S&P Capital IQ

## CONTENTS



# CNA Financial Corporation NYSE:CNA

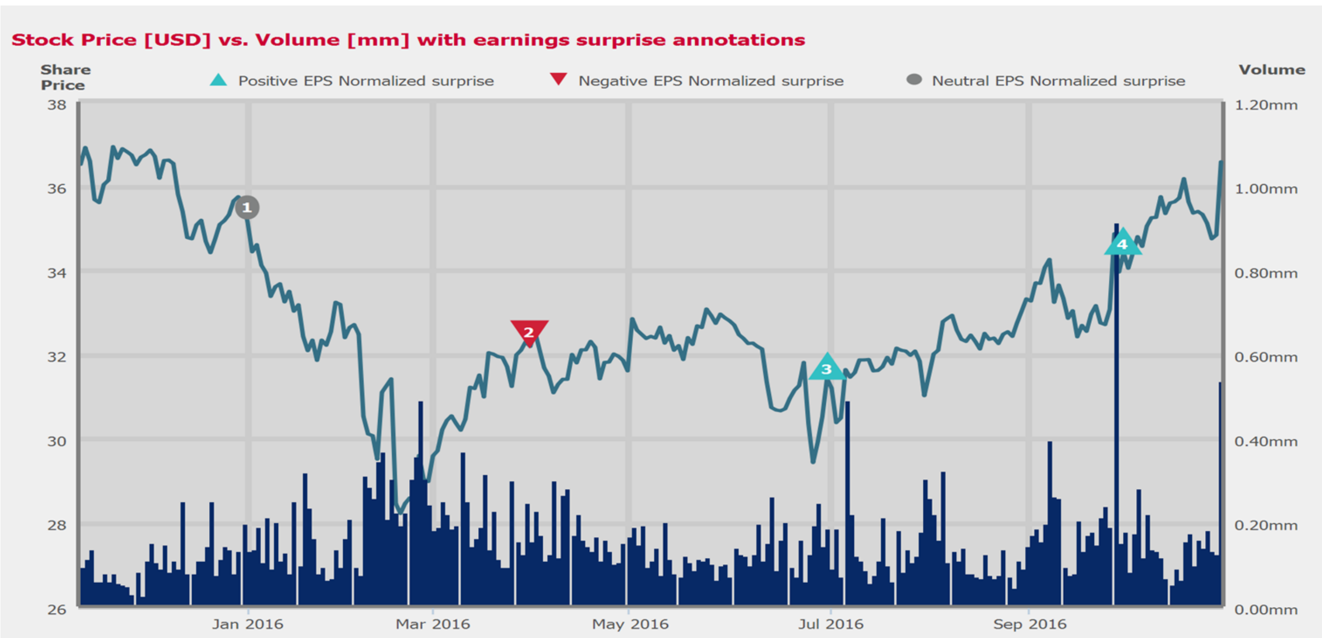
*FQ4 2016 Earnings Call Transcripts*

Monday, February 06, 2017 3:00 PM GMT

## S&P Capital IQ Estimates

| | -FQ4 2016- | | | -FQ1 2017- | -FY 2016- | |
|---|---|---|---|---|---|---|
| | CONSENSUS | ACTUAL | SURPRISE | CONSENSUS | CONSENSUS | ACTUAL |
| **EPS Normalized** | 0.79 | 0.82 | ▲3.80 | 0.77 | 3.01 | 3.04 |
| **Revenue (mm)** | 1620.00 | 1525.00 | ▼(5.86 %) | - | 6554.50 | 6442.00 |

Currency: USD
Consensus as of Feb-06-2017 12:36 PM GMT




**- EPS NORMALIZED -**

| | CONSENSUS | ACTUAL | SURPRISE |
|---|---|---|---|
| **FQ4 2015** | 0.89 | (0.19) | NM |
| **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 % |

# 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

**Amit Kumar**
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# Presentation

**Operator**

Good day, and welcome to the CNA Financial Corporation Fourth Quarter 2016 Earnings Conference Call. Today's conference is being recorded. At this time, I'd like to turn the conference over to Mr. James Anderson. Please go ahead, sir.

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

Thank you, Shannon. Good morning, and welcome to CNA's discussion of our 2016 fourth 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'll open it up for your questions.

Before turning it over to Dino, I would like to advise everyone that during this call, there may be forward-looking statements made and 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, February 6, 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 also 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. First, let me say that it feels great to be back in the game. After spending 29 years immersed in insurance, I made the best of my time away, but not being in the market for one year was difficult for me and I couldn't wait to start again late last November. I want to thank the team at Loews, particularly the CEO, Jim Tisch, for the opportunity to lead CNA, and I believe that there is a lot of upside for us to capture. I'm absolutely honored and thrilled to be here.

Before I get into my remarks, I also want to thank Tom Motamed for his development of an organization built around continuous improvement. Having worked with Tom in the past, it is an honor for me to take the baton from him and continue the work of making CNA a top-tier carrier. As you might expect, over my first 75 days, I have immersed myself in virtually all aspects of CNA with a particular emphasis on CNA's underwriting operation, and more specifically, the people, processes, portfolio and governance, as well as our expense infrastructure. Starting in late November allowed me to immediately engage in 2017 business planning discussions, as well as quickly turning the fourth quarter results. These activities naturally had me interacting with the senior management here on the initiatives and issues of the day. I couldn't have asked for a better starting point.

In that 75-day period, I have learned, and in some cases just confirmed, a lot of great things about CNA. Namely, the Specialty business not only performs well, but also has meaningful portions of the portfolio that are very difficult to replicate by others. In particular, in the professional services and health care segments. Decades-long relationship with these customers and our producer partners has allowed us to develop strong underwriting claims and risk mitigation expertise as well accumulate extensive historical claim and exposure data both from internal and external sources that we have in turn used to build proprietary predictive models. This breadth and strength in these segments as well as Surety and Warranty are competitive pillars we will continue to build upon in Specialty.

