S&P Capital IQ

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The Hanover Insurance Group, Inc. NYSE:THG

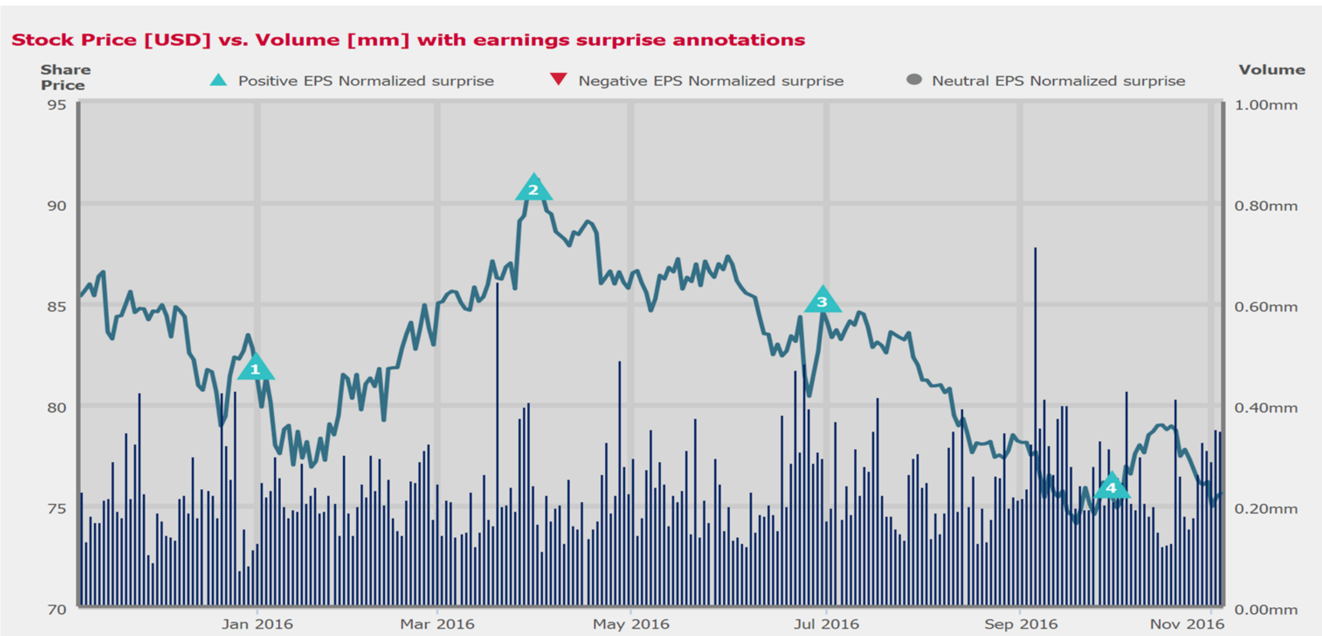
FQ4 2016 Earnings Call Transcripts

Friday, February 03, 2017 3:00 PM GMT

S&P Capital IQ Estimates

	-FQ4 2016-			-FQ1 2017-	-FY 2016-	
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	ACTUAL
EPS Normalized	1.03	(0.46)	NM	1.69	5.56	4.27
Revenue (mm)	1072.93	1082.00	▲0.85	-	4688.73	4698.80

Currency: USD
Consensus as of Feb-03-2017 6:21 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ4 2015	1.60	1.82	▲13.75 %
FQ1 2016	1.60	1.64	▲2.50 %
FQ2 2016	1.19	1.24	▲4.20 %
FQ3 2016	1.55	1.83	▲18.06 %

Call Participants

EXECUTIVES

Jeffrey Mark Farber
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Former Chief Executive Officer

Joseph M. Zubretsky
Chief Executive Officer, President and Director

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Paul Newsome

Presentation

Operator

Good day, ladies and gentlemen, and welcome to the Hanover Insurance Group Fourth Quarter Conference Call. My name is Marc, and I'll be your operator for today. [Operator Instructions] As a reminder, this conference is being recorded for replay purposes.

I would now like to turn the conference over to your host for today, Oksana Lukasheva, Vice President of Investor Relations. Please proceed.

Oksana Lukasheva
Vice President of Investor Relations

Thank you, operator. Good morning, and thank you for joining us for our fourth quarter conference call. We will begin today's call with prepared remarks from Joe Zubretsky, our President and Chief Executive Officer; and Chief Financial Officer, Jeff Farber. Available to answer your questions after our prepared remarks are Dick Lavey, President of Personal Lines; Jack Roche, President of Commercial Lines; and Johan Slabbert, Chief Executive Officer of Chaucer. Before I turn the call over to Joe, let me note that our earnings press release, financial supplement and a complete slide presentation for today's call are available in the Investors section of our website at www.hanover.com.

