The Hanover Insurance Group, Inc. NYSE:THG

Earnings Call

Wednesday, May 3, 2023 3:30 PM GMT

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
Senior Vice President of Corporate Finance

Richard William Lavey
Executive VP & President of Hanover Agency Markets

ANALYSTS

Grace Helen Carter
BofA Securities, Research Division

Jon Paul Newsome
Piper Sandler & Co., Research Division

Matthew John Carletti
JMP Securities LLC, Research Division

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

Michael David Zaremski
BMO Capital Markets Equity Research

Robert Edward Farnam
Janney Montgomery Scott LLC, Research Division

Presentation

Operator

Good day, and welcome to the Hanover Insurance Group's First Quarter Earnings Conference Call. My name is Jason, and I will 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
Senior Vice President of Corporate Finance

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 Dick Lavey, President of Agency Markets; and Bryan Salvatore, President of Specialty Lines. 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 available in the Investors section of our website at www.hanover.com. After presentation, we will answer questions in the Q&A session.

Our prepared remarks in 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. These statements can relate to, among other things, our outlook, catastrophe load, economic conditions and related effects including inflation, supply chain disruption, potential recessionary impacts, and evolving insurance behavior.

These statements can also relate to other risks and uncertainties such as severe weather and catastrophes that could affect the company's 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, 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 ratio, 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 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, and good morning, everyone. I will begin with an overview of our first quarter results, a discussion of the accelerated steps we are taking to address the risks posed by extreme weather events, as well as an update on the progress we are making towards our margin recapture plan. I will conclude my remarks with an update on our agency relationships and key takeaways from our recent annual agency conference. Jeff will review our financial and operating results in more detail, and then we will open the line for your questions.

Our first quarter results, excluding catastrophes were strong, consistent with our expectations and supported by the progress we've made to advance the margin recapture plan we established last year.

We are executing price increases slightly above expectations in Personal Lines, while also meaningfully advancing pricing and underwriting measures across the board in commercial property. Throughout the quarter, however, Hanover and the industry experienced heightened catastrophe activity, stemming from severe freeze events and several storms with widespread wind and tornado activity, which turned what was a very solid quarter for our company into one of essentially breakeven operating results.

I first want to take a moment to recognize the efforts of our exceptional cat response team. Our cat team members are working tirelessly to settle claims as swiftly and effectively as possible for our valued customers. The team once again stepped up to do what they do best, providing responsive service to our customers in their time of need and helping them recover from these storms as quickly as possible.

Given the continuing pressure related to changing weather patterns and elevated cat activity, I want to provide more insight into the actions we are taking to address its effects. On our fourth quarter call, we highlighted our past success in managing traditional catastrophe risks by combining disciplined underwriting, data, analytic tools and technology to reduce our micro concentrations and coastal exposures and enhance our pricing for the catastrophe perils.

These actions have resulted in lower exposures to hurricanes and coastal risks over the last 10 years reduced vulnerability to storms along the tornado alley, and have also helped build a significantly more diversified book of business. Across our industry, however, it's abundantly clear that the increasing severity of claims from changing weather patterns, including winter storms necessitates even more aggressive strategies.

While we have significantly reduced our catastrophe concentrations in many geographic markets across our portfolio over the past several years, we are acting with a heightened sense of urgency given the recent events.

With that in mind, we are pursuing 3 key areas of action to respond to these new weather patterns. These actions include property underwriting enhancements, pricing acceleration and more proactive and assertive loss control and risk prevention measures.

On the underwriting side, we are implementing new and revised underwriting guidelines, including even more stringent coastal and wildfire guidelines. Additionally, we are seeking to reduce exposure in specific sectors and geographies, non-renewing risks that lack appropriate winter weather controls and utilizing higher deductibles for certain types of losses with particular emphasis on water damage.

We are also requiring temperature and water sensors on risk with higher property limits in specific industry classes, particularly those with prior losses. And we are leveraging our property segmentation tools, which allow us to model weather perils at specific locations and identify underfunded properties for significant price increases or nonrenewal. This will help reduce portfolio volatility and should drive expected cat ratio improvement.

We are also significantly increasing the use of technology to assist with large property assessments. Infrared thermography, advanced AI risk evaluation tools and drone programs are helping us better recognize and minimize potential hazards and vulnerability to weather-related storms.

With respect to pricing, we are leaning into the hard market to push for even more rate and greater exposure increases, which should help offset elevated cat losses and the anticipated increase in reinsurance costs. Both our personal and core commercial businesses are achieving their highest premium exposure increases in many years.

