S&P Global
Market Intelligence

CNA Financial Corporation NYSE:CNA

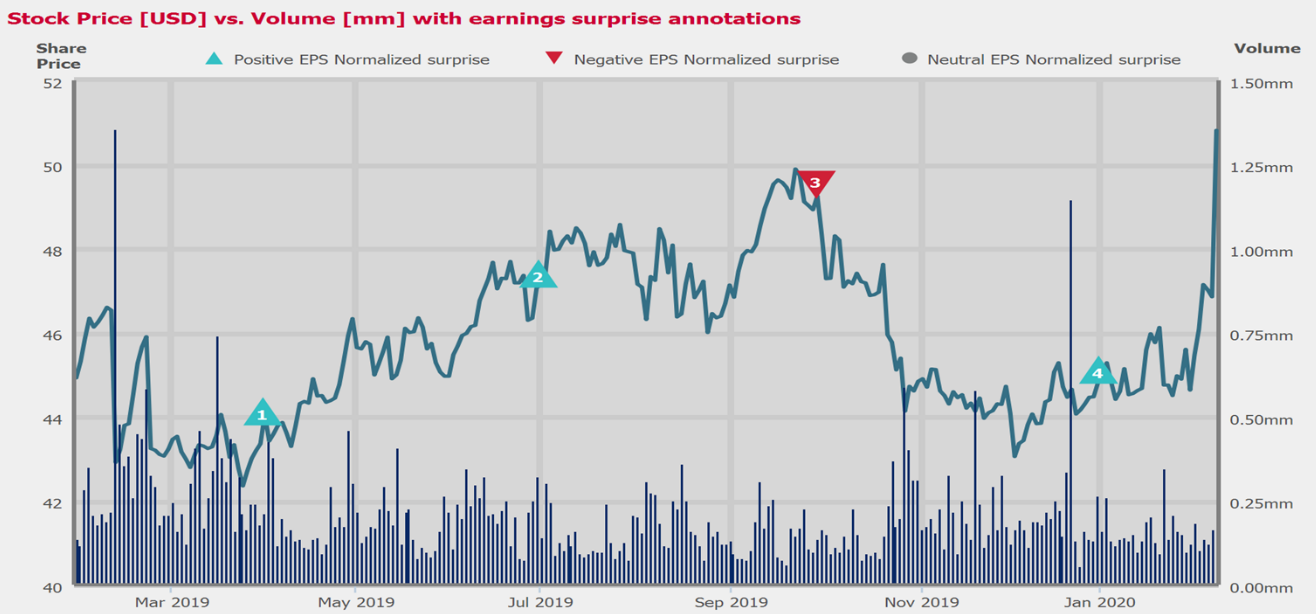
FQ4 2019 Earnings Call Transcripts

Monday, February 10, 2020 3:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ4 2019-			-FQ1 2020-	-FY 2019-	
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	ACTUAL
EPS Normalized	0.93	0.97	▲4.30	1.04	3.55	3.59

Currency: USD
Consensus as of Feb-07-2020 9:21 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ1 2019	1.08	1.17	▲8.33 %
FQ2 2019	1.02	1.08	▲5.88 %
FQ3 2019	1.02	0.37	▼(63.73 %)
FQ4 2019	0.93	0.97	▲4.30 %

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Call Participants

EXECUTIVES

Dino Ennio Robusto
Chairman & CEO

James Michael Anderson
Executive VP & CFO

ANALYSTS

Gary Kent Ransom
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Jeffrey Paul Schmitt
William Blair & Company L.L.C., Research Division

Meyer Shields
Keefe, Bruyette, & Woods, Inc., Research Division

Presentation

Operator

Good morning, and welcome to the CNA's discussion of its 2019 fourth quarter financial results. CNA's fourth quarter earnings release, presentation and financial supplement were released this morning and are available via its website, www.cna.com.

Speaking today will be CNA's Chairman and Chief Executive Officer, Mr. Dino Robusto; and CNA's Chief Financial Officer, Mr. James Anderson. Following their prepared remarks, we will open the lines for questions.

Today's call may include forward-looking statements 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 the call. Information concerning those risks is contained in the earnings release and in CNA's most recent SEC filings. In addition, the forward-looking statements speak only as of today, Monday, February 10, 2020. 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 and other information have been provided in the financial supplement.

