S&P Global
Market Intelligence

The Hanover Insurance Group, Inc. NYSE:THG

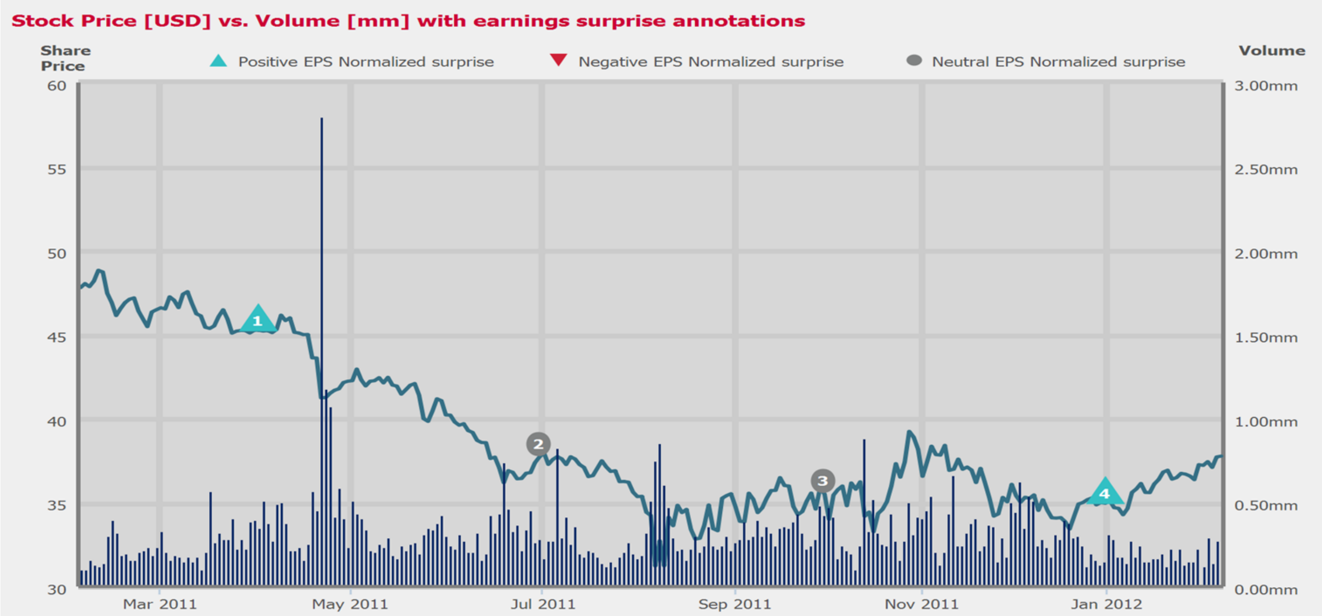
FQ1 2012 Earnings Call Transcripts

Tuesday, May 01, 2012 2:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ1 2012-			-FQ2 2012-	-FY 2012-	-FY 2013-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.95	1.01	▲6.32	0.95	4.10	4.23
Revenue (mm)	1107.45	1016.80	▲(8.19 %)	1145.34	4322.83	4493.88

Currency: USD
Consensus as of May-01-2012 6:00 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ1 2011	0.50	0.53	▲1 6.00 %
FQ2 2011	(0.56)	(0.84)	NM
FQ3 2011	(0.44)	(0.41)	NM
FQ4 2011	0.81	1.00	▲2 23.46 %

Table of Contents

Call Participants

EXECUTIVES

Andrew Robinson

David B. Greenfield
Former Chief Financial Officer, Principal Accounting Officer and Executive Vice President

Frederick Henry Eppinger
Former President & CEO

Marita Zuraitis
Executive VP, President of Property & Casualty Companies

Oksana Lukasheva
Vice President, Investor Relations

Robert Arthur Stuchbery
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JMP Securities LLC, Research Division

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Sterne Agee & Leach Inc., Research Division

Lawrence David Greenberg
Langen McAlenney

Raymond Iardella
Macquarie Research

Vincent M. DeAugustino
Stifel, Nicolaus & Company, Incorporated, Research Division

Presentation

Operator

Good day and welcome to the Hanover Insurance Group first quarter conference call and webcast. [Operator Instructions] Please note, this event is being recorded. I would now like to turn the conference over to Oksana Lukasheva, AVP Investor Relations. Please go ahead.

Oksana Lukasheva
Vice President, Investor Relations

Thank you, Andrew. Good morning, and thank you for joining us on our first quarter conference call. We'll begin today's call with prepared remarks from Fred Eppinger, our President and Chief Executive Officer, and David Greenfield, our Executive Vice President and CFO. Also, in the room and available to answer your questions after our prepared remarks are Marita Zuraitis, President, Property and Casualty Companies; Andrew Robinson, President of Specialty Lines; and Bob Stuchbery, President of International Operations and Chief Executive Officer of Chaucer.

Before I turn the call over to Fred, let me note that our earnings press release, statistical supplement and a complete slide presentation for today's call are available in the Investor section of our website at www.hanover.com. After the presentation we will answer questions in the Q&A session. Our prepared remarks and the responses to your questions today, other than statements of historical fact, include forward-looking statements such as our outlook for segment income per share for 2012.

