Q2 2013 Earnings Call

Company Participants

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

Other Participants

- Amit Kumar, Analyst
- Gregory Locraft, Analyst
- Jay Cohen, Analyst
- Jay Gelb, Analyst
- Josh Shanker, Analyst
- Josh Stirling, Analyst
- Meyer Shields, Analyst
- Michael Nannizzi, Analyst
- Mike Zaremski, Analyst
- Vinay Misquith, Analyst

Presentation

Operator

Good day, everyone. Welcome to Chubb Corporation's Second Quarter 2013 earnings conference. 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 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 today 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 the financial supplement for the Second Quarter 2013, which are available on the Investor Section of Chubb's website at www.Chubb.com.

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I would now like to turn the call over to Mr. Finnegan.

John Finnegan {BIO 1735942 <GO>}

Thank you for joining us. As we said in our earnings release, Chubb produced excellent results in the Second Quarter of 2013. We generated operating income per share of $1.77 and net income per share of $2.21, both of which were among the highest of any quarter in Chubb's history. These results were achieved despite the adverse impact of catastrophe losses of $0.59 per share.

Earnings in the quarter benefited from a positive effect on earned premiums of rate increases in recent periods and a continued low level of non-CAT loss activity. Net written premiums for the quarter were flat. We produced a combined ratio of 88.8, including nearly 8 points of catastrophe losses. Excluding catastrophes, our combined ratio was 80.9%, which is 5.4 points better than the Second Quarter of last year, and the best ex-CAT combined ratio we have had in any quarter since 2007. These results reflect our focus on bottom-line profitability, underwriting discipline and push for higher rates, necessitated by the dual headwinds of lower investment income and continued high levels of catastrophe losses.

Annualized operating ROE for the Second Quarter was 13.1%. Annualized GAAP ROE was 14.7%. GAAP book value per share at June 30, 2013 was $60.76. Our capital position is excellent, and we made good progress in our share repurchase program, as Ricky will discuss later.

In terms of the US market environment, the data would indicate that the Second Quarter was at least as strong as the first. In homeowners, renewal change increased nearly half a point to just over 7 points, and is now more than 2 points higher than in the Second Quarter of 2012, without any impact on retention.

Professional Liability was especially strong with a 9 point renewal rate increase, the same as in the First Quarter, with retention moving up 3 points from 81 to 84. Professional Liability renewal rate increases are now 2 points higher than they were in all of calendar year 2012, with a slightly high retention level.

In standard commercial lines, renewal rates continue to increase at an 8% level, consistent with our experience over the last 18 months. With retention dropping 1 point from 84 to 83, due to the intentional nonrenewal of one large poor performing account.

Outside the US, renewal rates for CCI and CSI range from flat to low single-digit increases. We also had rate improvement in Personal Lines comparable to that in the US.

Coming on the heels of a great First Quarter, the outstanding Second Quarter helped us attain a record operating income per share of $3.91 for the first six months of 2013, as well as record net income per share of $4.69. In light of our performance in the first half of the year and our outlook for the second half, we have increased our guidance for full-year 2013 operating income per share to a range of $7.30 to $7.50 from the $6.40 to $6.80 range we provided in our January 2013 guidance.

We have raised our guidance despite an increase in our catastrophe loss assumption for the full year, from 4percentage points to 4.6 points.

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

Paul Krump {BIO 5211397 <GO>}

Thanks, John. The Chubb commercial insurance net written premiums for the Second Quarter declined 3% to $1.3 billion. The combined ratio was 89.9 versus 97.5 in the Second Quarter of 2012. The impact of catastrophes in the Second Quarter of 2013 was 8.1percentage points, nearly identical to the 8.2 points we had in the corresponding quarter of 2012. Excluding the impact of catastrophes, CCI's Second Quarter combined ratio improved 7.5 points to 81.8 from 89.3 in the Second Quarter of 2012, due to improved rate levels as well as unusually low non-CAT property losses.

We are pleased that CCI's average US renewal rates increased in the Second Quarter by 8%, the ninth consecutive quarter of rate increases in the United States for CCI. The 8% compares with the 8% we obtained in this year's First Quarter and 9% in the year-ago Second Quarter. This level of rate increases has been consistent through the past six quarters.

CCI obtained US renewal rate increases in each line of business in the Second Quarter of 2013. General liability rates increased the most, with a low double-digit average. These were followed by monoline property, Workers' Compensation, package, excess umbrella, automobile, boiler and Marine. Rate increases across the product lines were very similar to what we obtained in the First Quarter of this year.

In CCI markets outside of the United States, average renewal rate increases in Canada, Europe and Australia were in the low single-digit range in the Second Quarter, similar to the First Quarter of this year. Average renewal rates in Latin America and Asia were flat in the Second Quarter, also similar to the First Quarter. CCI's Second Quarter US renewal retention rate was 83%, down 1 point from the First Quarter of the year.

CCI's new to lost business ratio in the United States was 0.7-to-1 in the Second Quarter, down from 0.8-to-1 in the First Quarter. The 3% decline in CCI's worldwide premiums in the Second Quarter included a 7% decline in written premiums outside of the United States. With the exception of Asia-Pacific, premiums declined in each of CCI's three other zones outside of the United States. Growth was down the most in Europe, where the sluggish economy negatively impacted renewal exposure growth.

In addition, in many countries and industry segments outside of the US, we experienced greater resistance to rate increases. And this took a toll on both renewal retention and new account acquisition. As we remain disciplined in our underwriting and pricing analysis, we find certain segments of the market are still unattractively priced. Finally, our growth outside the US reflected a small adverse impact from currency translation.

In the United States, CCI premiums in the Second Quarter were down 1%, reflecting the slight decline in retention, along with a decline in renewal exposure. These declines resulted primarily from our decision to not renew a large unprofitable account, and to greatly reduce our participation on another sizable account, which has substantial CAT exposure in the Northeast.

