S&P Global
Market Intelligence

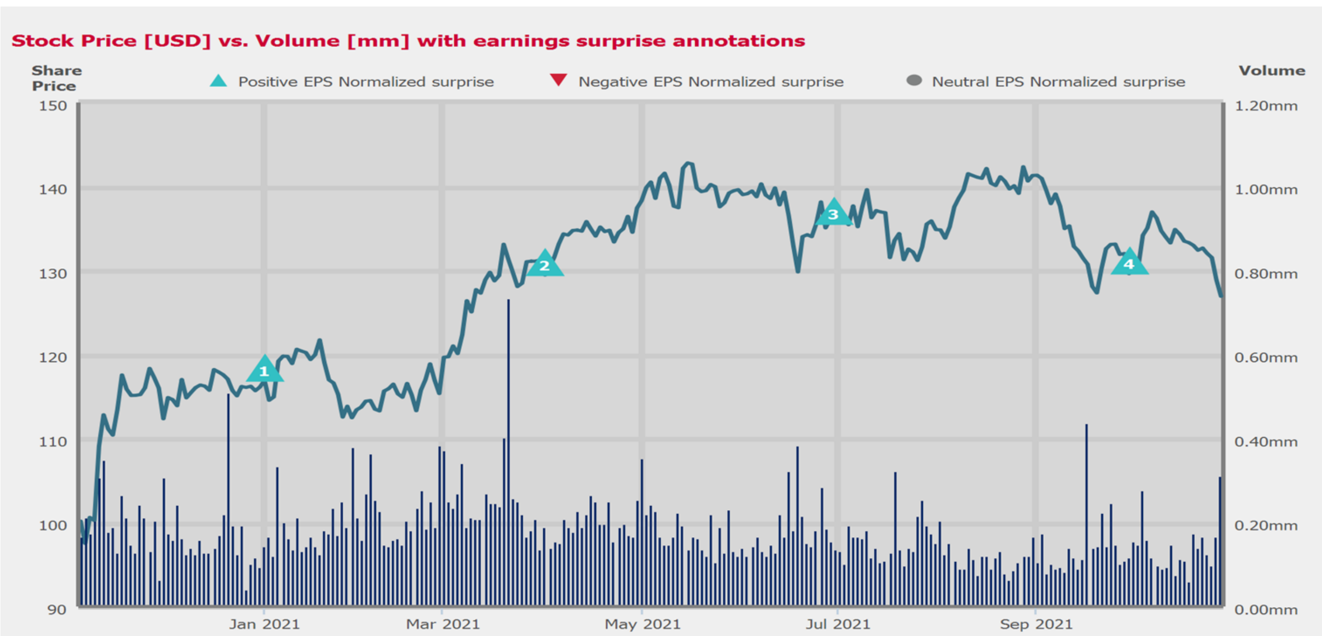
The Hanover Insurance Group, Inc. NYSE:THG
FQ3 2021 Earnings Call Transcripts

Thursday, October 28, 2021 2:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ3 2021-			-FQ4 2021-	-FY 2021-		-FY 2022-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	GUIDANCE	CONSENSUS
EPS Normalized	0.62	0.85	37.10	2.61	7.87	NA	NA
Revenue (mm)	1358.40	1375.20	1.24	1204.30	4982.80	NA	NA

Currency: USD
Consensus as of Oct-28-2021 8:10 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ4 2020	2.37	3.02	1 27.43 %
FQ1 2021	0.78	1.66	2 112.82 %
FQ2 2021	2.31	2.85	3 23.38 %
FQ3 2021	0.62	0.85	4 37.10 %

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Call Participants

EXECUTIVES

Bryan James Salvatore
Executive VP & President of Specialty

Jeffrey Mark Farber
Executive VP & CFO

John Conner Roche
President, CEO & Director

Oksana Lukasheva
Vice President of Investor Relations & Financial Planning

Richard William Lavey
Executive VP & President of Hanover Agency Markets

ANALYSTS

Grace Helen Carter
BofA Securities, Research Division

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

Michael David Zaremski
Wolfe Research, LLC

Paul Newsome
Piper Sandler & Co., Research Division

Robert Edward Farnam
Boenning and Scattergood, Inc., Research Division

Presentation

Operator

Good day, and welcome to the Hanover Insurance Group's Third Quarter Earnings Conference Call. My name is Gary, and I'll be your operator for today's call. [Operator Instructions] Please note, this event is being recorded.

I would now like to turn the conference over to Oksana Lukasheva. Please go ahead.

Oksana Lukasheva
Vice President of Investor Relations & Financial Planning

Thank you, operator. Good morning, and thank you for joining us for our quarterly conference call. We will begin today's call with prepared remarks from Jack Roche, our President and Chief Executive Officer; and Jeff Farber, our Chief Financial Officer. Available to answer your questions after our prepared remarks are Bryan Salvatore, our President of Specialty Lines; and Dick Lavey, President of Agency Markets.

Before I turn the call over to Jack, let me note that our earnings press release, financial supplement and a complete slide presentation for today's call are posted on the Investors section of our website at www.hanover.com. After the presentation, we will answer questions in the Q&A session. Our prepared remarks and responses to your questions today, other than statements of historical fact, include forward-looking statements as defined under the Private Securities Litigation Reform Act of 1995 regarding, among other things, our outlook and guidance for 2021, the ongoing impacts of the COVID-19 pandemic, economic conditions and related impacts, and other risks and uncertainties that could affect company performance and/or cause actual results to differ materially from those anticipated. 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, the presentation deck and our filings with the SEC.