In the first quarter, core commercial property renewal increases were 11.4%, Property-focused specialty lines achieved an average increase of 16.8%, while our homeowners line achieved an average increase of 18.9%.

Additionally, as of March, automated insurance to value adjustments in Small Commercial are set between 6% and 8% on top of rate, which will push overall future renewal price change even higher.

As part of our focus on loss control and risk prevention, we doubled down on water and temperature sensor installation in 2022, resulting in an increase in avoided property damage and business interruption.

Customer adoption of this technology has grown significantly following Winter Storm Elliott, allowing us to increase the number of protected buildings by 25% over the last few months. While penetration of this technology is still low relative to our overall property portfolio, we are encouraged to see customer adoption continuing to gain momentum, and we have plans to drive greater utilization where exposures to winter weather are most severe.

One of the key learnings we've taken away from our analysis of Winter Storm Elliott, is that a limited number of properties drove a large portion of total losses.

In response to these findings, we are strategically prioritizing larger, more complex risks for sensor installation, which will ultimately generate higher, more significant save rates. Working in partnership with 1 of the recognized leaders of risk prevention technology, we have the infrastructure to scale our existing risk prevention platform and are mobilizing quickly.

Furthermore, we are supplementing these risk prevention initiatives with active agency management and customer education tools and programs. We are also enhancing our robust database of risk managers, building engineers and facility personnel at our larger insured locations, so we can deliver more timely, directed and targeted communications to help our customers prevent losses and/or mitigate damage when losses occur.

Turning to our margin recapture plan, which primarily targets property lines and amplifies the effects of our cat management initiatives, I will note the following: our first quarter ex-cat results underscore the strong progress we've made in all 3 segments of our business.

In Personal Lines, our overall average price increase was nearly 13% across the account, driving premium growth of 10.1% in the quarter. Renewal price increases were slightly above expectations with acceleration in both home and auto.

Retention remains strong, and we believe that there is additional room and market support for further price increases. And in addition, new business pricing continues to be very robust, and we will be very disciplined to ensure that our profitability objectives are not compromised in any way.

An increasing number of Personal Lines carriers, public and mutual are taking significant rate increases on both renewals and new business, resulting in an even stronger hard market in Personal Lines.

Regulators in most states are more understanding of rate need. We revised our Personal Lines filings and pricing expectations upward relative to our view we shared in January. In auto, we now expect to achieve 13% to 14% renewal price increases in the second half of the year, which is about 2 points above our original expectations.

Home renewal price should be around 20% for the remainder of the year, which is 2 to 3 points higher compared to what we originally planned. As a result of these actions, we remain committed to delivering meaningful loss ratio improvement in Personal Lines in 2023, and bringing this business back to target profitability in the latter part of 2024.

In core commercial, we continue to execute on a combination of rate and exposure increases as well as targeted underwriting actions during the quarter. Price increases averaged 11.5%, reflecting an uptick from the fourth quarter. Retention is at target levels, providing room for even higher price increases going forward.

We remain focused on further differentiating our approach to pricing by leveraging granular segmentation tools to push additional price increases in the areas we need it most with emphasis on property. We are pleased to see our pricing and underwriting actions starting to earn into the book and show itself in our results, as demonstrated by the solid underlying first quarter performance in core commercial.

We are off to a strong start for the year in specialty, as demonstrated by our excellent first quarter results. Price increases remained healthy, coming in at nearly 13% for the first quarter, led by property lines. The pricing environment in specialty remains firm in the majority of our markets, with increases in the quarter supported by strong exposure growth.

Specialty delivered an ex-cat combined ratio of 83% and growth of 7.1%, despite some ongoing segmentation and underwriting actions. The diversified nature of this book with 9 different businesses in over 20 product areas continues to be helpful in acting as a buffer to property and cat exposure.

At the same time, we continue to execute on our specialty strategic objectives. During the quarter, we further enhanced our offerings with the launch of a new product for miscellaneous professional liability E&S market. This product is focused on providing E&O coverage for the small to midsized firms that we had previously not been positioned to write and will significantly enhance our ability to align with our distribution partners on a larger portion of their NPL business.

Our top-notch team has decades of related experience, and we are looking forward to the opportunity to drive profitable growth in this segment, as we provide this valued and sought after offering to our agents.

We also continue to leverage and actively market our newer capabilities such as Retail E&S, Cyber and Specialty General Liability. At the same time, we are further promoting our industry specialization, primarily by identifying areas of superior strength in specific regions and distribution points and leveraging them for growth in key sectors.