The Commercial business has made meaningful strides in recent years. Over the past 18 months, we have upgraded the leadership team and their employees to take the next step towards consistent profitability. Our International segment includes a well-performing, consistently profitable operation in Canada and our limited company market business has performed well. The Continental European and Hardy businesses have experienced some volatility recently, but provided a solid quarter, drive improved results. And long-term care, a business previously unfamiliar to me, is making great strides to provide good service to policyholders, deliver improved claim outcomes efficiently and be breakeven or better financially, all the while continuing to explore ways to derisk.

And I've also confirmed the strength of our balance sheet and capital position as well as the value of our brand and dedicated team, extensive branch footprint and strong local relationships with agents and brokers. All this gives us a great foundation to continue to build the business.

With that said, there are opportunities for us to get better, which is consistent with the messages management has conveyed in prior earnings calls related to our efforts to improve the combined ratio. Indeed, we need to continue to address the expense ratio and there's also more to be done on the loss ratio. Simply put, we need to grow our underwriting profit, which in part entails expanding opportunities in business segments where we have noted competitive advantage in addition to decisively acting on individual accounts that don't meet our profitability expectations. And I believe growing underwriting profits is viable even when market pricing is running below long-run loss cost trends because there are other underwriting levers that we can continue to pull on for improvement, although it is arguably more difficult.

The levers to drive underwriting improvement include risk selection, matching terms and conditions to exposure policy by policy, driving improved claim outcomes, strengthening underwriting talent, producer management, and of course, expense management. I actually believe we have opportunities to improve in each of these areas. In addition, we continue to develop increasingly sophisticated pricing models and data analytics within underwriting, claims and risk control, which will also provide opportunities for improvement. Although that will not happen overnight, I assure you I'm acutely focused on improving our capabilities in each of these areas. Of course as you know, any underwriting actions we take in 2017 will primarily benefit 2018 and beyond given the earnings premium lag.

Now let me say a few words on expenses. CNA's expense ratio is running high compared with peers' group's average, which can put us in a competitive disadvantage so we're going to remain focused on this. As you may recall, management outlined an expense initiative last year and Craig will provide an update in his remarks. I believe fostering a culture of disciplined expense management, which includes continuously challenging where and how we spend, is table stakes for ensuring value for all stakeholders. It means we must always drive productivity improvements across the entire value chain, including automating more processes end-to-end and streamlining our operations. This discipline will facilitate the investments we will invariably continue to make in order to position the business more competitively in the future such as the ones I just touched on around technology, analytics and talent.

As we continue to build our talent and overall underwriting capabilities over time, we also expect the denominator to contribute to improving the expense ratio. Over the coming months, the executive management team and I will continue discussions regarding our strategic direction and our path to get to sustainable underwriting profitability. But you should expect that we will act on opportunities as they arise in 2017 and further position CNA for success in the future. Our recent press release announcing our new executive to lead technology and operations is the first of several steps we will take to increase our overall capabilities. In this case, our technology, digital and analytics capabilities as well as streamlining our operations with increasingly automated end-to-end processes.

Now this is a quarterly earnings call, so let's discuss our earnings for the fourth quarter and full year 2016. CNA earned $221 million of net operating income or $0.82 per share in the fourth quarter of 2016, a solid result, with very good performance in our Specialty and International segments somewhat offset by reserve strengthening in the run-off Defense Base Act business within Commercial and a marked improvement from the fourth quarter 2015's adjusted $171 million. Investment income for the quarter was higher in long-term care in $20 million as a result of a favorable claim reserve review, but more on that later.

For the full year, net operating income was $824 million or $3.04 per share. We are pleased to announce our regular dividend of $0.25 per share as well as another $2 per share special dividend capping another year where we have returned nearly 100% of our earnings and dividends. Our P&C business generated a 99.9% combined ratio in the fourth quarter. For the full year, our combined ratio was 95.9%, generally in line with 2015's results with 4.5 points of favorable reserve development in 2016 versus 3 points in 2015. Our P&C net written premiums for the quarter were down 4% with growth in a few areas being offset by negative growth in many of Specialty and Commercial segments due principally to decreased new business. Adequately priced new business was more difficult to find in the fourth quarter as some carriers appear to push hard for year-end production.

Our Specialty segment generated an excellent 85.6% combined ratio in the fourth quarter and 85% for the full year, driven by favorable reserve development of 11 points in the quarter, which is roughly the same amount for the full year. This now makes 9 consecutive years of favorable development to the testament and strength of the Specialty portfolio. Specialty's underlying combined ratio for the quarter was 96.1% and 95.1% for the year.

Specialty's net written premiums were down 5% in the quarter and flat for the full year. In the quarter, growth was however achieved in the core areas that I referred to earlier, namely professional services and certain parts of health care. Premium rate was up 0.5 point in the quarter and retention was 86%.

As we begin 2017, we expect the current market conditions to continue, with strong competitive pressure particularly on large accounts. We are actively engaging our agents and brokers on these accounts to ensure our value proposition is being fully conveyed and we get the appropriate price as well as terms and conditions for the risk. In that process, we have been willing to let accounts go if the terms and conditions didn't meet our account profitability target, which contributed to the negative growth. Notwithstanding this competitive dynamic, most of the books continue to get some rate, resulting in overall rate remaining slightly positive.

Moving to Commercial. The combined ratio for the fourth quarter was 118% and 105.8% for the full year. Both periods were significantly affected by adverse reserve development related to our Defense Base Act, or DBA business, which is in run-off. This DBA reserve charge added nearly 13 points to the combined ratio in the quarter and more than 3 points for the year. Commercial's results were also affected by premium adjustments in our loss sensitive workers' comp business and our small business unit. Craig will discuss these items in more detail in a moment.