After the presentation, we will answer questions in the Q&A session. Our prepared remarks and responses to your questions today other than statements of historical fact, include forward-looking statements. There are certain factors that could cause actual results to differ materially from those anticipated by this press release, slide presentation and conference call.

We caution you with respect to reliance on forward-looking statements, and in this respect, refer you to the forward-looking statements section in our press release, Slide 2 of the presentation deck and our filings with the SEC.

Today's discussion will also reference certain non-GAAP financial measures such as operating income and accident year loss and combined ratios excluding fourth quarter and full year domestic development and catastrophes, among others. A reconciliation of these non-GAAP financial measures to the closest GAAP measure on a historical basis can be found in the press release, the slide presentation or the financial supplement, which are posted on our website, as I mentioned earlier.

With those comments, I will turn the call over to Joe.

Joseph M. Zubretsky
Chief Executive Officer, President and Director

Thank you, Oksana. Welcome everyone to our fourth quarter earnings call. Today, I will discuss overall results in our business performance, Jeff will cover financial details and an in-depth discussion of the results of our annual reserve analysis. And then I will provide some framing statements about our upcoming Investor Day before opening the line to your questions. In the quarter, we had an after-tax operating loss of $19.7 million or $0.46 per share and a consolidated combined ratio of 107.7%. For the year, we earned operating income of $184.4 million or $4.27 per fully diluted share and produced a consolidated combined ratio of 98.6%, generating an operating return on equity of 7%.

Our results were significantly impacted by the $174 million domestic reserve charge we recorded in the fourth quarter for prior year reserve development. The outcome of our annual loss reserve review. This, combined with some less significant prior year development in each of the first 3 quarters of the year, resulting in domestic prior year developments of $235.6 million for the full year. Excluding the domestic prior year development, operating earnings after tax for the quarter were $94.3 million, an increase of 6.8% from $88.3 million a year ago. For the full year, excluding the domestic prior year development, operating earnings after-tax were $337.5 million, an increase of 13.7% from $296.8 million in 2015.

This comparison, which includes favorable reserve development at Chaucer, is a more meaningful portrayal of the current business trends and the continued improvements we have made to our business mix and underwriting in pricing discipline. Chaucer favorable development has historically been stable and more consistent.

I will first provide my perspective on our reserve position and then discuss our operating performance excluding the impact of domestic prior year reserve development. We completed our annual in-depth reserve review led by our new CFO, Jeff Farber, and our Chief Actuary, Rick Burt, who joined our team a year ago. The review included an intensive actuarial analysis, evaluation of the underwriting profile over the various businesses, the strength of underlying case reserves and many other considerations, including independent reviews by third parties.

As a result, we concluded that it was appropriate to add $174 million to our domestic 2015 and prior reserve balances to reflect our best estimates by line of business.

We did not make any material changes to Chaucer reserve levels or its reserving methodology. Chaucer has continued its process of setting appropriately conservative loss estimates for the current accident year, given the natural lag in claims reporting in the excess layers and the complex nature of the coverage as it writes. As reported, Chaucer continued to have significant favorable development in 2016.

The net unfavorable development in our domestic business in recent quarters strongly suggest that trends were emerging that were not recognized in prior estimates. We increased ultimate loss estimates based on our current view of historical and emerging development patterns along with industry and economic data, giving more weight to a recently observed increase in severity in certain lines. We also adjusted reserves among business lines to result in a best estimate by line of business to ensure our clear view of loss cost trends, which ultimately inform our pricing decisions. Additionally, we completed thorough business reviews in the affected lines to help us understand the sources of the increased loss cost, and to inform our view of the quality of our current book of business.

These reviews confirmed our belief that the vast majority of reserve additions relate to business issues the company has successfully addressed in the recent past. This gives us increased confidence in the profitability of our current business portfolio and the resulting current accident year loss ratios. A significant amount of the total charge emerged from our specialty business segment, specifically, in the program business and the contract surety business. We strengthened our reserves for the AIX program business by approximately $50 million in the quarter, to address the challenging run-off of older terminated programs and substantially modified ongoing programs. We believe that the emerging loss experience mostly related to general liability coverages was not systemic but rather idiosyncratic to the specific programs written. Many of these programs were poorly underwritten with unproven distribution partners and significantly underpriced.