The outstanding agency partnerships we have cultivated over many years are serving us exceptionally well, as we execute on our underwriting and pricing imperatives. It's more critical than ever to have an experienced and capable distribution network to address and overcome challenges and to attract the right opportunities.

Last week, we held our Annual President's Club Conference, a gathering of over 120 of our largest, most critical and successful agent partners. We conducted important executive meetings focusing on our capabilities, industry trends and pricing needs, and how we can help our agent partners more effectively serve their customers during this very dynamic time.

We came away from these meetings extremely encouraged about our prospects and with several key takeaways. First, it is clear that agent partners are more keenly focused than ever on improving their efficiency through more effective operating models, staff optimization and the use of advanced analytics and technology, seeking to enhance EBITDA margins. And we are incredibly well positioned to partner with them on their journey.

Second, in light of increasing cat losses industry-wide and the impact of inflation, our agents understand the need for increased pricing, more focus on risk prevention and enhance customer education and communication. Agents fully recognize the critical role they play in our efforts to advance customer adoption of risk prevention and mitigation tools. And they are committed to partnering with us to make this important mindset shift and execute on risk control initiatives.

And third, our differentiated Personal Lines, core commercial and specialty offerings continue to be in high demand among the best agents in the country, as they acquire midsize and smaller agencies who have considerable amounts of this business and also look to continue developing areas of specialization.

Our partner agents are particularly invigorated by the broad and expanding product capabilities in our specialty portfolio, enabling them to strengthen the depth of their customer and Hanover relationships, as they write more lines of business with us.

Additionally, our TAP Sales platform offering, combined with our robust product capabilities and specialized industry verticals, sets us apart from many competitors and enables continued growth opportunities. Ultimately, we came away from the event with more conviction that our agent partnering approach represents a greater competitive advantage than ever, and that our strategy is further resonating with them, which positions us exceptionally well going forward to drive strong, sustained profitability and deliver outstanding value for our shareholders and other stakeholders.

We began 2023 with the benefit of several quarters of strong price increases that will continue to earn into our book of business, as we move throughout the year. We are working hard to mitigate our exposure to changing weather patterns and extreme weather events that are elevating catastrophe losses across the P&C industry. And we are confident that the actions we are taking will generate positive results. We are making excellent progress on our margin recapture plan with solid positive trajectory in 2023 and further gains expected in 2024.

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

Jeffrey Mark Farber
Executive VP & CFO

Thank you, Jack, and good morning, everyone. Our consolidated results for the first quarter reflected elevated catastrophe losses, which led us to exceed our cat assumption by approximately $112 million or about 8 points. First quarter catastrophe losses stem from over 20 events, including severe freeze events in February and the beginning of March as well as widespread wind and tornado activity, particularly in mid- to late March.

According to preliminary industry estimates, this first quarter was one of the highest for catastrophe losses over the last 10 years. Excluding catastrophes, we've performed in line with our expectations, registering an ex-cat combined ratio of 91.7%. Our expense ratio for the first quarter of 2023 was 30.7% compared with 31.1% in the prior year quarter, keeping us on track to achieve our expense ratio target of 30.8% for the full year 2023.

Prior year reserve development was favorable in the quarter by $3 million, primarily attributable to specialty as well as workers' compensation and core commercial lines, partially offset by unfavorable development in Personal Lines and commercial auto.

Turning to a discussion of our underwriting results by segments, starting with core commercial. Our combined ratio, excluding catastrophes, was 92.1% in the first quarter of 2023, above the prior year quarter, but in line with our expectations. Core commercial current accident year loss ratio, excluding catastrophes, was 58.5%, 1.1 points higher than the year earlier period, driven by higher property loss severity in commercial auto.

The underlying loss ratio in core commercial was in line with our expectations in the quarter. We were also pleased to see the frequency of large losses in our CMP business come down from elevated levels seen in the second half of 2022. Performance of other major lines within core commercial was also in line to slightly better than the prior year quarter results.

Turning to specialty. Our combined ratio, excluding catastrophes, decreased 2 points from the prior year quarter to 83%, driven by favorable prior year reserve development and underlying loss ratio improvement. Specialty favorable development stemmed primarily from claims-made management liability business, and to a lesser extent, health care and surety businesses.

The Specialty current accident year loss ratio, excluding catastrophes, improved by about 1 point from the first quarter of last year, primarily reflecting lower-than-expected losses in Marine as well as the benefit of increased rates earning in.

