And affected customers in 30 states and three Canadian provinces. The vast majority of our cat losses were in the US and were skewed to CPI.

As we are all aware, the season of hurricanes and heightened wildfires is upon us as evidenced by Hurricane Arthur in the Carolinas, as well as the wildfires that are burning in the northwestern United States. Thus far, we have had only a handful of small claims from these events. That said, it takes just one significant event to create intense demand for the claims services which are the hallmark of the Chubb brand. Therefore, each year we thoroughly review our cat preparedness protocols to ensure they are current and we incorporate lessons learned from prior events.

And with that, 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 review our updated earnings guidance. Looking first at our operating results, we had underwriting income of $278 million in the quarter. Property and casualty investment income after tax was down 4% to $275 million, due once again to lower reinvestment rates in both our domestic and international fixed maturity portfolios.

Net income was higher than operating income in the quarter due to net realized investment gains before tax of $125 million or $0.33 per share after tax, of which $0.15 per share came from our alternative investments. For comparison, in the Second Quarter of 2013, we had net realized investment gains before tax of $179 million or $0.44 per share after tax, of which $0.12 per share came from alternative investments.

You will recall that in the Second Quarter of last year we also recognized the gain of $0.21 per share related to the merger of Alterra Capital and Markel Corporation. As a reminder, unlike some of our competitors, we is 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 before tax at June 30th, was $2.6 billion, compared to $2.2 billion at the end of the First Quarter. The total carrying value of our consolidated investment portfolio was $43.5 billion as of June 30, 2014. The composition of our portfolio remains largely unchanged from the prior quarter. The average duration of our fixed maturity portfolio is four years and the average credit rating is AA3.

We continue to have excellent liquidity at the holding company. At June 30 our holding company portfolio had $2 billion of investments, including approximately $575 million of short-term investments. Book value per share under GAAP at June 30, 2014, was $68.60, compared to $64.83 at year-end 2013. And $60.76 a year ago. Adjusted book value per share which we calculate was available for sale fixed maturities at amortized costs, was $63.87, compared to $61.86 at 2013 year-end and $57.03 a year ago.

As for loss reserves, we estimate that we had favorable development in the Second Quarter of 2014 on prior-year reserves by SBU as follows. In CPI we had about $15 million. CCI had about $70 million. CSI had about $80 million. The runoff reinsurance assumed business had none, bringing our total favorable development to about $165 million for the quarter. This represents a favorable impact on the Second Quarter combined ratio of about 5.5 points overall.

For comparison, in the Second Quarter of 2013, we had about $215 million of favorable development for the Company overall, including $40 million in CPI, $115 million in CCI, $55 million in CSI. And $5 million in the runoff reinsurance assumed business. The favorable impact on the combined ratio in the Second Quarter of 2013 was about 7 points.

For the Second Quarter of 2014, our ex-cat accident year combined ratio was 90.6% compared to 88% in last year's Second Quarter. During the Second Quarter of 2014, our loss reserves increased by $28 million, including an increase of $35 million for the insurance business. And a decrease of $7 million for the runoff reinsurance assumed business. The overall increase in reserves reflects an increase of $21 million related to catastrophes and the impact of currency translation on loss reserves during the quarter resulted in a decrease in reserves of about $10 million.

Turning to capital management, during the Second Quarter we repurchased approximately 4 million shares at an aggregate cost of $375 million. The average cost of our repurchases in the quarter was $92.95 per share. At the end of the Second Quarter, we had $823 million available for share repurchases under our current authorization. And as we have said previously, expect to complete this program by the end of January 2015.

Before turning it back to John, let me provide you with some additional details on our updated guidance. We've revised our guidance for operating income per share for the full year to a range of $6.75 to $6.95 in the range of $7.10 to $7.40 that we provided in January. As John mentioned, we've reduced our guidance primarily because of our operating results in the first half of this year.

Our outlook for the second half of the year remains essentially unchanged from January when we provided our initial guidance. As a result, at the midpoint of our updated guidance, we expect our ex-cat combined ratio in the second half of the year to improve by about 1.5 points from our actual results for the first half of 2014, which was impacted by an unusually high level of large fire and non-cat weather-related losses.

Our revised guidance is based upon the following underlying assumptions. We expect our combined ratio for the full year 2014 to be in the range of 90% to 91% compared to the January guidance assumption of 89% to 90%. This change reflects our actual operating results in the first six months of the year. We are assuming 5 points of catastrophe losses for the second half of 2014. Based on the 5.7 points of actual cat losses we had in the first half, our assumption for the full year calculates to (5.3) points compared to the 5 point cat assumption in our original guidance.