This call is being recorded and webcast. During next week, the call may be accessed on CNA's website. If you are reading a transcript on this call, please note that the transcript may not be reviewed for accuracy, thus it may contain transcription errors that could materially alter the intent or meaning of the statements.

With that, I will now turn the call over to CNA's Chairman and CEO, Dino Robusto.

Dino Ennio Robusto
Chairman & CEO

Thank you, Margarette. Good morning, everyone. I'm pleased to share our fourth quarter and full year results with you today, which reflects continued strong underwriting performance, accelerated price increases and robust growth across our U.S. operations.

Core income for the fourth quarter was $265 million or $0.97 per share, inclusive of a $48 million or $0.18 per share after-tax noneconomic charge related to our annual asbestos and environmental pollution reserve review. I'll provide more context to the quarter in a moment. But first, I'll make a few comments on the full year results.

P&C underlying underwriting profit for the full year was up 15% to $362 million as the underlying combined ratio came down more than 0.5 point to 94.8%. This is the third consecutive year of improvement in the underlying combined ratio. We achieved 7% gross written premium growth ex captives, which strengthened as the year progressed, as we leveraged the improving market conditions. Rate increases for the full year were 2.5x higher than 2018 and increased each quarter. New business was up 8% as rate increases and overall improved terms and conditions led to more high-quality opportunities.

Now back to the fourth quarter results. The P&C underlying combined ratio was 94.9%, a significant improvement over last year's fourth quarter results and in line with the full year 2019 results. Strong underlying performance in both Commercial and Specialty, combined with improved International performance drove the strong results. The P&C all-in combined ratio for the fourth quarter was 95.6%, which was nearly 10 points better than the fourth quarter of 2018. Now it is fair to point out that I had categorized the 2018 fourth quarter result as an outlier, and improvement in the subsequent quarters proved that out. Nevertheless, the 2019 fourth quarter result is also a full point better than the full year result.

Catastrophes in the quarter were 2.9 points or $40 million after-tax and our 2019 full year cat impact of 2.6 points was well below the prior 2 years, aided by the reunderwriting executed in the International property book. Prior period development in the quarter was a favorable 2.2 points. Our expense ratio in the quarter was 33.7%, about 0.5 point higher than our current run rate driven by some year-end true-ups. As usual, James will provide more detail on our prior period development and expense management.

Gross written premium ex third-party captives grew 8% in the quarter, while net written premium growth was 5% in the quarter. This growth came primarily from our U.S. segments, which grew 9% on a gross basis and 6% on a net basis.

International gross written premium was up 3% as growth in Canada and Europe both fueled by strong rate increases offset the reunderwriting actions in our Lloyd's syndicate.

In the fourth quarter, we continued to achieve higher rate increases. Our P&C overall was plus 7%, up 1 point from the third quarter, and it got better as the quarter progressed. For December, rate overall was 8%. Commercial rate in the quarter was plus 5%, up 1 point from the third quarter. Specialty was plus 8%, up 2 points from the last quarter. And International rate was plus 13%, up 3 points.

In addition to greater rate achievement, we are effectively leveraging the market environment to strengthen terms and conditions and raise attachment points where needed. For example, in our aging services book, we have continued to introduce large deductibles on medical malpractice coverage, a process that began 2 years ago and is starting to have a positive impact on frequency trends. In umbrella, we have meaningfully increased our average attachment points, and we continue to reduce our limits exposure, which, in the case of Umbrella, were in response to the severity trends we began to see in 2018 and I discussed in detail during our last earnings call. We believe these underwriting changes not only improve our loss exposure similar to the effect of rate increases, but also result in a longer-term positive impact as it usually takes years before market pressure reemerges to expand policy terms and conditions.

New business in the quarter grew 27%, and we are right where we want to be, in that submissions are up as the transitioning P&C environment pushes more opportunities into the market. As well, we are benefiting from stronger new business pricing, which has been increasing at the same rate as our renewal pricing. But our quote and bind ratios are down slightly in the quarter, which is appropriate as we only reach for high-quality opportunities within our target segments. We will continue to be similarly opportunistic throughout 2020.

