S&P Capital IQ

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CNA Financial Corporation NYSE:CNA

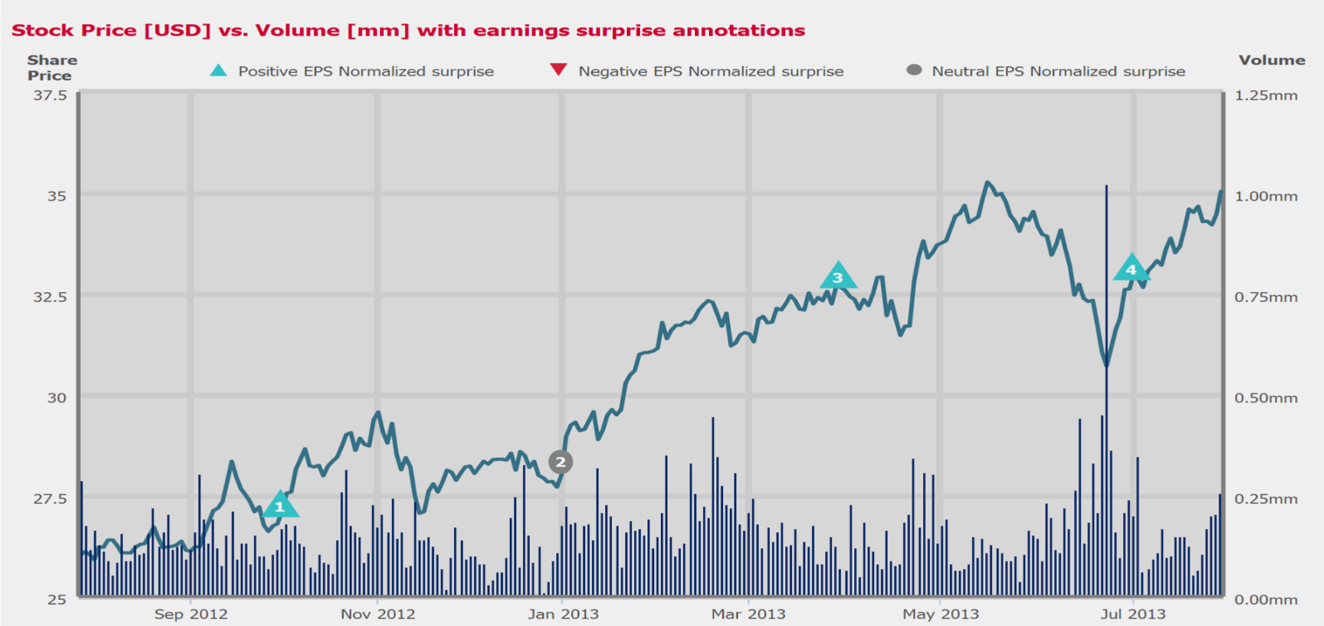
FQ3 2013 Earnings Call Transcripts

Monday, October 28, 2013 2:00 PM GMT

S&P Capital IQ Estimates

	-FQ3 2013-			-FQ4 2013-	-FY 2013-	-FY 2014-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.76	1.00	▲31.58	0.76	3.15	3.19
Revenue (mm)	1661.33	1619.00	▼(2.55 %)	1679.00	6838.50	8134.05

Currency: USD
Consensus as of Oct-28-2013 12:12 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ3 2012	0.65	0.80	▲1 23.08 %
FQ4 2012	0.22	(0.03)	NM
FQ1 2013	0.71	0.86	▲2 21.13 %
FQ2 2013	0.64	0.75	▲3 17.19 %

Call Participants

EXECUTIVES

D. Craig Mense
Chief Financial Officer and Executive Vice President

James M. Anderson
Senior Vice President of Financial Planning & Analysis and Corporate Development

Thomas F. Motamed
Former Chairman and Chief Executive Officer

ANALYSTS

Adam Klauber
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Macquarie Research

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Joshua David Shanker
Deutsche Bank AG, Research Division

R. Scott Frost
BofA Merrill Lynch, Research Division

Robert Ray Glasspiegel
Janney Montgomery Scott LLC, Research Division

Ronald David Bobman
Capital Returns Management, LLC

Presentation

Operator

Good day, and welcome to the CNA Financial Corporation's Third Quarter 2013 Earnings Conference Call. Today's call is being recorded.

At this time, I would like to turn the conference over to James Anderson. Please go ahead.

James M. Anderson
Senior Vice President of Financial Planning & Analysis and Corporate Development

Thank you, Jessica. Good morning, and welcome to CNA's discussion of our 2013 third quarter financial results. By now, hopefully all of you have seen our earnings release, financial supplement and presentation slides. If not, you may access these documents on our website, www.cna.com, under the Investor Relations menu.

With us on this morning's call are Tom Motamed, our Chairman and Chief Executive Officer; and Craig Mense, our Chief Financial Officer. Following Tom's and Craig's remarks about our quarterly results, we will open it up for your questions.

