S&P Capital IQ

CONTENTS

CALL PARTICIPANTS 2

PRESENTATION 3

QUESTION AND ANSWER 8

CNA Financial Corporation NYSE:CNA

FQ1 2017 Earnings Call Transcripts

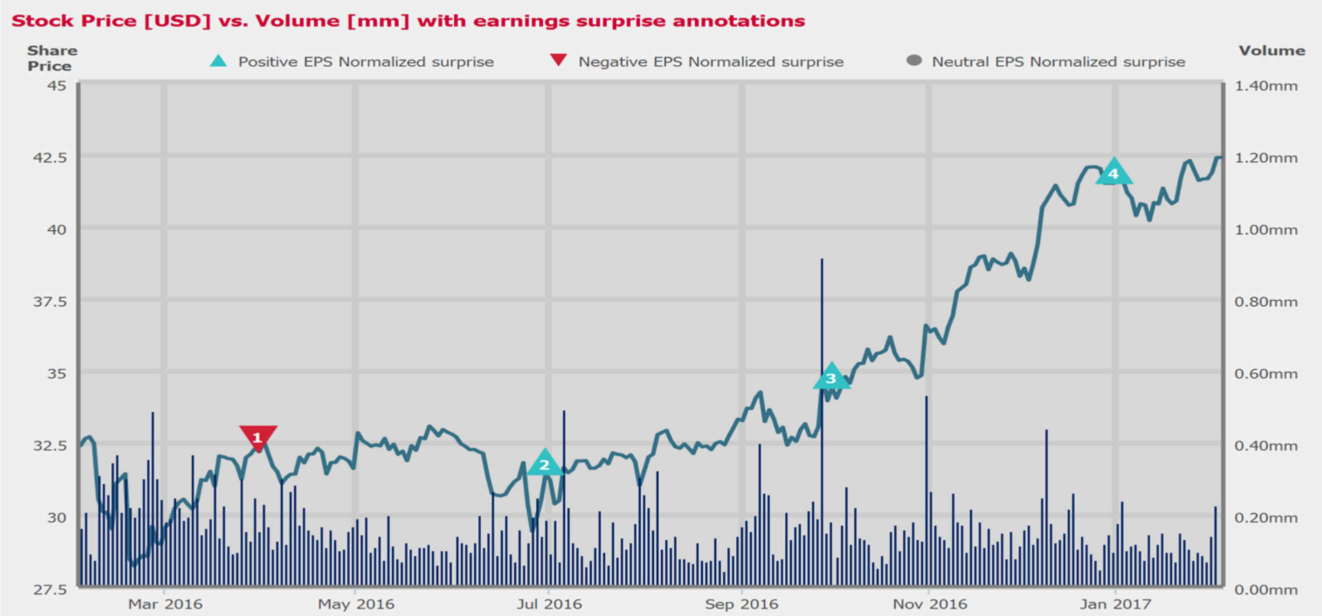
Monday, May 01, 2017 2:00 PM GMT

S&P Capital IQ Estimates

	-FQ1 2017-			-FQ2 2017-	-FY 2017-	-FY 2018-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.79	0.87	10.13	0.75	3.17	3.16
Revenue (mm)	2018.00	1632.00	(19.13 %)	2342.00	9362.00	9315.00

Currency: USD

Consensus as of May-01-2017 12:36 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ1 2016	0.62	0.34	1 (45.16 %)
FQ2 2016	0.71	0.74	2 4.23 %
FQ3 2016	0.82	1.15	3 40.24 %
FQ4 2016	0.79	0.82	4 3.80 %

Call Participants

EXECUTIVES

D. Craig Mense
Chief Financial Officer and Executive Vice President

Dino E. Robusto
Chairman & CEO

James M. Anderson
Senior Vice President of Financial Planning & Analysis and Corporate Development

ANALYSTS

Cliff Gallant

Gary Kent Ransom
Dowling & Partners Securities, LLC

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Jeffrey Schmitt

Joshua David Shanker
Deutsche Bank AG, Research Division

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

Robert Ray Glasspiegel
Janney Montgomery Scott LLC, Research Division

Ronald David Bobman
Capital Returns Management, LLC

Presentation

Operator

Good day, everyone. Welcome to the CNA Financial Corporation First Quarter 2017 Earnings Conference Call. Today's conference is being recorded. At this time, I'll turn the call over to Mr. James Anderson. Please go ahead.

James M. Anderson
Senior Vice President of Financial Planning & Analysis and Corporate Development

Thank you, Shirlon. Good morning, and welcome to CNA's discussion of our 2017 first quarter financial results. By now, hopefully, all of you have seen our earnings release, financial supplement and presentation slides. If not, you may access these documents on our website, www.cna.com.

With us on this morning's call are: Dino Robusto, our Chairman and Chief Executive Officer; and Craig Mense, our Chief Financial Officer. Following Dino and Craig's remarks about our quarterly results, we will open it up for your questions.

