The Hanover Insurance Group, Inc. NYSE:THG

Earnings Call

Thursday, February 2, 2023 3:00 PM GMT

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Presentation

Operator

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

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

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 and guidance for 2023 economic conditions and related effects, including inflation, supply chain disruption, potential recessionary impact evolving insured behavior emerging from the pandemic and other risks and uncertainties and such as severe weather and catastrophes 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 us. Today, I'll begin with an overview of our performance, discuss Winter Storm Elliott and ways to address future impacts of winter storms, update you on progress we've made in the fourth quarter to recapture our top-tier underwriting margins, and I will conclude my remarks with a review of our 2022 strategic accomplishments and the important strides we made this past year, strengthening our competitive position and executing our winning strategy. Next, Jeff will review our financial and operating results by segment as well as our balance sheet and provide an update on our outlook and longer-term financial expectations.

We'll then open the line for your questions.

For the full year, we delivered operating income per share of $5.53 and an operating return on equity of 6.7%. Both reflections of the inflationary economic environment and the magnitude of the cat activity in the fourth quarter. From a growth standpoint, we generated net written premium increase of 9.7% for the year with strong contributions across all segments. Our full year combined ratio, excluding catastrophes, was 92.1% toward the lower end of the guidance we provided on our third quarter earnings call in November. Given the frequency and severity of catastrophes in recent years, including unusual atmospheric events like Elliott, I'd like to take a minute to highlight the work we've done in the past and most recently, in terms of the strategic management of our catastrophe risks.

We've built a strong track record in addressing catastrophe risks in particular, hurricanes and convective storms, employing disciplined underwriting strategies augmented by data, analytic tools and technology. As a result, our share of catastrophe losses over the last 5 years relative to the domestic P&C industry has declined significantly.

Additionally, our catastrophe losses during the same period generally have been in line or smaller than our market share in the affected territories. But as evident from our fourth quarter results, extreme cold weather like we saw with Winter storm Elliott, can challenge the conventional wisdom of what level of losses a winter storm can bring. And our prior catastrophe management actions clearly weren't as effective in this type of storm.

While our top priority in these circumstances is to address the needs of our customers and agents, it is also incumbent upon us to leverage all we learn from this event to advance our financial and operating performance. With changing weather patterns affecting more geographies, and we've intensified our focus on pricing and volatility management over the last few years.

We have further expanded our capabilities in the area of risk solutions and mitigation, collaborating with innovative technology partners. Today, we are gathering vital information from visual intelligence technology, water and temperature sensors, AI risk assessment data and other advanced tools to make underwriting decisions and prevent claims.

A relatively small number of early adopters of water and temperature sensors and related property IoT solutions have already begun to benefit from their use.

We believe Winter Storm Elliott will drive a needed market movement on adoption of these risk solutions more broadly, and we have the infrastructure ready to quickly scale our existing risk prevention platform as customers better understand their exposure. We are focusing our efforts to address weather loss volatility around the following levers: actively repricing products consistent with change in weather risks, addressing risks for which we cannot achieve adequate price, significantly increasing water damage deductibles and enhancing the implementation of water sensors using lower deductibles as incentive.

We're confident our focus on risk selection, pricing and use of innovative tools will enable us to even more effectively address these less frequent but more broad-based storms in the future. Now I will take a few minutes to update you on our progress, regaining our top-tier margins in personal and core commercial property lines despite the persistence of inflationary and supply chain pressures.

As we discussed in our third quarter call, our margin recapture plan includes 3 main levers: enhanced pricing, significant insurance to value adjustments and targeted underwriting measures, and we have successfully executed on all 3 areas in the fourth quarter.

First, on pricing. As guided, we achieved Personal Lines pricing increase of 10% in the fourth quarter, up nearly 3 points sequentially, with meaningful gains in both auto and home pricing. Personal Lines retention remained solidly above 86% with only slight sequential moderation, which is a testament to our unique account proposition and strong agency relationships. Additionally, we are operating in an unprecedented hard market in personal lines. And the regulatory environment is evolving to allow further rate increases in most states. Given the disciplined market conditions and elevated loss trends, we now expect Personal Lines pricing to further strengthen and end 2023 in the mid-teens. We also made meaningful strides increasing core commercial pricing, with underlying property renewal price change up 11%, slightly above third quarter levels and expect even higher increases for 2023.

A disciplined strategy is essential in the current environment. And our superior agent partnerships and strong market position should enable us to hit our pricing targets while maintaining satisfactory retention levels. Second, we're using property-specific insurance to value adjustments to complement renewal increases for certain middle-market property risks. The adjustments we made in the fourth quarter, in combination with the work we completed throughout the year, added approximately 3 points of middle market premiums in 2022.

And third, we continue to make enhancements to our underwriting strategies. We are tightening criteria with our targeted underwriting risk appetite to restrict new business and renewals in challenging industry classes and updating underwriting guidelines, particularly related to secondary perils.