Today's discussion will also reference certain non-GAAP financial measures such as operating income and accident year loss and combined ratios, excluding catastrophes, 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, the slide presentation or the financial supplement, which are posted on our website, as I mentioned earlier.

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

John Conner Roche
President, CEO & Director

Thank you, Oksana. Good morning, everyone, and thank you for joining today's call. It seems like only yesterday we spoke to you at our Investor Day. I would like to thank everyone for their participation and positive feedback. We enjoyed the opportunity to update you on our businesses, and share our vision for the future.

I'll begin today's earnings call by discussing our third quarter financial highlights in the context of the current business and economic environment. I'll then provide a strategic review of each of our business segments. Jeff will review our financial results and outlook in more detail, and then we will be happy to take your questions.

Overall, we are pleased with our financial performance for the quarter, especially in light of the severe weather and inflationary pressures that are broadly affecting the industry. We posted net written premium growth of 8.4% and a combined ratio, excluding catastrophes, in line with our original expectations for this quarter. Our performance on both metrics underscores our ability to capitalize on market opportunities while prudently managing the complexities of the current environment.

In particular, I want to call your attention to 3 highlights for the quarter. First, our continuing growth momentum; second, our overall business diversification, which was emphasized with some unevenness in our segment results in the quarter; and third, the effectiveness of the steps we are taking to position our company to manage the effects of changing weather patterns.

Our net written premium growth again exceeded our expectations with strong contributions across all segments. Year-to-date through September, our growth rate of 8.4% was equally robust driven by successful execution of our differentiated business strategy and disciplined capital allocation. Our balanced approach to personal lines pricing has proven to be quite effective and critical as loss trends continue to evolve. At the same time, the overall Commercial Lines environment, including rate and exposure remains strong, fueling our robust premium momentum.

During our recent Investor Day, we highlighted the growth levers that have and will continue to enable us to build competitive advantage in this dynamic market. Specialized capabilities, a unique distribution approach, and an extraordinarily talented team are among the many reasons why we are becoming a premier P&C franchise for the nation's top independent agents. And we continue to lean into our mission every day. our distinctive strategy and our high-quality book of business inspire confidence in our ability to achieve our guidance of high single-digit growth for the full year. Overall, ex-CAT loss activity was in line with our expectations with many moving parts, which Jeff will review in more detail shortly.

From a macro perspective, there is no doubt that the environment is changing rapidly. The third quarter reflected that movement for us and the industry. Our Personal Auto and some other lines continue to benefit from lower loss frequency in the current uncertain environment. At the same time, inflation, labor shortages, rising cost of materials and supply chain bottlenecks are adversely affecting certain lines, albeit to different degrees.

As I noted during our Investor Day, in my more than 3.5 decades in this business, industry trends have never been as dynamic as they are today. But as our results have demonstrated over time, our diversified book of business and broad-based profitability have enabled us to maintain a well-balanced portfolio and consistently deliver strong overall performance. This result speaks directly to the quality of our underwriting, integrated capabilities and the analytical tools we leverage to effectively manage the fluctuations inherent in our industry, and we believe we will continue to win in this dynamic environment that presents both challenges and opportunities. The third quarter marked an especially active catastrophe season across the industry.

At $153.5 million, our third quarter losses were in line with the preliminary estimate we shared with you in our September 22 pre-release. Hurricane Ida represented approximately $75 million of the total, with the balance comprised of rain, flood and tornado events. We are looking carefully at the increase in the frequency and severity of weather events, including nonmodeled storms. The changing weather patterns are an issue we and others in the industry will likely contend with going forward. We have been monitoring and addressing this issue for several years using all the levers available to us, including exposure management, reinsurance, and improvements in data and analytics.

Our continued focus on exposure management has proven effective across our portfolio. As you'll recall, we have withdrawn from the Personal Lines market entirely in Florida and have carefully managed our exposures in other Gulf states. We have benefited from this strategy in the wake of Hurricane Ida when we sustained lower cat losses proportional to the industry, in general, in the South. We also restricted our capital allocation in wildfire exposed regions in the West and coastal exposures in the East. And we continue to emphasize growth in casualty lines to ensure good balance and enable continued property capacity in our most profitable territories.

Additionally, we bought a substantial amount of catastrophe and property per risk reinsurance with broad terms. Finally, we have augmented our cat management and aggregation tools, including PML underwriting, dynamic cat pricing, single property cat load and micro concentration models. While these actions have served us well in the past and continue to do so, we believe pricing still requires additional focus. Given the volatility the industry is seeing on cat and non-cat basis, we expect commercial property rates to remain firm going forward, and even move higher. We also expect industry participants to coalesce and partner more with the government to protect our customers through better infrastructure, stronger building codes and expanded risk-sharing pools, among other things.

Overall, our past and current actions, combined with our commitment to sustainability, position us to effectively navigate the ongoing effects of changing weather.

I will now turn to a review of our business, beginning with Personal Lines, which generated net written premium growth of 8% in the quarter. Policies in force continued on an upward trajectory with all lines contributing to the growth. Broad interest in our offerings, combined with our measured and less reactive pricing strategy, continues to drive increased retention and spur new business growth. At 88.7%, our retention places us in the top quartile in the industry, supported by our account strategy and focus on being a market leader for customers with sophisticated insurance needs. New agency partner appointments are on track and continue to supply a robust flow of new business as they work to achieve relevance with us.

In addition, we are also seeing a new business lift from continuing market and book consolidations among our strongest and most established agents. I also would mention that we are continuing to see terrific momentum with Hanover Prestige, our popular full account offering. This solution has found a sweet spot between commodity players and high net worth carriers for customers in the $750,000 to $3 million homeowners coverage range, with broader and more complex insurance needs, providing us a substantial competitive advantage and future growth opportunities. Overall, we are successfully navigating the dynamic Personal Lines market environment while striking the right balance between growth and profitability. Our Personal Lines results are tracking in line with our expectations for the quarter.