Commercial's net written premiums were down 4% and rate was down 1%. Each of these metrics were affected by the premium adjustments, which lowered net written premiums by more than 4 points and rate by 1 point. We had growth in middle markets, Marine and umbrella, which combined, grew 4.5%. Also noteworthy is that retention remains steady at about 84%.

DBA's reserve increased and the premium adjustments are in our results, but we don't excuse them. Nevertheless, I think it is important to highlight what we believe is the current ex-cat underlying run rate performance of the Commercial business. At this juncture, we believe it is consistent with the 2016 full year underlying combined ratio of roughly 99%. Obviously, it is still too high, particularly when you incorporate a normalized cat load, so expect that to be a focus of mine.

Our International segment generated an 86% combined ratio in the fourth quarter, a strong ending to an uneven year. For the full year, the International combined ratio was 99%, including nearly 8 points of favorable reserve development. For the quarter, Canada and CNA Europe performed particularly well within the segment. Net written premiums in the fourth quarter were up 2% and flat for the year with growth depressed 4 points in each case due to currency fluctuations. All in all, I think the P&C market remains stable and there was nothing we see in the trends that suggest the market won't continue to act rationally.

Life & Group generated net operating income of $20 million in the fourth quarter and $20 million for the full year. As Craig has mentioned throughout 2016 following our reserve unlocking in Q4 2015 and the related resetting of assumptions, we expect Life & Group to be breakeven going forward. We are now 4 quarters into the new assumptions and it is good to see that they are holding. The fourth quarter's result was driven by a $30 million claim reserve releases coming from our annual claim reserve review, which tests our assumptions of current claims. In addition, we performed our annual growth premium evaluation in the fourth quarter, which tests the assumptions in the reserve supporting future claims known as active life reserves. The results of the growth premium valuation was to improve our margin by $255 million. The drivers of this change are shown on Page 13 of our slide presentation. So overall, a good result for our Life & Group segment.

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.

We reported fourth quarter 2016 net operating income of $221 million and net income of $241 million, markedly different from last year's results for the fourth quarter. For the full year 2016, net operating income was $824 million and net income was $859 million, increases of 60% and 79%, respectively from 2015's full year results. Our operating ROE was just above 7% this quarter, relatively consistent to the 2016 full year result of just under 7%.

Our Property & Casualty Operations produced net operating income of $217 million, 7% above the prior year quarter, helped by improved net investment income. For the full year, P&C's net operating income was $982 million, a 2% increase over 2015. P&C's 2016 full year underlying combined ratio was 97.9, 1.5 points higher than 2015, with both the accident year loss and expense ratios contributing to the increase. These factors are offset by an overall higher level of favorable prior year reserve development producing a 2016 calendar year result relatively consistent with the prior year.

Specialty had another strong quarter, highlighted by the favorable reserve release. The favorable reserve outcome lowered Specialty's loss ratio by 11 points and came from a broad-based number of professional and management liability products. The majority of the release was centered in accident years 2012 and prior. Specialty's underlying combined ratio for the quarter was 96.1%, slightly above the prior year's quarterly result and reflecting a higher level of large losses this quarter.

Commercial's overall underwriting result was burdened by the $90 million increase in loss reserves of our run-off Defense Base Act business, adding approximately 13 points to the loss ratio and just under 1 point to Commercial's expense ratio in the quarter. You'll recall that CNA decided to exit what we call the program Defense Base Act business in 2012, but given contractual obligations with the federal government, we continue to produce premium through year-end 2015. Due to the run-off nature of the business, the complexity of the claim handling and the variability in our reserve estimates during the past several reviews, we acted in the second half of 2016 to add additional expert resources. We refocused this reformed and dedicated team and charged them with managing all aspects of DBA claims with particular emphasis on the associated process for obtaining recoveries from the federal government for those claims deemed to be caused by war hazard. The team completed a thorough analysis of our DBA claims exposures, including a claim-by-claim analysis of our potential war hazard recoveries. This was completed during the fourth quarter and resulted in a reduction of our expected future war hazard recoveries. This was the primary driver for our adverse development in the quarter.

We reacted immediately to reset our loss reserve and anticipated recovery levels to fully reflect the team's analysis, so we do think that our DBA reserve position is solid now. Of course, as has been a long tail line that is in run-off, we'll need to remain vigilant.

Commercial also had 2 premium adjustments affecting the quarter. The first adjustment related to retrospectively rated workers' compensation policies and resulted from a review of assumptions that ultimately adjusted downward both our expected loss and related retro premium expectations. The second adjustment related to small business and resulted from an error in the rating process of one of our products. These 2 adjustments combine to reduce earned premium in the quarter by $33 million. These earned premium reductions had a knock-on effect of adding 2 points to the loss ratio and over 1.5 points to the expense ratio for the quarter in Commercial.

We did take another look at all of the Commercial lines major products in the fourth quarter, which included extensive reviews of our most potentially volatile products, as I indicated in last quarter's Q&A. Those reviews reaffirmed our confidence in the current loss reserve estimates. We did however, increase our full year 2016 accident year loss ratio in Commercial upward by 0.5 point from 61.6 to 62.1, reflecting a modestly higher-than-expected level of large losses in the fourth quarter. This full year re-estimation added a little over 2 points to this quarter's booked loss ratio.

International's quarterly results have exhibited volatility this year. However, the segment finished the year with a strong fourth quarter result, delivering a combined ratio of 86.1. International benefited from about 13 points of favorable reserve development. This reserve release was attributable to a number of small favorable changes across our International portfolio in terms of both products and accident years. The underlying combined ratio was 97.2, nearly 6 points better than the prior year's fourth quarter result. The International segment also benefited from a light cat quarter. After incurring a number of onetime costs in the third quarter as a result of actions taken to improve our operating efficiency and to reduce expenses, I'm disappointed that our report expense ratio is not yet showing the benefits.