Our ongoing program portfolio is producing much improved returns, showing no signs of profit deterioration and continues to be an important contributor to our specialty offerings. We are confident that our recent accident year loss ratios achieved target profit and reflect our current view of the business.

We strengthened reserves in our contract surety business by $38 million in the quarter. During 2014 and 2015, surety bonds were written on smaller, less financially stable contractors. Slow government payers, financial stress of a slow economy and the frailty of these contractors have caused contract defaults and prompted us to take a much more pessimistic view of the losses expected to emerge from this portfolio. We performed an intense credit review of each surety bond and each contractor. We concluded that certain advances made to contactors under the terms of the surety contracts would not be recovered, and certain accounts on the watch-list warranted case or IBNR reserves.

We also determined that the remaining portfolio of accounts required additional IBNR due to an increase to an assumed default rate. We believe our reserves reflect the confident best estimate. New leadership has implemented stricter underwriting guidelines and taken other appropriate actions. We are now targeting higher-quality, more financially stable accounts for our products in specific geographies and through agents that's specialized in this business.

The remaining components of the reserve charge, primarily related to the previously reported pressure in the liability coverages in commercial multi-peril and commercial auto. These were partially offset by a reserve release in workers' compensation and the net effect of rebalancing each line of business to best estimate levels. These reserve adjustments significantly increase our confidence in the quality of our balance sheet. When we look through to the underlying performance metrics, the company produced solid results for the quarter and the full year.

In Personal Lines, the full year 2016 combined ratio of 92%, excluding prior-year development represents an improvement of 3.6 points over 2015. This improvement was driven primarily by lower catastrophe and noncatastrophe weather losses in the homeowners line. Personal auto underwriting performance remained stable year-over-year, as increased severity in physical damage, and to a lesser extent, bodily injury were offset by earned rate increases.

The growth in Personal Lines net premiums written of 5.2% in the year was attributed to rate increases, higher new business momentum from our account-based Platinum product and improved retention. Policies in force grew approximately 1 point year-over-year. This marks our first reported annual PIF growth since we began to execute targeted exposure and profit improvement actions in 2011. Account business is now 83% of our total book, and 89% of new business. Our commitment to being a bundled account provider continues to produce stronger customer retention, and ultimately, higher customer lifetime value.

Following the successful Platinum launch in our existing states, we entered Pennsylvania in December, introducing our new agency quoting and service platform, which we plan to rollout across our footprint over time. This is our first step in delivering technology and product capabilities to target the emerging affluent market, which totals $5 billion to $8 billion in our current 18 state agency footprint.

With respect to Commercial Lines, full year 2016 accident year combined ratio of 95.5% was an improvement of 2.9 points over 2015. This improvement was driven by lower catastrophe losses, improved accident year loss experience in most businesses as well as a slightly lower expense ratio, as we achieved some expense leverage due to

growth. The 3.5% full year growth in net premiums written largely reflects the impact of price increases, which are tracking slightly below our long-term loss cost assumptions, improved retention and modest new business gains. This core growth was somewhat offset by lower premiums at AIX and surety due to the account calling we previously described and prudent underwriting adjustments and pricing decisions.

We will continue to leverage our business insurance and specialty capabilities to achieve greater agency penetration, using our deep agency insight tools and business consolidation expertise. We also will seek to further extend our offerings through industry segmentation and specialty product penetration to capture a larger share of agency controlled business for profitable growth.

At Chaucer, we continue to effectively leverage our lead market position in underwriting expertise, delivering a strong result and a challenging global environment, with a combined ratio of 90.4% in 2016 compared to 87.5% in 2015. 2016 was characterized by benign catastrophe losses, but was partially offset by elevated large manmade losses, experienced throughout the year. We expect this type of volatility from time-to-time given the nature of the business. As expected, challenging market conditions place pressure on the top line. Excluding the sale of the U.K. motor business in 2015, net premiums written decreased 9.1% for the full year 2016, while gross written premiums only decreased by 2.4%. Maintaining gross written premium is important for our overall leadership position in the market as we are able to satisfy our clients and brokerage coverage needs. We continue to use reinsurance more actively and opportunistically in 2016, while limiting our risk appetite in classes associated with low margins and heightened competition, notably within energy and certain marine and aviation classes. Our new business initiatives in 2016, including our direct accident and health team in London, and our partnership with AXA in Africa help to replace the business that we can no longer write profitably.

