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Earnings Call

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Call Participants

EXECUTIVES

Dino Ennio Robusto
Chairman & CEO

Ralitza Todorova
Vice President of Investor Relations & Rating Agencies

Scott Robert Lindquist
Executive VP & CFO

ANALYSTS

Joshua David Shanker
BofA Securities, Research Division

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

Presentation

Operator

Ladies and gentlemen, good day, and welcome to the CNA Third Quarter 2023 Earnings Conference Call. [Operator Instructions] As a reminder, today's conference is being recorded. I would now like to turn the call over to Ralitza Todorova, Vice President of Investor Relations and Rating Agencies for opening remarks and introduction of today's speakers. Please go ahead.

Ralitza Todorova
Vice President of Investor Relations & Rating Agencies

Thank you, Jason. Good morning, and welcome to CNA's discussion of our third quarter 2023 financial results. Our third 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 their 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, October 30, 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 supplement 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. In the third quarter, CNA continued to produce very strong results with a significant increase in core income driven by higher investment income, record P&C underlying underwriting gain, lower levels of catastrophe loss and improved results in Life & Group.

Our top line production continues to be driven by our Commercial business segment with broad success across our middle market, construction and national accounts units. And as discussed in prior quarters, we have continued to push for appropriate rate in those lines, which have been adversely affected by social inflation. Last quarter, I specifically addressed the inflection point that we saw in excess casualty and commercial auto where rate increases accelerated. And this quarter, that trend continued. We believe higher rates for longer are appropriate in these lines, and we are pleased that there is an increasing awareness for this need in the marketplace.

Drilling down on the details for the quarter. Core income increased considerably in the third quarter to $289 million from $43 million in the prior year period. We conducted our annual Life & Group reserve assumption review in the quarter, resulting in an essentially neutral change in total. Last year, the reserve assumption review resulted in a loss of $143 million after tax adjusted to reflect LDTI accounting. Excluding the impacts of Life & Group reserve assumption review in both periods, core income was still up 56%.

Net investment income was up 31% with positive income in our alternatives portfolio compared to a loss in the prior year quarter and a higher gain in our fixed income portfolio, due to greater yield and a higher volume of invested assets. Scott will provide more detail on investments and Life & Group results. P&C

core income was up 35% in the quarter, reflecting higher investment income, record pretax underlying underwriting gain and lower cat losses. The P&C all-in combined ratio was strong at 94.3%, with pretax catastrophe losses of $94 million or 4.1 points of the combined ratio compared to $114 million or 5.5 points in the third quarter last year.

Our cat result in the quarter was also below our 10-year average for third quarter catastrophes. Favorable development was 0.2 points in the quarter. The underlying combined ratio was 90.4%, generating a record $220 million of pretax P&C underlying underwriting gain. The underlying loss ratio was 60% and the expense ratio was 30.1%. The P&C expense ratio benefited by 0.6 points in the quarter from a favorable reinsurance acquisition-related catch-up adjustment in International.

In the quarter, we achieved 7% growth in gross written premiums ex-captive and 6% growth in net written premium. Renewal premium change in the quarter of 6% reflected a rate change of 5%, consistent with the first half of the year and included an exposure increase of 1%. Exposure change is lower than the prior quarter because of underwriting actions we took on certain accounts, leveraging the favorable hard market conditions to further improve the loss profile.

As an example, we increased attachments and reduced participation on certain large national accounts. While these actions had the effect of reducing the exposure metric we report, it is masking the positive impacts of exposure increase that act like rate, which we continue to experience in the quarter. This includes mid-single-digit exposure increases in work comp and high single-digit valuation changes in our property portfolio similar to last quarter.

Rate and exposure that acts like rate is still covering our long-run loss cost trends, which continue to run at about 6.5% in aggregate. Retention was 84% in the quarter, down 2 points compared to the prior quarter. And in any given quarter, there can be some fluctuation based on the mix of accounts under competition. And when we can't get the terms and conditions we deem necessary, we'll let the account go. Year-to-date, our renewal retention is 85%, which is the same level for the first 9 months of 2022 and in line with expectations. New business was up $20 million in the quarter or 4% or $127 million or 9% for the first 9 months of the year.