That said, we are actively watching frequency and severity trends, particularly given the industry-wide increase in severity in 2021. The loss frequency benefit in the third quarter was greater than we had originally anticipated at the start of the year, and is helping to counteract the increase in auto severity. The pricing environment remains competitive, although we are observing signs of auto rates increasing across the industry with a significant uptick in competitor rate filings. We are carefully reviewing our pricing selections along with the competitive environment, and have made necessary adjustments.

Turning to Commercial Lines. Strong growth of 8.7% in the quarter was driven by positive exposure activity, rate increases, strong renewals in core Commercial Lines and continued momentum in Specialty. Exposures continue to meaningfully contribute to our premium increases as businesses grew in a more favorable economic environment. We are maintaining our strong agency position and continuing to capitalize on book consolidation opportunities. The pricing environment continues to be robust in our markets within both Core Commercial and Specialty. We achieved Core Commercial rate increases of 6.9% in the third quarter, consistent with the second quarter dynamics. Specialty rate remained strong with robust pricing trends in most lines particularly in property, including HSI and Marine.

We expect the firm market to continue as the drivers of rate increases are not showing any signs of slowing down. With such dynamic loss trends and a more uncertain risk environment than ever marked by elevated weather, supply chain disruptions, materials inflation and a return of litigation trends and increased severity, we will be seeking additional rate in many lines of business.

The rollout of our TAP Sales platform for small commercial is progressing very well. We added 10 more states over the last 3 months, bringing the total number to 30, now covering the vast majority of our existing small commercial footprint. As the deployment of this platform continues, it is supporting our transactional and new business flow as well as providing additional growth and agency penetration opportunities.

In middle market, we continue to focus on pricing segmentation and mix management, emphasizing growth in our target states, product lines and industry classes. Over time, we see significant opportunity to further penetrate this segment and enhance our agency partnerships. However, we remain somewhat cautious in the near term, particularly until loss trends become a bit more predictable. Specialty continues to be a strong source of revenue expansion, with underlying growth holding at near double digits for our most profitable businesses, and continuing robust rate of 8% in the quarter.

We continue to make strides in E&S and professional and executive lines as we advance our digital capabilities, and market our broad capabilities more holistically. Book consolidations with many of our best agents continue to build and supplement our new business flow. We are also excited to further drive our total Hanover strategy by expanding our distinctive Specialty offerings across more and more of our core commercial customers.

Earlier this month, several members of our leadership team joined other industry leaders at the Council of Insurance Agents & Brokers' Leadership Forum, a gathering of many of the largest and most successful agents in our business. We conducted over 40 executive meetings, both in-person and virtually, talking with many of the top 100 agents around the country. These conversations allowed us to review our current and planned capabilities and discuss how we can help them more effectively serve their customers and expand their businesses. We came away from these meetings extremely encouraged about our prospects, and with several key takeaways.

First, Agency M&A is continuing at a rapid pace with new consolidators emerging and presenting new opportunities for small and midsized agents to join forces. Second, Agency M&A trends, combined with labor shortages are driving more agents to further explore various tech solutions, and engage with carriers that have invested in state-of-the-art platforms and capabilities, seeking to drive operating efficiencies and enhance EBITDA margins. Our commitment to innovate alongside, and for the benefit of our agents and their customers, is making our value proposition even more attractive as evidenced by the success of our Agency Insights engagement and market consolidation efforts.

Third, differentiated Personal Lines and Small Commercial offerings continue to be in high demand among the best agents in the country as they acquire midsize and smaller agents who have considerable amounts of this business. Agents are getting very serious about consolidating their flow of business with the right carriers to drive additional operational efficiencies and better serve their customers. The combination of our Agency Insight work and our TAP Sales offering presents an unmatched competitive advantage.

Fourth, many agents continue to develop areas of specialization, particularly among vertical industry segments, and are deliberately pursuing growth in these areas, very often, including health care, manufacturing, human services, tech and life sciences, among others, areas where we are especially strong. Our industry specialization and our admitted and non-admitted product capabilities garnered substantial interest during these strategic conversations.

Ultimately, we came away from the conference with even greater conviction that our strategy is further resonating, and we are well positioned going forward to drive strong, sustained and profitable growth, and to deliver outstanding value for our shareholders and other stakeholders.

We are delighted by the continued growth momentum and strong underlying results we have generated year-to-date. Our differentiated agency and customer-centric strategy, combined with our specialized capabilities, are key to our continued success. Supported by our strong team and unique culture, I have immense confidence in our ability to monitor and adapt to changing market dynamics and capitalize on emerging opportunities for profitable growth.

With that, I will turn the call over to Jeff.

Jeffrey Mark Farber
Executive VP & CFO

Thank you, Jack, and good morning, everyone. In the third quarter, we reported net income of $34 million or $0.94 per fully diluted share compared with net income of $118.9 million or $3.13 per fully diluted share in the same period last year. After-tax operating income was $30.8 million or $0.85 per diluted share compared with $93.5 million or $2.46 per diluted share in the prior year third quarter.

Before I review our quarterly performance in more detail, I would like to note that similar to our second quarter 2021 analysis, prior year quarterly comparisons reflect unprecedented distortions the pandemic created in our results and industry results last year. Given the unusual nature of the third quarter of 2020, we believe our more recent growth trajectory and loss experience as well as our original expectations for 2021 are better parameters by which to assess our performance.

