Q4 2016 Earnings Call

Company Participants

- Evan Greenberg, Chairman and CEO
- Helen Wilson, IR
- John Lupica, Vice Chairman
- Paul Krump, EVP and President, Personal Lines and Claims
- Phil Bancroft, CFO

Other Participants

- Brian Meredith, Analyst
- Charles Sebaski, Analyst
- Elyse Greenspan, Analyst
- Ian Gutterman, Analyst
- Jay Cohen, Analyst
- Jay Gelb, Analyst
- Kai Pan, Analyst
- Mike Nannizzi, Analyst
- Paul Newsome, Analyst
- Ryan Tunis, Analyst
- Sarah DeWitt, Analyst

Presentation

Operator

Good day. Welcome to the Chubb, Limited, Fourth Quarter year end 2016 earnings conference call. Today's call is being recorded.

(Operator Instructions)

For opening remarks and introductions, I would like to turn the conference over to Helen Wilson, Investor Relations. Please go ahead.

Helen Wilson {BIO 2078659 <GO>}

Thank you. Welcome to our December 31, 2016 Fourth Quarter year-end earnings conference call.

Our report today will contain forward-looking statements, including statements related to Company performance, investment income expectations, pricing and business mix, economic and insurance market conditions. And integration of our acquisition of the Chubb Corporation. And potential synergies and benefits we may realize. All of these statements are subject to risks and uncertainties. And actual results may differ materially. Please refer to our most recent SEC filings, as well as our earnings press release and financial supplement, which are available on our website at investors.chubb.com, for more information on factors that could affect these matters.

Will also refer, today, to non-GAAP financial measures. Reconciliations of these non-GAAP financial measures to the most direct comparable GAAP measures and related information are provided in our earnings release and financial supplement, which are available at investors.chubb.com.

Now I'd like to introduce our speakers. First, we have Evan Greenberg, Chairman and Chief Executive Officer, followed by Phil Bancroft, our Chief Financial Officer. Then we'll take your questions. Also with us to assist with your questions are several members of our Management team. Now it's my pleasure to turn the call over to Evan.

Evan Greenberg {BIO 1444445 <GO>}

Good morning. Chubb had a very good quarter that contributed to an excellent year in both financial and non-financial results. We set a big agenda for ourselves. And accomplished most all of what we set out to achieve. Financially, we produced record annual operating earnings per share, world-class combined ratios, strong book and tangible book value growth. And a good operating ROE. We accomplished these results despite elevated catastrophe losses and soft P&C market conditions globally.

Operationally, we completed the largest merger in insurance history. And managed a transformational Company-wide global integration effort, all while staying focused on our core business of underwriting and servicing customers and distribution partners, retaining our commercial and personal lines customers at or above all-time highs.

We launched new products and entirely new businesses, made investments in our people, technologies. And capabilities. And began to harness the complementary strengths of the organization in cross-selling and other revenue initiatives. We achieved or exceeded substantially all of the financial and non-financial targets we established when we initiated the merger.

After-tax operating income for the quarter was $1.3 billion, or $2.72 per share, compared to $2.38 per share, up over 14%. For the year, net operating income was over $4.7 billion, or $10.12 per share, up about 3.5%. And illustrating the accretive nature of the merger. Earnings in the quarter included a one-time, $113 million pre-tax benefit related to the harmonization of our US retirement programs. Phil will have more to say about the retirement program changes. And both one-time and ongoing income benefits they will produce.

As a reminder, when discussing our underwriting results and premium growth, I will compare our results to the 15-year as if we were one Company back then. And excluding the effects of purchase accounting from the 16-year underwriting results. That's how I look at it. And I think that gives you the clearest view of operations.

Our combined ratios for the quarter and year were simply excellent. Beginning with the quarter, the P&C combined ratio was 87.6%. That compares to an 87.3% last year, as if we were one Company back then. Included in that combined ratio are about $100 million more of cat losses. And slightly less positive prior-period reserve development than prior year.

Therefore, the P&C current accident year combined ratio excluding cat losses was outstanding at 87.1%, versus 88.6% prior year, driven by both our core global P&C business, which produced very good results. And our crop insurance business, which had a simply outstanding quarter, due to a very strong crop underwriting year.

Crop insurance underwriting income in the quarter was up $128 million over prior-year quarter. The current accident year also benefited from a reduced expense ratio, about 0.5 point. For the year, powered by $3.2 billion of underwriting income, the combined ratio was 88%, compared to 87.5% last year. That's with about $211 million more in cat losses. And pretty flat year-on-year prior period reserve development, which again speaks to the quality and underlying strength of our underwriting and product portfolio construction.

Net investment income for the quarter was $845 million, which was above the top of the guidance we gave you last quarter. For the year, net investment income was $3.3 billion, about equal to underwriting income. And an excellent result given the interest rate environment, which was at historic lows for most of the year until the sudden rise following the election.

In the quarter, I was encouraged by what I hoped is the beginning of a shift towards a greater fiscal related stimulus policy in the US, including tax reform, reduced business regulation. And increased infrastructure investment in place of an over-reliance on monetary policy, which in my judgment has more than run its course. However, given continued over-reliance on cheap money and excessive liquidity in Europe and Japan in particular, coupled with lackluster global economic growth, the world is not coordinated. And one impact of that is the stronger dollar.

Chubb's strong earnings led to a very good operating ROE of 11% for the quarter. And 10.5% for the year. Keep in mind that every 100 basis points of investment portfolio yield for Chubb is equal to approximately 175 basis points of ROE.

Book and tangible book value growth in the quarter was negatively impacted by the sharp rise in interest rates. And to a lesser extent, the dollar. There were a number of offsetting positive items that all together meant net book and tangible book were relatively flat, a very good result. For the year, book value per share increased about 15.5%. And tangible book value per share decreased 16%, both as a result of the merger.

However, it is worth noting that from the merger closing on January 14 to year end, book value per share increased 7.5%. And tangible book value per share increased over 13%. We are ahead of where we expected to be in both per-share and tangible book value growth, with the latter now down 16%, versus an initial 29% at the time of the merger closing. And on track to hit pre-transaction levels in 3.25 years.