We will continue to leverage our lead position in the market and our intellectual capital to drive disciplined underwriting, pricing and reselection.

I will now turn the call over to Jeff to review the highlights of our financial performance. Jeff?

Jeffrey Mark Farber
Chief Financial Officer

Thank you, Joe. As previously mentioned, the strengthening of domestic prior-year loss reserves by $174 million had a major impact on our fourth quarter results, leading to a net loss of $14 million or $0.32 per basic share in the fourth quarter of 2016 compared with net income of $78 million or $1.76 per diluted share in the prior-year quarter. For the year, we reported net income of $155 million or $3.59 per diluted share compared to $332 million or $7.40 per diluted share in 2015.

On an after-tax operating income basis, our loss for the quarter was $19.7 million or $0.46 per basic share compared to income of $80.3 million or $1.82 per diluted share in the prior-year quarter. For the year, after-tax operating income was a $184.4 million or $4.27 per diluted share compared to $280 million or $6.25 per diluted share in 2015.

Operating earnings, excluding domestic development for all periods were $94.3 million for the quarter, up from $88.3 million, and $337.5 million for the full year compared to $296.8 million in 2015. As Joe mentioned, based on our reserve and business analysis, we selected our best estimates. The estimates reflect our desire to be more conservative, given the inherent uncertainty of the reserving process, taking into consideration the unfavorable development in a number of recent quarters.

Overall, the prior-year domestic reserve strengthening of a $174 million, represents roughly a 1 point increase in the ultimate loss ratio to each year from 2013 to 2015, and a 0.5. point increase to both 2011 and 2012. However, as you would expect, accident years did vary by line. I will now review the impact of the reserve charge by line, starting with commercial multi-peril and general liability.

In commercial multi-peril and general liability, prior-year reserve additions of $68.8 million were primarily driven by 2012 to 2015 accident years, related to increased claim severity and litigation costs, concentrated primarily in 3 major metro areas. The $68.8 million in the aggregate consisted of $43.7 million for commercial multi-peril and $25.1 million for general liability. The latter is reported in other commercial lines.

We also have increased 2016 accident year reserves in commercial multi-peril to reflect a higher severity assumption as in prior accident years. As the company has mentioned on previous calls, areas of concern are addressed through pricing and underwriting decisions in affected geographies and risk classes and through claims initiatives. Despite isolated reserve challenges, our commercial multi-peril business continues to be profitable and remains an important part of our small commercial and middle market strategy. We also strengthened the balance sheet by $20.1 million in liability, claims made coverages, largely professional and management liability. Because these lines are still immature, growing businesses with a moderate tail, we believe they warrant a higher level of conservatism. This $20.1 million strengthening for claims made together with the $25.1 million of general liability mentioned earlier, represents the total $45.2 million of general liability reserve additions.

Moving to commercial auto. We added $18.4 million to the 2012 to 2014 accident years. We have seen a substantial moderation in trends in commercial auto bodily injury severity in 2015 and 2016 accident years, which has helped to affirm our view of the most recent ultimate best estimates in this line. However, we increased ultimate loss specs and reserves in years prior to 2015 due to some continuing claims severity concerns. As a whole, we remain encouraged by our recent progress and are confident in our ability to bring commercial auto to target profitability. Pricing and underwriting actions have been taken here starting several years ago. Our workers compensation line continues to be very profitable due to its small sized account characteristics and relatively low risk profile.

Prior-year loss emergence has been favorable for several years now leading to our decision to release $32 million of the carried reserves in the fourth quarter. Our AIX program business had reserve increases of $49.6 million, relating to years prior to 2015. Surety reserves were strengthened by $37.9 million, largely for 2014 and 2015 years, as Joe indicated. We needed to strengthen our balance sheet in these lines and we feel comfortable going forward given the underwriting and other actions taken.

These domestic reserves strengthening actions together with improved analytics, enhanced claims management, targeted pricing increases and re-underwriting initiatives give us confidence in the quality of our book of business as we move forward to execute on our strategic objectives in 2017.

While it is always a challenge when confronted with the need to strengthen reserves, we are pleased with the continued progress of our pricing and underwriting decisions as well as our line of business profitability. The improvement in our domestic loss ratio results over the last 4 to 5 years is still quite strong and steady despite the domestic reserve charge.

Our annual reserve review process included a review of Chaucer reserves as well. While we had favorable development in the fourth quarter, the balance sheet reserving of Chaucer for 2016 is appropriately conservative and very consistent with the approach taken in years passed. I will now move on to a discussion of accident year underwriting results, primarily focusing on full year performance by highlighting quarterly details as appropriate.