Turning to our 3 business units. The all-in combined ratio was 90.1% for Specialty this quarter, which includes 0.6 points of favorable prior period development. The underlying combined ratio was 90.7% with an underlying loss ratio of 58.6% and the expense ratio was 31.8%. Gross written premiums ex-captive growth was down minus 1%, similar to the second quarter, and net written premium growth was down minus 2% this quarter. New business was down 7%, and the decrease continues to be driven by the protracted decline in business opportunities we commented on over the last few quarters, such as M&A activity and our prudent approach to new business on management liability lines.

Within Specialty, the rate change turned positive to plus 1% in the quarter, up 2 points compared to last quarter. [FIML] pricing improved 5 points driven by D&O price decreases which moderated in the quarter, and we believe that is rational as the third quarter reflects the start of a second round of price decreases. Although encouraged by the moderation, it is too early to know if this is a hard inflection as the result in any one quarter, as I just mentioned, can be impacted by the mix of individual accounts renewing in the quarter.

We were also successful in raising rates by an additional 2 points in the quarter to 7% in our health care Med Mal business. And our affinity programs continue to produce stable rate increases in the low to mid-single digits. Retention in Specialty remained very strong at 87% in the quarter and 88% on a year-to-date basis, up 2 points compared to 86% in the same 9-month period last year.

Turning to Commercial. The all-in combined ratio was 98.9% which includes 7.4 points of cat loss in the third quarter. The underlying combined ratio was 91.5%, 0.4 points lower than last year and the lowest on record. The underlying loss ratio of 61.5% was stable year-over-year and the expense ratio improved by 0.4 points to 29.5% in the quarter, representing the lowest quarterly expense ratio in 15 years.

We had another strong double-digit growth quarter in Commercial. Gross written premiums ex-captives grew by 13% and net written premium grew by 11% in part, fueled by continued excellent new business growth of 19% in the quarter. Renewal premium change was plus 9% in the quarter, down 2 points from the second quarter, due mainly to the exposure decline from underwriting actions that I mentioned earlier. The Commercial rate change was plus 8% in the quarter, comparable to the prior quarter. Casualty rates continue to improve with commercial auto rates at low double digit in the quarter, 1 point higher than the prior quarter. And rates for excess casualty are now double digit, up a couple of points from last quarter.

Property pricing continues to be very strong. In national accounts, rate increases in the quarter were in the mid-20s and middle-market property rate increases are at their highest levels during this hard market at low double-digit levels. Work comp rates were a couple of points lower than the prior quarter, a continuation of the quarterly fluctuation we have seen in the pricing between slightly positive and slightly negative over the last 3 years.

Additionally, renewal price change in the quarter remained positive as we continue to benefit from exposure increases as payrolls rise. Audit premiums continued to favorably impact growth as well. And medical trends continue to be below our long-run loss cost trend assumptions, which we have not lowered despite the favorable trends over the last several years.

Commercial retention was solid at 83%, down a few points in national accounts and middle market. I am very comfortable with the rate retention decisions the underwriters are making as they focus on leveraging this hard market, to write quality new business while increasingly optimizing the portfolio. The evidence of this can be seen across the Commercial portfolio, through the continued very strong pricing on property as well as the rate improvement we are achieving in the casualty lines, the consistently lower catastrophe results against our 10-year average and our record underlying profitability.

For International. The all-in combined ratio was 88.3% and the underlying combined ratio was 86%. The underlying loss ratio of 57.9% is 0.7 points lower than last year and the expense ratio was 28.1%. As I mentioned earlier, our International segment benefited from a favorable reinsurance acquisition-related catch-up adjustment. And excluding this benefit, the International expense ratio would be 32.8% in the quarter.

International gross written premium growth was 6%, and net written premium growth was consistent with last quarter at 9%. New business of $62 million was down in the quarter, but in line with last year on a year-to-date basis. Renewal price change was 7%, similar to the prior quarter and retention was strong at 84%. As I've highlighted before, our International operation is consistently contributing profitable growth to CNA.

And with that, I'll 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 $289 million in the quarter compares to $43 million last year, and our core return on equity was 9.4%. On a year-to-date basis, core income of $922 million is a record high. Our third quarter P&C expense ratio was 30.1%, which is a decrease when compared to last year's third quarter expense ratio of 30.8%. The lower expense ratio in the current year is the result of higher net earned premium as well as a favorable reinsurance acquisition-related catch-up adjustment in the International segment, which reduced the total P&C expense ratio by 0.6 points. We continue to believe that a 31% expense ratio is a reasonable run rate going forward.

