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Earnings Call

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Presentation

Operator

Good day, and welcome to the Hanover Insurance Group's Second Quarter Earnings Conference Call. My name is Betsy, and I'll be your operator for today's call. [Operator Instructions] Please note this event is being recorded.

I would now like to turn the conference over to Oksana Lukasheva. Please go ahead.

Oksana Lukasheva
Senior Vice President of Corporate Finance

Thank you, operator. Good morning, and thank you for joining us for our quarterly conference call. We will begin today's call with prepared remarks from Jack Roche, our President and Chief Executive Officer; and Jeff Farber, our Chief Financial Officer. Available to answer your questions after our prepared remarks are Dick Lavey, President of Agency Markets; and Bryan Salvatore, President of Specialty Lines.

Before I turn the call over to Jack, let me note that our earnings press release, financial supplement and a complete slide presentation for today's call are available in the Investors section of our website at www.hanover.com. After the presentation, we will answer questions in the Q&A session. Our prepared remarks and responses to your questions today, other than statements of historical fact, include forward-looking statements as defined under the Private Securities Litigation Reform Act of 1995. These statements can relate to, among other things, our outlook, reserve position, economic conditions and related effects, including economic inflation, potential recessionary impact as well as other risks and uncertainties such as severe weather, catastrophes and social inflation that could affect the company's performance and/or cause actual results to differ materially from those anticipated. 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, the presentation deck and our filings with the SEC.

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

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

John Conner Roche
President, CEO & Director

Thank you, Oksana. Good morning, everyone, and thank you for joining our call. I'm pleased to report our second quarter results demonstrate the strength and diversification of our business, our financial discipline and our ability to execute in a dynamic market environment. Despite significant catastrophe activity, we delivered strong earnings with a 9% operating return on equity in the quarter and a 12% operating ROE through the first half of this year. Our performance reflects strong execution on 2 critical priorities. First, ex-CAT margin enhancement. We significantly improved our underlying margins in Personal Lines and delivered consistent strong profitability in Core Commercial and Specialty in the quarter.

This focus on profitability yielded outstanding results as demonstrated by an ex-CAT combined ratio of 88.5% compared to 92.8% year-over-year; and second, the progress and execution of our catastrophe mitigation actions. Although severe convective storms in the Midwest and South Central U.S. made the second quarter more challenging than anticipated, we continue to have a high level of confidence that our proactive approach to managing catastrophe exposure will clearly bear fruit. In Personal Lines, our actions to address convective storm exposure are well underway. We remain optimistic about the rapidly growing impact of increased all peril deductibles and the introduction of wind and hail deductibles on our CAT claims intake and ultimately, loss severity.

As a reminder, these terms and condition changes only began impacting renewals in April of this year. We expect as a higher proportion of the book of business is rolled under these terms, the impact will dramatically increase in each of the next few quarters. Additionally, we are anticipating that close to 2/3 of our homeowners business in the Midwest will have wind and hail deductibles applied to the policy by the end of 2024. And the vast majority of the book will have the desired deductibles both all peril and wind and hail ahead of the spring storm season.

The current effect of property and CAT actions in Core Commercial is more significant after several quarters of increasing deductibles and pricing as well as risk-specific PML pricing and risk prevention initiatives. As a result, our modeled CAT loads are significantly reduced in middle market, especially in states exposed to convective storms. And 75% of the most vulnerable middle market accounts have been addressed through underwriting actions or sensor deployment.

Our second quarter results also reflect our commitment to balanced and thoughtful growth. We grew written premiums by 5.1% in the second quarter, up 2.8 points from the first quarter of this year, and we expect growth to increase sequentially each quarter for the remainder of the year as we elevate our new business and renewal retention in areas where profitability is strongest and where we'll benefit from continued diversification.

Now let's look at the second quarter performance of our business segments in more detail, starting with Specialty. Specialty achieved top line growth of 8.2%, 3.4 points higher than in the first quarter of the year helped by strong retention and accelerated double-digit new business growth. Retention remains strong at 83% with continued renewal pricing momentum of 11.7% further reinforcing the Specialty segment's integral role with our agents as a key element in our value proposition.

The specialty market in our target markets remain strong. We achieved double-digit growth across multiple lines, including surety, marine, industrial property, health care and management liability. Our excess and surplus lines business also grew double digits in the second quarter. The E&S market remains very attractive as freedom of rate and form allow us to capture opportunities at good margins while helping us further diversify our portfolio with respect to catastrophe risk. In Marine, we are pursuing growth initiatives by expanding our portfolio geographically and by class of business to further limit us from concentration-related CAT and market volatility. Across most of our Specialty portfolio, we continue to expand distribution points, including substantially growing the wholesale channel to capture broader market opportunities.

