S&P Capital IQ

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CNA Financial Corporation NYSE:CNA

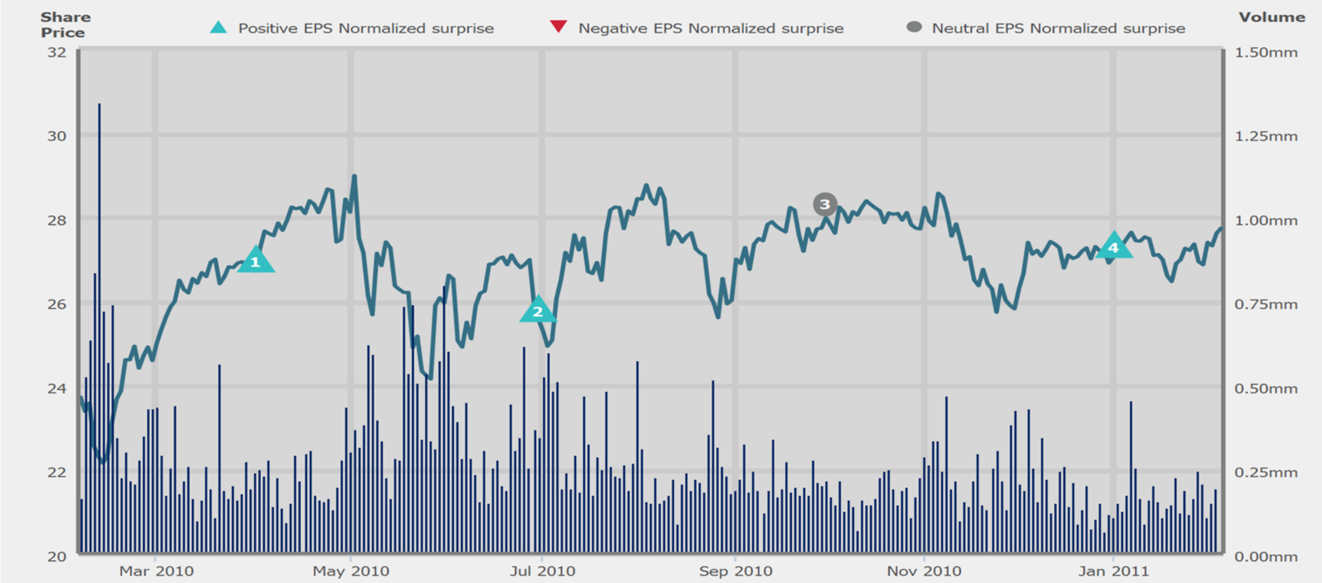
FQ1 2011 Earnings Call Transcripts

Monday, May 02, 2011 2:00 PM GMT

S&P Capital IQ Estimates

	-FQ1 2011-			-FQ2 2011-	-FY 2011-	-FY 2012-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.68	0.80	▲17.65	0.71	2.67	2.68
Revenue (mm)	1889.06	-	▲22.55	1865.02	7474.86	7583.10

Currency: USD
Consensus as of May-02-2011 12:37 PM GMT



- EPS NORMALIZED -	CONSENSUS	ACTUAL	SURPRISE
FQ1 2010	0.65	0.74	▲1 13.85 %
FQ2 2010	0.58	0.91	▲2 56.90 %
FQ3 2010	(0.40)	(0.66)	NM
FQ4 2010	0.67	1.09	▲3 62.69 %

Call Participants

EXECUTIVES

D. Craig Mense
Chief Financial Officer and Executive Vice President

Nancy M. Bufalino
Former Assistant Treasurer

Thomas F. Motamed
Former Chairman and Chief Executive Officer

ANALYSTS

Amit Kumar
Macquarie Research

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Robert Ray Glasspiegel
Langen McAlenney

Ron Bobman
Capital Returns

Unknown Analyst

Presentation

Operator

Good day, and welcome to the CNA Financial Corporation's First Quarter 2011 Earnings Conference Call. Today's call is being recorded. At this time, I would like to turn the conference over to Nancy Bufalino. Please go ahead, ma'am.