We recorded an all-in combined ratio of 102.3%, which included catastrophe losses from Hurricane Ida. Third quarter catastrophe losses of $153.5 million before taxes, which represented 12.9% of net earned premiums, were at the lower end of the guidance we provided in our prerelease on September 22. Ida added $75 million in losses to an already active cat season within our geographic footprint. This hurricane caused significant and widespread damage in Louisiana, New Jersey, New York and Pennsylvania. Together with our agent partners, we continue to help our customers and the affected communities recover from the storm.

Our performance, particularly in Southern states, speaks to our prudent catastrophe management philosophy and the proactive steps we have taken over the past decade to diversify our geographic footprint, and reduce our exposure in cat-prone regions. And equally important, it speaks to our use of sophisticated cat management and aggregation tools, data analytics and pricing to mitigate the effect of climate change on our business. Our ex-CAT combined ratio is 89.4%, reflecting the strong underlying performance of our diversified business.

Turning to our reserves. We reported net favorable development of $20.9 million in the third quarter 2021, primarily due to continued favorability in Personal Auto and workers' compensation, in addition to some favorability in other commercial lines. Personal Auto favorability of $10 million includes the benefit from revised fee schedules and loss control measures that came into effect in Michigan on July 1, 2021, as part of the PIP insurance reform there. Mindful of uncertainties surrounding inflation, court and medical delays and changing weather patterns, we continue to maintain and establish a prudent level of reserves, and we remain committed to maintaining a strong balance sheet and our overall conservative reserving philosophy.

Looking at expenses. Our expense ratio improved 0.7 points from the prior year third quarter to 31.1%, largely as expected. Our expense ratio year-to-date stands at 31.3%, a 20 basis point improvement from the first 9 months of 2020, and we are confident in our ability to deliver on a 30 basis point improvement for the full year.

Now let's review our underlying performance by segment, beginning with Personal Lines. We delivered a combined ratio, excluding catastrophes, of 87.7%, better than our original quarterly expectations driven by favorable development. Our Personal Auto current accident year loss ratio was 68.9%, which is consistent with our plan, and was contemplated in our guidance. However, it rose 8.8 points relative to the third quarter of 2020, and was up 6.7 points sequentially. Severity pressures coming from increased prices for auto parts, used cars and supply chain disruptions were well covered by industry press. They certainly affect our book of business as well. However, our book continued to benefit from lower frequency albeit at a lesser degree than in the second quarter of 2021. We believe the underlying causes for rising auto property loss costs are temporary, but they likely will persist over the next several quarters, putting continuing pressure on severity.

Looking ahead, we expect the long-term persistency of the frequency benefit in our book of business to offset some industry-wide severity trends. We also believe that the higher cost of vehicles countrywide, in combination with unwinding frequency benefits, will drive industry insurance pricing up. We are seeing signs of it already and believe the trend will continue for the near future. With our balanced and prudent rate strategy throughout the pandemic, and our granular pricing and competitiveness monitoring tools, we are successfully balancing our rate and growth to preserve pricing consistency and overall profitability of our book of business.

Our Personal Lines strategy during the pandemic has been to focus on long-term value creation. The unusual frequency benefits served to reduce the loss ratio, but also created a more competitive pricing environment. We reacted by adjusting our pricing later in 2020 to protect our renewal book and to obtain new business that we believe will create long-term value.

By temporarily moving pricing below long-term loss trend, we allowed the temporary frequency benefit to fund profitable business growth. Our renewal rate always remained positive. And the current Personal Lines rate of 2.1% in the third quarter is the low watermark in our rate trajectory. We knew that later in 2021 as frequency benefit waned, margins would reduce on some of this business. We anticipated this in our plans. As it turned out, some of the frequency benefit persisted but was offset with the severity increase we are seeing now. We are confident that the business we are writing and the rate we will be getting will set us up for substantial value creation even if the Personal Lines auto margins are reduced a bit for the next year or so.

Fortunately, we have a very diversified book of business, which will show itself in the potential margin expansion of the Commercial Lines businesses. More on that shortly. Our profits are broad-based with nearly all segments delivering target long-term profitability, and we have full confidence in our continuing trajectory, including 2022.

Homeowners current accident year loss ratio, excluding cats, was 51.9%, up 3.7 points from the prior year period, which was reduced last year during COVID. This quarter's loss ratio was in line with most recent trends. Our homeowners rate, including exposure, is approximately 6% in the third quarter, and it is moving to approximately 8% starting in 2022. Inflationary pressures in this line, combined with active weather, continued to support the need and ability to achieve additional rate, which is substantially within our control.

Premium growth of 8% in Personal Lines was driven by robust new business activity and increased retention. Policies in force continued on an upward trajectory with all lines contributing to the growth.

Turning to Commercial Lines. We reported a combined ratio, excluding catastrophes, of 90.5%, a decrease of 1.3 points from the prior year period, helped by an improved expense ratio from growth and higher favorable development. Our current accident year loss ratio, excluding catastrophes, was relatively stable, only slightly elevated. An increase in large property loss activity in CMP was nearly offset by improvements in other commercial lines and, to a lesser degree, workers' compensation.

Our CMP current accident year loss ratio ex-CAT was 64.2%, an increase from the third quarter of last year, and above our expectations. And while there is always an element of randomness in large property losses, our team completes a thorough review of each loss during which policies were determined to be generally consistent with our underwriting guidelines.

Our loss experience, primarily fire and water damage, was spread across several industries and geographies with no obvious patterns. We are seeing some potential correlation in the losses to the unevenness of the economic recovery, post COVID. Some clients are having tremendous success in record sales, and in turn, are likely straining their facilities and equipment to keep up with demand. As such, there was a need for additional rate in property in response to materials cost inflation, weather pattern changes and some labor disruption issues.