For the year, we nonrenewed approximately $25 million of middle market commercial property business that presented outsized volatility. We expect this to improve CMP property profitability by approximately 1.5 points in 2023, all things being equal. Overall, I am pleased with the strides we made in the quarter to address recent inflationary pressures in property. We are already beginning to see the impact of our action plan and expect to achieve solid profitability gains in 2023 as a result of these actions.

Now let's take a broader look at the past year and discuss our strategic accomplishments in 2022. While the year was certainly not without challenges, we remain well on track on the execution of our strategic priorities, continued expansion of our specialty business, investment in innovative technology to enhance analytics and ease of use, deepen and broaden our agency partnerships and further cultivate our strong culture to build on our talent momentum.

Our Specialty business continues to deliver in terms of financial contributions as well as becoming a critical element of our agency value proposition. Specialty Lines delivered a combined ratio of 89.3% for the full year, an improvement of nearly 4 points from 2021. This business continues to serve as a major source of growth, increasing annual premiums by 11% in 2022 and enabling us to pursue an even better balance between property and casualty risks over time.

Our highly diversified and specialized portfolio enables us to offer our retail agents one of the broadest ranges of products in the small to midsized market. We continue to expand our offerings in 2022. And completing the nationwide rollout of our specialty general liability product and strengthening offerings for financial institutions, retail, E&S, management liability and other sectors. Additionally, we implemented automatic renewal capabilities in the underwriting system for professional and executive lines, reducing manual intervention and creating greater operational efficiencies for both us and our agents.

We continue to be impressed with the diligent work of our specialty team and their ability to drive our strategic initiatives forward. And it certainly gives us confidence in our continued momentum and success in this business. On the technology front, our investments in digital capabilities, underwriting tools and innovative platforms enabled us to react more quickly to the dynamic environment we faced in 2022.

We made enhancements to our claims platform to improve user, customer and agent experiences while reducing manual intervention and workarounds, driving increased productivity. In a similar vein, we launched Hanover Small Business Digital Exchange gateway to streamline the small business placement process for agents. We also made important strides in 2022 and advancing our independent agency relationships, helping many agents succeed in the midst of continuing consolidation trends and a challenging employment market and better serve their customers.

We gained share with many great existing agents while at the same time, making 290 new agency appointments, enhancing personal lines, small commercial and specialty niche market access. Finally, we believe our organizational culture has been a distinct competitive advantage for us. And in 2022, we continue to build on this strength making additional investments to further attract, retain and cultivate talent.

Despite the challenging employment market, we have real momentum with employee engagement and talent acquisition. From our efforts to advance our inclusion, diversity and equity initiatives to multiple skills training opportunities and workshops. We expect our accomplishments from last year to feed our great culture and talent depth in the years ahead.

We entered 2023 with the advantage of several quarters of strong rate increases and the benefit of sophisticated underwriting expertise. We will continue the necessary work of adjusting to our dynamic, rapidly changing environment. And I have every confidence we have the team and the expertise necessary to anticipate the impact of the changes ahead, delivering long-term value for all of our stakeholders.

With that, I will turn the call over to Jeff.

Jeffrey Mark Farber
Executive VP & CFO

Thank you, Jack, and good morning, everyone. I will begin by reviewing our consolidated results and discussing our segment operating performance in more detail. Next, I will update you on our investment portfolio and capital position. And then I'll close my prepared remarks by providing our guidance for 2023. In the fourth quarter, we incurred catastrophe losses of $190 million or 13.9 points. Winter storm Elliott accounted for approximately $165 million or 12.1 points of the total losses. Over 70% of the losses from Elliott were within our core commercial property book. Properties with the largest losses were likely unoccupied for an extended period of time during the holiday week which we believe may have delayed the discovery and remediation of water damage that resulted from burst pipes.

Catastrophe losses aside, the fundamentals of our business remain very strong, and loss trends were within our expectations as evidenced by our ability to deliver ex cat results in line with the guidance we provided on the prior quarter call. The enterprise combined ratio, excluding catastrophes, was 94.1% in the fourth quarter, bringing the full year ratio to 92.1%.

For the full year, we recorded favorable prior year reserve development, excluding catastrophes of $20.6 million or 0.4 points driven by specialty lines and continued favorability in workers' comp. These results underscore the success we've had building a solid balance sheet over the past several years. We entered 2023 in a really strong position and with heightened vigilance in assessing liability trends. We delivered an expense ratio of 30.9% in the fourth quarter, which reflected a strong improvement from the prior year quarter. The full year expense ratio came in at 30.8% and an improvement of 50 basis points from 2021, primarily driven by the impact of fixed cost leverage from growth as well as some onetime favorability, including lower-than-expected agency and employee variable compensation.