Nancy M. Bufalino
Former Assistant Treasurer

Thank you, Casey. Good morning, and welcome to CNA's discussion of our first quarter 2011 financial results. Our press release was issued earlier this morning and can be found on the CNA website at www.cna.com along with our financial supplement.

On the call this morning are Tom Motamed, our Chairman and Chief Executive Officer; and Craig Mense, our Chief Financial Officer. Following Tom and Craig's discussion of the quarterly results, we will open it up for your questions.

Before turning it over to Tom, 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 this call. Information concerning those risks is contained in the earnings release and in CNA's most recent 10-K and 10-Q on file with the SEC. In addition, the forward-looking statements speak only as of today, May 2, 2011, and CNA expressly disclaims any obligation to update or revise any forward-looking statements made during this call.

With respect to non-GAAP measures, reconciliations with the most comparable GAAP measures have also been provided in our most recent 10-K and 10-Q, as well as the financial supplement. Finally, this call is being recorded and webcast. During the next week, the call may be accessed again on CNA's website. With that, I'll turn the call over to CNA's Chairman and CEO, Tom Motamed.

Thomas F. Motamed
Former Chairman and Chief Executive Officer

Thank you, Nancy. Good morning, everyone, and thank you for joining us today. We are pleased to report our first quarter results. The highlights were: Our core Property & Casualty Operations' net written premiums increased 6%, driven by growth in CNA Specialty; CNA Commercial's net written premiums were flat, a dramatic improvement from last year's negative trend; our Commercial segment generated slightly over one point of improvement in the accident year loss ratio before catastrophes, reflecting the positive impact of our ongoing underwriting initiatives to improve profitability; our capital position continued to improve, book value per common share increased 3% to $41.75, with GAAP common shareholders' equity increasing to $11.2 billion; we completed a $400 million debt offering, with the proceeds used to prepay senior notes due in August of this year; we signed a definitive merger agreement with CNA Surety: finally, we announced a quarterly common stock dividend of $0.10 per share.

Turning to our financial results. First quarter net operating income was $216 million or $0.80 per common share in 2011 as compared to $223 million or $0.74 per common share in 2010. Net income in the first quarter was $223 million or $0.83 per common share as compared to $245 million or $0.82 per common share in the first quarter of 2010. First quarter net operating income for Property & Casualty Operations improved to $261 million in 2011 from $226 million in 2010. Our catastrophe losses were higher quarter-over-quarter, but the increase was more than offset by higher investment income and improved underwriting results before catastrophes. The first quarter net operating loss from our Non-Core segments increased to $45 million in 2011 from $3 million in 2010. Craig will discuss the Non-Core segment results in a moment.

The Property & Casualty Operations combined ratio improved slightly to 101.9% as compared to 102.1% in the prior year period. The ratio included 3.7 points of catastrophe losses in the current quarter as compared to 2.7 points in the first quarter of 2010. Favorable prior year development reduced the first quarter combined ratio by 2 points in 2011 compared with a 2.7 point help in 2010. Excluding development and catastrophes, the first quarter 2011 combined ratio improved nearly 2 points to 100.2%, which was primarily expense driven. The first quarter expense ratio was 31.7% in 2011 as compared to 33.5% in 2010. Two nonrecurring items accounted for the improvement. This year's first quarter expenses were reduced by recoveries of insurance receivables written off in prior years. Last year's first quarter included onetime expense charges associated with our IT outsourcing initiative.

The Property & Casualty Operations' first quarter accident year loss ratio excluding catastrophes was 68.5% in both 2011 and 2010. In CNA Specialty, we grew net written premiums 13% in the first quarter, a continuation of the growth we achieved in last year's fourth quarter. Renewal rates were essentially flat in this year's first quarter, a one point improvement over last year's first quarter. First quarter renewal retention was 85% in 2011 as compared to 86% in 2010. Exposures increased approximately 1% in the first quarter.