Our CMP property rate is in the high single digits, and we are consistently achieving double-digit rate increases in our Specialty property coverages. We expect to take additional rate going forward, and we believe the market will support it.

In Commercial Auto, the ex-CAT loss ratio was generally in line with the third quarter of 2020 at 65%. Consistent with our experience in Personal Lines, we are observing an increase in property severity, offset by some lingering frequency benefits. We are taking rate increases to address that evolving dynamic and continue addressing the industry-wide multiyear liability issues affecting this line.

Our workers' comp ex-CAT loss ratio improved 4.2 points to 57%, primarily due to positive audit premium adjustments for prior period policies. Our underlying loss picks remain in line with prior quarters. Workers' compensation frequency is now level with our pre-COVID experience, and we are watching for the unskilled or not fully trained labor phenomenon in this line. While we are confident that our favorable portfolio mix towards smaller accounts and skilled professional industries will continue to deliver favorable workers' comp results, we remain cautious in our reserving approach, given the still anemic rate environment and further risks posed by offices and facilities reopening for more businesses.

In other Commercial Lines, the ex-CAT loss ratio improved 2.4 points from Q3 2020 to 51.7%, which was also better than our expectations driven entirely by Marine and HSI, which both experienced lower-than-expected losses in the quarter. Our Commercial Lines segment generated premium growth of 8.7% in the quarter, with solid contributions from both core and Specialty. Core Commercial is benefiting from strong retention and exposure as the economy strengthens. Professional lines as well as excess and surplus fueled the growth momentum in Specialty, which overall achieved rate increases of 8% in the quarter.

We remain focused on driving growth in our most profitable Core Commercial and Specialty segments, and rounding out our total Hanover value proposition through which we offer our highly specialized capabilities to our Core Commercial Lines clients.

Q3 was a strong quarter from an investment income perspective as we delivered net investment income of $78.8 million, up nearly 17% from the prior year quarter on higher investment partnership income. Partnership income continued to contribute significantly to our investment income, adding approximately $19 million to our pretax income instead of an expected $7 million based on the strong equity returns and some meaningful underlying investment monetization.

Fixed maturities, earned yields continue to slowly drift lower, now standing at 2.96% due to lower new money yields. We do expect continuing strong cash flows to offset pressure from lower new money yields in the future. Cash and invested assets were $9.3 billion at the end of the third quarter, with fixed income securities and cash representing 85% of the total. Our fixed maturity investment portfolio has a duration of 5 years and is 96% investment grade. Our well-laddered and diversified portfolio remains high quality with a weighted average rating of A+.

Turning now to our equity and capital position. Our book value per share of 87.04 reflects a decline of 1.3% from the second quarter due to the impact of rising interest rates on our fixed income portfolio and quarterly dividends. We remain focused on our capital management priorities and committed to being strong stewards of our investors' capital. For the third quarter and through October 27, we repurchased approximately $34 million of stock, slowing down the pace of repurchases a bit during the cat season.

In addition, we paid a regular cash dividend of approximately $25 million during the quarter. Our priority is to maintain strong capitalization and adequate liquidity and to use internally generated capital to support profitable growth, which remains the most accretive use of our capital. Reflecting the higher catastrophe losses during the quarter, our return on equity was 4.3%, well below our historical trends and our long-term target. Our annualized year-to-date ROE was 9.3%. However, if we were to normalize the ROE for cats in the quarter and the year-to-date periods, such returns would be at or above our long-term targets. We remain confident in our ability to deliver top quartile performance over the long term.

Turning to guidance, and incorporating our third quarter results, we now expect to deliver high single-digit growth for the full year 2021. Additionally, with 3 quarters of the year now in the books, we believe that we will end the year at the bottom of our 89% to 90% ex-CAT combined ratio guidance. This guidance includes a typical seasonal increase in the auto loss ratios and a decline in the home loss ratios in addition to continuing inflationary trends we will likely see during the quarter. We're also on target to reduce our expense ratio by at least 30 basis points in 2021 to 31.3%, and we expect our fourth quarter cat load to be 3.9%. We have a well-diversified and profitable set of businesses. Our portfolio provides ample opportunities for us to make investments in the future value of our businesses. The strong growth in Commercial Lines and the meaningful rate in excess of loss trend for both Specialty and Core Commercial should be very helpful as we go forward.

We executed well in Q3 despite an exceptionally active cat season and industry-wide inflationary pressures. We are well positioned to sustain our profitable growth momentum and long-term top quartile profitability. We begin the final quarter of the year in great financial shape, and we are excited about the opportunities ahead.
With that, we will now open the line for questions. Operator?

Question and Answer

Operator

[Operator Instructions]

Our first question is from Paul Newsome with Piper Sandler.

Paul Newsome
Piper Sandler & Co., Research Division

The sort of issue of the last quarter -- this quarter, last quarter has been inflation. One of your peers talked about a little bit higher expectation for inflation in commercial property, and they also said that some of that has to do with the differentiation that they're seeing between what we're generally seeing with commercial property and versus personalized property. The inflation has hit basically private passenger auto and home insurance before it has hit commercial property and Commercial Auto. My question is, have you seen that as well and you have similar expectations for a modest increase in the expected inflation rate because of that property-type [loss].

John Conner Roche
President, CEO & Director

Yes. Thanks, Paul. This is Jack. We certainly are witnessing much of what others are seeing in terms of inflationary effects in the short term across Personal Lines and Commercial Lines. And we're monitoring, and obviously trying to factor as quickly as we can how much of that should translate into some improved rates. But I think what's serving us well is we have worked really hard on our claims analytics to make sure that we're segmenting what we're seeing at an even finer level and make sure that we have an assessment of what we think might be transitory, what might be more permanent and how to allocate that across our portfolio.

