S&P Global
Market Intelligence

CNA Financial Corporation NYSE:CNA

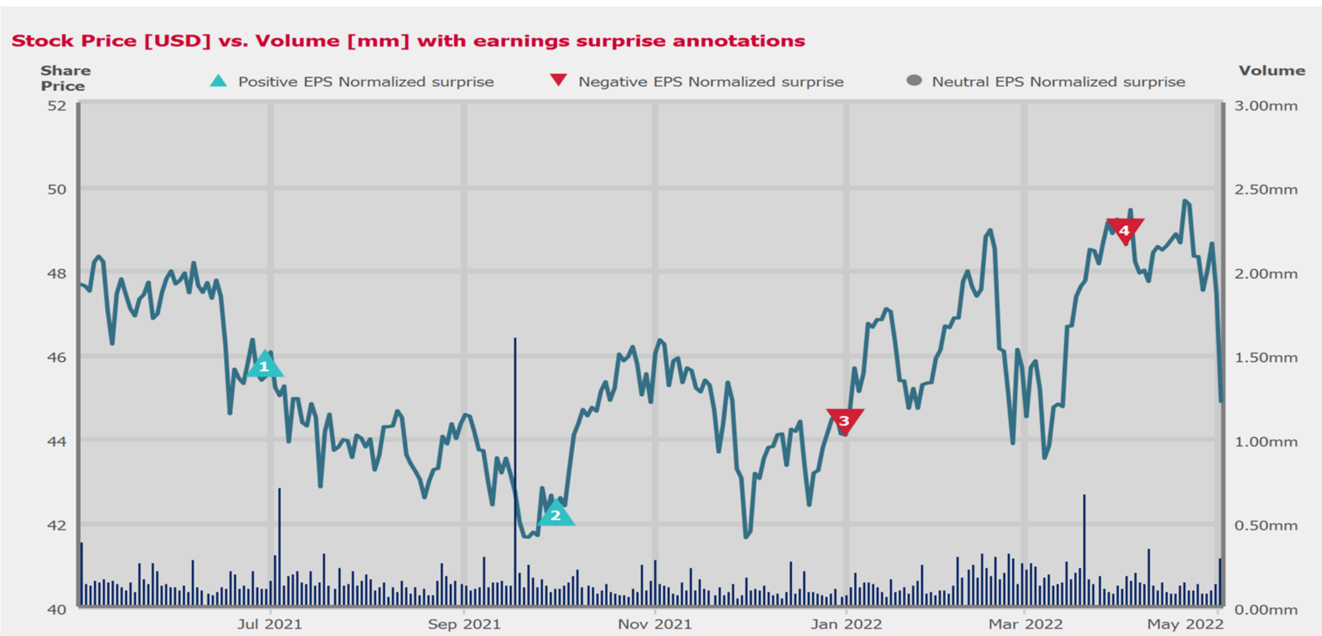
FQ1 2022 Earnings Call Transcripts

Monday, May 02, 2022 1:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ1 2022-			-FQ2 2022-	-FY 2022-	-FY 2023-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	1.22	1.16	(4.92 %)	0.96	4.05	NA
Revenue (mm)	NA	NA	NA	NA	NA	NA

Currency: USD
Consensus as of May-03-2022 2:06 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ2 2021	1.12	1.25	11.61 %
FQ3 2021	0.68	0.87	27.94 %
FQ4 2021	1.00	0.97	(3.00 %)
FQ1 2022	1.22	1.16	(4.92 %)

Table of Contents

Call Participants

EXECUTIVES

Dino Ennio Robusto
Chairman & CEO

Scott Robert Lindquist
Executive VP & CFO

ANALYSTS

Gary Kent Ransom
Dowling & Partners Securities, LLC

Joshua David Shanker
BofA Securities, Research Division

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

Presentation

Operator

Good morning and welcome to CNA's discussion of its 2022 first quarter financial results. CNA's first quarter earnings release, presentation and financial supplement were released this morning and are available via its website, www.cna.com.