Before turning it over to Tom, I would like to advise everyone that during this call, there may be forward-looking statements made and references to non-GAAP financial measures. Any forward-looking statements involve risks and uncertainties that may cause actual results to differ materially from the statements made during this call. Information concerning those risks is contained in the earnings release and in CNA's most recent 10-K and 10-Q on file with the SEC. In addition, the forward-looking statements speak only as of today, Monday, October 28, 2013. CNA expressly disclaims any obligation to update or revise any forward-looking statements made during this call.

Regarding non-GAAP measures, reconciliations to the most comparable GAAP measures have also been provided in our most recent 10-K and 10-Q, as well as in the financial supplement. This call is being recorded and webcast. During the next week, the call may be accessed on CNA's website.

With that, I will turn the call over to CNA's Chairman and CEO, Tom Motamed.

Thomas F. Motamed
Former Chairman and Chief Executive Officer

Thank you, James. Good morning, everyone, and thank you for joining us. I am pleased to report that the trend of consistently improving financial performance continued through the third quarter. Last quarter, I talked about our margin improvement, our disciplined underwriting, pricing and expense management actions and our meaningful rate attainment. Each of these trends has continued in the third quarter, and the impact is evident in our bottom line results.

CNA produced operating income of $269 million, an increase of 25% compared with the third quarter of 2012. Operating ROE was 9% for the quarter, and 8% year-to-date. Our Property & Casualty calendar year combined ratio was 94% for the quarter, a 5.7 point improvement from the third quarter of 2012. We believe our concerted efforts to actively manage our Property & Casualty portfolio are clearly having a positive impact.

Our underlying underwriting margin, as defined by the combined ratio, excluding catastrophes and development, has now improved 3.8 points on a year-to-date basis as compared with full year 2012, reflecting material improvement in our loss ratios. Our Specialty business had an outstanding third quarter, with a combined ratio of 85.3. Excluding catastrophes and development, the combined ratio was 93.5. Net written premium growth was 8%. Rate was 6% and retention remained constant at 85%. The Commercial combined ratio was 103, which included 2.9 points of catastrophes. Excluding catastrophes and development, the combined ratio was 99.3. Third quarter rate at 8% was strong. Revenue and retention is in line with our expectations as we continue to build and manage a profitable book of business with attractive growth prospects.

Hardy reported net operating income of $12 million in the third quarter, with a combined ratio of 85.1. And excluding catastrophes and development, it was 84.6. Net written premiums grew 45% to $81 million.

I'm now going to turn the call over to Craig. Craig?

D. Craig Mense
Chief Financial Officer and Executive Vice President

Thanks, Tom. Good morning, everyone. Before I get into the results, let me again remind you that presentation slides have been posted on our website to provide additional perspective on our financial and operating trends.

Third quarter net operating income improved to $269 million, a 25% increase over the prior year period, which produced an operating return on equity of 9%. Operating income available to common shareholders was $1 per share, up from $0.80 per share in the third quarter of 2012. Net income was $272 million or $1.01 per share, which also compares favorably to the prior year period.

We are encouraged by the improved underwriting margin generated across our core P&C businesses, reflecting targeted underwriting actions and continued strong rate increases. Our core P&C operations produced net operating income of $330 million in the third quarter, up 25% as compared with the prior year period. Improved non-cat accident year underwriting results drove the increase.

Our third quarter loss ratio for P&C operations was 60.9%, 4.5 points better than last year's third quarter. Excluding catastrophes and development, the loss ratio was 62.8%, a more than 3.5 point improvement over last year's third quarter. However, we believe that comparing year-to-date loss ratio performance with results for the full prior year is a better measure of our progress and the quarter-over-quarter comparison. On that basis, our 2013 year-to-date loss ratio, excluding cats and development of 64.7%, is now 3 points better than full year 2012.

Our third quarter expense ratio was 32.9%, consistent with our second quarter reported result and more than 1 point better than full year 2012. This reflects expense reductions, enhanced productivity and the growth in earned premium. Improving our expense competitiveness continues to be a major focus for us.

Specialty's third quarter net operating income improved to $187 million from $136 million in last year's third quarter, with a combined ratio of 85.3%. Specialty's results benefited from just under 10 points of favorable development. Excluding catastrophes and development, Specialty's loss ratio was 63.8%, more than 3.5 points lower than last year's third quarter.

The year-to-date loss ratio, excluding catastrophes and development of 65.5%, is more than 2 points better than full year 2012. The improvement has been driven by both the rate achievement and targeted underwriting actions that continue to refine the portfolio of mix. The Specialty expense ratio improved more than 1.5 points year-over-year to 29.4%.

Commercial's third quarter net operating income increased to $131 million, up 5% from the prior year period. Excluding catastrophes and development, the Commercial loss ratio was 64.2%, an improvement of more than 3 points over last year's third quarter. On a year-to-date basis, the loss ratio, excluding catastrophes and development, was 66.3%, an improvement of over 2 points versus full year 2012.