Before I turn it over to Dino, I would like to advise everyone that during this call, there may be forward-looking statements made in references to non-GAAP financial measures. Any forward-looking statements involve risks and uncertainties that may cause actual results to differ materially from the statements made during the call. Information concerning those risks is contained in the earnings release and in CNA's most recent 10-Q and 10-K on file with the SEC. In addition, the forward-looking statements speak only as of today, Monday, May 1, 2017. CNA expressly disclaims any obligation to update or revise any forward-looking statements made during this call. Regarding non-GAAP measures, reconciliations to the most comparable GAAP measures and other information have been provided in the financial supplement.

This call is being recorded and webcast. During the next week, the call may be accessed on CNA's website. With that, I will turn the call over to CNA's Chairman and CEO, Dino Robusto.

Dino E. Robusto
Chairman & CEO

Thank you, James. Good morning, everyone. It's a pleasure to share our results for what is my first full quarter with CNA. We had a good quarter both financially and operationally. Each of our P&C segments posted underlying combined ratios that were the same or better than a year ago when Commercial is adjusted for its premium development. We posted favorable loss reserve development in each of our P&C segments. Rate improved modestly as retention held strong across the P&C segments. We avoided outsized catastrophe losses. Our expense base was smaller. Investment income was strong. And our long-term care business continues to perform at a breakeven level.

But before we go into more detail on our results, let me first talk about what we are working on operationally. The time has gone by quickly as we have been actively working to further strengthen the organization. You'll recall that my primary objective is to improve our performance, indeed to build a disciplined underwriting culture specifically focused on growing our underwriting profits. Significant effort is being invested to both continually enhance the expertise of our talent and to supplement our team with selective hires from across the P&C supply chain.

Early in the first quarter, you may have seen the announcement of our new role of Chief Underwriting Officer. The role was created to further strengthen our underwriting governance and to develop more profitable growth opportunities. In this role, Doug Worman's first priority, working together with the leaders of our 3 P&C segments, is to institutionalize collaboration among the underwriting, claims, actuarial, risk control, enterprise risk management and analytic teams. The closer the alignment and the more timely and effective the feedback loops among the teams, the more efficient we will be at utilizing all the sophisticated tools at our disposal to grow our underwriting profits and to be more effective at embedding lessons learned across our entire employee base.

There is tremendous capability in our organization and an imperative to drive needed improvement to more quickly and seamlessly bring those collective capabilities to bear on our opportunities and issues. This process takes more time than one quarter, but CNA's senior management team has emerged from the starting gate with tremendous conviction and our employees have responded quite favorably to the new focus. In fact, the energy has been raised to such a level that the momentum is starting to build on itself across the organization.

Of course, our focus is not just internal and the first quarter has seen us bring our underwriting mission to the marketplace and reintroduced our meaningful value proposition of sophisticated products and services to our agents and brokers. Together with our executive management team, I have personally been involved in a number of high-level strategic discussions with agents and brokers and have been very encouraged by the reception we are getting.

Additionally, the leadership of our Commercial segment spent many weeks of the quarter visiting our branch locations providing advanced training, highlighting best practices across the various levers that all of our underwriters utilize. During the visits, they also spent significant time with key agents and brokers to reinforce CNA's capabilities. Moreover, we continue to strengthen the Specialty segment through some select hires to further fortify our underwriting talent available in the market. In addition, our International segment leadership has had strategic meetings with brokers to ensure that we are reinforcing both our domestic value proposition in Canada, Europe and the U.K. as well as our multinational capability.

Bottom line, everyone is very engaged internally and externally to build and demonstrate our strong value proposition. Over time, this consistent focus on underwriting discipline and producer relationships will lead to greater access to more high-quality new business and improved overall underwriting financial performance. All the while, we continue to reinforce a clear bias toward expense discipline. The quarter's expense ratio showed improvement from a combination of 2016 actions as well as early benefits of coupling an emphasis on challenging the status quo to gain process efficiency and productivity gains with strict accountability.

With that, let me make a few high-level comments on our first quarter financial results, and then Craig will provide much more detail by business unit. Net operating earnings were $235 million or $0.87 per share in the first quarter of 2017 and a marked improvement from the first quarter 2016's $91 million. Net operating return on equity was about 8%.

Our P&C business generated a 97.2% combined ratio in the first quarter, a point higher than 2016's first quarter results. However, the result was inflated by nearly 2.5 points due to a premium adjustment in our small business units within the Commercial segment, which Craig will describe in more detail later. Excluding this adjustment, our combined ratio was 94.8%, nearly 1.5 points lower than the first quarter 2016 including a loss ratio of 60.5%. The underlying combined ratio, which excludes the impact of catastrophes and prior year development, was 96.5%, an improvement of nearly a point from the first quarter of 2016, driven by the expense ratio, which was 34%.