We remain well on our trajectory towards our long-term expense ratio target. Moving on to a discussion of our underlying underwriting loss performance. Compared to the prior year quarter, the consolidated underlying loss ratio increased 3.7 points to 63.3% for the fourth quarter and increased 3.2 points to 61.7% and for the full year, reflecting higher loss costs due to inflation and higher property large losses in the second half of the year.

Fourth quarter outcome was consistent with the outlook we provided on our third quarter earnings call. with some puts and takes by segment. Relative to our expectations, strong improvements in our specialty business and more benign property large loss experience in home and CMP relative to third quarter levels were offset by the impact of higher frequency and severity of losses in personal auto comprehensive coverage.

Looking at underwriting results by segment, starting with core commercial. The core commercial loss ratio, excluding catastrophes, increased 2.2 points for the fourth quarter and increased 0.4 points for the full year, primarily due to an uptick in loss cost inflation and property large losses in the second half of the year.

We were pleased to see property loss pressure in CMP abate somewhat in the fourth quarter from elevated Q3 levels. That said, we continue to push for additional rate across the core commercial book of business, which the market certainly supports.

In the quarter, we achieved rate increases of 7.2% and total renewal price increases of 10.2%. More specifically, the renewal price change in the property portion of the book of 11.2% was up slightly from the third quarter and we expect additional increases in 2023. In casualty coverages, while we continue to see robust rates, some of the elevated exposure increases we experienced post COVID are beginning to normalize. As Jack mentioned, we remain focused on leveraging property-specific insurance-to-value adjustments to recapture target margins in core property lines.

Our ability to quickly adjust exposures to align with prevailing inflation combined with granular data and analytics and targeted underwriting actions positions us well to deliver improved margins in core commercial going forward.

Looking into 2023, we expect earned price and select underwriting actions to meaningfully drive margin improvement in our core commercial book. At the same time, we are cognizant of the current dynamics with the reinsurance market and expect part of this improvement to be temporarily offset by an increase in the cost of July 1 property reinsurance treaty renewals.

Specialty posted another quarter of excellent results, delivering top line growth of 8.7% and a combined ratio of 90.5%. For the year, our specialty team delivered 11.2% net written premium growth and a sub-90s combined ratio. Specialty current accident year loss ratio, excluding catastrophes, was 51.5%, reflecting an improvement of 90 basis points from the prior year fourth quarter. The specialty pricing environment remains firm in the majority of our markets as we achieved renewal price increase of 13.2% in the fourth quarter a sequential acceleration of 80 basis points from the third quarter, resulting from both rate and exposure growth.

We have full confidence that our specialty business will continue to be an outsized contributor to our results. At the same time, in light of an expected uptick in medical inflation as well as prudence in liability assumptions for certain lines we embedded more conservative expectations in our loss picks for 2023 relative to 2022 results. Turning to Personal Lines. The business reported a combined ratio, excluding catastrophes, of 98.9% for the fourth quarter, driven by the impact of inflation and supply chain delays on personal auto and homeowners property. In Personal Auto, -- the current accident year loss ratio, excluding catastrophes, was approximately 2 points above our expectations for the fourth quarter exiting Q3, which was primarily due to the elevated frequency of animal hits.

We are among the largest personal auto insurers in Michigan, where Deer hits reached their peak in Q4 and impact the frequency and severity of comprehensive coverage claims. Putting comprehensive coverage aside, the underlying loss trends in auto remain in line with our expectations and frequency continues to track below pre-COVID levels. We are addressing higher prevailing auto severity through robust rate and non-rate actions. Auto pricing increases of 6.7% in the quarter reflected an acceleration of 2.6 points from the third quarter. Furthermore, we have line of sight to further price increases and expect to achieve auto renewal price change of approximately 9% in the first quarter of 2023.

In homeowners, we were pleased to see large loss experience stabilize somewhat in the fourth quarter. At the same time, we continue to experience somewhat elevated inflation on property losses. The homeowners underlying loss ratio was slightly better than our expectation due to somewhat reduced frequency of lower non-cat weather losses.

We are beginning to see the impact of the robust pricing increases on profitability in home. Written price change in our homeowners book remains on a strong upward trajectory as evidenced by increases of nearly 16% in the fourth quarter. We have line of sight to further price acceleration to 18% in the first quarter of 2023, and expect it to remain in the upper teens for the remainder of the year. As an account writer, we are intently focused on the profitability of our Personal Lines business as a whole. We expect overall personal lines loss ratio to improve by over 2 points in 2023 from 2022 led by homeowners. Adjusting for normal weather seasonality, we expect each quarter of 2023 to reflect a sequential improvement.

We anticipate underlying results in auto will follow a more paced progression as current and future rate actions earn in and some of the residual auto frequency benefit from early 2022 levels create comparison headwinds for the first half of 2023. However, we expect further personal lines improvement in 2024, supported by both auto and home, and this business should return to target profitability in 2024, all things equal.

