CNA Financial Corporation

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Earnings Call

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Call Participants

EXECUTIVES

Dino Ennio Robusto
Chairman & CEO

Ralitza Todorova
Assistant Vice President of Corporate Development

Scott Robert Lindquist
Executive VP & CFO

ANALYSTS

Dong Yoon Han
Keefe, Bruyette, & Woods, Inc., Research Division

Presentation

Operator

Ladies and gentlemen, good day, and welcome to the CNA First Quarter 2023 Earnings Conference Call. [Operator Instructions] Please note, this event is being recorded.

I would now like to turn the call over to Ralitza Todorova, Assistant Vice President, Investor Relations, for opening remarks and introductions of today's speakers. Please go ahead.

Ralitza Todorova
Assistant Vice President of Corporate Development

Thank you, Andrew. Good morning, and welcome to CNA's discussion of our first quarter 2023 financial results. Our first quarter earnings press release, presentation and financial supplement were released this morning and are available on the Investor Relations section of our website, www.cna.com.

Speaking today will be Dino Robusto, Chairman and Chief Executive Officer; and Scott Lindquist, Chief Financial Officer. Following the prepared remarks, we will open the line for questions.

Today's call may include forward-looking statements and references to non-GAAP financial measures. Any forward-looking statements involve risks and uncertainties that may cause actual results to differ materially from the statements made during the call. Information concerning those risks is contained in the earnings press release and in CNA's most recent SEC filings. In addition, the forward-looking statements speak only as of today, Monday, May 1, 2023. CNA expressly disclaims any obligation to update or revise any forward-looking statements made during this call.

Regarding non-GAAP measures, reconciliations to the most comparable GAAP measures and other information have been provided in our earnings press release, financial supplements and other filings with the SEC.

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

With that, I will turn the call over to our Chairman and CEO, Dino Robusto.

Dino Ennio Robusto
Chairman & CEO

Thank you, Ralitza, and good morning all. Before I begin my remarks on the quarter, I would like to acknowledge the contributions of Tom Motamed to our organization. As you all know, Tom passed away on April 18, leaving behind an incredible legacy in our industry, which he served with distinction for 45 years.

Tom was truly an insurance man through and through, climbing the ranks at Chubb for over 30 years and then joining CNA as Chairman and CEO in 2009. His myriad contributions and effective leadership helped define CNA's capabilities and reputation. Our entire organization is saddened by Tom's passing, and we will always be grateful for his commitment to not only CNA, but to our entire industry.

In the first quarter, CNA produced very strong results with excellent profitability and double-digit top line growth from significant new business success, continued high retention and a rebound in rate change from the fourth quarter of last year. Core income increased by $27 million in the first quarter to $325 million. Net investment income of $525 million pretax increased $77 million year-over-year. And our pretax P&C underlying underwriting gain was up 19% to a record $197 million in the quarter.

Against the backdrop of elevated industry catastrophe losses in the first quarter, the all-in combined ratio was very strong at 93.9% with pretax catastrophe losses of $52 million or 2.4 points of the combined ratio, which is well below our 10-year first quarter average of 3.1 points, which we believe is strongly reflective of our prudent management of catastrophe exposures.

Prior period development for P&C overall was slightly unfavorable by 0.7 points on the combined ratio from adverse development on the professional liability segment we exited several years ago as part of our re-underwriting actions in our London portfolio.

The P&C underlying combined ratio was 90.8% and is 0.6 points lower than the first quarter of last year. The underlying loss ratio in the first quarter of this year was 59.8%, down 0.3 points year-over-year. And the expense ratio of 30.7% was also down 0.3 points.

In the quarter, we achieved a very strong production performance with 11% growth in both gross written premium ex captives and net written premium. Excluding currency fluctuation, the growth was 12% for both metrics and was particularly strong in our Commercial and International segments.

Written rate increase was 5% in the quarter, up 1 point compared to the fourth quarter with acceleration in Commercial where rates were up 2 points to 7%, and Commercial rates are up a full 3 points compared to the third quarter of last year. These higher levels of written rate will favorably impact earn rate throughout the year.