Rate and retention trends, as shown in the presentation slides on Page 9, reflect our disciplined risk selection and strong rate achievement. Commercial has attained 8% written rate this quarter, following 9% in each of the first 2 quarters of 2013. Retention of 71% in the third quarter is reflective of targeted underwriting actions on portions of the portfolio. As shown in the slide on Page 10, these underwriting actions had a 4-point impact on retention in the quarter and a 3-point impact year-to-date.

Hardy made a meaningful contribution to earnings this quarter, with a calendar year combined ratio of 85.1%. Hardy's combined ratio, excluding catastrophes and development, was just under 85%, reflecting superior loss ratios and an improving expense ratio.

Our Non-Core Life & Group segment produced a $35 million operating loss in the quarter, primarily due to higher long-term care morbidity, modestly offset by the effect of rate increase actions and a favorable persistency in that business. Our corporate segment reported a $26 million third quarter net operating loss, unchanged from the prior year period.

Our balance sheet continues to reflect CNA's financial strength and stability. Our capital adequacy metrics remain at or above our targeted levels and our liquidity profile remains very strong. Book value per common share increased to $45.06 per share, excluding accumulated other comprehensive income, book value was $44.64 per common share. Both measures are up just under 2% from the end of the second quarter. Our investment portfolio's pretax net unrealized gain stood at approximately $2.2 billion at quarter end, a decrease of approximately $350 million from the end of the second quarter 2013. Approximately $250 million of the decline's impact on book value was offset by a decrease in Shadow reserves related to our Life & Group runoff business.

In addition, as I've noted before, while the increase in interest rates had an adverse impact on our unrealized gain position during the quarter, at current reinvestment rate levels, it should have a favorable effect on earnings going forward.

Our statutory surplus at quarter end was $10.4 billion, up nearly 2% from the end of the second quarter. This was after a $100 million dividend paid to the holding company during the third quarter. We continue to maintain significant dividend capacity at the insurance operating company level. Cash and short-term investments at the holding company level were approximately $500 million at quarter end, well above our 1 year annual net corporate obligations target. Our liquidity profile also includes a $250 million revolving credit facility, as well as access to over $325 million of additional liquidity from Continental Casualties recently completed membership with the Federal Home Loan Bank of Chicago.

In the third quarter, operating cash flow, excluding trading activity, was approximately $340 million. Cash principal repayments through pay-downs, bond calls and maturities were approximately $680 million.

Net investment income was $597 million pretax in the third quarter. Income from our fixed maturity securities was $504 million pretax, essentially unchanged from the prior-year period. Income from Lyttelton Partnership investments was $93 million, up 18% from this year's second quarter and 4% from the prior year period. The third quarter 2013 rate of return for our limited partnerships was 3.5%.

While our overall portfolio allocation did not change significantly in the third quarter, we did continue to take advantage of attractive yield opportunities in the tax-exempt municipal bond market. The investment grade corporate bond sector continues to represent the largest component of our invested assets.

The average credit quality of our fixed maturity portfolio remained at A. Fixed income assets, which support our long-duration life-like liabilities, had an effective duration of 11.4 years at quarter end, a slight increase from the prior year -- from the prior quarter end and in line with portfolio targets. The effective duration of the fixed income assets, which support our traditional P&C liabilities, was 4.4 years at quarter end, up from 4.3 years at the end of the second quarter. Overall, our investment portfolio remains well-diversified, liquid, high-quality and aligned with our business objectives.

Before turning the call back to Tom, I did want to encourage you to get involved in the current debate about insurance accounting standards and the changes proposed by both the Financial Accounting Standards Board and the International Accounting Standards Board. While there is some theoretical merit in several individual aspects of the proposed update, the practical effect, if adopted, would significantly increase complexity, reduce transparency, provide less meaningful financial reporting results and make comparability between periods and peers exceedingly difficult, if not impossible. The proposed models would require significant changes in operational and actuarial processes that would be extremely coiffed to implement, difficult to maintain and are not consistent with how we manage the business. While comment letters were due last Friday, October 25, the FASB has indicated an openness to consider comments beyond that date. Your opinion as investors and analysts carries considerable weight with the members of these boards. If you don't take the time to express your opinion, others will decide for you.

Tom?

Thomas F. Motamed
Former Chairman and Chief Executive Officer

Thank you, Craig. Before we open it up for questions, I would like to close with some highlights. We are especially encouraged by our continued progress in our Property & Casualty portfolio. Specifically, growth in customer segments and products, reduced exposure in classes outside our appetite and strong targeted rate achievement. Our 2013 year-to-date loss ratio, excluding cats and development of 64.7, is 3 points better than full year 2012. Our expense ratio remain just under 33% in the third quarter, down from 34% at year end 2012. We have solid investment results and improved capital position and our book value per share, excluding AOCI, has increased 4.7% since the beginning of the year. Lastly, we declared a quarterly dividend of $0.20.
With that, we'd be glad to take your questions.