There are certain factors that could cause actual results to differ materially from those anticipated by this press release, slide presentation and conference call. We caution you with respect to reliance on forward-looking statements and, in this respect, refer you to the forward-looking statements section in our press release, Slide 2 of the presentation deck and our filings with the SEC.

Today's discussion will also reference certain non-GAAP financial measures, such as total segment income, after-tax earnings per share, ex-cat loss and combined ratios and accident share loss of combined ratios, among others. A reconciliation of these non-GAAP financial measures to the closest GAAP measure on a historical basis can be found in the press release or the statistical supplement, which are posted on our website as I mentioned earlier.

With those comments, I will turn the call over to Fred.

Frederick Henry Eppinger
Former President & CEO

Thank you, Oksana, and good morning, everyone, and thank you for joining our call today. I'm pleased with our results for the first quarter as we continued to see favorable trends in our businesses and overall results were in line with the outlook we shared with you earlier in the year. Net income per share for the quarter was $1.09 and operating EPS was $1.01, which translates into an annualized operating ROE of 8%. Our book value per share increased 3.6% during the quarter and 5.7% over the last 12 months after adjusting for the adoption of the accounting change for deferred acquisition costs.

Before I comment on our results by segment, I would like to touch on our strategic priorities for 2012. This should be helpful as we review our quarterly results and evaluate our progress throughout the year. As we discussed at Investor Day, we have accomplished a lot in the last several years to reposition the company for better long-term performance.

We transformed our company from a regional insurance company with a challenging geographic and product mix into a national player with global reach and an attractive business mix and strong and growing position with some of the best distributors in the industry. While we have improved our performance from the early days of the journey, our goal is to build a company that can deliver 11% to 13% ROE through the cycle.

In 2012, we believe we are now well-positioned to both capitalize on the current market opportunities and position our company for improving profitability and sustainable attractive returns. Each of our businesses is focused on 3 critical value levers to improve our performance in 2012 and set up continuing financial improvement in 2013.

The 3 levers are: first, improving the quality and attractiveness of our current mix through targeted underwriting activities and growing higher margin businesses. Second, further strengthening our position and alignment with winning agents. And third, improving our underwriting and financial performance through a disciplined focus on pricing and operating model efficiencies.

Our first quarter results provide evidence that our focus on these 3 levers is working. In personal lines, our 3 main priorities translate into implementing rate and non-rate actions to improve profitability and refining our business mix by managing pockets of property concentration and reducing lower return business.

We continued to achieve rate increases during the quarter. The filed rate increases were over 4% in auto and over 7% in homeowners. We also achieved strong retention, which at 81% was a 2-point improvement from prior year quarter. At the same time, our strong market position and our account-focused strategy enables us to successfully adjust our business mix without sacrificing retention or our position with the best partners. And we expect rate increases to be greater in both lines of business in the second quarter.

The relatively mild winter was a welcome change this year. However, a very early and unusual tornado season, which impacted many of the states and territories we do business in, including Michigan, Tennessee and Indiana, offset some of the benefits of the benign winter.

Catastrophe losses in personal lines were $23 million, substantially in line with our increased cat assumptions this year, but still relatively high compared to our longer-term historical trends. As we mentioned on previous calls, we continue to actively mitigate properties exposure in certain areas to ultimately improve returns in 2012 and beyond by changing policy terms and non-renewing certain business.

These efforts are ongoing and had a slight negative impact on our personal lines growth. These activities will continue into the second quarter and the rest of the year. We remain satisfied with our underwriting profitability in personal lines. Non-catastrophe weather was clearly more favorable in the quarter, but we also saw an improvement in underlining loss trends, especially in our homeowners lines, which we attribute to our pricing and non-pricing actions over the last several quarters.

Our outlook for auto is also positive, but we are reacting to higher severity trends in auto liability lines that've recently emerged in our most recent prior accident year performance. We are working on a number of levers, including accelerating rate increases in the affected areas. We believe these actions, coupled with other pricing and underwriting initiatives, will drive improved results in personal lines going forward.

In commercial lines, the 3 priorities I mentioned earlier crystallize our focus on balanced rate increases, continued penetration of specialty and higher margin lines and our efforts to drive further efficiency and effectiveness in our operating model.

This quarter, our 12% growth in small, commercial and middle market was driven by price increases of approximately 6%, strong retention in the mid-80s and notable new business growth. Pricing accelerated as the months progressed with middle market pricing standing at 8% for March, and we expect to see continuing trend in the second quarter.

New business writings accelerated substantially compared to the first quarter of 2011 as writings in new geographies, the broader acceptance of our more recent product enhancements and our strong momentum with partners drove a higher pace of submissions. We believe the quality of our new business we are putting on the books today is excellent. It is coming from our targeted industry classes and regions. The growth is also primarily generated by our leading partners, who have aligned incentives and understand and share our focus on adequate pricing, quality and profitability.

Our partnership strategy allows us to take select-approach to the market and achieve pricing on new business that is in line with what we see on renewals, thus substantially improving profitability prospects for our book of business. We believe in 2012 the quality and pricing levels of our new business will lead to continued improvement in our margins.