Turning to Personal Lines. The ex-cat combined ratio was 96.2% and primarily reflected higher prior and current accident year auto losses. Personal Auto, unfavorable prior year development of $7.9 million or 2.4 points was impacted by loss activity, primarily in the third and fourth quarters of last year, due in part to delayed reporting of third-party claims in our property damage coverage.

Home and Other unfavorable prior year development of $3.7 million or 1.6 points was primarily related to liability and reflected additional new information received on a couple of larger claims and a large unfavorable court verdict pertaining to a 2020 fatality claim.

Personal Lines current accident year loss ratio, excluding catastrophes was 68%, primarily reflecting continued inflationary pressures at auto property and homeowners. Relative to our expectations, the underlying ratio in the quarter was about 1 point higher. Personal auto current accident year loss ratio, excluding catastrophes, of 75.8% was slightly above our expectations with higher severity, mostly offset by lower accident frequency in the quarter.

The increased severity stemmed from the effect of continued inflation on repair parts and labor rates and increased car rental costs stemming from extended cycle times. In home, some large fire loss activity drove the loss ratio to 56.9% which was slightly above our expectations.

While the cost of lumber has come down and some other material costs have flattened over the past several quarters, labor costs continue to be elevated. As a result, we are continuing to lean into the use of rate and non-rate tools such as home evaluations and ITV increases in our pricing.

We remain pleased with the execution of our margin recapture plan in Personal Lines. We continue to achieve exposures and rates slightly above our expectations and are capitalizing on strong retention and a hardening market to push rates higher.

Now moving on to a discussion of our investments. Net investment income came in at $78.7 million, $1.8 million higher than the prior year quarter, helped by higher bond and reinvestment rates and growing operational cash flows, partially offset by partnership income, which was approximately $10 million lower than the prior year quarter.

Partnership returns can fluctuate from quarter-to-quarter. Partnerships produced $5 million versus $15 million a year ago and our expectations of roughly $7 million per quarter in 2023.

What's important, however, is that for the vast majority of our portfolio, the current higher interest rate environment continues to provide an accumulating benefit to net investment income and allows us to reinvest at attractive market yields without compromising the credit quality of the portfolio.

Our investment portfolio is high quality, diversified and thoughtfully built with robust growing yields. The portfolio is well laddered with modest allocation to risk asset classes and benefit from significant issuer diversification. Given the recent attention on the global banking industry and investments related to commercial real estate, I would like to cover the composition of our investment portfolio and our limited exposure to these 2 areas.

The banking sector represents approximately 10% of our total invested assets with an average rating of A-. The portfolio includes a mix of U.S. money centers, U.S. regionals and foreign banks with no single issuer representing greater than 0.4% of total invested assets. We have limited investment exposure to Silicon Valley Bank, which represented $20.8 million in fair value at year-end 2022 and $14.8 million in fair value on March 31. Additionally, we do not have any investment exposure to Signature Bank or any other distressed banks.

We own $835 million of commercial mortgage-backed securities. The portfolio is very high quality, supported by an average overall rating of AAA. Within the portfolio, approximately 91% is rated AAA and 5% is rated AA, underscoring our confidence in the quality and strength of these investment holdings. Our holdings are diversified by property type, geography and vintage.

Additionally, the CMBS investments have significant credit enhancements of 30% or more, which allows the securitization to withstand substantial underlying defaults with no losses to our tranche.

Commercial mortgage loans represent approximately 4% of total investment assets. The loan-to-value ratio on average across our entire commercial mortgage loan portfolio is 58%, demonstrating an ability to withstand downside from price declines in commercial real estate.

We recognize that in general, the level of uncertainty related to investments is currently higher than much of the last decade and investor concerns may continue to migrate from 1 asset class to another. However, our investment portfolio has proven to be very resilient. We have a relatively predictable stream of cash inflows and outflows and generally hold most assets to maturity. Overall, we feel very comfortable with the investment risks and confident in the quality of our portfolio.

Looking at our equity and capital position, our book value increased approximately 2% on a sequential basis to $66.89 in the first quarter. We remain disciplined and balanced on our capital management priorities and committed to being strong stewards of our capital.

I'll conclude my prepared remarks by saying that despite the industry-wide challenges we face, I am confident the actions we are taking put us on a strong trajectory to deliver solid financial and operational performance in 2023, with the expectation for excellent performance in 2024 and beyond.

Our planned cat load for the second quarter of 2023 is 6.0%. We are aggressively focused on executing our catastrophe management initiatives and are pushing harder on our margin recapture plan to continue to drive superior returns for our shareholders. The underlying fundamentals of our business are strong. Our team is exceptional, and we are well positioned to continue executing against our ambitious strategic priorities.
With that, we will now open the line for questions.

