The Hanover Insurance Group, Inc. NYSE:THG

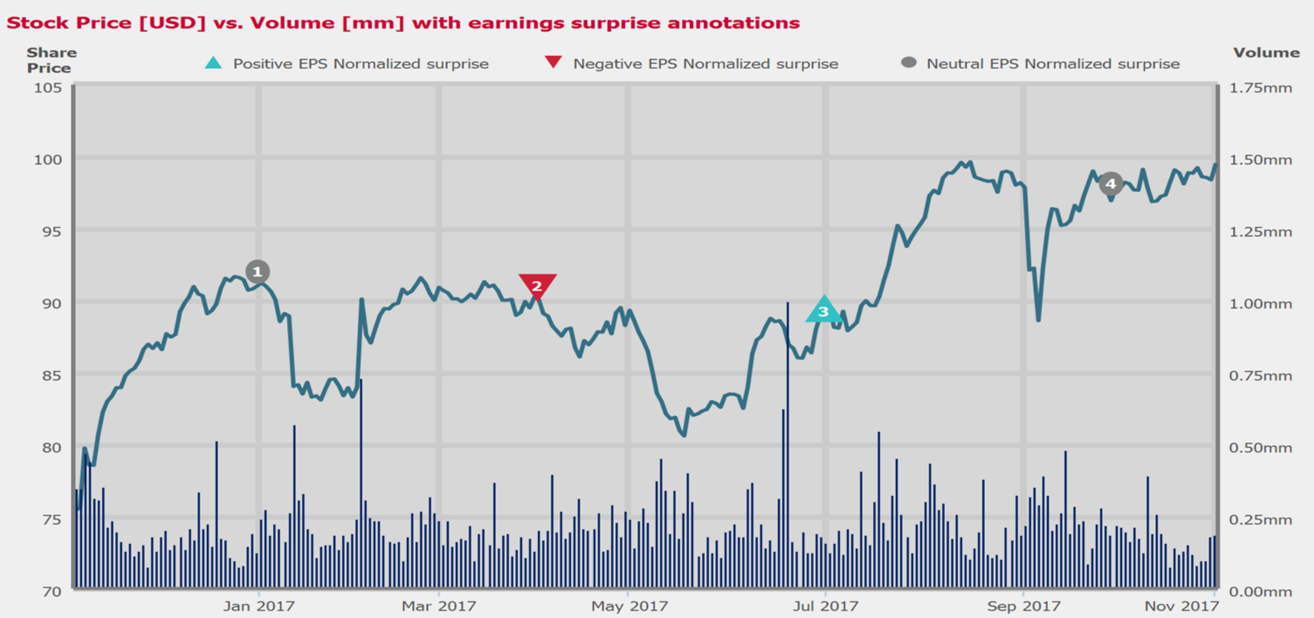
FQ4 2017 Earnings Call Transcripts

Thursday, February 01, 2018 3:00 PM GMT

S&P Capital IQ Estimates

	-FQ4 2017-			-FQ1 2018-	-FY 2017-	
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	ACTUAL
EPS Normalized	1.85	2.00	▲8.11	2.09	4.60	4.74
Revenue (mm)	1157.80	1173.20	▲1.33	-	4942.80	4958.20

Currency: USD
Consensus as of Feb-01-2018 1:15 AM GMT



	- EPS NORMALIZED -		
	CONSENSUS	ACTUAL	SURPRISE
FQ4 2016	1.03	(0.46)	NM
FQ1 2017	1.72	0.95	▼1 (44.77 %)
FQ2 2017	1.55	1.69	▲2 9.03 %
FQ3 2017	(0.63)	0.11	NM

Call Participants

EXECUTIVES

Bryan J. Salvatore
Executive VP & President - Specialty

Jeffrey Mark Farber
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John C. Roche
CEO & President

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Presentation

Oksana Lukasheva
Vice President of Investor Relations

Good morning, and thank you for joining us for our fourth quarter conference call. We'll begin today's call with prepared remarks from Jack Roche, our President and Chief Executive Officer; and our Chief Financial Officer, Jeff Farber. Available to answer your questions after our prepared remarks are Dick Lavey, President of Agency Markets; John Fowle, Chief Executive Officer of Chaucer; 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. Our prepared remarks and responses to your questions today, other than statements of historical facts, include forward-looking statements, including our guidance for 2018. We caution you with respect to reliance on forward-looking statements and in this respect, to refer you to the Forward-looking Statements section in our press release, Slide 2 of the presentation deck and our filings with the SEC.

Today's discussion will also reference certain non-GAAP financial measures such as 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 C. Roche
CEO & President

Thank you, Oksana. Good morning, everyone, and thank you for joining our call.

This morning, I will provide an overview of our performance in the quarter and the year as well as reinforce my confidence in our go-forward strategy. Jeff Farber will review our financial results in detail, including specific financial guidance for 2018, and then we will open the line for questions.

