The Hanover Insurance Group, Inc. NYSE:THG

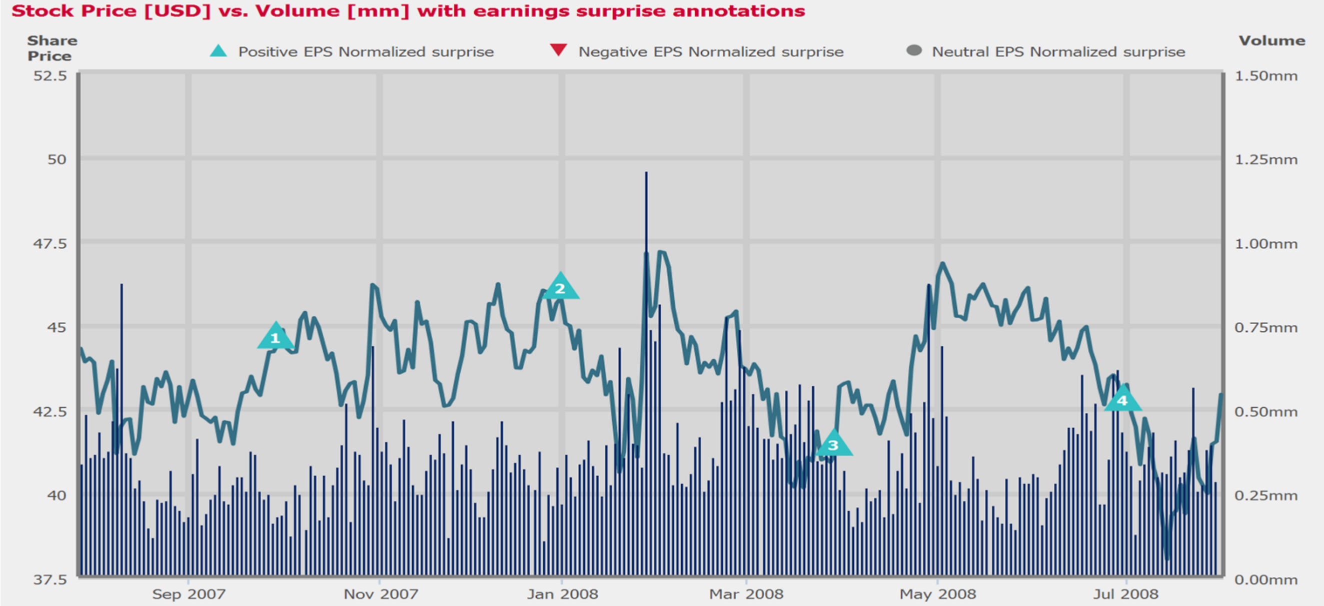
FQ3 2008 Earnings Call Transcripts

Friday, October 31, 2008 2:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ3 2008-			-FQ4 2008-	-FY 2008-	-FY 2009-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.01	0.07	▲(58.82 %)	1.16	3.45	4.40
Revenue	-	-	▲1.51	-	-	-
Revenue (mm)	641.90	651.60	-	578.13	2493.87	2547.00

Currency: USD
Consensus as of Oct-31-2008 1:58 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ3 2007	1.00	1.01	▲1.00 %
FQ4 2007	1.14	1.20	▲5.26 %
FQ1 2008	1.05	1.10	▲4.76 %
FQ2 2008	0.96	1.07	▲11.46 %

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Call Participants

EXECUTIVES

Eugene M. Bullis

Frederick Henry Eppinger
Former President & CEO

Marita Zuraitis
Executive VP, President of Property & Casualty Companies

Robert P. Myron

ANALYSTS

Michael Phillips
Stifel Nicolaus

Rohan Pai
Banc of America Securities

Presentation

Operator

Good day ladies and gentlemen and welcome to the Third Quarter 2008 Hanover Insurance Group Incorporated Earnings Conference Call. My name is Dan and I will be your coordinator for today. At this time, all participants are in listen-only mode. We will conduct a question-and-answer session towards the end of this conference. [Operator Instructions]. As a reminder, this conference is being recorded for replay purposes. I would now like to turn the call over to your host for today's call, Mr. Bob Myron, Treasurer of the Company. Please proceed.

Robert P. Myron

Thank you operator. Good morning and thank you for joining us for our third quarter conference call. Participating in today's call are Fred Eppinger, our President and Chief Executive Officer; Gene Bullis, our Executive Vice President and CFO; and Marita Zuraitis, President of Property and Casualty Companies.

Before I turn the call over to Fred for a discussion of our results, let me note that our earnings press release and a current report on Form 8-K were issued last night. Our press release, statistical 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 in responses to your questions today, other than statements of historical fact include forward-looking statements. These includes statements regarding expectations of earnings, pricing, accident year results, premiums, expenses and other projections for the year 2008 and beyond. There are certain factors that could cause actual results to differ materially from these 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 two of the presentation document, and our filings with the SEC.

Today's discussion will also reference certain non-GAAP financial measures such as total segment income, segment results excluding the impact of catastrophes, X count loss ratio's, and accident year loss ratios 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 or the statistical supplement which are posted on our website as I mentioned earlier. With those comments I will turn the call over to Fred.

Frederick Henry Eppinger
Former President & CEO

Good morning, thanks Bob. I want to thank everybody for joining our call. And today with all that is going on in the insurance marketplace and the credit market in general, I thought it would be helpful to focus my remarks this morning on our observations about the industry, our current position both financially and strategically, and to provide some brief comments on our performance. Obviously Marita and Gene will provide a lot more insight about our third quarter results and our year-to-date trends.