In addition to broadening our portfolio of Specialty offerings, we are accelerating key technology investments as well to ensure we are optimally positioned to compete in the evolving digital environment and help agents create efficiencies, particularly with their smaller specialty policies. These investments should result in significantly improved turnaround times and allow us to capture more of the robust new business opportunities in the market. More broadly, our technology investments have positively impacted all of our businesses. We deployed digital APIs to work with our distribution. We use advanced analytics for pricing sophistication and risk selection, and we have targeted generative AI use cases to achieve operational efficiencies.

Turning to Core Commercial. This segment also delivered strong performance this quarter, achieving solid net written premium growth of 5.5%, driven primarily by an 8.5% increase in Small Commercial. We remain very optimistic about opportunities in Small Commercial with accelerated new business growth to be driven by several key initiatives. These include the continued build-out of our TAP Sales platform with the rollout of our workers' compensation product in the first half of next year, the expansion of virtual sales capabilities across all states and deeper market share penetration with our best agents.

Additionally, we are very pleased with the pricing, class, geographic mix and quality of new business and renewals as the TAP Sales platform includes enhanced capabilities for pricing sophistication and product expansion. While focusing on small commercial growth, we are simultaneously implementing profitability and property improvement initiatives in middle market, including the catastrophe management work I referenced earlier.

Although middle market growth remained low at 1%, it showed sequential improvement and we have executed very well on the key margin and CAT management initiatives. As we near the end of our portfolio optimization, we expect to elevate our growth in middle market beginning in the fourth quarter. Looking ahead, the Commercial Lines market is expected to remain firm and disciplined for the remainder of this year and into 2025, supported by challenging liability trends. While we continue to closely monitor liability trends and proactively work to manage through the environment, we remain highly confident in the strength of our reserves and disciplined in our loss ratio picks.

Over the past several years, we have dedicated significant effort to analyzing the expected trajectory of liability severity and its potential impact on our operations. This proactive approach led us to adopt a more defensive posture, both in terms of strengthening our balance sheet and refining our underwriting practices. And from where we stand today, we believe our current liability profile is very well positioned to navigate social inflation challenges. Our strategy includes maintaining lower limits, reducing risk in large metro areas in difficult geographies, reducing premises liability exposure and refraining from writing stand-alone excess umbrella policies.

Additionally, we have implemented rate increases above our prudent loss trend assumptions, maintain a low reinsurance attachment point and have a lower reserve duration, which is inherent in a small account size book of business. These tactical decisions have collectively enhanced our resilience in the face of evolving market conditions. As we look ahead, we remain committed to navigating the evolving liability environment with vigilance and agility.

Turning to Personal Lines. We delivered tremendous year-over-year improvement of 7.6 points in our ex-CAT current accident year loss ratio, reflecting the outstanding execution of our margin recapture initiatives. Personal Lines net written premiums grew 3.3% in the quarter, in line with expectations. Although we continue to project segment growth in the low single digits in 2024, we expect to see the pace accelerate slightly in the second half of this year. Higher all peril deductibles and new wind and hail deductibles are being applied to new business and renewals in all targeted states judiciously and on schedule. We continue to operate in a hard market across our geographies, especially in homeowners and believe this will continue at least for the foreseeable future as many of our peers continue to file for higher rate increases as well as terms and conditions changes.

We are seeing a number of carriers starting to follow our actions, particularly in the Midwest, and we have continued support from our agent partners. The elevated catastrophe experience across the industry reinforces the importance of our terms and conditions changes as well as the more aggressive approach based on specific underwriting metrics such as quality of root score. In conclusion, our strong second quarter and year-to-date performance serves as compelling evidence that we are on the path to meaningfully improve financial outcomes. While the industry landscape remains dynamic with increasing liability trends and more frequent severe weather events, we are confident in our ability to navigate these complexities.

Our distinctive strategy is a key advantage positioning us to capitalize on emerging opportunities in the current market. Our flexibility and agility allow us to pivot quickly in response to changing conditions and to maintain our competitive edge. With this formidable foundation in place, combined with our inherent strengths and talented team, we are exceptionally well positioned for future success.

With that, I'll turn the call over to Jeff.

Jeffrey Mark Farber
Executive VP, CFO & Director

Thank you, Jack, and good morning, everyone. We are pleased to report strong performance in light of catastrophe losses, while demonstrating significant enterprise-wide ex-CAT margin improvement. Notably, all 3 of our business segments achieved underlying loss ratio improvements year-over-year, surpassing our projections. We're observing stable property loss trends and maintaining discipline over liability activity, which positions us well for continued growth and improved profitability. Our combined ratio for the second quarter was 99.2%, which included 10.7 points of catastrophe losses, largely the result of severe convective storm activity in personal lines.

It's worth noting that 10.7 points included 1.4 points of favorable catastrophe prior year development, much of it relating to commercial lines events that are at least 18 months old. Ex-CAT prior year development was favorable by $17.4 million in the quarter, paced by broad-based property favorability in Specialty, Personal Lines and Core Commercial.