Question and Answer

Operator

[Operator Instructions]. Our first question comes from Matt Carletti from JMP.

Matthew John Carletti
JMP Securities LLC, Research Division

Jack, you spent a good amount of time there talking about a lot of the things you're doing to tackle the elevated weather and catastrophe losses. Elliott was kind of a very different issue than kind of what we saw this quarter. I was just wondering, if you view kind of winter weather or spring weather is kind of being equal things you need to tackle? Or if you think one is maybe more persistent and more of an issue than the other? Is it less of an issue on year-end and more of just cat happen when they happen and not in a straight line?

John Conner Roche
President, CEO & Director

Yes. Thanks, Matt. There's no doubt, as we said in our prepared remarks that the type of winter storms that we encountered, starting with Elliott, but also to a lesser degree in the first quarter are different in that they're not as responsive to the property aggregation work, we've done and the elimination of some micro concentrations. And so in that regard, that rises to the top of our list of areas that we really want to improve upon fast.

Stating the obvious, all of that was accentuated by and exacerbated by the inflation and supply chain issues that continue. So it's a bit of a perfect storm in terms of the cost that we have to incur.

So as we said, we're going hard at this. We had momentum, frankly, in some of the areas of risk mitigation versus just loss reimbursement. I think in a lot of ways, Elliott and the subsequent storms give us an opportunity to advance those more quickly.

And also, if you look back at Elliott, roughly 250 commercial customers made up an outsized proportion of our losses, which allows us, I think, to be even more surgical about how we go after that versus the broader catastrophe kind of terrain. So we'll continue to work very, very hard on the broader catastrophe management and including pricing and terms and conditions, but we are definitely putting winter storms at the top of our list to go at very surgically.

Matthew John Carletti
JMP Securities LLC, Research Division

Great. And then you mentioned kind of on that risk mitigation point, and you talked about working with your agents to get your insureds on board. What does that look like? Is it a -- if you install this, there's policy discounts? Is it, you need to install this, or you'll be nonrenewed? Or is it Hanover will pay for it or provide some funding for you -- the customer to install it and carry on? Kind of how does that -- how do you incentivize your customers to install these things?

John Conner Roche
President, CEO & Director

Yes. Our plan of attack is going to include all of that. It really does start with what did we learn about the type of customers, why weren't they able to respond to a pretty well advertised freeze that came across the country and hit almost every state in the union.

So we've been pretty firm about which customers do we think really did not -- were not responsive enough from a risk management standpoint. There are certain sectors, whether it be educational institutions and schools or certain types of real estate accounts that frankly are more susceptible to that type of event.

So we are kind of tiering it as where do we believe that maybe we should kind of take some chips off the table relative to some of our portfolio concentration, where can we lean in hard and put some incentives in place that say, if you put these controls in place, we will give you some pricing consideration, which these days means less of an increase, not a decrease. And then we'll contemplate what kind of deductible is appropriate for the water damage based on the responsiveness at the customer level.

And I think last but not least, as we look at this going forward, we are trying very hard to get as much price as we possibly can, particularly where the elevated limits really aren't being fully contemplated with the new severity. Even after the inflation eventually starts to subside some, we are really focusing on making sure we have the proper insurance to value and pricing for the kind of where the severity is presenting itself.

Matthew John Carletti
JMP Securities LLC, Research Division

That's great. And then one, just if I could kind of shifting topics to think about Personal Auto and a little bit just a very high-level question.

Just as we look at -- obviously, there's a lot of inputs into the cost pressures there that we've talked about on past calls. I'm just wondering as you look at kind of extended repair times and other things. How much of an impact is kind of the growing presence of electric vehicles having? I would think your book might have an okay proportion of mass affluent and then being more expensive vehicles. Does that kind of shift over time as the industry, the fleet on the road goes that direction? Is that contributing to this? Or is it just a really, really small issue?

Jeffrey Mark Farber
Executive VP & CFO

Matt, this is Jeff. So that latter point, it really is not a material issue to us at that point. There's certainly elevated costs for some of those types of vehicles. It's just really not that big a part of our portfolio, frankly. And so I wouldn't say that's the center of our bull's eye.

I'll let Dick comment on the PL trends real briefly. But what I would say in the macro is the industry, as you see, is trying to get their arms around, the impact of inflation and supply chain and, frankly, labor shortages that are dragging out some of these claims and making inflation a little bit more stubborn than maybe it otherwise would be.