Our P&C net written premiums, excluding the small business premium adjustment, grew about 1% as retention remained strong and rates were slightly higher in all 3 segments. Reported net written premium growth was down 2% as a result of the premium adjustment. High-quality new business continued to be difficult to come by, but it does exist. Acquiring it requires more focused prospecting and greater underwriter effort and reinforcing the relative benefits of our value proposition in order to judiciously win more of the high-quality new business that is written by our peers, in particular, for the customers in the niches we have targeted for years with tailored products and services and for which we have industry-leading expertise. Our efforts are gaining traction as evidenced by our modest increase in new business in the first quarter for Commercial, specifically in our key middle market segments.

More generally, in terms of industry dynamics, the P&C marketplace in the U.S. remains competitive but stable, with market pricing trends generally in line with what we saw in the fourth quarter of 2016 and terms and conditions are essentially rational. Of course, you can always find pockets of what appears to be inappropriately aggressive quotes. Fortunately, we have the underwriting expertise to steer clear of these accounts.

Outside the U.S., it is essentially the same story for CNA. Lloyd's business continues to be under greater pressure with more aggressive pricing. And the team there, as well as the teams at all our locations, knows that we place no undue pressure to produce growth for growth's sake. Our focus is to grow underwriting profits.

Our Life & Group segment had net operating income of $4 million for the quarter, continuing to be near breakeven since 2015's unlocking event. For long-term care, favorable morbidity trends offset unfavorable persistency. Overall, the long-term care book continues to perform as anticipated, and we are continuing to get approval of needed rate actions from many state regulators.

We completed our annual asbestos and environmental reserve review in the first quarter. This year's review resulted in a $60 million increase to reserves for asbestos and environmental liabilities that have been ceded to National Indemnity as a part of our 2010 loss portfolio transfer. The resulting $13 million after-tax charge contributed to the corporate segment net operating loss of $37 million in the quarter compared with a loss of $114 million in the first quarter of 2016, a significant year-over-year improvement. We are also pleased to announce our regular dividend of $0.25 per share.

And with that, I'll turn it over to Craig.

D. Craig Mense
Chief Financial Officer and Executive Vice President

Thanks, Dino. Good morning, everyone. Our first quarter 2017 net operating income of $235 million and net income of $260 million are much improved from last year's first quarter results and they are reflective of steady underwriting performance, favorable loss reserve development across all 3 P&C business segments, reduced expense spend, another small positive earnings contribution from Life & Group, and a significant positive net investment income contribution.

Our Property & Casualty Operations produced net operating income of $268 million, nearly 30% above the prior year quarter. This earnings achievement was despite the dampening impact of the small business premium adjustment. Notably, our improving underwriting discipline is evident in both P&C Operations underlying loss ratio of 62.2%, which is a little over 0.5 point better than where we ended the full year 2016, and our $57 million of favorable loss reserve development, which is consistent with last year's first quarter.

The small business premium adjustment affected both our reported Property & Casualty and Commercial business segment results. I would ask that you refer to the earnings slides, Pages 5 and 8, where we have outlined the impact on this quarter's reported results. You'll recall last quarter, we have identified rating errors in our small business package product and recorded a charge to reflect our decision to voluntarily refund premium to affected policyholders. In our 10-K, we noted that we are continuing our review. We have now concluded that effort and found that there were also rating errors in our small business workers' compensation product. Consistent with our approach on the package product, we will voluntarily refund amounts to affected policyholders.

The earnings slides highlight how the underlying business is performing and the specific impact of the earned premium charge on our reported results. The most significant impacts of this premium adjustment at the Property & Casualty Operations level were to reduce our written and earned premium, which inflated our combined ratio by 2.4 points and lowered our net written premium growth from a positive 1% to a negative 2%.

You will note as you review our reported results that our underwriting expense dollar spend was reduced $22 million or 9% as compared to the prior year's quarter. Our adjusted expense ratio of 34% is approximately 1 point lower than both the prior year's quarter and our 2016 full year result. I would attribute a little over 50% of the improvement to actions taken in 2016 and our improving expense culture, with the remainder attributable to some favorable expense timing. This is true with both the Property & Casualty and Commercial business segment level.

Our Specialty segment had another strong quarter with a calendar year combined ratio of 90%, including a 58.2% loss ratio, which reflected 5 points of favorable net prior year development. The favorable loss reserve development of $31 million was driven by a number of our professional liability products, predominantly across accident years 2011 through 2015. Specialty's underlying combined ratio for the quarter was just below 95%, in line with both the prior year's first quarter and full year results with relative consistency in both the underlying loss and expense ratios. Specialty's net written premiums were down 1%. Premium rate was up a point in the quarter, and retention was a very strong 88%.

As shown on Slide 8, our Commercial segment's adjusted calendar year combined ratio was 99.1%. Commercial's adjusted underlying combined ratio was 98.1%, an approximate 1 point improvement from the prior year's quarter and full year 2016 results. The adjusted underlying loss ratio of 62.3% was relatively consistent with the full year 2016 results. The adjusted expense ratio of 35.3% was more than 1.5 points better than the 2016 full year result.