Last quarter, I commented in detail on rate and loss cost trends and described the actions we took over the last several years, both in terms of our actuarial picks and our underwriting actions in the 2 areas experiencing meaningful loss pressure, namely aging services medical malpractice and portions of our umbrella book, specifically where there are auto exposures. Based on the reserve reviews we completed in the fourth quarter, we remain comfortable that our current accident year loss ratios and long-run loss cost trend assumptions continue to appropriately account for the loss patterns in our portfolio.

And since I remain confident that rate increases will continue running above our loss cost trends throughout 2020, I expect that, all else equal, we will see some margin improvement in the latter part of 2020. And we started off this year in good shape with respect to pricing momentum as we achieved an additional point of overall rate increase for the month of January compared with the fourth quarter.

And with that, I'll now turn it over to James.

James Michael Anderson
Executive VP & CFO

Thanks, Dino, and good morning, everyone.

Our Property & Casualty operations produced core income of $337 million in the fourth quarter and $1.2 billion for the full year. Pretax underlying underwriting profit for the fourth quarter was $87 million. For the full year, pretax underlying underwriting profit was $362 million, a 15% increase over 2018.

Our P&C expense ratio was 33.7% in the fourth quarter and 33.5% for the full year. It's worth noting that our U.S. expense ratio for the full year 2019 was 32.8%. As we head into the new year, we expect our 2020 P&C expense ratio to be at or below 33%, as the benefit of premium growth becomes more significant on an earned basis, particularly in the latter half of the year.

Prior period loss development was favorable 2.2 points in the quarter, which reflects the outcomes of the reserve studies completed in the fourth quarter. For the full year, prior period development was favorable 0.7 points, and we remain confident in the strength of our reserve position.

Moving to each of our individual P&C business units. Specialty's underlying combined ratio in the fourth quarter was 93.3%, an improvement of 1 point compared with the fourth quarter of 2018. Specialty's overall combined ratio for the quarter was 88.2%, including 4.9 points of favorable prior period development. This favorable development was primarily in accident years 2017 and prior, driven by professional liability within our Affinity segment. For the year, Specialty's underlying combined ratio was 93% and the overall combined was 90.2%, including 3.3 points of favorable prior period development. Specialty's gross written premium, excluding third-party captives, grew 7% in the quarter, with strong rates and new business growth more than offsetting a lower retention level, which was driven by underwriting actions within health care.

Our Commercial segment's underlying combined ratio was 95.4% in the quarter, which includes an underlying loss ratio of 61.4%, both substantially better than the fourth quarter of 2018. The fourth quarter overall combined ratio for Commercial was 100.6%, including 6.5 points of catastrophe losses primarily driven by isolated tornado events in Texas and in the Southeast; and 1.3 points of favorable prior period development driven by workers' compensation as well as property. Commercial's full year underwriting -- excuse me, underlying combined ratio was 95.2%. The overall combined ratio for the year was 100.8%, a 0.3% improvement to 2018. Commercial's gross written premium, excluding third-party captives, grew 11% in the quarter driven by strong new business growth, increasing rates and stable retention.

The underlying combined ratio for our International segment was 97.7% in the fourth quarter, a significant improvement from the fourth quarter of 2018, and approximately 1 point better than the first 3 quarters of 2019. In the fourth quarter, the underlying loss ratio was 59.7%. As we have noted in previous calls, the improvement in International will take time, but we're encouraged by the progress made in 2019. The expense ratio in the quarter deteriorated by 2 points year-over-year due to the reduction of earned premium from our reunderwriting efforts. International's all-in combined ratio in the fourth quarter was 100.3%, including 2.6 points of adverse prior period development. Catastrophe losses were negligible. As we've mentioned previously, we've significantly reduced our International catastrophe exposure over the past 18 months and, therefore, we're not exposed to the International catastrophe events that occurred in the fourth quarter. For the full year, International's underwriting -- underlying combined ratio was 98.6%, and the all-in combined ratio was 101.8%, a nearly 5-point improvement in each compared with 2018. International's gross written premium grew 3% in the quarter driven by 13 points of rates.

Our Life & Group segment produced a core loss of $4 million in the quarter. Coming out of the unlocking in the third quarter, we'd expect close to breakeven results going forward with some natural variability from quarter-to-quarter.

Our Corporate segment produced a core loss of $68 million in the fourth quarter. This loss was driven by our annual asbestos and environmental reserve review. The results of the review was a noneconomic charge after-tax of $48 million. Following this review, we have incurred losses of $3.2 billion within the $4 billion limit that we purchased in 2010, while paid losses are now at $1.9 billion.