2016 consolidated accident year combined ratio improved by 2 points to 95.6% compared to 97.7% in the prior year. Catastrophe losses representing 3 points of the accident year combined ratio, down by approximately 1 point from a year ago, aided by benign weather in the U.S.

The underlying loss ratio improvement in both commercial and personal line segments was partially offset by a higher current accident year loss ratio at Chaucer. In Commercial Lines, the accident year loss ratio, excluding catastrophes, was 56.5% for the year compared to 58% in 2015. The improvement was driven by favorable property loss experienced in commercial multi-peril as well as stronger accident year performance in auto liability as the past and more recent pricing, underwriting and claims initiatives discussed earlier manifested themselves.

Within Commercial, you will notice increases and decreases in underlying lines in the fourth quarter, which is the results of adjusting each line to the best estimate for the full year 2016. In Personal Lines, the current accident year loss ratio was 60.1% for the 2016 year, 2 points better than we reported in 2015. Lower noncatastrophe weather and earned rate increases in homeowners drove the improvement, while auto results remained relatively consistent with 2015. We continued to see a rise in physical damage and bodily injury severity throughout the year. Our overall auto frequency is slightly below our expectation due to favorable noncatastrophe weather in the beginning of the year. And overall, our rate increases cover the loss trends we are experiencing. Our focus on account business continued to drive the overall profitability in Personal Lines.

At Chaucer, we experienced elevated loss activity in the quarter, closing the year marked with higher large loss experience compared to recent years. The current accident year loss ratio was up about 5 points compared to fourth quarter '15, and up 1.4 points for the full year. Our analysis shows no correlation between losses aside from trade credit activity earlier in the year, which has since subsided. Overall, despite declining premium rates across many lines of business, we are satisfied with Chaucer's combined ratio for the year of 90.4%, which underscores the value of its specialist expertise, disciplined underwriting and risk management culture.

Moving onto expenses. Overall, our expense ratio remained in line with 2015 at 34.5%. In Commercial Lines, the expense ratio declined in the fourth quarter from a year-ago, simply due to the timing of certain expenses. More importantly, the expense ratio declined 40 basis points for the full year in line with our expectations. Personal Lines expenses were up a 1 point over the prior year quarter. For the year, Personal Lines is running about 0.5 point higher driven by higher agency commissions associated with increased profits. As expected, incremental investments in technology and new state expansion were evident in the year.

Chaucer's expense ratio was 43.9% in the fourth quarter, driven by the impact of foreign exchange and increased brokerage commissions. This brought the full year expense ratio to 40.4% compared to 38.3% in 2015. The increase in the expense ratio at Chaucer is largely driven by changes in business mix causing higher brokerage commissions.

Moving on to top line premium results. In the fourth quarter, we increased total consolidated net written premiums by 3.4% compared to the prior-year quarter, driven by a very strong performance in Personal Lines. Net written premiums in Personal Lines increased 6.7% with solid new business momentum of approximately 30% growth, and a healthy retention of 83.8%, as a result of our high-quality account-centric mix. We achieved the rate of 4.1% consistent with the third quarter.

In Commercial Lines, we delivered measured net written premium growth of 3.3% for the quarter, and an increased core retention of 85.3% with new business more than offsetting premiums lost at renewal. We continue to place emphasis on balancing price and retention, maximizing retention on an attractive business, while improving profitability on lower-performing accounts. Overall, pricing increased in small and middle market commercial businesses by 3.4% for the fourth quarter, which now tracks slightly below our long-term loss cost assumptions. We are achieving rate in areas most needed and will continue to push profit actions in underperforming pockets of the book.

Chaucer net written premiums declined 2.6% in the quarter and 9.1% for the full year, excluding the impact of the exit from the U.K. motor business last year. This decline is a consequence of challenging market conditions and thoughtful risk selection. We continued to use reinsurance opportunistically to manage our risk appetite, while retaining leadership and influence in our chosen specialty classes.

Moving on to investments. Our fourth quarter net investment income increased to $74.2 million, up from $70 million in the prior-year quarter due to increased operating cash flow and some small unusual items. The underlying performance of the portfolio, including new money yields is in line with our expectations and recent trends. For the year, net investment income was in line with 2015 at $279 million, while lower new money yields continued to impact returns, we offset this impact by reinvesting higher operating cash flows into the portfolio. The earned yield on our total portfolio was 3.4% in the quarter and 3.38% for the year compared to 3.47% in the prior-year quarter and 3.44% in 2015.

