S&P Global
Market Intelligence

The Hanover Insurance Group, Inc.

NYSE:THG

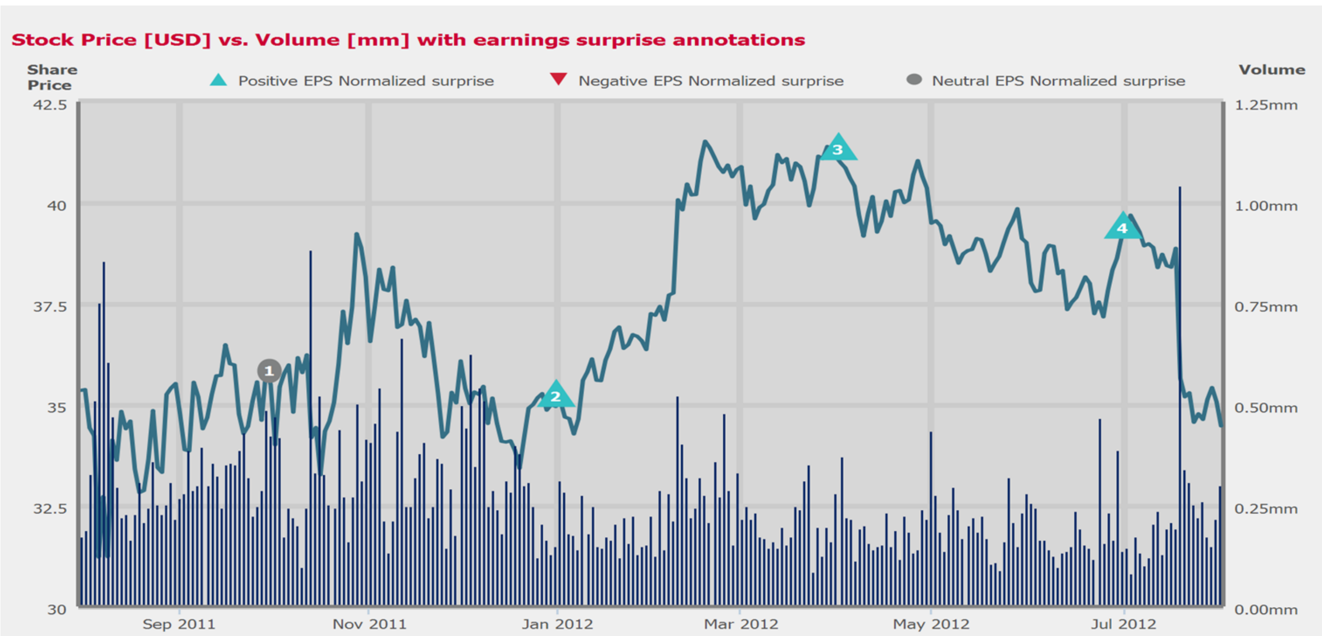
FQ3 2012 Earnings Call Transcripts

Thursday, November 01, 2012 2:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ3 2012-			-FQ4 2012-	-FY 2012-	-FY 2013-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.68	0.72	▲5.88	0.27	1.99	3.70
Revenue (mm)	1111.49	1120.10	▲0.77	1058.10	4402.49	4611.21

Currency: USD
Consensus as of Nov-01-2012 9:56 AM GMT



- EPS NORMALIZED -	CONSENSUS	ACTUAL	SURPRISE
FQ3 2011	(0.44)	(0.41)	NM
FQ4 2011	0.81	1.00	▲1 23.46 %
FQ1 2012	0.95	1.01	▲2 6.32 %
FQ2 2012	0.19	0.22	▲3 15.79 %

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EXECUTIVES

Andrew Scott Robinson
Executive VP, Corporate Development & President, Surety

David B. Greenfield
Former Chief Financial Officer, Principal Accounting Officer and Executive Vice President

Frederick Henry Eppinger
Former President & CEO

Marita Zuraitis
Executive VP, President of Property & Casualty Companies

Oksana Lukasheva
Vice President, Investor Relations

Robert Arthur Stuchbery
Former Chief Executive Officer and Executive Director

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Sterne Agee & Leach Inc., Research Division

Raymond Iardella
Macquarie Research

Sam Hoffman

Sarah Elizabeth DeWitt
Barclays Bank PLC, Research Division

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Stifel, Nicolaus & Company, Incorporated, Research Division

Presentation

Operator

Good day, ladies and gentlemen, and welcome to The Hanover Insurance Group Third Quarter 2012 Earnings Conference Call. My name is Tony and I'll be your coordinator for today. [Operator Instructions] As a reminder this conference is being recorded for replay purposes.

I'd now like to turn the presentation over to your host for today's call Ms. Oksana Lukasheva. Please proceed ma'am.

Oksana Lukasheva
Vice President, Investor Relations

Thank you, Tony. Good morning, and thank you for joining us for our third quarter conference call. We will begin today's call with prepared remarks from Fred Eppinger, our President and Chief Executive Officer, and David Greenfield, our Executive Vice President and CFO. Also in the room and available to answer your questions after our prepared remarks are Marita Zuraitis, President, Property and Casualty Companies and Andrew Robinson, President of Specialty Lines. Bob Stuchbery, President of International Operations and Chief Executive Officer of Chaucer is on the line from London as well.