Favorable loss reserve development of $24 million came primarily from Commercial Auto. You'll recall that in 2013 and '14, we strengthened reserves for Commercial Auto. However, in recent periods, we are seeing some of those pressures abating and actual claim outcomes coming in lower than expected.

Commercial's net written premiums in the quarter, excluding the premium adjustments, were up 2%. Premium rate was up a 0.5 point, slightly better than recent quarters, while retention continued to be strong at 83%. New business in our middle markets specialized industry segments was a positive contributor.

Our International segment generated a 95% combined ratio for the quarter, including 3 points of favorable reserve development. This is a 4-point improvement year-over-year, 3 points of improvement on the loss ratio and 1 point on the expense ratio. The Ogden rate impact was not material. The underlying combined ratio was 96.4%, nearly 3 points better than the prior year's quarter results and 6.5 points better than the 2016 full year result. The International segment also benefited from a light cat quarter. Net written premiums were up 1%. Rate and retention showed slight improvement through recent quarters.

Our Life & Group results are consistent with the last few quarters and our expectations. The favorable morbidity that Dino mentioned is driven by lower frequency, also referred to often as incident rates. We did close the sale of our life settlements business last quarter. While there was no real impact to reported financial results, the sale does mark another modest, but important, effort to continue to reduce volatility and expense at CNA.

Net investment income was $545 million in the first quarter compared with $435 million in the prior year quarter, as you can see on Page 16 of the earnings slide. Our limited partnership portfolio had a strong quarter, producing $90 million of pretax income, a 3.8% return compared with a $14 million pretax loss in prior year quarter. Income from our fixed maturity portfolio was $455 million compared with $446 million in the prior year quarter, reflective of a higher invested asset base and steady yields.

Our investment portfolio's net unrealized gain was $2.7 billion at quarter end, a slight increase since the end of the fourth quarter. The composition of our investment portfolio is relatively unchanged. Average credit quality of our fixed maturity portfolio remained at A. Fixed income assets that support our traditional P&C liabilities had an effective duration of just over 4.5 years at quarter end, in line with portfolio targets. The effective duration of the fixed income assets, which support our long-duration Life & Group liabilities, was 8.8 years at quarter end, which continues to reflect both the low interest rate environment and our tactical decisions.

At March 31, 2017, shareholders' equity was $11.7 billion and book value per share was $43.15, a decrease of 2.5% since December 31, reflecting the $2.25 of dividends paid in March. Shareholders' equity excluding accumulated other comprehensive income was $11.8 billion. Book value per share ex AOCI was $43.49, a 2% increase from year-end 2016, adjusting for the $2.25 of dividends paid. More notably, the year-over-year increase was 9% adjusting for the $3 of paid dividends.

Our financial strength and strong liquidity profile are outlined on Pages 13 and 14 of the earnings slides. Cash and short-term investments at the holding company were approximately $520 million at quarter end. We continue to target cash at the holding company equal to approximately 1 year of our annual net corporate obligations. In the first quarter, operating cash flow was just under $300 million. We continue to maintain a very conservative capital structure. All our capital adequacy and credit metrics are well above our internal targets and current ratings.

With that, I'll turn it back to Dino.

Dino E. Robusto
Chairman & CEO

Thanks, Craig. Before we move to the question-and-answer portion of the call, let me leave you with some summary points. Each of our P&C segments produced an underlying combined ratio equal to or better than the first quarter 2016 result when you exclude Commercial's premium adjustment, nearly a point improvement in total. Moreover, our P&C underlying loss ratio was 62.2%, more than 0.5 point improvement from the full year 2016. Each of our P&C segments reduced favorable prior year loss development totaling nearly 4 points, consistent with the prior year period. Underwriting expense dollars were down 9%. Rate across our P&C segments was almost a point higher than the prior quarter, while retention continued strong in the mid-80s. Our long-term care business continues to be stable and executing efficiently. Our employees as well as our agents and brokers have responded very favorably to our reinvigorated underwriting focus.
With that, we will be glad to take your questions.

Question and Answer

Operator

[Operator Instructions] We'll have our first question from Josh Shanker, Deutsche Bank.

Joshua David Shanker
Deutsche Bank AG, Research Division

I guess my first question goes to Craig. I wonder if you can walk us through the accounting for A&E losses in the quarter and how that impacts us down the road. I read that the losses show up on the P&L, but they're actually going to NICO. I needed you refresher on that I guess.

D. Craig Mense
Chief Financial Officer and Executive Vice President

All right. Well, recall that the growth ceded losses are -- so the first starting point, so we increased those $60 million. So given the fact that we're already in a gain position relative to the contract, you would add that $60 million to what is already almost $400 million gain position. We can give you those specific numbers in a callback, Josh, to make sure we're giving this to you accurately. But what then happens is that you have to essentially refresh your calculation of how you take into account the deferred gain. And what you're allowed to do is recognize the gain in proportion to the paid losses against your estimated full liability. So right now, we're at about 48% of paid loss to where we are estimated reserves, which is $2.9 billion. So $1.4 billion or so against the $2.9 billion. So what then happens -- so then there is a deferred gain on the balance sheet. And as losses are paid over the course of this year, in future years we'll recognize the rest of that deferred gain.