Overall, we are very pleased with our fourth quarter and full year results. Our performance reflects the building strength of our company's capabilities and the effectiveness of our strategy. Our fourth quarter net operating income of $2 per share was solid and in line with our expectations. Our full year results of $4.74 per share reflect the underlying financial health of our company. While catastrophe losses adversely affected our earnings for the year, our ex-catastrophe performance was strong with a 90.8% combined ratio, in line with our original guidance.

Additionally, we made important strategic progress building on the positive momentum we have established across our business. Our full year operating ROE of 8% was significantly impacted by third quarter catastrophe events, while our fourth quarter ROE was strong at 12.4%. Normalized for the catastrophe losses and its unrelated benefits, our full year ROE of 11% more accurately reflects the earnings power of our company. We believe we can continue to generate strong growth while maintaining attractive profit margins and generating double-digit returns on equity.

Our results show the continued benefit from our key earnings improvement levers across the enterprise: first, as our younger businesses in newer states have matured and our underwriting execution has enhanced, we have improved diversification and overall operating performance; second, we are achieving meaningful expense benefits after years of actively investing in our businesses.

Our domestic expense ratio improved by approximately half a point in 2017, primarily driven by the leverage of fixed costs on growing premiums and the expense savings initiatives we undertook last year. We expect additional expense ratio benefits on a full year basis in 2018. All of these levers enable us to be build earnings momentum despite challenging market conditions. We saw the benefit of these key levers across our businesses in 2017.

In Personal Lines, we grew 8% with a combined ratio of 94.1% and an ex-cat combined ratio of 89%. Our growth during the year was driven by renewal premium gains, including rate increases and improved retention.

New business also was strong, with continued positive momentum from our account-based Platinum product and deeper agency penetration. At year-end, our total account business represented 83% of our Personal Lines book and 87% of our new business.

We continued to build an increasingly strong brand in the account business, further differentiating our company in the Personal Lines space. Account business increases the lifetime value of our customers and allows us to increase penetration with customers who have more sophisticated insurance needs. Going forward, we will opportunistically pursue rate in certain states as we continue to balance profit and growth opportunities. As a result, we expect our overall Personal Lines growth to be in the mid-single digits in 2018.

We generated solid growth in our Small Commercial business as well. We increased net written premiums by 7.4% during the year, delivering above target returns and creating meaningful expense leverage. Our growth in the Small Commercial segment reflects the positive impact of price increases, improved retention and increased new business. The combination of our Small Commercial and Personal Lines portfolio now represents well over $2 billion of stable, high-quality business, with strong retention and high returns on capital. We grew more selectively in middle market this year due to the more challenging market conditions and actions taken in some underperforming classes. We are pleased with the impact of these profit improvement actions.

We believe that strong underwriting execution and a shift to more profitable risk classes will continue to drive improvement in our middle market portfolio.

Our Domestic Specialty business performed well during the year, despite an unusually high incidence of large losses in certain property lines. Maturing businesses, in particular, professional and management liability, continued to contribute to overall growth and profit. At the same time, we remain cautious in our approach to recently challenged areas, including contract surety and the program business. With that said, we feel good about the progress we have made in these segments.

Overall, we expect our Domestic Specialty business to continue to grow its contribution to our top and bottom line as we increase our agency penetration with specialized capabilities in markets where we can compete most effectively.

With strong growth in Small Commercial and continued underwriting refinements in Specialty and middle market, we expect our Commercial Lines business to grow in the mid-single digits in 2018.

Chaucer also performed well, delivering net written premium growth for the year of 4%. New business initiatives, including growth in our treaty business, continued to help offset business we moved away from in markets under the greatest pricing pressure.

In the fourth quarter, net written premiums increased 12.9%, reflecting the timing of certain new initiatives. Fourth quarter growth also reflects favorable impact of foreign exchange movements as well as premium increases on loss-sensitive accounts in our treaty business.

In 2018, we expect net written premium at Chaucer to essentially be flat, depending on the market environment as we continue to prioritize profitability over growth.

We are satisfied with Chaucer's overall ex-cat combined ratio of 90% in 2017, given the challenging market environment. Following the high third quarter catastrophe losses, there are signs that the market sentiment is starting to change somewhat and we remain cautiously optimistic. We saw price increases in the market on January 1 renewals and catastrophe-affected classes, and we are seeing signs of market stabilization in other classes. There also is evidence of rate increases in the casualty markets, following many years of industry-wide price decreases, increased losses and declining prior year reserve releases.

Overall, we are pleased with the momentum we have established across our business. We continue to execute on our key strategic priorities: delivering strong growth, exceptional underwriting and significant expense savings. We fully expect these actions will position our company to continue to generate sustainable earnings growth over time.

Looking ahead, we believe we have what it takes to further distinguish our company in the marketplace, positioning our organization as a premier property and casualty company while providing exceptional insurance solutions in a dynamic world. We have the talent and the organizational commitment to deliver for our partners and our customers every day, and we have a distinctive business model, one focused on building deep mutually-beneficial partnerships with a select group of the best independent agents in our business.