Before I turn the call over to Fred, let me note that our earnings press release, statistical supplement and a complete slide presentation for today's call are available in the Investor 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 facts, include forward-looking statements such as our guidance for segment income per share for 2012. There are certain factors that could cause actual results to differ materially from those anticipated by the 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 total segment income, after-tax earnings per share, ex-cat loss and combined ratio and accident share loss and combined 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 supplements 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

Thank you, Oksana, and good morning, everyone. Thank you for joining our call today, especially as many are dealing with the aftermath of Hurricane Sandy. Our results this quarter demonstrate an improvement over what was a challenging weather story in last year's third quarter. Net income per share for the quarter was $0.89, and operating EPS was $0.72 cents, which translates to an annualized operating ROE of 5% through the 9 months of this year.

Our book value per share increased this quarter to $61, which represents 12% growth over last year and 4% for the quarter. Perhaps most importantly we are continuing to make progress on our strategic initiatives with some notable trends this quarter.

Price increases accelerated in all our major lines. As we anticipated, the market and our agents continue to be supportive of our differentiated pricing strategy in both personnel and commercial lines.

The quality of our business mix improved to targeted underwriting measures and exposure management activities. Expense ratio declined in commercial lines through growth and operating model efficiencies.

And Chaucer performed well and made another strong contribution, and we believe improving market conditions the team's strong underwriting acumen and our successful integration efforts provide additional confidence in the success of this franchise going forward.

With that said, our industry continues to face some significant headwinds due to the low interest rate environment and still difficult economic conditions in many industry classes. In our business, we recognized some modest loss experience in the areas we discussed last quarter. Auto lines and surety, but we leave we have taken the necessary steps to address these areas and we are confident we are on the right path to improve our underwriting results and overall returns.

Before I comment further on progress we are making on our strategic priorities and offer some perspective on the fourth quarter and longer-term prospects, David will provide you with some important context we're reviewing our third quarter numbers and trends.

David B. Greenfield
Former Chief Financial Officer, Principal Accounting Officer and Executive Vice President

Thank you, Fred, and good morning, everyone. Our third quarter results came in largely in line with our expectations. We believe we are making progress on our goals to achieve improved profitability. Net income was $40.4 million or $0.89 per diluted share this quarter compared to a net loss of $10 million or $0.22 per diluted share last year. After tax, segment income was $32.5 million or $0.72 per diluted share. This compares to a segment loss of $18.8 million or $0.41 per diluted share in the prior-year quarter.

Through the first 9 months of this year, we earned $88.5 million of after-tax segment income compared to a loss of $31 million for the same period last year. Several factors contributed to the improvement. In our domestic businesses, the most notable drivers were milder weather and lower catastrophe losses this quarter. We also made important strides in improving pricing and mix in our property business, which has led to favorable loss trends in the CMP and homeowners lines. Additionally, Chaucer provided a strong contribution to earnings.

At the same time, we also noted the continuation of trends in auto severity and surety that was marginally higher than what we discussed last quarter, but still within our overall range of expectations.

Let's review the catastrophe loss activity and prior year reserve development and then I'll comment on accident year results. Pre-tax, catastrophe losses this quarter were $52 million compared to a $100 million in the third quarter of last year. Cat losses this quarter represented 4.8 points of the combined ratio, 5 points better than the 9.8 reported last year.

The early July storms in the mid-Atlantic and in the Midwest which were a continuation of the late June activity resulted in the largest portion of catastrophe losses in our domestic business. At Chaucer, cat losses of $7.2 million this quarter were mostly driven by an estimate for crop losses incurred as a result of the severe drought in the U.S. this past summer.

We reported favorable prior-year reserve development for the quarter of $8.3 million or one point of the combined ratio, mostly driven by $17 million of favorable reserve development at Chaucer. Offsetting this was modest unfavorable reserve development of approximately $4 million in commercial lines and $4 million in personal lines. The unfavorable reserve development this quarter is primarily related to the noted severity trend in the personal and commercial auto lines, particularly for liability coverages in the 2011 accident year as well as loss activity in the SURETY business. It's also worth noting we continue to see favorable trends in our domestic CMP and workers' Competition Lines.

Favorable development in Chaucer's business reflects positive loss experienced in casualty and other as well as the energy line. I just want to add a few additional comments on the SURETY development. You'll recall I previously mentioned the complexity that exists in separating losses between current and prior years in this business.

As a result, I prefer to focus on overall results rare than the current and prior accident-year splits. On that basis, the SURETY business performed largely in line with the way we expected it would this quarter. In general, the frequency and severity of losses are trending down notably. With that said, we recognize the potential for additional losses to emerge, but continue to feel it will be to a much lesser degree than in the past.

In the go-forward portion of the SURETY book we are continuing to focus to shifting the business mix to commercial SURETY while maintaining a focused underwriting process in contract SURETY. This shift should continue to drive improved results in this business as we progress through 2013.