In Core Commercial, all the major lines of business developed favorably. We experienced healthy favorability in most property coverages, and we took the opportunity to position our reserves more defensively in liability lines, in response to industry headlines as well as our own experience in certain pockets of our Core Commercial business. Our financial discipline, reserve prudence and proactive risk selection and underwriting allow us to effectively manage liability trends.

As Jack mentioned, our previous actions relating to geographic, industry, limit and other underwriting choices have significantly advantaged the portfolio. Our liability severity assumptions have been and continue to be very prudent, while we benefited from significant frequency reductions in recent years relative to pre-pandemic trends.

In Specialty, favorable prior year reserve development was $11.3 million or 3.4 points, primarily driven by lower-than-expected losses in our professional and executive lines claims made business. In Personal Lines, overall prior year development was favorable by $4 million, with property favorability primarily in Auto, offsetting unfavorability in the umbrella line reported in Home and Other. We continue to experience pressure related to elevated personal umbrella losses stemming from auto bodily injury coverage, which we are addressing by increasing our prior year loss expectations, current year picks and achieving higher personal umbrella rates in virtually all states.

Our team continues to prudently manage expenses. The expense ratio for the quarter totaled 30.8% in line with our expectations. The year-over-year increase of 20 basis points primarily reflected talent and technology investments in our Specialty segment as well as increased variable compensation. We remain on track to achieve our expense ratio guidance of 30.7% for the full year.

Now I'll turn to our segment ex-CAT underwriting ratios and loss trends, starting with Personal Lines. This business generated an excellent ex-CAT combined ratio of 89.5% for the second quarter, a 10.5 point improvement from the prior year period. Margin recapture initiatives in both Auto and Home and Other drove a 7.6 point improvement in the underlying current accident year loss ratio. The Auto current accident year loss ratio, excluding catastrophes, improved 9 points to 70.1%. The comparison was somewhat impacted by elevated loss picks in the second quarter last year, which subsequently developed favorably by 1.7 points.

The vast majority of the improvement, however, is the result of earning in double-digit price increases and, to a lesser extent, lower-than-expected auto loss frequency. Collision loss severity has stabilized as costs have leveled for parts and used vehicles and labor cost inflation has reduced. Although bodily injury frequency remains well below pre-COVID levels, severity continues to be elevated due to a higher proportion of large catastrophic claims, including pedestrian, bicycle and motorcycle hits and also high-speed crashes.

As of the second quarter, we have achieved target returns on an earned basis in Personal Auto. Homeowners and Other current accident year loss ratio improved meaningfully in the quarter to 57.5%, reflecting earned rate increases well above contemporary loss trends as well as normalization of large losses as compared to a higher-than-usual level of large losses in the second quarter of 2023. Our other initiatives, including more frequent home inspections and underwriting restrictions in specific pockets of our book of business are also helping to improve our ex-CAT home results. We continue to see the benefit of earned pricing substantially building in the homeowners portfolio. We expect that trend together with loss pressures normalizing should help drive substantial margin improvement through the back half of this year positioning us to return to target profitability in Personal Lines on an earned basis in 2025.

On the top line, Personal Lines net written premiums improved sequentially to 3.3% in the second quarter, and we expect growth to modestly increase throughout the remainder of the year. As expected, renewal price increases for Personal Lines in the quarter moderated sequentially to 18.5% from 22.8% in the first quarter of this year. As I noted on our Q1 call, we expected home exposure increases to begin ticking down in the second quarter as insurance-to-value inflation adjustments normalized and as we began to apply all peril and wind and hail deductibles to the majority of our renewals. Nevertheless, we are achieving strong rate increases in both lines of business. We believe rates will remain robust and ahead of loss trends.

Personal Lines retention improved by over 2 points to 82%. PIF count a lagging indicator was down as expected, with a year-over-year reduction of about 10% in the Midwest and 3% in other areas. Turning to Core Commercial lines. We delivered a combined ratio, excluding catastrophes of 88.7%, 0.6 points better than the prior year period. The underlying loss ratio improved to 55.7% supported by the successful execution of our margin improvement plan, including strong pricing and effective property underwriting, particularly in middle market. We continue to capture the benefit of earned rate above loss trend in Core Commercial. Workers' compensation liability trends remain stable, albeit with a slight increase in indemnity. Consistent with the NCCI reported trends, we are observing a slowdown in claims emergence, which merits caution as we think about current year loss selections. We were satisfied with the solid performance of commercial multi-peril in the quarter as continued strength in property was partially offset by our move to proactively increased current year loss selections in liability.