For those who like to micro-analyze, it was 3.25 when we announced the merger in July of 2015. Then we lost three months due to the dramatic rise in interest rates in the Fourth Quarter. And its mark-to-market impact on book value. However, by the end of the quarter and now, we are back to where we started. Phil will have more to say about investment income, change to VA portfolio, tangible book value, prior period reserve development. And cat.

For the quarter, premium revenue growth was in line with what we experienced during the year -- in fact, a little bit better. The same themes prevailed -- strong retentions of business, less new business due to market conditions, modestly more new business due to cross-selling and the strength of the organization. And a revenue penalty due in large part to merger-related underwriting actions, including the purchase of additional reinsurance. The impact from this last item will ameliorate as we move through 2017.

For the year, P&C net premiums and global P&C net premiums, which exclude agriculture, were both down 1% in constant dollars, excluding merger-related underwriting actions. For the quarter, P&C net premiums on the same basis were essentially flat, while global P&C net premiums were up over 1%. The commercial P&C insurance market globally is soft. And conditions vary, depending on the territory, line of business. And size of risk. Rates are generally flat or declining, depending on class of business, size of customer. And territory.

Terms and conditions have been softening a bit in a number of classes. On the other hand, there are a few stressed classes here and there where we are achieving rate. As noted in prior quarters, large account business, particularly shared and layered, is more competitive than mid-sized, though middle market is becoming more competitive, particularly in the US and Europe, as companies stress about growth and reach more aggressively. Wholesale is again more competitive than retail.

Certain markets are notably more competitive than others. London, Bermuda, Australia. And Brazil, by example, are particularly competitive, while in the US and continental Europe, competition is a little less ferocious. And a bit more orderly. But softening nonetheless.

Claims inflation has been lower than historical averages in recent years. But hardly non-existent. As pricing hasn't kept pace, industry combined ratios are coming under pressure. At the same time, as you have noticed, loss-cost inflation has increased in certain classes -- professional lines and automobile in the US come to mind.

As I mentioned earlier, natural catastrophe losses were up last year. It was the sixth costliest year on record for cats. But not enough to impact the over-supply of industry capital. The industry capital base continues to expand, from a combination of retained earnings and new investors.

Globally, new business remains harder to come by. It is a hungry market. And competition is fierce for new business. On the other hand, speaking for our Company, our total capabilities in terms of product, ability to serve different insurance customers, our deep distribution strength and extensive geographic reach, means our optionality or ability to capitalize on opportunity, is simply outstanding. And we are just getting started.

Rate movement for the business we wrote in the quarter varied by territory and market segment. Renewal pricing overall ranged from flat in our US middle-market business to down 2% in both our US major accounts. And international retail commercial P&C businesses.

In North America, retail general and specialty casualty-related pricing ranged from flat to down 1.5%. Financial lines pricing ranged from flat to down 2%. And property-related pricing ranged from down 1.5% to down 5%. Internationally, general and specialty casualty related pricing ranged from up 3% to down 3%. Financial lines pricing ranged from flat to down 3%. And property-related pricing ranged from down 1% to down 5%.

With that as context, let me give you some detail on our revenue results for the quarter. In our North America commercial P&C business, net premiums were down about 5%. Normalizing for the impact of the additional re-insurance we purchased and for the underwriting actions we took, net premiums were down 2.5%. The renewal retention rate as measured by premium was quite good, at over 89%, with middle market at 88%. And major accounts at 92%. Overall, new business writings for North America commercial lines were down about 8%.

In our North America personal lines business, net premiums written were down almost 5%. The additional reinsurance we purchased had a 6.5 point impact. And the Fireman's Fund had about a 0.5 point impact. Therefore, growth was 2.2% for the combined Chubb and ACE portfolios. Rates were up 2%, exposure changes added about 3.5%. Retention remained quite strong for the Chubb and ACE portfolios, at about 95%.

Turning to our overseas general insurance operations, net premiums written for our international retail P&C business were up 5% in the quarter, in constant dollar. And up over 7.5% when normalized for the additional reinsurance and underwriting actions. However, it is worth noting that we benefited in our international business from a $48 million, one-time premium increase that will not repeat.

Growth in international was led by Latin America, with net premiums up over 10%, followed by the Continent of Europe, Asia. And the UK, with growth of 7.5%, 6.5%. And 2.5%, respectively. In our London-market-based D&S business, premiums were flat.

As I said earlier, our agriculture business had a great year, highlighted by a combined ratio of about 74%. This is a cat-like business. And therefore it has a certain volatility to it by its nature. It's weather-exposed, with weather impacting crop yields and commodity prices.

We've experienced both sides of volatility, years with great growing seasons and others with drought. This has been and continues to be a good business for Chubb.

In sum, while market conditions globally are competitive, I expect as we progress through 2017 and the impact of the merger continues to fade. And the compelling power and capabilities of the organization gain more momentum, matched against the long list of opportunities in front of us, we will produce faster growth. John Keogh, John Lupica, Paul Krump. And Juan Andrade can provide further color on the quarter, including current market conditions and pricing trends.

I want to say a few words about integration. Among the noteworthy accomplishments of last year was the integration of two large companies, realizing substantial efficiencies, while remaining outward-facing in managing and growing our business in all aspects. While more work remains, a substantial portion of the heavy lifting is moving behind us. And will continue as 2017 progresses. From underwriting to claims to real estate and IT, to finance and HR, our operational integration has been detailed and all-encompassing. And we are ahead of schedule in all areas.

As for cultural integration, there is a strong sense of unity in place and growing in the Company. Through shared experiences, small and large, we are knitting ourselves together and breeding familiarity that in time creates trust, loyalty, friendship. And a one-team spirit. We don't overly talk about and contemplate our culture, except to the extent we all need to be on the same page, with clarity and comfort. Instead, we prefer to simply live our culture.