In essence there are three messages that I would like to leave you with today. Of course while the quarter was challenging for us given the significant level of catastrophes and the turmoil in the financial markets, I like our current financial position and our ability to take advantage of the market turbulence now and in the future. Our capital and liquidity position gives us the ability to thoughtfully capitalize on business opportunities that are becoming more abundant.

In addition, our investment portfolio is very conservative given our very limited exposure to equities and alternative investments which gives us confidence in our ability to successfully manage in today's economic conditions and still focus on profitable business growth. Our portfolio is also every transparent and easy to understand. And we hope that the information we provided in the press release and in today's call will make it even more so.

Second, though the market has been competitive, we see real progress and impact from our strategic initiatives around our partner conversions and our specialty business growth. This gives me confidence in our ability to grow profitably even in the current economic environment and deliver on our promises to our shareholders and our other stakeholders.

Third, the significant investments we have made across our company over the past five years around attracting and developing account uniquely position us vis-à-vis our regional competitors to capitalize on the tremendous disruption and dislocation in the market today. This is particularly critical given that we believe this to be of better pricing environment over the next year and some significant movement of business.

It is clear that our industry is undergoing significant change, which creates opportunities for strong and nimble companies. In the beginning of our journey, we have focused on building a financial, underwriting, and product and operating platform that could capitalize on the weakness of other companies in the down markets. As we have said before, pricing cycle puts significant pressure on weaker companies and just before the churn, you see these companies dramatically pull back giving stronger companies the solid balance sheet and underwriting capabilities, the opportunity to capture more business at a better margin. We believe that the combination of the weak economy, Midwest storm, and turmoil in the financial markets will accelerate this trend.

We also believe that this will create real opportunities for us and for winning independent agents as they look for strong, stable markets to help them compete, but without becoming overly concentrated with a few large markets. Given the severity of some of the trends we see, many companies will have to shrink to preserve capital which could accelerate the hardening of the market pricing as soon as that we might have expected just a few weeks ago.

We are well positioned to compete and win in this environment. Over the course of the past five years, we've been building companies that will be able to deliver on its promise regardless of prevailing market conditions. While we could not have predicted how disrupted this situation would be, we knew all along there would be an increasing disruption to marketplace, and that in order to achieve our goal of being the best regional P&C company in the markets we serve, we will need to build a company that could thrive on challenging times.

We have been careful to establish a very solid financial foundation to maintain a disciplined investment management approach, and to create an infrastructure that would help our agent partner succeed when others struggle. Our momentum around financial strength is countered to the trend in the market and is apparent to our agents. In a time of numerous down grades, we are one of the few financial companies receiving upgrades. In the previous two quarters, our financial rating has been upgraded by S&P and Moody's, and we are one of the very few P&C companies with a positive outlook from AM Best [ph].

We are generating strong quarter earnings and profitable growth in all our lines of business. We have built a strong balance sheet in capital position, putting hundreds of millions of statutory capital on our P&C focus since we began our journey in 2003. Our C&L mix of business is focused on attractive industries and lines of business. Our reserve position remains very strong as we continue to retain recorded reserves in excess of 5% over our actuarial indication. And our debt is only 20% of total capital.

With the upheaval on the financial markets, we have very carefully examined our investment strategies, investment portfolio, and we have great confidence in both. We have managed our investments with great prudence. As I've said before, I'm willing to take expense risk as we build our franchise since that represents controllable investment in our future, but we have to be very careful with our investment and underwriting risks.

Cash and investment grade bonds represent approximately 96% of our invested assets. Our paired assets this quarter represent only 1% of our overall portfolio. We do not have sub-prime mortgage debt; we have very smaller allocation to equities, commercial mortgage is an alternative strategy, and has negligible derivative exposures. As a result, we do not have to make significant adjustments to our investment portfolio and drastically reduce investment return. This means we will not get caught up in fixing problems, and reducing exposures and leverage. Our focus will be where it should be on building our business.

We are confident about our capital position and liquidity. In fact, we expect our liquidity as a holding company to be enhanced by the anticipated closing of our sale of FAFLIC later this quarter, and we use a portion of those associated proceeds to close on the purchase of AIX Holdings. We are not in position of having to raise capital in order to continue to meet our current objectives, and the Board's announcement last week of our fourth consecutive increase in our annual shareholder dividend is further evidence of the confidence we have and our capital level and liquidity.

In fact, there are some capital positions that creates opportunity for us. We are well positioned to continue to make strategic acquisitions to the small balance sheet, books of business, and what is quickly becoming a buyer's market. We will continue to seek out opportunities to broaden our product capabilities to the extent these opportunities are financially compelling.

We are making smart investments in our business. We have increased our local market presence with some of the most well respected professionals in the industry, significantly upgrading our management team and added specialty capabilities by building teams and through acquisitions. Additionally, we have invested over $250 million in the past five years to enhance our products and to improve either doing business, providing our agent partners, and our customers the service and capabilities they expect. As a result, we have an outstanding operational foundation and we are really seeing our partnership strategy take hold.

Today, our product portfolio and service capabilities represent a distinct competitive advantage, enabling our agent partners to meet a wide range of their customers' needs. And we will continue to invest or acquire new products to enhance our product offering.

Given that most of our partners and potential partner agents have carriers on their shelves, they will need to either make changes to their expenses and business mix. There will be business shift that creates openings for us to significantly enhance our position in our agencies and deepen our relationships. As always, the key for us is to remain intently focused on the execution of our key strategic priorities.

Before I turn the call over to Marita and Gene, I would like to comment just briefly on the quarter. Our results like those of most our peers reflect the unusually high storm activity for the quarter. We expect that insurer industry losses will well exceed $20 billion as well as the turmoil in the financial market. With this in mind, I think it's important to note that the scope of our strong losses were consistent with our risk models, our market share, and our pricing models, and we feel very good about our catastrophe management initiatives we have under taken in the past few years. And that overall, since the credit crisis began some 15 months ago, our investment portfolio has performed well.