Turning to reinsurance. On January 1, we successfully completed our multiline casualty reinsurance renewals. We are pleased with our ability to renew our treaties with limited changes and at an acceptable price. As a reminder, our cat program is a 3-year rolling program that renews on July 1, which gives us time to study coverage options adjust our risk exposures where necessary and seek pricing increases ahead of anticipated reinsurance cost increases.

Now moving on to a discussion of our balance sheet and investment portfolio. Higher interest rates continue to provide a meaningful lift to our net investment income and overall earnings. In the fourth quarter, net investment income came in above our expectations at $75.9 million. helped by higher bond reinvestment yields, which more than offset slight partnership underperformance in the quarter. For the year, we delivered net investment income of $296.3 million which beat our original expectations by about $25 million. Looking ahead, we expect the current interest rate environment to have a substantial building impact on net investment income as the portfolio turns over and is reinvested at higher interest rates.

We continue to achieve new money yields on purchases of fixed maturities well above our total portfolio yield. -- and also above what is rolling off the portfolio. We expect higher interest rates and cash flows to provide a meaningful tailwind in 2023. We -- we experienced a favorable change in our investment portfolio valuations of $80.3 million before tax during the fourth quarter, driven by the increase in the fair value of fixed income securities, but the portfolio remains in an unrealized loss position at year-end.

We typically hold fixed income securities to maturity, and therefore, we are not overly concerned with temporary interest rate-driven movements in the market value of the portfolio. The increase in interest rates in 2022 has allowed us to invest portfolio cash flows at attractive market yields and at higher quality and shorter duration. Portfolio duration at year-end stood at 4.3 years compared to 4.9 years at the beginning of 2022.

Looking at our equity and capital position. Our book value increased in the fourth quarter, while being down for the year due to mark-to-market losses on our investment portfolio. Statutory capital remained relatively unchanged at $2.7 billion compared to the end of last year as investment losses on equity securities and a $100 million dividend payment to the parent were nearly offset by insurance company earnings.

We remain disciplined and balanced on our capital management priorities and committed to being strong stewards of our capital. In December, the Board of Directors approved an 8% increase in the company's quarterly dividend. This increase reinforces our commitment to maximize value for shareholders and reaffirms our confidence in the long-term earnings potential of our business.

Turning to our guidance for 2023. We expect overall consolidated net written premium growth to be in mid-single digits, driven by growth in our most profitable businesses, partially offset by the impact of repricing and targeted underwriting actions in certain parts of the commercial lines business. We expect net investment income growth of approximately 8% after incorporating an assumption for some lower partnership performance in 2023 relative to 2022.

Net investment income on fixed income securities is expected to increase by approximately 18%, propelled by higher operating cash flows and higher yields. Our expense ratio should be 30.8% for the year, improving 30 basis points from the 2022 guidance and putting us at 50 basis points of improvement over 2 years.

The full year combined ratio, excluding catastrophes, should be in the range of 91% to 92%. In addition to usual weather seasonality and our quarterly ex-cat combined ratios will be impacted by progressive earning in of price increases and the changes of frequency for personal auto. Additionally, quarterly comparisons of 2023 to 2022 will be impacted by the lower frequency of auto claims in the first half of the 2022 year. The cat load for 2023 increases 10 basis points from 2022 guidance to 5.1%. The cat load for the first quarter is 4.6%. And we expect an effective tax rate to approximate the statutory rate, which is 21%.

In conclusion, our differentiated offerings, strong pricing capabilities and underwriting discipline position us well for 2023 and beyond. 2023 should represent solid operating performance and meaningful improvement from 2022, on our way to 2024 return to top-tier profitability. We continue to partner with the nation's best agents and look forward to driving margin growth throughout the year.
With that, we will now open the line for questions. Operator?

Question and Answer

Operator

[Operator Instructions] Our first question will come from Mike Zaremski with BMO.

Michael David Zaremski
BMO Capital Markets Equity Research

Our First question is on loss cost inflation, and I appreciate all the great commentary. Maybe you can kind of give us an update, and I think you did, but maybe elaborate a bit more about whether you're seeing a pickup, not just on the property side, but I heard medical inflation mentioned to bids and some peers have talked about liability inflation kind of moving up a bit as well. But just curious if you -- if there's any more color you can offer rather than the property side, which I think we better understand and we're seeing rate accelerate there to get in front of that on the more property side. That's my first question.