I think we and most of the industry has just had enough time now to get their arms around all the moving parts that contribute to getting your loss trend analysis, right? So Dick, maybe you could just add to your point.

Richard William Lavey
Executive VP & President of Hanover Agency Markets

Before I do that on the electric vehicle point, indeed, it's not yet showing through. But it is one we're watching closely because we do know those repairs, the cost of the battery, the materials actually have there an elevated costs. So that's one that I think in the future, we'll watch, and we'll make its way into the pricing.

A loss trend in general, the themes are still similar, the ACV or the cash value of used cars, new cars, you're seeing some of the wholesale metrics and KPIs coming down, but that's not yet making its way into the retail side. So they're still elevated, but coming down. The real cost pressure is coming on the repairable side.

So as Jack mentioned, parts -- the labor component is quite sticky. And even as parts and supply chain come down, the labor component probably persist. So we are segmenting our losses very closely to understand how they differentiate and that helps us understand how those losses will develop into the future. But many of the themes stay the same.

So therefore, the pricing, as you see, we're getting in the book, we will be over loss trend in the second half of the year, and which gives us confidence that we're going to be able to get on top of it.

Operator

Our next question comes from Paul Newsome from Piper Sandler.

Jon Paul Newsome
Piper Sandler & Co., Research Division

Maybe some additional thoughts on what all of these efforts you're doing to reduce cats will have on the top line? Are we seeing that there'll be a meaningful shift in certain lines of business from just a policy perspective? Or is this -- I mean maybe some sizing of how much the nonrenewals might be?

John Conner Roche
President, CEO & Director

I think because, Paul, we have been really continuing to cull out certain subsectors of our business, particularly in middle market, that I'm not anticipating a major drop-off in the growth trajectory. As you can see, particularly in middle market, our growth is substantially about pricing and not really about growing new exposures, whereas in small commercial and specialty we're trying to grow the book of business beyond just what the pricing in the marketplace is.

So we're -- I think this is a significant actions that we're taking, but the marketplace, as you can expect is getting firmer by the moment. And that's allowing us to get done what we need to get done without removing a ton of business out of the system. I'm hopeful that in some of these subsectors will get more adoption and more compliance with what we're doing. But frankly, if we don't, then we will be more than happy to lose a point or 2 of growth to get the improvement that we're looking for.

Jon Paul Newsome
Piper Sandler & Co., Research Division

I guess somewhat similarly on the Personal Line side, how much are we talking about geographic mix shift versus other efforts, fairly concentrated in a couple of states? Is that really about getting out of those concentrations? Or is there -- is it much more simplifying?

John Conner Roche
President, CEO & Director

Well, I don't think you're oversimplifying it, but I think that, as you know, we're in 20 states today, and we're pretty substantially driven by Michigan and Massachusetts, despite all the diversification we've done in those other states. We outperform in those states. We're closer to target returns in those states.

When we look at the catastrophe experience, we have not been outsized in those states vis-a-vis our writings or at least in our estimate of lost share to market share. So I think in the present tense, Paul, you won't see us do anything dramatic from a geographic shift.

And our diversification as a business allows us to think more broadly than just our Personal Lines footprint, right? Heavy emphasis on growing specialty and specialty casualty and small commercial. So I think that buffers the fact that we can continue to diversify the firm without doing something dramatic with our Personal Lines' footprint in the short-term.

Operator

Our next question comes from Mike Zaremski from BMO.

Michael David Zaremski
BMO Capital Markets Equity Research

Lot of great color. A lot of the discussion has been on the inflation side -- I still think on the property side of the portfolio. And by the stock reaction, I think investors are getting comfortable that pricing move in the right direction and you're taking a lot of corrective actions that will have pace.

But I'm just curious, any insights on the liability side of the equation, maybe on commercial lines, is loss cost trend there inching up to? Or are things fairly stable or maybe even better than expected? It looks like reserve releases were -- have been a little bit light in the commercial segment, but maybe that's just because of the property side, too.

John Conner Roche
President, CEO & Director

Mike, this is Jack again. I think that's a really appropriate question at this stage of where we are in the business because there's obviously a lot of appropriate focus right now on property, cat and non-cat based on the volatility that we've experienced. And so that is really always at the top of our list in terms of priorities.

But as we think about our growth into the future, we're also being very mindful of what is happening kind of behind the scenes in liability trends. And it varies across the portfolio, and I won't go too far with this. But there are some areas in specialty, for example, where you know that as things mature management liability in some of those areas. The results have been a little better than we expected, and we've been able to recognize that.