Speaking today will be Dino Robusto, CNA's Chairman and Chief Executive Officer; and Scott Lindquist, CNA's Chief Financial Officer. Following their prepared remarks, we will be opening 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 release and CNA's most recent SEC filings. In addition, the forward-looking statements speak only as of today, Monday, May 2, 2022. CNA expressly disclaims any obligation to update or revise any forward-looking statements made during the call.

Regarding non-GAAP measures, reconciliations to the most comparable GAAP measures and other information have been provided in the financial supplement. The call is being recorded and webcast. During the next week, the call may be accessed on CNA's 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 now turn the conference over to CNA's Chairman and CEO, Dino Robusto. Please go ahead, sir.

Dino Ennio Robusto
Chairman & CEO

Thank you, Cecilia, and good morning all. We started off the year strong with increased underlying P&C profitability, lower catastrophe losses and good production results. But before we begin with the details, I wanted to acknowledge the unconscionable loss of life and devastation in Ukraine. Our hearts reach out to the displaced and suffering.

Turning back to the quarter. Core income was up 20% to $316 million, despite lower investment income from LPs and common stock. In the first quarter, the all-in combined ratio was 91.9%, 6.2 points lower in the first quarter of 2021 and our best quarterly all-in combined ratio since the third quarter of 2016. Pretax catastrophe losses were only $19 million or 1 point of the combined ratio. The P&C underlying combined ratio was 91.4%, a 0.5-point improvement over the first quarter of 2021. The expense ratio of 31% was lower by 0.5 point, and the underlying loss ratio of 60.1% was the same as the prior year quarter.

But as I've mentioned in prior quarters, the property quota share treaty that we purchased in June of last year lowered the premium mix between property business and our other classes. And since our property business has a lower underlying loss ratio, this mix effect increased overall P&C underlying loss ratio. In the first quarter, this mix effect on P&C overall was 0.3 points. So we actually recognized a 0.3 points of margin improvement in the quarter after adjusting for the mix.

There was margin improvement in Specialty and International. And accounting for the mix effect, which for Commercial is 0.7 points, the underlying loss ratio in Commercial was consistent with the prior year's quarter. For P&C overall, the prior period development was favorable by 0.5 points on the combined ratio, similar to the first quarter of 2021.

Now turning to production. Gross written premium, excluding our captive business, grew by 8% in the first quarter, and net written premium grew by 4%. Excluding currency fluctuations, the growth was 9% and 5%, respectively. The impact of the property reinsurance structure change from June of last year also had the effect of widening the spread between gross and net written premium growth.

New business grew by 14% this quarter to $451 million. Retention was 83% this quarter and was up 2 full points in each of Specialty and Commercial compared to last quarter. Exposure change was plus 2% this quarter. The overall written rate increase was 7% this quarter, down 1 point from last quarter. While generally showing a moderating trend in aggregate, the movement was varied in different parts of our portfolio.

For Commercial, the rate increase of plus 5% remained the same as it was in the fourth quarter of 2021. Excluding workers' compensation, the Commercial rate increase was plus 7%, also consistent with the last quarter. Specialty achieved rate increases of 9% in the quarter. This is down 2 points from the fourth quarter, but about half of this decline is due to the seasonality mix of business as our Affinity professional E&O programs are a larger percentage of [specialty] premiums in the first quarter compared to the remainder of the year. And these profitable programs have low single-digit rate increases.

International rate increase of 9% moderated from the double-digit highs but remained strong and will continue to fuel the earned rate, which in the quarter was plus 13% for International. Overall, earned rate for P&C in total was plus 9% this quarter and still represents a meaningful gap above our loss cost trends, which now are between 5.5% and 6% in aggregate.

Recall that during the third quarter of last year, we spoke to you about how we raised our long-run loss cost trend assumptions in property in response to the economic inflation we were seeing at the time. That put our overall loss cost trend assumptions at about 5%. In the last 6 months, the rate of economic inflation in the U.S. has accelerated. And as the courts have started to reopen and slowly clear the backlog in their dockets, with it, social inflation, which we consistently contended, was merely obfuscated by the pandemic rather than extinguished, also remains an inflationary factor.