Our core business also continues to perform well with favorable underlying trends. We continue to achieve solid growth across all our businesses, in line with our plan and ahead of industry average. We are maintaining our margins and favorable reserve development remains strong, indicative of our disciplined underwriting practice.

So, in spite of the strong market and developments in the financial markets, we are on track to generate solid results for the year. Obviously, our economy and industry are going through difficult times, which make it critical that we remained intently focused on all the key financial levers of our business. The improvements we have made across our business obtain substantial dividend. We have built an organization that today is competing with the best companies in our business, one that can manage in difficult times and can capitalize on market opportunities creating a real value for our shareholders.

With that I will turn it over to Gene, and I look forward to taking your questions shortly.

Eugene M. Bullis

Thank you, Fred. Good morning everyone, and thank you for joining our call. As usual the slide presentation accompanies my remarks and I trust all of you have this available.

Please turn to slide 5, which presents our consolidated results for the quarter. For the quarter, we reported a net loss of $62 million, or $1.21 per share compared to income of $54 million or $ 1.03 per share in the third quarter of 2007.

Net loss in the third quarter of 2008 reflects realized losses on investments from our continuing operations of $53 million as well as losses on investments of $16 million realized in discontinued operations. The total realized losses of $69 million reflect pre-announced impairments associated with holdings at Lehman Brothers and Washington Mutual of $37 million as well impairments on other fixed income securities in the financial and other sectors.

The net loss for the third quarter also includes an additional loss of the pending sale of FAFLIC, comprised of the aforementioned $16 million of loss on invested assets as well as other adjustment of about $6 million principally related to estimated tax effects on the transaction, but overall FAFLIC lost $22 million in the third quarter of 2008. As you remember, in the second quarter of 2008, we reported a loss related to the FAFLIC sale of $68 million. The third quarter results and adjustments bring our total year-to-date FAFLIC loss, including the expected loss on sale to $93 million. The FAFLIC closing process is on track, and it is still our expectation that we will complete this transaction in this fourth quarter.

Let's now turn to slide 6 for a discussion of our segment earnings. Our P&C operations generated $14 million of pretax income, down from $88 million in the prior quarter, primarily due to higher catastrophe and related storm losses in the current quarter, which were $98 million and $25 million in the third quarters of 2008 and 2007 respectively. Ex-cat P&C pretax earnings were $112 million compared to $113 million in the prior year quarter.

Now let's turn to slide 7 for a review of Personal Line's. The Personal Line segment reported pretax earnings of $18 million in the current quarter compared to $49 million the prior year quarter. Catastrophe and related storm loses were $40 million in the third quarter of 2008 compared to $5 million in the third quarter of 2007. Excluding catastrophes, segment income was $58 million in the current quarter compared to $54 million in the prior year quarter.

Favorable prior year reserve development was $16 million in the current compared to $10 million in last year's quarter, and was favorable in all lines with improvements primarily coming from personal auto. Underwriting expenses were lower in the quarter driven in part by lower variable compensation. These positive impacts were partially offset by higher ex-catastrophe accident year losses in the quarter in our Auto Line due primarily to an unusually low level of incurred losses in this line of third quarter 2007.

Now let's look at Commercial Line's on slide 8. Commercial Line's pretax segment loss was $7 million in the quarter compared to income of $39 million in the third quarter of 2007. Catastrophes and related storm losses were $59 million in the third quarter, $39 million higher than the $20 million incurred in the third quarter of 2007.

On an ex-cat basis, Commercial Line segment income was $52 million or $7 million lower when compared to the prior year quarter due to lower accident year margins. The deterioration was observed primarily in our commercial multiple parallel lines and relates to higher incidents of large property losses in the quarter compared to the prior year quarter.

Marita will discuss loss impacts, large loss impacts in our book of business in more detail. On a year-to-date basis, the C&P line shows an improvement in trends in both large property losses as well as in the ex-catastrophe accident year loss ratio when compared to the same period in the prior year. The ex-cat accident year loss ratio in our C&P line was 49.3% for the nine months of 2008 compared to 50.6% in the same period of 2007.

Our Commercial Lines underwriting expenses compared favorably to the prior year quarter. As in Personal Lines, lower underwriting and loss adjustment expenses reflect a reduction in variable compensation. A favorable development of prior year reserves was $19 million in the third quarter of 2008 compared to $22 million in the prior year quarter. Loses developed favorably in all lines with suddenly less development coming out of our specialty lines this quarter compared to the prior year quarter.

Finally, net investment income was up $4 million. This is primarily due to the transfer of employee benefit related assets and liabilities with FAFLIC to hand over insurance which was effective January 1st.

Turning to slide 9, it provides a snapshot for our underwriting trends for the third quarter and year-to-date. And I will use this slide to share with you our full year 2008 outlook. You can see that our third quarter of 2008 results were marked by catastrophe loses of 15.8 points. Through nine months this year, catastrophe's impacted our losses by $156 million, or 8.4 points of combined ratio, compared to $46 million or 2.6 points during the same period last year. Therefore, our full year 2008 earnings will reflect substantially high catastrophe loses and accordingly, we expect to see a contraction in 2008 segment earnings when compared to 2007 results.

The table on page 9 also shows quarter-over-quarter deterioration of our ex-cat accident year loss ratio which is due to the higher incidents of large loses this quarter. On a year-to-date basis however, our ex-cat accident year lost ratio as well as our ex-cat accident year combined ratio compared favorably to the same period of last year. Based on our current visibility for the fourth quarter we continue to expect to maintain or slightly improve, our ex-cat accident year margins for the full year of 2008 compared to the full year of 2007.