Now that we've covered catastrophe losses and prior-year loss development, I would like to provide some comments on our accident year underwriting results excluding catastrophe losses by segment. In Commercial Lines, the accident year combined ratio was 101 for the quarter compared to 105 last year. Aside from weather and lower SURETY related accident-year charges in current quarter, the improvement is driven by favorable loss trends in the CMP line as a result of pricing and profitability improvement actions.

We continue to experience rate increases in this line that are ahead of loss trends, and as we continue to work through our planned property exposure management actions, we anticipate we can deliver margin growth and lower volatility within this line in the future.

In Commercial Auto, the higher severity trends we are seeing in 2011 caused us to increase our severity picks for the current year. Concurrently we experience an acceleration of rate increases in this line, and we plan to continue to seek additional rates going forward. The lower commercial lines expense ratio also contributed to the improvement. Expenses during the quarter were down to 37.2% from 38.8% in the third quarter of 2011. However, as you will recall, timing of expenses are seasonal, and we expect the full year expense ratio for this segment will be closer to 38%.

Turning to Personal Lines, the accident year combined ratio was 92.8% this quarter compared to 96.7% last year. The improvement is partially attributable to more favorable non-catastrophe weather losses in the current quarter and most notably improved underlying loss trends in our homeowner's line due to earned rate increases and other underwriting actions. Fred will provide more color on these items in a moment.

Turning to Chaucer, the accident year combined ratio of 91.4% in the current quarter compares to 96.3% in the third quarter of 2011. We experienced lower frequency and severity of attritional and large losses in the current quarter, which drove most of the positive change. Chaucer's expense ratio was 38.7% this quarter, down slightly from the prior year quarter and relatively in line with our overall expectation.

Moving on to a discussion of our investment portfolio, at September 30th, 2012, we held $7.9 billion in cash and invested assets with fixed income securities representing 86% of the total. Roughly 95% of our fixed income securities are investment grade, and the average duration of the portfolio is 3.9 years.

Net investment income was $69.2 million for the quarter compared to $67.8 million in the prior year quarter. The increase is primarily driven by investments of Chaucer's cash into fixed maturities through the past year; but of course offset by extremely low new money yields.

Net investment income also benefited from our modest investment in high dividend yielding equities, although this quarter was even better than expected due to timing and acceleration of certain fourth quarter dividend payments. In the third quarter, our overall earned yield on the fixed maturity portfolio was 4.2% with new money rates now standing at 2.2%. This compares to 4.5% and 3.7% respectively for the third quarter of 2011.

Given the current market conditions, I'd also like to provide some perspective on the yield environment. Our strategy of low asset turnover has allowed us to maintain strong investment returns. However, as rates remain low for a prolonged period as is widely expected, the historically low new money rates will begin to have a greater impact on net investment income and overall investment returns going forward.

To provide some data points on how this might impact our returns, at the current portfolio duration of about 4 years, about 11% of the portfolio or approximately $750 million will turn over each year. We estimate that reinvesting $750 million at 200 basis points below current earned yield rates would reduce net investment income by roughly $15 million on an annualized basis. Of course, the actual impact in net investment income will be based on the new money rates available at the time these assets are reinvested.

Our balance sheet remains strong. We ended the quarter with $2.7 billion in shareholders' equity after delivering $13 million in shareholder dividends and repurchasing approximately 283,000 shares of common stock for $10 million. Our book value per share at September 30th, 2012 reached an all-time high at $61, up 12% from $54.40 at September 30th, 2011, and up 4% from $58.81 at June 30th, 2012.

We will continue to be diligent and balance our internal and external capital requirements while remaining vigilant to opportunistic uses of capital, such as reinvestment into our business. We also have good financial flexibility and our total capital remains in excess of rating agency requirements for our ratings.

Our debt to total capital ratio currently stands at 25%, down from its peak at 27% in the second of last year. Our financial goal for this metric remains in the mid to low 20s, and we will continue to look at ways to efficiently deploy capital to the opportunities we have and provide improved returns to shareholders.

Holding company cash and investments were $170 million at September 30th, representing approximately 2x our external interest and dividend requirements. We also maintain $200 million credit facility that provides us with additional capital support and flexibility. Overall, we're pleased with the trends that are emerging in our business and satisfied that we will be able to deliver improved overall returns to shareholders.

Now, before I turn the call back to Fred, I'd like to say a few words about our guidance. Before hurricane Sandy, we remained confident in our ability to achieve the full-year guidance of $2.70 to $2.90 per share established last quarter. Hurricane Sandy will be an important variable at our fourth quarter results that obviously was not contemplated in the guidance.

It's clearly too early to provide a reliable estimate for the storm losses, and it's equally clear that our guidance range can no longer be viewed as valid. In the meantime, I can tell you that our guidance included a fourth quarter planned catastrophe loss ratio of approximately 4% of earned premium, and we'll certainly update that as we develop a reliable estimate for the storm losses.

With that, I'd like to turn the call back to Fred.

Frederick Henry Eppinger
Former President & CEO

Thank you, David. And as we assess potential financial impact of this event, I want to comment on the mobilization of the company as engaged and to ensure that all those impacted receive prompt and professional response from the Hanover. With millions of people in hurricane Sandy's path beginning to assess the damage they've sustained and to reach out for help, our claims team is there to ensure all those impacted receive prompt and professional response from the Hanover.