P&C's fourth quarter expense ratio of 35.1 is 7/10 of 1 point below the prior year quarter, but higher than we anticipated just a quarter ago. Our actual dollar spend was consistent with expectations and 3% lower than our previously -- previous quarterly run rate. Loss-based assessments relative to the DBA reserve increase as well as the downward earned premium adjustments in Commercial combined to inflate P&C's expense ratio by just over 1 point.

Our Life & Group operations produced $20 million of net operating income in the quarter, improving from a breakeven position for the first 9 months of 2016. The quarter's result reflects a pretax $30 million favorable claim reserve release as a result of our annual claim reserve review. The reduction in claim reserves was driven by favorable severity relative to expectations. This marks a significant improvement from 2015, and we are pleased that the past year's performance is at least consistent with, if not slightly favorable, to our reset assumptions. The quarter's underlying long-term care operating results were relatively consistent with previous quarterly results this year. Favorable morbidity, lower expenses and higher net investment income more than offset a persistency miss.

The outcome of our annual gross premium valuation completed in the fourth quarter of 2016 was also favorable and added $255 million of margin to our reserve position. On Page 13 of the slide presentation, you'll note that the largest driver of margin improvement relates to premium rate actions. This improvement was a result of 2 factors: First, we have been successful in receiving regulatory approval for rate increases in our group long-term care business that were higher than we had anticipated. The second component is the inclusion of a new individual long-term care rate action initiated in the late 2016. This improvement from rate actions was partially offset by minor changes in morbidity assumptions. The effects of persistency in discount rate were relatively small and offset one another.

Our Corporate segment produced a net operating loss of $16 million in the quarter, in line with our expectations. Net investment income was $527 million in the fourth quarter compared with $428 million in the prior year quarter. The performance of our limited partnership portfolio produced $58 million of pretax income, a 2.4% return, as compared with $23 million of pretax income or less than 1% return in the prior year period. Income from our fixed maturity portfolio was $467 million compared with $407 million in the prior year period. This favorable comparison reflects a higher asset base, relatively consistent yields and last year's investment accounting change. Our investment portfolio’s net unrealized gain decreased by approximately 38% to $2.5 billion at quarter end as a result of the increase in interest rates. 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 8.7 years at quarter end, which continues to reflect both the low interest rate environment and our tactical decisions.

At December 31, 2016, shareholders' equity was $12 billion and book value per share was $44.25, a decrease of 1.8% since September, reflecting the change in our investment portfolio’s net unrealized gain. Shareholders' equity, excluding accumulated other comprehensive income, was $12.1 billion, up 1.5% as compared to September 30, 2016. Cash and short-term investments at the holding company were approximately $488 million at quarter end. We continue to target cash at the holding company equal to approximately 1 year our annual net corporate allocations. In the fourth 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 our current ratings.

I would like to make one final, and I think, important comment relative to potential changes to corporate tax rate. First, it's hard to predict exactly what will happen given we don't know what a tax reform package would ultimately look like should it come to pass. But more importantly, as you just heard Dino say, our singular focus is to grow underwriting profits. The underwriting levers Dino laid out provide significant opportunities to improve our results, and I'm sure you could tell from the tone of his comments that he is intensely focused on having every underwriter use those levers to drive improved decision-making, leading to improved results. This is fundamental to building a superior underwriting organization and is not dependent on tax code or tax strategy.

With that, I will 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 offer a brief summary.

We were able to generate net operating income of $824 million in 2016, a significant improvement from 2015. We are pleased to have once again returned essentially 100% of our earnings to shareholders. Our Specialty and International segments posted very good results in the fourth quarter, but we still have a number of opportunities to improve each of these segments as well as in our Commercial operation. Our long-term care business has been stable and executing efficiently over the past year. Our balance sheet remains rock solid with more than $45 billion of invested assets generating $2 billion of investment income each year.
With that, we'll be glad to take your questions.

# Question and Answer

**Operator**

[Operator Instructions] We'll take our first caller, Amit Kumar, with Macquarie.

**Amit Kumar**
*Macquarie Research*

Welcome to a great franchise. A few quick questions. The first question maybe is a numbers questions. Did you break out the amount of large losses in the quarter? I guess, I'm trying to figure out what is the real underlying LR.

**D. Craig Mense**
*Chief Financial Officer and Executive Vice President*

I think that, that, as we've said, the large losses is really what drove our 0.5 point increase for the full year estimate. And that's what we'd really point you to, Amit. So look at the year-over-year change from 2015 to '16, so that added about 0.5 point. Those are largely within Commercial. Those losses were largely property-related. And in Specialty, there's no significant -- I can't really point you to any individual particular trend.

**Amit Kumar**
*Macquarie Research*

Got it. The second question I had was going back to the discussion on the defense book. Do you have a sense -- after the steps you've put together, you sort of ring-fenced this issue, and going forward, we won't -- the likelihood of seeing any noise is minimal.

**D. Craig Mense**
*Chief Financial Officer and Executive Vice President*

That's correct. Absolutely.

**Amit Kumar**
*Macquarie Research*

Okay. That's good to know. The third question or the third and fourth question might be for Dino. The first question for him is, going back to the discussion on capital management, should we anticipate the continuation of that thought process in terms of returning capital? Or does anything change on that front going forward?

**Dino E. Robusto**
*Chairman & CEO*

I think, just like we said and been consistent on prior calls, we continue to generate capital through consistent earnings. And we're going to return that capital to shareholders unless we come up with options to deploy it at any higher returns. So steady as she goes.