In terms of financial measures, while early days at the end of one year, we are on track or ahead of the objectives underpinning the merger. These include expense savings, operating EPS, ROE. And as I noted earlier, per-share book and tangible book value. Where we said the merger would be immediately accretive to earnings in book value per share, we are ahead of our own internal projections, as well as what we would likely have been on our plans as a stand-alone ACE Limited Company.

Broadly speaking, we are in a time of uncertainty, economically and geopolitically. On the one hand, the world is a tense place marked by growing nationalism and populism that are feeding protectionist sentiment. This is a global phenomenon. I might add while early days, I am concerned about our own country's potential trade and security posture.

On the other hand, in the US, the monetary and fiscal changes afoot around tax, regulation of business, infrastructure. And higher interest rates are a real positive for business, jobs. And the economy, if implemented in a way that doesn't exacerbate budget deficits.

Finally, we are a country of immigrants. Our country's openness to immigration is fundamental to our identity and history as a nation. And vital to our future prosperity. I am 100% for the security of our citizens. But at the same time, America is the land of the free. And we are a beacon and place of refuge for those seeking a better and safer life for themselves and their families. Shutting our doors to immigration is a mistake.

Despite our challenging environment, Chubb is a Company built to out-perform. I have never been more confident in our people and capabilities. And I am optimistic and simply energized when I think about our Company's future, both 2017 and beyond. With that, I will turn the call over to Phil. And then I'll be back to take your questions.

Phil Bancroft {BIO 4621336 <GO>}

Thanks, Evan. We've come through our first year of the merger with excellent and stable ratings, a strong balance sheet. And substantial capital-generating capability. Our operating cash flow was $1.5 billion for the quarter. And $5.3 billion for the year.

In the quarter, investment income was $845 million, which was higher than our previously expected range of $820 million to $830 million. $8 million was due to a one-time positive merger-related adjustment. We also had increased call activity on our corporate bond portfolio. And we're benefiting from the changes we've made to the management of our portfolio. While there are always a number of factors that impact the variability in investment income, we are raising our expectation for our quarterly investment income run rate to a range of $830 million to $840 million.

Net realized and unrealized losses after tax for the quarter were $1 billion, comprising a $1.3 billion loss from our investment portfolio, primarily from rising interest rates. And a foreign currency loss of $300 million. These were partially offset by a $275 million gain from our VA reinsurance portfolio, also from rising interest rates. And a $350 million favorable adjustment related to our retiree plans.

Net loss reserves decreased $687 million for the quarter on a constant-dollar basis. This reflects the favorable impact of the agriculture book of $339 million, favorable PPD of $238 million. And $60 million of amortization of the fair value liability adjustment established in purchase accounting. On an as-if and constant-dollar basis, net loss reserves increased $1.2 billion for the year, adjusted for the items discussed above.

The paid-to-incurred ratio was 99% for the quarter. And 92% for the year, both also adjusted for the items discussed above. We had positive prior-period development of $238 million pre-tax, or $208 million after tax, with 56% from short tail lines and 44% from long tail lines, principally from accident years 2010 and prior. This included $78 million pre-tax of adverse development for legacy asbestos exposures, which are now included in corporate.

Our catastrophe losses in the Fourth Quarter net of reinsurance were $268 million pre-tax, or $222 million after tax. Cat losses included $190 million from Hurricane Matthew and $60 million from the New Zealand earthquake.

During the Fourth Quarter of 2016 the Company harmonized. And amended several US retirement programs to create a unified retirement savings program. In 2020, the Company will transition a traditional defined benefit pension program that had been in effect for certain employees, to a defined contribution program. Additionally, after 2025, the Company plans to eliminate a subsidized US retiree health care plan that had been in place for certain employees.

The US pension and retiree health care plan changes favorably impacted book value by $322 million, reflecting a more favorable -- a decrease in benefit obligations. Net income and operating income were favorably impacted by the one-time, $113 million, pre-tax benefit related to the harmonization of the US pension plans. This item is excluded from the P&C combined ratio.

On an annualized basis, the Company expects to continue to recognize a benefit of $100 million pre-tax, or $65 million after tax, each year for the next five years relating to the harmonization, after which the benefit continues in a range of $50 million to $80 million pre-tax, depending on interest rates at the time.

Life underwriting income includes the unfavorable impact of an adjustment made to the long-term benefit ratio used in determining operating income associated with the Company's variable annuity reinsurance business. During the quarter, the Company determined that certain assumptions, primarily long-term interest rates, underlying the long-term benefit ratio, should be updated. This adjustment resulted in a pre-tax and after-tax operating charge of $17 million.

Since we carry the overall GMIB reserves at fair value, this adjustment represents a shift between operating income and realized gains. And does not impact book value. The Company expects a similar incremental impact to underwriting income and realized gains in future quarters, which will total an approximate $60 million reduction in operating income. And a corresponding realized gain in 2017.

During the quarter, premium growth was negatively impacted by merger-related underwriting actions, including additional reinsurance of $206 million, bringing the total for the year to $650 million. And impacting growth by 2.3%.

Our integration efforts are either on track or ahead of schedule, as Evan said. Total integration-related savings realized in the quarter and for the year were $123 million and $325 million, respectfully. Annual run-rate savings of $800 million by the end of 2018 are on track. Total revenue synergies produced in the quarter and for the year, were $83 million and $297 million, respectively. For some additional color, revenue synergies for the quarter related to our North America retail P&C business represented 14% of our new business. I'll turn the call back to Helen.

Helen Wilson {BIO 2078659 <GO>}

Thank you. At this point, we'll be happy to take your questions.

Questions And Answers

Operator

(Operator Instructions)

Ryan Tunis, Credit Suisse.

Q - Ryan Tunis {BIO 16502263 <GO>}

Hi, thanks. Good morning. My first question, just on the pension. Is the $100 million that you're expecting to recognize over the next five years or so additive to the $800 million expense save guide you've given in the past?

A - Phil Bancroft {BIO 4621336 <GO>}

Yes. It is. The $800 million does not include the incremental benefit from the pensions.