As we set out to deliver on our 2018 plan and hit our financial targets, we are focused on 3 operating principles: first, we will leverage the strengths of our agent-centered distribution strategy to grow our highly profitable businesses, most notably our Personal Lines and Small Commercial businesses. In Personal Lines, we will focus on the customer segments with more sophisticated and diverse insurance needs, leveraging our prestige products. On the Commercial Lines side, we will deliver more relevant industry solutions to our agents in the sectors that are more important to them, helping our partners address a wider range of their customers' evolving needs while helping us grow in desirable business segments.

Second, we will leverage our specialized capabilities to further strengthen our overall product offering. We will continue to expand our capabilities in domestic and international markets while maintaining underwriting excellence and our leadership position in our preferred markets.

Third, we will continue to drive innovation throughout our organization. We are working with our agenting partners to identify opportunities to develop new business models and targeted underpenetrated customer segments. We also are in the process of testing a number of digital tools to improve the customer experience and to increase operational efficiencies. We believe these new tools, coupled with improved data and analytics should bring our insight and effectiveness to the next level.

We are making excellent progress on the go-forward strategy we shared at our Investor Day last February. That strategy reinforces our commitment to our agent partners, defines our 2021 growth and financial targets, and aligns our organization to successfully deliver on our strategic goals.

Before I turn the call over to Jeff, I would like to share some thoughts on the new tax law.

We believe both the lower U.S. tax rate and territorial system are good for the economy and good for our company. Increased business activity and economic growth should drive increasing insurance needs, while a level tax playing field should create more parity between domestic and international insurers. We are in the early stages of analyzing the impact of our new tax laws. We do not expect tax reform to lead to changes in our strategic focus in any way. We do believe, however, that it will create a tailwind as we execute on our strategy. We will continue to drive operational excellence, leveraging and carefully managing our expenses. We also will continue to improve our competitiveness as we develop and invest in new capabilities, products, people and services. We believe the reform ultimately will benefit our shareholders through both increased performance from our business investments and return of capital.

With that, I will now turn the call over to Jeff for a review of our financials and 2018 guidance. Jeff?

Jeffrey Mark Farber
Executive VP & CFO

Thank you, Jack. As Jack mentioned, we are pleased with our underlying results. We reported net income of $51.5 million or $1.20 per diluted share in the quarter compared to a net loss of $13.5 million or $0.32 per diluted share in the same period of 2016.

For the year, we reported net income of $186.2 million or $4.33 per diluted share compared to net income of $155.1 million or $3.59 per diluted share in 2016.

After-tax operating income for the quarter was $86 million or $2 per diluted share compared to a loss of $19.7 million or $0.46 per basic share in the fourth quarter of 2016. For the year, after-tax operating income was $203.8 million or $4.74 per diluted share compared to $184.4 million or $4.27 per diluted share in 2016.

Our annual earnings reflected an underwriting combined ratio of 98.7% in 2017 compared to 98.6% in 2016. Our 2016 results were impacted by a fourth quarter domestic reserve charge, while 2017 earnings were significantly reduced by the third quarter industry-wide catastrophe events. Our catastrophe experience throughout the year was in line with, or better than, our market share and the modeled expected results, given the magnitude of the losses for the industry. Our results reflect the benefits of our strong reinsurance programs, domestically and at Chaucer as well as our careful risk selection and the prior exposure and diversification actions.

On an accident year basis, excluding catastrophes, we delivered an improved combined ratio of 91.5%, compared to 92.9% in the prior year. Our 2017 performance is a testament to our underwriting execution and profitability momentum. We believe this comparison is a more meaningful portrayal of our current business trends and the continued improvements we have made to our business, including improved cost efficiencies, underwriting discipline and overall financial rigor. One year after making significant adjustments, we remain comfortable with our reserves.

As a result of the 2017 annual review, we made adjustments in domestic reserves to ensure that all lines in accident years reflect our best estimates and we maintain our commitment to the level of conservativism as communicated last year. The cumulative impact of prior year adjustments in our domestic business was 0. We also have made significant progress on expense savings initiatives in our organization. As of year-end 2017, we achieved an improvement of our expense ratio by 0.5 point in our domestic businesses. We expect to see another 0.5 point of improvement in 2018, net of additional strategic investments, as we earn in both the benefit of the growth and expense initiatives we implemented in 2017. With our 2017 expense program fully implemented, we will maintain our focus on rigorous and prudent expense management going forward.

I will now review our financial results by business segment. As mentioned, fourth quarter comparisons in our domestic business were affected by the significant reserve adjustments in 2016. Accordingly, I will focus my review on the full year comparisons.

Our Personal Lines business continues to perform exceptionally well with strong returns on capital. We delivered a combined ratio of 94.1% for the full year compared to 92.3% in the prior year. The increase is fully attributable to higher catastrophe losses in 2017. Our Personal Lines business continues to achieve strong profitability, running at an 89% ex-cat combined ratio into 2017.