Pretax net investment income was $545 million in the quarter, a significant improvement to the prior year quarter. Our limited partnership and common equity portfolios produced pretax income of $69 million, a 3.7% return. For the full year, the LP and common equity portfolio generated an 11.7% return.

Pretax income from our fixed income portfolio was $464 million. The pretax effective yield on the fixed income portfolio was 4.7%. For the full year, the fixed income portfolio generated a 4.8% pretax effective yield, slightly better than 2018. However, given the current interest rate environment, we expect the level of performance to be difficult to maintain going forward.

Fixed income assets that support our P&C liabilities had an effective duration of 4.1 years at quarter end, in line with portfolio targets. The effective duration of the fixed income assets that support our Life & Group liabilities was 8.9 years at quarter end.

Our balance sheet continues to be extremely strong. At quarter end, shareholders' equity was $12.2 billion or $45 per share, and our unrealized gain position decreased slightly to $4.1 billion. Shareholders' equity, excluding accumulated other comprehensive income, was also $12.2 billion or $44.81 per share, an increase of 8% from year-end 2018 when adjusted for the $3.40 per share of dividends paid during the course of the year.

In the fourth quarter, operating cash flow was $160 million. We continue to maintain a very conservative capital structure. All of our capital adequacy and credit metrics are well above our internal targets and current ratings.

And I'd be remiss if I didn't mention that CNA was upgraded by Standard & Poor's to a financial strength rating of A-plus during the fourth quarter. Finally, our capital management philosophy continues to be that we will look for opportunities to invest capital back into the business if we believe we can achieve appropriate returns. Otherwise, we will return the capital to shareholders. In 2019, we returned $946 million of capital or 95% of net income to shareholders, primarily in the form of dividends. And as we begin 2020, we're pleased to announce a special dividend of $2 per share. In addition, we're raising our quarterly dividend to $0.37 per share.

With that, I'll turn it back to Dino.

Dino Ennio Robusto
Chairman & CEO

Thanks, James. Before we move to the question-and-answer portion of the call, let me leave you with some overarching thoughts on our performance.

The full year underlying combined ratio of 94.8%, improved for the third straight year, and it is the best in a decade. Our underlying P&C loss ratio was 60.9% for the quarter and 61% for the year. U.S. gross written premium ex captives grew 9%, while net written premium grew 6% for the year. We achieved 7 points of rate in the fourth quarter, 1 point higher than the third quarter. I'm encouraged by our pricing trajectory in recent quarters. And based on what we have seen in January, I am optimistic that we can continue to drive rate above our long-run loss cost trends through 2020. We increased our regular quarterly dividend to $0.37 per share, and we once again declared a special dividend of $2 per share. With that, we'll be glad to take your questions.

Question and Answer

Operator

[Operator Instructions] We can now take our first question from Jeff Schmitt from William Blair.

Jeffrey Paul Schmitt
William Blair & Company L.L.C., Research Division

Looking at the International book, obviously, you had a pretty good quarter. But could you give us an update on where that sort of property book stands? Is that largely repaired? Or is there additional work that need to be done there?

Dino Ennio Robusto
Chairman & CEO

Jeff, it's Dino. What I'd say is, look, we're doing the right things in International. I think it's showing up in the results. The underlying combined ratio, as we indicated, was down 5 points. And we also had lower cat losses, which we had expected, because the Lloyd's book, the syndicate was down 17%, even with the strong rate increases. So clearly, we've done a lot of work on that portfolio, but there's still some work that continues, and there could be some volatility quarter-for-quarter. I think what I would say, if you think about it in terms of the premium base, I think we -- you should expect the reunderwriting to probably affect our premium base for a few more quarters. And so there's a little bit more work to do, but a lot of it has already been done, and we expect to go into 2021 with a really great portfolio.

Jeffrey Paul Schmitt
William Blair & Company L.L.C., Research Division

Okay. And then thinking about the Commercial book, you had mentioned a number of times loss cost or rates in excess of loss cost trends. You plan on keeping that through 2020. And I guess with rate accelerating, it suggests the loss cost trends are accelerating. So do you -- as you look ahead and you think about rate, I mean, are you expecting that loss cost trends to continue accelerating? And if you're going to stay out ahead of that on rate, I mean, are you foreseeing a potential impact on retention, if that's the case?