Q - Ryan Tunis {BIO 16502263 <GO>}

Okay, understood. Then going back to Evan's discussion about the positive impact on ROE from higher interest rates. And just thinking about how to balance -- how to think about balancing underwriting returns, ROE. And growth through this next cycle, if you've got higher interest rates, lower tax rates, arguably more competition, should we be more focused on ROE as the metric you're pricing around, or should we continue to be thinking about underlying combined ratios that are sub-90? Thanks.

A - Evan Greenberg {BIO 1444445 <GO>}

I think you should be -- with the exception of your final comment, I think you should be focused on for underwriting combined ratio. We look at underwriting independent of investment income. We underwrite around here to an acceptable combined ratio.

Yes. We do look at senior-most levels in terms of capital management, we do look at how much capital each business draws. And at certain combined ratio hurdles, what kind of ROE it will produce. That sets, to a degree, targets we establish for our businesses that of combined ratios, we don't want them exceeding, if that helps you.

Q - Ryan Tunis {BIO 16502263 <GO>}

That's helpful, thanks. I'll get back in the queue.

A - Evan Greenberg {BIO 1444445 <GO>}

Okay, Ryan.

Operator

Elyse Greenspan, Wells Fargo.

Q - Elyse Greenspan {BIO 17263315 <GO>}

Hi. Good morning. I was hoping first to get some (inaudible; background noise) used in terms of the potential for corporate tax reform in the US. I know Chubb is in a little bit of a different position given your Swiss domicile. How do you high-level see tax reform impacting Chubb? When you think about the potential for tax reform, do you think it gets competed away, meaning if a company is operating at a higher tax rate, they can potentially push for lower prices as they manage their book to a certain ROE?

A - Evan Greenberg {BIO 1444445 <GO>}

Yes, I'm going to answer your first part first. Anybody who runs a decent business, they don't run their business based on tax. Tax does not drive how you make your fundamental decisions and how you operate a business. I've worked in more than one company. And I have never -- that kind of conversation has never entered into how we think about our business. We think about underwriters, underwriting, which is what we do for a living. And combined ratios. Hardly does tax ever enter the discussion.

As to the first part of your question, for our US-sourced business, our US business represents over 60% of our Company's business. Our US-sourced business has a tax rate in the 20%s. Tax reform is important to us. And it's important to our country. As the US economy would improve in my judgment with tax reform, that would benefit the insurance industry, because that would mean faster economic growth. And faster economic growth means more exposure. More exposure means faster growth for insurance. I am in favor of tax reform.

Right now, they're discussing -- as you know, it's a long way before we have tax reform. We're very early stages. What Republican Congress has put on the table so far revolves around border adjustment. How border adjustment will be interpreted for financial services is not yet clear. In fact, to those who are writing tax policy, who we are very engaged with, it is not clear to them.

When it comes to insurance, the question on the table right now revolves around two -- reserves, how reserves will be treated. And number two, in particular how reinsurance will be treated. In my judgment, border adjustment tax, reinsurance, is clearly an export of risk. You're exporting risk and you don't know the profit and loss until that risk has ultimately been earned through. It is hardly an importing of capital. I would expect that would be treated in a reasonable way in tax policy. And that would be the advantage of the US. We're taking advantage of the world balance sheet for insurance has benefited corporate America and consumer America just greatly over the years.

Q - Elyse Greenspan {BIO 17263315 <GO>}

Okay. Thank you. Last quarter on your call you alluded to some initiatives on the small commercial side. Can you just talk to the receptivity from agents in that business? I know it's still early days. Any takeaways from the Fourth Quarter and into 2017?

A - Evan Greenberg {BIO 1444445 <GO>}

It's very early days. We will talk about it a little bit. But I'm measuring this so that the lease we stay on would be square on perspective. I'm measuring this over years, given the nature of it. These are relatively small policies. And it takes a long time to build something.

Paul Krump loves to tell stories. He's from the Midwest. And I'm going to turn it over to him for a moment.

A - Paul Krump {BIO 5211397 <GO>}

Thank you, Evan. Elyse. And thanks for the question. Yes. Small commercial, I think, is very much on track. But as Evan said, I can't over-emphasize this is -- we're building this over years.

To your direct question, the receptivity by the agents and brokers has been outstanding. First of all, they love the plethora of products that we're bringing to bear. They know and they've seen what we're building for the CSRs so that it's easy for them to do business with us. There's some really strong competitors in this space. But this is a very fragmented market place. And we're being welcomed. It's going to take some time to continue to build it.

Q - Elyse Greenspan {BIO 17263315 <GO>}

Thank you. One last question, if I may. As we and you alluded to, Evan, in your comments about the prospects for higher inflation, as the industry deals with inflation, I think it's just some people start to think about the potential for reserve picks to be tested on some of the longer tail lines. Now that the Company's been merged for about a year and you've got through both of the legacy Company reserves, can we just got some high-level view about the conviction that you have in the picks on some of your longer tail lines, as we think about potential inflationary trends picking up from here?

A - Evan Greenberg {BIO 1444445 <GO>}

Yes. It's very simple. The last number of years, most recent past, inflation has been benign. Loss-cost inflation has been benign. But both companies have continued to use historic trend factors. And we have done that right through our current year in our casualty-related lines. That's what matters. With that, I think we're comfortable if we return to a higher loss trend.

Q - Elyse Greenspan {BIO 17263315 <GO>}

Okay. Thank you very much.

Operator

Charles Sebaski, BMO Capital Markets.

Q - Charles Sebaski {BIO 17349221 <GO>}

Good morning. The first question is on the North America retail. I think Phil mentioned the 14% of the new business synergies are from that. Just hoping to get a little more clarity on where the synergies are coming from. And if that includes the A&H within that synergy line, or how you're thinking about that?

A - Evan Greenberg {BIO 1444445 <GO>}

Sure it does. Let's see, who would like to take this? John Lupica?