Turning to Chubb's Specialty Insurance. Net written premiums declined 2% in the Second Quarter, to $626 million. And the combined ratio was 86%. For the Professional Liability portion of CSI, net written premiums were down 1% to $549 million. And the combined ratio was 91.9 -- a 6 point improvement compared to the 97.9 we recorded in the Second Quarter of 2012. We are very encouraged that average renewal rates for Professional Liability in the US increased by 9% in the Second Quarter, making it the seventh consecutive quarter of rate increases. The 9% increase compares to 9% in the First Quarter of this year, and 7% in the Second Quarter a year ago.

CSI obtained renewal rate increases in the United States in each of its Professional Liability lines of business in the Second Quarter of 2013. Rate increases were led by private company D&O, which experienced average renewal rate increases in the mid-teens. Private company D&O rate increases were followed by EPL, not-for-profit D&O, public company D&O, prime, E&O, and fiduciary.

In markets outside of the United States, average renewal rates for Professional Liability improved in the Second Quarter by low single digits with small variations by territory. Renewal premium retention for Professional Liability in the Second Quarter was 84% in the US, an improvement of 3 points over the First Quarter. The new to lost business ratio for Professional Liability in the US also improved to 0.7-to-1 in the Second Quarter, from 0.6-to-1 in the First Quarter of this year.

With respect to the overall market tone for Professional Liability lines in the Second Quarter, we saw the US market experience a more widespread acceptance of the need for rate increases for the typical account, especially in the EPL and private company D&O lines. In fact, in the United States, we secured rate increases on 84% of all the Professional Liability policies that we renewed in the Second Quarter, compared to 73% in the First Quarter.

Regarding the surety portion of CSI, net written premiums in the Second Quarter were down 7% to $77 million. And the combined ratio was an outstanding 42.1. As you know, surety is a lumpy business. For example, the 7% decline in Second Quarter surety premiums is in contrast to the 30% growth we experienced in the First Quarter of this year when several existing customers won larger bondable projects.

And with that, I will turn it over to Dino, who will review our Personal Lines results, as well as corporate wide claims.

Dino Robusto {BIO 15021398 <GO>}

Thanks, Paul. Chubb Personal Insurance net written premiums increased 4% to $1.2 billion, and CPI produced a combined ratio of 89.6 compared to 91.2 in the corresponding quarter last year. The impact of catastrophes on CPI's Second Quarter combined ratio was 12.7 points in 2013. In the Second Quarter a year ago, the CAT impact on CPI's combined ratio was 11.5 points.

On an ex-CAT basis, CPI's combined ratio was 76.9 in the Second Quarter compared to 79.7 in the Second Quarter of 2012. Homeowners premiums grew 4% for the quarter, and the combined ratio was 86.9 compared to 90.3 in the corresponding quarter last year. CAT losses accounted for 20.1 points of the homeowners combined ratio in the Second Quarter of 2013, compared to 18 points in the Second Quarter of 2012.

I will provide more detail on catastrophes when I review corporate wide claims activity. Excluding the impact of catastrophes, the 2013 Second Quarter homeowners combined ratio improved to 66.8 from 72.3 in the same period a year ago, reflecting an unusually low level of non-CAT fire losses.

Personal auto premiums increased 5%, and the combined ratio was 95.3 compared to 93.2 in the Second Quarter of 2012. The growth in personal auto for the quarter reflected higher premiums, both in the United States and outside the US.

In other personal, which includes our accident, personal access liability, and yacht lines, premiums were up 3%, and the combined ratio was 93.3 compared to 92.6 in the Second Quarter a year ago. Quality retention in the Second Quarter was 91% for homeowners and 89% for auto, both of which are essentially unchanged from the First Quarter of 2013 and the Second Quarter of 2012. In the Second Quarter of 2013, we achieved homeowners rate and exposure premium increases totaling about 7% in the United States. In short, Personal Lines had another excellent quarter.

Turning now to claims corporate wide, catastrophe losses for the Second Quarter totaled $237 million before tax, with $173 million coming from the US and $64 million stemming from catastrophes outside the US. Personal Lines accounted for about 55% of the catastrophe losses, and commercial lines for about 45%.

There were 14 declared CAT events in the United States in the Second Quarter of this year. However, most of the losses we experienced were from four severe thunderstorms, hail and wind events, in the central United States. The most severe of the four was the tornado in Moore, Oklahoma, which particularly affected one of our large commercial customers. Outside the United States, we had five CAT events, but roughly 90% of our losses were attributable to the floods in Southern Alberta. Several affluent communities in Calgary, where we have a significant market share of the high-value homes, were particularly impacted by this unprecedented event in Alberta's recorded history. By contrast, we had virtually no losses from the severe flooding event in Central Europe.

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

Richard Spiro {BIO 15061279 <GO>}

Thanks, Dino. 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 strong underwriting income of $317 million in the quarter compared to $159 million in the Second Quarter a year ago. Property and Casualty investment income after tax was down 6% to $286 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 $179 million or $0.44 per share after-tax, of which $0.12 per share came from our alternative investments. During the quarter, we also recognized a gain of $0.21 per share related to the merger of Alterra Capital and Markel Corporation. The remainder of our gains during the quarter came principally from the sale of equity securities.

For comparison, in the Second Quarter of 2012, we had net realized investment gains before tax of $47 million or $0.11 per share after-tax, of which $0.13 per share came from alternative investments. Unrealized depreciation[ph] before tax at June 30, 2013 was $2 billion compared to $3.1 billion at the end of the First Quarter. Unrealized depreciation[ph] declined this quarter due to the recent sharp rise in interest rates.

The total carrying value of our consolidated investment portfolio was $42.9 billion as of June 30. The composition of our portfolio remains largely unchanged from the prior quarter. The average duration of our fixed maturity portfolio is 3.8 years, and the average credit rating is AA three. We continue to have excellent liquidity at the Holding Company. At June 30, 2013, our Holding Company portfolio had $2 billion of investments, including approximately $600 million of short-term investments.