Dino Ennio Robusto
Chairman & CEO

Sure, Jeff. That one is a good question, obviously. Look, I think our long-run loss cost trend assumptions incorporate all that we know and we see now. So as that evolves, we'll continue to incorporate the new information. What I'd highlight is that we have a conservative bias on how we set those loss picks, and we tend to jump on bad news rather quickly. I think our track record bears it out. If you look at our historical record of favorable development, we also -- we worked really hard to react early on our underwriting actions. And then depending on the overall market environment, to your point, we either get what we need or we let retention drop, which is evidenced clearly in our aging services book and we've been detailing that for you over the course of the last year. As I said, based on the quarter's reserve reviews, we feel our picks, our long-run trend assumptions incorporate our loss patterns, and we feel comfortable with the position. And we'll just keep reacting both internally, actuarially, externally in underwriting actions quarter-for-quarter.

James Michael Anderson
Executive VP & CFO

And I would just add one thing to that, Jeff. I think just because rate is going up, does not mean that loss cost trends are going up. Rate is going to be a factor of what we think we need, and it's also going to be a factor of what the market bears. And so we're going to do exactly what Dino said with loss cost trends, and we're going to continue to push hard for rate.

Operator

And we can now take our next question from Gary Ransom from Dowling & Partners.

Gary Kent Ransom
Dowling & Partners Securities, LLC

I wanted to zero in on that health care retention of 66%. I think it's one of the lowest ones that's been there for a long time.

Dino Ennio Robusto
Chairman & CEO

Yes.

Gary Kent Ransom
Dowling & Partners Securities, LLC

And I know it's -- yes, you're pushing rate, you're losing customers, but it just seems like that it's a lot more significant this quarter. Can you comment on that?

Dino Ennio Robusto
Chairman & CEO

Yes. I mean it has been double-digit rate on rate. There's no question, Gary. And that when you start to compound double-digit rate increases, it's a little bit more difficult. We're also being very aggressive on what it is that we need -- and we have been increasing it. And the fourth quarter rate was 25%. And what we do is we put out the terms and conditions. And if we don't get it, then the message to all the underwriters, and they do know it, is you let it go. And I think it always depends on a mix for mix. And you'll see, if you were to go back, there were some other quarters where the retention was in the low 60s, then it rebounds a little bit and it depends a little bit on the mix. But we continue to push this very aggressively. And then, of course, you compound it with the terms and conditions. We're putting larger deductibles on medical malpractice. We've pretty well doubled actually the amount of policies that now have $25,000 medical mal deductible. I mean a few years back, the medical mal had virtually no deductibles or very, very low. So you put all of that together, and we try to get those terms and conditions. If we don't, we'll lose it, and it's going to fluctuate quarter-for-quarter, but what isn't going to fluctuate is our pattern of rate increases and terms and conditions. We're going to keep pushing that hard.

Gary Kent Ransom
Dowling & Partners Securities, LLC

What's surprising to me is just how -- what it says about the industry that here's a problem that seems well-established and yet others are taking it at a lower price. I don't know if that's surprising to you...

Dino Ennio Robusto
Chairman & CEO

Well, I mean, as far -- yes. As always, Gary, you look at it across the industry, and I understand that. For us, I can only tell you, we've been quite transparent on our health care, not only actions or loss picks, our loss cost trends. And so we do what we think is the right thing. We think we're doing the right thing. You get it right on every deal? Of course, not. And difficult to say how some others may view it, in particular, when they take what we let go.

Gary Kent Ransom
Dowling & Partners Securities, LLC

All right. And then, I'm just flipping to the other extreme, where it's a small business, where rates are still down. Can you remind us how much is workers' comp or what the mix is there that's causing that?

James Michael Anderson
Executive VP & CFO

Yes. Yes, Gary. The -- when you look at rate ex work comp, it's up about 2 points. So work comp is the largest single line in that segment.

Gary Kent Ransom
Dowling & Partners Securities, LLC

Okay. Right.

Dino Ennio Robusto
Chairman & CEO

But it continues to grow, and we got good policy retention. And so we're happy with the -- and the profitability is good. So we're happy with the small business.