In summary, we are very satisfied with the quality of growth we are seeing, rates are good at both new business and renewals, retention is strong and mix of business continues to shift to more desirable classes. All of these factors are driving a better quality book.

While our growth in commercial lines was strong during the first quarter, it was still lower than the 21% premium increase we achieved in our specialty lines this quarter. We continue to shift our business to a specialty mix, which historically is more profitable and balances [indiscernible].

Our program business continued to grow during the quarter stemming from strong pricing and retentions on our renewal programs, as well as from new programs for The Hanover, which are mature and well established in the industry. With about $300 million in the annual gross premiums, a strong technology platform and a solid underwriting talent, AIX has become a market leader in the specialty program market.

We also saw quality growth from our Hanover Professionals Portfolio as well as newer specialties, including management liability and non-public D&O. Most of our emerging businesses are now positive contributors to our bottom line.

We continued to be satisfied with the quality and pace of growth in our domestic commercial lines. And we remain very optimistic about our expectations for the full year.

A couple of thoughts on Chaucer. Chaucer continued to be accretive to our earnings, producing a combined ratio of 94% and a pre-tax segment income of over $25 million. Catastrophes were below plan, although we did see some several large losses slightly above plan, which were reflected in our ex-cat accident year results. The current underlying trends and prior loss trends in the business continued to be favorable in the quarter.

Market conditions are improving in the majority of property lines, especially in areas affected by the last year's cats. Additionally, as the market responds to recent losses in the energy and marine sectors, we are seeing prices and terms and conditions in these accounts improve as well. We are confident Chaucer will continue to add to our earnings power and strengthen our market position going forward.

Before I turn the call over to David, I would like to provide some commentary on our capital management. We continue to strive for effective use of our capital, balancing the use of leverage, driving efficiencies from Chaucer's assets and capital, and eliminating pockets of capital inefficiencies in certain areas of our domestic operations.

I would like to reiterate that in 2012, we continue to focus our efforts on improving profitability and driving higher ROE, using the profitability levers we discussed. We do not think this will be a year of large acquisitions. Instead, we are centering our attention on executing on our priorities, refining our portfolio and enhancing margins for the capabilities of resources we have.

Given the results for the quarter, we continue to be confident in our regional outlook for 2012 we provided to you in February. While we saw some development activity in a couple of areas, we believe we have reacted quickly and they are offset by many of our other trends that are better than our plan. And more importantly, we are confident that our actions around the key levers position us well to improve our earnings power and lead to stronger returns in 2013 as we consider our momentum and favorable trends around pricing, retention and mix for this quarter.

Given our strong position with agents and brokers, the growth we've achieved in recent years, as well as additions we've made to our team, our products and our business portfolios, we will continue to fully capitalize on the changing market and achieve our financial goals. With that, I'll turn the call over to David.

David B. Greenfield
Former Chief Financial Officer, Principal Accounting Officer and Executive Vice President

Thank you, Fred, and good morning, everyone. I'm very pleased with our first quarter results, which reflect our diversifying and growing earnings power, the strength of our franchise and how well we are positioned for the future. We continue to move forward on our path to an 11% to 13% ROE. Net income for the first quarter was $49.7 million or $1.09 per diluted share compared to $29.3 million or $0.64 per diluted share in the prior year quarter. Our segment income this quarter was $46 million or $1.01 per diluted share compared to $25.9 million or $0.56 per diluted share in the prior year quarter.

On a year-over-year basis, the favorable comparison is driven by several factors. For the third consecutive quarter, Chaucer has provided a strong contribution to earnings. In addition, we continue to achieve meaningful growth in margin expansion, resulting in higher earnings in our domestic business. Fred has already provided commentary about our top line performance and the pricing environment, so I'll focus my remarks on our segment results.

Starting with commercial lines, the combined ratio was 100.3% for the quarter compared to 103.7% last year. The 3.4 points of improvement over last year was primary driven by a better current accident year loss ratio and lower catastrophe losses, which were partially offset by a decrease in favorable reserve development.

I'd like to break this down a little further. The current accident year loss ratio improved by 2 points compared to the prior year quarter. Clearly, a more mild winter drove some of this improvement. More importantly however, we also see an improvement in underlying loss ratios. We attribute this to many factors, including the continued benefit of a shift in our mix of business, as well as diligent underwriting actions that drove better severity trends.

Additionally, we noted improved rate activity and retention in commercial lines for several quarters, as well as positive pricing in new business. We believe all of these factors combined to contribute to growth in earnings power this quarter. In terms of reserve development, we saw favorable trends in our CMP and worker's compensation alliance this quarter, and we added incrementally to reserves in the commercial auto and surety lines.

In commercial auto, we noted an increase in severity of losses, primarily affecting the 2011 accident year. As a result, we adjusted our loss picks up slightly for 2011 and also factored in a modestly higher severity assumption in our 2012 loss fix. Concurrently, we continue to actively implement rate increases and other underwriting actions in this line in order to offset any potential for adverse impact going forward. Our pricing in commercial auto was 5% this quarter, up sharply from only 1% increase in the first quarter of last year.

In surety, we continue to experience some loss activity in our contract book, given little improvement in the overall economy and continuing pressures on the construction industry. We are continuing to focus on shifting the business mix to commercial surety, while maintaining a focused underwriting process in contract surety. This should result in improved results in surety going forward.