Book value per share under GAAP at June 30, 2013 was $60.76 compared to $60.45 at year-end 2012, and $58.54 a year ago. GAAP book value in the quarter was negatively affected by the change in unrealized depreciation that I described earlier. Adjusted book value per share, which we calculate with available-for-sale fixed maturities and amortized cost, was $57.03 compared to $53.80 at 2012 year-end and $52.34 a year ago.

As for loss reserves, we estimate that we had favorable development in the Second Quarter of 2013 on prior-year reserves by SBU as follows. In CPI, we had about $40 million. CCI had $115 million. CSI had $55 million, and reinsurance assumed had $5 million, bringing our total favorable development to about $215 million for the quarter. This represents a favorable impact on the Second Quarter combined ratio of about 7 points overall.

For comparison, in the Second Quarter of 2012, we had about $165 million of favorable development for the Company overall, including $30 million in CPI, $85 million in CCI, $40 million in CSI, and $10 million in reinsurance assumed. The favorable impact on the combined ratio in the Second Quarter of 2012 was about 5.5 points, including about half a point of favorable development for prior-year catastrophes.

For the Second Quarter of 2013, our ex-CAT accident year combined ratio was 88 compared to 91.4 in last year's Second Quarter, an improvement of nearly 3.5 points. During the Second Quarter of 2013, our loss reserves increased by $19 million, including an increase of $36 million for the insurance business and a decrease of $17 million for the reinsurance assumed business, which is in runoff. The overall increase in reserves reflects an increase of about $60 million related to catastrophes, and the impact of currency translation of loss reserves during the quarter resulted in an increase in reserves of about $50 million.

Turning to capital management, during the Second Quarter, we repurchased approximately 3.7 million shares at an aggregate cost of $323 million. The average cost of our repurchases in the quarter was $87.28 per share. At the end of the Second Quarter, we had $758 million available for share repurchases under our current authorization. as we have said previously, we expect to complete this program by the end of January 2014.

Before turning it back to John, let me provide you with some additional details on our revised guidance. We have increased our guidance for operating income per share for the full year to a range of $7.30 to $7.50 from the range of $6.40 to $6.80 that we have provided in January. As John mentioned, our increased guidance reflects our strong ex-CAT operating performance in the first half of this year, as well as our outlook for the balance of the year.

Our increased guidance is based upon the following underlying assumptions. We expect our combined ratio for 2013 to be about 88, compared to the January guidance assumption of 89 to 91. We are assuming 5 points of catastrophe losses for the second half of 2013. Based on the 4.3 points of actual CAT losses that we had in the first half, our assumption for the full year calculates to 4.6 points, or it's 6/10 of a point higher than the 4 point CAT assumption in our original guidance. This increase in our catastrophe assumption is more than offset by the expected improvement in our full-year ex-CAT combined ratio.

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 $0.30. We expect net written premiums for the full year to increase 1% to 3%, including a 1% negative impact of foreign currency translation based on exchange rates as of June 30, 2013. Our January 2013 guidance had assumed that net written premiums would be up 2% to 4%, with no impact of foreign currency translation.

We expect Property and Casualty investment income after-tax to be down 6% to 8%. Our January guidance assumed a decline of 7% to 9%. Finally, we assumed 259 million average diluted shares are outstanding for the full year, compared to 260 million shares in our January guidance.

And now I'll turn it back to John.

John Finnegan {BIO 1735942 <GO>}

We had an outstanding Second Quarter with operating earnings per share of $1.77 and an annualized operating ROE of 13.1. This performance is driven by a terrific ex-CAT combined ratio of 80.9. These results came on top of a record First Quarter performance and resulted in record six-month operating income per share of $3.91, an ex-CAT combined ratio of 82.4, and an annualized operating ROE of 14.7. GAAP ROE for the first six months was 15.6. And it's frequently been the case over the last few years, this quarter was marked by a high level of catastrophe losses and an unusually low level of non-CAT losses. On the catastrophe side, losses have been above our historical averages for the last three years, and this trend has continued into the first half of 2013.

It's a combination of higher catastrophe losses and lower investment yields, which continues to drive our rate base[ph]. Excluding catastrophe, our first half combined ratio of 82.4 was the second-best we have recorded in recent memory. These outstanding results have been driven in part by significant rate increases, which have resulted in longer-term margin expansion in the United States. And our current rate is now running about 2 to 3 points above[ph] our long-term ex-CAT loss from core[ph] insurance.

In addition to margin expansion, our results have benefited from an unusually low level of non-catastrophe related losses, which recently have been running well below longer-term trend lines. In part, this can be ascribed to rigorous underwriting initiatives implemented two years ago to call our existing book and to greatly enhance underwriting discipline as it relates to new business. Both have had the intended effect of significantly re-profiling our book for the better.

At the same time, however, we recognize that we've also enjoyed a great deal of good fortune in terms of the unusually low level of non-catastrophe-related losses. This is particularly illustrated by our outstanding first half results in our commercial and homeowners property lines, where we had benefited from the absence of almost any large losses. In homeowners alone, fire losses were down 5 points in the Second Quarter from historical averages.

In terms of the current environment, the US market remains firm, as evidenced by the fact that we continue to achieve mid to high single-digit rate increases in all of our business units in the Second Quarter, with generally stable retention levels. Assuming rate increases that are close to current levels in the second half of the year, this should result in continued margin expansion, although actual results in the second half will be more a function of swings in actual loss experience than longer-term trends.

In developing our updated guidance, we believe it to be overly optimistic to assume that large losses would continue to run at unusually low levels. Thus we have assumed some partial reversion to hire historical levels of loss experience from large losses in the second half of the year. This is one of the reasons for our forecast 2 point deterioration in our second half ex-CAT combined ratio from our near-record first-half performance. Even with this forecasted deterioration, our revised guidance at the midpoint implies operating income per share in the second half of $3.49, which would be the best operating EPS of any second half in our history.