Specialty's first quarter ratio of new-to-lost business was 1.7:1. Quarter-over-quarter, submissions increased 23%. The hit ratio improved by 3 points to 36%. We are especially pleased by strong new business production in Professional & Management Liability as well as our warranty business. We generated 5% growth in policy count in Professional & Management Liability. These results validate our investment in more than 70 additional Specialty underwriters since mid-2009. Specialty's first quarter combined ratio was 94.9% in 2011 as compared to 92.5% in the first quarter of 2010. Favorable prior year development reduced these ratios by 3 points and 4.2 points, respectively. The impact of catastrophes was minimal in both periods. Before development and catastrophes, Specialty's first quarter combined ratio was 97.6% in 2011 compared with 96.4% in 2010. Specialty's x cat accident year loss ratio was 66.9% in the first quarter of 2011, an increase of 1.5 points over first quarter of 2010 but relatively unchanged from full year 2010.

Turning to CNA Commercial. First quarter net written premiums were flat in 2011, a welcome improvement from last year's premium trend even as we continue to focus on improved pricing and risk selection. Renewal rates in Commercial increased 2% in the first quarter, our sixth consecutive quarter of positive rate increase. Renewal retention was 79%, a one point improvement from the prior year's first quarter. As for Commercial's flow of business, first quarter submissions were up 6% and the hit ratio was down one point to 24%. The new-to-lost business ratio was 1.1:1. The return premium audits that reduced our premium volume in prior quarters continues to moderate. In last year's first quarter, return premium audits represented 3 points of a 10% decrease in net written premiums. This year, return premium audits had a negative one point impact. The return premiums continue to be concentrated in our construction business.

CNA Commercial's first quarter combined ratio was 107.7% in 2011 as compared to 109.8% in 2010. These ratios included catastrophe losses of 6.6 points and 4.7 points, respectively. First quarter favorable prior year development was 1.2 points in 2011 and 1.5 points in 2010. Before catastrophes and development, commercial's first quarter combined ratio improved more than 4 points to 102.3%. Three points of the improvement are from the expense ratio, which included the onetime items I mentioned earlier. More significantly, we are pleased to note that Commercial's first quarter x cat accident year loss ratio improved more than one point to 69.9%, driven by our underwriting strategies. With that, I will turn it over to Craig. Craig?

D. Craig Mense
Chief Financial Officer and Executive Vice President

Thanks, Tom. Good morning, everyone. I would characterize the first quarter as a good one from an operating perspective. We produced steady earnings and demonstrated meaningful progress across a number of fronts. CNA's net operating income was $216 million and operating return on equity of 8.1%. Operating income attributable to common shareholders increased 8% as compared to the prior year period to $0.80 per common share. Operating EPS in the prior year period was reduced by the dividend paid on the senior preferred stock, which was fully redeemed over the course of the last year.

Our Property & Casualty business delivered improved operating earnings of $261 million, up 15% over last year's first quarter, fueled by investment income and helped by lower expenses, increased revenue and a stable accident year loss ratio.

First quarter net income of $223 million includes after-tax realized capital gains of $8 million. Impairment losses were modest and as in previous period, the impairment largely reflects intent to sell decisions that are part of our ongoing portfolio management.

We continue to build on the strength of our balance sheet and to improve our financial flexibility. We maintain a conservative capital structure. All key capital adequacy metrics show consistently improving trends, and our liquidity profile remains strong. As previously announced, we completed a $400 million debt offering in February and used the proceeds to prepay senior notes due in August of this year. Our current outstanding debt maturities are well distributed with no significant maturities until December of 2014.

Book value per common share increased 3% from year-end 2010 to $41.75 per share, reflecting first quarter earnings and an approximate $100 million increase in the market value of our investment portfolio. Our investment portfolio's pretax net unrealized gain stood at approximately $1.3 billion at quarter end. Our common shareholders' equity excluding other comprehensive income increased 2% from year-end 2010 to $10.8 billion or $40.20 per common share. Our statutory surplus also increased 3% to $10.1 billion from year-end 2010. We continue to maintain approximately $1 billion of dividend capacity in our primary insurance operating company.