Question and Answer

Operator

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[Operator Instructions]

We'll go first to Amit Kumar with Macquarie Capital.

Amit Kumar
Macquarie Research

Just 2 quick questions. First is on Hardy, looking at Slide 11 of the slide deck, the loss ratio, excluding cats and development, is there a reason why that number moves around quite a bit from one quarter to another?

D. Craig Mense
Chief Financial Officer and Executive Vice President

Yes, just remember, Amit, that it's -- that they are property -- first part of property related -- predominant, I should say, company and underwriter. So those results are going to be affected by outcomes within the quarter, could be affected less a lot by changes in attritional results, could be affected by changes in some variability in large results. Also, obviously could be affected by some change in our in [indiscernible] terms of the outcomes. So all those things are intertwined with the decisions made about the quarter.

Amit Kumar
Macquarie Research

I guess, what I was trying to ask is, it jumped from I think 36.5% to 40% and I understand you said that don't look at quarters, look at the year-to-date. But was there a reason for that increase to 40% in this quarter?

D. Craig Mense
Chief Financial Officer and Executive Vice President

Well, you look at the quarter before was 47.3%. So it was down 7 points and the quarter before that was 51%. So it's down 11.5% from that. So I wouldn't get hung up on change in the quarter. Just means there was a slightly higher level of large losses in this quarter than there was in the third quarter of 2013. I still think that's a very attractive loss ratio to be producing.

Amit Kumar
Macquarie Research

Got it. And then what sort of a normalized number would you think exiting out all the noise?

D. Craig Mense
Chief Financial Officer and Executive Vice President

I don't think you should be looking for a normalized number there, given that there's going to be some noise in those results.

Amit Kumar
Macquarie Research

Okay, that's fair enough. The only other question, and I'll stop and requeue, is going back to the discussion, I guess, on the Non-Core assets. And -- can you talk a bit about the profitability metrics on the payout annuity business? And maybe also address there was recently a story, which talked about that business. Can you just expand on that a bit?

D. Craig Mense
Chief Financial Officer and Executive Vice President

But we don't -- there's really no profitability metrics, in specifically that we have disclosed on payout annuity. You could see within the Life Group segment, you know that it's about -- that business has about $2.7 billion of reserves. That's -- I mean stat surplus that's associated with that is disclosed. But beyond that, we don't have any comment about the press reports.

Operator

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We'll go next to Jay Cohen with Bank of America.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Yes, a couple of questions. This first one is the Federal Home Loan Bank news. What is the rationale behind that action?

D. Craig Mense
Chief Financial Officer and Executive Vice President

It just simply gives us additional flexibility, capital management flexibility, Jay. So it's a relatively inexpensive source of liquidity.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

And I assume it doesn't bring on any other regulatory burden?

D. Craig Mense
Chief Financial Officer and Executive Vice President

No.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Okay, second question, I guess, if I look at Commercial lines and Specialty, the underlying accident year loss ratio improved quite nicely from the first 3 quarters of the year. And clearly you've been taking appropriate action to drive that. Is there anything that you can see unusual in the quarter, a low level of property losses, a low level of non-cat weather losses that may have helped that number more than we would expect?

D. Craig Mense
Chief Financial Officer and Executive Vice President

Well, I think what maybe just -- it's just the math probably more than anything, Jay. So that's why we were pointing everybody to the year-to-date numbers because as we have been -- as we said before, as we earn the rate in excess of trend, we've been recognized that as we're kind of marching forward. So right now, overall, the loss ratio, P&C total was 3 points on a year-to-date basis better. But as we would then readjust that for the quarter, there's a 3 quarter catch-up. So essentially, those loss ratios has just looked at for the quarter about 2 points lower than the run rate is. So I think that's probably what's surprising you.

Operator

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We'll go next to Josh Shanker with Deutsche Bank.

Joshua David Shanker

Deutsche Bank AG, Research Division

I want to talk about normalized run rates for the expense ratio of the company, excluding Hardy, and then normalized run rate expense ratio for Hardy. And how much time it will take you to get to those levels in your mind.

D. Craig Mense
Chief Financial Officer and Executive Vice President

Well, I think the Hardy adds only about half a point to the total company's expense ratio. So...

Joshua David Shanker
Deutsche Bank AG, Research Division

But it skews things. It's easier to talk about x Hardy I guess. That's my thinking.

D. Craig Mense
Chief Financial Officer and Executive Vice President

So it's a half-point lower x Hardy. Hardy 44, you can see it's come down considerably over the course of the year, and I mean that is the normalized today. Although I'd tell you Hardy management has suggested overtime, the target would be something closer to 40, which is would be in line with Lloyds peers. But that'll take us some time to get there.

Joshua David Shanker
Deutsche Bank AG, Research Division

A year, 2 years?

D. Craig Mense
Chief Financial Officer and Executive Vice President

That sounds reasonable enough.

Joshua David Shanker
Deutsche Bank AG, Research Division

Okay. And for the rest of the company, I guess, on a trailing 12-month basis, you're around a 32.6. The other quarter was at 31.9, this is excluding Hardy. Was that at near-normal or do you think that will be going lower?