So Jeff, I don't know if you want to -- I know there's also some benefits that we derive from inflation in terms of our premium basis. But Jeff, maybe you can make some comments further.

Jeffrey Mark Farber
Executive VP & CFO

Sure. Paul. With respect to building materials, property, we're largely seeing and reacting with the same phenomena around the labor issues, the cost of lumber, all those sorts of things that we're seeing in both auto and home on the personal side. The 1 area that Jack was referring to, certainly in workers' comp and in liability, the premium increase with receipts and both payroll. So we're getting some exposure benefit there. But in our loss picks and in our reserving, we have assumed very similar increases in inflation. The only real difference is the used and new car phenomena that we're seeing in auto maybe is a little bit more extreme.

But I think importantly, we're getting lots of rate on the commercial property side. So give or take, 10 points of rate, both in Specialty a little bit higher and in certain areas like home and in the middle market at or 10 or even -- or just a little bit lower. But we're optimistic that we can keep up with it.

Paul Newsome
Piper Sandler & Co., Research Division

And somewhat relatedly, we also see wage inflation kind of broadly across the U.S., certainly in the insurance world. Does that -- if we have a sustained sort of wage inflation issue in the U.S., does that change the math of your long-term 20 basis point improvement in expense goals, materially?

Jeffrey Mark Farber
Executive VP & CFO

Clearly, every good company is paying attention to their people and making an assessment of where their expertise lies, where they want to be offensive, if you will, on retaining talent and, frankly, acquiring talent that's available. I think we're confident, Paul, that while we'll make some adjustments to remain competitive and to retain good people, we have a lot of levers to continue to meet our expense objectives, and they're essential. And probably one of the most powerful things that can help us is our growth that we're seeing an opportunity to grow thoughtfully in this marketplace, and that has a major effect on our expense leverage.

Operator

The next question is from Mike Zaremski with Wolfe Research.

Michael David Zaremski
Wolfe Research, LLC

Great. A lot of great color on Personal Lines. Maybe on just auto to make sure I'm thinking about this correctly. The pricing statistics cited, you say that it don't include -- I believe there's an inflation guard and exposure increases. And so since we're kind of all -- we all know severities running a little hot or maybe more than a little high in auto. I just want to make sure does -- the inflation guard and/or exposure increases, does that mitigate the delta kind of between price and rate in personal lines? Maybe you could include home in that as well.

John Conner Roche
President, CEO & Director

Yes. Mike, this is Jack. Yes, the inflation guard that we're referencing is primarily in homeowners and obviously, on the Commercial Lines side and property. The inflation of auto [fizz dam] is reflected more in how we adjust for those prices that are going through and primarily how we adjust for that in rate. So Dick, do you want to maybe take that?

Richard William Lavey
Executive VP & President of Hanover Agency Markets

The only other color I'd add is on the auto side. You have some exposure increase through model year in the autos as the years of the car become more modern, that brings increased exposure. But really inflation cars really at homeowners reference.

John Conner Roche
President, CEO & Director

And really maybe at the heart of what you're getting at, Mike, I think, is that we think we navigated the last few quarters better than most, in that we resisted the temptation to drop our rates to try to overreact to the loss frequency benefit that we were driving from the environment. And as you saw, we took a little bit of a retention dip but very quickly bounced back. And I think we're in a really terrific position, particularly since we are still having some loss frequency benefits to reset the dials. And really, as we predicted, the environment is starting to firm up. Many people are starting to file for rates or make adjustments in their multi-barrier products that will allow them to start moving their pricing up. So at the end of the day, what's key is that we're doing the claims analytics and understanding our cost of goods sold, and able to move our pricing to reflect that. And that's where, as we said in our prepared remarks, we have a lot of confidence in our team.

Michael David Zaremski
Wolfe Research, LLC

Okay. Got it. And I guess a quick follow-up on auto. Some folks are also talking about bodily injury severity being actually a little bit better than it has been but still, I guess, maybe on an absolute level higher than they want. Any color on bodily injury for Hanover? I see that you might have -- you had a good amount of actually reserve releases. So there might be some pluses going on there, too, maybe on PIP or whatnot, or new fee schedules.

John Conner Roche
President, CEO & Director

Yes. Overall, we have been watching for it. Obviously, trying to look for whether there would be a minor version of what the industry is seeing in Commercial Auto. But frankly, we have not, and we'll continue to monitor it. But we have not seen any real meaningful elevation there. And again, for us, it's all about making sure that we look at those trends and we adjust our pricing appropriately. Jeff, do you want to speak to the reserve side of that?

Jeffrey Mark Farber
Executive VP & CFO

Yes. Our assumption when we've looked at our reserves in particular, prior year development, is that there is a delay in case matters and in medical procedures and submissions and costs. So we have been providing for and assuming that these are going to come. So we're assuming social inflation is there. It hasn't gone away. The large cases are just delayed. And so the favorable development you're seeing is simply matters that the case or the claim just simply didn't happen. And in some cases, it's 2020. In many cases, it's older years. So it's not just a delay phenomenon. And in fact, Michigan PIP actually provided some benefit to us with prior years on the rates and the new requirements that have come in that have actually put statutory limits on certain providers of health, and that's actually helped us. So we've seen some favorability there really since the July 1 law went into place.