Our expense ratio in commercial lines continued to improve, lowering the combined ratio by almost 1 point this quarter. We attribute this to fixed cost leverage from continued earned premium expansion and the continued improvement of our operating model.

Overall, the level of profitability improvements in commercial lines is in line with our expectations. Perhaps as importantly, better pricing trends and a continued shift to a more profitable mix provide us confidence in continued margin expansion going forward.

In personal lines, the combined ratio was 98% for the quarter compared to 97.5% for the first quarter of 2011. Catastrophe losses this quarter, primarily from the late February and March tornadoes, where $23 million compared to $22 million in the prior year quarter. We had about $4 million or 1 point of adverse reserve development, primarily in auto liability, in the current quarter, compared to 4 points of favorable reserve development in the prior year quarter.

As we noted in previous comments, the trend in reserve releases overall has been declining over the past 4 quarters. In addition, we reacted this quarter to modestly higher severity trends in auto liability that emerged in our most recent prior accident year. Together, these items resulted in a small amount of adverse reserve development this quarter.

The action year combined ratio, which excludes catastrophe losses and prior year reserve development, was 90.7% in the current quarter compared to 95.2% in the first quarter of 2011. While a part of the improvement is attributable to more favorable non-catastrophe weather losses in the current quarter, we are also seeing favorable trends in our underlying margins, especially in the homeowners line. We are pleased to see that recent rate and underwriting actions we've taken to improve personal lines probability are translating into better loss ratios.

Moving on to Chaucer, this business delivered its third profitable quarter since the acquisition, generating $25 million of segment income before taxes. The combined ratio of 93.8% included $7 million related to catastrophe losses, approximately 3 points, which is somewhat lower than our normal expectations for the quarter. The ex-cat accident year loss ratio for the quarter is slightly higher than normal and includes higher-than-expected large loss events which we do not classify as catastrophes, such as the Costa Concordia loss.

The combined ratio also included 9 points of prior-year releases this quarter. The favorable development came mostly from the 2010 and 2011 accident years related to energy and property businesses as well as favorable adjustments to marine reserves, primarily from the 2008 accident year.

Chaucer's expense ratio was 36.2% this quarter, which is slightly lower than our expected long-term run rate of about 37%. Chaucer's gross written premiums were $382 million this quarter and net written premiums were $200 million. The quarter's net to gross ratio is lower than our full-year expectation. The reason for this is that a large part Chaucer's seated excess of loss reinsurance program is booked in the first quarter, whereas the underlying business will be written throughout the year. This quarter's net written premium is not an indication of reduced premiums for the year and you should anticipate a higher net to gross ratio for the remaining quarters.

Overall, the underlying trends in Chaucer's business are favorable. We continue to be pleased with the disciplined underwriting and more positive market trends. And we believe Chaucer will continue to contribute to our earnings going forward.

Moving on to a discussion of our investment portfolio, net investment income was $69 million for the first quarter of 2012, up about 14% compared to the $60 million earned in the prior-year quarter. This increase was driven primarily by the increase in invested assets acquired with Chaucer last year. R&M investment income this quarter was also boosted in part by dividends on equity securities that won't necessarily be repeated in subsequent quarters.

For the first quarter, the overall earned yield on our fixed maturity portfolio was 4.38%. The Hanover's fixed maturities yielded 5.2% and the Chaucer investments delivered 2.2%.

At March 31, 2012, we held over $7.6 billion in cash and invested assets, with fixed income securities representing 85% of the total. Roughly 94% of our fixed income securities are investment grade and the average duration in the portfolio is 4 years. In the first quarter of 2012 we deployed a portion of Chaucer's cash and short-term assets into higher yielding securities, primarily in corporate bonds. As a result, the book yield in Chaucer's portfolio increased by about 15 basis points, the duration grew slightly, while the quality of the portfolio remained very strong at AA-.

As it relates to the overall investment portfolio, we also invested approximately $75 million in stable, primarily large cap equities with attractive dividend yields during the first quarter. With only 4.4% of our total portfolio currently allocated to equity securities, we felt comfortable taking on incremental equity risk while benefiting from the additional diversification and dividend yield.

Our balance sheet remains strong, providing excellent financial flexibility. We ended the quarter with $2.6 billion in shareholders' equity. Our book value per share at March 31, 2012, was $57.65, up 3.6% from $55.67 at December 31, 2011, and up 5.7% from $54.55 at March 31, 2011.

As we've previously discussed, we adopted the new accounting guidance related to deferred acquisition costs, or DAC, which we applied retroactively by restating prior periods. As a point of reference, the new methodology reduced shareholders' equity by approximately 1% or $26 million. The adoption of this guidance did not have a material effect on underwriting income or earnings, nor do we believe it will have a material effect going forward.

Our debt-to-total capital ratio was 26.3% at the end of the first quarter, which is well within rating agency thresholds for our current ratings. This compares to 26.8% at year end. Holding company cash and investments was $196 million at March 31, which is above our target level, and we continue to maintain a $200 million credit facility that provides additional flexibility.

Before I open the line for questions, I'd like to provide a couple of comments on our full-year outlook. Our business trends and the market dynamics we've seen this past quarter clearly give us continued confidence in our 2012 earnings guidance of $3.85 to $4.15 segment income per share.