The bottom line is that we performed superbly in the first half of 2013 from both a market and profitability perspective. Going forward, we're optimistic about the rest of the year, as is evidenced by our updated guidance. As Ricky has indicated, all of this results in updated operating income per share guidance of $7.30 to $7.50 for the full year, which would easily be record calendar year results for Chubb.

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

Questions And Answers

Operator

(Operator Instructions) Amit Kumar, Macquarie.

Q - Amit Kumar {BIO 15025799 <GO>}

Thanks. Good afternoon and congrats on the results. Two quick questions. I guess first is the numbers question. You mentioned there was a large and profitable account that was nonrenewed. Can you sort of qualify what the impact was?

A - John Finnegan {BIO 1735942 <GO>}

It was about 1 point. It was about the entire reason for the 1 point decline in retention. Now as there are obviously a lot of pluses and minuses, around that, but it was about 1 point.

Q - Amit Kumar {BIO 15025799 <GO>}

1 point. Okay, that's helpful. The other question is in the opening remarks you mentioned this is the ninth consecutive quarter of rate increases. Obviously, very strong rates. As you look forward, do you expect to be able to push forward for these rates? Or do you think we are at an inflection point in terms of pricing?

A - John Finnegan {BIO 1735942 <GO>}

I don't have a crystal ball, and there are lots of opinions all over the place. I would say that we had a strong a Second Quarter as we had a first. And we seem to be off to a pretty good start in the Third Quarter. So I guess trees don't grow to heaven and some time it may change, but right now, we're feeling pretty good about the market.

Q - Amit Kumar {BIO 15025799 <GO>}

Got it. And then can you also talk about -- and this is the last question -- on I guess the interplay between exposure change and the economy, have you seen some initial impact of that on your numbers yet?

A - Paul Krump {BIO 5211397 <GO>}

Hi, Amit. This is Paul, and thanks for congratulating us on the quarter. As respects of the CCI numbers, the interplay here was quite interesting for the quarter. First of all, Workers' Compensation actually had some renewable exposure increase. That means that our customers actually gave us higher payroll projections for the year going forward than they had in the past.

The drop was really in the other lines. And I would tell you that after Irene and Sandy, we looked at our CAT exposure, in particular in the Northeast, and there were a number of accounts where we decided to take smaller participations on them. That drop-off in participation gets recorded as an exposure drop-off, and that's really what impacted the exposure.

As respects going forward, you probably have a better handle than I do on the economy, but I think it's probably much the same. But I don't think we will have the same type of culling exercise going on in the Northeast that we experienced in the Second Quarter.

Q - Amit Kumar {BIO 15025799 <GO>}

Got it, thanks. Thanks for the answers. That's it.

Operator

Mike Zaremski, Credit Suisse.

Q - Mike Zaremski {BIO 20606248 <GO>}

Could you comment on pricing and competition in Personal Lines in the US, auto versus homeowners?

A - Dino Robusto {BIO 15021398 <GO>}

Yes in our case, the pricing continues; we continue to have good momentum in both auto and homeowners. On our homeowner rate increases, we are in the process of filing mid to high single digits, and up to about the low-teens in some areas of the Northeast, as I mentioned previously. And so that's -- so continued momentum, because you're looking at historically 2011, we had ended the year with a homeowner renewal change written impact for rate and exposure of about 3%. By year-end '12, we had gotten a 5% and we expect to have about 7% at the end of '13.

And in auto, we have gotten a couple of points of rate and we're also seeing some exposure on auto. And we expect that to continue. The momentum is good on both homeowners and auto.

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Q - Mike Zaremski {BIO 20606248 <GO>}

And what about auto loss cost expenses, if I may?

A - Dino Robusto {BIO 15021398 <GO>}

Yes, so, our loss cost trend on auto is roughly about 3 points. So with our pricing and our exposure changes that we are seeing, we're about at loss cost and going forward, we will see some meaningful margin expansion. You know, all else, of course, being equal.

Q - Mike Zaremski {BIO 20606248 <GO>}

Okay, and lastly, I know you guys don't have a crystal ball, but you do have a decent size book of business of Workers' Comp. Does Chubb expect medical loss inflation levels to rise next year when the Affordable Care Act is implemented?

A - John Finnegan {BIO 1735942 <GO>}

Paul?

A - Paul Krump {BIO 5211397 <GO>}

I don't think that we are necessarily going to predict which way it's going to flow. We have had a lot of debates here, but at this point, it's really the House is divided if it's going to go up or maybe even come down.

Q - Mike Zaremski {BIO 20606248 <GO>}

Got it. Nice quarter. Thanks.

Operator

Gregory Locraft, Morgan Stanley.

Q - Gregory Locraft {BIO 16836287 <GO>}

Wanted to just sort of understand from an ROE perspective, things are running really well now. Sounds like you're not going to take the foot off on the pricing side; margins should continue to expand. Is there an ROE that you are sort of aiming for or we're trying to get to? Or -- yes. I mean, how do you think about how much you want to do?

A - Richard Spiro {BIO 15061279 <GO>}

(multiple speakers) Sure. Hey, Greg, it's Ricky. As we have stated in the past, our ROE target has been pretty consistent over the last number of years. Our goal is to achieve a return on equity of inflation plus 10% over the life of the cycle. This obviously would imply that we would expect to (technical difficulty) this target in hard markets and possibly underperforming and soft markets. And if you look at our historical results, we have tracked pretty well with this objectives from past cycles. And at this time, we're sticking with that ROE target.

Q - Gregory Locraft {BIO 16836287 <GO>}

Okay, are you at that target now? I mean, it seems like you guys are hitting that.