A - John Lupica {BIO 4213297 <GO>}

Sure, I'll take a crack at a. Thank you for the question, Charles. In terms of that cross-sell, it's coming from all forms of synergies, mainly in our specialty lines. The great hallmark of Chubb was in the phenomenal distribution and the agency network. ACE brings a lot of specialty products. We've been spending the better part of a year making sure that product breadth is getting introduced into that agency force and into our core customer base.

Specialties like environmental and like A&H that we are selling, builders' risk, all through the industry verticals, is driving that cross sell, in addition to the strength of the organization, where we are bringing our core product to a new distribution force. We're measuring that as well. Between growth initiatives, specialties, strength of the organization, we really do see the power of the group coming together.

Q - Charles Sebaski {BIO 17349221 <GO>}

Okay. On a broader base on product lines, Evan, a lot of the rate commentary you gave seemed to be that a lot of lines are reasonably managed in a couple of points, plus or minus. Are there any lines that give you pause? I've seen some stuff recently that there's been some pull-outs of political risk. Is there areas where things are just -- maybe needing to take a step back, or the market is not where you think it should be, rational, reasonable?

A - Evan Greenberg {BIO 1444445 <GO>}

Yes. Charles, sure. There's not lines of business where we need to step back because we see trouble underwriting. We don't see that. We've been very on top of it. And vigilant about that. We always look for early signs. We did, obviously with the merger, there are businesses that weren't meeting our standards that we have canceled. Some were canceled. We put them in run-off. And I've spoken about that.

Beyond that, I think the message is pretty simple. We don't like a lot of the market pricing for new business. We're willing to take the new business penalty. The numbers I gave you were the numbers -- the rates and the rate movement, was for our renewal portfolio. We measure relativity of the new business pricing against our renewal rates. Our new business pricing is very similar to our renewal pricing.

To be able to achieve that, we have to be willing to write less business We're seeing more submissions. The First Quarter our submission activity was up substantially. But the amount that we'll write is down. And that reflects the competitive market conditions where we're just simply not going to do dumb stuff for growth.

Q - Charles Sebaski {BIO 17349221 <GO>}

Okay. Finally, I think at the very beginning, Evan, you made a comment that you said you've accomplished most of the things that you wanted to with the merger and the integration of Chubb. Curious on what may not have gotten to par?

A - Evan Greenberg {BIO 1444445 <GO>}

I didn't want to use the word everything, because I thought that would just sound a little arrogant. We always want to remain humble about things. When I step back, I've got to tell you. And I really look at it, there's always little crap on the margin. But we have accomplished what we set out to achieve in the year.

Our revenue growth was a little less than I wanted it to be. But when I look at it, sure, in the early part of the year there was market distract, there was internal distractions of your merging. But we expected that. It was -- the market, itself, I think just given the nature of competition -- we didn't write as much new as I would like to have written. But okay. That's it. I'm not -- don't worry about it.

Q - Charles Sebaski {BIO 17349221 <GO>}

Thank you very much.

A - Evan Greenberg {BIO 1444445 <GO>}

We did lost -- we lost a handful of people we wish we hadn't lost. But we planned -- we knew we were going to lose people we didn't want to lose. We lost far fewer of those. But still, each one of them breaks your heart.

Q - Charles Sebaski {BIO 17349221 <GO>}

Thank you, much.

Operator

Jay Gelb, Barclays.

Q - Jay Gelb {BIO 21247396 <GO>}

Thank you. With regard to the comment that growth should improve looking ahead, does that mean we should expect positive growth in North America commercial and personal lines?

A - Evan Greenberg {BIO 1444445 <GO>}

Yes. For 2017 in total, I expect that's what we're going to see. That's our objective.

Q - Jay Gelb {BIO 21247396 <GO>}

Great.

A - Evan Greenberg {BIO 1444445 <GO>}

Remember, there's going to be -- I'd just give you a little more color, The underwriting actions we took due to the merger break into two pieces -- business that we canceled. And that run-off will have an impact through the year. That impact will diminish.

The additional reinsurance we purchased -- that will have an impact fundamentally in the first half of the year. And should be about gone by mid-year. Then we have underlying actions that we already see the power building in our core business, our core middle market, in our A&H business. I expect specialty casualty areas.

I expect in our large account business more of a flight to safety and quality, which we're seeing in our risk management and our multi-national business. I expect our industry verticals and the power of that to produce a better result. Our high net worth business, the two legacy companies together, the core portfolio, will do better. I expect specialty personal lines internationally and small middle-market around the world to contribute. On A&H, I said, I mean that globally.

Q - Jay Gelb {BIO 21247396 <GO>}

Okay. Evan, you just mentioned the flight to safety and quality. There's been a number of large global property-casualty insurers facing ongoing turmoil. Can you update us your thoughts in terms what that means for Chubb?

A - Evan Greenberg {BIO 1444445 <GO>}

Yes. Chubb is a steady-as-she-goes. And going from strength to strength. Our product offering has never been broader. Beyond that, our ability to coordinate all of the skills of the organization and bring it to bear for a customer, honest to God, has never been more compelling.

The technology that we have to service that large account business and bring total solution but manage it for the customer, we are really distinguishing ourselves. Our service and our service reputation in both underwriting and claims is a breath of fresh air for most who have experienced some of those companies that are having issues. We have been very predictable and steady for our customers. And for those who might be interested in trying us out.

That's what they want. They want predictability and steadiness of both breadth of product offerings -- because we offer as broad or broader a product offering than any other competitor to our customers -- from risk management to excess casualty, to professional lines, to environmental, to their international needs around the world. Very few can do that. And we do it in a very steady, predictable way. We're not changing year to year in our appetite or how we approach the underwriting of that business.

That has just caused us to gain more customers. We continue to. First of January was very good for us that way. We're gaining more customers. We're gaining more who are taking a look at us, particularly as they get -- they're more uncomfortable with where they've been. It's easy to see why they're uncomfortable. Some of those companies appear to be run-off.

Q - Jay Gelb {BIO 21247396 <GO>}

Interesting. My final question is on asbestos trends. A number of other large companies with legacy asbestos exposures have had to raise their reserve estimates this year. Chubb didn't, I believe. Can you discuss that?