For those who would like to make a higher or lower cat assumption, the impact of each percentage point of catastrophe losses for the full year on operating income per share is approximately $0.33. We expect net written premiums for the full year to increase 2% to 4%, with an insignificant impact of foreign currency translation. This assumption is unchanged from our January 2014 guidance.

We expect property and casualty investment income after tax to decline 4% to 6%, which is also unchanged from our January guidance. Finally, we assume 244 million average diluted shares are outstanding for the full year, compared to 245 million shares in our January guidance.

And now I'll turn it back to John.

John Finnegan {BIO 1735942 <GO>}

Thanks, Ricky. Despite an unusually high level of fire and weather-related losses, we produced solid earnings in the Second Quarter of this year, which included a number of very positive developments. With respect to the US market, we enjoyed mid-single digit rate increases, while increasing our overall retention to levels better than we've enjoyed for a number of years. In addition, our new to lost business ratios improved. The upshot was ex currency premium growth of 5% in the quarter, versus 1% in the First Quarter of this year.

Profitability of our professional line business continued to improve -- professional liability, I'm sorry -- reflecting rate increases in the underwriting initiatives begin to undertake at the end of 2011. Our combined ratio in professional liability of 83.9% for the first six months of 2014, represented about a 5 point improvement from calendar year 2013. And almost a 13 point improvement from calendar year 2012. In fact, the 83.9% posted in the first six months of this year is better than our professional liability performance in any full calendar year since 2007.

We also enjoyed terrific performance in other long-tail lines. For example, our 85.3% combined ratio in casualty was the best quarter we've had in three years. Equally as impressive was workers' compensation, where our combined ratios in each of the first two quarters of 2014 were the best we have recorded in any quarter in about six years. Our reserve position remains strong as reflected in the 5.5 points of favorable development we had in the quarter. And finally, during the first six months of 2014, book value per share increased 6% from year-end and will return more than $1 billion to shareholders in the form of stock repurchases and cash dividends.

On the minus side, our Second Quarter earnings were significantly dampened by an unusually high level of fire and non-cat weather; related losses, in both our commercial property and homeowners businesses. As we have mentioned in the past, wide fluctuation in losses in these areas from quarter to quarter are generally a function of the presence or absence of good fortune. Nevertheless, we have reviewed these losses exhaustively on a case-by-case basis to ensure that they do not reflect any important underlying trend.

So we expect a reversion to the mean over time. And as Ricky noted, in our updated guidance we've assumed some improvement in this loss experience in the second half of this year. With that, I'll open the line to your questions.

Questions And Answers

Operator

(Operator Instructions)

Amit Kumar, Macquarie.

Q - Amit Kumar {BIO 15025799 <GO>}

Thanks and good afternoon. Two quick questions on the guidance and the discussion on pricing. You mentioned better priced new business a few times. What is the approximate delta between the new business pricing and the renewed business pricing?

A - Dino Robusto {BIO 15021398 <GO>}

Hi, Amit, it's Dino. As we've always mentioned, it's not surprising that renewals are always going to perform better than new lines. We have an ability to review, lock, control and modify terms and conditions as needed. That usually results in reduced losses. We are always careful in our new business selection process. And that's why we just focused on the target niches that we did, where we have developed some expertise. And we see a little bit of contraction in that gap. But it's really just a function of new business always going to be a little bit less than renewals. There's always going to be a little bit of that gap.

We just stick to what we know in our target markets that we like and where we have expertise. And we were able to write a little bit more new business in the Second Quarter. Again, it's still at levels that are much lower than what they have been several years ago so just keep that (multiple speakers) new business volume.

Q - Amit Kumar {BIO 15025799 <GO>}

Got it. The other question I had is on the guidance on premiums. Based on your comments, it seems that you're probably incrementally more satisfied with the price adequacy of your accounts, guess the buckets which need rate increases. I would have imagined that seven months from the initial guidance probably you would have ended up thinking about retaining more and hence the NPW guidance might have changed. But it is essentially unchanged seven months from when it was announced. Can you maybe just explain that to me?

A - Ricky Spiro {BIO 15061279 <GO>}

I guess -- it's Ricky, I'll try. I guess as we think about the premium growth and we look at what we did in the first half and what we were thinking about when we came into the year, we were probably a little bit lighter in the first half for the year on margin than we had thought, given in the First Quarter this year we had premium growth of about 0% and 1% on an ex currency basis.

If I'm answering your question correctly, you probably will get a little incremental growth in the Second Quarter in order -- in the second half -- to get from where we were in the first half for the year to say the midpoint of the guidance. Does that help?

Q - Amit Kumar {BIO 15025799 <GO>}

Yes, I guess what I was asking was, Dino, are you now with seven months elapsed, are you more satisfied with the price adequacy of accounts than what you might have imagined at Jan, when you come out with the guidance?