With 3- to 3.5-point gap between 9 points of earned rate and our loss cost trends, we have continued to reflect a small portion of this implied margin. This quarter, we did so of 0.3 points. For the full year of 2021, we recognized about 0.6 points of margin improvement in the underlying loss ratio, excluding the impacts of COVID in the prior year.

We continue to remain prudent in reacting to margin improvement in our portfolio because economic and social inflationary pressures may continue to increase or persist longer than anticipated, making it difficult to know at this time how actual margin will materialize over time. And if we have been too conservative, we will benefit from the margin later on, all else being equal.

Now let me provide a little more detail on our 3 business units. The all-in combined ratio for Specialty was 88.7% in the first quarter, which is the seventh consecutive quarter below 90%. The underlying combined ratio was 90%, consistent with last year. The underlying loss ratio improved by 0.5 point to 58.9% as earned rates are exceeding loss cost trends. The expense ratio of 30.9% is up slightly from the first quarter of 2021.

Gross written premium ex captives grew by 8% in the first quarter, and net written premium growth was 4%. Specialty growth was negatively impacted by approximately 3 points this quarter,, due to the continuation of nonrenewals in parts of our Healthcare portfolio that I previously discussed. Despite that, retention still improved 2 points this quarter to 85%, and new business was up 41%.

Turning to Commercial. The all-in combined ratio was 94.5% in the quarter, including 1.8 points of cat. This is the lowest all-in quarterly combined ratio since 2008.

The underlying combined ratio was 92.7%. The underlying loss ratio of 61.5% is 0.7 points higher than the prior year quarter. However, as I mentioned earlier, it is consistent year-over-year, adjusting for the mix impact of the property reinsurance program we purchased last June. The expense ratio improved by 0.7 points to 30.7% in the first quarter.

Commercial gross written premium ex captives grew by 9% this quarter, and net written premium growth was 4%. Earned rates for Commercial continue to remain strong at plus 7% in the quarter and plus 9%, excluding workers' comp. And based on the moderation of written rates we've been experiencing, Commercial earned rates ex work comp, we believe, would remain at or above loss cost trends for the remainder of 2022.

Additionally, some portion of the exposure increase, which for Commercial, was 3% in the quarter, could have comparable benefit to margin as rate increases do. Even if we assume only 1/4 of the exposure increase acts as rate or roughly 0.5 point, it is still quite meaningful in offsetting some of the long-run loss cost trend increases this quarter.

We are experiencing mid-single-digit exposure changes in lines of insurance with inflation-sensitive exposure basis like work comp and general liability. We are also seeing exposure increases in property more consistently with insurance-to-value adjustments to reflect the current inflationary environment.

Commercial retention was up 2 points this quarter at 85% and was higher than any quarter since prior to the pandemic. For International, the all-in combined ratio was 92.4% this quarter. This is the best all-in combined ratio since 2016. The underlying combined ratio was 91.2%, reflecting 2.8 points of improvement from the prior year quarter. The underlying loss ratio was 58.6%, including a full point of margin improvement compared to the last year, and the expense ratio of 32.6% is down almost 2 points.

In terms of the Russia-Ukraine war, our insurance exposure in Ukraine and Russia is small, and any impacts to our portfolio are expected to be de minimis. International gross written premiums grew 6% or 9% excluding currency fluctuation, and net written premiums grew 7% or 11%, excluding currency effects. Retention of 73% for International this quarter was lower due to some targeted nonrenewals in January where we couldn't secure appropriate terms and conditions in the market. Retention quickly improved to 80% for February and March.

Now as I mentioned last quarter, Scott Lindquist joined CNA early this year and formally transitioned into the CFO role in February. Larry Haefner is also with us for his last call, and he will be available for the Q&A portion of our call today.

With that, I will turn it over to Scott.