Pricing remains rational, increasing where we need it most. And the overall renewal premium change remained strong at slightly more than 7%. And importantly, rate change and the portion of exposure change that acts like rate continues to cover our long run loss cost trends, which are up a few tenths of a point this quarter at close to 6.5%.

New business was up 12% for the quarter to $503 million. The new business was particularly elevated across the board in Commercial where we capitalized on a number of opportunities in each of our target classes.

Over the last several years, we've commented on strengthening our industry verticals. We built strong verticals in areas such as National Accounts Property, National Accounts Casualty, construction and marine in addition to verticals we have had for a long time like middle market, surety, health care and affinity programs.

We have since built top industry expertise in those business segments and not just in underwriting, but across the value chain in areas such as claim and risk control. Moreover, the re-underwriting I've discussed extensively in prior calls is well behind us. And so we are clearly engaged in the marketplace.

We are single-mindedly focused on growing profit dollars across our business segments. And we closely track the strength of our new compared-to-renewal pricing, and that has remained consistent as have the stronger terms and conditions achieved during the hard market years.

In the first quarter, we saw more opportunities to grow new business in Commercial and International than we saw in Specialty. And that, of course, will vary across the quarters. Retention remained high at 86% this quarter and has been at this level for 4 straight quarters as we seek to retain as much of the business as possible that has generated our strong underlying combined ratios of around 91% for the last 2 years.

Turning to our 3 business units. The all-in and underlying combined ratios for Specialty were each very strong at 90% in the first quarter. The underlying loss ratio improved 0.5 points to 58.4%, and the expense ratio was up by 0.5 points to 31.4%.

We have limited exposure to community, regional and large banks as part of our D&O portfolio. Our banking exposures represent less than 2% of our aggregate management liability portfolio. And we continue to maintain prudent current accident year loss ratio picks.

Gross written premium ex captives growth for Specialty was flat this quarter, and net written premium growth was up plus 2%. Growth was lower due to less new business in our transaction liability program from significantly fewer M&A opportunities in the quarter. Excluding this program, Specialty gross growth was 5% in the quarter. And new business production in the other Specialty lines of business was similar or slightly higher than the amounts we wrote in the first quarter of 2022.

Within Specialty, rates were plus 2% this quarter, down 1 point from the fourth quarter. Management liability experienced rate decreases of minus 3% this quarter, which is down from flat during the fourth quarter, largely impacted by D&O pricing.

In D&O, the softening rate environment continued this quarter where pricing was down 3 points from the fourth quarter to minus 12%. This line of business had a high double-digit cumulative rate throughout the hard market cycle, which peaked towards the end of the first quarter of 2022. Since that point, fewer new financial opportunities, combined with new entrants into the market, is creating this price softening in the near term. How long it will continue depends on the claims activity, which can change pretty quickly in this line of business as history has taught us.

We continue to underwrite conservatively. And we will secure the right accounts at the needed terms and conditions, which clearly exists as many clients value the proven track record associated with long-standing, stable and expert insurers as they construct their towers of coverage. Retention remains very strong at 88% for the third straight quarter with all products in Specialty achieving high retention levels.

Turning to Commercial. The all-in combined ratio was 96%, which includes 4.2 points of cat loss in the first quarter. The underlying combined ratio was 91.8%, the lowest on record and 0.9 points lower than last year. The underlying loss ratio of 61.5% was stable year-over-year. The expense ratio improved by almost a full point to 29.8% in the quarter, representing the lowest quarterly expense ratio in 15 years.

Gross written premiums ex captives and net written premium each grew by 19% this quarter. All business units within Commercial benefited from stable to improved pricing, high retentions and strong levels of new business.

In the quarter, Commercial renewal change was slightly higher than 9%. Rates were up plus 7% in Commercial, up 2 points from the fourth quarter, driven by acceleration in property rates wherein our National Accounts Property portfolio rate was above 25%.

Price increases continued to climb through the quarter from the levels in January that I commented on during our fourth quarter call. Our middle-market property accounts had rate increases in the high single digits, which is a great result given the multiline nature of middle-market package business, just a different competitive dynamic than the larger monoline property business.