A - Richard Spiro {BIO 15061279 <GO>}

Yes, we are hitting at when you look at it on a reported basis, but when you look at it on an accident year basis, even with the 88% ex-CAT accident year combined ratio we had in the Second Quarter, if you add a normalized CAT load on top of that, and we can all debate what's the right normalized CAT load, you are still talking about accident year ROEs that are high single-digits, low double digits. And that's for us, and we think our numbers are going to be probably as good as anyone in the industry. Right? So if you look at the rest of industry, they are still in single-digit land in terms of ROE on an accident year basis.

Q - Gregory Locraft {BIO 16836287 <GO>}

Right, okay, great. Good, well congrats again. Great numbers.

Operator

Jay Gelb, Barclays.

Q - Jay Gelb {BIO 21247396 <GO>}

With regard to the pace of rate improvement, particularly in CCI, we have heard from a number of other insurers that the pace of improvement in rate and price has crested. So I'm just thinking -- I am just trying to get a better sense of what you feel is different about your book that rate increases are sustained not only in 2Q, but you're saying also that could probably be the case for the remainder of this year.

A - Paul Krump {BIO 5211397 <GO>}

Hey, Jay, it's Paul. I will take a stab at this. Maybe just talk a little bit about the Second Quarter and then what we know so far. I mean, rate increases for commercial business in June were very consistent with the overall rate increases for the entire Second Quarter. With respect to the market in July, we obviously do not have the final data for the month. However, based on the preliminary assessment of interim monthly reports, some of the feedback from our most trusted field officers, we're seeing no significant change in overall market tone.

This is probably at odds with some of the industry participants who have suggested that some parts of the commercial market may be softening or experiencing some additional competition. But probably the big difference with us is that we are primarily a middle-market commercial player. We hear the talk about the large property accounts. We have much less participation in that jumbo risk management property market than many others that might be making those comments.

So, we'll -- right now everything that we see, it's very much similar to what we saw in First Quarter and what we saw in the Second Quarter. And speculating going forward is --

we're just not going to do it.

Q - Jay Gelb {BIO 21247396 <GO>}

Okay. And then the other point I just wanted to clarify was on the 2Q CSI, the downshifting in growth there. I mean, I know you talked about pulling back a bit on catastrophe exposed commercial accounts, and including in the Northeast, but I'm just wondering what else is going on there to have overall CCI down 3% year-over-year, when it was, I believe, up around 3% in the First Quarter?

A - Richard Spiro {BIO 15061279 <GO>}

Yes, you're going to see some bouncing around when it comes to the exposure. I mean, it really was -- I think the anomaly when we looked at it really was that that action that we were taking on a number of the property accounts. Obviously, the sluggish economy is playing a role here. And then overseas is playing a big piece of it as well.

In the markets overseas, we haven't been getting the overall rate increases that we've been getting in the United States. Our focus overseas is very much like it is the United States. It's on profit. Our book overseas is as profitable as our book in the United States over the recent years. So what we still believe ultimately we need to take rate there as well.

A - John Finnegan {BIO 1735942 <GO>}

Yes, I would add that I think the Second Quarter had a few anomalies in it, but I do think that growth will be -- will not be robust in CCI, given our focus on profitability. However, we are certainly inspecting to be back in the positive zone and CCI growth in the second half of the year without affecting the way we underwrite some -- what we have in guidance implies a positive growth in CCI in the second half of the year.

Q - Jay Gelb {BIO 21247396 <GO>}

Makes sense, thank you.

A - Richard Spiro {BIO 15061279 <GO>}

This is Ricky. One quick clarification to my earlier comment on accident year ROE. I just want to make it clear that when I'm talking about accident year returns, we are talking about new money rates and not looking at the existing portfolio yields in our portfolio. Thanks.

Operator

Michael Nannizzi, Goldman Sachs.

Q - Michael Nannizzi {BIO 15198493 <GO>}

So I guess first question, do you guys -- by any chance, do you use, Ricky, any derivatives or anything on the interest rate management side as far as the portfolio is concerned?

And is there an interest rate scenario where you might do that? Or is that not kind of part of the protocol?

A - Richard Spiro {BIO 15061279 <GO>}

You know, it's something that we have looked at from time to time. We just never thought that the risk reward of it made sense, so we have not been in the past. I wouldn't rule it out, but it is not something we have done historically to any great extent.

Q - Michael Nannizzi {BIO 15198493 <GO>}

Got it. And then I guess -- I mean, I try to do the math and get close, but if you were to back out in the Second Quarter, I mean, how much of the increase in guidance is related to the big favorable development that we saw in the Second Quarter, as opposed to better outlook for the back half of the year on an underlying basis?

A - John Finnegan {BIO 1735942 <GO>}

I'll take that. It's sort of two different questions. I mean, obviously, the improvement of guidance for the year is a function of how well we did in the first half, to some degree, clearly.

Q - Michael Nannizzi {BIO 15198493 <GO>}

Right.

A - John Finnegan {BIO 1735942 <GO>}

As I said, we are forecasting about a 2 point deterioration in ex-CAT combined ratio in the second half from the first half, due to what we believe to be the -- it would be very bullish to assume we're going to continue to have such a low level of large losses. Now that 2 point deterioration still gives us a second half which -- ex-CAT combined ratio, which is better than our initial January guidance for the full year.

How those come about, those -- come in a variety of scenarios, and a large losses hit in a variety of ways, whether it be by business unit or accident year, prior period development. So we don't break out any prior period development number for the second half of the year. I think that attainment of our objective in the second half will require some prior period development, clearly. But it's under a variety of scenarios. It has no precise development number in it.