John Conner Roche
President, CEO & Director

Thanks, Mike. This is Jack. I appreciate the question. I think we are not seeing any material lift in medical inflation at this point, while we're watching it very carefully. We obviously look for that not only in the workers' comp line, but also in the liability lines to see if we're starting to see some eventual medical inflation, which we do expect to evidence itself eventually. On the liability trends more broadly, we continue to monitor and see some evidence of the litigation environment and elements of social inflation starting to show up, and we've tried to stay on top of that from a claims analytics standpoint. I think we've captured that, frankly, in our picks. So we're not seeing anything that we haven't contemplated to date. But like any prudent underwriter, we're watching it like a hawk and making sure that we have the right analytics in place to see what's on the horizon now that the courts are really fully up and running, and those cases are making their way through.

Jeffrey Mark Farber
Executive VP & CFO

As far as expectations are concerned or guidance for 2023, we've incorporated increased lawyer involvement and increases in some medical procedures and the costs there on into those picks.

Michael David Zaremski
BMO Capital Markets Equity Research

On the property side, not taking into account reinsurance costs. I know you guys have -- or sorry, the company has a rolling reinsurance program. But is there any changes in what you're seeing in terms of the property inflation side in terms of maybe a step down from what's been historically high levels trailing 12 months?

John Conner Roche
President, CEO & Director

I don't think we've experienced the material step down as of yet. And so we're not certainly reflecting that in our picks. We're watching and hoping for that to eventually show up in terms of something more than, say, the cost of lumber and things that have come down a bit, but not -- we haven't seen a material dip yet. I think overall, related to our property trends is we were glad to see some stabilization in some of our property large losses, particularly in CMP which we anticipated after seeing a little volatility earlier in the year. But overall, we have a pretty robust pricing environment, and we've done a lot of things from an underwriting standpoint to try to get at some of the volatility we've seen and try to stay ahead of this as much as possible.

Jeffrey Mark Farber
Executive VP & CFO

We're getting a lot more rate than we are in terms of loss trend across virtually all of the different segments. And the assumption that we've made through 2023 is inflation remains high and then it begins to -- the increase in pricing begins to soften a little bit as you get later in 2023.

Michael David Zaremski
BMO Capital Markets Equity Research

Okay. My final follow-up is just thinking about the long term. I know this is long-term return on equity I guess, targets that you put out about 1.5 years ago at the Investor Day of '14 and kind of being cognizant, we can see the '23 guidance, what it implies a lower level, and we know that the inflationary environment is somewhat elevated and you'll be getting in front of it. But just curious, one, has the world changed a lot in the last 1.5 years that maybe we should be thinking about a different long-term number puts and takes? And also, just curious, ultimately, when we and investors look at kind of the proxies and compensation targets for upper level decision makers, should we expect a step-up in targets to given that the 14 ROE is higher than current expectations over time?

John Conner Roche
President, CEO & Director

So Mike, we have a lot of confidence in the long-term trajectory and the drive over the period of time to the 14-plus percent 2023 will be very solid results. And you're right. If you were to do the math, think something like the guidance would imply 11.5% to 12% ROE. And that's not where we wanted it to be, but it's solid. But as you think about the rate and how it earns in and we think about 2024, for 2024, we are every bit as strong as we would have anticipated in the Investor Day, if not stronger, when you bake in investment income. So we're still very, very optimistic about the trajectory. But clearly, 2022 and even into '23 are not exactly on that line, but I think we're perfectly fine with that.

Michael David Zaremski
BMO Capital Markets Equity Research

Any comments on just will the firm -- the firm's compensation structure given we're 1.5 years in -- does it reflect a step-up in ROE over time?

John Conner Roche
President, CEO & Director

Well, remember that particularly for our senior executives, we're heavily influenced in our compensation by long-term stock. So I would argue that our performance, meeting expectations of investors is heavily weighted in our compensation scheme. But I think our Compensation and Human Capital Committee regularly intersects with our -- with the management team to set appropriately aggressive goals and to adjust those as the environment starts to improve, and we have high expectations that we're going to achieve those longer-term targets like we said, and our goals will reflect that.

Michael David Zaremski
BMO Capital Markets Equity Research

Okay. Understood. And maybe sneak one last one in. Just in terms of kind of appraising property values to reflect inflation over the last couple of years. Is there -- I don't know if it's baseball and in an analogy in terms of kind of reunderwriting on the property side of the portfolio, maybe on the commercial side that you could kind of give us some insights into? Is it kind of latter half baseball innings or still a lot of work to do there.

John Conner Roche
President, CEO & Director

Well, I'll just say a quick thing about this. This s Jack, and then maybe let Dick get his perspective on the table. But I would say we're pretty far along in our overall property reunderwriting and repricing, but the environment is dynamic. And if we've learned one thing over the last few years, including the pandemic implications as well as the inflationary and supply chain pressures, some of the weather dynamics going on is that our job is never done in terms of assessing those trends against our portfolio. And making sure that our underwriting and our pricing reflects those changes. So I'm confident that we know how to do that and that we're making all the right adjustments. But I think because of the dynamics, Mike, it's hard to say what inning in the game is, I think the game continues, and it may be more like a soccer match where you have to just keep going until the PKs are done. But Dick, do you want to build on that?