With respect to expenses, our OUE and LAE ratio improved by nearly 2 points on a quarter-over-quarter basis and by 6/10th of a point year-to-date. This was primarily due to some favorable prior year development in LAE this quarter compared to LAE Katrina reserve additions in the third quarter of last year. Also this quarter included adjustments to variable compensation which will now recur in the fourth quarter. Finally we have some seasonality in our expenses which usually causes the fourth quarter to trend upward. Therefore, despite a slight improvement in expenses through nine months, we continue to believe that our full year LAE and OUE ratio combined will come in flat to our full year 2007 ratio, as we discussed in last quarters call.

Now let's turn to production which is on slide 10. Overall Net Written Premium was $652 million for the third quarter up 4.8% from the third quarter of last year. This overall growth is inline with our expectations and is supported by growth in Commercial Lines of 11% primarily from our specialty businesses including our recent acquisitions, and an uptake on our Personal Lines growth to 1.2% arising primarily from rate increases and fixed growth in our newer states.

Given the first three quarters of 2008, we continue to expect to meet our full year outlook for overall mid-single digit Net Written Premium growth. Marita will discuss our production and underwriting results in more detail in her remarks.

Turning to a review of our investment portfolio beginning on page 12, the quality of our portfolios remains solid. The company holds 6 billion in cash in invested assets at September 30, 2008 which includes 1.1 billion of FAFLIC assets that will move to the buyer upon closing of the sale.

Cash and fixed maturities represent 96% of our investment portfolio with a carrying value of $5.8 billion, 95% of our fixed income portfolio was rated investment grade. We continue to have no direct exposure to investments in sub-prime mortgages or sub-prime mortgage back securities.

Skipping over to slide 14, we provide a breakdown of our corporate holdings, which represents 48% of our overall fixed income portfolio. Industrials constitute about 27% of the overall fixed income and about 13% or $677 million is invested in financial sector holdings. The unrealized losses related to the portfolio of financial issues were a $102 million at September 30th reflective of deteriorated market valuation during the quarter. We believe these unrealized losses after adjustments for impairments in the quarter are temporary based on several premises.

First, our portfolio of financials is made up of high quality debt securities, primarily banking. 92% of the overall portfolio was rated investment grades, is well diversified with 74 distinct issuers plus the average position is about 22% of the total fixed income holdings.

Second, recent government actions aimed at supporting the banking system should help the market values of financials recover. We expect the preferred equity infusions and the guarantees to bank borrowings via the top government programs will lead to stabilization of banks capital and lending, thus improving their financial strength and ultimately the market values of their debt.

Third, with our substantial liquidity position in light of duration structure in our fixed income portfolio, we have the ability and intent to hold these securities until recovery or maturity which will allow us to realize their anticipated long-term economic value.

On the next two slides we've provided amortized cost and fair value for our largest corporate holdings. This is information that would otherwise be available in our quarterly statutory filings but we have provided it here in the interest of improved transparency.

Slide 17 describes our RMBS holdings. They constitute about $1.1 billion of our invested assets with less than 15% held in non-agency prime securities. The market value of our RMBS portfolio was principally unchanged from last quarter and has only declined $10 million since December of 2007. Commercial mortgage-backed securities constitute $462 million of our invested assets. This portfolio is well seasoned with approximately 92% from pre-2005 vintages and is also well diversified by geography and industry type.

As of September 30, 2008 we held 785 million in municipal bonds with an overall rating of AA minus. Financial guarantor insurance and hence municipal represents $344 million or 44% of this portfolio. The overall credit rating of our insured municipal bond portfolio giving no effects of the insurance enhancement is A minus. Our direct commercial mortgage portfolio was only $43 million, is high quality, and 64% of the mortgages mature by year end 2010. Equity securities represents $54 million of fair value including $37 million of redeemable preferred with an amortized cost of $47 million.

On slide 20 we display gross unrealized loss changes from the second and third quarter. The majority of unrealized loss is a $192 million related to our fix income corporate holdings due to the widening of spreads and credit market liquidity contractions. Again, we believe that the loss of market value is temporary. We will be able to hold these securities in question until recovery and ultimately realize their anticipated economic value. It is worthwhile noting that of the $263 million of gross unrealized loses as of September 2008, about $50 million related to securities held by FAFLIC that are expected to be transferred to the buyer at the time of closing.

Moving on to slide 21, we have some key metrics that outline the strength of our balance sheet. You see a contraction in the book value through September 30th, which is impacted by losses in our discontinued FAFLIC of approximately $93 million or $1.83 per share year-to-date. The decrease in book value also reflects higher unrealized losses in our investment portfolio.

Despite investment impairments and the impact of the FAFLIC sale, per share book value excluding AOCI remains above $44. Excluding AOCI and the impact of exiting FAFLIC, book values increase 6.2% in the last 12 months. Our debt-to-total capital including AOCI is up slightly resulting from a lower book value base, still at 20% our debt leverage are very conservative.

Holding company cash and investment securities were 2$60 million at September 30th and will increase by about $220 million as a result of the expected FAFLIC sale transaction. We expect to pay about a $100 million for the acquisition of AIX which should also take place sometime during the fourth quarter. We've also declared and included ordinary dividend of a $166 million from our Hanover Insurance subsidiary to THG Holding as of September 30th, which will be paid in the fourth quarter. This is the first dividend from our PNC subsidiary in several years and it maximizes our capital and liquidity flexibility.