Michael David Zaremski
Wolfe Research, LLC

Okay. Great. That's helpful. Maybe a follow-up on the commercial casualty side. I know there's a lot of good commentary. I think, Jack, I heard you used the words return of litigation trends. And then you guys also talked about maybe looking out for the unskilled workers' comp phenomenon as unemployment gets tighter. So just kind of curious, are you guys seeing in your book kind of a resumption of kind of courts opening or kind of workers' comp claims coming kind of steadily back online? Or is some of the cautiousness in the written marks and middle markets kind of the trends are still maybe better than you'd expect longer term, but they're -- but you're just -- they're coming back a little bit in terms of the frequency trend or severity?

John Conner Roche
President, CEO & Director

Let me take a shot at the liability side first in that what we're doing is being very granular in our analysis around some of the smaller cases that appear to be settling out, maybe even at a more rapid pace than historical levels. We are monitoring and seeing some of the more severe cases or certainly litigated cases building. And so we have very much accounted for that and made sure that we are not assuming that some of the more severe cases are going to settle out quickly or, frankly, at low levels. So I think we're being very prudent with our reserves and with our picks, and we're watching those cases in particular. The courts are clearly opening up. There's still a backlog, but I think really good companies can segment the losses and the types of losses and start to make some assumptions that are appropriate going forward. We'll see if that levels off over time. But right now, we're assuming that there's some residual effect of that.

Real quickly on the workers' comp side, I believe we are seeing some indication that the labor shortage, combined with some economic activity is starting to bring workers' comp cases back to maybe more normal levels. But it's still at historically low levels given the last 6 years that we've all observed. Dick, do you want to maybe just make a couple of comments on that?

Richard William Lavey
Executive VP & President of Hanover Agency Markets

Yes. I would absolutely agree. We -- as the economy has come back online, we've seen increase in frequency, and some severity in workers' comp. To your question of is there a correlation to unskilled worker phenomenon. It's really hard to exactly pinpoint that. We analyze every loss, particularly our large losses, and attempt to determine cause. It's hard to decipher. Is it the individual? Is it just the excess sales that are going through some of the factories, and manufacturers? So it's something we're watching very closely. We can't say today exactly that if there is a direct correlation, but we're watching it.

Michael David Zaremski
Wolfe Research, LLC

And maybe just one quick follow-up on workers' comps as you guys have given great color in the past at the Investor Day. Are there any -- as a result of pandemic, any kind of changes structurally in terms of how workers' comp is going to be adjudicated in the future? Or is now that could have been benefiting or could change the kind of the curve in terms of on the medical side or just LAE side?

John Conner Roche
President, CEO & Director

I think it's premature to make that kind of assessment. I think the biggest issue will be how much people return to work and what the implications are for determining when somebody is in a compensable role within workers' comp. But I wouldn't say that we're seeing anything that's worthy of commentary at this time.

Operator

The next question is from Bob Farnam with Boenning and Scattergood.

Robert Edward Farnam
Boenning and Scattergood, Inc., Research Division

Yes. A question for Jack, perhaps Dick, on the book rollers. How successful have they been? I'm just trying to figure out as a proportion of the new business, is it material? And why have you been successful getting book rollovers? Are you offering agents incentives? Or is it just more of the traction of a broad-based product? Just -- maybe just more details on the rollovers.

John Conner Roche
President, CEO & Director

Yes. Let me -- this is Jack. Bob, thanks for the question. I would really clarify that we're really not into book rollers. What we are into is working with agents that believe that consolidating the markets that they do business with for the full benefit of better servicing their clients and also creating some efficiencies because the business is so fragmented. And so because of our tools, because of our broad appetite, because of our operating models, we're just really effective at helping people when they decide to do that, and sometimes even influencing them to do that.

So to me, that's a clarification worth noting because I think this is all in the best interest of our customers. But the short answer is that we are -- really in Small Commercial Personal Lines, and even on the smaller end of Specialty, we have a meaningful amount of our new business that comes from not only direct market consolidation, but also pipelining that comes from the work we do with our Agency Insight tool. I don't know, Dick, if you want to make a comment in there?

Richard William Lavey
Executive VP & President of Hanover Agency Markets

Yes. I would just offer that this part of our strategy continues to be a really important growth lever for us. The Agency Insight work we do is really -- it leads to a strategic dialogue, as Jack was just pointing out, with our partner agents about markets and market consolidations and efficiency, and it brings forward the insights that lead to a conclusion of, hey, this customer is better suited in a Hanover product or Hanover solution.

So it really is part of a strategic road map we have to build out our partnerships. It is in the range of 12% to 15% of new business for us, and that has been consistent. In fact, in past years, we've had record signings from our agents. And I would just offer, we're really unique in the industry to have dedicated resources that do this analysis, do all the work and kind of shoulder the hard lifting on behalf of the agent.

John Conner Roche
President, CEO & Director

And we'll keep moving. But I think that 12% to 15% is really in that direct market consolidation. I think it's ranged from 15% to 20%, frankly, when you include the pipeline that we're doing that we don't necessarily call that a consolidation, but it's a direct result of those strategic dialogues.

Robert Edward Farnam
Boenning and Scattergood, Inc., Research Division

Okay. The second question for me is given the potential for increased cat activity increased non-cat losses, increased inflation. You increased your ROE target to 14% at the last investor meeting, up from 13%. So I'm curious if that -- is that realistic in this type of environment?

John Conner Roche
President, CEO & Director

Well, I think it requires us to lean into the rate environment, particularly on the property side, and we are doing just that. You're right in suggesting that if the weather is going to continue to be challenging, and some of the property volatility that we've experienced requires us to kind of reprice that line of business, really across the portfolio.