On the top line, Core Commercial delivered net written premium growth of 5.5% in the quarter, paced by Small Commercial. Renewal price change remained in the double digits, consistent with Q1. The Specialty segment's combined ratio, excluding catastrophes, increased 80 basis points to 86.4% compared to the prior year period, driven by higher expenses, as noted before. The segment's underlying loss ratio of 53.1% aligned with our expectations and our target of a low 50s loss ratio, property large loss activity remained within anticipated levels.

We are monitoring select lines for inflationary indicators and maintaining a prudent approach in our current accident loss selections. Specialty net written premiums grew 8.2%, driven by robust performance across several business lines. Retention remains strong at 83% while renewal pricing metrics ticked up again with average renewal increase standing at 11.7% in the second quarter.

Turning to reinsurance. We completed a successful renewal of our property treaties on July 1. We experienced very favorable market responses, which speak to the strength of our pricing, underwriting and data quality. The market was especially complementary of the underwriting work we have done with regard to commercial properties as well as our continued work on CAT exposures. The key elements and highlights of our current property reinsurance program are as follows: we renewed both treaties, property per risk and CAT occurrence maintaining a very consistent structure from expiring treaties. Pricing was significantly better than our expectations, helped by our property work, in particular, in middle market and specialty. We secured full capacity across our catastrophe occurrence program, maintaining our $200 million retention, and we purchased an additional $150 million in the traditional reinsurance market at the top of the existing CAT occurrence tower.

Taken together, these changes have resulted in increased reinsurance limits in our CAT occurrence program that exhaust at $1.9 billion compared to the previous $1.75 billion for our highest concentration states. Overall, the success of these renewals provides third-party validation of our underwriting and catastrophe mitigation actions. Moving to investment performance. Net investment income increased $2.8 million or approximately 3% to $90.4 million in the second quarter compared to the prior year quarter as higher interest rates drove strong fixed maturity and short-term income. This was partially offset by a decrease in partnership income. Income from limited partnerships was subdued in the quarter, driven by underperformance in a handful of funds. Variability in quarterly results is inherent in private fund valuations and fully expected in this long duration asset class.

Adjusting for the nonrecurring $6.8 million benefit in the second quarter of 2023, partnership results for the first 6 months of 2024 are only $1 million lower than the first 6 months of 2023. We remain comfortable with our partnership investments. Excluding partnerships, net investment income was up approximately 20% in the second quarter of 2024 as compared to the year ago quarter. During the quarter, we completed the previously announced transfer of our investment-grade fixed maturity portfolio to an external manager.

We expect this move will broaden our asset class exposure and further optimize investments contribution to overall results. In conjunction with this transfer and considering investment tax gains expiring this year, we repositioned sector exposures within investment-grade fixed income and realized approximately $30 million in pretax losses. From an asset allocation perspective, we reduced exposure to CMBS and with reinvestment of proceeds into other high-quality subsectors of securitized product, including RMBS and CLOs.

We also repositioned within corporate bonds to extend duration slightly and move out of less favored credits at attractive spread levels. Looking ahead, we believe a more normalized partnership income expectation is approximately $7 million to $8 million per quarter, though we remain cognizant of the tendency for private fund returns to follow a lumpy pattern. The current rate environment should continue to provide an accumulating benefit to NII in 2024 and subsequent years. We expect overall growth in NII of at least 10% in 2024 compared to '23.

Moving on to book value and capital position. GAAP book value per share increased 1.1% sequentially to 70.96% per share, reflecting net income partially offset by shareholder dividends. Our capital management strategy continues to balance reinvestment in the business, maintaining strong financial ratings and providing returns to shareholders through consistent quarterly dividends and share buybacks when warranted. Our outlook for the second half of 2024 remains consistent with our original expectations, and our third quarter planned CAT load is 7.4%.

In summary, our margin recapture initiatives are yielding excellent results. While our disciplined growth strategies are effectively targeting our most profitable lines of business. Looking ahead to the next 12 to 18 months, we are confident our positive trajectory will continue. Underwriting margins should continue to improve as past and current rate increases earn in and we execute against our catastrophe exposure initiatives. Furthermore, we expect the current interest rate environment should continue to provide an accumulating benefit of higher investment yields. We couldn't be more excited about our prospects and remain committed to delivering value to our stakeholders through sustainable, profitable growth and top-tier performance.
With that, we'll be happy to take your questions. Operator?

Question and Answer

Operator

[Operator Instructions]

The first question today comes from Michael Phillips with Oppenheimer.

Michael Wayne Phillips
Oppenheimer & Co. Inc., Research Division

First question is on Personal Lines, specifically homeowners, ex-CAT kind of question. Given your Core margins are really doing well and expanding there, I guess, do you expect kind of your right below 20% rates, does that accelerate from here? Is that -- we are at a peak for that?

John Conner Roche
President, CEO & Director

Mike, thanks for your question. I'm going to make sure I clarify, you're speaking specifically to homeowners pricing?