Scott Robert Lindquist
Executive VP & CFO

Thanks, Dino, and good morning, everyone. Based on our 20% increase in core income, our core ROE of 10.3% is up from 8.8% in the first quarter a year ago. Our P&C operations produced a core income of $321 million, which is a 22% increase as compared to Q1 2021. A key contributor to the strong result was our pretax underlying underwriting income of $165 million. In addition, our catastrophe losses were relatively modest at $19 million pretax compared to $125 million pretax last year first quarter.

Our Q1 expense ratio of 31% is in line with expectations that was set out in last year's earnings call and 0.5 point lower than Q1 2021. While we continue to make investments in technology, analytics and talent, and we are beginning to incur more G&E as we emerge from the pandemic, lower acquisition costs in Commercial and the higher effect -- the effect of higher net earned premiums have more than offset the effect of these higher costs. I will note, there will be a certain amount of variability quarter-to-quarter. However, we continue to believe an expense ratio of 31% is a reasonable run rate.

For the first quarter, overall P&C net prior period development impact on the combined ratio was 0.5 points favorable compared to 0.6 points favorable in the prior year quarter. Favorable development in our Specialty segment was driven by Surety and Warranty for more recent accident years, somewhat offset by Medical Malpractice.

Our Corporate and Other segment produced a core loss of $28 million in the first quarter, which compares to a $36 million core loss in Q1 2021. Prior quarter results include $12 million after-tax loss on a loss portfolio transfer of certain legacy excess workers' compensation reserves. For Life & Group, we had core income of $23 million for Q1 2022, which was $13 million lower than last year's Q1, primarily from lower investment income and higher expenses.

While we are on the topic of Life & Group, I'd like to comment on the approaching change in GAAP accounting methodology related to Long Duration Targeted Improvements that will apply to our long-term care business, which we have set forth on Pages 17 and 18 of our earnings presentation. We will adopt this new accounting guidance effective January 1, 2023, and will apply it as of January 1, 2021. 2 years of adjusted financial results will, therefore, be included in our 2023 financial statements.

As we noted in last quarter's call, this change in accounting has no impact to the underlying economics of CNA's business. This change in accounting requires entities to update discount rate assumptions on a quarterly basis using an upper medium-grade fixed income instrument yield. This new accounting also requires cash flow assumptions, which includes morbidity and persistency, to be reviewed, and if there is a change, updated on at least an annual basis. The effective changes in discount rate assumptions will be recorded in the other comprehensive income component of stockholders' equity, while the effect of changes in cash flow assumptions will be recorded in the company's results of operations.

The most significant impact at the transition date will be the effect of updating the discount rate assumptions to reflect [a] yield rather than using the expected yield from our investment strategy. This adjustment will be partially offset by the derecognition of shadow adjustments associated with long-term care reserves. As you can see on Page 18 of the earnings presentation, we estimate the net impact of these changes will be a $2.2 billion to $2.5 billion decrease of stockholders' equity as of the transition date of January 1, 2021. As I mentioned, we will be adjusting our quarterly results from Q1 2021 through Q4 2022 when we implement the accounting change in 2023.

In a rising interest rate environment like we have seen over the past 15 months, as the corporate Single-A rates increase the impact of the adoption decreases. As an example, assuming March 31, 2022 interest rates were in place on January 1, 2021, we estimate the transition impact would have been significantly lower to a decrease of $1 billion to $1.3 billion to stockholders' equity as corporate Single-A rates are substantially higher at March 31, 2022, than at January 1, 2021.

I do want to emphasize that this accounting pronouncement applies only to GAAP basis financial statements and has 0 impact to the underlying economics of CNA's business. This change has no impact on statutory earnings, capital or risk-based capital metrics and has no impact on the dividend capacity of our insurance underwriting subsidiaries. As such, this accounting change is viewed by us and the industry as noneconomic, as none of the underlying fundamentals of the business are changed by it.