Turning now to the quarter. As I mentioned earlier, and as David just reiterated, we remain focused on making progress toward target returns. We continue to see positive signs across our businesses and in the current markets. Of course, there are some challenges. However, we believe we have taken and will continue to take the appropriate actions to revise improved underwriting results going forward.

Creating a distinctive portfolio that can sustain returns through the cycle remains our overarching priority. Our pricing, profit improvement initiatives and improving quality of our business mix is evident across all of our businesses. With this in mind, I'd like to review the business initiatives we continue to implement this quarter as well as discuss our prospects in each of our business segments given the prevailing market conditions.

Beginning in core commercial lines, we had a strong quarter from a top-line perspective. Net written premiums continue their positive trend up 12% year-over-year driven primarily by increases in pricing, new business growth in targeted areas and strong retention levels.

Looking at pricing, the momentum we saw in the beginning of the year accelerated during the third quarter. Our renewal pricing was up over 7% compared to 6% of positive pricing in the second quarter of

2012, and up over the 3% achieved in the third quarter in 2011. We are encouraged that rate increases accelerated in both small commercial and middle market. Middle market pricing stood at 8% in the quarter with an acceleration in September, particularly in property and commercial auto, where we are taking some additional targeted actions.

This quarter we continue to actively manage property exposures in certain areas to ultimately improve returns. We are successfully reducing micro-concentration primarily in the Midwest, northeast and south-central regions. In specialty, we continue to generate growth, driven by rate increases, targeted new business and increasing renewal premium. Pricing increases averaged over 10% in our domestic specialty business.

In the aggregate, if you look at commercial lines, we are making meaningful strides in profit - improvement actions. Our pricing is at a healthy and improving levels and retentions are strong, all of which supports our expectation for improved profitability going forward.

We also shed another point and a half of our Commercial Lines expense ratio in the quarter compared to the third quarter of 2011. We've ranged -- we've gained traction in operating efficiencies as a result of the maturing of the new operating model investments we made over the last 18 months and for the maturing of our geographic investments.

Given our trends and momentum, we see additional opportunity in 2013. Through Commercial Lines -- though Commercial Lines returns are not where we want them to be, they are in line with our short-term expectations we discussed last quarter. And the actions we just discussed provide us confidence in improved loss and expense ratios going forward.

Now looking at Personal Lines, this quarter, our net written premium grew 1%, as our focus continues to be on improving profitability through rate increases and an active exposure and mix management. The pricing momentum we experienced in the first half of the year accelerated during the third quarter as our overall Personal Line supply rate was 7% with over 5% in auto, and nearly 10% in homeowners.

As David mentioned, we are now seeing the benefit if our prior rate actions, especially in the improved margins of our homeowners business. With our retentions holding, we expect to continue to take advantage of the pricing momentum going forward.

Presently, we are also working a number of levers other than rate and target improved underwriting margins in homeowners. Specifically we are implementing new underwriting standards with respect to deductible and ZIP code aggregation.

As a result our average deductible is increasing with new business deductible at over a $1000, and given our focus on writing the total counter Personal Lines, new business continues to shrink as it represented only 5% of our new home business written this quarter, down from 20% in the third quarter last year.

Additionally we continue to execute our renewal rights transaction we discussed with you last quarter, which affects approximately 80 legacy agents in New York, New Jersey and Connecticut.

This transaction reduced our premium by about 2% this quarter, and we believe it will help us reduce micro concentrations, help lower our losses from such events as the recent catastrophe and overall cat tail risk in the northeast. This should improve margin and long-term earnings stability in our business while providing additional profitable opportunities for partner agents.

To summarize our progress in Personal Lines, we are effectively improving homeowner's profitability and we believe we are taking the appropriate actions to improve margins in the auto lines. Recent severity trends in bodily injury are higher than our regional expectations, but given the steps we've taken to address our auto profitability over the last 2 quarters, we believe going forward we will see improved returns.

Finally, Chaucer has again performed well this quarter, earning 42 million in segment income before tax, highlighting the earnings benefits of our diversified underwriting portfolio. That said, together with

Chaucer, we have a more balanced company with greater scale, higher earnings power and great year earnings resiliency. Chaucer's net written premium grew 2% compared to the third quarter of last year.

During the third quarter of this year, we continue to benefit from rate increases for a majority of the lines, including energy and marine as a result of the higher-level market losses of 2011. We are pleased with this performance as we continue to actively manage the composition of the Chaucer portfolio given our overall risk appetite and market conditions. Overall results this quarter were largely consistent with our expectations, and we are pleased with our competitive position in the improving market cycle today. We continue to believe we have the right actions in place in each of our businesses and that the underlying trends in each are encouraging.

We continue to make good progress on our strategic initiatives as we seek to strengthen our business and continue to improve our portfolio we remain committed to underwriting quality business, implementing appropriate rate increases and executing targeted mixed management actions.