A - Dino Robusto {BIO 15021398 <GO>}

Maybe I can just take a look at -- answer from overall rate adequacy and how we look at that if I can. And give you a little color and hopefully this answers it. I don't want to talk about rate adequacy in terms of specific percentage of the book because that's a little too over simplistic. The book is very dynamic, it is diversified, sophisticated, geographically diverse. And also risk characteristics of an account, or a set of accounts can change in any one year.

Having said that, clearly after the compound rate increases we've achieved over the last several years as well as the underwriting action, it's important to keep that in mind, we clearly feel that the book has improved in terms of rate adequacy. But there still are portions of the book that need rate. And you have to keep in mind that this happens really at the individual account level.

As I mentioned in my earlier remarks, our underwriters are focused on managing the rate retention dynamic based on the underwriting characteristics of each individual account. And so you'll still see some variation on the individual accounts. As an example, in the Second Quarter, in the top quintile by premium of rate increases, we're still getting greater than a 15% increase. And in the lowest quintile we were getting, giving about a 5% decrease. You're still seeing that variation. Clearly bottom line, after several years both of the rate increases and the underwriting actions the book has an improved in terms of rate adequacy.

A - John Finnegan {BIO 1735942 <GO>}

I would just point out thought, that it is a moving target and more rate we got over the first six months and improved rate adequacy. On the other side, interest rates and therefore investment income, prospects are down from the end of last year. You might remember interest rates are 50 points lower than they were at year end. There's headwinds here too.

Q - Amit Kumar {BIO 15025799 <GO>}

Got it. You answered my question. I apologize. I phrased the question poorly. Thank you.

Operator

Jay Gelb, Barclays.

Q - Jay Gelb {BIO 21247396 <GO>}

Thank you. And good afternoon. I want to ask you, given that we have seen the underlying combined ratio tick up to the low 90% range, from kind of high 80% level, should we anticipate going forward that low 90s is probably a more reasonable run rate? And that's excluding cats and prior development.

A - Ricky Spiro {BIO 15061279 <GO>}

Jay, it is Ricky. I don't think that is the correct assumption. If you look at the guidance that -- the updated guidance. And as we mentioned on the call, we are expecting some improvement in the combined ratio performance in the second half of the year. I wouldn't make that assumption.

In fact, (multiple speakers) -- as I mentioned when I talked in my remarks, when we came into year -- if you look at what our initial guidance was on an ex-cat combined ratio basis, you do the math between what the midpoint of our guidance is now versus what we had in the first half, in essence, we believe that were going to have the same performance in the second half as we'd assumed we started the year.

Q - Jay Gelb {BIO 21247396 <GO>}

So you would attribute the underlying combined ratio in the first half being in the low 90s more to these --

A - John Finnegan {BIO 1735942 <GO>}

Definitely. (multiple speakers)

Q - Jay Gelb {BIO 21247396 <GO>}

Fires and non-cat weather?

A - John Finnegan {BIO 1735942 <GO>}

Absolutely. If you look at the comparison to this year's -- to last year -- we look at year-over-year comparison, you're talking -- I think, Dino and Paul kind of gave it. But you're talking $180 million deterioration due to fire and non-cat weather. And in the commercial property and marine line. That's on $6 billion of premium -- that's a mouthful. That's three points right there.

And I guess for the second half our guidance is what 88%, 89%? What's the second half guidance? We gave 90% to 91% in the second half is a --

A - Ricky Spiro {BIO 15061279 <GO>}

Again, doing it on an ex-cat basis, it would be something similar to the ex-cat combined ratio we assumed at the beginning of year, which was about 84.5%, calendar year.

Q - Jay Gelb {BIO 21247396 <GO>}

I see. Okay. And on a separate issue, with regard to the Halliburton decision, I would have thought that could be more than a mild positive, given it has the ability to cull the number of securities claims before they get the class certification. So wouldn't that meaningfully, if not reduce the number of class actions, then at least take down overall severity and defense costs?

A - John Finnegan {BIO 1735942 <GO>}

If it all worked out, Jay. But I think we have to watch and see how the courts rule following the Supreme Court decision here. It's not clear what kind of real threshold they're applying in practical matter. So we're not beating a war drum, to it's a great victory. We have to see. And there are some arguments that it might increase defense costs on the other side. If courts take an aggressive approach to that decision, it would help. But again, we'll have to see what happens here.

Q - Jay Gelb {BIO 21247396 <GO>}

The defendants have the ability to say (multiple speakers) prove to us that you actually relied on that statement or that you didn't rely on that alleged fraud when you bought the stock.