Turning to investments. Total pretax net investment income was $448 million in the first quarter compared to $504 million in the prior year quarter. The decrease was driven by our limited partnership and common stock returns, which generated $8 million of income in the current quarter compared to $61 million in the prior year quarter. As a reminder, private equity funds, which represent about 70% of our LP portfolio, primarily report to us on a 3-month or greater lag. So our results this quarter are primarily reflective of performance from Q4 2021.

Hedge funds were down for the quarter, directionally in line with markets and reflect mixed results for managers. Hedge funds, which now represent about 30% of our LP portfolio, predominantly report results on a real-time basis. Our fixed income portfolio continues to provide consistent net investment income, slightly higher than the last few quarters and the prior year quarter. We continue to benefit from higher invested asset base,, driven by strong operating cash flows.

As a point of reference, our average book value has increased $1.4 billion from the prior quarter (sic) [prior year quarter]. And while our average portfolio yields are lower relative to the prior year quarter, I am pleased to note that in this current rising interest rate environment, we are now achieving significantly higher yields on reinvestment relative to the last several years. In fact, as of last week, reinvestment rates are on average 50 basis points higher when compared to those we achieved this past first quarter just ended. And we will take advantage of this as our bond portfolio matures, which is roughly on average, 7% each year, and as we put a significant portion of operating cash flows to work.

While the rising rate environment positively impacts the outlook for investment income, from a balance sheet perspective, it has reduced our net unrealized investment gain position to $1 billion at quarter end. This is down from $4.4 billion at the end of the fourth quarter 2021. I would like to note that interest rate-driven fluctuations in market values do not impact how we manage our investment portfolio as we generally hold our fixed income securities to maturity.

Notwithstanding the decrease in our net unrealized gain position, our balance sheet continues to be very solid. At quarter end, stockholders' equity, excluding accumulated other comprehensive income, was $12.1 billion or $44.67 per share, an increase of 2% from year-end adjusting for dividends. Stockholders' equity including AOCI, which reflects the reduction in net unrealized investment gains during the quarter, was $10.8 billion or $39.87 per share.

We continue to maintain a conservative capital structure to leverage ratio of 20% and continued to sustain capital above target levels in support of our ratings. First quarter operating cash flow was strong once again at $645 million and was a result of solid underwriting and investment results. In addition to strong operating cash flow, we continue to maintain liquidity in the form of cash and short-term investments, and together they provide ample liquidity to meet obligations and withstand significant business variability. Finally, we are pleased to announce our regular quarterly dividend of $0.40 per share, which will be payable on June 2 to shareholders of record on May 16.

With that, I will turn it back to Dino.

Dino Ennio Robusto
Chairman & CEO

Thanks, Scott. Before opening the call to the Q&A session, I have a few additional comments. We are bullish about 2022. The market conditions are excellent when you consider that rates are up plus 30% on a cumulative basis since the beginning of 2019, and we are benefiting from the compounding impacts of progressively better terms and conditions over that same time period from things like higher deductibles, coverage restrictions and limit reprofiling. And our new business pricing as well as terms and conditions track similar to renewals, so our new business rates are up substantially on a cumulative basis as well.

We believe these favorable conditions afford us the opportunity to continue to grow our portfolio through new business and strong retention. Relative to rate increases, they hit their peak in the fourth quarter of 2020 and have moderated at a measured pace of about 1 point per quarter to 7% in the first quarter of 2022. With written rate increases still in excess of long-run loss cost trends and earned rates at 9%, this should portend positive margin persisting through 2022.

Of course, there could be further upward pressure on loss cost trends. But the market has behaved rationally to prior increases in loss cost trends that have either accelerated precipitously or persisted at elevated levels for a protracted period of time, and we would anticipate the market pricing behavior would continue to react accordingly if loss cost trends accelerate further.
And with that, we'll be happy to take your questions.

Question and Answer

Operator

[Operator Instructions] We will now take our first question from Josh Shanker from Bank of America.