Michael Wayne Phillips
Oppenheimer & Co. Inc., Research Division

Yes, sir. Yes. Just under, it looks like 20% for the quarter, right?

John Conner Roche
President, CEO & Director

Right. Yes. I think, as we said in our prepared remarks, Mike, that we're obviously coming off of the peak of combination of significant insurance to value enhancement as well as increased rate and so we're very pleased, frankly, with our Personal Lines team's ability to meet the market and in some ways, lead the market, and we're now at the point where insurance to value is very adequate, and we'll continue to look at that in terms of staying on top of that adequacy and maintaining strong rate consistent with what we think the market is enabling us to do. So it's going to be, I think, pretty stable from here on out, but we'll continue to watch the weather and the overall patterns and stay disciplined in the market.

Jeffrey Mark Farber
Executive VP, CFO & Director

Mike, I think it's also important to remember, while written rate will be relatively consistent for a short period of time, earned rate will actually increase because of the higher written rate that we've gotten in the last few quarters. So you'll start to see that impact in the financials.

Michael Wayne Phillips
Oppenheimer & Co. Inc., Research Division

Okay. Good. Second question, Jeff, you said something -- first, I didn't really catch and so maybe I want to make sure I got it right and then expand upon a little bit. You were talking comp, and I think you said something about a slowdown in claims emergence. Did I get that right? And if so, what's driving that? And kind of maybe go back a little bit on that one.

Jeffrey Mark Farber
Executive VP, CFO & Director

I think it relates to the indemnity portion and what we're seeing is some people that originally were out for a period of time, that's getting extended a little bit. But it's important to remember that the offset to that is the increased payroll that we've gotten over the last few years. So I think we've been extraordinarily prudent with our workers' comp releases and workers comp loss picks. So I'm feeling comfortable with that, Mike.

Michael Wayne Phillips
Oppenheimer & Co. Inc., Research Division

Was part of the payroll -- I mean, your comp growth was a little bit higher than expected. Was that part of the payroll or anything else behind that 8% or so growth in the quarter?

John Conner Roche
President, CEO & Director

Yes. This is Jack, Mike. I think again, we have been very disciplined in the workers' comp market and watching both medical cost inflation and indemnity trends. I think the net-net of that is that the increase in payroll overall has been extremely helpful in making sure that we have pricing adequacy, but I think what we're sharing in our prepared remarks is that we're watching to make sure that particularly the indemnity side of it that isn't constrained by fee schedules like medical costs that there isn't something going on there that would cause some margin compression. We're not seeing any dramatic changes there, but we're just signaling to folks that we're maintaining a level of discipline in our analysis and looking ahead.

Jeffrey Mark Farber
Executive VP, CFO & Director

Yes. And I'll just add, Mike, our work comp book as a percentage of our portfolio is less than 18% of our book. So it is Core Commercial. Thank you. We are targeting growth in work comp in the Small Commercial business, which performs very well. So our Small Commercial initiatives include rounding out accounts and writing more of that business.

Operator

The next question comes from Mike Zaremski with BMO.

Michael David Zaremski
BMO Capital Markets Equity Research

Trying to reread the part of the transcript on your prepared remarks is always great. I think it was said that in Core Commercial, there was kind of healthy maybe favorability better than expected in property, and you took that to be more defensive in casualty lines. I don't know if you're saying you added that -- am I understanding that correctly that you're saying you're kind of -- once the stat data comes out, I guess, not until next year, we'd see more IBNR? Or what did you -- just want to unpack that comment?

John Conner Roche
President, CEO & Director

Yes. So the property favorability in Core was very useful. Some of that was recorded and some of it allowed us to be more prudent or defensive in the casualty lines across the book. And at this point, it's generally IBNR as those claims haven't shown themselves, you're seeing those in prior years.

Michael David Zaremski
BMO Capital Markets Equity Research

Got it. Okay. And are you just staying with the theme on cash lines since it's been a big topic of conversation for especially recently. I feel like you all have done a good job of explaining to us that over the last 5-plus years, you have taken proactive decisions to exit certain metros where there is higher social inflation, et cetera. Have you -- is there a way to unpack or have you looked at data to try to help us triangulate whether your loss trend assumptions might be different than others? Or are you -- just anything that you feel that you want to better unpack to give folks more confidence that the reserve trends we've been seeing for you all, which have been excellent our run rateable?

Jeffrey Mark Farber
Executive VP, CFO & Director

Mike, during 2016, you may remember, we strengthened our balance sheet with a large reserve charge. At that time, we became increasingly concerned with the liability and legal trends in major metropolitan cities and with certain industries being more prone to losses. We also removed any remaining monoline or unsupported umbrella. We were talking externally and demonstrating these underwriting actions in 2018 and '19. As a result of those geographic and industry portfolio choices, we're experiencing, as you referenced, a very substantial commercial liability frequency decline since pre-COVID 2019 levels.