A - Paul Krump {BIO 5211397 <GO>}

Jay, this is Paul. I would augment that a little by saying it's not just Halliburton, you've got Omnicare, you've got IndyMac, you've got a number of decisions out there. And what really encourages us, is that at first to court continues to choose these cases. So they have a right to accept them or not and they're choosing to take them. I think that gives us a lot of hope.

And second because these cases do present opportunities for the court to make changes that could benefit our insureds, the compounding effect of all of these cases could certainly be more than mildly positive. But taken on an individual basis, I think it is characteristic of a mild positive for Halliburton is correct.

A - Dino Robusto {BIO 15021398 <GO>}

And again, Jay, it was also the context that we didn't think it's going to change the marketplace in the near term, right? That people are going to wait.

Q - Jay Gelb {BIO 21247396 <GO>}

I see. That's helpful. Thank you.

Operator

Josh Stirling, Sanford Bernstein.

Q - Josh Stirling {BIO 17463087 <GO>}

Hi. Good evening. Thanks for taking my call. As you guys are shifting from focusing on driving margins to really more about retention and getting into growth mode, I thought I'd ask a couple more longer-term questions on your posture with growth. Paul, think you mentioned -- you brought up a topic I hadn't heard you guys talk about before which was sophisticated analytics. And I thought it was interesting because I always think of you guys first and foremost of having a brand. And agent relationships. And sort of good business selection to start off with.

I'm wondering if you could give us a sense of what -- maybe what more is behind the comment? And what kinds of things are you guys doing to integrate analytics in your strategy? And maybe where you think you stand compared to some of your competitors? And if you think that analytics can start to be a competitive advantage for you guys?

A - Paul Krump {BIO 5211397 <GO>}

Absolutely, Josh. We've talked before, I know Dino, last year for example, brought up our panorama of product and that is certainly taken our auto to a far more sophisticated level. We've got many tiers there. Remember, what we write in automobile isn't the same as, say, some of the large direct writers that have been using sophisticated analytics for a very long time.

That said, when we talk about our fleets of affluent or high net worth or high valued cars, that type of thing, these tools are very sophisticated in helping us a lot to retain the right business and to attract new business. The same thing can be said for our pricing tiers and our predictive models around the homeowners as well for the affluent. Now, your point about our brand, our relationships with agents, all of that comes into play. And the analytics are just one part of the tool. But they're not everything. Dino, do you want to touch on the (multiple speakers) side?

A - Dino Robusto {BIO 15021398 <GO>}

Yes, just at the introduction of your question, our increased retention, is increased retention of profitable business. We are always focused on increasing our margins. I don't want -- just want to clarify that point.

Just to talk a little bit about the analytics on professional liability. As an example there, our strategy and our capabilities are geared toward really taking advantage of the wealth of experience and our tremendously rich data set of information that we have, having underwritten literally hundreds of thousands of professional liability policies over roughly more than three decades.

It's through this expertise and the data mining of coverage, pricing, loss data we've built proprietary underwriting and account ranking tools. And these tools can be also supplemented with external data feeds. And it's the proprietary analytical tools are then just one more arrow in the underwriter's quiver, for them to drop on making renewal decisions. As Paul said, analytics are increasing in this industry. But where we see it as being a real competitive advantage for us is because of the history of proprietary data that we have amassed over time. And the underwriters are very pleased with the additional insight gained from these tools. And we intend to continue to invest in this area.

A - Paul Krump {BIO 5211397 <GO>}

Yes, Josh, not to beat it to death but we not only use them on the front-end underwriting side but we're using an awful lot of tools on the backend, on the claim side as well. So for example, some of our tools -- our predictive models around fraud detection and workers' compensation. You are seeing that manifest itself in some of the spectacular world-class combined ratios in workers' comp.

A - John Finnegan {BIO 1735942 <GO>}

Let me interrupt, Josh, we are primarily focused on profitability. We are very happy with the growth we've gotten in the Second Quarter. We didn't have much growth in the Second Quarter. Our accounts are in strong form, we want to retain more of the accounts and we think that is certainly a stepping stone to more profitability. But we're not giving away any rate to do so. We're getting what the market will bear and what we need on the accounts.

Q - Josh Stirling {BIO 17463087 <GO>}

Got it. That's really helpful. If I could ask just one other topic that comes to mind. A bit not so internally focused, a little more risk management and just sense of growth and how you think about the risk return and the opportunity. Obviously the property markets changed a lot with changes to the reinsurance industry. Smaller guys starting to try to take share and write more Florida business, more coastal opportunities. How do you guys think about the coast these days? Are you still running from them and try to play defense? Or is it something we could see you be -- sort of a big opportunity for Chubb here?