Joshua David Shanker
Deutsche Bank AG, Research Division

And the amortization of that gain is included in the net income number, but not the operating income number?

D. Craig Mense
Chief Financial Officer and Executive Vice President

No. It's in the operating income number and it's in the [indiscernible].

Joshua David Shanker
Deutsche Bank AG, Research Division

It is in the operating as well?

D. Craig Mense
Chief Financial Officer and Executive Vice President

Yes.

Joshua David Shanker
Deutsche Bank AG, Research Division

And so what was then the offsetting gain in this quarter?

D. Craig Mense
Chief Financial Officer and Executive Vice President

Well, the offsetting -- we put up the $60 million or so, about 50% of that would be offset. And then you also have the amortization of the rest of it. So essentially, this quarter's pretax income was a $20 million hit, pretax hit to operating income and $13 million after tax.

Joshua David Shanker

Deutsche Bank AG, Research Division

Okay. I'm still going to work on that a little bit, but I'll come back to you. And then I guess for Dino, thinking about 100% combined ratio as a general idea for the P&C industry where we are given interest rates, as you try and improve things, are you also running up against this unusual time where insurance is possibly written below 100%? How should we think about the improvements that can be made at CNA and the backdrop of, I guess, rising interest rates pushing the envelope about what is possible?

Dino E. Robusto
Chairman & CEO

I'm not sure I follow that one completely. Not sure I got exactly, Josh, what you were after there.

Joshua David Shanker
Deutsche Bank AG, Research Division

So is it possible over the long term to be much better than 100% combined?

Dino E. Robusto
Chairman & CEO

Sure. Sure. And I think, as I mentioned at the last -- on the last call, right, I think about it right now our own goals and objectives on sort of this absolute basis, right? We -- I sort of track the 15 to 16 sort of peer companies that we compete with in our business. We do a little mathematical exercise, take a look at the top sort of 4 or 5, look over the last couple of years, what their combined ratio has come in at. Right now, if you look at that cohort and the top performing, we've got to close the gap about 4 to 5 points, which I think is going to come from a combination of both the loss ratio and the expense ratio. And what we need to do here to continue to improve it, is drive many of the things that I talked about over my earlier remarks. And we put in operational goals across the management team to make sure that we're achieving this target. I think it's going to take a little bit of time for us, but we are moving forward with real urgency. And so we clearly do see the ability to do that in the long term without a doubt.

Joshua David Shanker
Deutsche Bank AG, Research Division

And when you think about closing that gap and thinking about those top 4 or 5 performers, is the gap going to be closed by you improving solely? Or are their numbers going to deteriorate in a higher interest rate environment?

Dino E. Robusto
Chairman & CEO

Yes. I mean, I understand the question, Josh. It tends why, right, as I talk about setting the goal, right, you can look at it in the absolute or the relative. And I think what you need to do is look at it in the relative. So we'll constantly take a look at this number, again, just a mathematical exercise. You want to say the best performing companies are able to achieve this. That's where you want to be. And so that's what we want to do. And that -- we're going to close that relative gap and we're going to keep it on a relative basis. Which means that it could come from both ends of that spectrum, from the right or from the left. The objective being, look, you decide what the best performing are doing. You want to get there. You keep an eye on it. You set at the right goals and you tell the team it can be done and this is what we're focused on. But -- so I hope that answers it for you.

Operator

We'll go next to Bob Glasspiegel with Janney

Robert Ray Glasspiegel
Janney Montgomery Scott LLC, Research Division

So the adjusted expense ratio of 34%, is that a sort of fair run rate? And can you improve from that without any help from premium growth?

Dino E. Robusto
Chairman & CEO

Yes. So it's Dino. Yes, so what -- as Craig indicated, right, excluding the premium adjustment, it was a function of some of the actions that we had put in place in '16, the expense culture, a little bit of the timing. So right now running in the sort of low 34s, and we think it's likely going to be in that range in 2017. So you should think about it in terms of about 0.5 to a 1 point better than what we saw in 2016. So we're making progress.

Robert Ray Glasspiegel
Janney Montgomery Scott LLC, Research Division

Where's the long-term goal of where you want to be? I mean, you've mentioned that that's a key focus to help you narrow the gap versus the industry.

Dino E. Robusto
Chairman & CEO

Yes. Indeed. And just going back to the prior answer. As we close what I consider to be an important relative gap, anticipate it's a combination of the loss ratio and the expense ratio, if you were to look at the gap now against this sort of cohort average over a couple of years, it's probably a couple of points on loss ratio and it's about 2 to 3 points on expense ratio. Now whether it's going to play out precisely to the tenth of a percent, not certain, but that's what we're looking at and that's what we're focused on.