We were pleased to have announced that we have signed a definitive agreement for CNA to acquire the public minority stake in CNA Surety for $26.55 per share. We continue to firmly believe that the transaction is in the best interest of all parties. The next step is the commencement of the tender offer, which we expect to commence as soon as practical. Subject to the satisfaction of the conditions to the tender offer, we currently anticipate that the transaction will be completed by the end of the second quarter. We expect the transaction will dilute our book value marginally but will be immediately accretive to earnings per share. We continue to sustain our disciplined reserving practices. Our Property & Casualty business segment benefited from $34 million or 2 points of pretax favorable reserve development. Our track record of favorable development now extends over 17 consecutive quarters. We remain confident in the overall adequacy of our reserves.

Net operating income during the first quarter included pretax net investment income of $620 million, a 5% increase from the prior year period driven by our limited partnership investments, which had another very strong quarter. Our LP investments produced first quarter pretax income of $114 million in 2011 as compared to $72 million in 2010. The current quarter rate of return was 4.9%.

Investment income other than from limited partnerships was down slightly quarter-over-quarter to $506 million pretax. The primary driver of the decline was a $1.1 billion decrease in our asset base, reflecting last year's loss portfolio transfer with National Indemnity, partially offset by a 4 basis point increase in average portfolio returns, reflecting reduction over the past year in our short-term holdings and a $2.2 billion shift from

tax-exempt to higher yielding taxable munis. Our investment portfolio remains well diversified, liquid and high quality, as well as aligned with our business objectives. Current allocation of assets is in line with our established longer-term targets. The average credit quality of the fixed maturity profile remained at A. We continue to segment our portfolio to facilitate our asset liability management discipline. The assets which support our long-duration life-like liabilities had an effective duration of 11.2 years at quarter end, up slightly from fourth quarter last year and in line with portfolio targets. The effective duration of the assets which support our traditional P&C liabilities was 4.6 years at quarter end, unchanged from the end of 2010's fourth quarter.

In the first quarter of 2011, we generated approximately $110 million of operating cash flow excluding trading activities. Additionally, we received approximately $1 billion of cash principal repayments through pay-downs, bond calls and maturities. Our financial flexibility is further enhanced by approximately $140 million of cash and short-term investments held at the holding company level. At quarter end, these investments represented onetime or annual net pretax interest expense. The full $250 million of our credit facility is also available to us.

Our Life & Group Non-Core segment produced a first quarter net operating loss of $18 million as compared with income of $1 million in the first quarter last year. This unfavorable comparison was primarily driven by the commutation of an assumed reinsurance agreement in the first quarter of 2010 that produced $15 million of after-tax favorable development. Results from our pension investment business were also down slightly while lower expenses partially offset these impacts.

Corporate segment produced a first quarter net operating loss of $27 million in 2011 as compared to a loss of $4 million in 2010. The Corporate segment profile was changed substantially by actions taken last year. Last year's asbestos and environmental loss portfolio transfer decreased our net reserve and associated asset and capital base. Consequently, investment income allocated to the segment was down significantly but was largely offset by reduced claim handling expenses. You will recall that we funded part of last year's senior preferred stock with redemption with long-term debt. That additional interest expense is also reflected in operating income while the more than offsetting benefit of the 10% preferred stock dividend elimination is only reflected in the earnings attributable to common shareholders' calculation.
With that, I will turn it back to Tom.

Thomas F. Motamed
Former Chairman and Chief Executive Officer

Thank you, Craig. All in all, we had a good first quarter. Our core Property & Casualty Operations performed well, investment results were strong and our capital position continued to improve. We grew significantly in Specialty. In Commercial, we improved our premium trend while continuing to execute our underwriting strategies and improve our loss ratio. Looking ahead, we are well positioned to continue our progress on improving our financial and operational results.
With that, we will be glad to take your questions.

Question and Answer

Operator

[Operator Instructions] We'll take our first question from Jay Cohen with Bank of America Merrill Lynch.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

I guess, first, a numbers question. The benefit to the expense ratio from the recovery of the premiums receivable write-down, can you quantify that for us?