Q - Michael Nannizzi {BIO 15198493 <GO>}

Thanks. So I mean, and I guess Professional Liability, you are definitely getting a lot of rate. It seems like there may be some new folks looking to compete there. Obviously, you are not seeing that. But when I look at the rate gain that you've gotten, I mean, we're still kind of now several quarters of now mid to high single-digit rate gains -- I'm sorry, I've got one, two, three, four five -- five quarters above 5%. But it looks like if all the development in that segment is related to Personal Liability, you are still writing that business at over 100%. And maybe my math is wrong, but it seems to be the case.

So I am just trying to connect those two. At what point do you get to -- how much more rate do you need to get to action in your underwriting profitability there?

A - John Finnegan {BIO 1735942 <GO>}

Well, that's a good point. Your farmer's math is good. We ran the accident year at about 100% in the Second Quarter, similar to First Quarter, slightly better. If you compare it to last year, our reported number was significantly better -- 6 or 7 points. And about half of that was more development. The other half we had an improvement of 3 points or so. A little -- an accident year, combined ratio. It would be closer to four if you add for the loss ratio.

We talked about this on the year end call and the First Quarter call. We're not obviously happy with where we are. The rate we're getting is going to help us. Our loss ratios have continued to improve. It's a long tail line of business so I wouldn't expect we'd have a significant improvement in accident year during the current year. You know, we have to get the data in.

But if rates continue, we will continue to improve next year in our accident year. And we are on the right -- but we have a ways to go in Professional Liability. You're going to get that down pretty low. But, fortunately, we have a good deal of development that's occurred so we're happy about that.

Q - Michael Nannizzi {BIO 15198493 <GO>}

Got it. And then just last one, I don't know, Ricky. if you could talk a little bit about the reinsurance program. Any changes in price or coverage that you purchased specifically? And did you take up or did you have any alternative capital participants take up any of your program? Thanks.

A - Richard Spiro {BIO 15061279 <GO>}

Sure, I talked a little bit about the renewal of our cap program on the last call. And there was a description in the First Quarter Q. Really no significant changes, and in terms of capital markets participants other than the CAT bonds that we have done nothing significant at all from that point of view.

Q - Michael Nannizzi {BIO 15198493 <GO>}

Okay, thank you.

Operator

Josh Stirling, Sanford Bernstein.

Q - Josh Stirling {BIO 17463087 <GO>}

Thank you for taking the call. So over the past couple of years, you folks have been awfully disciplined, started early re-underwriting. And now we're seeing the market maybe move away from you a little bit. I am wondering when do you think you'll be able to shift back from sort of a clear focus on profitability to one that's a bit more balanced with growth, in US commercial and specialty, for example?

A - John Finnegan {BIO 1735942 <GO>}

Well, I think, you take specialty, I mean, we've got to continue to focus -- you heard the answer to the last question, we have to continue to focus on profitability, because at 100[ph], there is no balance to be had. I mean, an accident year of 100[ph] just isn't acceptable. So we will have a foot on the metal on that one for a while. If the market continues to improve, we will see some growth to go with it. But we shall see.

A - Dino Robusto {BIO 15021398 <GO>}

In commercial, obviously, we have a more profitable book. We're hoping that, given the rate environment that you're going to see some new business now that's acceptable to us. More rates improved and more likely that is to occur, prefer a little improvement in Europe.

I think that you will see that the Second Quarter, when growth was low, 4% in the First Quarter was probably in line with the industry. And we expect to revert to the positive in the third and Fourth Quarters. So we will always err on the side of profitability, especially in areas that require more rate, but we expect growth to improve from the Second Quarter as we get into the second half of this year.

Q - Josh Stirling {BIO 17463087 <GO>}

Got it, that's helpful. And a question -- just follow-up on the question of low double-digit ROEs is sort of with new money pricing targets, the question would be with written rate is running ahead of earned, and we're starting to see the money rates rise, when you're sitting and working with your actuaries, what sort of magnitude of rate increases do you think we still need? And I think that is sort of a factual question, not a forecast one.

A - John Finnegan {BIO 1735942 <GO>}

Well, first, I'll start on that. Written rate now, just to clarify, we have kind of caught up with earned rate and written rate for the most part, except in Personal Lines, there's a little to go. But in commercial has been running 8% for so long, and written and earned is there. And professional, there's not much of a difference. Personal, maybe there is a point or two difference.

So think of written and earned as being pretty close together. Now in terms of money rates, I will let Ricky take that.

A - Richard Spiro {BIO 15061279 <GO>}

Sure. Look, obviously, we welcome the impact of higher yields on our investment income, but as I mentioned earlier, even with -- where new money rates are today, we're still not making what we deem to be acceptable accident year ROEs. And, again, the industry is doing probably well behind us. So while the rise in rates is a nice -- in interest rates, is a nice thing, it's certainly better than a decline in interest rates. And there is still a long way to go, and we don't see that really impacting our push for rate.

Q - Josh Stirling {BIO 17463087 <GO>}

Great, thanks, and congrats on the quarter.

Operator

Jay Cohen, Bank of America Merrill Lynch.

Q - Jay Cohen {BIO 1498813 <GO>}

Two questions. The first is, you brought up your yield assumption for the year on your portfolio modestly, but you took it up a little bit. I assume -- I shouldn't say that -- you took up your investment income assumption. Is that due to the good first half result? Or is it more due to the recent rise in interest rates that we have seen?

A - Richard Spiro {BIO 15061279 <GO>}

It's probably a combination, but the recent rise in interest rates has improved our outlook for reinvestment yields going forward, compared to where we were when we started the year.

Q - Jay Cohen {BIO 1498813 <GO>}

Got it. And I guess for Dino, I think I probably know the answer to this based on the reserving actions you've taken, but can you talk about what you are seeing in liability claims costs for some of the longer tail businesses you guys write?

A - Dino Robusto {BIO 15021398 <GO>}

Yes. So I give you all a few sets on our claim trends. So I will start with -- I will give you some counts, and then I will give you a little view of severity on claims in general.