I have a few items related to the outlook that may be helpful to you. Since Hurricane Katrina in 2005 and as a result of our coastal management actions over the last several years, our catastrophe loss patterns have changed. Tornado and hail events that are usually more active in the second quarter have had a more meaningful impact on our earnings and cat loads in recent years. Accordingly, our 2012 plan has an expectation for the second quarter catastrophe loss ratio to be higher than the rest of the year.

We continue to expect less favorable reserve development in 2012 as compared to 2011 on a full-year basis. Additionally, we continue to expect flat to slightly declining net written premium volumes in personal lines for the full year. Quarterly patterns may be affected as we continue to implement our agency and exposure management actions in certain states.

We believe we will continue to see improved accident year ratios in our domestic businesses in the second half of the year as a result of robust retention, improved rates and a continued shift in business mix. We continue to expect only a slight increase in net investment income for the full-year of 2012 as the addition of Chaucer's invested assets is expected to be partially offset by continued low new money yields. And finally, we continue to assume that weighted average shares outstanding for the year to be 45.5 million shares.
Operator, we are ready now to open the line for Q&A.

Question and Answer

Operator

[Operator Instructions] The first question comes from Vincent DeAugustino of Stifel, Nicolaus.

Vincent M. DeAugustino
Stifel, Nicolaus & Company, Incorporated, Research Division

Just one real quick clarification question and then 2 short follow-ups, if I might. For Chaucer, sorry if I missed it, but what was the loss ratio impact from the abnormal large losses?

David B. Greenfield
Former Chief Financial Officer, Principal Accounting Officer and Executive Vice President

We haven’t disclosed that specifically. It’s not something we've put out there. And I mentioned, the one loss, the Costa Concordia, was the largest in there. What I would say is that, overall, the slightly higher large loss activity was nothing of significance, just a higher volume, if you will, or frequency of events. But just slightly above what the plan is for the year. And I think when you look at that in context with the cat benefits, you're probably looking at an overall loss ratio around where we expected.

Vincent M. DeAugustino
Stifel, Nicolaus & Company, Incorporated, Research Division

Great. And then just the 2 follow-ups would be on auto, real quick. I know you had mentioned some of the severity trends popping up. I was just curious if you could give us an update on Michigan or whether or not there was any geographic concentration of where those severity trends were popping up at?

Frederick Henry Eppinger
Former President & CEO

It was across our core states, essentially, that we saw it. There was nothing that made Michigan stand out in any of the tends. It was really just the core areas. Marita, is there anything particular --

Marita Zuraitis
Executive VP, President of Property & Casualty Companies

No, the only thing I would say is the BI severity was clearly coming from New York, New Jersey, Connecticut. We saw it in the 2011 year and reacted to it, and we have been and will continue to price accordingly.

Vincent M. DeAugustino
Stifel, Nicolaus & Company, Incorporated, Research Division

Great. And then this is kind of a forward-looking question, but we’ve heard a lot about other auto players that are implementing usage-based insurance programs, namely Progressive. And to my knowledge, most of them are doing it in-house or mostly in-house with some outside help. So my question is, is how long, if at all, do you think it is before some of the middle sized players like yourself would need to implement UBI programs? So I mean, how much longer do you have before you have to do that? And when it comes time to get that done, does partnering with some sort turnkey third party provider that provides sensors and analytics, is that the route that you might go? I was just kind of curious of your thoughts looking out and maybe how you’ve been looking at how you’d go about doing such a thing.

Frederick Henry Eppinger
Former President & CEO

Yes, we obviously are assessing that. We actually have a pilot going on right now in that, and we’re trying to assess what the benefit would be and how it fits with our target customer group, which is more of a full account based customer group. Because obviously some of the experiments to date are really as a service, if you will, to the clients, because they use it to monitor the quality of driving as well, as you know, some people doing it. So we are in a middle of a pilot. And my view is we'll be ready if we think that the market acceptance fits our customer segment. It is something that we're paying attention to. We don't see the broad benefits yet from it, but we are monitoring it or, as I said, we're actually piloting it.

Vincent M. DeAugustino
Stifel, Nicolaus & Company, Incorporated, Research Division

Great. Would you say we're a few years or are we still 5, 10 years away from broad...

Frederick Henry Eppinger
Former President & CEO

It's hard -- it really is hard to tell. I mean, again, if it's purely for rate making, it obviously is a 0 sum gain at some level. And depending on how it's used and where it's used, again, it gives you obviously some insights, but for me, it's one of those things that because of privacy issues and a number of issues surrounding it, it's not crystal clear how broad adoption it's going to get. And again, for us, what we think about, is it appropriate for our target segment and how would it be used by our target segment. That's part of what we're trying to make sure we understand is the value for our target clients. But to your point, this is something that every -- if it happens -- a lot of people have read about equipment costs and all that. If it happens, right, all that will get taken out of play, because not only will there be third parties, but the cost of all that equipment will go way down. Right? So it's one of those things a lot of people, as you know, are paying attention to. But right now, I'd still say it's quite uncertain.

Operator

The next question comes from Dan Farrell of Sterne Agee.