Personal, auto, current accident year underwriting performance improved slightly year-over-year with a loss ratio of 69.7%. As rate increases continue to offset loss trends, frequency remained benign, while severity increases were in line with our expectations. The personal auto accident year loss ratio ex-cat was 72.5% for the fourth quarter of 2017, which is consistent with our expectations and reflects normal winter weather seasonality. We made minor adjustments in the quarter to the auto prior year loss estimates as a result of our annual reserve analysis.

In homeowners, we adjusted current and prior accident year loss ratio estimates in the fourth quarter 2017 to reflect higher severity on some large property losses. However, at a 45% full year accident loss ratio, our homeowners business continues to be very profitable. In Personal Lines, we increased net written premiums by 8.3% for the full year and 9% for the quarter. This strong growth was driven by an increase in renewal premiums, with retention of 84.5%, and accelerating rate increases throughout the year at 4.8% in the fourth quarter as well as new business growth. We are very satisfied with the quality and profile of our new business as it includes a high percentage of full account business, high umbrella penetration and increased insured value of properties.

Moving to Commercial Lines. We delivered a combined ratio of 99.3% for the year compared to 105.1% in the prior year. Once again, the elevated combined ratio in 2017 was driven by the third quarter catastrophe events, while the performance in the prior year reflected 2016 reserve increases.

Our full year 2017 accident year combined ratio excluding catastrophes of 92.6% was in line with 2016, as a result of an improvement in the expense ratio offset by a higher large loss experience in some property lines.

Our current accident year loss ratio excluding catastrophes was 57% for the year compared to 56.5% in 2016. This slight increase was driven by a comparison to very favorable property loss experienced in 2016, especially in commercial multi-peril. Additionally, we experienced elevated large property losses in Specialty, including marine and our specialty industrial property unit in 2017. These elevated losses are expected from time to time, given the specialized nature of the business.

Liability coverages continued to perform in line with our expectations in response to previous pricing and underwriting actions, notably in the commercial multiple-peril line as well as in Professional Lines coverages within our Specialties segment reported in Other Commercial lines.

Workers' compensation had an excellent year, as reflected in the improvement of the current accident year loss ratio, excluding catastrophes by 6 points to 61.6%. This performance was a result of prior mix initiatives and favorable loss trends, similar to those experienced in 2016.

Commercial auto's current accident year loss ratio of 69.4% in the quarter and 68.4% for the full year were in line with our expectations and full year 2016 results. The comparison to the fourth quarter 2016 was affected by a significant reserving activity in the prior year period. Overall, we reported favorable development in Commercial Lines, with most lines performing better than our expectations.

We released $9 million of reserve in workers' compensation, partially offset by minor additions in commercial auto. Commercial Lines net written premium grew 6.6% and 4.3% for the quarter and year respectively, aided by price increases and stable retention. Overall, Commercial Lines performed well despite the market headwinds during the year. As Jack noted, we are confident in our ability to grow this business selectively while delivering improved profitability.

Chaucer's performance in the year was heavily impacted by third quarter catastrophe events, which drove the overall combined ratio to 105.3%. Our combined ratio, excluding catastrophes, was 90%, in line with last year's ratio, as we continue to effectively leverage our lead market position and underwriting expertise, delivering a strong result in a challenging global environment.

2017 was characterized by a more normal current accident year large loss environment compared to an elevated large loss experience in 2016. We recorded a total of $58 million of favorable development, consisting of ex-cat development of $34 million and cat development of $24 million. We experienced lower ex-cat prior-year favorable development, including in the fourth quarter, somewhat driven by large prior-year claims as well as timing impacts of accounting for certain reinsurance treaties, which we do not expect to occur to such a degree going forward.

Adjusting for these items, 2017 development is more indicative of favorable development we expect to see in the foreseeable future versus that which we experienced in the 2012 to 2016 period.

Chaucer business continues to warrant extra caution in setting reserves due to the nature of the claims process and risks involved, necessitating our very conservative reserving philosophy. Chaucer's 41% expense ratio in 2017 was below our long-term expectation for this business, impacted by several discrete items, including lower performance-based compensation. Going forward, we expect Chaucer's expense ratio to gravitate to the long-term target of approximately 45%, particularly in view of the currency impact of a weakening dollar upon our sterling expense base. Despite the pressures of a challenging market condition, Chaucer delivered 4% growth in 2017, gaining momentum throughout the year. Our newer business initiatives, including Chaucer's direct accident and health team in London, our partnership with AXA in Africa and the acquisition of an Australian sports and leisure underwriting franchise earlier this year helped replace business in other markets that we could no longer write profitably.

Going forward, we will continue to leverage our lead position in the market and grow in profitable niches and classes, underscoring the value of our specialist expertise, disciplined underwriting and risk management culture.

As we have discussed in the past, we believe the long-term target combined ratio at Chaucer is approximately 95%. However, due to timing of market dynamics, we expect the combined ratio to increase slightly for the 2018 calendar year.