Even after this dividend, we expect to have an RBC in excess of 300 and a B-CAR of well in excess of 200 in our PNC Insurance Company at year end. Upon completion of these transactions and the payment of our annual shareholder of dividend, the holding company liquidity is expected to be at approximately $450 million.

As you know, we have a positive outlook from AM Best with respect to our financial strength rating and we intend to present a strong occasion as possible for upgrade this raining season. We believe we have sufficient capital at the insurance subsidiary and the holding company to achieve this objective.

We have a $100 million stock repurchase program in place. To date we've repurchased 1.4 million shares for about $60 million which is unchanged from the second quarter. We will likely maintain this cautious approach to share repurchases for the intermediate term. As always, our goal is to use our capital as effectively as possible to strengthen our organization and ensure that we are positioned to win in the long term. With that, I will turn the call over to Marita.

Marita Zuraitis
Executive VP, President of Property & Casualty Companies

Thanks, Gene. Good morning everybody and thanks for joining the call. As both Fred and Gene have discussed catastrophe losses and the turmoil in financial markets have provided significant challenges in the quarter. However, we remain very pleased with the underlying trends and the momentum of our business. Specifically, catastrophes contributed 16 points to the third quarter results, bringing our combined ratio to a 108%. Our ex-cat combined ratio was 92.6%. This represents an increase of 1 point from prior year driven primarily by a higher incident of large losses in the quarter and our Commercial Multi Peril Line into a lesser degree of Personal Auto Line. However, large losses can be lumpy in our business, in any given quarter.

On a year-to-date basis, our large loss activity in CMP and auto is down. In fact our full year ex-cat accident year combined ratio has improved from last year, which is notable if considering the adverse weather patterns, we and the industry had experienced in 2008. We have a disciplined underwriting culture and we've maintained a solid book of business in this challenging environment, while delivering on our expectation of above average growth.

Let me provide you with some perspective on the $98 million of catastrophe losses occurred in the quarter. As you know this quarter was marked by several sizeable catastrophe events, with Hurricanes Ike and Gustav being the largest. Catastrophe activity was obviously a major event for the industry, with, as we believe over $20 billion of industry losses in the quarter.

Gustav's damage was concentrated in Louisiana where we have made good progress in managing our catastrophe exposure in both Personal and Commercial Lines. This resulted in overall losses from Gustav, being lower than our respective market share reflecting the impact of exposure management efforts. Ike was an unusually far reaching and long lasting storm affecting Central and Midwestern Regions, and even impacting Michigan. Total loss estimates vary with expectations approaching $15 billion to $20 billion. Even at the lower end of that range, our Ike experience would be consistent with our market share in those affected states.

As we do after each large event, we have reviewed and analyzed all claims coming from catastrophe affected states and we were satisfied with the results. Our risk selection was in line with our appetite and our underwriting guidelines were followed. Catastrophes are part of our business. Over the past five years, we have invested a great deal of time to more effectively manage our catastrophe exposures, in order to reduce earnings volatility and preserve capital.

Our exposure management actions are on track. We continue to strengthen underwriting guidelines, through the proactive use of model data and we closely monitor increased exposures in our new growth states like Illinois, Wisconsin, and Ohio. The catastrophe events of the third quarter demonstrate that we're on track and our efforts have been successful. While we work very hard to manage our exposures at appropriate levels, we're committed to meet the needs of our agents and customers when they suffer losses. Our claims teams continue to be highly responsive on these major events and our efforts were recognized by our agents and their customers.

Now let me discuss our segment results, for the quarter, our Personal Lines segment recorded net written premium growth of 1.2% and an ex-cat combined ratio of 92.9% representing over a point of improvement from prior year. This improvement was driven by higher favorable development and lower expenses.

Our ex-cat accident year loss ratio was higher by approximately 2 points in the current quarter driven by Personal Auto Line and somewhat offset by an improvement in the homeowners line. Our Personal Auto results were affected by a difficult comparison to an abnormally low third quarter in 2007. In fact, our accident year lost ratio of 63.7 in the quarter equals the full year 2007 accident year lost ratio.

As I mentioned earlier, third quarter losses in our Auto Line were also impacted by an unusually high incident of large losses. As always we are monitoring our large losses closely and although we have clearly experienced abnormal weather losses this year, we do not see any other issues or unusual trends. We continue to take pricing actions in most of our states in the quarter.

The pricing remains stable at about 1.7%. This figure does include an 8% rate decrease in Massachusetts Personal Auto coinciding with the introduction of managed competition in that state. Excluding Massachusetts, pricing would have been about 2.6% in the quarter.

Now turning to growth. Personal Lines growth of 1.2% during the quarter is in line with our expectations and our business mix continues to improve. We are shifting our mix to a more desirable high quality multi-car, multi-line business. This is more consistent with our strategy to write focused... to write account focused business and these accounts are typically less price sensitive and have higher retentions.

As I've done on recent calls, I'll focus on four geographic segments, Michigan, Massachusetts, Louisiana, and Florida together and the rest of our footprint. Results continue to be in line with expectation in each of these groups. In Michigan where the economy is under the greatest pressure, we continue to focus on maintaining profit margins. Net written premium was up 1% in the quarter, an improvement over declining premium in the first half of the year. The improvement was driven primarily by rate increases and a stabilization of policies in force. Net written premium growth in our Homeowners line was helped by the launch of our new Homeowners product effective September 1st. This product provides for more pricing points in our toughest segments and our target segments while emphasizing our account focus and providing numerous packaging capabilities. Agency feedback has been very positive and we've seen an up tick in better quality business in both the homeowners and the Auto since implementation.

As I mentioned, our goal in Michigan is to maintain margins in this challenging economic environment, while maximizing our opportunities for growth. We have a long history and strong community type in the state and our partner agent base is extremely strong, helping us to achieve this goal.