We have very good momentum in the market, and we feel very good about our ability to deliver on objectives and further improve our financial position going forward. Given our significantly improved portfolio on business mix and our strong position with agents and brokers and the strength we're seeing with Chaucer business, we are confident we will be in a position to show further improvement in our earnings power in 2013 and beyond.

Oksana Lukasheva
Vice President, Investor Relations
Operator we are ready for the Q&A session.

Question and Answer

Operator

[Operator Instructions] Your first question comes from the line of Dan Farrell of Sterne, Agee.

Daniel D. Farrell
Sterne Agee & Leach Inc., Research Division

Couple questions, first in the auto lines where you still had some reserves additions coming through, can you talk about your underlying assumptions there at that point? I know you've highlighted the uptick in loss cost trend, are you assuming a further acceleration of that within your reserving right now? Is there a leveling off at some point? I just want to try and understand how far ahead of that you think you might be at this point.

Frederick Henry Eppinger
Former President & CEO

Yes. I mean, let me start off by -- I think, as we talked about last quarter, Dan, and some of the remarks I made, we saw an uptick in the severity in the line. We took action in the second quarter, a little bit more in this quarter, including as you know, we added to our loss picks for the line. We think it's going to be past us pretty quickly. It's a fairly short tail or short time for us to determine the impact and the rating effects of it. And so as Fred kind of commented at the end of his remarks when we look at `13, I think we think it will be a much more positive story in `13.

Daniel D. Farrell
Sterne Agee & Leach Inc., Research Division

Okay. And then if I could just ask a question on surety as well, and I think probably [indiscernible] -- but do you still have the same level of confidence that by the end of this year you get past a lot of these troubles lines because you did obviously say there's some uncertainty around that area? And then also if you can just update us on where the combined ratio is running year-to-date right now on a GAAP basis for surety and a ballpark number would be fine?

Frederick Henry Eppinger
Former President & CEO

Sure. Well let me start with the first item. There was nothing in the quarter that caused us to have any substantive change in our position or view on the line. Most things occurred as we expected they would occur. The activity was what was anticipated, and we still feel just as good as we did at the end of last quarter about where we are. As we said, there are still some things that have to work through the system here; but effectively, we feel as positive about it as we did last quarter, and that's what I tried to convey in my commentary. In terms of combined ratio, we don't talk about it on an individual line. We don't usually give that out on an individual line basis. I haven't really disclosed a current year combined ratio there. Last quarter, I gave you a cumulative multiyear number, and I would just simply tell you that we're still -- we're not -- we are certainly below that number now; but we're still in the same vicinity. So we had a good quarter, but I wouldn't want to talk about a one-year combined ratio on that line.

Operator

The next question comes from the line of Ray Iardella of Macquarie.

Raymond Iardella
Macquarie Research

So I guess not to kind of peg you guys on any numbers -- number for Sandy, because I know it's still really early; but maybe I'll approach it a little bit of a different way. Can you maybe talk a little bit about the property cat reinsurance program, where it currently stands? And then secondly, when that would renew, and I guess if there is any thought in terms of appetite in terms of reinsurance purchasing in 2013.

David B. Greenfield
Former Chief Financial Officer, Principal Accounting Officer and Executive Vice President

Well, I'll take the first one, and then I'm going to ask Andrew Robinson to also talk a little bit about kind of our going-forward strategy, which is still early. But we have a $200 million-retention on our property cat program. So that's in play or in effect now. You'll find that information in our 10-K from last year. And then the program renews on January 1st, obviously we're in the midst of thinking about that and strategy around that. Andrew, I don't know if you want to add anything more to it.

Andrew Scott Robinson
Executive VP, Corporate Development & President, Surety

No, what I was going to say is that the very top level, the top 400 million renews July 1st. So the first 500 million is as of January 1st. Every year we reevaluate it and see if there's an opportunity for us to buy differently and look at that in the context of our PMOs and our plans to manage our exposures.

Raymond Iardella
Macquarie Research

Okay. And I know you guys -- or I don't think you guys have talked about sort of PMOs in the past; but has that number significantly changed over time? Has there been sort of an increase or decrease in any particular region?

Andrew Scott Robinson
Executive VP, Corporate Development & President, Surety

Yes. I think -- this is Andrew again. We have increased PMOs when we executed the OneBeacon transaction, and obviously, as we've gone west, we've had some diversification in our portfolio or not, an earthquake right around [ph] a primary basis. So there's some change in sort of the overall mix, but the northeast continues really to drive our cat purchase and really drives our PMOs and our tales predominantly, which I think then runs right into what we've been talking about quarter after quarter after quarter, which is, our property exposure management actions is all about obviously managing that number, Ray.

Raymond Iardella
Macquarie Research

Okay. Now, that's certainly helpful. Another question, I guess, you know, workers' compensation just looking sort of at the loss ratio improvement year-over-year. Just maybe can you talk about sort of the rate increases you're getting in that business and in particular, also something along the lines in terms of audit trends and then maybe just comment on loss cost trends as well if you could?