There are other areas and probably commercial auto and to a lesser degree, Personal Lines liability where you're starting to see some inching up of those liability trends pretty consistent with what our expectations were, but there's evidence that as the courts kind of fully reopen, as the cases make their way through the system, there is clear evidence to us and I think the industry that litigation trends and social inflation will emerge to be something that the industry has to reckon with.

So what I'm really proud of is our team is all over these trends, and why you can't be perfect. They're much more focused on anticipating where things are going based on some metrics that we've established in each of these areas that are about where the litigation is manifesting itself and how that's turning into kind of severity trends versus just reflecting on past trends. To some degree, are hard to analyze coming out of the pandemic and the most recent environment.

So overall, liability trends are creeping up, I think, for the industry, and it's something that certainly we're watching very closely.

Michael David Zaremski
BMO Capital Markets Equity Research

Okay. That's helpful. And my final question on the reinsurance side, and I'm cognizant your renewal is coming up, so maybe you don't want to tell us your exact thoughts. But maybe you're willing to shed more light than others, given, I believe, Hanover's reinsurance program has been more profitable for reinsurers and kind of the average -- your average peer. Do you expect the reinsurance renewal to have a potential impact on the income statement as we model things out? Anything we should be thinking about? Or is it kind of a relative nonevent?

Jeffrey Mark Farber
Executive VP & CFO

So as you mentioned, Mike, 7.1% is our property renewal, both the per risk in the cat program. And we were fortunate in 2 respects or maybe 3. Number one, we did a lot more purchasing of cat -- both with the cat bond and higher portions up the top.

At the 7.1% renewal last year, we buy on a 3-year basis, and we haven't used that treaty since 2005. So the reinsurers have done well on that. We also were fortunate because we could have visibility to the [1/1] renewal. So when we established our plan and our guidance, we built in very extensive increases in the cat program and the property program.

So we're very optimistic that we can renew at the same attachment point, and we've built into our guidance a hefty increase in that program, which we believe to be achievable.

Operator

The next question comes from Grace Carter from Bank of America.

Grace Helen Carter
BofA Securities, Research Division

You have mentioned over the past couple of quarters already some re-underwriting actions in certain middle market accounts like you just mentioned. I was curious to which the same account sort have driven the pressure and attritional losses have also driven pressure in catastrophe losses, like, if there should already be any sort of benefit coming through the portfolio on the catastrophe loss side just given the underwriting actions you've already started to take over the past several months?

John Conner Roche
President, CEO & Director

Yes, Grace, this is Jack. I'll make a couple of comments, and I'm sure Dick will want to chime in here.

But there's always an intersection when you're managing down your limits on the larger side of your business to catastrophes, right? I mean catastrophes show up in a variety of different places. And the more limit you have, the more likely you are to catch some large losses when those events happen.

So I can't say that precisely, we can go back and say these are the accounts we got rid of, and we would have had a loss there or that they're going to -- by nonrenewing them, we're going to automatically make ourselves less susceptible. But from a modeling perspective, there's clear overlap in the AALs that we see running through the models based on the actions that we've been taking in middle market.

Richard William Lavey
Executive VP & President of Hanover Agency Markets

Yes, exactly. Great. So I would just say in certain geographies, that is your statement is more true. Some pockets of the Midwest and some of the Northeast territories, where we took some action to re-underwrite some property-centric, real estate-centric classes, food manufacturers, some schools, right? Those are some of the same classes that potentially have been hit in the cat -- on the cat side. So it varies by geography this the way I would add some color to.

Grace Helen Carter
BofA Securities, Research Division

Okay. And on specialty lines, it seems like the gap between pricing and premiums written growth grew a little bit this quarter. I know you all mentioned some resegmenting and underwriting actions in the prepared remarks. I was just curious, if you could give us a little bit more color on those and where growth might go for the rest of the year?

John Conner Roche
President, CEO & Director

Yes. I'm sure Bryan will want to chime in here. But overall, as we said in our prepared remarks, we really are quite happy with the way specialty is developing not only in terms of the results and our ability to continue to grow and diversify the firm, but the impact that it's having on our agents and the value proposition that we present.

But inherent in all of that, as you're seeing, I think, with some of our competitors, you have to have a good healthy offense and defense in your game plan. That's -- specialty can bring additional volatility. And so we're on top of both where we're offensive and where we're more defensive based on where the market is guiding us.

So Bryan, maybe you can chime in there.

Bryan James Salvatore
Executive VP & President of Specialty

Yes. I mean first also to echo that; we are pleased with how specialty overall is performing both from a profitability and a growth perspective. And I would add that I'm pleased with the first quarter new business results too, good growth there, that was well in line and better than our expectations.