Net unrealized investment gains were approximately a $186 million before taxes at the end of the fourth quarter of 2016 compared to a $101 million at the beginning of the year, and $382 million at the end of the third quarter. The fluctuations are predominantly interest rate related and have no material impact on the way we manage the portfolio over time.

We do not consider unrealized volatility as a significant performance criterion, as we typically hold assets to maturity and have a very well laddered portfolio. Cash and investment assets were $8.7 billion at the end of the quarter, with fixed income maturities and cash representing 87% of the total. I'll conclude with remarks on the strength of our capital position.

Book value per share was $67.40, up 2% from December 31, 2015. At 21.6%, our debt to total capital leverage ratio is comfortably within our target range. From a capital management perspective, we've returned a $106 million to shareholders through stock repurchases in 2016, leaving a $184 million available for purchase under our current share buyback authorization. We also increased our dividend for the 12th consecutive year, paying $80.4 million to shareholders in 2016. Going forward, we will be opportunistic with share repurchases.

With our Investor Day coming up in 3 weeks, we will defer our 2017 guidance discussion until then. We will share with you our expectations for items such as growth, combined ratio, expenses, catastrophe assumption as well as net investment income and our tax rate. However, we have decided to no longer specifically provide annual EPS guidance.

Joe and I both believe that Property and Casualty business doesn't naturally lend itself to the level of precision EPS guidance implies.

With that, I'll turn the call back to Joe.

Joseph M. Zubretsky
Chief Executive Officer, President and Director

Thank you, Jeff. When we consider the underlying metrics of our business, the quality and volume of new business, renewal retention rates, accident year loss ratios, returns on allocated capital, we see a strong foundation on which to grow. Putting the strengthening of the balance sheet behind us was a necessary step, in order to move forward and execute our growth strategy. We will be sharing our strategic thoughts with you at our Investor Day on February 23 in New York. During this time, we will describe the key tenants of our go-forward strategy. One, leveraging the inherent strength of our core agency business by making some modest additional investments to gain market share and more prominent shelf space with our 2200 agent partners. We believe the first wave of significant growth to be harvested from our solid market position in this channel.

Two, expanding and growing our specialty capabilities, both domestically and with Chaucer. We can capture more specialty business opportunities within the independent agent channel by modestly expanding our risk appetite, while leveraging Chaucer's capabilities in the U.S. and globally. Three, innovating renewed business models and technologies to help our distribution partners succeed in a world in which risk pools, customer preferences and a competitive environment are changing. And we will provide our 2017 guidance and long-term financial targets.
With that, we will now open the line for your questions. Operator?

Question and Answer

Operator

[Operator Instructions] Your first question comes from the line of Charles Sebaski from BMO Capital Markets.

Charles Joseph Sebaski
BMO Capital Markets Equity Research

I guess, going forward, what I'd like to try to better understand is in the commercial segment. Looking forward into 2017 on an accident year basis. And so if I look at the fourth quarter versus the full year '16. Fourth quarter was a little bit higher than full year '16, and given some of your commentary on loss trend being a little bit higher than earned rate. Is fourth quarter accident year a better proxy to think about 2017 coming out? Or do you think full year 2016 is -- on how we think about or how you think that, that business is going to evolve over the next year?

Joseph M. Zubretsky
Chief Executive Officer, President and Director

Sure, Chuck. Really you need to look at the full year. So let me take you through how we looked at this. We looked at the discrete portfolios of business, and we tried to understand the underlying trends that were causing us to increase our loss estimates. And as soon as we were done being comfortable with our loss reserve picks for '15 and prior, we immediately began to look at the current accident year. And what you see in the fourth quarter and take the CMP line for instance, you'll see a significant increase in the fourth quarter because we took a new view of the liability experience in our CMP portfolio for the full accident year. So even though the CMP loss ratio is down a 100 basis points year-over-year on a full year basis because the property component is outperforming and the liability component is underperforming. We really took a full year view in the fourth quarter for 2016 based on what we learned on 2015 and prior.

Charles Joseph Sebaski
BMO Capital Markets Equity Research

Okay. So that fourth quarter kind of includes a full year true-up for the calendar year '16?

Joseph M. Zubretsky
Chief Executive Officer, President and Director

That is correct.

Charles Joseph Sebaski
BMO Capital Markets Equity Research

Excellent. That is helpful. I guess the other question had was in personal and auto trend that you're seeing there, it seems like things are trending well and there is growth going, but the -- you don't see anything that's concerning about BI trend in personal/auto?