**Amit Kumar**
*Macquarie Research*

Got it. And so -- then the final question, Dino, for you. I mean, obviously, you’ve come from a company which might've had a different playbook, which used to trade at a premium to book, one of the top franchises out there. Now that you're here, are you willing -- and again, it's been -- not that long that you've been here. Are you willing to sort of disrupt the status quo in terms of when you look at all the operations, the options this company has and some of the frustrations we have faced in terms of where the stock trades, even though it's recovered nicely over Tom's tenure, but still, it trades at a relative discount to other franchises. Are you willing to disrupt the status quo and do sort of whatever it takes to get us to the right multiple? Or near term, should we anticipate you following in Tom's footsteps and sort of blocking and tackling from here at least for the near future?

**Dino E. Robusto**
*Chairman & CEO*

Thanks, Amit. So just a couple of observations, right? I think we tried to provide considerable detail in the opening remarks about the focus on growing underwriting profit, pulling a host of underwriting levers, all of them, including levers on the expense ratio. I think I highlighted it's a serious focus of mine. And I think that's the way you should take a look at it. If you look at the strategy, you've heard over numerous prior calls, CNA increasingly becoming a middle market specialist, going after certain nations where you got product expertise, underwriting expertise. And that has led to an improvement. So I'm going to continue to obviously, drive on that. But there's always refinements you can make. So can we drive deeper into the ones where we make the most profits? What new ones are we going to go after? How are we going to sequence that? What are we going to export in terms of if we've got segments that really work for us in this country, United States, maybe we'll -- it makes sense to have them in Canada or have them in Europe, right? And so there's a -- I referenced talent. There's an enormous amount of strong talent here in CNA. And it's partly [ph] my job to make the strong talent even stronger and then to continue to look for opportunities. Tech and analytics, right? Those are important components. We've already taken a step, we're going to focus on it. Expense discipline. So I think you got a sense for how I'm going to drive this. You know what's intriguing, Amit? And I think important to recognize is the people at CNA are smart. They understand what's working and what needs improvement. What's great about that is it makes for an open dialogue. It makes for an ability to be able to change, to be able to drive with less disruption. So that's maybe more than what you wanted, but I'll leave you with that.

**Amit Kumar**
*Macquarie Research*

No, no that's actually very helpful. Thanks for those comments, and I can see the passion. So thanks for the answers and good look for the future.

**Operator**

Next question comes from Josh Shanker with Deutsche Bank.

**Joshua David Shanker**
*Deutsche Bank AG, Research Division*

Welcome, Dino. So oftentimes, us investors, sell-siders, we often think that a new CEO comes and has an opportunity to look over the reserves and just true-up the book to some extent. Obvious there were some reserve changes here in the quarter, but it seems that these were CNA-oriented changes that would've been made regardless. Do you -- are you bringing a new set of eyes to the reserves? To what extent does this -- did these reserve reactions have your stamp on them? And to what extent are you comfortable to stay the reserves at CNA today?

**Dino E. Robusto**
*Chairman & CEO*

Okay, Josh, clearly, understandable question. So what I would say is, as I said in the opening remarks, look, I confirm the strength, right, of the balance sheet, that it's rock solid, the capital position. The balance sheet obviously includes a reserve that's in there, right? As part of year-end reserve meetings, we had independent auditor to do the final year. So that's included in the statement on a rock solid balance sheet. The reserve increased on the DBA business, because, as you saw, it was discussed earlier in 2016, I believe it was in the second quarter. So clearly, something that management, Craig and the folks, have been intimately looking at and been working on. And so that's the way to really consider this. And it's more confirming, I think, the rock solid nature of our financial statement. But important question.

**Joshua David Shanker**
*Deutsche Bank AG, Research Division*

And do you feel that your best practices that you bring with to the reserving function have already been incorporated to the numbers?

**Dino E. Robusto**
*Chairman & CEO*

Look, every day, right, you learn more and more about the company and the process. And it's 75 days. At some level, given the hours, it's maybe 100 days, but that's neither here nor there. The reality is every day, you're going to get more and more intimate. And we're going to have more of these calls in every quarter. We're happy to continue to talk through what we see and how we're moving forward the strategy and in the pursuit of trying to be as transparent as we can. So more to come, Josh. But I stand by the statement I made about the balance sheet.

**Joshua David Shanker**
*Deutsche Bank AG, Research Division*

Very good. And in terms of personnel. I think there's a lot of people in the insurance industry who'd like to come to work for you. To what extent are you seeing new talent coming in the door? And to what extent are you allowed to pursue talent from your former employer?

**Dino E. Robusto**
*Chairman & CEO*

Okay. So I would just say -- again, a couple of observations. But I would just say that's one of the most important questions. So I appreciate you putting it out there. Look, as a CEO, I consider it my personal responsibility to be intimately involved with talent management. And by talent management, it's the entire gamut. It's recruiting. It's retaining. It’s taking the strong talent you have and making it the best that it can be. Now what I'm focused on is talent from companies across the entire P&C supply chain. That’s very broad and the best companies that touch upon all aspects of the supply chain. There isn't any one focus on one company. But I think you made an interesting observation, which I do believe and have seen it already, there is an increasing desire by real talent from this variety of companies to want to be a part of CNA and to build a rewarding career here. So I see that, I can feel it. And again, I just -- bottom line, I view it as my personal responsibility to be intimately involved with talent management. So really, thanks for that question.

**Operator**

Next question comes from Bob Glasspiegel with Janney.

**Robert Ray Glasspiegel**
*Janney Montgomery Scott LLC, Research Division*

Let me echo Amit's and Josh's welcome to you to CNA. Look forward to meeting you, Dino.

**Dino E. Robusto**
*Chairman & CEO*

Thank you. So do I.