Claim counts continue to be a good story in the US. Excluding catastrophes, P&C, new rise claim counts overall were down about 5% for the Second Quarter against the prior quarter, and down 3% for six months of 2013 compared to the first six months of 2012. New rise counts increased slightly for personal auto, physical damage. We're seeing exposure growth in that line. Homeowners, commercial property counts decreased despite an increase in non-CAT weather. And new rise counts also decreased for commercial Work Comp, commercial general liability and Professional Liability. And when we get to severity and more of in line with your question, I mean, the trends obviously vary significantly by line of business based on obviously the different cost drivers.

But we are seeing essentially claim cost severity increases that are generally consistent with our longer-term trend assumptions, about low to mid-single digit severity for auto classes; mid-single digits for the core property and general liability classes; and the mid to upper single digits for Work Comp and some excess liability.

Now on the longer tail Professional Liability severity, these we obviously look at a little bit differently, from obviously auto and homeowners, where there is a lot more consistency. So we tend to look at, as we've spoken in the past, some leading indicators such as security class-action filings. And if you take a look at that, the number of SCA's under Chubb qualities is done for the Second Quarter against the prior year quarter, and it's lower than the average of the prior for Second Quarter. So, but in general, from a severity standpoint, it's consistent with our longer-term assumptions that we have had.

Q - Jay Cohen {BIO 1498813 <GO>}

And, obviously, no change for the adverse this quarter?

A - John Finnegan {BIO 1735942 <GO>}

What -- no change for the what?

Q - Jay Cohen {BIO 1498813 <GO>}

For the worse this quarter. In other words, you're not seeing any deterioration in this environment; it's remaining fairly benign. Is that fair?

A - John Finnegan {BIO 1735942 <GO>}

I think claims counts continue to come in very well. Loss experience on prior periods, as you can tell, has come in very strong. Things have been looking good on the loss front for about a year and a half now.

Q - Jay Cohen {BIO 1498813 <GO>}

Right. Thanks for the details.

Operator

Josh Shanker, Deutsche Bank.

Q - Josh Shanker {BIO 5292022 <GO>}

Yes, mostly a numbers question. On the guidance revision on the CAT number, is the increase related to higher-than-projected first half CATs? Or are you guys thinking we're going to be more conservative going forward on how we project our CATs for the back-half?

A - Richard Spiro {BIO 15061279 <GO>}

Last July, we used the 4.5 point assumption for CAT losses in the second half of the year in our updated guidance, Josh. This year, we did decide to increase the PIC by half a point, really to reflect a higher level of CAT losses that we've experienced in recent periods. No real magic or silver bullet, but we definitely have seen an uptick in the second half over the last few years, so we conservatively added half a point to our normal second half assumption.

A - John Finnegan {BIO 1735942 <GO>}

Probably comes from both, Josh. I mean a little bit, but primarily, from first half being higher than one would imply by our original 4 points. Right? And then a little bit of conservatism maybe in the second half, although no CAT assumptions have proved to be conservative in recent memory.

Q - Josh Shanker {BIO 5292022 <GO>}

Understandable, understandable. And then on the -- is there a new to retained business -- or new to lost business ratio that you can now share with us, or some sort of details on that?

A - John Finnegan {BIO 1735942 <GO>}

Were you talking about a particular business line?

Q - Josh Shanker {BIO 5292022 <GO>}

I mean, in terms -- particularly in the CCI lines mostly, but I mean, if you -- the personal lines -- I don't think it matters as much, given your business is somewhat unique, but on the commercial lines.

A - Paul Krump {BIO 5211397 <GO>}

Josh, in the early remarks, the prepared remarks, I gave it both for CCI and CSI and CI -- how quickly we forget. It was 0.7-to-1 in the Second Quarter, which was down from 0.8-to-1 in the First Quarter. (multiple speakers) Professional Liability was up from 0.6-to-0.7.

A - John Finnegan {BIO 1735942 <GO>}

Hopefully due to high retention.

A - Paul Krump {BIO 5211397 <GO>}

Yes, we had 3 points of better retention, so that's what helped drive that.

Q - Josh Shanker {BIO 5292022 <GO>}

I appreciate that. Thank you.

Operator

Meyer Shields, KBW.

Q - Meyer Shields {BIO 4281064 <GO>}

John, is it fair for 2Q to infer that the year-to-date outperformance due to fewer large losses is 2 points?

A - John Finnegan {BIO 1735942 <GO>}

You are probably -- must be into the mathematics. I don't think we have that number, because you know we can talk about fire losses, we can talk about non-CAT related weather. You can get non-CAT related weather and you can itemize that a little bit more, but quantify it better in personal lines and in commercial. Fire losses, especially can quantify them in both.

And then you have specialty where large losses affect you too. So what I will tell you, in the Second Quarter, if you look at -- year-over-year Second Quarter, we had a 5.5 point improvement. 2 points of that was development; 3.4 points of that was accident year. If you applied the margin expansion, the theoretical margin expansion number to it, which assumes that your losses are running in line with longer-term cost trends, that's 2 points. So it gives you 1.5 points in loss trends -- loss cost -- actual loss cost instead of a low trend line of which a big bunch or maybe even all is related to unusual large losses.

Q - Meyer Shields {BIO 4281064 <GO>}

Okay, that's very helpful. You talked for a while, I think, about the continued need for some rate increases in Professional Liability. Have you been trying to take bigger rate increases over the past couple of years than you have actually been able to?

A - John Finnegan {BIO 1735942 <GO>}

Oh, sure. When you're running 100[ph], you need a lot more. We have. I mean, if you go back to only two years ago, we weren't getting any. I mean, so this has been kind of ramped up and it's pretty good. We would like it either larger or we'd like the ones we have to last a longer time. But we could use more rate in this business. And also some improvement in the BPL area, a variety of areas where losses did trend up.