Moving to investments. Net investment income increased 5.3% in the quarter and 6.7% for the full year of 2017 as we continue to reinvest higher operating cash flows from underwriting activity and generate higher income from partnerships. Cash and invested assets were $9.4 billion at year-end, with fixed maturities representing 82.6% of the portfolio. Our fixed maturity investment portfolio has an average duration of 4.3 years and 95% is investment-grade. Our investment portfolio continues to contribute to our bottom line and remains well positioned to capitalize on economic opportunities. Based on continued improvement in our operating cash flow, offset by the persistent low-yield rate environment, we expect our net investment income to remain flat in 2018.

As it relates to capital actions and our balance sheet, in 2017 we returned $37 million to our shareholders through stock buybacks. We have $146 million available for stock repurchases remaining under the program. We also increased our dividend in the quarter for the 13th consecutive year, which reflects our board's confidence in our overall financial condition and our earnings capacity going forward.

Our book value per share was $70.59 in the fourth quarter compared to $70.10 at the end of the third quarter. Book value per share excluding net unrealized gains on investments were $65.75, up from $64.71 on September 30.

As a result of the new tax law, we took a onetime charge of $22.3 million or $0.52 per diluted share in 2017 from the revaluation of our deferred tax assets and the tax payment on undistributed foreign earnings, primarily related to our non-underwriting Syndicate Manager income at Chaucer. Going forward, this tax reform will provide a meaningful boost to our earnings, reducing our effective tax rate from approximately 33% to 21%. As Jack mentioned, the reduction in corporate tax rates creates options for enhancing our long-term shareholder value. We will continue to evaluate these options which may include dividends, buybacks and investments that meet our capital requirements. Of course, it remains to be seen how market pricing will be impacted by reduced tax rates. We will apply the same capital management and allocation rigor to our additional capital as we always do when we make investment and capital management decisions.

Before opening the line for questions, we want to share our views of what we expect in 2018.

We anticipate overall net written premium growth of mid-single digits. NII should be relatively flat as increased cash flows are offset by non-recurrence of some one-time benefits in 2017, such as higher investment partnership returns. Our domestic expense ratio should improve by 0.5 point from 2017, while Chaucer's expense ratio will return to a more normal level of approximately 45%.

Our combined ratio excluding catastrophes should be 90% to 91%, plus a catastrophe load of approximately 5% for the year. As I mentioned earlier, we expect an effective tax rate of 21%. We would also like to remind you of the seasonality of our business. While our first quarter catastrophe load at 4.4% is slightly below the full year average, our more northern footprint tends to show higher noncatastrophe weather losses in the first quarter. Also, growth in 2017 and into 2018 creates some enhanced profit as the year progresses, as we saw in 2017. As a result, the first quarter tends to be our lowest quarter of earnings.
Operator, we will now open the line for questions.

Question and Answer

Operator

[Operator Instructions] Our first question on the line comes from Christopher Campbell from KBW.

Christopher Campbell
Keefe, Bruyette, & Woods, Inc., Research Division

So my first question is just on the pricing environment and how that's improving in Personal and Commercial Lines. Can you give any details on where you're seeing better rates in commercial? And how would you describe that momentum, like as we were as we're in 1Q '18? How has that momentum been progressing?

John C. Roche
CEO & President

Thanks for the question, Chris. Overall, I would tell you that we see the pricing environment as reasonably stable. I think we -- as time has gone by, you're seeing that more and more carriers have different challenges in different aspects of their portfolio, and so the pricing changes are less uniform than maybe we've seen in the past. As you look at our progression, we continue to get price in our Personal Lines book slightly above loss trend, a little behind in Commercial Lines, but are, obviously, pulling other levers, including mix and other adjustments, to improve our profitability. So as we look at the business, while there is some signs of some improvement in the casualty area, we saw Q4 as a reasonably stable and somewhat consistent with the market we've been experiencing. Dick, I don't know -- on Personal Lines, whether you wanted to add any more color to that?

Jeffrey Mark Farber
Executive VP & CFO

Yes. No, I would just -- you said it well. I think in the Personal Lines environment we are optimistic that the hard market in auto should continue and we'll be able to get rate above lost costs. In home, the trend is more at-loss cost, but the environment certainly suggest that it's -- that those trends will -- the market will accept it and those trends will continue.

John C. Roche
CEO & President

And our Commercial Lines portfolio has become quite diverse, as you know. So there's a lot of -- we can look at it from a line of business standpoint and make some observations. Workers comp, obviously, continues to tend to be the most challenged in term of pricing, and commercial auto tends to be the most opportunistic, given where the overall market is. And so we are -- we continue to push for prices where we most need it, and we saw some slight improvement in the fourth quarter and we'll watch that as we move into 2018.

Christopher Campbell
Keefe, Bruyette, & Woods, Inc., Research Division

Got it. That was very helpful. Just a question on the adverse reserve development. There was some in Personal Lines, Commercial Auto and CMP. Any specific trends you're seeing behind that? And I know Jeff gave a few details on it. Just any trends or any emerging trends you're seeing since the reset last year? Or any specific accident years in any of those lines that could be causing any additional concern?