Daniel D. Farrell
Sterne Agee & Leach Inc., Research Division

Could you talk about the pricing increases that you're getting maybe relative to the loss cost trends that you're observing? And then in the specific localized lines that you're seeing some adverse development trends, what's your confidence level that you're addressing it through rate and accident year picks? And particularly accident year picks it seems like the recent quarters in those specific areas have seen a lot higher loss pick than you have been. So I'd just like to get your view on what kind of cushion or confidence level you have on that.

Frederick Henry Eppinger
Former President & CEO

Yes, again, what's interesting about our pattern, right, you know this, our pattern's a little unique. We weren't -- a lot of pattern in our industry, there's been a lot of reserve releases from '03, '04, particularly in the casualty, long tail line. Because of where we were in '03, '04, because our mix is short tail, most of our patterns is very mechanical around our recent years. We obviously -- to Marita's point, we've been watching some of the severity in some of the auto lines, in particular, because that's really what we're talking about here, and we have adjusted along the way. So again, we don't see anything that significant. I mean, the numbers aren't great, but because we don't have outsize reserve releases, it does change the percentages to some extent. And so I feel very good about it. I mean we're all over it, we're tracking it, we know where it's from. Again, these are little bit more controlled, if you will, than, say, excess comp or something like that. I mean, these really are the auto lines and we believe that we've adjusted it appropriately. That's really the only place we're seeing things.

Marita Zuraitis
Executive VP, President of Property & Casualty Companies

And even within the quarter that increased pattern continued, with January pricing being at 5, February being at 6 and March being at 7. So we even saw the increase in the pattern within the quarter.

Daniel D. Farrell

Sterne Agee & Leach Inc., Research Division

That’s helpful. And then just on Chaucer, on the expense ratio. That's bounced around, and I think you’ve indicated it would in the early quarters as you've worked through some stuff. Is the 36% expense ratio maybe something more of a trend now or how should we think of that going forward?

David B. Greenfield
Former Chief Financial Officer, Principal Accounting Officer and Executive Vice President

Yes, Dan. I think, again, as I said in my remarks. I like the number of 37% as a long-term run rate for us. There is some timing of items coming through there which bounce it around a little bit. And there's also sometimes a little bit of FX that are going to come into it. But I think you should really think about it at around a 37% on a long-term basis.

Operator

The next question comes from Ray Iardella of Macquarie.

Raymond Iardella
Macquarie Research

The first question, I guess maybe for David. On Chaucer, what is the threshold as far as you guys breaking out catastrophe losses in that segment? Is there a dollar threshold or does it vary by line of business? Can you maybe give us some color on that?

David B. Greenfield
Former Chief Financial Officer, Principal Accounting Officer and Executive Vice President

Yes, a couple of things there. We have a corporate cat policy threshold, which you'll find in our annual report, and typically it’s about a $5 million event, if you will. Cat -- I mean one way you can look at a cat definition for us is the difference between man-made or natural disaster. Certainly natural disasters tend to always show up in the cat line. Man-made disasters are going to be more about how widespread they are. And Chaucer’s business is just different than the domestic businesses so -- because of the types of risk they ensure and the programs they write. We could see a $5 million, $6 million, $7 million loss, which is what they consider large losses, but they're more attritional in a sense. And the only thing that really happened in this quarter was there were just a few extra that showed up in here. And it’s hard to predict when rig is going to require a control or a boat's going to sink. So you might see a little bit of moment here, but you really shouldn't over anticipate that. I mean that was just sort of an aberration this quarter.

Raymond Iardella
Macquarie Research

Okay, that’s helpful. And then maybe just a sort of more broader question. Can you maybe talk about some of the smaller acquisitions you guys have done over the past 2 or 3 years and how they are performing? I think we spend a lot of time looking at Chaucer because it’s broken out as a different segment, but maybe -- I know you touched on AIX in your prepared remarks, but maybe touch on some of the other acquisitions you guys have done and how they've been performing.

Frederick Henry Eppinger
Former President & CEO

We've been very fortunate. Essentially, they’ve all worked out very, very well. Our professional lines business, our LPL business, has created a nice core to our professional lines. It was the platform, if you will, that we’ve used not just for LPL, it's become the platform for the other professional lines as well. So that business now is a nice contributor to us. Our business, our HSI, which is our HPR business, which was the Verlan acquisition, is a wonderful business for us. It has been a very good contributor and a high margin business. So that’s worked out as well. Our A&E business, which is a small business with our architects and engineers, that is now within our professional lines has worked out. Again another one contributing to the bottom line right out of the get-go, has been a very good, positive thing for us. Obviously, the OneBeacon allowed us to -- you saw the data we showed on the renewal rights. And on

OneBeacon we were able to beat all our assumptions as far as both profitability and on retention for that. We retained over $300 million. And on the healthcare side, Companion, it's a little bit earlier days, but also is a contributor now. We had some investments we've been making in that platform, but it is now a positive contributor. What you've seen in all of these businesses, we've had quick accretion to the company, because they were small, obviously, they're all small, and it allowed us to acquire a team and in many cases a platform that we were able to grow off of. But we really haven't had any, yet, that have been disappointing to us in any of those small specialty businesses. And as I commented, they're really all now contributing. We believe in '13, they're all going to be very significant contributors to the company.