**Robert Ray Glasspiegel**
*Janney Montgomery Scott LLC, Research Division*

You come from sort of behind the Chubb curtain. So just curious if there's any low-bearing fruit that you see out there? You've mentioned the expense ratio, and the company's already had actions in that regard. The home office move, Craig, I actually want you to talk about that, flows through the numbers as well. But where can the expense ratio get to over time? And do you have to spend money to get there? Or can you do it from the get-go?

**Dino E. Robusto**
*Chairman & CEO*

Okay, Bob. So again, I look forward to meeting you also. So I just -- let me make a couple of observations about the expense ratio, and then I'll turn it over to -- Craig's got some more details on the specific question you had. Look, when you take a look at the expense ratio in the organization, you look back, there's been a lot of investment, and prior management talked about it. A lot of investment in replacing legacy technology. That's an expensive proposition, but it has to be done. Over the years, we continue to broaden that branch infrastructure, not only in the United States, but in Canada, and in particular, in Europe. And then hire talent for the branches because we're very much a company that believes in local producer relationships. Now during that time, they were also shedding underperforming businesses, right? So -- which led to negative growth. And you put that together, you get the expense ratio increase. And so is it low-hanging fruit? I think at the end of the day, it's important -- I don't know if I call it low-hanging fruit. It's a mindset. It's an expense discipline management that has to be incorporated so that every day in every decision, you're thinking about where you're spending your money, how it's being spent, what the returns are. More importantly though, it's what can I do to make what I do be more -- much more productive? And if everybody's focused on doing that and we're using things like technology and analytics that we've been investing in, then we're going to get that. And as I said, hopefully, as we work on the underwriting levers and you work on your focus at growing profitably, then the denominator starts to help. And I'll turn it over to Craig on that more specific office question.

**D. Craig Mense**
*Chief Financial Officer and Executive Vice President*

So what can I answer for you, Bob? About the office move?

**Robert Ray Glasspiegel**
*Janney Montgomery Scott LLC, Research Division*

I think you said $10 million in savings in the December press release, if I recall. You're doing a sale leaseback. It's a complicated transaction. So I didn't know if there's anything other than the $10 million number that you're throwing out.

**D. Craig Mense**
*Chief Financial Officer and Executive Vice President*

Well, do -- and do remember that, that doesn't really manifest itself until we move. So that's a 2000 -- that's a mid-2018 run rate kind of adjustment downward that happens then. I'd stand by the other numbers I gave you last quarter, which we expect about $50 million a year less of annual run rate expenses in '17 from '16 as a result of the actions we took over really last quarter, and there's a little bit of that noise in this quarter, but it's not enough to have mentioned or make really a difference. And recall that another of that 50, 10 of that was changing IT infrastructure providers, which you did see in the Commercial, as we point out in the press release and that expense ratio. So we acted on that. That's real. That's happening. So I think those numbers are happening. But we all recognized, that's -- there's more to be done. I think that's really the message from here and nobody's complacent and no one's -- no apologies are made with the decisions we made. But we're going to need to do more to improve our competitiveness and you should expect to -- that we're going to keep acting.

**Robert Ray Glasspiegel**
*Janney Montgomery Scott LLC, Research Division*

If I could squeeze one more in Craig and Dino. In the Corporate & Other line, that's slowing down, sequentially. I see there was $9 million of other revenues and your other expenses also trended down. Any sense in sort of where that's leveling off as a run rate?

**D. Craig Mense**
*Chief Financial Officer and Executive Vice President*

The run rate is more in the prior quarters in the low to mid-20s loss. So we had a couple of recoveries. And the amortization of the deferred gain and national indemnity was a little elevated because pay losses were a little elevated. So I'd point you to more in the low mid-20s ranges run rate.

**Operator**

Next question comes from Jeff Schmitt with William Blair.

**Jeffrey Schmitt**

Could you talk about loss trends in some of your key liability lines? Any detail you could provide on workers' comp, professional liability or anything in more detail.

**D. Craig Mense**
*Chief Financial Officer and Executive Vice President*

I think in comp, frequency remains low and frequency trends are down. I think in -- but we do build in a medical loss cost inflation expectation around 6% and that's about what we're seeing. So most loss trends' relatively benign. In professional and management liabilities, we have seen a bit of an elevation in large losses. I don't know if you call that a trend particularly because it's been more large accounts and maybe large underwriting bets that didn't work out. And -- but we have seen, probably more importantly, some elevation in public D&O. Some elevation in some the financial institution business. And more importantly, elevated risk in aging services and nursing home business where we see a litigation uptick of some significance. I think those are the -- those would be the most important things to point out to you.

**Jeffrey Schmitt**

The -- and then we're hearing some competitors talk about a more active plaintiff bar. It sounds like you're seeing that in health care specifically. Is there any more you can say about that or anything in the other areas you're seeing that?

**D. Craig Mense**
*Chief Financial Officer and Executive Vice President*

Not particularly, no.

**Jeffrey Schmitt**

Really, just kind of health care issue?

**D. Craig Mense**
*Chief Financial Officer and Executive Vice President*

Yes. And very much pronounced in health care, nursing home business, but not -- we have not really seen that across the board.

**Operator**

Next question comes from Jay Cohen with Bank of America Merrill Lynch.

**Jay Adam Cohen**
*BofA Merrill Lynch, Research Division*

I guess, for Craig. On the large losses, you talked about the year-to-year change, what that meant. Was 1 year outsized or undersized? In other words, is what you saw in 2016 kind of a normal run rate and '15 was light, or vice versa?

**D. Craig Mense**
*Chief Financial Officer and Executive Vice President*

No. '16 was elevated. As we said, by about 1 point over what we'd think would be more normal and elevated over what we even had in '15.