D. Craig Mense
Chief Financial Officer and Executive Vice President

Well, I think that for the quarter, it was 32.9, right, so take half a point off, I'd say 32.5. I wouldn't expect -- given the actions we've taken and also the actions we're taking on the underwriting side in Commercial, don't expect any real change in that through the rest of this year. Like what we mentioned last quarter's call was that we did have actions that we've already taken or in the process of being taken to improve that further in '14.

Joshua David Shanker
Deutsche Bank AG, Research Division

And did you guys have an internal target that you would share with us, or it's not really a target number?

D. Craig Mense
Chief Financial Officer and Executive Vice President

No, we don't have an internal target, but we did -- I think -- we have said before that the run rate today is about -- used to be 2 or 3 points higher than peers. It's now 1 to 2 points higher than peers and certainly, we need to get it to be equal to peers to eliminate that disadvantage. At least my...

Operator

We'll go next to Adam Klauber with William Blair.

Adam Klauber
William Blair & Company L.L.C., Research Division

A couple of different questions. I mean, it's great to see the loss ratio, core loss ratio coming down. Could you talk about some of the underlying trends in the key markets, professional liability, workers' comp, excess liability? I mean, what's the, I guess, general loss trend just from a number standpoint? But even underlying, we just continue to see not a lot of core cases, or anyway you can illuminate would be helpful.

D. Craig Mense
Chief Financial Officer and Executive Vice President

Well, I think that you ought to -- maybe Tom want to add some color here, but just see. The loss trend that we assume long term in Commercial lines is around 4%, and a loss trend that we expect longer term in Specialty, professional and management liability is more like 3%. Now, obviously, there are differences inside that.

Thomas F. Motamed
Former Chairman and Chief Executive Officer

Maybe you can -- let's go line by line, pick a line and we can talk about it.

Adam Klauber
William Blair & Company L.L.C., Research Division

Sure. What about workers' comp?

Thomas F. Motamed
Former Chairman and Chief Executive Officer

Okay. So if you look at workers' comp, we have a couple of key strategies: the first is, #1, we're looking by geography so that we tend to avoid those states that really have adverse results; #2, we are moving much more into what we would call white-collar workers' comp, which runs at much better loss ratios than what we call the blue collar kind of business. We continue to get strong rate increases in workers' comp, just under 10%. So the fact is we're pushing rate, we're re-profiling the book. All of that is going to impact the loss ratio over time. So we're pretty pleased with the direction on that. And clearly, the written rate is turning into earned rate increases, which exceed, as Craig mentioned, the loss trend; so margin improvement.

Adam Klauber
William Blair & Company L.L.C., Research Division

Okay. How about professional liability?

Thomas F. Motamed
Former Chairman and Chief Executive Officer

Professional liability, we continue to get significant rate increases on our D&O business, just under 10%, and as Craig said, loss trends are more in the 3 to 4 range. So once again, margin improvement there. E&O, we would find that rate increases exceed the loss trends there as well, and those are big part of the book. So once again, I think we can point to almost any line and see that we continue to earn very good written rate increases, and that's turning into earned rate increases in excess of loss trends. So all of them are improving.

Adam Klauber
William Blair & Company L.L.C., Research Division

And a different topic. As far as growth, you have some core targeted areas. Do you think you'd be able to have growth next year given the market environment?

Thomas F. Motamed

Former Chairman and Chief Executive Officer

Yes, we think we can grow. We think we have some differentiated product and strategies in the 7 segments, as we call them, and they are all doing very well. In fact, new business today is 74% of the total coming from those areas; on an overall basis, it's 72% of the book. Those numbers continue to climb, so we continue to push those. So yes, we like the segments. We think they are performing pretty well. And we expect to get growth, and we're getting really good rate increases in those areas. So if you look at something like package, we're doing very well in the package business. So I'd say, yes, we expect it to continue.

Adam Klauber
William Blair & Company L.L.C., Research Division

Okay. And then finally -- I mean you're generating a nice level of cash flow. You've got some expanded cash capability. How are you thinking about uses of cash as we go into 2014?

D. Craig Mense
Chief Financial Officer and Executive Vice President

Well, that's something that we'll reconsider are going to step back as we come to the fourth quarter, Adam, more likely, and that's more the normal time to kind of reassess the accumulation of cash and capital and reset expectations for going forward.

Operator

We'll go next to Bob Glasspiegel with Janney Capital Markets.

Robert Ray Glasspiegel
Janney Montgomery Scott LLC, Research Division

Just following-up on Adam's question on capital, you've traditionally been a quarterly dividend payer. Would a special dividend at all be a possibility of something you'd consider, the board would consider?

Thomas F. Motamed
Former Chairman and Chief Executive Officer

I think we get asked that question every quarter, and we say we would prefer to do something with the quarterly dividend. That's our strategy.