Joseph M. Zubretsky
Chief Executive Officer, President and Director

No, not at all. There's a lot to like in the Personal Lines story for the quarter and the full year. You see the 5.2% top line growth, we're able to put 4 points of rate in the market, which is comfortably above loss trend. Our PIF count is growing again, and our retention rates are 83% and rising. So there's a lot to like there, and no, we haven't seen the increase in severity probably due to demographic mix and geographic mix of our book compared to some of our competitors. But we have seen a slight uptick in severity on both the physical damage component and the liability component, which is fully reflected in our results.

Charles Joseph Sebaski
BMO Capital Markets Equity Research

Okay. And I guess, just finally, capital management going forward into 2017. You've taken these actions for that the legacy years and get back on to a strong earnings story. What's the thought process around capital management going into 2017?

Joseph M. Zubretsky
Chief Executive Officer, President and Director

I'll kick it to Jeff in a second, but as we've said, and Jeff and I share a common view on this. We like a balanced approach to capital deployment. We know that delivering superior returns and a superior evaluation is going to require steady and measured book value per share growth. And ROE production leveraging our fixed expense base and increasing our profitability, and leveraging our expense base to produce a better ROE. But we are big fans of balanced deployment of capital, share buybacks opportunistically and to maintain a good competitive dividend.

Jeffrey Mark Farber
Chief Financial Officer

Just to amplify a bit. Obviously, a balanced approach, couldn't agree more. Deploying capital in our businesses is obviously important, and we're going to allocate capital to our businesses where we think it has the most appropriate and best returns. And then thinking on a balanced basis between dividends and stock buybacks and other uses will be appropriate.

Operator

Your next question comes from Paul Newsome from Sandler O'Neill.

Paul Newsome

I just want to make sure that when I'm putting pen to paper is that I'm doing this right, but just to reiterate that if I'm thinking of sort of perspective accident year results for the Commercial and then Personal Lines unit, the full year number that you've reported in '16, is the right base per se to think of what the profitability of the book is. Is that fair?

Joseph M. Zubretsky
Chief Executive Officer, President and Director

Yes, that is the right way of looking at it.

Paul Newsome

Even though there's a bit of a true-up in the fourth quarter for all these reserve issues?

Joseph M. Zubretsky
Chief Executive Officer, President and Director

Yes, we -- as I mentioned previously, Paul. Anything we learned about our business as a result of the -- a deep dive into the reserve in the business reviews, we then took into the '16 accident year and updated our assumptions embedded in the accident year loss pick. And we did that in the fourth quarter. So the fourth quarter tended to be a little choppy and lumpy, but the full year view is the correct way to look at it.

Paul Newsome

Is that the same way I should -- should I think about it the same way on the Chaucer side, was there anything that would have changed the accident year pick, given that the process that you went through?

Joseph M. Zubretsky
Chief Executive Officer, President and Director

No, we maintained the same reserving methodology and process at Chaucer. Given the nature of the business, the complexity of the risk it writes, the high excess layers in which it operates, it's always prudent to hold a current -- conservative current accident year loss pick and let it run off favorably. And we did not disrupt that methodology at all. The chopping as you saw was basically large manmade losses, which was offset by an incredibly benign global catastrophe environment.

Operator

Your next question comes from Larry Greenberg.

Lawrence David Greenberg
Janney Montgomery Scott LLC, Research Division

So just a couple of questions on the reserving study. So will anything change either conceptually or quantitatively in your reserving framework or processes going forward? And then curious, I assume you use kind of a range of estimates and then a best estimate within that. And is that process similar for both Chaucer and the domestic companies. And with the best estimate be set at a similar point or given the nature of Chaucer's business, is that -- does that require a more conservative pick there?

Joseph M. Zubretsky
Chief Executive Officer, President and Director

I'll kick it to Jeff in a moment. But I would characterize our U.S. domestic reserving process as a best estimate with a conservative bias. Reserves are going to run off favorably or unfavorable, you'd always like to see them run off favorably, and Jeff and I share that view. And Chaucer, it's really a different business model. It's more of the nature of the business. Jeff, I don't know if you want to expand on that.

Jeffrey Mark Farber
Chief Financial Officer

So just to start off, Larry, we took a really thorough process in the fourth quarter, which culminated quarterly process we do, and we would anticipate continuing that process, continuing the thoroughness, continuing the conservatism in which we have built that up. As we think about the Chaucer reserves, we largely didn't change the process that we had always gone through. So we have always been appropriately conservative with our best estimate there. We made some changes in how we thought about domestic. But we're going to really continue with that model.