For example, having a relatively small contractor book is serving us well. This overall frequency decline has generally offset our actions to consistently and meaningfully increase our casualty severity assumptions since 2019. This decline along with more recent property line favorability has allowed more prudent reserving and increases in loss picks. Loss trend severity is intense broadly in the industry, but we're relatively well positioned to navigate the challenges. It's hard to say whose loss picks might be higher, but our loss picks since '19 have gone up consistently very dramatically.

Michael David Zaremski
BMO Capital Markets Equity Research

Okay. That's helpful. And if this is a stat, you don't want to show you don't have, that's fine, but any way you can dimension what percentage of your reserves are umbrella and I'll just say many of your competitors don't want to disclose that. So I'm not saying you need to. But just curious if you could help us to mention that.

Jeffrey Mark Farber
Executive VP, CFO & Director

Yes, I don't have that right in front of me, but that's something that we can get back to people if they're interested.

Michael David Zaremski
BMO Capital Markets Equity Research

Okay. Great. And just lastly, back to Personal Lines. In terms of kind of the -- clearly, the plan to redimension the -- especially the Home portfolio well in action. Can you remind us -- I believe you glide past us to a CAT ratio that would eventually fall over time as kind of the actions took place. Is that kind of -- based on the trajectory of the portfolio repositioning over the last 6 months, has anything changed at a high level in terms of kind of that glide path down over time in the CAT ratio -- catastrophe load ratio, sorry, over time?

John Conner Roche
President, CEO & Director

Mike, this is Jack. I'll talk broadly. From an enterprise perspective, middle market has dramatically changed the profile of their CAT exposure over the last couple of years. And as we looked at some profit improvement opportunities, we also looked at what types of classes and within which geographies could we reset our catastrophe exposure and, frankly, enable the enterprise to have some maneuvering relative to our property aggregations across the country. So I think that's having a profound effect. I also think that we can't state enough that when you combine dramatic price increase in our Personal Lines book, combined with the deductible implementation that we're well underway with and some PIF growth patterns that further enable a better diversification, all of that aids us in having confidence looking forward that our CAT loads will certainly start to move in a better direction.

And we'll continue to, frankly, monitor the weather patterns and make additional adjustments if that's required. But based on what we know today and based on the actions, we have the highest level of confidence we've ever had that we are addressing our CAT loads and further diversifying our portfolio.

Operator

The next question comes from Paul Newsome with Piper Sandler.

Jon Paul Newsome

Piper Sandler & Co., Research Division

I guess a little bit of a follow-up on Mike's question about CAT. I mean, specifically looking at the terms and conditions on the Personal Lines side, is there any way to think about the quantification of those changes? Does it have an impact you can measure on PMLs or anything that you could tell us or maybe if you can describe what you've known internally as a description for that impact? Or maybe just kind of have to know a direction is a good idea?

John Conner Roche
President, CEO & Director

Listen, first of all, we understand the desire to be able to get more specific KPIs or more transparency to metrics. The reality is, the way you kind of answer the question for us is exactly how we're trying to pursue it is that we have to take our measured steps that we've taken, both in Personal Lines and more broadly and continuously model the business and look at where our AALs micro concentrations are and how that affects ultimately the PML first for earnings volatility metrics driven by severe convective storms, but also relative to our tail. And I think we are more effective than we've ever been.

We've added some additional resources to make sure that we're as proficient as we possibly can be in measuring the impact that we're making on the actions we're taking today and thinking about what else we could do if that's necessary. But as I said earlier, we are really confident that we are moving our CAT loads in the right direction and also providing ourselves additional incentives to grow in other less concentrated areas because of the diversification credit that is more visible to us now as we use the enhanced models.

Jeffrey Mark Farber
Executive VP, CFO & Director

Paul, the impact on the second quarter of additional deductibles was extremely limited because it only started going in April 1 for renewal business. So -- but as you think about coming around to what we consider the severe convective storm primary season second quarter of next year, it's going to be a completely different story. We're very optimistic.

Jon Paul Newsome
Piper Sandler & Co., Research Division

Second question, I wanted to ask maybe a broader question about the expense ratio and the target over time. At one point, you had, I think it was 20 basis points per year goal that changed with the profit struggles that you had several years ago. Are we kind of back to that theme? Or has the nature of the company changed such that that's not something that necessarily makes a lot of sense if we look forward over the long term?

Jeffrey Mark Farber
Executive VP, CFO & Director

So I think the 30.7%, Paul, that we guided to and are still guiding to for this year's expense ratio is a consistent 20 basis points improvement. Now from time to time, it's been 30 or 10, but it's -- over time, it's been pacing that way. Generally speaking, we're still committed to that, and we should be able to drive that. Having said that, our mix could change, and that could change the trajectory a little bit overall. Most importantly, we're looking for hundreds of basis points improvement in the combined ratio and in any given year, a little less focused on whether it's 10 basis points more or 10 basis points less of the expense ratio. I think there's more action right now in the loss ratio for us.