Robert Ray Glasspiegel
Janney Montgomery Scott LLC, Research Division

And just following up on Josh's question, how much -- I'm trying to limp through the K, can't quite make this out. How much of the Berkshire cover have you utilized on either a paid or incurred basis?

D. Craig Mense
Chief Financial Officer and Executive Vice President

On a ceded basis, gross ceded basis, we have used $2.9 billion against the $4 billion. On a paid, it's a little over $1.4 billion.

Robert Ray Glasspiegel
Janney Montgomery Scott LLC, Research Division

And this year you incurred, you said, $60 million?

D. Craig Mense
Chief Financial Officer and Executive Vice President

I said we increased our gross ceded by $60 million, and what I said was the incurred impact was $20 million pretax and $13 million after, for the impact of that increase.

Robert Ray Glasspiegel
Janney Montgomery Scott LLC, Research Division

I'm just trying to say though, you've got $1.1 billion left to go on a gross basis, and you used $60 million. Just trying to see the survival rate shows, sort of on what the right numbers to think about.

D. Craig Mense
Chief Financial Officer and Executive Vice President

Well, I'm not sure. I mean, I think that -- remember, it's a $4 billion cover. So if there's a little over $1.4 billion paid, you're going to look at it against the limit, right, there's $2.6 billion still left against the limit.

Robert Ray Glasspiegel
Janney Montgomery Scott LLC, Research Division

On a paid basis, yes.

D. Craig Mense
Chief Financial Officer and Executive Vice President

On a paid basis, right. On incurred basis, we said we have ceded $2.9 billion, so there's a $1.1 billion still left against the limit.

Robert Ray Glasspiegel
Janney Montgomery Scott LLC, Research Division

And $60 million is the right numerator to use against those numbers or?

D. Craig Mense
Chief Financial Officer and Executive Vice President

No, not exactly. Why don't we -- we would be happy to call you back, Bob, and we'll go through exactly. Because we had put together some exhibits in prior calls, they would probably be helpful if we pull them out and send it to you and then we can just walk through the whole thing. But do remember, I think most importantly, that the existing incurred increase is not -- there's no economic impact. So it's an accounting charge and it does get amortized back into income, the deferred gain in income, over the life of the contract.

Robert Ray Glasspiegel
Janney Montgomery Scott LLC, Research Division

No, I got you there. I'm just trying -- it seems like a relatively small wiggle is sort of the thrust of my question, unless you're telling me something otherwise.

D. Craig Mense
Chief Financial Officer and Executive Vice President

No. I would tell you exactly. That's what I would hope you would take away that this is a small adjustment.

Robert Ray Glasspiegel
Janney Montgomery Scott LLC, Research Division

Right. And the small wiggle was mainly related to what?

D. Craig Mense
Chief Financial Officer and Executive Vice President

It was just related to slightly elevated payments under no losses. So it's nothing -- no new sources of losses being identified or no new cohort of claimants or anything else like that. It's just a small adjustment that we've made this quarter.

Robert Ray Glasspiegel
Janney Montgomery Scott LLC, Research Division

So you're the first company to do A&E reviews this year, so what you're finding is of interest to me. So I appreciate the color. And I would like the tutorial again, I know you've done it before.

Operator

We'll go next to Jeff Schmitt, William Blair.

Jeffrey Schmitt

Could you touch on loss cost trends in the Commercial segment in a little bit more detail, maybe touch on the legal environment and medical cost inflation, what you're seeing there?

Dino E. Robusto

Chairman & CEO

It's Dino, just an overarching commentary first, right, in terms of loss cost trends. We, right now actually, are not seeing anything that suggests that they're really changing. Actually, we've been seeing a slight improvement rather than deterioration in Commercial. Specifically to your question, in Q1, we saw a slightly lower frequency in comps, somewhat lower severity in Commercial Auto. In the Specialty side, just to give you a little bit of detail there, a little bit of higher frequency trend in health care, which was a function of aging services which Craig had spoken about in prior calls. FI management liability, the actual loss trend was consistent with 2016. Now, we have seen security class actions running a little bit higher in '17, but we haven't seen any of that manifest itself in our books. So again, from our sort of vantage point, actually, not really changing, maybe net-net slight improvement. I don't know, Craig, was there anything you wanted to add to...

D. Craig Mense
Chief Financial Officer and Executive Vice President

No. I think that's exactly the point, really not much. The 2 spots where we have heightened expectation that we built into pricing and reserving are for medical cost inflation and auto loss reserve trend. But we haven't, at the moment -- the businesses are performing in line with that. And we certainly don't see anything else of significance in terms of loss trend-wise across the book, beyond what Dino just mentioned in that small amount of the medical professional.

Jeffrey Schmitt

Okay. And then the commercial auto book, I mean, obviously, there were some issues there with increased frequency and severity. But was a legal driver of that severity piece more than anything?