Turning next to Massachusetts, as anticipated Net Written Premium growth moderated to more normal levels of about 2% growth in the quarter. As we anticipated, this is down from 10% in the second quarter as the initial new business rush from the Massachusetts auto reforms slowed. The growth, we've achieved in Massachusetts came despite the 8% filed rate decrease in auto which I mentioned earlier. We are very pleased with the results in Massachusetts Auto, as our product is being well received by our partners agents, that's allowing us to grow our business and also maintain our profitability.

Now turning to Florida and Louisiana, our exposure management actions are in full swing. The non-renewal of our Florida homeowners business is progressing as planned and should be completed by year end. As I mentioned earlier, our concentration management actions in Louisiana are also on track. Our expectation is for a 16% reduction in premium by year end in those two states combined which will suppress our Personal Lines growth rate for the year by about 1.5%. Outside these four states, we've gained momentum as expected during the quarter, with the growth rate of 5% showing improvement each quarter this year. Our success is based on our partner agent strategy and we have a growing pipeline of opportunities to continue this success.

In summary, I continue to be pleased with our Personal Lines results and I'm confident that we will maintain our Net Written Premium compared to last years levels while delivering solid margins in this segment.

Now turning to Commercial Lines. Our Commercial Lines results this quarter like those in Personal Lines were significantly impacted by catastrophe losses. On an ex-cat basis, our combined ratio was 92% or 5 points higher than the prior year quarter. As I discussed earlier, this was driven by results in our C&P line and specifically large losses in the quarter. A few large losses can produce swings in our quarterly underwriting results. Our large loss of experience was favorable in the first two quarters of this year. So even with this third quarter activity, year-to-date large losses in C&P have actually declined. Additionally, our ex-cat loss ratio has improved for the full year in both the C&P line and Commercial Lines overall. Obviously, we are monitoring the book of business closely as we constantly review underwriting and watch for any symptomatic trends.

Now a couple of points on growth. Net written premium growth was 11% in the quarter. It came primarily from our specialty business, with growth of approximately 30%. Our recent acquisitions of Verlan and PDI, now referred to as Hanover Specialty Property and Hanover Professionals respectively, made meaningful contributions to our overall growth. We're extremely pleased with the substantial traction that these business has achieved in the third quarter. We saw an uptake in new business production from Hanover Professionals with approximately two thirds of the new business coming from Hanover Partners. This validates the synergies between this recent acquisition and the Hanover.

Hanover Specialty Property new business also increased significantly. Based on a very positive response to the new capabilities from our partner agents, we expect continued momentum. Our other specialty lines grew almost 20%, driven by a very successful quarter in our school program, one of our key niches which has a significant amount of 7-1 business. This type of impacts from our niche business is an important part of our strategy and we have several opportunities to be delivered in the short term including capabilities in the non-profit social services segment.

Additionally we saw a continued growth in our bond business with the availability of high quality business opportunities remaining solid. We continue to approach this business with strong underwriting discipline and a conservative appetite. Our traditional lines also showed an improvement in growth in the third quarter driven by new business levels, improved retention, and less renewal pricing declines. Additionally, growth from our partner agents continued to out pace overall growth demonstrating the success of our agency focused strategy.

Also, we continue to show momentum in the small market segment, where our small commercial platform has been very well received. This new platform coupled with our commitment to exceptional service, gives us confidence in continued partner agent growth in this important segment. Perhaps most importantly and as I have stated, we have seen a reduction in price declines in our traditional commercial lines in the quarter. Certainly I do not pretend to know exactly what the pricing environment will bring going forward. But we are encouraged to have seen a lessening of the soft market in the quarter and are optimistic that we may start to see an opportunity for price strengthening going forward.

As we looked to close out the year with a strong quarter, we will maintain our commitment to underwriting discipline, putting margins and prudent risk management before growth and gaining market share in a manner that's consistent with our strategies. And with that I'll turn the call back over to Bob.

Robert P. Myron

Thank you, Marita. That concludes our prepared remarks. Operator, could you now please open the call to questions.
Question And Answer

Question and Answer

Operator

[Operator Instructions]. Your first question comes from the line of Michael Phillips from Stifel Nicolaus. Please proceed.

Michael Phillips
Stifel Nicolaus

Thanks and good morning everybody.

Frederick Henry Eppinger
Former President & CEO

Good morning, Michael.

Michael Phillips
Stifel Nicolaus

Couple of questions. First, I guess high level on Personal Lines, with the new leadership at the top there, I guess for about two months. What have you heard from Gary, in terms of what he sees is his top priorities going forward in Personal Lines? I'll start off with that.

Frederick Henry Eppinger
Former President & CEO

The key in Personal Lines for us as you know from the beginning is where Personal Lines is small commercial is what we call balance for our overall strategy with partner agents. We're a little bit different than most, we don't try to attack at one risk at a time. What we're trying to do as they consolidate their shelf space with fewer players, is to have more of our partner agents give us a significant share of their Personal Lines but really that's dormant, what I mean by that is account based business that they had for quite a while. We clearly have and that's really been the focus of our strategy and so much for our investment portfolio and so before Marita talks about the specifics, I just want to talk a little bit about why we went out and got Gary.

My view is that the opportunity in Personal Lines is greater than we anticipated, probably 5 years ago. Given what I'm seeing is that portion of an agent business is becoming more important part of their profit pool. It is more stable, it is more consistent, and as they go through the pressures of the economic downturn and churns in the economy maybe even consolidation of the number of customers they have, that is becoming more important even to the wining on more significant agents in the country, and when Gary became, it was clear to me that there was some turmoil at his prior place. It was important for us to get somebody that had been a CEO for quite a while in that business and could handle a significant business, so we're thrilled to have him on board. So with that Marita, if there are any specifics you want to share with him about strategy.