Robert Ray Glasspiegel
Janney Montgomery Scott LLC, Research Division

Okay. So you're saying the fourth quarter is when you review where your annual dividend is. So what Craig's comment suggested? You want to get through the fourth quarter?

Thomas F. Motamed
Former Chairman and Chief Executive Officer

Yes, that's when we look at it. You're correct. And we will look at it again.

Robert Ray Glasspiegel
Janney Montgomery Scott LLC, Research Division

Okay. Could you quantify what the adverse morbidity in long-term care in the quarter was and what drove that?

D. Craig Mense
Chief Financial Officer and Executive Vice President

Well, it was both individual and just increased claim frequency in the long-term care business, both group and individual, mainly individual. So that's just increased frequency of claims. We saw it both this quarter and in the second. If you recall, in the first quarter, morbidity was way down, driven by really improved mortality across all the businesses. So we've seen an increased level each of the last 2 quarters, and that's what's kind of pushed that losses up from the 20s range to the mid-30s range.

Robert Ray Glasspiegel
Janney Montgomery Scott LLC, Research Division

So a $15 million after-tax sort of swing from that? Because you said that there were some positive things that offset that, so could it be more than that?

D. Craig Mense
Chief Financial Officer and Executive Vice President

No, that's reasonable. Bob, there is also so much other lumpiness in that business. Remember, we had this viatical settlements business, it kind of depends on individual debt from the quarter that drive a little variability there. But that's -- the math that you just did is a reasonable quantification of the impact.

Robert Ray Glasspiegel
Janney Montgomery Scott LLC, Research Division

Okay. And maybe walk us through what pricing that you're getting on that book. You mentioned there is an offset in positive consideration.

D. Craig Mense
Chief Financial Officer and Executive Vice President

We have filed for price increases of about 40% of the book over the -- that came off of rate guarantee over the last year, and we filed for rate increases ranging from 0 to 80%. We're probably about halfway through the states and have been working with state regulators on that. We're certainly not achieving or getting all of that, or getting a good portion of that. But it does -- I just cautioned you, it takes a considerable amount of time and, I guess, take that 40% against about $550 million of net written premium that we would generate on an annual basis. But that 40% takes a long -- or that percentage takes a long time to be approved and then implemented, authorized and then implemented. It's about an 18-month, I'd say, transition period before you see it.

Robert Ray Glasspiegel
Janney Montgomery Scott LLC, Research Division

Any rough guesstimate on just how much has been earned today, 5 to 10 or...

D. Craig Mense
Chief Financial Officer and Executive Vice President

That's actually very reasonable. Good guess.

Operator

We'll go next to Ron Bobman with Capital Returns.

Ronald David Bobman
Capital Returns Management, LLC

I just had a couple of questions. I'm taking a look at the CNA Commercial production metrics, the rate and retention chart. And the retention in the small business, obviously it's slid fairly significantly in the last few quarters as rates have -- that you've gotten have steepened. Are you going to sort of modify your approach to small business? I'm sort of really sort of getting at what do you think of the 73% retention in small business Commercial? And I know it's obviously has to be looked at in the context of 11%, which is quite good.

Thomas F. Motamed
Former Chairman and Chief Executive Officer

I think, Ron, our objective here is to make this a profitable book. We are pushing rate very hard. We are, I would say, becoming more selective on the types of business we want to write, whether that be by geography or whether it be by line of business. So clearly, there is underwriting action as we like to describe it going on in small. But we think that's necessary to get to a more profitable book, and that's the plan. So I don't think the retentions that far out of line with what we're doing on the underwriting side.

Ronald David Bobman
Capital Returns Management, LLC

And, Tom or Craig, is the slide from 80% to 73%, is that really sort of all your doing, the company's doing, or is there some element of competition contributing to that slide?

Thomas F. Motamed
Former Chairman and Chief Executive Officer

I would say, it's all us.

Ronald David Bobman
Capital Returns Management, LLC

And should I assume by virtue of the steepness of the rate increases and the slide in retention for small business, of those 4 buckets, small, middle, international and other, small has been sort of the biggest unfavorable contributor to the -- basically, you're running about 100 combined in this segment, Commercial, is small business sort of the biggest problem of the 4 buckets?

Thomas F. Motamed
Former Chairman and Chief Executive Officer

Well, I think, clearly, that's a business that's over 100 today. We have to get that down. But you could find other things that affect the result. Obviously, the areas that we've exited were all Commercial-related, and we have addressed those. We're addressing small in a different way. We want to be in the small business, but that's more of a fix. And then you know you can look at a particular line like automobile and workers' comp, which are not a specific plague to CNA, but really the industry, and we're getting kind of double-digit auto reps, and workers' comp is a little less than double digit. So those are businesses we want to be in, and we're going to fix them. And I think you're seeing that around the industry. I don't think anybody else has said they're delighted with their auto results.

Ronald David Bobman
Capital Returns Management, LLC

I'm sorry, but is small business currently running at the highest combined ratio of those 4 categories?