Gary Kent Ransom
Dowling & Partners Securities, LLC

Right. All right. And on A&E, I wanted to just ask if there was something that -- I know it's economically nothing to you, but you are seeing some trends beneath the surface. And I just wondered if you could give us a little more detail about what it was you saw that caused the adverse development there.

James Michael Anderson
Executive VP & CFO

Sure. Yes. What we saw in the quarter and really for the year was an increase in defense costs, primarily, but also some indemnity costs, all on known accounts for asbestos and environmental. So that was really -- that in combination with reviewing our expectation for reinsurance recoverables were the 2 pieces that drove the change there.

And maybe just to add one thing to -- just to add one thing to that, Gary, what we're not seeing is increase in mesothelioma claims. That trend is actually on its way down.

Gary Kent Ransom
Dowling & Partners Securities, LLC

Okay, helpful. And just one last question or a broader question on the whole social inflation issue. I mean I see your numbers, you've actually improved for the full year, year-over-year on an underlying basis. And I -- everyone has been talking about the social inflation, and yet you're sort of keeping up with whatever it is. And I just wonder if you have any comments on anything new you're seeing in that area.

Dino Ennio Robusto
Chairman & CEO

Gary, it's clearly been a big topic for everyone. I think it depends when you start to see the trends, how you react and how conservative you are. And as I said, we don't get it right all the time, but I do think the conservative bias has played out. I mean, I guess, one comment, there's a lot of using as a benchmark sort of attorney involvement on cases. So I can just tell you from our portfolio, there actually has not been a significant change. And we track it by all the lines of business. We've actually seen slightly lower level of attorney involvement in primary auto, a little slight uptick in primary general liability. And it's actually been flat now for several years in aging services. And when you sort of put it all together on the third-party lines, it really hasn't changed. So I don't know if that helps at all, but it's sometimes commented on. So I just thought I'd share with you what we have in our claim patterns.

Operator

[Operator Instructions] And we can now take the next question from Meyer Shields from KBW.

Meyer Shields
Keefe, Bruyette, & Woods, Inc., Research Division

Two quick questions, if I can. First, is it fair to assume that Affinity growth should accelerate in 2020, given what the, I'll call it, gain/loss trends that you're still seeing?

Dino Ennio Robusto
Chairman & CEO

Meyer, I don't think we heard that full question. Can you repeat it?

Meyer Shields
Keefe, Bruyette, & Woods, Inc., Research Division

I'm sorry. It sounds based on Dino's last comments, like overall loss trends remain under control and I'm assuming that that's true in the Affinity book as well. Given the concerns that we're hearing from other companies there, is it fair to expect top line growth to pick up in Affinity because of that?

Dino Ennio Robusto
Chairman & CEO

Well, on the Affinity, as we've talked about, Meyer, is these are programs, they're multiyear, they're long term. Now we happened to write a large program. We added one large program in 2019. And but -- '18 actually, which played out throughout the quarters of '19, all 4 of the quarters actually, which makes some of the growth comparison on Specialty seem less because of this program. But you don't write those every quarter, right? There -- we go after them. We clearly have an expertise over the last several decades. We're always looking for them, but it's got to fit, it's got to be the right type of program with the right profitability in all of its component parts. So they're harder to come by, but clearly, we have a team that's always focused on it. And we'll keep our eyes open, but continue to grow it because it is very profitable for us.

Meyer Shields
Keefe, Bruyette, & Woods, Inc., Research Division

Okay. Second question, I just want to make sure I understood your response to Jeff. It sounded like there are still some works coming in the International segment. But in the fourth quarter, I guess, it looks like the upside of rate outpaced the exposure reduction. Is that a fair expectation for 2020?

James Michael Anderson
Executive VP & CFO

I think what Dino's comments were primarily around the Lloyd's portfolio. Remember, we also have a Canadian business, which is not undergoing the kind of reunderwriting that's happening in London and that's growing quite nicely as well as the Continental business is actually growing as well based on significant rates that they're getting there. So you have really 2 of the 3 components of that International business are growing more organically and offsetting what's happening in the Lloyd's portfolio.

Operator

[Operator Instructions] There are no further questions on the line at this time. I would now like to turn the call back to the host for any additional or closing remarks.

Dino Ennio Robusto
Chairman & CEO

That's great. Thank you, and we'll chat next quarter.

Operator
Thank you. That concludes today's conference. Thank you for your participation, ladies and gentlemen. You may now disconnect.