A - Paul Krump {BIO 5211397 <GO>}

This is Paul. Just to augment what John just said, we don't just take a one-size-fits-all approach, though, to the pricing in this business. We spend a lot of time thinking about each account, and the thought is, what does it actually need? We tend to start out by putting each of the accounts into one of five ranking, and go from there thinking about what we really need.

There are certainly some accounts that we are happy to renew at flat, and there's others, quite frankly, that we've gotten 40% to 50% rate increases on. And if they walk, they walk.

Q - Meyer Shields {BIO 4281064 <GO>}

Understood. Okay, and one last question, if I can. Obviously, there has been a lot of talk about the impact of interest rate increases on investment income expectations. I know that you have been reserving sort of incredibly conservatively. We see that in the releases. Is there any reason to expect the -- or future loss cost inflation to reflect the interest rate increase?

A - John Finnegan {BIO 1735942 <GO>}

No, I don't think there's any direct relationship between the two, except to the extent that you believe that inflation is going to run up with interest rates. We haven't seen that to date. So you focus more on the underlying inflation rate than the interest rates. Obviously, in many periods, they are correlated, but we haven't seen that yet. And even within the inflation rate, you've got to look at things that are very important to us -- construction costs, healthcare costs, not quite the same as the CPI.

I think as we said on endless calls, we have had very benign loss experience except for two quarters in 2011 for a number of years. Inflation has been relatively low over that period, but loss cost, things we've done have helped, loss cost trends have been good. So right now, there is no sign of a lot greater inflation, so I don't think the interest rates have anything to do that.

Q - Meyer Shields {BIO 4281064 <GO>}

Okay, thank you very much for all this.

Operator

Vinay Misquith, Evercore.

Q - Vinay Misquith {BIO 6989856 <GO>}

The first question was a numbers question. Just wanted to clarify that the benefit from lower large losses were about 1 to 1.5 points? Is that what you said before? (multiple speakers) For the first half of this year?

A - John Finnegan {BIO 1735942 <GO>}

Let me clarify then, Vinay. No, what I said is -- and I want to provide -- there is no real number for that. But what I tried to do is say a question many of you ask is that how much of the quarter's improvement was due to margin expansion, and how much was it due to loss experience that was different than margin expansion? So I just took a simple analysis of looking at this year's Second Quarter versus last year's Second Quarter, said it was about a 5.5 point improvement, of which 2 points were attributable to favorable development.

Of the other 3.5, you could theoretically attribute 2 to earned rate margin expansion. It was about 1.5 points -- the 1.5 points I referred to was that loss experienced below theoretical long cost loss -- long cost --

A - Richard Spiro {BIO 15061279 <GO>}

Long-term.

A - John Finnegan {BIO 1735942 <GO>}

-- long-term loss cost trends that are implicit in the margin expansion calculation. So if you just thought it would improve by the amount of the margin expansion, we improved by 1.5 points better than that because of lower loss -- lower actual loss experience. And that I think that a good deal, all -- or maybe even more than all were due to lower large losses. But that's hard to break out.

Q - Vinay Misquith {BIO 6989856 <GO>}

Sure, and that's only for the Second Quarter? You're re not talking about the First Quarter, correct?

A - John Finnegan {BIO 1735942 <GO>}

Not talking about the First Quarter, although the First Quarter, I think we had pretty -- was similar. I forget the exact numbers, but, yes, actual losses in the First Quarter were lower than the long-term trend too.

Q - Vinay Misquith {BIO 6989856 <GO>}

Sure, fair enough. And these trends -- these are not specific only to Chubb, I mean I'm sure it's true with everybody, correct? Low loss cost trends or low loss cost?

A - John Finnegan {BIO 1735942 <GO>}

Yes, let's say -- yes, I mean, I gather from the reports that it looks to me like -- I don't know -- it looks like people have a pretty favorable loss experience. Non-CAT related weather, for example, is probably going to be relatively similar to everyone. Fire losses can be different. I mean, I don't think sometimes people underestimate the sensitivity. In a quarter, we run $3 billion a premium. We have one[ph] limit fire loss of $30 million, you are talking 1 point on your combined ratio that can't be explained by margin expansion. We have had many quarters with one big loss or even two big losses. So fire losses tend to be a little bit more unique to an individual company than non-CAT related weather.

Q - Vinay Misquith {BIO 6989856 <GO>}

Sure, fair enough, thank you. Just a second question. And like this is an overall loss, industry question, and you guys have been pushing rate stronger and harder than I think most people have. But within the industry, we have seen rising interest rates. We have seen margins improving, low loss cost trends. What do you think keeps the momentum going for the industry to keep rates high?

A - John Finnegan {BIO 1735942 <GO>}

I believe that -- we don't know that will occur. We hope it will occur. What would be the driver? The driver would be the fact that, alluding to what Ricky said, that accident year ex-CAT combined ratios are not at target levels. Or stated another way, we have a rate need to get our new business to an acceptable return. And if we have the rate need running 80's and 82's on our ex-CAT's accident year, you can imagine the industry has a significantly higher rate need, they are probably in the mid-single digits. And that's not everyone, but as an average, it couldn't be better than that.

So the industry has a need for rate adequacy still. And, again, that's doing the calc on new money rates, as it should be done, what you can earn on new business.

A - Richard Spiro {BIO 15061279 <GO>}

And, also, don't forget as John pointed out in his remarks, the combination of the interest rate environment plus the higher level of catastrophe losses that we in the industry have experienced over the last number of years, that continue to push for rate.

A - John Finnegan {BIO 1735942 <GO>}

Loss cost trend is always a pressure.

Q - Vinay Misquith {BIO 6989856 <GO>}

Okay, that's helpful. Thank you, very much.

Operator

And we currently have no further questions in the queue. I would like to turn the conference back over to today's speakers.

A - John Finnegan {BIO 1735942 <GO>}

Thank you, very much and have a good evening.

Operator

Again, this does conclude today's conference. We thank you all for your participation.