Joshua David Shanker
BofA Securities, Research Division

I appreciate the color on the alternative investment performance and about the hedge funds. A couple of questions. One is, if we break it up to limited partnerships and hedge funds, I mean, limited partnerships for peers had a fairly good return in 4Q. Does that portend that the hedge fund performance in 1Q was rough and continues to be so? Do we need to be concerned? Because in 2Q, we're going to see obviously the 1Q marks for the limited partnerships. Do you have any sort of color on how we should be anticipating that in 1 quarter ahead?

Scott Robert Lindquist
Executive VP & CFO

Josh, it's Scott. Thanks for the question. Yes. So if you take a look at our limited partnerships, again, 70% are private equity. This quarter results really reflected fourth quarter overall market performance. So yes, I would expect the second quarter private equity lag limited partnerships to reflect the first quarter overall equity performance. And of course, the hedge funds, those are real time, flow right through earnings real time. And then I would note about $200 million of common stock mark-to-market is within those results, too. That, of course, is real time also.

Joshua David Shanker
BofA Securities, Research Division

Okay. And have you -- I mean, as real time, have you seen any recovery on the hedge fund side from the 1Q marks?

Scott Robert Lindquist
Executive VP & CFO

I don't know if I can really comment on that right at this point in time.

Joshua David Shanker
BofA Securities, Research Division

Okay. It's totally fair. And I realize business mix has had a huge influence on combined ratios, and the rate and loss cost trends don't really explain the whole story, and you did explain that in the prepared remarks. But I'd also say that the rate in excess of loss costs, I think, has been the main story in P&C over the last 3 years. When I look at the Commercial segment, underlying 62.2 loss ratio, it's a very good number, but it's also the highest since 2Q '19, and it's really higher than the annual averages from 2016 to 2020. And I'm scratching my head a little. I think about -- maybe it would be worthwhile if you talk about when you came in, in 2015 what the business mix looked like in Commercial, what it looks like today and how that's been affecting the loss ratio despite the fact that you've been getting a lot of rate in excess of loss costs.

Dino Ennio Robusto
Chairman & CEO

Okay, Josh. I mean, I think we're comfortable today with the portfolio. We've made a lot of different re-underwriting changes that we've talked about on many calls, whether it is some of our cat exposure, some of our property exposure here in the United States, et cetera. So we're comfortable with the portfolio. I think -- when you take a look at the calendar year, Commercial loss ratio and combined ratio as indicated, I think it's been -- it's amongst the best that we've seen since 2008. The underlying Commercial loss ratio is consistent with the fourth quarter when you adjust for the property mix. The property mix did have the effect from the reinsurance to put pressure on the loss ratio -- on the underlying loss ratio because we ceded more property premium away.

But again, one of the reasons we purchased the reinsurance treaty, having also reduced a lot of our cat exposure, was to be able to balance the book a little bit going forward. It represented of -- about 20% in Commercial. 20% is property in our P&C overall. 80% is all the other sort of casualty lines. And in fact, it's interesting. If you were to take a look at the first quarter, property growth, we still had some re-underwriting going on from cat-exposed property. But if you take that aside, which is coming to the tail end, property was up actually above most of the other lines from a growth standpoint. And so I think we start to take advantage of that reinsurance treaty that impacted it sort of adversely.

So look, at the end of the day, we're pleased with our Commercial portfolio. We're pleased with how our PML to premium ratios have improved. And so we see it benefiting us both from an underlying standpoint and from a calendar standpoint. And then the margin conversation is what it is, Josh. We're going to -- we've been prudent, and we're going to stay that way. And if it's been a little too prudent, then maybe we'll benefit it -- from it, all else equal, later on.

Operator

We will now take our next question from Gary Ransom from Dowling & Partners.

Gary Kent Ransom
Dowling & Partners Securities, LLC

I wanted to ask a little bit more about inflation. And clearly, it's affected many of the short-tail lines, the economic inflation that we've seen over the last year. But how do you think about how that might seep into the social inflation that might affect long-tail lines? Can you share your thoughts on that?