Looking forward, we do not see any signs of significant change in the marketplace. In fact, in some areas of National Accounts Property, we see rates accelerating beyond the high-20s level we are experiencing today.

Outside of rate, we continue to capitalize on improved terms and conditions, which, as we described to you last quarter, have a significant positive impact on controlling our catastrophe exposure. We also remain extremely focused on securing appropriate insurance to value during these inflationary times. And valuation increases in National Accounts Property were high single digit in the first quarter.

As you know, our major property reinsurance treaties renew on June 1. Although still a little early, our sentiment remains in line with what we said in the fourth quarter. We have had good results in our Property business, which has also benefited our reinsurers. And the first quarter of this year reveals again our prudent management of cat, and we expect all of that to help with that renewal.

We expect to maintain a strong program in line with what we've had over the last several years. And while we anticipate securing the program at higher prices, we nonetheless expect pricing to reflect our strong performance and underwriting expertise.

Outside of property, Commercial auto rates also improved by more than 1 point in the first quarter to slightly above 9% and were even higher in the month of March. Excess casualty rates were mid-single digits, and renewal premium change was over 8% for the quarter, keeping pace with long-run loss cost trend in this line.

And rates moved higher throughout the quarter, and that trend continued in April, which is encouraging as it is needed in light of the impact industry nuclear verdicts have on this line. As we have highlighted in the past, we also have brought down our limits profile over the last several years in response to the social inflationary pressure, and that has benefited the performance of this portfolio as well.

Primarily (sic) [Primary] general liability, renewal premium change was mid-single digit in the quarter and also moved higher in April. Work comp pricing continued to be slightly negative. And in the quarter, overall commercial pricing, excluding work comp, rates were up 9% and renewal premium change was up 11%, which continues to be well above our long-run loss cost trends.

Commercial retention remained strong at 86% and was strong in all business units. New business was up 36% and also strong across all business areas, as I mentioned earlier. Given the firming rates in commercial lines and our well-established and specialized business verticals, we anticipate quality new business opportunities to persist.

For International, the all-in combined ratio was 97.2%, and the underlying combined ratio was 89.3%, a record low. International had strong top line this quarter with gross written premiums up 10% or 17% excluding currency fluctuation. Net written premiums grew 8% or 16% excluding currency fluctuation.

Renewal premium change was 8% in the quarter with both rate and exposure increase up 4%. Retention was strong in International at 83% for the quarter and has been at or above this level for 4 straight quarters. New business was up 9% in the quarter and 15% excluding currency fluctuations. Our International operation is now consistently growing and producing meaningful profitability for CNA overall.

And with that, I will turn it over to Scott.

Scott Robert Lindquist
Executive VP & CFO

Thank you, Dino, and good morning, everyone. I will provide some additional information on our results, as Dino indicated.

Core income of $325 million is up 9% compared to the first quarter of last year, leading to a core return on equity of 10.8%, while our P&C segment had record pretax underlying underwriting income of $197 million.

Turning to investments. Total pretax net investment income increased 17% to $525 million in the first quarter. The increase was driven by our fixed income and other investment portfolios, which were $57 million favorable to the prior year quarter, while our limited partnership and common stock results returned a $28 million gain in the current quarter compared to an $8 million gain in the prior year quarter.

Our fixed income portfolio continues to produce consistent net investment income, which has been steadily increasing over the last year as a result of favorable reinvestment rates in our P&C portfolios as well as a growing investment base funded by strong cash flow from operations. Within our P&C and Corporate segment portfolios, the average fixed income effective income yield was 4% in the first quarter compared to 3.6% in the prior year quarter.

As of the end of the first quarter, reinvestment rates were well above our P&C effective income yield, while our Life & Group portfolio effective income yield was flat in the first quarter compared to the prior year quarter as this portfolio is longer duration and has embedded yields more comparable to today's interest rate environment. Additionally, within the Other category investment income, which includes short-term investments, we are benefiting from significantly higher short-term rates as compared to a year ago.