Operator

The next question comes from Grace Carter with Bank of America.

Grace Helen Carter
BofA Securities, Research Division

While we've listened to peer results this quarter, it sounds like everyone is concerned with social inflation, obviously. But the commentary has varied a bit from one period to another with some industry participants more concerned on general liabilities, some more with commercial auto, some commentary is focused more on primary layers and others on excess. I guess I'm wondering, in your opinion, is there a particular area of commercial liability that deserves more attention than others these days? Or is the potential pressure from social inflation, pretty widespread in your view?

John Conner Roche
President, CEO & Director

Grace, this is Jack. Thanks for the question. I think ultimately, social inflation and legal system abuse are just affecting the severity of the severity of liability trends. And more broadly, you see, obviously, in auto accidents or in kind of business-to-consumer type of exposures, you have individuals being harmed that lend themselves to higher jury awards, higher litigation rates and the court system clearly has changed and that more cases are going further into duration and that's somewhat helped by litigation finance. So I think those are pretty broad-based. Some of the differences, I think you're observing are what kind of portfolio one has and how much of that is susceptible to those social inflationary trends, whether that be limits profile or kind of classes of business and to some degree, geography that you play in.

But also, I think as Jeff has been articulating both in his prepared remarks and in his response to the previous question, it's -- what changes have you been making along the way that could be running against some of those liability severity trends. And in our case, we know that we have made some real portfolio actions, particularly in middle market that are showing -- are giving us some advantages. And that frequency of severity improvement is offsetting the natural severity of the severity trends that's going up. And then last but not least, the decision we made 8 years ago, starting 8 years ago to really get out of the excess umbrella business, particularly over other companies is proving to be very beneficial because we obviously know our book of business well and we know how to provide umbrella coverage above our own business, I think where some companies might be getting quite short as they don't do the primary underwriting and so they have an excess book of business that tends to be much more vulnerable and harder to understand where those trends are coming from.

Grace Helen Carter
BofA Securities, Research Division

And we've also seen some of the pressure on casualty reserves kind of spilling out of the soft market years into more recent accident years over the past couple of quarters. I mean, I guess, could you talk about your observations from that standpoint? And you mentioned some of the repositioning that you've done in your casualty portfolio starting maybe 2018, 2019. And if those actions have insulated you so far from some of the pressure that we started to hear about in the experience from the past couple of years?

John Conner Roche
President, CEO & Director

Grace, I think the frequency benefits that were evident in 2020 year, during the COVID year unrelated to what we were talking about a few minutes ago, have provided an opportunity to cushion those phenomena that you were just referring to. So we weren't really sure whether liability matters were delayed or whether they just didn't happen in 2020. And so prudence with those picks in that year, have proven to be quite useful as we roll forward and deal with, as you referred to, the softer market periods. So it really is the combination of all those things coming together, and how thoughtful and conservative were you along the way with your picks and you're reserving, and that's where I think we want to share our confidence that particularly on a relative basis, we think we have done extremely well.

Operator

Next question comes from Meyer Shields with KBW.

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

If we go back to workers' compensation, 2 things. First, you mentioned an uptick in, I guess, indemnity-related severity. And I'm wondering, doesn't that be covered by the exposure unit growth in line. Is that a reserve concern or an adequacy concern?

John Conner Roche
President, CEO & Director

I don't believe it's a reserve concern. I think what we're making is more of an observation that we see some evidence that lost time cases on average have moved out a little bit further. And that the payroll -- increased payrolls that obviously are captured in our premium base are also showing up in the indemnity dollar. So we're not sending out any alarms. We're trying to address the fact that in the industry, everyone is trying to determine where are we in the workers' comp, medical cost inflation and the broader workers' comp trends, and we're trying to reinforce investors that we are on top of these trends. We're not being overly optimistic, we're, if anything, being conservative with our picks, and I wouldn't read any more into it than that.

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

Also on workers compensation, is anything happening on the medical side of things, I guess it goes beyond comp, but since you called that [indiscernible] today, I'm wondering about medical trends?

John Conner Roche
President, CEO & Director

I think we still see relatively modest increases in medical costs, particularly related to workers' comp because of the fee schedule phenomenon. And again, almost 2/3 of the loss costs in comp are medical costs related, we get a real tailwind from the surge in payrolls that have come along for the ride that make their way into our premium base. So I think that's why you're seeing more stability than people predicted is because you're getting both the premium side -- the premium side is getting aided by payrolls and medical costs on a relative basis are still relatively benign.

Operator

The next question comes from Bob Farnam with Janney.