A - Paul Krump {BIO 5211397 <GO>}

I'll mention the coastal piece here, Josh, because I think you're probably thinking along the homeowners side of it. Again, I'll go back to what John really emphasized around profitable growth. Where we're seeing it on the homeowners side, frankly is, mainly we're seeing some customers that have exposure in Florida along the coast, where heretofore, we weren't able to necessarily take on that house. But given their spread of risk that they bring to us, not just in Florida. But maybe in the Northeast, Illinois. And other places, we're able to use some reinsurance opportunistically to hang on to those type of customers. Or to even write some more than we've seen in the past. Dino, I don't know if you want to touch on anything commercially?

A - Dino Robusto {BIO 15021398 <GO>}

I'll point out that the cat modeling agencies have significantly reduced PMLs on the coastal areas which hasn't hurt either.

Q - Josh Stirling {BIO 17463087 <GO>}

Got it. Thank you.

Operator

Vinay Misquith, Evercore.

Q - Vinay Misquith {BIO 6989856 <GO>}

Hello. Good evening. The first question is the above average property, marine losses and the fire losses in homeowners. We've seen that for a couple of quarters. And I think you touched upon this in your remarks -- in the opening remarks. But if you could help us understand if we see some sort of trend developing? Or is it just quarterly volatility?

A - John Finnegan {BIO 1735942 <GO>}

I think that in the First Quarter, we had a very high non-cat weather related losses in homeowners. And that's because the weather was awful. We'd expected that. This quarter we had somewhat higher non-cat related weather, fire losses kicked in. First quarter we really didn't have unusually high commercial property and marine loss, just the Second Quarter last year was so unusually low, at 63% combined. This quarter, sometimes they stack up. You just never know. The quarters are discrete on a piece of paper but things roll forward. We -- our loss experience was not very good in the Second Quarter. But we can't find any trend.

Last year when I was on these calls and we had usually low losses I certainly didn't talk about any trends. In fact, what I suggested to you all was that you should not project our combined ratios in the future based on margin expansion off the base period last year -- combined ratio last year, because it was so low. Similarly, I don't think you should project anything out to next year off this year's Second Quarter combined ratio, because I think it's unusually high. You're talking way beyond what we normally have in way beyond we had Second Quarter last year.

A - Paul Krump {BIO 5211397 <GO>}

This is Paul, if you look back on the homeowners side to 2009 you can see another period where we had some anomalous losses. We've been writing high net worth homes now for 30 years and as we go back and we looked at the history of this, there have been periods where you do get that misfortune of a rash of some fires. As John mentioned, we've scrubbed each of these individual accounts to look for anything that we can learn from them and try to detect any trends. But at the end of the day, I think the conclusion is this is the insurance business.

Q - Vinay Misquith {BIO 6989856 <GO>}

Sure, that's helpful. Thank you. Just to follow up on the pricing and the competitive environment. If you could just give us an update on the competitive environment out there? Thanks.

A - Dino Robusto {BIO 15021398 <GO>}

Sure, we categorize it as clearly the market is competitive. But frankly, it usually is. On average, we would say that the pricing dynamics though in the market are rational. We can always point to a situation where you're going to scratch your head asking why a competitor may have written an account at a low price. But in general, we're see most of the pricing pressure emerge on the most profitable accounts. If you have an account with longer term profitability will, on average, it's going to be priced much more aggressively than an insured with a similar operation that is historically less profitable, or inherently has tougher exposures. Which makes sense, in particular after multiple years of rate increases.

One area where we might question the rationality of pricing is around some large accounts. Example, a situation where you have a low six-figure property account versus say a large seven-figure similar property account, the latter is going to tend to have much more aggressive pricing, even if the true exposure to loss on the larger one is far greater. And this dynamic seems to be especially prevalent in, at least wholesale and E&S markets, as we see it. I guess for some you can conclude that the lure of the big premium is the driving motivation.

Quite frankly, in our opinion size doesn't matter. It's really the price and the terms and conditions measured against the risk characteristics that we rely on. In fact, if you look at our retention rate on these larger accounts is below our overall retention rate. We just choose to draw a line in the sand.

In professional liability -- that was mainly commercial but in professional liability you see the same dynamics. The better businesses is being more aggressively priced, however we also continue to see general acceptance in professional liability for meaningful price increases on those lines of business that have had particularly poor profitability over the years, such as EPL and we view this stability as encouraging.

I guess I'd say that's against this kind of competitive backdrop, we are pleased with our mid-single digit average rate increases, in both commercial and professional liability. And combined with some of the highest levels of retention so that's a general feel for the market. I hope that helps.

Q - Vinay Misquith {BIO 6989856 <GO>}

Yes. Thank you.