We believe our investment portfolio to be both high quality and well diversified. Our fixed income portfolio, which makes up 90% of our total investments, has a weighted average credit rating of A and is made up of 95% investment-grade securities. While we maintain an allocation to risk assets, including limited partnerships, common stocks and below investment-grade securities, we believe it is positioned conservatively and well within our risk appetite.

Additionally, we maintain ample liquidity to meet obligations and withstand significant business variability at both the holding and operating company levels. Given the recent focus on the commercial real estate sector, we have included supplemental disclosure of our exposure in our earnings presentation, financial supplement and our first quarter Form 10-Q that will be filed later this morning.

Our direct exposure to commercial real estate is through fixed income securities in the form of commercial mortgage-backed securities and issuer obligations of real estate investment trusts as well as through our direct mortgage loan portfolio. Together, these 3 portfolios comprise about 9% of our total investment portfolio.

Our commercial real estate holdings are high quality and well diversified as to underlying property type and geography. Taken together, our CMBS and REIT portfolios are 95% investment-grade with 50% rated A or higher. Finally, we are limited in exposure to commercial real estate in our limited partnership portfolio as this is not one of our core alternative strategies.

Prior to discussing Life & Group results, I'd like to discuss our adoption of the change in GAAP accounting methodology related to long-duration targeted improvements, otherwise known as LDTI, that now applies to our long-term care business. We adopted the new guidance effective January 1, 2023, using the modified retrospective method applied as of the transition date of January 1, 2021.

Our 2023 first quarter results include adjusted financial results for Q1 2022, reflecting LDTI accounting. As this is the first period under LDTI, there are adjusted financial statements for each of the 2022 quarters as well as full years 2022 and 2021 that could be found in our first quarter financial supplement as well as transition-specific disclosures, reconciling previously published financial data in our Form 10-Q to be filed later this morning.

Measured as of December 31, 2022, the impact of LDTI to stockholders' equity was a $277 million decrease, which was comprised of a $236 million decrease to retained earnings and a $41 million decrease to accumulated other comprehensive income.

As we have noted in prior calls, I'd like to emphasize this change in accounting has no impact to the underlying economics of CNA's business. However, the cumulative effect of assumption differences and differences in reserving methodologies will have an impact on the pattern of GAAP earnings emergence over time.

And as we have many policy groups with a net premium ratio capped at 100%, we also expect a certain amount of quarter-to-quarter volatility. As such, over the next several years, we expect a modestly higher underwriting loss under LDTI as compared with legacy GAAP.

As to Life & Group's first quarter results, we had a core loss of $3 million as compared to a $5 million core income result for last year's first quarter. Investment income was about flat with the prior year, while the underwriting loss was higher by $10 million pretax, which reflected the impact of $55 million of cash policy buyouts during the quarter.

Looking forward, we continue to -- we expect to continue offering policy buyouts in connection with rate increase activity, although the effect on Life & Group's earnings will vary quarter-to-quarter.

Our first quarter P&C expense ratio was 30.7%, which is a slight decrease when compared to last year's first quarter expense ratio of 31%. At the segment level, both Commercial and International saw improvements in their expense ratios compared to prior, primarily driven by strong growth in net earned premium.

For Specialty, the expense ratio increased by 0.5 point due to employee-related costs that includes higher legacy pension plan expense. As I've noted in prior calls, there will be a certain amount of variability quarter-to-quarter, and we do expect a somewhat higher expense ratio in the second quarter as employee compensation market adjustments take effect. However, we continue to believe an expense ratio of 31% is a reasonable run rate for 2023.

As Dino noted earlier, P&C net prior period development impact on the combined ratio was 0.7 points unfavorable in the current quarter, which is coming out of our International segment, while Specialty and Commercial were both flat.

The P&C paid-to-incurred ratio was 0.81 in the first quarter. This is down slightly from the fourth quarter and consistent with the first quarter of 2022. The ratio, which fluctuates quarter-to-quarter, has been consistently lower over the past 3 years.

Our Corporate segment produced a core loss of $18 million in the first quarter compared to a $28 million loss in Q1 2022. As we have noted in prior calls, we perform our annual review of asbestos and environmental reserves during the fourth quarter and all other Corporate segment reserves, including legacy mass tort exposures, during the second quarter.