Raymond Iardella
Macquarie Research

Okay. That's helpful. And then I guess last question, going back to sort of the surety book and maybe some of the adverse there. You guys had some adverse in the third quarter, and I think the commentary was a couple of years ago you started making that switch towards more commercial surety and away from the contract business. Just curious, how big is the surety business for you guys? And kind of can you give us an idea of where the level of commercial surety was in the past and kind of what percentage it represents of your book presently?

Frederick Henry Eppinger
Former President & CEO

Let me just -- on the contract, what we said and I'll echo it, we've trumped that pretty aggressively in the last 2 or 3 years. It was the one specialty business that the company was in when we started all this 8 years ago, and because of our downgrade it was a -- it was what I would say is a mixed bag as far as the book of business. Highly concentrated between Michigan and Mass. So that business now is down to 50. I like it quite well what we have, what we're active with. We got a great team on the ground. But we've had some development, particularly on what I call the run-off business, the stuff that we really are no longer on, and we've had some activity because of the economy of it, but this is a small business now. The commercial surety, we started really focusing on that probably 3, 4 years ago, and in earnest when we got the upgrade, went to full A, because that's a business where I didn't want to really do a lot of investment until we had the ratings. And we feel very good about that business now. I think the -- Andrew, the magnitude of that business…

Andrew Robinson

It's about -- this is Andrew. It's about 1/3 of our total surety business, which will be somewhere probably between $90 million, $95 million into our [indiscernible] for the year, and 1/3 of that, it's commercial surety. And I think it's also probably worth noting 2 other points. One is that we have systematically gone out and really upgraded our talent. So we feel very good about team. We have a commercial surety leader that we brought in last year, very senior fellow from Zürich, who we feel very strongly about. We continue to build that team. And we recently brought in a person to drive the contract business for us, from Arch on the underwriting side, and feel very good about the scene behind him. And I think that the last step here over last 6 months as we did a top-to-bottom review of our portfolio, and that is sort of measure of additional confidence for us in terms of understanding where we are with the contract business. So all in, we're pleased with the position we're at in terms of mix and making sure that we're confident with the existing account portfolio that we have.

Operator

The next question comes from Larry Greenberg of Langen McAlenney.

Lawrence David Greenberg
Langen McAlenney

You talked about, with Chaucer, pricing changes. And it sounded like, and you're not alone on this, that property in loss-exposed areas was probably the most robust right now. I'm just wondering how you're thinking about the opportunities there versus managing your aggregates? And are you putting limits, or just how you are managing that trade-off.

Robert Arthur Stuchbery
President Intl. Operations & Deputy Chairman of Chaucer

Yes, this is Bob Stuchbery. We've made some adjustments to the property account at the first of January, particularly around some of the risk appetites that we once [indiscernible], but at this time the opportunities we saw in Japan, we sought to get a little bit more active at that stage. Rates were up higher than we expected, particularly on those contracts that had been affected. So I will tell you that there's sort of adjustments and tweaks in the portfolio that we've got in order to [indiscernible]. As you say we’re seeing some good healthy price increases, particularly in those areas that have been affected by losses.

Frederick Henry Eppinger
Former President & CEO

Yes, I guess in total, Larry, we feel very good. The portfolio, as we put in the package a little bit of an overview, where we feel like for most of the businesses we’re getting good rate increases. We’re taking advantage of some areas that are better than that. But I would go back to what Bob said, which is we purposely have taken some of the volatility out and some of the aggregations. We reduced their position in U.S. Fact [ph], for instance, right out of the gate, matter of fact, frankly, before we ever closed, we really started working the portfolio well. So we’re very excited about the potential here, because a lot of the synergy we’re seeing is going to be in the specialty lines that we go after together in some of the skill sets they have. But we feel very good about the choices we’ve made to date and we like the outlook this year for the returns out of the business.

Operator

[Operator Instructions] The next question comes from Vincent DeAugustino of Stifel, Nicolaus.

Vincent M. DeAugustino
Stifel, Nicolaus & Company, Incorporated, Research Division

Considering the strong commercial lines’ new business growth, especially on some of the longer tailed lines, I’m just curious if you might be able to talk about some of the controls or, I guess, early indicators that you might be looking at just to see if the new accounts that you’re picking up are performing as you would expect, just because maybe you’re not as familiar with them sort of thing?

Marita Zuraitis
Executive VP, President of Property & Casualty Companies

Yes, I mean we feel good about the new business that we’re writing in the core commercial lines. We have robust pricing tools. We’re seeing increases in premium audit. When you take premium audit and rate out of the growth, it is not substantial, but we’re comfortable with it. We like the underwriting tools, we like the pricing tools that we have and we feel good about the new business that we’re writing, not only what it is and the mix it is, but who it’s coming from.

Andrew Robinson

I’d say similarly on the specialty side, the longer tail, the longer tail, although they’re not a very long tail, pension liability, professionals, some of the areas in healthcare. We are very diligent about looking at effectively our deviation to our manual pricing renewal versus new business. So we really can see how we feel about all the pricing from the new business. Obviously mix is something that we’re very diligent about, whether it be area practice to sort of gauge severity or state or any of the many attributes that we use. Those are the things that we’re watching. And then in terms of really emergence, we’re measuring effectively our incurred numbers against earned premium in any of the younger businesses. And we’re looking at that year-on-year and make sure that we’re improving. For example, in our MPL business we’re in our third year. So we’re able to measure how we’re doing in our first quarter against where we were with our first quarter of ‘11 and ‘10 and we’re looking at those metrics for improvement. And so it's a combination of things.