I will say, and I think we pointed this out in our prepared remarks, that property volatility non-cat though moves around, and it's not pervasive, right? You saw -- we -- our specialty property and even our Small Commercial this quarter behaved quite nicely from a non-cat perspective, and it was really middle market that drove some outsized losses in the third quarter. And if you look back at our calls over the last few years, some of the volatility that we've spoken to came from our Marine business and our HSI business, and I think a couple of quarters ago, some Small Commercial. So it's really -- if we look at property holistically on a non-GAAP basis, it's still a good business for us. It just requires us to keep pushing on the rate.

Jeffrey Mark Farber
Executive VP & CFO

But all of the improvement in the getting to 14-plus percent is really around expenses and claims activities. Our view is that the loss ratio will be relatively flat. There may be some movements to run pieces of the portfolio, but it will be relatively flat. So our view is that we can get price, which is consistent with loss trend over time. And to the extent that there are heavier property losses or greater cat activity or weather is stronger, then we will be pricing for that accordingly.

Operator

The next question is from Grace Carter with Bank of America.

Grace Helen Carter
BofA Securities, Research Division

I was thinking that with kind of the preferred bundled business that you all work within Personal Lines. A lot of that business tends to be pretty sticky across the industry, but it sounds like there's potential for kind of industry-wide homeowners and auto pricing to be rising at the same time, maybe that's not really what those customers are used to seeing. So since you all have tried to maintain pretty consistent pricing relative to some other players over the past year. I guess I'm wondering how you're thinking about any opportunities going forward that might result from shopping activity over the next few months as the industry tries to correct pricing.

John Conner Roche
President, CEO & Director

Yes. Great question, Grace. I think there's a lot going on in that white space between kind of the traditional middle market business and the high net worth. And we are very bullish on our Prestige product, and our ability to price that business appropriately and deal with some of the volatility -- pricing volatility that's coming particularly from the high net worth carriers who have to have an infrastructure and a cost structure to service the larger high net worth customers. And it becomes challenging for them on the lower end of that, which obviously is where we -- where we're playing. So Dick, I don't know if you want to speak to that?

Richard William Lavey
Executive VP & President of Hanover Agency Markets

Yes, absolutely. We are very bullish about our Prestige prospects. The growth rate has been significant. And not only what Jack just referenced with the opportunity coming from the high net worth players, equally we see some terrific opportunity for the independent agent channel to grab these accounts from the captive channel where there's a significant amount of this business embedded in, frankly, inferior products and coverages. So we work really hard and closely with our agents through our Agency Insight work to identify great bundled customers in that segment. So it's a good source of new business for us.

Grace Helen Carter
BofA Securities, Research Division

And just quickly another question on Personal Auto. I mean we've talked a lot about your book of business having a frequency benefit relative to the industry, just given a higher percentage of office workers. But I was wondering, if we think about from the severity perspective, I mean, maybe the book of business is more likely to have newer cars with higher technology. I guess just how to think about the net impact of maybe a bit more of a severity impact in the current inflationary environment versus the ongoing frequency benefit, and just kind of how you'll see that playing out over the next few quarters?

John Conner Roche
President, CEO & Director

Again, I'm sure Dick can add some color. But I think as you go through that calculus, Grace, you also have to kind of remind yourself that we have kind of a stronger casualty aspect of our business because our customers basically buy higher limits. So there is some truth to what you're saying is the higher-value customer has better autos. And that translates into, frankly, more premium for us also. But I think some of what offsets what you're talking about is the fact that right now, we're not seeing any real challenges on the liability side, and that's a bigger part of our book of business than, say, below limits, auto folks who are really primarily in the physical damage business .

Operator

The next question is from Meyer Shields with KBW.

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

Just 2 very quick questions, if I can. First, this is across different lines of business. Are you seeing any signs of medical inflation getting worse?

John Conner Roche
President, CEO & Director

Holistically across the -- you're talking about liability and workers' comp?

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

Yes. I'm thinking auto liability workers' comp, mostly.

John Conner Roche
President, CEO & Director

Not any more than what we've contemplated, frankly. We've -- I think it's been a pretty steady level that we've watched it and priced for, but we haven't seen an uptick beyond what -- where our loss trends contemplate.

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

Okay. No, that's good to hear. Second, this is probably a Specialty question, but I just want to get a sense as to how benefits kind of ballpark the potential upside in premium, assuming that some sort of infrastructure bill actually passes?

John Conner Roche
President, CEO & Director

I'm glad you asked about Specialty. Because frankly, I'm anxious to reiterate what we said in our prepared remarks that we are really bullish on the Specialty environment and the execution of our Specialty businesses right now. Specific to the Marine business and some of the businesses that might respond to infrastructure opportunities. Clearly, we're looking forward to that in both surety and marine. But Bryan, maybe you can speak more holistically to really the momentum that we have on all levels in Specialty.

Bryan James Salvatore
Executive VP & President of Specialty

Sure, Jack. And I think I'd probably start by saying I'm really pleased with, like you said, the performance of the businesses and the results for the Q3 period, and really year-to-date, right? The growth that you guys mentioned really cuts across all of Specialty. Certainly, in some of our most profitable lines, that growth was even stronger, double-digit growth. So our most important area is growing at the double-digit level, but growth across the businesses. And then when I layer that with getting of 8% rate quarter-over-quarter, consistently continuing into the third quarter and then the retentions that we've been achieving, well in excess of plan as well as better than last quarter, better than the prior year period. So a lot of our pieces are in a very, very good position. And so with that kind of momentum that we have, I feel really good about our continued trajectory from a growth and profitability standpoint.

Operator

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

Oksana Lukasheva
Vice President of Investor Relations & Financial Planning

Thank you, everybody, for your participation today, and we are looking forward to talk to you next quarter.

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