The P&C net prior period development impact on the combined ratio was favorable by 0.2 points. In the Specialty segment, favorable development in surety was partially offset with unfavorable development in professional and management liability. The P&C paid-to-incurred ratio was 0.82 for both the current quarter and on a year-to-date basis.

Our Corporate segment produced a core loss of $33 million in the third quarter compared to a $25 million loss in the prior year quarter. The Corporate segment results include a $16 million after-tax charge related to unfavorable prior period development, largely associated with legacy mass tort abuse claims. As a reminder, our asbestos and environmental reserves are reviewed every fourth quarter.

In Life & Group, we had a core loss of $29 million compared to $192 million core loss last year. Both periods were impacted by our annual reserve assumption update and essentially neutral $2 million unfavorable after-tax impact for the third quarter of 2023, and a $143 million unfavorable impact for Q3 2022.

As we have noted in earlier calls this year, 2022 results have been adjusted to reflect the adoption of LDTI accounting for our long-term care business, which we adopted earlier this year. Life & Group investment income was up $29 million pretax compared to the prior year quarter, mostly driven by limited partnership performance, while underwriting results for the quarter include an estimated $4 million pretax unfavorable impact from $39 million of cash policy buyouts during the quarter. Excluding the impact of the reserve assumption updates and this quarter's policy buyouts, Life & Group underwriting results are flat compared to prior year.

Each year, in the third quarter, we undertake our reserve reviews for Life & Group, which includes the analysis of reserving assumptions underlying our long-term care and structured settlement reserves. The key result of this year's update is essentially a neutral impact to Life & Group GAAP reserves. The results of that review are highlighted on Slide 13 of our earnings presentation. Our analysis involves a thorough review of all of our reserving assumptions, including cost of care, inflation, morbidity, persistency and rate increase assumptions.

Note that under LDTI accounting, the net premium ratio can defer favorable or unfavorable results into future periods, depending on the policy or cohort impacted. The 2023 assumption updates lowered our net premium ratio, which defers some of the favorability into future periods. The result was an $8 million unfavorable adjustment to long-term care reserves after the deferral of $78 million of favorability into future periods.

Finally, we have a $6 million favorable adjustment to structured settlement reserves, mostly due to more favorable interest rate assumptions. And while on the topic of long-term care, I would like to point you to Slide 14 of our earnings presentation, where we will provide a business update on our long-term care block. We believe our proactive approach to managing this block combined with the current higher interest rate environment over the last 18 months has considerably improved the outlook for this business.

As a reminder, our individual block has been closed since 2004 and our group business has been fully closed since 2016. We have achieved substantial reduction in policy counts since then, while achieving meaningful rate increases and benefit reductions. And on the investment side, the favorable interest rate environment since early 2022 has improved the underlying economics of this business as we have been able to lock in high-quality, longer-duration securities at attractive coupons to support the liability duration of the business.

Turning to Slide 15 of the earnings presentation, we drill into the individual block characteristics. This block is more mature with an average age -- an average attained age of 81 years and generally features richer benefits, including inflation riders on the majority of policies and lifetime benefits on some policies. The derisking of this block is well underway through in-force initiatives with policy counts down by 40% since 2015 and stable open claim counts. We believe that individual LTC reserves have hit an inflection point and have begun to decline using locked-in discount rate assumptions.

On Slide 16, looking at the group block characteristics. The attained age is 68 years and compared to the individual block, the group block features less rich policy benefits. Only 1% of group policies feature lifetime benefits, the block has a relatively modest exposure to inflation and is more appropriately priced. We currently believe group reserves will peak in the mid-2030s and at a significantly lower level relative to the individual block, primarily due to the lower benefit features and more appropriate pricing.

Turning to investments. Total pretax net investment income increased 31% to $553 million in the third quarter. The increase was driven by our limited partnership and common stock portfolios, which returned a $28 million gain in the third quarter compared to a $44 million loss in the prior year quarter. Additionally, income from fixed income and other investments was $59 million favorable compared to the prior year quarter. Our fixed income portfolio continues to produce consistent income, which has been steadily increasing as a result of favorable interest rates and strong cash flow from operations.

The effective income yield of our consolidated portfolio was 4.7% in the third quarter compared to 4.6% in the second quarter and 4.4% in the prior year quarter. As of the end of the third quarter, reinvestment rates continue to be significantly above our P&C effective income yield and have now surpassed our Life & Group portfolio effective income yield, which is a longer duration portfolio with embedded yields more comparable to today's interest rate environment.