Operator

Mike Nannizzi, Goldman Sachs.

Q - Mike Nannizzi {BIO 15198493 <GO>}

Thanks. One question maybe on other personal lines, saw that picked up a bit. Was that -- is that bundling? Or is there another effort or something else that's whooshing that lift a couple quarters here in the double digits recently? So I'm just curious, sort of what's been driving that? An then just a follow up. Thanks.

A - Paul Krump {BIO 5211397 <GO>}

No problem, Mike. Other personal is where we report our accident and health business. And that makes up just a little that 50% of other personal. The remainder then as represented by personal excess and yacht. Accident, as I mentioned, has the highest growth driven by travel accident coverage in the United States. Personal excess liability also grew. But that was fueled by both rate and exposure.

On a year-to-date basis other personal grew about 6%. And I think it grew at 6% for the entire year of 2013. Other personal growth it will oscillate a little bit throughout the year because if we have an addition or subtraction of a single premium program. That can pretty much drive the growth in any one three month period of time. I would just tell you that overall, we are very optimistic about our opportunities in accident, as well as personal excess. And in the last couple of months we've seen some uptick in the yacht purchasing. In the mega yacht business. And that's good for us as well. That's what you're seeing out there on other personal.

Q - Mike Nannizzi {BIO 15198493 <GO>}

Got it. And is the A&H cohort something expect to trend higher? Is that relatively sustainable?

A - Paul Krump {BIO 5211397 <GO>}

Yes. We've got some very good plans for A&H in the coming years. I've mentioned before that we've invested in a team of underwriters over the last five years. We built in some infrastructure around the globe. And we are finding out that our reputation and our quality of our paper and the relationships are making a big difference in that marketplace. And in fact, we're finding that there is just an awful lot of commercial accounts that we can round out with A&H coverage. And we're also seeing a lot of high net worth individuals that are looking to purchase travel accident as well.

Q - Mike Nannizzi {BIO 15198493 <GO>}

Great. Thanks. Then just one sort of bigger picture question. On this recent volatility we have seen. I get, it is part of the business and it's part of the reason that you're able to extract the premiums you do. But I would imagine there are reinsurance solutions out there, especially given the state of that market on the property side at this point. Would you or have you looked into solutions that might help you reduce the volatility of earnings and attritional losses outside of cats?

A - Ricky Spiro {BIO 15061279 <GO>}

It's Ricky. Obviously given the environment, as you point out, we to constantly monitor the reinsurance alternatives available in the market to see whether they can not only improve our overall performance of our portfolio. But also to help us manage our volatility, perhaps potentially grow. All at the same time while trying to maintain or improve our combined ratios. We have and will continue to consider a variety of options in both the traditional and alternative markets. And as always, we look at the cost of these alternatives versus the benefit of purchasing protection. And while we routinely manage our overall portfolio reinsurance strategy by reviewing various types of risk, transfer options we're not going to change our long-standing strategy of focusing on proper underwriting and pricing of each risk.

Having said all that, we are looking at all kinds of different alternatives. We understand that there are opportunities in the marketplace. But as you might expect as always, we try to balance the potential short-term opportunities with our long-term objectives and strategies. We are looking at things but they've got to meet our particular objectives and our strategy.

A - John Finnegan {BIO 1735942 <GO>}

In the end, we're an insurance company and we have to bear some risk. And eliminating volatility is a big step from eliminating true balance sheet risk. And you've given away a lot of profitability. So you look at the downside. This was the worst quarter we've had since I've been here, in terms of fire losses and this kind of thing. And at three points worse than the five year average and guess what? We still made $2.00 a share in net income. We're sorry we didn't hit what we expected to hit. But this awful quarter we make $2.00 a share, I don't think we have to insure it away.

Q - Mike Nannizzi {BIO 15198493 <GO>}

Got it. Okay. Thank you very much.

Operator

Kai Pan, Morgan Stanley.

Q - Kai Pan {BIO 18669701 <GO>}

Good evening. Thank you for taking my call. The first question is, do you see any loss cost trend across your business? And the question is really, as you see the pricing increase gradually slowing down, I just wonder at what point the price increase essentially matching the loss cost trend that we'll see no margin expansion or potentially margin contraction?

A - John Finnegan {BIO 1735942 <GO>}

Let's talk a little about it. Let's take -- we used, we say often that we have 4% loss cost trend. I don't think from looking at -- margin expansion is kind of a theoretical notion. But as you project combined ratios out, I think it's important to understand what's really going on there. We're above that in CPI and CSI. We are right about that in CCI.