Marita Zuraitis
Executive VP, President of Property & Casualty Companies

Yes. I'll be glad to take that question. This is Marita. In the workers' comp line in the quarter, we saw 8 points in new money, and actually 8.2 points of that was pure rate. We have been shifting our portfolio in workers' comp over some time, and we talked about that. We are decreasing our PIPs in middle market while we're increasing our PIPs slightly in small commercial writing less complex smaller workers' comp policies that have a much better profit potential for the future. We feel good about the workers' comp business. We are writing. As far as premium audit, we saw $4 million of additional premium in the quarter. That benefited our overall Commercial Lines growth youth by about a point. So we are seeing some positive additional premium, and we're comfortable that the majority of the workers' comp growth is coming from either rate, as I mentioned, or some minor PIP growth in the small commercial arena.

Raymond Iardella
Macquarie Research

Okay. That's certainly helpful and last one and I'll requeue after this. In terms of -- and I know, Fred you talked a little bit about sort of the mix shift of the business and how that's going to improve underlying results; but just -- I mean maybe there's a little bit of noise in the numbers; but looking year-to-date results and the other commercial, looks like the accidental loss ratio is up a little bit. Maybe can you talk about sort of the trends you're seeing there? I think surety is in that line of business. But maybe just give us a sense of where the specialty business, if you will, is trending?

Frederick Henry Eppinger
Former President & CEO

Yes. I think we talk a little bit about the last call. Actually feel very good about the maturing of all of our specialty businesses. As you know we did a number of small acquisitions and some start-ups, and if you look at that portfolio of business, they are getting to the point where they're at the size and the operating models where they've matured and should contribute nicely to 2013. That other category obviously is dominated by the activities you've seen in that surety line to date. I think there was a little bit last year because of -- some of the weather related losses in marine that runs through that line as well, but it really -- that is what you're seeing in that. Now that category, that mix, it's a mix adjusted loss ratio, which is hard to see, because obviously we've shrunk our contract surety business pretty dramatically and increased our commercial surety as well as some of our marine and some of our program business. So part of what you're seeing the loss ratio is actually the result of mix of lines of business, because contract surety even with these difficulties has a lower loss ratio, higher expense ratio component than some of those other lines, so -- but if you look at our specialty, I'm quite pleased. They're young and have been matured, and so I look to them to be very helpful in '13. Let me go back to -- somebody asked about exposure management. You know, our whole strategy in the last 7 years has been about this balance in the portfolio. We've gone from 70% property and 70% northeast as a company to a much balanced, more 50-50 between property and casualty and a much different geographic spread. So we feel pretty good about what we've done over the years getting out of Rhode Island homeowners, shifting a lot of concentration mix all the way to this last renewal right deal that we just did that reduced a pretty significantly our exposure of property in the Northeast. So we like our balance right now, and part of it is the maturing of the specialty businesses and some of the casualty things we've done, and so I feel pretty good, but overall I think we're in pretty good shape for our mix going forward. And so what you're seeing us do now is take advantage of that extra pricing. So that helps all of our businesses. And while I feel very good about our underwriting, many of those businesses are relatively young, so this pricing is very helpful to us, right. We're not growing a lot. We're getting a lot of mix improvement and we're getting a lot of margin improvement from pricing and proof [ph] retention. So it's getting there.

Raymond Iardella
Macquarie Research

Okay. And not to kind of put expectations as a quick follow-up, but would you expect that to improve going forward just based on mix, or is it a combination of rate, mix and sort of the noise going away in surety in 2013?

Frederick Henry Eppinger
Former President & CEO

I think it's the combination of all of those things. What we've commented on the last quarter, I think one of the big -- we've got a couple of issues that were getting behind us this year on the auto -- getting behind on the auto liability side as well as the surety. But it's also the other things we've mentioned. So that other category into `13, in our view, is a much improved story for us.

Operator

Your next question comes from the line of Vincent D'Agostino from Stifel, Nicolaus.

Vincent M. DeAugustino
Stifel, Nicolaus & Company, Incorporated, Research Division

Just want to apologize in advance in case I missed anything after joining a few minutes late, but joining the conference call this morning but just a…

Frederick Henry Eppinger
Former President & CEO

That's a pretty good sign, specifically your time.

Vincent M. DeAugustino
Stifel, Nicolaus & Company, Incorporated, Research Division

Just to clarify on an earlier point on auto. If I'm understanding your earlier commentary, if loss cost trends stay where they are, where they're currently running, we should basically expect the adverse reserve development on those 2 lines to taper-off in the next quarter or so?

Frederick Henry Eppinger
Former President & CEO

Yes. Now, we should probably comment, and you all know -- everybody who follows us knows this. But let me just comment on the accident years in the fourth quarter. Because we are a Midwest, Northeast company that has drive time snowstorm, et cetera, traditionally our accident year, loss ratio goes up in auto in the fourth quarter, and you could look at our patterns over the last whatever years. And we have taken a higher pick, as you know, in the accident year, which will also continue to the fourth quarter. But we do believe that your question, have we taken the actions to get after the '11 development? Absolutely. So we feel like we've taken good aggressive action there, both on the '11, which is -- and you've seen this -- you saw this quarter, this shrinking impact of that, but also on just making our pick different or the go forward years. David is there anything...