Net investment losses were $31 million in the quarter and included modest losses in our fixed maturity security portfolio, which were largely reflective of a modest amount of portfolio repositioning. At quarter end, our balance sheet continues to be very solid with stockholders' equity, excluding AOCI, of $12.3 billion or $45.43 per share, an increase of 7% from year-end 2022, adjusting for dividends. Stockholders' equity, including AOCI was $8.6 billion or $31.61 per share.

With the increase in interest rates during the third quarter, the net unrealized investment loss in our fixed income portfolio stood at about $4.5 billion at quarter end. However, the LDTI single A interest rate adjustment of our liability for future policy benefits served to offset a portion of the unrealized investment loss in AOCI income by $807 million at quarter end.

We continue to maintain a conservative capital structure with a low leverage ratio and a well-balanced debt maturity schedule. During the year, we have successfully issued $500 million of senior notes to help position us ahead of the upcoming debt maturities in November 2023 and May 2024. Operating cash flow remains very strong. In fact, the highest operating cash flow quarter since 2011. During the third quarter, cash flow from operations was $828 million, up from $737 million in last year's third quarter.

Turning to taxes. The effective rate on core income was 20.6% for the quarter. And as I have noted in recent calls, looking forward, we expect an effective tax rate to be about 21%. Turning briefly to another topic. We expect to take a $24 million pretax Corporate segment impairment charge in the fourth quarter related to opportunities to optimize some of our real estate footprint in the post-pandemic work environment. We expect to continue to evaluate our own-use real estate portfolio for further optimization opportunities which will allow us to utilize future savings to make additional investments in technology, talent and analytics. Finally, we are pleased to announce our regular quarterly dividend of $0.42 per share to be paid on November 30, 2023, to shareholders of record on November 13, 2023.

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

Dino Ennio Robusto
Chairman & CEO

Thanks, Scott. The recap, CNA had an excellent quarter with strong levels of core and net income driven by increased levels of net investment income, which will continue to be a tailwind going into 2024, continued improvement in our core P&C underlying underwriting income and prudent cat management.

We experienced continued pricing improvement in the quarter in the areas we believe need to stay higher for longer. Property pricing remains historically high in large national accounts and at a high watermark in our package business, which is rational given the persistent elevated levels of industry cat losses. Commercial casualty lines, most impacted by social inflation improved further in the quarter. And overall, Specialty pricing turned back positive on the pricing improvements in management liability and Med Mal. And finally, the dedicated focus to derisk our runoff long-term care portfolio has had a major impact as policy counts are down more than 40% since the block was closed to new participants. And with that, we'd be happy to take your questions.

Question and Answer

Operator

[Operator Instructions] Our first question comes from Josh Shanker from Bank of America.

Joshua David Shanker
BofA Securities, Research Division

So look, the combined ratio results are excellent in the P&C industry. You've been doing this a long time. Can you frame for us 30, 40 years of experience in markets, are we at the bottom? Can combined ratios get better 10 years from now, 5 years now, 3 years from now? How should we be thinking about what this business can underwrite to compared with where we are right now?

Dino Ennio Robusto
Chairman & CEO

Okay. There's a heck of a start of a question, Josh. Thanks for the question. I mean, Josh, all I can say is after the financial crisis, there was a lot of concern about whether the insurance industry faced with lower interest rates for longer, could actually continue to generate similar strong return on equities, that it would require a considerable decrease in combined ratios. And I think there was some skepticism back then in '07, '08, and I think the industry and in particular, the best players have clearly responded.

And I guess, as we look over the last few years, one of the things that clearly surprised us was the impact of social inflation that we started to see in 2017 and literally doubled our long-run loss cost trends in the last 3 or 4 years in the industry, along with its elevated cats responded, I think, effectively in pushing for better pricing and better terms and conditions. It doesn't specifically tell you what's going to happen in 5 or 10 years from now, Josh. But I think it reflects the resiliency of this industry, it's increased discipline to do what it needs to do to maintain reasonable returns. And I guess that's the best I can offer you.

Joshua David Shanker
BofA Securities, Research Division

Okay. Switching gears, I know, I mean, the P&C results are great and maybe a lot of long-term care in the past. But when I'm looking at the long-term care book with the third quarter reserve review ongoing, to what extent are the policies in that, I guess, maybe as a percentage or maybe as sort of a block. Are they being offered alternatives in terms of changing the terms of the policy? And what's the take-up rate on those who are offered changes in terms?