Frederick Henry Eppinger

Former President & CEO

And I think you all know this as you follow us, one of the things we've done very, very diligently is we don't like the large face value polices. We are really focused on the smaller policies. We also are, with partner agents, we don't typically do the large brokers with a large panel. This is really mature business. For the most part, this has moved over to us in chunks from partners as we've introduced these products whilst we help them bypass wholesalers in some cases to give us their mature business. So we've had very good luck. I mean if you look at all the specialty businesses we're in, we feel very good about the quality in the portfolio. The only place especially we've had really any noise at all has been the surety, which ironically is the one that we were in historically.

Andrew Robinson

On the project site.

Frederick Henry Eppinger
Former President & CEO

On the project side. Because on everything else we feel it's developed beautifully for us. And frankly, the pricing we're getting right now is excellent as well, so.

Marita Zuraitis
Executive VP, President of Property & Casualty Companies

You also mentioned small face value. That also is true about our workers comp book, where the majority of that growth is coming from. Small commercial, virtually all of it, low risk grade and small commercial workers comp business in coordination with our total account strategy and small business. So we're seeing that on the comp side as well.

Operator

The next question comes from Matt Carletti of JMP Securities.

Christine Amanda Worley
JMP Securities LLC, Research Division

It's actually Christine. I've got a quick numbers question, if you have it available. I was wondering if you had the both net and gross written premiums for Chaucer in the first quarter of 2011.

David B. Greenfield
Former Chief Financial Officer, Principal Accounting Officer and Executive Vice President

We don't have that disclosed because we won't have it on the same basis of accounting. But we can talk about it off line and I can see what we have out in the public domain that may be helpful to you.

Operator

The next question comes from Ray Iardella of Macquarie.

Raymond Iardella
Macquarie Research

Couple follow-ups, and thanks again for taking these extra questions. I guess, first, workers comp, just to touch on the commentary before. The growth on the small side. I mean, is that basically what's driving retention down a little bit? I'm assuming pricing is moving higher, but PIF growth is certainly moving much higher. Is that kind of the right way to think about that business and the dynamics there?

Marita Zuraitis
Executive VP, President of Property & Casualty Companies

You just answered your own question. I think you nailed it. On the workers comp side we are seeing some increase in premium audit. We're getting a decent amount of real rate. When you look at the pricing in small, the pricing in middle market, the shift in the risk grades, we're -- you just nailed the answer to your own question. We did see some sequential quarter-over-quarter PIF growth, but if you remember, some of that is coming from the OneBeacon policies now being counted as our policies. So there's some shift in the numbers as we took on OneBeacon premium as our own premium. You remember in the first year we did a reinsurance arrangement, and that eventually that PIF counted as ours. So you'll see that PIF increase as well. But when you cut through all the numbers, at the end of the day, there is relatively smaller amount of real growth, and that real growth is all coming from small commercial.

Raymond Iardella
Macquarie Research

Okay. That's helpful. And then maybe on the expense ratio in the commercial business, nice year-over-year improvement. Just curious, David, I don't believe you mentioned any change in the guidance in mid single digit growth on the commercial side. But if growth reverts back to that level. I mean how much expense ratio leverage do you guys have in that business?

David B. Greenfield
Former Chief Financial Officer, Principal Accounting Officer and Executive Vice President

Well, I think, I'm going to stick with really kind of where our guidance is for the current year, and I wouldn't anticipate a lot more leverage in the expense ratio. We've had quite bit of improvement over the last year or so. We saw some this quarter. But overall for the year we don't anticipate that ratio is going to move much based on our growth expectations.

Frederick Henry Eppinger
Former President & CEO

But in all of these levers, your question is good about '13, right? So if you look at, our whole game has been to solidify our position with these agents, be able to shift better business and get pricing. We believe we have the portfolio in place and it does set up '13. So if you look at the ramp-up of earned rate, you look at retention, which then goes to growth, it does create leverage and expense in '13 for these businesses, obviously. Because we grew, as you know. We expanded, for instance, in small commercial last year into 12, 13 additional states and set up the national network on the back end of some of the OneBeacon stuff. And so lot of this stuff, while it's not a huge impact for '12, is something that makes us feel good about the continued improvement. So you're right. You've seen what we've said what would happen has happened. It will pause for a minute here, probably the rest of the year. But what's going to happen, because of the growth, this additional growth from our plan, it's likely to help again in '13. So I think it's the right observation of what we're trying to do on these. On all our economic levers, we believe they're coming in place nicely for us.

Operator

This concludes our question-and-answer session. I would like to turn the conference back over to management for any closing remarks.

Oksana Lukasheva
Vice President, Investor Relations

Thanks to all of you for your participation today, and we look forward to speaking to you next quarter.

Frederick Henry Eppinger
Former President & CEO

Thank you.

Operator
The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.