Dino Ennio Robusto
Chairman & CEO

I mean, look, I think you could see it impact some of the social inflation and some of the correlation that we see from some of the inflationary pressures. I think, though, from -- honestly, from a social inflation standpoint, what we're looking at is, as the courts open up, Gary, and the dockets get cleared up a little bit, it will be interesting to see if that accelerates. I think our early read is we're clearly starting to see a little bit more attorney representation on certain claims, a little bit more pressure. But that's really where we think social inflation has got some pressure points and what we're watching very closely.

Gary Kent Ransom
Dowling & Partners Securities, LLC

All right. Yes. Have the dockets actually cleared very much? I mean, is that -- I realize it's opening...

Dino Ennio Robusto
Chairman & CEO

No. It's still early. It's still early, it's still early. So that's why when we think about being prudent, we just need some additional time to really see what is going on with the sort of social, legal toward sort of inflation. And so still early. But like I've always contended, right, it's -- it was just obfuscated by the pandemic rather than extinguished.

Gary Kent Ransom
Dowling & Partners Securities, LLC

Another thing you mentioned in the comments in the press release is that the rates remain robust where they're needed the most. And so I assume there's some pockets where there's still -- where profitability is not quite back to where it needs to be. Can you tell us what some of those places are? And maybe they're the same as they've always been, but I just wanted to ask.

Dino Ennio Robusto
Chairman & CEO

Yes. Yes, yes. Quite frankly, Gary, to a large extent. But look, I mean, Commercial auto, we're getting about 9 points of rates. That's good. It's slightly above loss cost trends, but it's going to have to sustain itself at 9% for a longer period of time, right, before we see that line of business getting into what we sort of consider a form of rate adequacy.

On the Healthcare, we're still seeing in parts of our Healthcare portfolio. We got double-digit rate increases. And there, too, that's required. International, in the quarter, still U.K., Europe, double-digit. Canada is a little bit less, but it's a lot more profitable. And then obviously, you know that work comp is down slightly. Cyber, it's not a big portion of the overall portfolio. It deteriorated quickly with ransomware claims, and we're still in and around almost triple-digit rate increases. So those are the lines that you would expect.

Gary Kent Ransom
Dowling & Partners Securities, LLC

All right. And then I just -- you told us that Ukraine was de minimis. But are -- do you have -- do you write any of those categories of lines that might be exposed and I mean, over there in the International book, whether it's credit risk or -- and I'm just trying to get a sense of the mix over there.

Dino Ennio Robusto
Chairman & CEO

That's fine. You may recall, Gary, one of the runoff lines several years back when we started to re-underwrite our Lloyd's syndicate was political risk and trade credit. And so that's all been in runoff. And we don't anticipate whatever might be a tail on that is going to come to be any form of an issue. And it's a small portion, a very small portion netted down on political violence that we will have through the syndicate, which we don't expect is going to amount to anything based on all of our analysis. So no, we're not a big writer of lines that are obviously getting affected, many of the -- many of which you and your analyst colleagues have all written about, and we don't play in those lines.

Operator

We will now take our next question from Meyer Shields from KBW.

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

Dino, can we get a little more color on the nonrenewals in International in January? Is there a particular line of business that you're finding less attractive?

Dino Ennio Robusto
Chairman & CEO

Yes. Sure. So it's really -- it's 2 things. There's a little bit of Healthcare portfolio. Since we have been in health care in the U.S. for a long period of time, we had a little bit of exposure. And it's under the same scrutiny as in the U.S. And unless we can get really substantially large rate increases, then we walked away from that.

And then as you know, Meyer, Jan 1, Europe is tacit renewal season. You get a lot of part of your portfolio that renews there. And for a lot of carriers, Jan 1 sometimes can be a feeding frenzy. And so there's some business that we could see, we're not going to get the terms and conditions that we wanted until we walk away from it, right?

Look, our International portfolio has come a long way. It's generating strong profitability, and we're going to work to make sure that does not go back to where it was.