You've got to take into account a couple of things when you project out loss ratios in the future. The first is that long term loss trends are different than what we might expect for losses in a given short term period. For example, when we talk about loss cost trends we generally meet the economic forces our portfolio faces before consideration of any underwriting initiatives. Any business exchanges that we might adopt. They assume a passive underwriting approach. Workers' compensation, it might be -- all we're talking about is -- it's going to be more than 4% there. But medical care and cost inflation and payroll inflation. It doesn't take into account the types of things we might do in terms of changes in business mix, (inaudible) predictive analytics we use in claims -- in adjusting these things.

We're constantly seeking to improve our books of business in ways beyond just rate taking. Focused underwriting initiatives, culling in performing risks. If we're successful in our book management, the effective year over year pressure on our loss ratios, over time, would generally be less than the long-term loss trend itself. That's one.

Two, as a mentioned before when you project loss ratios you better pick a base period that's representative. Last year, as I said, we talked about don't use the Second Quarter last year -- that's very, very low. And we found out that wouldn't have been a good quarter to use, both because the Second Quarter was low and this year's Second Quarter was high. Going forward I would suggest that you look at what you call margin expansion or future loss cost, you also take into account that the Second Quarter is awfully high loss ratio and you probably need to assume some reversion to the mean, as you project out into the future for loss trends. Just not apply the difference in margin expansion. That help?

Q - Kai Pan {BIO 18669701 <GO>}

Yes. Thank you for that. Just different topic on the buyback. Looks like the first half, you returned some buybacks and dividends more than what you earned in operating earnings. Is it fair to assume that you could return 100% operating earnings through the entire 2014?

A - Ricky Spiro {BIO 15061279 <GO>}

Yes. Our objective, as we've said in the past, on average is that the buyback in essence would be equal to operating earnings less shareholder dividends. If you actually did the math when we came into this year, we were going to give back a little bit more than that formula might suggest. And even with the updated guidance, operating earnings will exceed that amount. Operating earnings less dividends will be a little bit less than our share buyback efforts. It depends on the period. But on average we would expect that we would use the operating earnings less dividends as sort of the guideline.

A - John Finnegan {BIO 1735942 <GO>}

You might recall last year the opposite happened. We were a couple hundred million dollars more in operating earnings less dividends. And we're not going to adjust the program if we're $400 million short in income this year. Obviously, if we have a big catastrophe all bets are off.

A - Ricky Spiro {BIO 15061279 <GO>}

We continue to believe that we have a significant excess capital position. So we have plenty of flexibility.

Q - Kai Pan {BIO 18669701 <GO>}

Thank you. So much for all the answers.

Operator

Jay Cohen, Bank of America Merrill Lynch.

Q - Jay Cohen {BIO 1498813 <GO>}

Thank you. Couple questions. First is on the surety business. Obviously a big contributor to your profitability. I guess we're hearing some noise that that business is getting more competitive. I want you to kind of discuss what you are seeing there. Secondly, the favorable developments in the specialty business, presumably that's coming from the professional lines business, was really the highest we've seen in something like six years or so. I'm wondering if you can get into more detail of what drove that pretty significant favorable reserve development in the quarter?

A - Dino Robusto {BIO 15021398 <GO>}

Maybe I can start just with on the surety piece. Clearly it's a competitive market because really surety capacity has increased over the last several years. But demand is down. Obviously due to the slow down in the construction in the US, as well as actually many geographies around the world. It has put pressure on rates. But we can and we obviously do compete successfully, really because of our brand, our underwriting acumen, our pricing discipline. And the quality of customers that we have. And we have been able to do that very well. Since it grows slowly -- the surety business. And it's a little bit lumpy. But has been historically very profitable. And we're going to continue steady as she goes.

A - Ricky Spiro {BIO 15061279 <GO>}

Jay, as a relates to the question on development, let me try to give you -- I'll give you a few data points to answer that. First, if you look at the development we took in CSI for this quarter which was $80 million, it was driven mainly as you rightly point out by professional liability. But surety was also favorable. And within professional liability it was driven by D&O and fiduciary and it was partially offset by some small adverse development in the crime and fidelity classes.

If you go back and look at it compared to a year ago quarter, where we also had more development this quarter than we did in the Second Quarter of 2013, that was mainly because a year ago we had more offsetting adverse development in crime and fidelity, E&O and EPL reflecting some of the trends that we've talked about on this call and on prior calls as well.

Q - Jay Cohen {BIO 1498813 <GO>}

That's helpful. And on the D&O and fiduciary, what accident years are we talking about?

A - Ricky Spiro {BIO 15061279 <GO>}

We're talking 2010 and prior.

Q - Jay Cohen {BIO 1498813 <GO>}

Great. Thank you.

Operator

Meyer Shields, KBW.