D. Craig Mense
Chief Financial Officer and Executive Vice President

No. That was -- maybe we should take you back to, we saw loss cost trend increasing back in 2012, is where it started. So we increased reserves pretty significantly in auto in 12, '13 and '14. And this is really what you're seeing now is that we had taken underwriting, in addition to increasing reserve substantially, we also took underwriting actions at that time. We got out of the -- an E&S auto book that we had. We reduced our small business auto writing, really, essentially got out of writing monoline small business auto. So the combination of the reserve increases and our underwriting actions of -- just resulted in what you're seeing today is just that the severities that we anticipated back there are just playing out at slightly lower claim settlements. So that's really the action that you're seeing here at the moment.

Operator

We'll go next to Ron Bobman, Capital Returns.

Ronald David Bobman
Capital Returns Management, LLC

I had some Commercial auto questions, but you just tackled them. My other just remaining question is on the adverse development cover. Craig, as it relates to paids and the rate of paids on the cover, I'm wondering, as compared to the expectations as far as the timing of payments when you entered into the agreement, has it been quicker, slower or generally at the speed of payment that you expected at the contract's inception? That's it for me.

D. Craig Mense
Chief Financial Officer and Executive Vice President

I would -- well, thanks, Ron. It's been generally at the speed we expected. Remember when we bought it, we said that we had hoped to essentially eliminate our asbestos and environmental pollution exposure. And we kind of defined that as thinking that there was a 20-plus-year payout term. We're now into year 7 of that payout. And so I would tell you that the -- that contract is working out exactly as we conceived and constructed it at the moment.

Operator

We'll go next to Jay Cohen, Bank of America Merrill Lynch.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

A couple of questions. First is, when you talked about the timing issues on the expenses. I assume that you're just talking about the kind of the underwriting expenses, not acquisition costs?

D. Craig Mense
Chief Financial Officer and Executive Vice President

That's correct.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Okay. So we need to kind of look at that underwriting expense number in the first quarter as being maybe a little bit better than we would normally have expected.

D. Craig Mense
Chief Financial Officer and Executive Vice President

That's exactly right. And that's detailed on -- I would point you to Page 4 of the supplement and you would see. So look at the other underwriting expense line there, Jay.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Got it. And then secondly on the runoff business, are you seeing any increased interest from potential buyers or reinsurers of that business?

D. Craig Mense
Chief Financial Officer and Executive Vice President

What runoff are you referring to, Jay?

Jay Adam Cohen
BofA Merrill Lynch, Research Division

The long-term care business.

D. Craig Mense
Chief Financial Officer and Executive Vice President

I would say not -- nothing material. We're certainly active and engaged in that process and in that marketplace. And there's always activity, so there -- and I -- so I wouldn't say there is ever inactivity, and we're certainly -- and we're highly engaged in it. But there hasn't been a significant shift in appetite at the moment.

Operator

We'll go next to Gary Ransom, Dowling and Partners.

Gary Kent Ransom
Dowling & Partners Securities, LLC

I wanted to follow up on the loss cost question. And clearly, you're not seeing a whole lot right now, so it's fairly benign for you. But as we've talked with others of your peers, there does seem to be some little upticks in some of the GL lines, maybe a little bit more propensity to sue. And I just wondered if you had seen anything in any of your subsegments that might confirm that or deny that.

D. Craig Mense
Chief Financial Officer and Executive Vice President

No. I mean, Gary, I would say that we don't. I mean, we've listened and read the narratives of the other calls and we have not seen a meaningful uptick in litigation activity affecting any of our business lines, except in the -- what Dino mentioned in the medical, professional and nursing business, but we've mentioned that in prior calls. So we certainly would acknowledge that, and our claim folks would acknowledge that there are greater number of law firms engaged in public D&O litigation. But that hasn't created anything meaningful in well -- in the way of loss cost or loss cost inflation. So I'm sorry we can't -- we do not see any of that noise.

Gary Kent Ransom
Dowling & Partners Securities, LLC

Okay. If I look at your -- the rate that you disclose and then look at you -- look that you've seen -- you're seeing loss ratio improvement, it suggests that the loss trends you're experiencing are very benign, maybe even down in some cases because you're seeing this improvement with rate that's maybe just 1% or so. Is that correct?

Dino E. Robusto
Chairman & CEO

Well, we have indicated -- Gary, we have indicated that they have been relatively benign. But it's another dynamic there. If you recall, and I mentioned it on the last call, right, there's a number of levers that I think we can really pull on to improve the underwriting performance. And in particular, Gary, when you're not operating at what -- I use the phrase internally called the efficient sort of underwriting frontier, that's when you have a consistently well-performing portfolio of accounts on a risk-adjusted basis executed within a competitive expense infrastructure. Now we're not there yet. So we have an opportunity to drive improvement even if the earned rate is below loss cost trend, which notwithstanding that being denied -- benign, right, the earned off is below. So I think there's an opportunity for us to continue to work on this dynamic, notwithstanding the rate and loss cost trend dynamic.