Richard William Lavey
Executive VP & President of Hanover Agency Markets

No, exactly. I would say we're leaning into the ITV increases throughout this next year, and we'll watch it closely, right, both on the building values, the contents, business income. So we've meaningfully increased what sort of rolls on to each policy upon renewal. And so we'll see that -- we're just going to continue to put that at a pretty high level and watch the actual loss cost. But then also, as Jack said, we took a hard look at where within our book, we might be -- there might be undervalued properties. And so you get at that in sort of a onetime basis where you not analyze where ITV may fall short and you make adjustments. So we're pretty far along on that process. And just -- this is one that will be in front of us absolutely for the next 18 to 24 months.

Operator

Our next question will come from Bob Farnam with Janney.

Robert Edward Farnam
Janney Montgomery Scott LLC, Research Division

A couple of questions on the guidance. So the first off is the cat loss ratio, 5.1%. That's kind of low relative to the past few years, probably low relative to the average over the last 10. So I'm just kind of curious if that's just because of the actions you've been taking to kind of reduce the volatility in cats?

John Conner Roche
President, CEO & Director

If you look at that over 10 years, that's definitely the case. So we've deconcentrated properties in order to reduce that. So the earlier periods in the 10 years, I think, had a little bit different mix of business. We've done our modeling. We've increased the load. We've increased the perils. We've done a lot of work on it, and I think we're comfortable with the 5.1%.

Robert Edward Farnam
Janney Montgomery Scott LLC, Research Division

Okay. And on the premium growth, so it sounds like it's probably going to slow down a little bit relative to 2022. How do you see the growth in each segment? It sounds like from your comments, you're going to see maybe a little slower growth in core commercial because of underwriting actions. Is that the right way to think about it?

John Conner Roche
President, CEO & Director

Bob, this is Jack. I think overall, we're trying to reflect our premium guidance, if you will, to make sure that we're emphasizing that margin recapture is more important than the last point of growth. That said, we're in a pretty dynamic environment. And if we can improve our pricing and get done what we want to do on the margin with some of our underwriting actions and the market stays as firm as it is than the growth may surpass that. But I think, at the sector level, PL, we're making material changes in personal lines that may move our PIP growth down obviously, the pricing will work against that from a growth standpoint and keep the growth from going down too low. But we're certainly going to see less growth in personal lines in 2023 than we saw in 2022. And I think you're right, within middle market in core commercial because of the limits volatility that comes with that business, we're going to be particularly focused on adjusting our growth and making sure that the growth is appropriate until we get more confidence in some of the pricing over loss trend.

I also would be remiss if I didn't say that there's a number of parts of our portfolio across the specialty lines, in small commercial and even sectors within middle market where we're very bullish. The combination of the pricing environment and our current profitability and our headroom with agents allows us to continue to stay on the offense in those parts of our portfolio. So really, that mid-single-digit guidance is a combination of all that, but with an emphasis on the fact that margin improvement trumps the last point of price in terms of our goals.

Robert Edward Farnam
Janney Montgomery Scott LLC, Research Division

All right. Okay. And that brings up another question for Personal Alliance as the rates keep going up. You said your retention seems to be holding up pretty well. Is there a point where you maybe pull back a bit if the retention drops too low. I'm just trying to get curious if there's a certain level of retention that you would say, all right, maybe we pushed the rate too much.

John Conner Roche
President, CEO & Director

Well, let me let Dick comment on that because I think if you watch us over the last few years, we've managed this particularly well in a pretty dynamic pricing environment. And so being an account writer, I think that gives us a little bit more stability than those that are writing monoline home and monoline auto tends to stabilize retentions. But Dick, why don't you share a few things.

Richard William Lavey
Executive VP & President of Hanover Agency Markets

This is at the heart of our state management and actuarial science and what we spend every waking moment of the day looking at price, the price retention trade-off, by state, by customer segment. We have profit pools that we obviously know of and want to protect. So we watch those retention metrics very closely, and we make our pricing increases appropriate such that we protect those.

So I wouldn't put a particular number on it per se. And as Jack referenced, we're proud of our capabilities in this regard back in the pandemic times when others were reducing rates, and we were sticking with our higher level rates, we did see retention start to drop a little bit and made adjustments and we think quite effectively. So with our account strategy. We like retention in the -- certainly the mid- to high 80s. So that's certainly a barometer that we'll watch closely.

Robert Edward Farnam
Janney Montgomery Scott LLC, Research Division

Right. Okay. And probably one last numbers question for Jeff. Just -- you keep mentioning that the new money rates are in excess of expiring. So can you just give us what the actual new money rate is these days?

Jeffrey Mark Farber
Executive VP & CFO

We haven't shared that. I guess treasuries are moving around so quickly, but I would suspect it's somewhere in the 4% or 3% quarter range, something like that to 5%, somewhere in that range.