A - Evan Greenberg {BIO 1444445 <GO>}

No. We raised our reserve estimates. We did take a charge this quarter. The net amount was about $87 million, I believe.

A - Phil Bancroft {BIO 4621336 <GO>}

$78 million.

A - Evan Greenberg {BIO 1444445 <GO>}

$78 million, dyslexic . It was -- that was a net of both Brandywine taking a bit higher charge. And we put the legacy -- the federal reserves on a light basis. And they had some favorable development. The two of them together produced the $78 million.

But we are not seeing, importantly, a change in trends in asbestos. It was very case-specific for us. The one place where we have seen a bit of an increase in cost is in defensive cases. We're defending cases rigorously. And the cost of defending those has been more inflated.

Q - Jay Gelb {BIO 21247396 <GO>}

Thank you for the answers.

A - Evan Greenberg {BIO 1444445 <GO>}

And we recognized that in our reserves.

Operator

Sarah DeWitt, JPMorgan.

Q - Sarah DeWitt {BIO 18946247 <GO>}

Hi. Good morning. There was talk about inflation picking up in an earlier question. But there's a difference between general US inflation and insurance claim inflation. I was wondering if you'd just talk about your outlook for the factors that drive claims inflation under the new administration and Congress. And if you could also elaborate on your comment that professional lines claims inflation is picking up?

A - Evan Greenberg {BIO 1444445 <GO>}

Yes. Professional lines claims inflation is an obvious that everybody can see who looks at the business. It's public information. I'll come back to it.

Look, Congress and the new administration, all speculation. I have no idea and you have no idea. It's one thing to have an agenda. But what are you actually going to pass. And how long is it going to take to accomplish? Then, what will be its impact ultimately? Well that's pretty far down the road. We don't speculate. And in our loss picks we don't speculate.

Insurance inflation is about parts and labor. It's about legal costs, medical expense. And that adds up to what we call social inflation. Those cost inputs are different than general inflation, as I'm sure you know.

When it comes to professional lines, there have been more security class-action suits. There are a number of sources of that in particular. We have noticed that in claims reporting and development, how many of those notices turned out to actual claims. And what are the size of those claims -- severity has been fairly constant. It's been an increase in frequency this year. And we're vigilant about that.

Q - Sarah DeWitt {BIO 18946247 <GO>}

Okay. Great, thank you. Secondly, if interest rates go up, do you think that benefit gets competed away by the market?

A - Evan Greenberg {BIO 1444445 <GO>}

To a degree, you've always seen that. There are companies who cash flow underwrite and underwrite to total returns. They usually aren't great underwriting companies. I've never noticed that they are. Then, good companies remain more disciplined about that. And don't compete it away. It's a chaotic world. You'll see all varieties.

Q - Sarah DeWitt {BIO 18946247 <GO>}

Okay. Thank you.

Operator

Kai Pan, Morgan Stanley.

Q - Kai Pan {BIO 18669701 <GO>}

First question, Evan. You mentioned about the given pricing pressure, the industry combined ratio is under pressure. If you look at Chubb, actually your underlying combined ratio has remained largely stable. I'm just wondering, can you see your underwriting actions or the more realized expense savings from the merger could overcome the pricing pressure to maintain or improve the margin in the coming years?

A - Evan Greenberg {BIO 1444445 <GO>}

What I see is that it will ameliorate a rise in combined ratio. Expense ratio will ameliorate a rise in loss ratio. The merger expense benefits -- the underwriting actions we take in portfolio management and mix of business will also ameliorate loss ratio.

But does it eliminate it? No. Over time, I expect -- naturally, if the market remains as it is. And I think the market you see is the market you get, I think it varies by line of business, et cetera, the dynamics. But in total, I expect that it rises.

We have certain lines of business like agriculture, like high net worth, like A&H, that really aren't subject to that at all. You have other businesses like middle-market commercial and traditional business that is less impacted by that. The mix of the portfolio and how we've selected our portfolio and constructed it and the geographies in which we conduct different businesses have a way of ameliorating.

But each individual line, by itself, has this pressure of loss ratio in a market where rate is flat or down. And trend continues. Of course, we're of the market. What I am confident about is that we will continue to distinguish ourselves and out-perform.

Q - Kai Pan {BIO 18669701 <GO>}

Thank you. My second question is on the capital management. The Board recently authorized a $1 billion program through 2017. I just wondered, when they discussed this topic, how do you allocate the size of the buy-back relative to your like $5 billion annual earnings and relative to your dividends, as well as potential growth and acquisition opportunities?

A - Evan Greenberg {BIO 1444445 <GO>}

As you know, first of all, we look at earnings on an after-tax basis. We have a dividend policy that we pay out roughly 30%. We save it's circa 30% in dividends. We then look at opportunity, both internal growth and potential external opportunities to grow over a period of time. And capital flexibility.

Through that discussion, we determine what a comfortable target is for Company need. And then what remains is how we determine what to return to shareholders. Then we have a discussion of what's the best form to return to shareholders. Is it dividend related, is it one-time dividend, or is it share repurchase? That's how we come to it.

Q - Kai Pan {BIO 18669701 <GO>}

Okay. Great. Well thank you so much.

Operator

Michael Nannizzi, Goldman Sachs.

Q - Mike Nannizzi {BIO 15198493 <GO>}

Thanks so much. Just wanted to get a little clarification. Evan, you were talking about growth. And we talked a little bit about reinsurance changes in 2016 in the Fourth Quarter. Do your comments imply that you expect growth on a gross basis, then, just to step out of the whole reinsurance conversation?

A - Evan Greenberg {BIO 1444445 <GO>}

Yes. But we also have business -- and we've been very transparent with you about that -- business portfolios that in the merger. When we pulled the companies together and went through the business, we said there are businesses' portfolios that are not meeting our standards. We've talked about some of those. And that we'd cancel those. Those, when you cancel them, you're eliminating gross as well as net. So you've got to keep that in mind.