**Jay Adam Cohen**
*BofA Merrill Lynch, Research Division*

Got it. That's helpful. And then when you talked about the premium adjustments, the retro workers' comp, small business, say, the error in the rating of that. I think this was -- you talked about the premium impact and then the loss ratio impact. Was that loss ratio impact all in the accident year? Or is that in the prior year as well?

**D. Craig Mense**
*Chief Financial Officer and Executive Vice President*

No, there's no prior year action in that. And really, what I was trying to describe, Jay, is just that by pushing the net earn down and losses, the level of dollar losses remain the same, you get an elevated loss ratio. So nothing more complicated than that.

**Jay Adam Cohen**
*BofA Merrill Lynch, Research Division*

So that really explains a fair amount of the upward pressure there, along obviously with the larger at-large large loss activity.

**D. Craig Mense**
*Chief Financial Officer and Executive Vice President*

Absolutely. Absolutely.

**Jay Adam Cohen**
*BofA Merrill Lynch, Research Division*

One other question. War hazard recovery. That's kind of a new one for me. Can you explain what exactly that is?

**D. Craig Mense**
*Chief Financial Officer and Executive Vice President*

Well the -- so remember, our contract -- or maybe not remember because maybe we didn't talk about it. But our contract in that Defense Base Act business really were with the Federal government. And we kind of had to take then all comers in different parts of the business. So what we do is if someone, a worker is injured in, say, Afghanistan, for example. If it's just a typical fell off, the -- in the construction site, fell and hurt himself, then that's our responsibility if we're a comp provider. If the injury was caused directly by a war hazard, meaning an act of war, then the Federal government reimburses 100% for that injured workers' cost. Now I think what's probably most important is that, that recovery process is very -- recovery from the federal government, now is very lengthy because there are a bunch of rules, as you would imagine, around documenting exactly the direct proximate cause, that it was a war hazard that caused it. And then there's a requirement that the injured worker returns to maximum medical recovery improvement before we can submit the claim. So it's really the -- some of the complexity of the process and it's the length of the process. And this is a relatively new business for CNA. So we did that. We did add in some extra resources that had long tenured experience and it was really kind of their view of what our ultimate recoveries and government ability to prove each of these is going to be that kind of drove the difference.

**Jay Adam Cohen**
*BofA Merrill Lynch, Research Division*

Got it. I'm sure the new administration can speed up that complexity.

**D. Craig Mense**
*Chief Financial Officer and Executive Vice President*

Please, if you could lobby in a tweet for us, that would be helpful.

**Operator**

Next question comes from Meyer Shields with KBW.

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

The retrospective premium adjustment, is that relevant to accident years before 2016? In other words, were those accident years' premiums volumes recalculated?

**D. Craig Mense**
*Chief Financial Officer and Executive Vice President*

Those are -- so it did affect other accident years really more '15, '16. But the amount that we took the charge is -- or the numbers I gave you accounted for those essentially.

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

Okay. And the DBA, I guess, reserve adjustment, does that have any bearing at all on the expectations for your go forward workers' compensation book?

**D. Craig Mense**
*Chief Financial Officer and Executive Vice President*

No, not at all. That's a completely isolated piece of business and it's a run-off line, run-off business so it actually has none. The ongoing workers' compensation, I try to say that even, in my remarks, that we took another look at all of the major reserving product lines in the fourth quarter and Commercial. And I would say that the workers' comp line particularly continues to perform very well.

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

Fantastic. And just last question. The P&C portfolio duration went up sort of materially from the end of September. And also, can you talk about what drove that?

**D. Craig Mense**
*Chief Financial Officer and Executive Vice President*

I don't think -- nothing in particular drove that. You could see there's not really -- there's little in the way of change in our portfolio allocation among -- we did add a fairly significant amount of, I'd say that like $500 million of taxes immunities because we did see a little opportunity in that window for a few weeks in November when the market kind of blew out, spread there, so we added -- so that might have added a bit. But there was nothing particularly intentional. There was nothing significant in the portfolio composition change.

**Operator**

Next question comes from Ron Bobman with Capital Returns.

**Ronald David Bobman**
*Capital Returns Management, LLC*

Patiently waiting here at the end of the line. Welcome aboard. I had a question about the Commercial lines business. Even obviously putting aside the Defense Base Act reserve adjustment, Dino, how far away is the expense ratio and loss ratio in that book from what you would consider, I don't know, top quartile and presumably sort of the destination of where you hope to get it to at some point?

**Dino E. Robusto**
*Chairman & CEO*

Yes. It's an important question. But look, at this particular juncture, it just -- as we -- in the past, just on earnings calls in the past, we're not going to set and put out targets now. I mean, you hit the nail on the head though, right? It's easy to know and see what top-tier performance looks like. And that's clearly what we're going after, and it's essentially, the top priority, right? And although having said that, truthfully, even as this combined ratio improves, it's still going to be the top priority because it's always going to be.

And so, the important thing right now is we're – we’ve put it out there. You can sense and understand our emphasis and focus on it. We're going to focus on all of the levers that we articulated. And as we start to see the improvement, we'll continue to refine our targets and we'll keep you abreast of our process and strategy.

**Ronald David Bobman**
*Capital Returns Management, LLC*

So but how -- I mean, I'm not asking you -- what do you consider top quartile for a loss and expense for that profile book of business?

**Dino E. Robusto**
*Chairman & CEO*

So again, I'm not trying to play around with the question, right? At the end of the day, if you're going to line up the companies and who we consider to be our peer group, and you can see what -- who falls -- what numbers fall into that top tier, right? And you want to be a top tier carrier, so you want to be able to play at that. And as I get more and more involved into the book and the portfolio and the organization, you get a much a better feel. So again, I'm not trying to work around the question. It's just simple -- mathematically what it is at top-tier, and that's where we want to play. That result changes as the marketplace changes. But usually, the top-tier performers tend to stay the same. And so...