John C. Roche
CEO & President

Well, Chris, I think, the short answer is no. We don't see any really overarching trends that I think are worth noting. We are committed to maintaining the discipline and the conservativism in our reserves, and that does require some adjustments at the line of business level as we move throughout the year to ensure that we don't erode our position. And I'll maybe turn that over to Jeff to provide a little bit more color in terms of how we continue to manage our reserves carefully.

Jeffrey Mark Farber
Executive VP & CFO

Sure. Thanks, Jack. Chris, as you know, we had no net domestic development, and we did a detailed reserve review, as we do every year, and we're committed to maintaining that philosophy of conservativism. First thing we do is look at workers' comp, and I think we really were sort of compelled to react to workers comp and, to some degree, management liability and professional liability. Obviously, offsetting that, we had the opportunity and took it. Looking at home and auto, there were some sort of unusual kind of idiosyncratic losses there which were largely isolated, that were kind of late traveling or severe. I don't think it really causes us to think any differently about the current period or other particular losses other than those. You know what, I'll just remind you, our home business is running at a 45% loss ratio for 2017. So it's just a -- it's a terrific business, highly profitable. I don't think the adjustment in prior years for the Personal Lines business causes us to think any differently about our Personal Lines business going forward.

Christopher Campbell
Keefe, Bruyette, & Woods, Inc., Research Division

Great. That's very helpful. Question on Chaucer. We're hearing from some competitors that Lloyd's and in trade publications that Lloyd's pricing is improving. But I think Jack mentioned in the opening monologue that he expects net written premium to be flat. Just any color if that market is hardening, why you wouldn't want to grow exposure? Or is...

John C. Roche
CEO & President

Yes, I think what you'll see is that we continue to manage the portfolio overall to try to be opportunistic in the areas where we think there is opportunity for profit. You've seen us develop a number of initiatives over the last several quarters to try to stay on the offense in the areas that are really most lucrative. That said, there is also some continuing pressure in certain lines and classes, and John Fowle and his team have been very diligent to make that explicit to us, but also to lay that out and not get kind of caught up in the overall sentiment. So I'll turn it over to John for maybe a little bit more color, but I think what we did see is some improvement on [1 1], and so we're cautiously optimistic as we look into '18. But it wasn't -- it certainly wasn't the firm market that was predicted several weeks back. John?

John Fowle
Chief Executive Officer of Chaucer

Yes, sure. Thanks, Jack. Chris, the -- I mean, overall, we see price strength coming into our business in '18, but it's not universal, and we're determined to get our combined ratio to a level that we think is acceptable. So really we will use the price strength to allow us to do some more work on the areas of the business that are underperforming. So overall, that flattens out our total growth for the year.

Christopher Campbell
Keefe, Bruyette, & Woods, Inc., Research Division

Got it. And then, just one last one for Jeff or Jack. Just in terms of -- I noticed that Hanover slowed its buybacks in 4Q. So how should we think about capital management priorities in 2018? And I'm thinking after factoring in a plan to grow dividends, what would you estimate Hanover's current excess capital is?

Jeffrey Mark Farber
Executive VP & CFO

Chris, yes, you did notice accurately. We put a grid together in the fourth quarter and the stock ran a little bit and we said, "Let's just leave it there for the moment" and didn't revise it. So we didn't end up buying up much back, if any, in the fourth quarter. We'll be back in the market on a regular basis after the earnings release, probably starting Monday, whenever the lawyers let us. But -- and I think, all through the year we go through our normal process of thinking about capital. We haven't shared excess capital. And candidly, as Jack said earlier, we're really still evaluating how much excess capital the new tax law creates. So no question, we're evaluating dividends, we're looking at stock buybacks, we're thinking about other uses of the capital that gets created, and you'll hear more about that as we go forward throughout the year. But certainly, we'll be back in the market with some stock buyback activity.

Operator

Our next question on the line comes from Matthew Carletti from JMP.

Matthew John Carletti
JMP Securities LLC, Research Division

I guess to start, Jeff, just follow up on Chris's question there on capital management as a follow-on. We -- do you have a desire, or would you consider, paying down some debt as a use of capital? Or are you very comfortable with kind of where your debt levels are and you see share buybacks or dividends or are there M&A or other things as better uses?

Jeffrey Mark Farber
Executive VP & CFO

Well, we certainly look at it all the time. I think, conceptually, we're relatively low leverage at this point with sort of 20% level, give or take 1 point or 2. So I think we feel pretty good about it. But we look at the debt and the capital opportunistically, and we're going to make an economic decision as to what the best thing's to do with the excess capital that we create over the course of the year, and that will include -- considering our debt, it'll include returning capital to shareholders and other opportunities that organically or even, perhaps, otherwise on some small things if they meet our capital hurdles.

Matthew John Carletti
JMP Securities LLC, Research Division

Okay, great. And then next question, just shifting to your comments on the Chaucer expense ratio. Did you say in the ballpark of 45%? Did I hear you correctly?