Q - Mike Nannizzi {BIO 15198493 <GO>}

Okay, got it. Then just quick on the ag book. The last couple years have been below -- well below that 88% to 90% range. Just trying to think about that business. You spent -- the last couple years have been both below the range, especially the last one, 2016 being that. How should we be thinking about whether it's your use of reinsurance in this line, or what the profitability should look like? Should it get back to that more normal level, or is this a good starting point to think about what that business should be able to contribute?

A - Evan Greenberg {BIO 1444445 <GO>}

I think you guys have short memories. This year was a very good year. Last year was a good year. But not that far off the normal trend, by the way. It was a good year. But not that far off. We look over a 10, 15. And 20 year. We put the business on level, because there are things that impact loss ratio in the current year that didn't impact 20 years ago because prices have changed, yields per acre and how seed and fertilizer behaves have changed to the positive in that, growing seasons have changed a bit because of weather. We actually consider all of that. And put on level to come to historic combined ratio. That historic that you cite of that 89%, 90% is where we remain.

That's why we're saying to you -- I don't wait for a bad year to say this, I'll say it in a good year. It's a cat-like business and it has a volatility to it. So you measure it over a period of time. But I think we get a reasonable -- it's not excessive -- we get a reasonable risk-adjusted return on that business.

I think we have very clear competitive advantages in our franchise that just put us light years ahead of fundamentally anyone else in that business, particularly around our analytics, our deep distribution and spread of business, our knowledge and insight of data and people with experience that go back so many years. We have a cost advantage and a technology advantage that is a very hard barrier to leap.

Q - Mike Nannizzi {BIO 15198493 <GO>}

Great. Thanks for that. Maybe if I could continue one last one, maybe for Phil on the legacy Chubb's municipal bond portfolio. How are you thinking about that? Is that -- do you expect to sell that down, or just reinvest once those bonds mature? Evan, one clarification, I don't have a short memory, I have a bad memory. That's totally different.

A - Phil Bancroft {BIO 4621336 <GO>}

If you look at our muni portfolio, it's very highly rated at AA -- 80% of it's rated AA or higher. It earns a pretty attractive book yield, it's 3.3%. It's got a duration of about 4.8 years.

What we're seeing now -- we talk about the changes of interest rates and the impact they may have on our choice to hold that portfolio. We're running scenarios at different tax rates to determine the impact on the portfolio. The ultimate allocation will depend not only on the tax rate. But also the relative value of the municipals to the other possibilities in the portfolio. We're evaluating it. And we'll look at it in light of the tax developments that emerge over the next months.

Q - Mike Nannizzi {BIO 15198493 <GO>}

Thank you. So much for the answers.

Operator

Paul Newsome, Sandler O'Neill.

Q - Paul Newsome {BIO 1541286 <GO>}

Good morning. I was hoping you could run me through the accounting for the negative combined ratio in the ag business, just so we know what went on there? It's a little strange to have a negative combined ratio for a quarter.

A - Evan Greenberg {BIO 1444445 <GO>}

We're not going to run you through it. Phil will take -- if you want to get more detail -- take it off-line. But it's pretty simple. In this business, remember, it's a public-private sector sharing program. This is a federal government sponsored program. There is a very clear formula that you follow, because the government takes a certain amount of the risk -- both individual risk and excess of loss protections that they provide. Depending on the actual year and how it comes out, you apply the formula of how you share with the government.

In this quarter, you have to give premium to the government. Therefore your earned premium base goes down substantially. And that's how you end up with a negative combined ratio. They take premium, they take a certain amount of losses. It's the denominator that is driving that. You following me?

Q - Paul Newsome {BIO 1541286 <GO>}

I am. That's getting me where I wanted to go. Thank you.

A - Evan Greenberg {BIO 1444445 <GO>}

You got it.

Operator

Jay Cohen, Bank of America Merrill Lynch.

Q - Jay Cohen {BIO 1498813 <GO>}

Thank you. Looking at the US businesses, North American businesses, what you did see in the personal lines side was that the accident year loss ratio excluding cats did jump up this quarter relative to the past four, relative to the past seven. I'm wondering if there's any unusual items in there -- weather, large loss activity. Then similarly in the commercial business, again North America, that accident year loss ratio ex-cat wasn't quite as big a jump. But it did go up from where it had been. I'm wondering what's happening there, as well?

A - Evan Greenberg {BIO 1444445 <GO>}

I'm going to ask Paul Krump to talk about one of them, the personal lines. Then I want to make a comment to you. Then I'm going to have John Lupica talk about the commercial lines (inaudible; low audio)

A - Paul Krump {BIO 5211397 <GO>}

Thanks for the question, Jay. As Evan said, I'm a bit of a storyteller. So let me just back up here a second. The 2016 Fourth Quarter combined ratio for PRS is 82.1% excluding cats and PPD. That compares to 80.9% in the Fourth Quarter of 2015. So up a little bit.

However, the Fourth Quarter of 2015 underwriting income benefited by $18 million from the DAC holiday related to the purchase of Fireman's Fund. If we reduce the 2015 underwriting income by that one-time adjustment, we actually end up with an 82.4% current accident year combined ratio, ex-cats and PPD, compared to the 82.1% that we had. All up, we actually saw, on a combined ratio basis, a 0.3-point improvement in the current accident year combined ratio, obviously mainly due to the expense ratio resulting from the synergies and the impact of the new reinsurance agreement that Evan has touched on numerous times.

The loss ratio was up a little bit. As you said, it was due to some losses. And they were in the non-cat weather. In particular, we saw some more water damage claims and some burst pipes. But as Evan also said in his earlier comments, that's a bit of noise. It's the insurance business. It goes up and down a little bit, quarter by quarter.

Q - Jay Cohen {BIO 1498813 <GO>}

Got it, that's helpful, Paul

A - Evan Greenberg {BIO 1444445 <GO>}

And John Lupica has actually the opposite

(inaudible; multiple speakers)

A - John Lupica {BIO 4213297 <GO>}

Yes, Jay, thanks. On the commercial side, for both Paul and I and all of North America, the year-over-year change is really just a fact that our 2015 current accident year had a fewer amount and lower large losses then we saw in 2016. I wouldn't say 2016 was above average; I would say 2015 is probably below average. And that's really the change.