Gary Kent Ransom
Dowling & Partners Securities, LLC

All right. And one other question on another topic, on your limited partnership income being strong. Is that the same strategy you've had all along there? I just wondered if you've made any changes or what the average expectation is for that book of investments.

D. Craig Mense
Chief Financial Officer and Executive Vice President

Well, I mean, that's a -- so I would say that we have not made any recent changes to that portfolio, but the structure has been in place for a pretty long period of time. We have, over the last several years, shifted from like 90% hedge fund. So it's a little less biased towards long equity, and it's now about 30% private equity and real estate. So it's a little slightly shifted towards private equity from what it used to be, but not elsewise. And this is a superior performance. We wouldn't expect to be able to duplicate this every quarter. But over the last 5 years, it's averaged about 9% return. Over the last 10 years, it's averaged about a 7% return. So I don't know if any of that kind of helps you.

Operator

We'll go next to Meyer Shields, KBW.

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

Some small detail questions, if I can. One, the fixed maturity portfolio in P&C, the average rating moved from A to A minus. Is there anything significant or is that just like where we finally cross over the threshold?

D. Craig Mense
Chief Financial Officer and Executive Vice President

Nothing significant. And I think that, really, that's driven by sale of some of the agency securities which were used to fund the dividend. So it's -- in April, it's back to A. But it also tells you kind of where we are relative to the line and what's available in the market.

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

Okay. And we're probably giving this too much attention, but the timing issue affecting the operating expenses -- or the underwriting expenses, is that a second quarter correction or should we expect that over the year?

D. Craig Mense
Chief Financial Officer and Executive Vice President

No. I think that -- I mean that's -- all we're trying to give you is that the indication that the improvement you saw isn't all going to be there. So remember what Dino just said, a little over half of the improvement was actions we've taken, a little less than half is things relative to timing. But we still expect there to be -- to run somewhere in the low 34s, so -- at the moment.

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

Okay. And then last, sort of big picture question for Dino. Tom, in the past, had talked about sort of the skepticism towards commercial auto, and that's worked out pretty well over the last few years. How are you thinking about the line, not in the immediate term, but over the long term? Is that something that you feel like you can build the necessary underwriting expertise to really build up your share?

Dino E. Robusto
Chairman & CEO

At this particular juncture, right, it served as well the strategy that Tom and the management team over the years had adopted. Which is essentially, right, you decide what target segment you want to go in. You put a value prop together. You get a product services and you go, you decide what is it that they particularly want. So it's risk control, it's a little bit better on the product service, a little bit better on the underwriting. And the need to fill it out or to be able to provide also the auto, not really as important. So in light of some of the dynamics of the economics you know so well about, I don't anticipate that it's anything that we would change from a strategy standpoint. It's serving us well going after the segments that we're doing. And there has, as Tom has said, there's many quarters where you're happy that you have small premium in auto. So we'd stick with the same approach for now.

Operator

We'll go next to Cliff Gallant, Philadelphia Financial.

Cliff Gallant

I wanted to go back to the opening comments where you were talking a little bit about the alignment of the different teams and organization. I was wondering if you could explain a little bit more about what you meant by that, maybe an example of sort of where CNA is today and where you want it to be.

Dino E. Robusto
Chairman & CEO

It's a great question. And it sounds like it isn't one sort of tangible strategic initiative, but it is core to what I consider to be -- if you really want to have a very strong underwriting culture, what you have to do is take all the expertise. Look, actuarial has very specific expertise. The claim organization, having managed that kind of an organization over the years, the insight that adjusters have on the dynamics that's happening on accounts is tremendous. Loss control, the risk control people, they're out there even before we write these risks, examining the exposures, getting a good sense for what customers really execute upon and why, what's the motivation, our enterprise risk management, all of the modeling, et cetera. So the expertise is there. What you have to do is institutionalize that feedback loop. And so -- and that's really been a really focus for us and it's -- looking at it not only from the various lines of business, but all kinds of postmortem. Postmortem on large losses and say, okay, let's take a look at that let's see what we've learned from this. When you're going after certain complex opportunities, bringing that -- those teams to bear, we're all here in the same building, it's a question of going up a few floors or sideways along the floor, and that's really something. Then the other thing that we're doing, but it's an important one because, clearly, analytics is really making a difference where it was a little bit more difficult and today Big Data and unstructured data information. You want to try to automate that process. And so what you learn from your claims automatically gets built in to the predictive algorithms and what we see from a risk control because you can take all that information now and put it into the systems. And so it is an automation. But beyond the automation, it's a mindset to say we're going to seek out every neuron we got and bring it to bear on the underwriting process.

Operator

That concludes our question-and-answer session. We'll turn the conference back over to Dino Robusto for any additional are closing remarks.

Dino E. Robusto
Chairman & CEO

Thank you, everyone, for your questions. Look forward to seeing again in 90 days. Bye now.

Operator
That does conclude today's conference. Thank you for your participation. You may now disconnect.