When I think about where we are driving that growth, we really are staying focused on the areas that are not only very profitable for us, but where the pricing is holding up in the way that we feel good about it, right? So a number of our areas in terms of that is property oriented, but not all, the pricing remains strong, and so we're growing disproportionately there.

Where we see a little bit of rate erosion, we're going to be prudent, right? You probably know that if you look at the some of the professional and executive lines and what's called quite a bit is a publicly traded D&O type business when rates have had fallen over a couple of quarters precipitously. And we're watchful of that. And we saw some of that work its way into our boat skews private and smaller to middle market.

When we see that, we're going to take a pause and look at it and try to hold our pricing closer to trend. And so if that causes us to lose a little ground there, we're okay with that. Overall, the book grew. I like the fact that it grew in the areas that we think are the best places to be growing right now.

Operator

Our next question comes from Bob Farnam from Janney.

Robert Edward Farnam
Janney Montgomery Scott LLC, Research Division

I have kind of a nuance question in the margin of the capture plan and Personal Lines. So both Jack and Dick, you mentioned the kind of the rates for both auto and homeowners are going up maybe a few points more quickly than you expected for the back half of the year, and it sounds like they're ahead of loss cost trends.

So the question is, do you see the margin improvement coming more quickly because of the change, the higher rates, or is it just a matter of -- it takes time to earn in, but maybe by the end of 2024, the margin improvement overall will be more than you expected because of the rate changes. Just kind of curious what your thoughts were on that.

John Conner Roche
President, CEO & Director

Bob, this is Jack. I think at the highest level, so much of that depends on where the inflation and supply chain issues take us, right? They are more stubborn than I think anybody expected. Eventually, I think we all know that, that should come down and that should start to be part of the margin improvement, but we frankly can't depend on it. If we've learned anything over the last 3 or 4 quarters is that we have to price as if these are the costs that we have to incur.

And so in that scenario, I think that the increased pricing that we're experiencing at least covers any gap that might have been created by the inflation being more stubborn. Our hope is that by the back half of the year, we're getting more price than we originally planned for, and the trends themselves start to come -- and come back the other way. So I think to be any more precise than that is probably -- crystal ball than we do.

Operator

The next question comes from Meyer Shields from KBW.

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

So a quick question for Jeff to start with. So the second quarter cat load or anticipation is still down year-over-year. I'm just hoping you could break that down between sort of the external loss trends of weather inflation and the internal exposure and rate components?

Jeffrey Mark Farber
Executive VP & CFO

You're referring to the second quarter, 6% load?

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

Yes, versus last year, 6.9%.

Jeffrey Mark Farber
Executive VP & CFO

Yes. So we use our models. We've got a best-in-class models. And it happens to be down in the second quarter because of stuff from other quarters. Overall, the cat load is up from 5% to 5.1%. I'd have to go back and see what was driving it down for last year's second quarter, this year second quarter because it's just the particular perils that are modeled and it's not indicative of rate versus loss trend per se.

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

Okay. Understood. And then a question for Jack. I'm not in any way questioning the margin focus. But in the medium term, is Hanover interested in building a specialty property underwriting capability so that it can address what seems to be a growing need among the agents?

John Conner Roche
President, CEO & Director

Meyer, to be honest with you, I think we have other opportunities to grow our firm and to do that in a way that further diversifies us. We have probably in the top 25 companies as a heavier property mix than most. And so I think optimizing our current portfolio relative to the property market and taking full advantage of the reset that is going on, it's a prudent strategy. And we get motivated to look at growth opportunities that, frankly, help our kind of overall mix and make it less property-centric over time. So we're probably not one of those markets.

Now remember, in our specialty business, we have a very significant and very profitable marine business, which is almost exclusively property oriented. We have our Hanover industrial business that is all property and very sophisticated kind of lower end of the ACR market. But I don't see us really leaning into like the layered property market or -- and we do, Bryan, have a portion of our E&S business is in the pretty sector also. To that degree, we are participating in some of that firming market.

Bryan James Salvatore
Executive VP & President of Specialty

And those areas for us have performed quite well over the last year or so. And those areas do continue to grow for us. So -- while we're trying to be very balanced where the growth comes from and have that both mix evolve, the areas that are profitable for us, like the ones that Jack mentioned, are continuing to grow for us.

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
Senior Vice President of Corporate Finance

Thank you very much, everybody, for a very good discussion today. Looking forward to talking to you next quarter. Bye.

Operator

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