Marita Zuraitis
Executive VP, President of Property & Casualty Companies

Yes, I think what it all blows down to is the reason why Gary joined us when as Fred said we went after him and it was because he thought the strategy was right. He believed in what we were doing and the account base strategy with partner agents and growing the majority of our business with franchised partners, he believed was the right way to maximize profitability and growth in this market. So he is really looking forward to continuing to advance that strategy and believes that what we're doing in the marketplace is right.

Michael Phillips
Stifel Nicolaus

Okay, thanks. I guess kind of a dud line follow-up to that is, can you give us some details on what you see is the [indiscernible] is doing well there?

Frederick Henry Eppinger
Former President & CEO

That's a great question. One of the things that's happening, as you know, our mix of business is becoming more balanced around kind of pre-stools. When we started we were probably a Personal Lines business. Six, seven years ago that did small commercial and accommodation. We now have a three store approach. Right, we have the Personal Lines, we have commercial core which has both small and very effective, what we call shmiddle, low end to middle market. And we have a specialty business that is growing significantly in breadth and capability, particularly in niche area.

If you think about, the... not the top 2 or 3 but the top BI 100 if you will, across the country, those agents that have significant guys and scope. We are becoming one of the most interesting markets for them because they are seeing consolidation in their markets and turmoil. And as we have grown our portfolio, while it's still very small face value, the breadth we have like in some of the legal liability area, the niches, those folks have significant portions of that business and so, it was important for us to have somebody that looked across region if you will. And... because most of these cross different regions and frankly in some cases are organized around different niches or lines of business and it was important for us to have some senior executive that could match up with the CEO's of these the institutions and really coordinate our efforts.

Both the actions still occur, location by location, underwriter by underwriter. But that coordination we think has real time for it. And again I would suggest that we have become interesting to them because they're facing consolidation of their shelf space with fewer, better players and are looking for a little bit of diversity in the market they deal with and we are building a better capability that's more relevant for them. So Jim on my view that's an important role for us and it is the right time for us to do it now that we have these other capabilities that are more appropriate for that customer segment.

Marita Zuraitis
Executive VP, President of Property & Casualty Companies

Yeah and I think building off that success was important over the last couple of years, one of the largest growth pocket, that we have seen in success with the Assurex Partners across the U.S., and building off of that success, Jim has really hit the ground running, tapped into a lot of the things that have already been successful for us, and is really getting some traction and momentum sharing best practices and driving some of those more complicated relationships across the footprint.

Michael Phillips
Stifel Nicolaus

That's perfect, thanks a lot. Last one now for me, still in Personal Lines. It sounds like Marita's comments on Michigan where a little bit more positive than in the past and isn't that good to hear, but in Personal Auto the stiff declines are still a little bit surprising, it doesn't sound like that has much of a Michigan drag as in the past. But kind of what else is going on there, that's bringing the PIFs down now to negative numbers?

Marita Zuraitis
Executive VP, President of Property & Casualty Companies

Yes, there is still some Michigan drag in there. You have to remember that we filed rate increases in Michigan as I mentioned that is helping there and Michigan is still a very tough environment. We're helped by playing insider baseball if you will in that State knowing the agents, knowing the environment, and our opportunities we feel are still strong. Focusing on margin is the key for us. It is a lot of work, and a lot of attention to do that but we're bullish on the fact that we can continue to do that but make no mistake, Michigan is a tough environment. Across the board, we are seeing a premium increase, step is beginning to stabilize. But this is a quarter by quarter...

Frederick Henry Eppinger
Former President & CEO

And I would also say that PIF decline is pretty severe both to Florida, Louisiana, and Michigan. And again, we believed that and as you know, the legal limits in some of those you've got to be thoughtful and deliberate but we got out of Homeowners essentially and that's working it's way through it. If you look at our PIF reductions, it's really concentrated in those three states.

And so I feel pretty good about all those decisions and also on Michigan, let me just... one of the nice... one thing that has happened in Michigan that makes it a little bit easier is the weather in Michigan has been significantly impacting our regional counter price. And so the combination of a tough economy and the weather that Michigan has experienced in the second and third quarter has created a lot of aggressive behavior in our regional guide to catch up with rate.

So I would see that the stabilization of Michigan will continue. I mean people are catching up with us on rate in a pretty fast order because of their problems financially. So... but the PIF decline as I said is very concentrated in those three states. There is probably a little bit and a couple of start up dates as we reconfigure the product a little bit by region, but it is really driven by that.

Michael Phillips
Stifel Nicolaus

Okay, that's perfect. Thanks a lot guys.

Operator

[Operator Instructions]. Your next question comes form the line of Rohan Pai from Banc of America Securities.

Frederick Henry Eppinger
Former President & CEO

Good morning Rohan.

Rohan Pai
Banc of America Securities

Good morning. Fred first question, you've highlighted in the past the Hanovar's value proposition to agents with a strong financial position and product relative to mutual and regional companies. At this point are you seeing any signs of capital stress among the mutual companies due to the equity markets?

Frederick Henry Eppinger
Former President & CEO

That's a question and it's one that's not as visible for the market because they're not big companies and doesn't get written about it. But to me Rohan, it is unbelievably pairings. I think you know, if anybody falls for mutual, but you know as they tend to carry a little bit more surplus because of their scale, their size. And what most mutuals do is they run their insurance company traditionally with kind of bond and fixed income. But they'll take what they consider "excess" and invest it in equity. So almost every mutual has a greater percentage of equities than a typical stock company. What you have seen is a dramatic decrease actually in those portfolios. So what is excess has gone down dramatically. We actually created database for our own benefit competitively of the top 100 mutuals in the country and look at their investment portfolio. If you look at that, the vast majority of them have taken surplus hits on their equity side.