Robert Edward Farnam
Janney Montgomery Scott LLC, Research Division

Unfortunately, one more question on casualty reserves. I don't know if you've actually given it explicitly, but what underlying severity trend assumption are you using for your current loss picks and how has that changed over the years? And I guess, how does that compare to pricing these days?

Jeffrey Mark Farber
Executive VP, CFO & Director

Well, we haven't given an individual severity assumption over time. And the reason is we just find it difficult to give one casualty severity assumption. The lines are so different, and we look at it individually. However, it has gone up dramatically, and it has gone up in our assumption similarly to price along the way, if not even higher. So as I said before, our frequency benefit has allowed us to increase that severity assumption without having to increase the loss pick or the loss ratio as dramatically as it otherwise would have been.

Robert Edward Farnam
Janney Montgomery Scott LLC, Research Division

Right. I think more importantly, I just wanted to make sure that the pricing these days was keeping up with the -- it sounds like you increased your expectations in this quarter. So I just want to make sure the pricing is still keeping pace?

Jeffrey Mark Farber

Executive VP, CFO & Director

It is. So it is our belief that the core commercial rate of 9.3% and overall price change of 11.7%, and when you deconstruct the casualty component under that, it is our belief that we are getting more price than loss trend at the moment.

John Conner Roche
President, CEO & Director

Yes, Bob, maybe to even link it up to a previous question regarding umbrella and, Dick, maybe you can speak to this. We have ratcheted up our pricing in the umbrella -- Commercial Lines, umbrella line significantly over the last few years with the assumption that the severity trends were going to deteriorate even before we saw it in our results. So maybe you could comment on that.

Richard William Lavey
Executive VP & President of Hanover Agency Markets

To put a number to it, I mean, over the last 4 years, we've seen our umbrella pricing upwards of almost 40%. So we've been getting ahead of it. We've been looking at the methodology of how we're rating and making the appropriate filings to make sure we're adequate.

John Conner Roche
President, CEO & Director

And I think that's a big part of how -- as you try to figure out how this is playing out in the industry is what was your starting point in terms of loss trend assumptions, how much have you priced over loss trend and what underwriting actions have you taken that might prove beneficial as those social inflationary effects start to kick in? And I think on all 3 of those dimensions, we've been very proactive.

Operator

[Operator Instructions] The next question comes from Michael Phillips with Oppenheimer.

Michael Wayne Phillips
Oppenheimer & Co. Inc., Research Division

Just a quick one. If you could spend a second, maybe our could [indiscernible] your Specialty Marine book. Can you just spend a second on kind of describing the nature of that book first?

John Conner Roche
President, CEO & Director

Yes. I think I heard a blip for a second there, but I think you said you wanted us to talk about the Marine book within Specialty.

Michael Wayne Phillips
Oppenheimer & Co. Inc., Research Division

Correct. Yes.

John Conner Roche
President, CEO & Director

Go ahead, Bryan.

Bryan James Salvatore
Executive VP & President of Specialty

Yes, sure. So I think it's a great question because we listed pretty simply, right, as marine, but under Marine, we have quite a number of product lines, right? Much of it is inland marine. It's a mix of builders risk business, contractors equipment business and things like that. But additionally, we have a lot of, what you would call, floaters for computers, musical equipment. So it's really diversified. I would say, there's probably 20 different product segments that we're going after in Marine.

So that's one of the things we like about the book. It's very diversified, both geographically and it's also got a real diverse mix of product that's in there. So that I think for us, and maybe you've seen this, that's really helped to remain very profitable even throughout all this time of increased CATs, et cetera, right? We've been able to manage through that and have a diversified book that absorbs that.

Michael Wayne Phillips
Oppenheimer & Co. Inc., Research Division

Yes. No, that's helpful. So still a follow-up, right? I imagine the answer is no. But I mean, I would imagine given your book is so different, but there's been a lot of buzz, obviously, around Marine where the global accounts and stuff what's happening right here in my [indiscernible] in Baltimore. None of that trickles down to -- none of that excitement, I guess, on the pricing, trickles down to your book, I imagine, right?

Bryan James Salvatore
Executive VP & President of Specialty

So like I didn't completely hear, I think you're alluding to that, call it, a crash that took place in Baltimore. And yes, so we have a little bit of what you might call, Ocean Marine as well, but that's really more like docks and marinas and lobster boats and really kind of simple stuff relative to what you're talking about. We don't do the large holes. We don't do that type of exposure that I think you're referring to.

John Conner Roche
President, CEO & Director

And we certainly don't put up limits that support major infrastructure across the country. So that's not our -- predominantly, in the Marine book of business that is very diversified, like we said, and one of our most profitable businesses over a very long period of time.

Operator
This concludes our question-and-answer session and concludes the conference call. Thank you for attending today's presentation. You may now disconnect.