Jeffrey Mark Farber
Executive VP & CFO

We did. That's been our long-term view, and that's the expectation over the course of the year, largely driven by some sterling currency movement and a few other things. Particularly, it was a little bit lower in '17-year because of some performance comp.

Matthew John Carletti
JMP Securities LLC, Research Division

Okay, okay. So -- all right, because I'm looking back and I haven't seen it there for quite a while, and so I just wanted to make sure that we're comparing apples-to-apples. So it's coming off of about 41% base in 2017, and I -- looking at the right kind of comp?

Jeffrey Mark Farber
Executive VP & CFO

It is, and we've been saying for quite some time that it'll be 45%. And you're right, it's consistently been a little below that, and we're hopeful that it'll be below that, but that's our best view at the moment.

John C. Roche
CEO & President

And this is Jack. Matt, also I would say that we just -- one of the things we'll try to continue to do relative to our updates to you is how mix shift can affect that over time to, right? We have a portfolio, and so as we work through which classes we're pursuing, we have some different new initiatives over time that can influence the expense composite of our overall combined ratio.

Matthew John Carletti
JMP Securities LLC, Research Division

Good point, understood. Last question. Just on your comments on Q1 weather, kind of more broadly just reminding us that seasonality is there. How would you characterize what you've seen in January so far in this Q1? Is it kind of average? Has it been worse than average? I know there's been a lot of ice and snow in the South and maybe that's not normal.

John C. Roche
CEO & President

Yes. I guess, you could always -- you could answer the question by saying, "If you could define normal, I'll give you a straight answer." So listen, it's -- we clearly saw some weather in January. We're still working through large loss components versus just the average pay on some of the more frequency. But clearly there's been some weather to start of the year and we're getting our arms around that. I can tell you, in the 11 years I've been here, the weather in January is rarely an indicator of how our full year results will be. So frankly, we just take it in stride and do our job and let the rest take care of itself.

Operator

[Operator Instructions] Our next question on the line comes from Paul Newsome from Sandler O'Neill.

Jon Paul Newsome
Sandler O'Neill + Partners, L.P.

Was I asking -- I wanted to ask about expense cuts, and I think you had a, if I recall, a $15 million effort that happened last year, and kind of where we are in that process, and where we might be in terms of improving the expense base perspective?

John C. Roche
CEO & President

Yes. This is Jack, Paul. Thank you. Clearly, we executed on our stated expense initiatives in '17, and worked through all of those started to see some benefit in the third, and certainly, in the fourth quarter, you'll see some continued improvement in that trajectory in '18, as we stated in our prepared remarks. So U.S. domestically, we expect that our expense position, through a combination of our growth as well as those expense initiatives coming through, of roughly 0.5 point on the U.S. domestic expense ratio into 2018.

Jeffrey Mark Farber
Executive VP & CFO

And just to amplify that a little bit, going forward into 2018, we're committed to the same kind of financial and expense rigor. So we've always got things that we want to be spending money on, that investments need to be made for growth and other reasons, and so we're going to be carefully monitoring our expenses in terms of that discipline as we go forward to make the right choices. But overall, we're committed, as we grow the top line, to really capture a substantial portion of the leverage on those fixed costs.

Jon Paul Newsome
Sandler O'Neill + Partners, L.P.

And then I was hoping you could talk a little bit about different subject, M&A and both buying and selling things. Obviously, management has changed quite a bit over the last couple of years, and I don't know if the philosophy has changed very much or the appetite or even if you feel your expertise has changed either what direction. Maybe you could just kind of review those general topics and give us a sense of what's the philosophy on M&A for Hanover is today?

John C. Roche
CEO & President

Yes. Thanks for the question. I would tell you that over the course of the last decade, certainly since I've been here, we have found the opportunity to do some inorganic activity, and I would suggest you that the great majority of the management team that has been involved in that is very much here and continuing to run the business and run the operations side of the business. So what I would tell you though is, as we look out over the next 18 to 24 months, we will continue to look into the world of, particularly, smaller nichey-type opportunities occasionally as other companies make decisions to change their focus. There becomes some renewal-rights-types opportunities. So we'll clearly, from a corporate development standpoint, stay active in that pipelining process. That said, we look into the next couple of years and see tremendous growth opportunity coming from the investments we've already laid down, both in terms of new geographies and in the newer businesses, and so we're particularly excited about, in a very thoughtful and disciplined way, getting paid back on those past investments and generating some solid organic growth in the right categories.

Operator

Our next question comes from Larry Greenberg from Janney.

Lawrence David Greenberg
Janney Montgomery Scott LLC, Research Division

So I guess it's almost been a year since your Investor Day of last year, and just looking for a little bit of an update on the initiatives to kind of bridge the gap between what Chaucer does and what you do in special products domestically. Kind of -- I think you've described it as high complexity to low complexity. And then there is a gap in the middle there that you had indicated you would target. So have there been any initiatives along that pathway?