In conjunction with that, those mutuals have also had very tough swarm seasons. Most of them are focused in Midwest companies. We've had two quarters of very difficult weather and when you add those to the fact that the reinsurance cost that those guys are going to have to incur, because remember, those guys buy down more than regular companies that you are used to. So they buy way down. The reinsurers now are taking their concentration into consideration. Because what we are learning in Iowa, in Ohio is that if you're too concentrated in one state, you have a above average risk for reinsurers. So as you see, reinsurance rates go up, and you will, because of their capital issues. It will hurt the mutuals more than people that are spread.

So what I see is this excess capital that people said were being built up by the mutuals has had a distinct turn in the last three quarters and so we see some stress. I think what you're going to see is commissioner start talking about financial strength, what is there to talk about. So again, it doesn't make to the press because they're small companies and --but if you remember our strategy, $135 billion of the market is in our kind of business with what we call sub-skill companies. And we believe in the next year, all of this is going to hit them a lot harder than people understand. And again I think it happens slow at mutuals, it tends to be organic.

What they tend to do, because again surplus notes are not accessible to them anymore, finite REIT [ph] is not accessible to them anymore, and so there's challenges about rating, right? Because if they lose their ratings, they have real problem. So what you'll see them do is shrink their business to support their surplus. That's what mutual tend to do, they slowly shrink when they have a problem like this to ensure that their surplus ratio is appropriate. So we think that translates into more pricing stability. Now its not that this stuff happens overnight, but it is the right question to ask for us, that is a very significant trend that we watch carefully and creates in our view, potential opportunity over the next 12 to 15 months.

Rohan Pai
Banc of America Securities

Thanks for the detail and possible answer. Second one, so assuming we head in to a dislocated PNC marketplace in 2009, how will you view your Specialty Commercial business, is it a segment that's going to expand in the new niche classes or will it still be the hook for agents to write your standard business which is...?

Frederick Henry Eppinger
Former President & CEO

Another good question. What we've tried to do is, as you know, in general the specialty businesses we have tried to get in through the cycles tend to have higher margins than some of these core lines. So we just didn't get into specialty businesses randomly. We are with small phase value stuff, that's high expense connection to it that is sticky. What you are going to see is a lot of those businesses should expand, and continue to expand because they tend to be businesses that are more monopoly [ph] because fewer people are in there. So there are places that require typically little bit more surplus reserves that are in them.

So if you are asking price in my view in those both solidify and increase maybe they'll even do a greater rate. But the reason we're in those businesses is to get the overall franchise. So we will grow those business and I'd like the diversity of the income that come with it, but what we always do is ask for... we don't give that capacity to agents without having the conversation that says we want a partnership across other lines. So it will continue to always be about the partnership, but it does present an opportunity for us and I would go a step further. The disruption in the market place is allowing us, as you know we've hired 2,500 to 2,800 people in the last 36 to 48 months. The amount of people that are terrific, that will be available in some of those interesting specialty lines is going up quite a bit. And so our view in a thoughtful way, we are continuing to do that. We have continued to interview and it allows us like in its human services that Marita talked about we think that it's a tremendous opportunity for us. The amount of quality people we brought in to do that is tremendous. And so again, I could see specialty continuing to grow faster than the rest of our business for quite sometime, as we thoughtfully expand the niches and the penetration.

The other point I would make is when you look at our, right, school was a great example, if you look at our mix. We are pretty thoughtful about roll out, so we've been in the school business for 3 years now. We've been incubating that. We've got a great team, we built the capability, but we're not even in all our states yet. I mean we are just barely probably in 50% of the states effectively at the end of the last quarter. It's going to be a lot greater in January, but some of this growth, just is from simply rolling out these niches to these additional states. So, we are both bullish on the specialty growth as well as on it's continued ability to leverage the core. I mean, is that fair Marita.

Marita Zuraitis
Executive VP, President of Property & Casualty Companies

I mean, I think its right. I think that's the whole beauty of the specialty business. It's got to double whammy, it's got the first by itself they are high margin good specialty businesses, but then they offer service looked to build stronger, deeper agency relationships. So you get both benefits from, I think you're absolutely right.

Rohan Pai
Banc of America Securities

Thanks, and finally for Marita, What is the commercial strategy in Louisiana again. I know you've been reducing your exposure for the last two or three years, but it somehow seems that even if you have a large event once every 5 or 8 years, it will be hard to make money in commercial lines in the state?

Marita Zuraitis
Executive VP, President of Property & Casualty Companies

Yes, we agree. We've taken an overall approach to the state and quite frankly have significantly reduced our Commercial's exposures to offset the fact that we can't by regulation get the personal line exposures as well as we might ultimately want to get them.

So balancing that and looking at that as a combined property writing in the state is how we've approached this from the very beginning. We have been very conservative with commercial business in the state and the majority of our new business writings is really coming from the Casualty Lines as we take a very conservative approach to cap management in the state. You're absolutely right. And we manage those concentrations down quarter by quarter.

Rohan Pai
Banc of America Securities

Great, thanks Fred, thanks Marita for the answers.

Operator

[Operator Instructions]. We have no further questions in queue. I would now like to turn the call back over to Mr. Bob Myron for closing remarks.

Robert P. Myron

Well, thanks to everyone for participating on our conference call and we look forward to speaking to you again next quarter.

Frederick Henry Eppinger
Former President & CEO

Thank you very much everybody.

Operator
Thank you for your participation in today's conference. This concludes the presentation. You may now disconnect. Good day. .