David B. Greenfield
Former Chief Financial Officer, Principal Accounting Officer and Executive Vice President

That's exactly right, Fred, and I would describe it the same way. So you'll see a little bit higher accident years in the fourth quarter, which is a normal trend for us. On top of that, you'll see the higher picks we've been talking about last quarter, and this quarter affect us in the fourth quarter similarly to where we are now. And then I think, as I said earlier, we're taking actions, rate actions, other actions that I think most of this, if not all of it will wear-off fairly quickly.

Frederick Henry Eppinger
Former President & CEO

The other thing about rate actions, just to be -- because it's an industry -- not only have we seen retention, because this is an industry phenomenon, the rates have been well received. I mean, we've been able to get them out there quickly and hold retention and do the actions we need, because it is a broader action than just us. It's an industry phenomenon that people are seeing. So we're confident.

Vincent M. DeAugustino
Stifel, Nicolaus & Company, Incorporated, Research Division

Great. And then on the commercial line side, are you finding that national carriers maybe can't be as account specific as they maybe should be with renewals right now? And does that open up any opportunity for you to win some business that maybe say being an across the board rate increase when maybe that's not warranted?

Frederick Henry Eppinger
Former President & CEO

No. I think that's absolutely well said. Our differentiated pricing strategy really starts with being able to take an individual account approach and being able to get out early with the communication of our rate need with our partner agents. So you said it well. We're clearly seeing that differentiate and help us get the price that we're pushing in the marketplace, absolutely.

David B. Greenfield
Former Chief Financial Officer, Principal Accounting Officer and Executive Vice President

And what happens at 1/1, is that the system gets clogged. So some of the best accounts that have high margin accounts get clogged in across the board actions around 1/1. And so for us, this is a period where cherry picking is very much available to us with our partner agents. And we -- as you know, we focus as a company on the [indiscernible] business. And that is prevalent in that $25,000 to $75,000 account range, where we're getting really nice price increases, and getting very attractive profiles of new business, right.

Marita Zuraitis
Executive VP, President of Property & Casualty Companies

A clear place where the fact that we have a lot less agents than the big national companies is very helpful to us in that regard as well.

Vincent M. DeAugustino
Stifel, Nicolaus & Company, Incorporated, Research Division

Okay. And then one last one if I may. Would you perhaps be able to maybe if you already did, just update me would be good. But would you be maybe quantify the impact of non-cat weather on the quarters combined ratio, would you say that non-cat weather was basically normal in 3Q?

David B. Greenfield
Former Chief Financial Officer, Principal Accounting Officer and Executive Vice President

Yes. I think it was -- this was a much more normal. I think what we said in the script is exactly right. If the third quarter of last year was odd both because of cat and because of non-cat weather, and some if our property improvement was exactly that. I would characterize this third quarter as…

Frederick Henry Eppinger
Former President & CEO

More normal.

David B. Greenfield
Former Chief Financial Officer, Principal Accounting Officer and Executive Vice President

More normal. We had a little bit of activity at the beginning of the quarter. But it was much more normal, and I think you're seeing that for everybody. It was a much more reduced level.

Operator

Your next question comes from the line of Sarah DeWitt of Barclays.

Sarah Elizabeth DeWitt
Barclays Bank PLC, Research Division

My first question, is just to clarify on the reserve strengthening, surety and commercial auto. What has changed versus the second quarter? Or is this just a continuation of the same trend? And then secondly, on workers' compensation, the accident year loss ratio improved there pretty dramatically. Does that just reflect rate increases and excessive loss trend, or was there anything else unusual there, and to what extent is that sustainable?

Frederick Henry Eppinger
Former President & CEO

Let me take the first one, Sarah, and then Marita, I think, will elaborate some more on workers' comp. But the trends are essentially a continuation of what we discussed in the second quarter. Some of the severity trends in commercial auto just continued as we moved into the third quarter, and we made some adjustments to prior reserves as a result of it albeit at a much lower level than we saw the previous quarter. And I think that that's working its way through, and my hope is it won't continue for much longer as we're getting a lot of rate in the book now, and we're making other adjustments. On surety, I got to go back to my comment there. The activity in the quarter was pretty much in line with where we anticipated. The split between current and prior year is a much more complex decision that goes into when was it reported, when did it fail, when did we get notified, and or when did we take action on our own. And so I give less credibility to the current and prior year there; but effectively, the underlying activity in surety is very much in line with what we discussed last quarter, and again I'll say we feel pretty positive about the position we're in right now overall with that book of business.

Marita Zuraitis
Executive VP, President of Property & Casualty Companies

Right. And on your second question, as far as workers' comp, I think you hit the first point, and that is we have been getting rate in excess the lost costs on that line, and with 8.8 points of new money in the quarter, that obviously continues. The second big thing is what I mentioned before, and that's the mix shift in this line over the years. It's something we've been talking about for some time now, where right now, our workers' comp book is predominantly small and shmittle and less complex as I mentioned. So it is pricing in the mix shift.

Operator

We have a follow up question from Dan Farrell from Sterne, Agee.