Operator

Our next question will come from Paul Newsome with Piper Sandler.

Jon Paul Newsome
Piper Sandler & Co., Research Division

Good morning, guys, and thanks for the call, all the help. I am getting a question from investors today that sort of surprises me, but I wanted to ask it. It's more of a philosophical question, maybe a little bit of a [indiscernible] , which is -- it sounds like you folks are what I would expect, focusing primarily on profitability improvements. I guess [indiscernible] question is, philosophically, why do you think in this part of the cycle, you should be -- you shouldn't be focused more on top line growth. in the various businesses. I think this is mostly coming from people looking at personal lines where they think price increases are pretty heavy and maybe we're seeing a reduction in competition. But -- just philosophically, how do you guys think about that?

John Conner Roche
President, CEO & Director

Paul, I actually appreciate the question because I think that is the appropriate question given the business we're in. And I think of growth really over a multiyear basis. The best underwriters in our business are able to generate good returns and grow ahead of the market over a period of time. And that is our aspiration you saw that in our September 2021 aspirational goals. I think this year, we have the proper humility coming out of 2022 that the combination of hyperinflation and a challenging storm in the last 2 weeks of the year caused us to want to be a little bit more cautious with regard to growth rates and make darn certain that we can get our margins back on track and be a top-tier performer like we've been accustomed to being. And we know we have plenty of headroom -- so I have complete confidence that as we see our margins improve and the environment play out the way we hope it will, that we have all the capability as a firm to elevate our growth back to where we were, and we can balance growth and profitability quite well as a firm.

Jeffrey Mark Farber
Executive VP & CFO

Paul, we have a lot of confidence in our ability to deliver on the growth goals that we set out there over a 5-year period. And just as an example, for the 5 quarters since the September 2021 Investor Day, we've averaged about 10% growth versus the 7 plus that we put out there. So if there's a period of time where we're slightly below the 7% to make sure our margins are great. We're perfectly fine with that, as Jack just said.

Jon Paul Newsome
Piper Sandler & Co., Research Division

And maybe just a couple of additional thoughts on the broader competitive environment across your businesses. It isn't really clear to me that people are actually -- our competitors are actually pulling back in material places. It looks kind of like it may be a pretty mixed environment that's just -- and basically at the same place with various lines may be a little bit less or a little bit more competitive. Is that a fair assessment? Or do you really think that given all the craziness and volatility of earnings and the big losses that there's some material areas where people are actually pulling back and just the competitive environment is getting better.

John Conner Roche
President, CEO & Director

I think that overall, we are in a reasonably disciplined marketplace. I think we see -- and as we predicted, there will be many cycles based on lines of business and sectors of the business. I think you saw on the extreme and some of the tougher specialty areas. There was a real hard market and some of that starts to subside a little bit, but already signs that may be in areas like Med-Mal that may reaffirm Relative to our portfolio, I think we see the same thing. If you look at specialty, we have areas of the specialty business that are performing extremely well. but we're still getting pretty good pricing.

And traditionally, what would happen is that you would see some hyper competition developed. To me, that means that there is the utmost respect for what could be around the horizon and acknowledging that liability trends are still evidencing themselves, particularly coming out of a pandemic. So when I put all that together, Bryan, maybe I know you're on the line, maybe you could add in your to sense, but specialty is probably the best example for me where the market is still pretty stable and firm despite some pretty good margins by some of the better companies.

Bryan James Salvatore
Executive VP & President of Specialty

Yes, Jack, glad to weigh in. Look, I would say, and I would agree with you that there's enough out there in terms of the potential for social inflation, the potential for rising and the rising insurance -- reinsurance costs that I think folks are paying attention to that. And that's the way we're thinking about it. So I feel good that we were able to achieve the kind of growth that we did, right, 11.2% last year, while continuing to appropriately is the way I would describe it, push on rate, whether it's on the casualty side or on the property side. we continue to push, monitor our results and adjust accordingly.

So on the property side, we continue to push and that is holding and our retentions are holding quite nicely. On the casualty side, we continue to push as well. And so we'll watch that throughout the year. But the -- our competition is not creating an environment for us where we feel like we have to deviate from that right now. And I guess the only other thing I would add is, our book composition is sort of an interesting one given that it skews towards middle and smaller risks with a lower limit profile. And so those attributes are also serving us well. So I think we're in a space where we can continue to push. We can continue to watch, and we're in a position to adjust should we think it's appropriate given the rate on the year-on-year rate increases we've gotten.

Operator

Our next question will come from Grace Carter with Bank of America.

Grace Helen Carter
BofA Securities, Research Division

Considering the catastrophe loss guidance for this year, I was wondering how the outlook for midyear reinsurance renewal factors into the increase? And just kind of if we should expect a bigger step-up in the second half of the year compared to the first half.