D. Craig Mense
Chief Financial Officer and Executive Vice President

No, it's not at the highest. It's probably, but it's -- of the ongoing core segments, it's at the moment at least producing the least profitable results and need some improvement, as Tom said.

Ronald David Bobman
Capital Returns Management, LLC

All right. Moving on, just one other question. I think, if my memory serves me right, ROI -- I think I don't want to say it was last week, made mention of the increasing number of competitors in the Surety line. And I was just wondering whether you are seeing that similarly as ROI commented?

Thomas F. Motamed
Former Chairman and Chief Executive Officer

Yes, I -- we're not seeing that here. We got a great Surety business, highly profitable. It's got a unique position in the marketplace. And I think the Surety business for the industry is down a little bit just because of the lack of construction in the U.S. So the fact of the matter is, we've done pretty well on the growth side in Surety, while others were -- had negative growth, where we're now slightly under 0, but I think we've weathered the storm pretty well, and it's a great business. And we're definitely committed to making it grow when it's the right time.

Operator

[Operator Instructions] At this time we'll go next to Scott Frost with Bank of America Merrill Lynch.

R. Scott Frost
BofA Merrill Lynch, Research Division

I have a couple of questions on the accounting that you mentioned. It seems like FASB is pretty adamant on trying to get something done here, and despite protests from both preparers and consumers of the statements. What do you think it would take for FASB to say, maybe this is just a bad idea. What do you think would have to happen for them to reevaluate this, and from where you think that pressure would come?

D. Craig Mense
Chief Financial Officer and Executive Vice President

Well, I think they're -- I think they're certainly hearing from preparers. I think, which is the reason I mentioned it, I think if more users of the financial statements, both analysts and investors weighed in, I think that carries more weight than a user might sound like we're complaining about it. Now, we've been active in -- with industry groups. We've been active -- we've planned kind of meetings with FASB. We have regular communications with them. I think you'd be surprised at how, if you pick up the phone and ask to drive up to Stamford to meet with them, they don't have that many people come actually talk to them. And you'd be surprised how influential you could be, if you decided to weigh in and have a conversation and are certainly in, that be a follow-up by writing your own letter to them. I think all of those things have an impact.

R. Scott Frost
BofA Merrill Lynch, Research Division

Right, we've seen that, and we understand they say that you complain. They typically -- or at least in the past what's happened is, when the debates turned pretty acrimonious. They accuse investors of kind of having an agenda as well, and without a trace of irony say that we are conflicted. But it seems that this debate has been going on for a long time, so what it sounds like you're saying is that keep at it and it'll register. Is that fair to say?

D. Craig Mense
Chief Financial Officer and Executive Vice President

I'd say, ratchet it up, and it'll register.

R. Scott Frost
BofA Merrill Lynch, Research Division

Okay. One other thing on that and a related note. At least on the fixed income side, the sentiment I sense is pretty much overwhelmingly negative. But some investors are reluctant to register opinions because they don't want to be seen as speaking for their institution on accounting matters. How have you advised your investment professionals on the fixed income side, for example, to register their opinions on this issue?

D. Craig Mense
Chief Financial Officer and Executive Vice President

I'm not -- you mean as investors?

R. Scott Frost
BofA Merrill Lynch, Research Division

Yes.

D. Craig Mense
Chief Financial Officer and Executive Vice President

I would advise them on the same basis. It's just difficult, that if the changes were implemented, it would be very difficult for you to assess cash flows, it'd be difficult for you to assess when real impairments, credit impairments happen and differentiate them from some averaging that's being done by some model that you're going to have to peek through about umpteen layers of assumptions to figure out what's really happening. So I'd say, absolutely the same arguments.

R. Scott Frost
BofA Merrill Lynch, Research Division

Got it. And last question. Have you -- do you have any kind of estimate as to how much the new rules would cost you in terms of preparation? And also, more importantly, what do you think the effect will be on your cost of capital? Is there any way to quantify that? And that's it.

D. Craig Mense
Chief Financial Officer and Executive Vice President

It's tough to quantify cost of capital and we haven't really assessed implementation. But it would be meaningful. That would be a meaningful reordering of all of our calculations and internal systems. We don't capture, as they're suggesting, like when you quote start generating exposure and earning premium, and [indiscernible] -- well, we don't have anything set up to do those kind of things nor do we have systems that go to what seems to be suggested at portfolio level, how they might divide at portfolio level for defining how we would reserve and how we'd assess, and it would require a bunch of different models and things here. But it would be a considerable number and definitely have an effect. And I don't -- on the cost of capital, it's difficult, difficult to say.

Operator

And we go back to Amit Kumar with Macquarie Capital.

Amit Kumar
Macquarie Research

I guess, 2 quick follow-up questions, going back to, I guess, Ron's question on pricing. If you sort of broadly look at pricing in the Commercial and Specialty line, what do you think about pricing sustainability for 2014, especially based on the meaningful rates, which you have gotten in the past?