**Ronald David Bobman**
*Capital Returns Management, LLC*

When you look -- sort of a related question. When you look at for example, the loss component of where CNA is now compared to admirable others, what is the differential that drives CNA's loss result as compared to that admirable other group? Is it the verticals that you're targeting being just higher loss in nature? Is it the accounts that CNA has retained in some of those verticals are just a greater loss producing cohort within those sort of industry verticals? Could you just talk about that in some form, please?

**Dino E. Robusto**
*Chairman & CEO*

Okay. So let me make a couple of [indiscernible] and then I'll turn it over to Craig, who's obviously been -- but so there has been a direction and a shift towards more of being, as I indicated, a middle market specialist, underwriter. Prior management has talked about that over the last couple of years, and it has shown loss ratio improvement. So yes, I think you are very correct when you talk about the portfolio, the verticals. And as those decisions have been made, you've clearly seen the improvement. Hence, in my opening remarks about you want to drive further into the ones that you've really develop a competitive advantage because some are going to have larger margin. Can we go deeper? Can we export those to other geographies? And so the -- we're going to continue the trend. We're going to try to do it as assertively, as possible as we can. But yes, that, in the broader portfolio management, your vertical does make a significant difference. I don't know, Craig, if there's anything sort of you want to add.

**D. Craig Mense**
*Chief Financial Officer and Executive Vice President*

I wouldn't -- yes, Ron, I'd just say look at Slide 11 in the earnings package. You can see where our full year loss ratio is in Commercial. Compare that to the very best tier underwriting companies, it's slightly -- it's above. So there's room to get better. But there's nothing -- we are largely a casualty-focused business. We have managed still 80% of our revenue as a longer-tail casualty, so there's certainly opportunities to improve that mix and drive improvement there. And I think that there's just all the levers that Dino laid out, it's really more of a -- it's not like it's not there in the market. It's an execution process and continued refinement and improvement, whether that's talent or process or those underwriting judgments. It's all the things that I really referenced in my final remarks about bringing that intense focus on all those things to just improve results. But there's no kind of hidden problem in there and that is -- but there's certainly some improvements on portfolio mix and there's a lot of improvement on the execution side.

**Dino E. Robusto**
*Chairman & CEO*

Or the expense ratio.

**D. Craig Mense**
*Chief Financial Officer and Executive Vice President*

Right. And that's the other big thing, is the -- and you could see that clearly. Right, exactly. You can see the expense ratio.

**Operator**

[Operator Instructions] We move to our next caller, Ron McIntosh with Lomas Capital.

**Ronald P. McIntosh**
*Lomas Capital Management, LLC*

Congratulations, Dino, first of all, on your new role and being back in the game. Got a question for you, a variation on Josh Shanker's question earlier. And this relates to the long-term care business. You mentioned at the outset you're -- that business is relatively unknown to you. How did your due diligence get comfortable with that business on the balance sheet in light of 2 recent industry trends, one being a PriceWaterhouseCoopers study that says the industry is 45% under-reserved and then recent guaranteed fund assessments on Penn Treaty where their reserves were roughly 200% under the levels.

**Dino E. Robusto**
*Chairman & CEO*

Okay. So thanks for the question. And I'll make a few general observations about long-term care, and then I'll let Craig, who's clearly much more familiar with the business, jump in. But so as I said, previously unfamiliar. So tried to spend some quality time understanding it better. What I would tell you is first, I think you really have to applaud management's efforts in the last couple of years to really generate much more operational effectiveness in this building -- in this business. Just as one example. Going from an outsourced claim operation to now it being in-sourced has provided an enormous amount of ability to affect the business, to learn a lot more. And I think that has really started to show up in the improvement. They have done an excellent job at attempting to de-risk the exposure. And that goes from at sort of the policyholder level where you might offer some reduced benefit in lieu of some large rate increases to mask management really looking at mechanisms to -- the large are meant to transfer some or all of it to third parties. Now there really hasn't been any viable options at that level. Just -- but clearly, something that we're going to stay vigilant. In the meantime, we're going to continue this process of operational effectiveness. And clearly, a lot more comfort in the last 4 quarters, hopefully, evidence that. But I'll turn it over. So that's just some observations I wanted to make. And I'll turn it over to Craig, clearly much more familiar with the portfolio.

**D. Craig Mense**
*Chief Financial Officer and Executive Vice President*

And I think what I -- there's really nothing better to point you to than the periodic results that we've had over the last 4 quarters. Because those periodic results reflect the reset assumptions in 2015, and they've -- so our periodic results have been breakeven and actually slightly better relative to claim severity that's in our assumptions. And I think that's the other -- you have to remember that while we're a member of the industry, it's -- everybody's beginning level of assumptions against any of those key levers are going to be different. So we are mindful of that. We look at our own, and our own at the moment have -- are working out and performing as we expected them to, and that's along the continuum. I think the other silver lining in that negative you just threw out there is what we said -- what I said earlier about part of the positive margin change is because the rate increases that we had filed, we actually were able to achieve more than we thought. And I'd say the regulatory environment is actually becoming more constructive. Not that we've ever had any particular problems with regulators in our own dialogue and conversation, but I think that's generally positive. And you have to look at yourself and look at your own results and be wary of what you're seeing outside. But we certainly examine it closely enough, I can assure you that.

**Operator**

And ladies and gentlemen, with no further questions in queue, I would like to turn the conference back over to Mister -- to our speakers for our closing remarks.

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

Well, thank you very much everyone. Real pleasure.

**Operator**
Ladies and gentlemen, that does conclude today's conference. We thank you for your participation. You may now disconnect.