Scott Robert Lindquist
Executive VP & CFO

Josh, it's Scott here. Thanks for the question. So we really started the policy buyouts late last year. We do those in conjunction with rate increases. Same with the benefit reduction options. We started those a few years back actually. And again, they are offered in connection with rate actions, rate increases. So it's going to vary state by state. We had significant amount of activity in our group business for several large states earlier this year.

It's still early days as far as take rates go. I would say, just off the top of the head, individual, we've seen 2% to 4% take rates on the group business, somewhat higher, 5% to 8%. But we're still very much in the midst of these offers. Some of these numbers are still developing. I would say right now, it's been a relatively small proportion of policies that have been offered, benefit reductions and policy buyouts. Again, the buyout piece, we really just started right about a year ago or so. So we still have some runway to go on that. We're -- our rate increase programs are ongoing. We were fairly successful this year in achieving rate increases, and we expect that to continue going forward and expect to continue to offer those buyout options going forward.

Joshua David Shanker
BofA Securities, Research Division

Just to understand, only a small percentage of the policies have been offered these options? And when I look at the amount taking up, it's in a single-digit percentage of the policies, either to the buyout or a benefit reduction?

Scott Robert Lindquist
Executive VP & CFO

That's correct. That's correct.

Joshua David Shanker
BofA Securities, Research Division

And when someone takes a benefit reduction, is it immediately beneficial to your capital position? Or what are the economics for CNA when somebody says, I'll limit the number of years of payout or I'll cap my benefit. What happens to your balance sheet, your capital position when that occurs?

Scott Robert Lindquist
Executive VP & CFO

So that's an improvement. I mean, that's a reduction in our reserves, both statutory and GAAP. So it's, obviously, reflective of the lower risk in that policy going forward, and that's reflected in our results when that happens.

Joshua David Shanker
BofA Securities, Research Division

Premium goes down, but capital goes up, I guess. Is that right?

Scott Robert Lindquist
Executive VP & CFO

In effect, correct, because the reserve will come down. Reserves may come down, too.

Operator

[Operator Instructions] Our next question comes from Meyer Shields from KBW.

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

Great. One question on long-term care, if I can. So Slide 14 notes that premium rates are 45% higher than 2015. What's the corresponding number for loss trend over that period?

Scott Robert Lindquist
Executive VP & CFO

I'm sorry, can you just repeat that? Corresponding and loss trend?

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

Yes, the loss trend that corresponds to the 45%.

Scott Robert Lindquist
Executive VP & CFO

Yes. I don't have that number on the top of my head. We can take that off-line, follow-up so we can get that for you.

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

Yes. Perfect, will do. And then a couple of other small questions. First, third-party captive gross written premium has been declining for almost 2 years. And I understand that, that has limited impact on underwriting results, but I was just trying to understand what's going on there.

Dino Ennio Robusto
Chairman & CEO

Yes. It's really -- and the captive is with respect to the cell phone business, and there's been a merger there, and so we lost some premium on the cell phone capital. That's all it is, Meyer.

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

Okay. That's helpful. And then final question, and this is absolutely not CNA-centric, but the industry has been struggling with commercial auto for a long time, and it's great to hear that rate increases are accelerating. What has seem anything you do differently so that this perpetual problem of not being able to catch up with loss trends, is no longer an issue?

Dino Ennio Robusto
Chairman & CEO

Yes. It's clearly been a catch-up game on commercial auto. It seems to be even though we don't have it, it seems to be some similar trends in personal auto. And I think it is the issue really around the same thing that's impacting, sort of excess casualty lines. The social inflation impacts had a big -- has a big impact. But on commercial auto, you tend to see it impact the results quicker than on complex sort of BI losses. And so it's just a catch-up game. And I think it started off slowly, but it seems to be picking up momentum. And I really do think this is going to be a continuing trend for longer.

And really, that's what you have to do. It just needs more pricing. And that's why we've been particularly focused on it. And whenever we do something like that, we highlight it to you. And we've seen an increase in this third quarter and in the second quarter. Now we just got to keep pushing because the social inflation, I think, impacts it quicker.

Operator

[Operator Instructions] There are no more questions in the queue. 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

No, that's great. Thank you, everyone, for joining us today, and we'll talk to you in a quarter.

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