A - Evan Greenberg {BIO 1444445 <GO>}

Yes. Make sense to you, Jay?

Q - Jay Cohen {BIO 1498813 <GO>}

Yes. Thank you.

A - Evan Greenberg {BIO 1444445 <GO>}

I've read a number of the analysts' early reports. And talking about these questions. I want to make a comment about that. We had simply an outstanding quarter. Our calendar year combined ratio reflects all the good and all the bad -- i.e., there were more cats, there was flat PPD. We had outstanding crop. We had excellent global P&C results.

Looking at the business as sort of well. But for this, or but for that, expect for one-time items like the pension benefit, which is fair, is misleading in my mind, because all these businesses are ongoing businesses. And they make a contribution.

We are in the risk business. You're going to see noise always from one quarter to another quarter. We didn't reach in our current accident-year reserving, whatsoever. And how we post loss ratios. We didn't suddenly grow more optimistic. I remind you that we're conservative in how we manage our business. We recognize bad quickly. And we're very slow to recognize good. As you look at the individual little pieces, I wanted to give you a bigger perspective on it.

Q - Jay Cohen {BIO 1498813 <GO>}

Got it.

Operator

Ian Gutterman, Balyasny.

Q - Ian Gutterman {BIO 18249218 <GO>}

Hi, thank you. First a quick numbers one. And then a question on reserves. Phil, can you just clarify the $60 million in VA, is that just for 2017, or is that a recurring thing well into the future?

A - Phil Bancroft {BIO 4621336 <GO>}

It'll go into the future, unless we change our view of interest rates, or change other assumptions. But based on what we feel now, that would be a continuing adjustment.

Q - Ian Gutterman {BIO 18249218 <GO>}

Got it, thank you. Evan, just to flesh out a little bit more what's going on in the industry. And where things may be heading on reserves and so forth, I was hoping we could flesh out a little bit more -- I think it came up a little bit earlier. Specifically, the topic of adverse development coverage, whether they be just people buying a little bit of protection for a line that they're a little nervous about, to some of these gigantic unprecedented deals.

It seems ADCs are back in a way we haven't seen in almost 20 years now. Last time when they were prevalent, it seemed to be a pretty good tell, right? The buyers were the smart ones and the sellers were the dumb ones. Does it feel like that's happening again this time? Maybe a better way to ask it is, would you guys sell an adverse development cover to anybody right now?

A - Evan Greenberg {BIO 1444445 <GO>}

I'm not in that business. The industry -- what do you see and soft versus the hard part of the cycle? People, as you get into -- some are better underwriters and more disciplined in a competitive environment in this business than others are. Some are more aggressive to go for growth. And they sell very broad covers. And they sell them at cheap prices. And they don't have the command and control in underwriting. And so they get surprised. You put those two things together. And now and again there is a derivative business for garbage collectors who come around and collect it. They collect the garbage out of portfolios. And that's what you've got here.

I am not a buyer nor a seller. I can't imagine that we'd be in a position where it would make sense for us to give up a substantial percentage of our loss reserve asset and its future income, because we were -- we didn't have the risk management and the control and knowledge of our business that we would have to -- that we'd be so insecure that we'd have to give up our portfolio that way, shrink our balance sheet that way. Makes no sense to me, for us, how we run our business.

But you know you've seen it. This is a business that has grown up over the years. There are a couple of guys who've been pretty good at it. And they've done a pretty good job. Not everyone, I would say, gets burned at it. But it is -- it's an industry where you look at the ROE of the industry. The mean is cooler. And there are both sides of that mean. On one side of that mean are those who out-perform and on the other side are those who under-perform. The ones who under-perform, they generate a lot of garbage. The garbage collectors come around.

Q - Ian Gutterman {BIO 18249218 <GO>}

Very apt analogy. Thank you, Evan.

A - Helen Wilson {BIO 2078659 <GO>}

We have time for one more person to ask questions, please.

Operator

Brian Meredith, UBS.

Q - Brian Meredith {BIO 3108204 <GO>}

Hi, thanks. A couple questions here for you. First one, Evan, I'm just curious. Are you at the point in the Chubb integration where you are comfortable enough that if something else comes up that you think you've got not only the financial capacity. But the Management capacity to absorb a small, mid-size acquisition?

A - Evan Greenberg {BIO 1444445 <GO>}

I want you to know, I am looking at a room full of colleagues who will absolutely take me out, burn me (inaudible -- background noise). You know what, we're focused on integrating and getting the power, it's the power, of the promise of all of the capability matched against the opportunity that this organization has right now. I'm going to leave it at that, except to say we have Management bandwidth.

Q - Brian Meredith {BIO 3108204 <GO>}

Okay. Great. My second question -- the VA annuity, lots of volatility. It's almost like a nuisance. Is there any opportunity, potentially, to get rid of that at some point, or do you think you're stuck with it forever?

A - Evan Greenberg {BIO 1444445 <GO>}

I don't know. But look, the VA -- and we're going to do this in 2017. We're going to split the life business into three pieces that you can see. Our international life earnings, in total -- don't hold me to the exact number -- was like $27 million this year. And they'll grow -- they ought to grow substantially in 2017. That's our international life insurance business. Our combined underwriting income for the combined insurance company that's in the life division, that part of it, produces good earnings. And you will see those two pieces.

The VA was producing circa -- at one point, about $150 million, $160 million a year of operating income. It's come down to about $120 million, $130 million. Now it's coming down to like $60 million going forward. It isn't -- keep in mind it isn't that it hasn't produced good income for us. But with obviously the book value volatility, that has gone with that from the market.

Q - Brian Meredith {BIO 3108204 <GO>}

Great, thank you.

A - Helen Wilson {BIO 2078659 <GO>}

Thank you, everyone, for your time and attention this morning. We look forward to speaking with you again at the end of next quarter. Thank you. And good day.