Q - Meyer Shields {BIO 4281064 <GO>}

Thanks. Good afternoon. I was just hoping I could get the catastrophe numbers for the other segments besides homeowners?

A - Paul Krump {BIO 5211397 <GO>}

Give me a second here.

A - Ricky Spiro {BIO 15061279 <GO>}

You want the split between commercial and personal?

Q - Meyer Shields {BIO 4281064 <GO>}

If I could get it by line, that would be great but I will take whatever is available.

A - Paul Krump {BIO 5211397 <GO>}

Okay. Let's see here, I have got -- right here by the line here. We have got package at 5 multi peril. Then we come down to property and marine, 13.1. Homeowners, 12.1.

Q - Meyer Shields {BIO 4281064 <GO>}

So nothing in auto?

A - Paul Krump {BIO 5211397 <GO>}

Auto, personal, it was tiny -- it was 0.6.

A - John Finnegan {BIO 1735942 <GO>}

That's enough.

Q - Meyer Shields {BIO 4281064 <GO>}

Okay. Thanks very much.

Operator

Ian Gutterman, Balyasny.

Q - Ian Gutterman {BIO 18249218 <GO>}

Hi. Thank you. I guess I wanted to follow up first on the fire losses. Was there any other, maybe the first split I'll take is -- was this a large number of fires relative to normal? Or was it a few in just very high-end homes? I'm basically getting at, is it frequency or severity issue?

A - John Finnegan {BIO 1735942 <GO>}

Both.

Q - Meyer Shields {BIO 4281064 <GO>}

Both. (multiple speakers)

A - John Finnegan {BIO 1735942 <GO>}

To get these numbers you've got to have a large number. And by our nature, the kind of business we have, they're large in dollars too. But it wasn't two major, major losses. There was a lot of losses.

Q - Ian Gutterman {BIO 18249218 <GO>}

Got it. But the fact that we are calling these non-cat means they weren't wildfire related or tornado related or anything like that?

A - Paul Krump {BIO 5211397 <GO>}

You are absolutely correct. We make a distinction between a brushfire that would get a PCS cat number, say a wildfire that might take place out in California or something and burn up a neighborhood. That may or may not. But if it got a cat number we would put that in the cat numbers. These are just large individual homes that burned to the ground, that's the business we're in.

Q - Ian Gutterman {BIO 18249218 <GO>}

Got it. And has there been any issue as far as on the severity that rebuild cost is maybe higher than you think? Or insured values were too low? Or anything that suggests, aside from the frequency that there might be something you might tighten up on the underwriting?

A - Paul Krump {BIO 5211397 <GO>}

It is a great question and the answer is no. We've gone through those files with a fine tooth comb. We're very proud of our appraisal process. Getting the insurance to value is absolutely key for us. It's part of our underwriting DNA because if we don't get that valuation right nothing else really matters because the rates are promulgated off of that. That's a big difference when we send people when they really understand high net worth homes. All the special millwork and all the special features and fixtures to the homes. We have fine art specialists, jewelry specialists, you name it. That's our bread and butter.

Q - Ian Gutterman {BIO 18249218 <GO>}

Perfect. That was my real concern. Ricky, a question on the guidance -- make sure I heard right. I think you said earlier that the implied second half is a point and a half better combined ratio than the first half? But it looks like the fire and the non-cat was about three points impact on the first half. So that would imply the second half apples to apples is a point and a half worse than the first half. I'm I doing that right?

A - Ricky Spiro {BIO 15061279 <GO>}

Yes. The other piece that I didn't talk about would be development.

Q - Ian Gutterman {BIO 18249218 <GO>}

Got it. Got it. Okay. So we're assuming less development in the second than the first?

A - Ricky Spiro {BIO 15061279 <GO>}

No. We don't make any specific development assumption. We run a whole bunch of different scenarios so you make your own (guess).

Q - Ian Gutterman {BIO 18249218 <GO>}

Got it. Got it. My last one, is it the pickup in the new to lost ratio, given that the retention picked up, was it more of a function of less lost business and stable new business? Or was it more new business and stable lost business? I'm just trying to get a sense of was it more of an offensive or defensive driver, I guess? Or both?

A - Ricky Spiro {BIO 15061279 <GO>}

It was both but it was mainly attributable to the higher retention ratio in both CCI in CSI.

Q - Ian Gutterman {BIO 18249218 <GO>}

Perfect. I think that's all I had. Thanks so much.

Operator

With no further questions in the phone queue, I would like to turn the call back over to John Finnegan for any additional or closing remarks.

A - John Finnegan {BIO 1735942 <GO>}

Thank you very much and have a good evening.

Operator

This does conclude today's conference. We thank you for your participation.