Daniel D. Farrell
Sterne Agee & Leach Inc., Research Division

Just a couple things with regard to Sandy, on Chaucer, you clearly it looks like you've shrunk some of the property lines there. Can you talk about how you think about exposure in that business given some of the stuff that you've done?

Frederick Henry Eppinger
Former President & CEO

Yes. Dan, let me start off, and then I think if Bob wants to elaborate he can certainly do so. As it relates to Chaucer, we've talked about over the course of the last year, making sure from our combined books perspective, that we didn't want to double up our exposure locations and the like. And so a lot has been done over the course over the past year to reduce property exposures where we have a greater exposure on the Hanover side to make sure that we're managing our overall companywide exposure. So that's part of what you see in terms of property reduction. And then I think the rest is just normal portfolio management, which I think Bob can comment on if he would like to.

Robert Arthur Stuchbery
Former Chief Executive Officer and Executive Director

Yes, David that's exactly right. I mean the first thing was just to measure some of our exposures and adjust those backwards. And the other thing is just genuine sort of management of coming out of certain lines, where we don't think the price is right.

Operator

Your next question comes from the line of Sam Hoffman with Nomura.

Sam Hoffman

I just had 2 clarifications on what you said about the commercial auto and other loss ratios. So I guess my understanding was that you expect the adverse development to tail off gradually over the next few quarters, especially by the end of the year. But on the accident year loss ratio, it's my understanding the commercial auto was reported 70.9%. Ex-cat, accident year, is that kind of the new run rate, which then reduces because you get pricing, or is that also you're experiencing losses in the quarter that will probably go away by the end of the year?

David B. Greenfield
Former Chief Financial Officer, Principal Accounting Officer and Executive Vice President

I think what I would say is we're getting a lot of pricing in that business. I think I would treat the 70.9 as a slightly elevated loss ratio given what we've talked about in the last couple of quarters. Sam, we have increased the pick this year to be a little bit more conservative in that line, and based on what trends we're seeing; but as we start to earn the pricing that we're getting on the book, I would expect that the ratio will come down a little bit.

Sam Hoffman

And what type of pricing are you getting in commercial auto?

David B. Greenfield
Former Chief Financial Officer, Principal Accounting Officer and Executive Vice President

I don't -- I don't know that I have the actual numbers in front of me, Sam; but it's been pretty -- it's been pretty aggressive...

Frederick Henry Eppinger
Former President & CEO

Well, what I mentioned in my script, right, is 8 plus percent in both commercial auto and in property, particularly in the middle market, where really the activity is and it was accelerating -- as I mentioned in my script, it's accelerating through the quarter, and we're getting, as I said earlier, the retentions are holding, because it's not -- we're not the only folks that are seeing it. Just a comment on our mix, too, we're not in the long haul trucking. This is not -- these are not big fleets or anything. This is just small fleets that acts relatively similar to some of the personal lines auto. So, again, we feel very good about getting ahead of it here with the rates that we're getting.

Sam Hoffman

Okay. And then my other question was, on commercial lines on the expense ratio, you talked about a 38% level for the year? Fred, whether you adjusted for the commercial line expense ratio overtime to achieve your overall corporate objectives?

Frederick Henry Eppinger
Former President & CEO

Yes. So again, the trouble with Sam what the overall is that it's so driven by mix of business, but what we've said is, as I look to `14 there is another point, point and a half that we're going to get out of a commercial line from the efficiency and the -- and frankly some of the scale because of the growing into some of the growth initiatives and some of these other investments that we've made in lines of business. Now the only caveat I would make to that is, again, what you are going to see is improvement in almost every commercial business; but the number changes dramatically depending on the mix of business, because some of these businesses, particularly the specialty businesses have a much lower loss ratio, much higher expense ratio and LAE ratio. So, again, but we're very confident that we're on track. We're getting improvement in almost every single commercial business now, and, again, a little bit of timing in the fourth quarter as we referred to our scripts; but we're going to see improvement next year, and we'll see improvement going from there, too. So we feel good about it, because it's all the things we measure, we're getting nice traction on it.

Sam Hoffman

So you see like a point 2, 1.5 points of expense ratio improvement by 2014, and therefore the margin improvement will be driven mainly by loss ratio improvement...

Frederick Henry Eppinger
Former President & CEO

Yes. So if you look exactly -- so if you look at within almost every one of our businesses, absolutely you nailed it, right, so the underwriting margin improvement. What you're seeing in these businesses is coming from the maturing of some of these younger businesses to mix and really importantly pricing. And you're seeing that across the board in a lot of these businesses, and we feel really good about it. Right. So -- and again, some of these are younger businesses, so it's just a natural thing where the picks you do in the first year and how you manage them, you're going to have that maturity, but we're also getting nice pricing in all of those lines as well. But that is the bulk of the improvement in our business over the next 2 years.

Operator

[Operator Instructions] There are no further questions at this time. I would like to turn it over to Ms. Lukasheva for closing remarks please.

Oksana Lukasheva
Vice President, Investor Relations

Thanks to all of you for your participation today and we are looking forward to speaking with you next quarter.

Operator
Thank for your presentation -- for your participation in today's conference. This concludes the presentation. You may now disconnect and have a great day.