At quarter end, our balance sheet continues to be very solid with stockholders' equity, excluding AOCI, of $12 billion or $44.21 per share, which is an increase of 2% from year-end 2022 adjusting for dividends.

Stockholders' equity, including AOCI, was $8.7 billion or $32 per share and reflects our investment portfolio moving into less of a net unrealized loss position during the quarter, partially offset by an LDTI adjustment on reserves for future policy benefits. We continue to maintain a conservative capital structure with a leverage ratio of 19%, excluding AOCI, and our capital remains strong.

Cash flow from operations was $436 million for the first quarter, which is down from $645 million for last year's first quarter. The decrease is primarily attributable to lower distributions from limited partnership investments and, to a lesser extent, higher long-term care policy buyouts I noted a moment ago. Otherwise, cash flow from P&C underwriting activities and fixed income investments remains very strong, reflecting continued excellent underwriting and fixed income results, respectively.

Turning to taxes. The effective tax rate on core income was 20% for the first quarter. As I noted in our last earnings call, we expect a similar effective tax rate for 2023 with a certain amount of variability quarter-to-quarter.

Finally, we are pleased to announce a regular quarterly dividend of $0.42 per share to be paid on June 1, 2023, to shareholders of record on May 15, 2023.

And with that, I will turn it back to Dino.

Dino Ennio Robusto
Chairman & CEO

Thanks, Scott. To recap, we had an excellent start to the year with strong top and bottom line performance. Pricing resiliency persists, evidenced by the rebound in several lines of business in the quarter, which I believe reflects a broader awareness that rate increases need to continue to compound for longer given the compounding effects of inflationary pressures on loss cost trends.

And the pricing environment should, in turn, allow us to maintain strong retention levels. We are well positioned to continue to secure high-quality new business in our target areas. And on the investment side, the improved fixed income yields will continue to be a tailwind.
And with that, we will be happy to take your questions.

Question and Answer

Operator

[Operator Instructions] The first question comes from Derek Han with KBW.

Dong Yoon Han
Keefe, Bruyette, & Woods, Inc., Research Division

So my first question is on reserve development. You had an absence of reserve releases in the Specialty and Commercial segments. Could you talk about what's kind of driving that, where the offsets are on the average front?

Scott Robert Lindquist
Executive VP & CFO

Sure. Thanks, Derek. It's Scott here. So that's right, development was flat for both Specialty and Commercial for the quarter. Just a little bit more color on Specialty, we had unfavorable claim settlements and older accident years in our run-off health care portfolio, but were offset by favorable reserve development in other parts of our Specialty portfolio, thus resulting in the flat result. And then as far as Commercial, just some puts and takes there, again, it's consistent with prior year, it's relatively flat this quarter.

Dong Yoon Han
Keefe, Bruyette, & Woods, Inc., Research Division

Got it. That's helpful. And then my second question was on cat losses. You said that first quarter was running maybe 70 bps below the historical pace. Can you just talk about maybe the guidance or 2023 outlook in terms of cat losses for the year?

Dino Ennio Robusto
Chairman & CEO

No, Derek, we don't give out guidance. But I just wanted to highlight our conservative and prudent management, and that's why I referenced the 10-year sort of looking at backwards, but we don't give guidance on cat.

Dong Yoon Han
Keefe, Bruyette, & Woods, Inc., Research Division

Okay. No, that makes sense. And then my last question, just on the pricing environment, D&O pricing worsened 3 points sequentially quarter-over-quarter. But is there any change in the bank D&O pricing? Just kind of curious about the impacts of the banking fallout.

Dino Ennio Robusto
Chairman & CEO

I mean when you look at it in the fourth quarter, it was negative. And then when you started to see some of the news, that started to change in the first quarter and then started to stabilize sort of closer to flat.

Operator

[Operator Instructions] This concludes our question-and-answer session. I would like to turn the conference back over to Dino Robusto for any closing remarks.

Dino Ennio Robusto
Chairman & CEO

Okay. Thank you, everyone, for joining us. And we look forward to telling you about the results for the second quarter next quarter. So thank you.

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