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

Okay. That's helpful. The second question, and this is, I guess, more broad. Can you talk about how so far relatively little of the gap between earned rate increases and loss trends is hitting the bottom line? Is there the same, I'm trying to think the right word for it, offset to reserve development? In other words, are there indicated reserve releases that you're just not comfortable booking at this point in time?

Dino Ennio Robusto
Chairman & CEO

No. Meyer, look, as I've always contended, right, social inflationary pressures affect your current accident years, but they can also affect prior accident years that play out and settle in a current period. But every quarter, we do our reserve reviews and we feel comfortable with where those are.

It has to do with -- and again, maybe at the risk of sounding a little bit like a broken record. If you -- I look back over the several decades of my career, the last several years are quite unique relative to the inflationary pressures that have been escalating loss cost trends. Meyer, first, it was social inflation. It emerged over these last 5 years and went up pretty significantly. Then we had the economic inflation. We've been discussing with you how it's all gone up, the economic inflation in the third quarter. We then put that, caused our overall loss constraints to go to 5.

And now in the last 6 months, both the economic inflation has increased. And as I said, we'll wait to see, right, as this court opens up, the dockets clear. I think you're still dealing with an inflationary pressure. So the way I think about it is in terms of how to trigger what would be maybe a little bit more a sort of uptick in margin, I think we need to see some stability in the rate of acceleration of those loss cost trends. And it could settle at a higher level but settle and be more stable. And until we're faced with that kind of a trigger, we're just going to remain prudent.

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

Okay. No, perfect. That makes a lot of sense. Final question, if I can. I'm asking this because we've gotten somewhat different descriptions of this. Are you planning workers' compensation rate pressure to be a little worse in the first quarter of this year than the fourth quarter of last year?

Dino Ennio Robusto
Chairman & CEO

If -- I'll just make sure I heard. Meyer, you're referring to the rates on work comp and how they moved from first quarter to fourth quarter? If that's it, no. If you actually look at our rate movement on work comp over the course of the last 4, 5 quarters, it's been -- there's been a little bit of fluctuation up and down but relatively the same at about low single-digit, and we haven't seen any sort of trend. Back then, you recall, Meyer, I said I didn't see an inflection point, and it's just still playing out at the low single-digit rate.

Operator

We will now take a follow-up question from Josh Shanker from Bank of America.

Joshua David Shanker
BofA Securities, Research Division

I'm just looking for a little education on the fronting business with, I guess, the cell phones. Obviously, growth continues to look good. Can you talk a little about -- I mean about your arrangements there, the relationships you have, how sticky they are and whether as the 5G revolution takes place, that you're going to be there at the forefront of providing that service?

Dino Ennio Robusto
Chairman & CEO

Okay. Let's -- so on the Warranty business, as you know, Josh, we have 2 components. We have the electronics, and in particular the cell phones, for which that is done through the captive and reinsured back 100%, which is why we always give you the growth ex captives. And we do have a longer-term arrangement, and it's a function of how that sort of business grows. Then there's a little bit of other electronics business that we also go after. And then, of course, there's our auto warranty. And all in all, the Warranty business continues to be in all its aspects of focus for us. And on the issue of the 5G revolution, I'm going to leave it to those that are considerably more intelligent than I am on the technology.

Joshua David Shanker
BofA Securities, Research Division

Yes. So the important thing that I want to clarify, your relationships have -- are locked in for the next 3 years?

Dino Ennio Robusto
Chairman & CEO

Yes. Well, they are longer term, and I don't know when the exact sort of is coming up. But yes, they're multiyear deals and have been for a long time, and we have excellent relationships with them.

Operator

As there are no further questions at this time, I would like to turn the call back to your speakers for any additional or closing remarks.

Dino Ennio Robusto
Chairman & CEO

Well, that's great. Thank you, Cecilia, and thank you all. Talk to you next quarter.

Operator
Thank you. That will conclude today's conference. Thank you for your participation. Ladies and gentlemen, you may now disconnect.