John C. Roche
CEO & President

Yes, Larry, thanks for the question. At the highest level what I would suggest to you is that The Hanover 2021 strategy and the levers that we outlaid, we feel terrific about. We really feel like we are now showing the power of our core businesses and how we can get profitable growth from that, which was, as you can remember, a very key lever of how we were going to take this company to the next level. Additionally, we're really pleased to have Bryan Salvatore joining us now, almost 8 months. He has spent a tremendous amount of time looking at our current portfolio and looking at some of the strategic work we did before his arrival and putting his stamp on how do we feel about the current portfolio and what areas will we consider moving to next, albeit in a thoughtful way. And so -- maybe it would be great to just to let you hear from Bryan a little bit about his view now, 8 months on the job, and where he sees some opportunities.

Bryan J. Salvatore
Executive VP & President - Specialty

Yes. Thanks, Jack. And Larry, thanks for the question as well. And I'd tell you, you're right, it's been 8 months of working very closely with the businesses, and I really actually like what I see. I see disciplined execution across our areas, I see growth in the areas that we want to be growing, we should be growing. I'll point to a couple of examples there. For example -- and you know, Jack and Jeff mentioned it before, in the professional liability areas, in the management liability areas, we've had strong performance and we're really seeing these areas come into their own, and they really disproportionately grew or drove our growth in '17. And that's what we're expecting in '18. Similarly, in our Marine business, that's been a consistent strong performer for us and very strong growth in '17, and we're anticipating strong growth, again, in '18. So if I look across the lines, I think we should be really confident in this business. The areas that should be growing are driving our growth, and the areas that we've been -- had in our watch list, I like the execution that I'm seeing there too. Real disciplined execution, really good underwriting action. And as a result, I would call it really measured growth. So I think we are leaning into the strategy, growing where we want to be growing as part of that strategy. So I think we should feel really good about the specialty business and The Hanover 2021 plan.

John C. Roche

CEO & President

So just to fully answer the second part of your question, or maybe the first part of your question, is, in terms of looking forward into the insights that John Fowle and his team bring to us from Chaucer, but also some of the ground-up work we're doing here in U.S. domestic specialty, we have started to outlay the very specific areas that we would like to go next. And they come in 2 flavors. They come in, going out slightly up market in some of these areas that we think we're performing well, and our insights from our distribution show us where we could fit in the mosaic of our agency plan. And then also some newer areas. And you'll hear more about this, but clearly what Chaucer and what Bryan and his team have been looking at is, where is a thoughtful place in the world for us in cyber? We do some cyber domestically, really as a add-on, if you will, to our package business. But over time we have to be a little bit more offensive about where the specific areas are that we could play more actively when that -- as that becomes more important to customers and to the agents. The management liability and professional liability, here we laid out some steps to make some additional investments there in some of the very specific subsectors of that business. And then there's some other new areas, Larry, that we're not ready to disclose, that we've been doing some analysis on. But as has always been in the case in the past, we are not going into any new areas without the proper level of expertise. So that's -- that is one of the critical steps that we're taking is, not only what the opportunity, but what is the investment or the resources that we need to capture to take the company to the next level.

Bryan J. Salvatore
Executive VP & President - Specialty

And I think I would just add that, where we move off the market, it's going to be measured. I think you said slightly. It will be measured, it will be thoughtful in turn, and it will really answer the needs that we see that our agents have in this business.

Lawrence David Greenberg
Janney Montgomery Scott LLC, Research Division

Great. That's very helpful. And then, just on the discontinued charge. You're certainly not alone in seeing some wiggles in long-term care. But could you just kind of frame what's left there? And did you do a special review of that block? Or was this just part of kind of an ordinary annual review process? Just give us a little flavor on that.

John C. Roche
CEO & President

I'm going to turn that over to Jeff. But obviously, we regularly review all aspects of our business, including discontinued operations. Anybody that has a newspaper knows that the long-term care business, it's just been seeing some pretty dramatic changes. So obviously, that was a particular focus this year, to make sure that we understood how that related to our current reserve position. But I'll turn it over to Jeff to maybe talk you through a little bit of about how we approached it.

Jeffrey Mark Farber
Executive VP & CFO

Sure. Larry, this was really an old pool, dating back to the life company. And we look at this thing every quarter and, obviously, do the underlying pool. We have a relatively small interest in the pool. So the underlying pool's actuaries do a little bit more work at year end. And there was some deterioration, and it seemed as if the pool actuaries were being substantially more conservative in terms of how they were looking at the underlying data and models. So we knew we needed to react to it. And for us, it was an opportune time to be more conservative in 2017 with this reserve. So I don't think we're particularly concerned about it at this point, and it was a good thing to do to increase our reserves here for this pool.

Operator

[Operator Instructions]

Oksana Lukasheva

Vice President of Investor Relations

Looks like we don't have any more questions. Thank you, everybody, for your participation today, and looking forward to speaking to you next quarter.

Jeffrey Mark Farber
Executive VP & CFO

Thank you.

John C. Roche
CEO & President

Thank you.

Operator
Thank you, ladies and gentlemen. This concludes today's conference. Thank you for participating. You may now disconnect.