D. Craig Mense
Chief Financial Officer and Executive Vice President

It's about -- Jay, it's about $20 million. So close to 1.5 in P&C on the expense ratio. It's all concentrated in Commercial, so that's 3 in Commercial.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Got it. Second question, again, more numbers question. The premium in the Commercial segment, our recollection is you had sold an Argentinean business, and I'm wondering if that's still, in this quarter, distorted the comparison, or is that over at this point?

D. Craig Mense
Chief Financial Officer and Executive Vice President

That's still in there. Last year would've been something close to $25 million of premium in the first quarter of '10.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

So x that, you would've seen a little bit of growth then, it sounds like it?

D. Craig Mense
Chief Financial Officer and Executive Vice President

Yes.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Right. Right. And I guess last question for now, the favorable reserve development in the quarter, which continued, but it was quite a bit smaller as far as the scale of that reserve related to what we've been seeing. And I know this number can jump around all over the place, but this was the lowest number in, really, sometime. Should we read anything into that? Have you seen any change in the claims trends that would suggest that this favorable development will eventually go away given that it was more –- a bit more modest this quarter?

D. Craig Mense
Chief Financial Officer and Executive Vice President

Maybe I can start. I don't know if Tom wants to add anything to this, but Jay, I'd say that if you looked at the amount of favorable development this year's first quarter, it's pretty consistent with what it was in the first quarter of last year, both in dollars and in point terms. And just remember that -- what our behavior has been. We look at -- we don't look at all the reserves every quarter. This quarter we looked at something slightly less than 25% of the reserves. And the decisions we’ve made were based on the estimate changes on reserves we looked at this quarter, so when we're confident in the numbers, we have to release it. I don't think I'd take it any further than that.

Thomas F. Motamed
Former Chairman and Chief Executive Officer

Yes, I think as Craig said, Jay, last year's first quarter was 2.7 points of favorable development. This year, it's 2 points. That's pretty close. It's lumpy quarter-to-quarter depending what we review. So we don't think it's remarkable.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

I do see now a pattern where the first quarter has tended to be smaller as far as the reserve change versus the other 3, so that's helpful.

Thomas F. Motamed
Former Chairman and Chief Executive Officer

Yes, you're correct.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

What's that?

Thomas F. Motamed
Former Chairman and Chief Executive Officer

You are correct.

Operator

We'll take our next question from Amit Kumar with MacQuarie.

Amit Kumar
Macquarie Research

Maybe just starting with the catastrophe losses. First of all, can you expand on what these losses were in Q1 and maybe also touch upon the recent Q2 losses, and how that could impact your results.

Thomas F. Motamed
Former Chairman and Chief Executive Officer

Okay, first of all, in the first quarter, it's $55 million, $29 million relate to the winter storms in the U.S., $25 million to Japan earthquake, tsunami, and if you combine Australia and New Zealand, about $1 million. As far as what's gone on in the U.S., claims are still coming in, but it's not material relative to dollars at this point in time.

Amit Kumar
Macquarie Research

Okay, that's helpful. And the Japanese loss, can you give some more color? Where exactly did that come from?

Thomas F. Motamed
Former Chairman and Chief Executive Officer

Well, if you look at property, we write accounts that have exposure around the globe, and that is typically called shared and layered business. So along with other insurers, we take, in most cases, a very small piece of the pie. So I would describe it as small losses, but there are a bunch them. But as I said it's $25 million. It's less than the U.S. winter storms.

Amit Kumar
Macquarie Research

Got it. That's actually quite helpful. Moving on, and this is a topic which you have touched upon previously, now that you're closer to closing this SUR acquisition, maybe we can revisit the discussion on capital management and refresh us on what your thoughts are for a special dividend since we cannot buy back stock.

D. Craig Mense
Chief Financial Officer and Executive Vice President

Yes, Amit, this is Craig. So we make it a practice of not commenting on future capital actions.

Amit Kumar
Macquarie Research

But maybe you can just share how do you think about capital? Do you plan to continue to grow your top line? Or where are we headed just based on the leverage?