John Conner Roche
President, CEO & Director

Grace, we went through our casualty renewals, as we said, and that was unremarkable or uneventful. We did a lot of additional buying last year. We added to the cat tower. We also put in place a cat bond, which has a 3-year program on it, assuming we don't hit it, which is highly unlikely to hit given it just at the very top. We have assumed a firm market based on what we see and what we read for 1/1. I suspect we'll be in good shape in getting it done since we've never impacted our treaty since Katrina. But we buy the program on a 3-year rolling basis. So we're always pushing out a third. So we've been conservative in how we've set our assumptions, but I'm feeling pretty good about it.

Grace Helen Carter
BofA Securities, Research Division

And one more quick one. As we consider, I guess, casualty loss cost trends being under more scrutiny, have you noticed any difference in umbrella loss cost trends in the latter part of the year?

John Conner Roche
President, CEO & Director

Well, I think umbrella, Grace is I think it's hard to look at those losses on a quarter or even a half year basis because they're kind of the law of small numbers, very few claims obviously produce your umbrella losses. I can't say that we've seen any huge material changes. But like many in the industry, we are observing more cases going to trial or staying longer in the litigation process.

We are seeing some awards that appear to be above traditional levels, some of which get resolved and appeal, others don't. So we're clearly monitoring the true implications of social inflation, which we believe exists, but we're not seeing a tremendous delta, if you will, on that aspect of our portfolio yet.

Operator

[Operator Instructions] Our next question will come from Meyer Shields with KBW.

Meyer Shields

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

Great. Two quick questions, I guess. One, we've got the expense ratio guidance, obviously. But I was wondering if you could talk about the impact of inflationary pressures on incentive compensation in 2022? And how we should think about that component changing in 2023, 2024.

Jeffrey Mark Farber
Executive VP & CFO

Meyer, are you talking about employee incentive compensation? Or you talking about agent incentive compensation.

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

I guess both because I assume that they are going to both be included in the expense ratio. But if I'm thinking about that incorrectly, please let me know.

John Conner Roche
President, CEO & Director

Sure. So with respect to 2022, one of the reasons that the expense ratio was 50 basis points better than it was the year earlier or 30 basis points better than the guidance was both of those elements were impacted by Elliott and were impacted by inflationary pressures in general. And they follow the fortunes of the underlying firm in both cases.

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

So does the 30.8% anticipate normal levels of incentive comp?

Jeffrey Mark Farber
Executive VP & CFO

Absolutely. So obviously, everything gets replanned and rebaselined based on the guidance that we have. And so the 30.8%, while flat to 2022 is a 50 basis point improvement over a 2-year period or a 30 basis point improvement over the 2022 guidance that we gave.

Richard William Lavey
Executive VP & President of Hanover Agency Markets

On the agency compensation side. So we look at that every single year. There's puts and takes on the direct compensation as well as the profit sharing or bonus plan calculation. So you'll see some ups and downs on that, but that's embedded in this expense ratio.

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

Okay. No, that's perfect. That's helpful. The second question, and I don't know if this is meaningful, but if we tease out the exposure unit growth from the pricing and rate changes in Core Commercial and Specialty it seems like exposure unit growth is decelerating in core commercial and picking up in specialty. Is that random? Is there something actually going on there? And should we expect that to continue going forward?

John Conner Roche
President, CEO & Director

So great question, actually. If you look at our pricing overall in core commercial, we have made progress in terms of getting rate up and holding it stable. We expect that, that will continue -- exposures on the property side will continue to go up. We are ratcheting up insurance to value appropriately and making sure, as Dick said, that certain occupancies and business types get reflected more than just the general increases. The casualty exposures for many classes are driven by payroll and/or sales, and those will fluctuate, particularly if the economy hits different sectors in different ways.

And we saw a little of that frankly, in 2022. So we try to reflect that. We're focused mostly on rate in the casualty lines because of that because when those exposures come down, generally loss costs tend to follow that. I think in the specialty lines, I think, for the most part, our exposures have been growing because there is some property also in our specialty portfolio. but exposures aren't as sensitive to those payroll and sales. And so I don't think you're going to see that same kind of up and down, if you will, on the casualty side of specialty.

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

Okay. Should we infer that there's maybe more not property exposure for property premium coming into the mix in specialty relative to core commercial?

John Conner Roche
President, CEO & Director

No. I would not come to that conclusion. I think it's just less downside on some of the casualty exposure, particularly when you think of workers' comp or the sales on manufacturing and retail and wholesale, it just doesn't have that dynamic in it.

Operator

This concludes our question-and-answer session. I would like to turn the conference back over to Oksana Lukasheva for any closing remarks.

Oksana Lukasheva
Senior Vice President of Corporate Finance

Thank you all for all your questions today, and we're looking forward to talking to you next quarter.

Operator
The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.