Thomas F. Motamed
Former Chairman and Chief Executive Officer

Yes, you never know what's going to happen that far out, but I would say this: number one, I think, in general, the property business, you'll probably see rates fall a little bit, because it is a short-tail business and it's been pretty quiet from a catastrophe standpoint. So I would expect property will become a little bit more competitive now. How you interpret that is, is that on the renewal book or is that on new business. But clearly, I think you might see a change there. I think casualty pricing needs to go up. So whether you are looking at the Specialty lines, which are volatile, you can have an event, and quite honestly, you got to put some money in the bank for those types of events. And I think if you look at the casualty lines in the Commercial space, whether it be general liability umbrella; auto, you are seeing pretty significant auto increases, at least we are too. So that would be kind of directionally the way I see it. What's kind of interesting is, we tend to look at things a lot more micro than you do. So if I look at Commercial month-to-month, September was the best month in Commercial in the quarter. It was higher than July and August. And if you look at Specialty, it was right on, every month was kind of the same number. So the fact is specialties continues to be very consistent, and I think there is probably some upside there. And I think on Commercial, we went from 9 to 8. That's not a poor result. And I think September looked pretty good. So we believe there is still rate taking to be out there, and we're seeing it in lines like package, which is a big part of the Commercial space. That pricing is very strong. So we are optimistic, but it's a long way out, year end 2014.

Amit Kumar
Macquarie Research

Got it, that's helpful. And then secondly, just going back to the discussion on capital, and thanks, Bob, for asking that question. Maybe we are looking at this wrong, perhaps, is building out the franchise more important for you right now than, I guess, looking at means to return capital? Are we not on the same page there when we ask the same question every quarter?

Thomas F. Motamed
Former Chairman and Chief Executive Officer

No, I don't think that's the case, Amit. So everything's on. We are quite aware of and sensitive to ROEs and improving operating ROEs. So we're looking at all the components of the business. I think what we've said to you past is just that we consider all the options. We've just told you what our bias is, and that's -- so that's our thinking so that you got to understand our bias, understand the deliberateness of the pace at which we've done things, and then I hope you would appreciate that. Of course, we are sensitive to everything and we're considering everything.

Amit Kumar
Macquarie Research

I do appreciate that clarification. And just finally, on I guess going back to my question on the payout annuity book, what's the tail on that -- on the reserves? What's the -- can you just talk a bit about that?

D. Craig Mense
Chief Financial Officer and Executive Vice President

It's a mid-teens duration, maybe a little longer than that.

Amit Kumar
Macquarie Research

Got it. And then - and I guess, if you look at that book, can you talk about the impact, I guess, on policyholder behavior based on the improvement in rates? Just that book separately. How...

D. Craig Mense
Chief Financial Officer and Executive Vice President

That because has -- no, that book is in runoff. Those prices and those premiums have been paid. There is 0 impact on income coming out of that book. So all the rate increases we've talked about are the long -- are the health business, the individual long-term care. None of that relates to the payout annuity business.

Amit Kumar
Macquarie Research

I guess, I was asking about the impact of interest rate on the payout annuity book.

D. Craig Mense
Chief Financial Officer and Executive Vice President

It's relatively -- well, it does have an effect, but it's extremely well-matched in terms of asset and liability duration. So any effect is very much on the margin.

Amit Kumar
Macquarie Research

Okay, that's helpful. And if there is a spike in the rates, do policyholders take their money out? How does that happen?

D. Craig Mense
Chief Financial Officer and Executive Vice President

No, they've already -- they are paid. These are annuity, so they're paid there. They paid a premium and we are matching an income stream to the premiums paid. So there's really no optionality in that business.

Operator

We'll go next to -- we'll go back to Adam Klauber with William Blair.

Adam Klauber
William Blair & Company L.L.C., Research Division

Just one quick follow-up. Could you guys give us an idea on the favorable development in Specialty, just general ballpark? What proportion of the reserve releases came from, say, maybe the '03 through '07 versus the '08 through 2012?

D. Craig Mense
Chief Financial Officer and Executive Vice President

That was actually in terms of all surety, and it's tenant [indiscernible].

Operator

[Operator Instructions] And we'll go to Ron Bobman with Capital Returns.

Ronald David Bobman
Capital Returns Management, LLC

I guess, the problem with the quarterly question on the capital is more about Bob Glasspiegel's memory and not the -- must be on the wrong page. I just had a follow-up question on Surety. I just wanted just to sort of confirm something. You -- I understand there are some problems in the Spanish surety market, and I just wanted to sort of confirm that you do not write there. You're surety book is all U.S., or substantially all U.S., is that right?

D. Craig Mense
Chief Financial Officer and Executive Vice President

That's correct. Our surety book is all North America.

Operator

And that was our last question. This does conclude our question-and-answer session for today. At this time, I will turn the call back to Tom Motamed with any closing or additional remarks.

Thomas F. Motamed
Former Chairman and Chief Executive Officer

Thank you. See you next quarter.

Operator
This does conclude today's conference. Thank you for your participation.