Lawrence David Greenberg
Janney Montgomery Scott LLC, Research Division

Okay. And Joe, you mentioned investing in and leveraging your strong agency position. Will this put pressure on domestic expense ratios in 2017?

Joseph M. Zubretsky
Chief Executive Officer, President and Director

No, I think we have the investment capacity to do what we need to do from a channel perspective or product perspective, et cetera. There is still a tremendous amount of expense leverage as we grow the business across our agency plant, which, as you know, is largely a fixed cost and pretty expensive to run. But there is a lot of headroom there in leveraging our fixed expense base. So no, I don't view any upward pressure on the expense ratio here in the U.S.

Operator

Your next question comes from Meyer Shields from KBW.

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

Within Chaucer, is there any way of sort of quantifying the benefit of low global cast against the above-average large losses, do those washout -- is one of the bigger provision at the beginning of the year?

Joseph M. Zubretsky
Chief Executive Officer, President and Director

I'm going to -- I'll kick it to Jeff and maybe let the Chaucer guys, but interject here. Basically with the account profile that they write, we sort of target roughly 10% of premium on an annual basis with catastrophes. And this year, it came in at less than 1%. The target combined ratio for the business is 95%. We have always said that, we expect to deliver that or better. And as you know, cumulatively since we've owned the property, it's produced cumulatively a 90% combined ratio. So we're happy with the profitability of the business. The CAT environment certainly helped this year. But it's -- the business has inherent volatility. And quarter-to-quarter, it will produce that volatility. Jeff or Johan, I don't know, if you have anything to add to that?

Jeffrey Mark Farber
Chief Financial Officer

Yes, I think as we've spoken about before, the previous 5 years were really low attritional and large losses in the business of Chaucer, and in this year, in particular, we had some higher losses and it's just sort of as a reversion for the mean kind of a concept and CATs will come when they come. But somewhere south of 95%, I think is a good overall combined ratio. It was 90% this year, it has been 90% or lower in other years. And I think it's going to move around a little bit, but it provides for a nice model. Johan?

Johan Slabbert
Former Chief Executive Officer

No, I'd just add that there's no correlation between the CAT risks and large loss accounts. We do write risk towards the catastrophe lines. So the fact that we've had very low activity on that side, but yet a higher number of large losses. Just to point out that the actual number of -- or the quantum of large losses paid out in the fourth quarter or reserved in the fourth quarter, is almost the exact same number is for a 12 running quarter average is. So it's not that much higher than our history shows.

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

Okay. That's very helpful. Second, and also in Chaucer, as you increase the reinsurance purchases, should that have a significant impact on, I guess, the expense ratio for Chaucer next year?

Joseph M. Zubretsky
Chief Executive Officer, President and Director

I'll kick that to Johan, you can talk. Go ahead Johan.

Johan Slabbert
Former Chief Executive Officer

Yes. So you're right from the fact that the higher the reinsurance purchasing is, the lower the net premium will be. And that would put pressure on the expense ratio itself. We have in 2016 actually reduced our expenses. But you could probably expect, which we normally targeted the 45% expense ratio. But that's going to be subject to volatility in the foreign exchange rate.

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

Okay. And then finally, looking at Personal Lines, you are -- your expense has been a lot better than some major competitors who are raising rates dramatically. Should we expect that to accelerate the growth rate, I'm thinking either auto or package auto and home in 2017?

Joseph M. Zubretsky
Chief Executive Officer, President and Director

I'm going to kick it to Dick Lavey for the answer.

Richard W. Lavey
Chief Growth Innovation Officer

Yes. So as you know, we've been really kind of thoughtful and measured on our rate strategy, and frankly have been ahead of the market by a point or 2 varying by lines. So we're going to continue that strategy. And we do see as our competition takes more rate that we may become more competitive on a relative basis, of course, that varies state-by-state. But generally speaking, we also will take some additional rate opportunistically in certain states. So you have sort of headwinds here and there, but generally the net of it will be that -- should expect kind of mid-single-digit growth on a go-forward basis.

Operator

I would now like to turn over to Oksana for closing remarks. Please proceed.

Oksana Lukasheva
Vice President of Investor Relations

Thank you very much for your participation on the call today. And we are looking forward to speaking with you next quarter.

Operator
Ladies and gentlemen, that concludes today's conference. Thank you for your participation. You may now disconnect. Have a wonderful day.