D. Craig Mense
Chief Financial Officer and Executive Vice President

Well, we are -- we have -- we are very happy with the capital level, so we certainly have more than enough capital to support the growth in the businesses. In the businesses we see, we have more than enough capital to deal with unforeseen circumstances, and then we certainly have another level of capital that we could decide something else to do with, but really, nothing to talk about at this point.

Amit Kumar
Macquarie Research

Okay. Just one other question and then I'll come back. On the Life & Non-Core, the $44 million, $47 million loss, that seemed to be a bit higher than the Q4 number. And I'm just wondering, is that sort of a good run rate going forward, or were there any other one timers in Q1 numbers?

D. Craig Mense
Chief Financial Officer and Executive Vice President

Well, let me break it down between the 2 segments. So Life & Group loss was $18 million. That's pretty consistent with the $15 million loss we had in Q4. And the Corporate loss this quarter was $27 million, which is pretty consistent with, I think the Corporate loss in the fourth quarter was $22 million. So this year in the first quarter, you kind of get the full amount of the interest expense coming through in Corporate. But I think both of those are relatively consistent with what you should expect and pretty consistent with what we've produced over the last year and in the Corporate, since we kind of redid the Corporate segment.

Operator

[Operator Instructions] We'll take our next question from Bob Glasspiegel with Langen and McAlenney.

Robert Ray Glasspiegel
Langen McAlenney

I was wondering if we could stay on CNA Surety. Now that we got a definitive agreement, I would love to have any commentary about motivations for doing it, and in general, what's going on in pricing in that business relative to the rest of your Specialty business. Are the rates and retention rates similar?

Thomas F. Motamed
Former Chairman and Chief Executive Officer

Well, I think, Bob, what we said a while ago was we like the Surety business. We understand the Surety business, and we thought it was a logical next step for us at CNA Financial to go after the remaining outstanding shares. So we think it's a good business, that's why we are buying the rest of the shares.

Robert Ray Glasspiegel
Langen McAlenney

So near term, what's going on in the pricing and persistency trends, retention trends in that business compared to the rest of your Specialty book?

Thomas F. Motamed
Former Chairman and Chief Executive Officer

Well, I think they reported on Friday, so that would be the public information. When we own it, we'll tell you more.

Robert Ray Glasspiegel
Langen McAlenney

Yes. You break out the stat surplus for your Life and PC; is the GAAP equity sort of associated with those businesses comparable?

Thomas F. Motamed
Former Chairman and Chief Executive Officer

We have not broken out how we've allocated GAAP equity, Bob.

Robert Ray Glasspiegel
Langen McAlenney

Okay. What do you think the trend is for your surplus levels in the Life company. I mean, it basically hasn't been going down over time. I mean, is this sort of $0.5 billion of stat surplus in that business for a bit, or is there a sort of visibility of 5 years from now, we could be a lot lower?

D. Craig Mense
Chief Financial Officer and Executive Vice President

No, I think what you see, it's just a little over $500 million in it now, it's like $509 million if I remember correctly, which was in the supplement. And we do produce a small amount of consistent earnings in that business, so asking some actions on our part to take it off, I expect it to kind of grow with the earnings, and the earnings of that have been pretty consistent over a few years, so I mean, it's very modest change.

Robert Ray Glasspiegel
Langen McAlenney

When you say your reported earnings, you’re talking about statutory as opposed to GAAP?

D. Craig Mense
Chief Financial Officer and Executive Vice President

Statutory earnings in the Life company, yes.

Robert Ray Glasspiegel
Langen McAlenney

Because you reported GAAP loss pretty consistently in that, right?

D. Craig Mense
Chief Financial Officer and Executive Vice President

Right. But recall that the Life Group segment includes, right, it's payout annuities, benefits settlement options, the pension deposit business, those are all in the Life legal entity. In the long-term care business, which we also report in the Life Group segment, that's actually in the Continental Casualty Company legal entity, and it's a different legal entity. So legal entities in the segment aren't 100% aligned.

Robert Ray Glasspiegel

Langen McAlenney

Okay. So the stat picture's better than the GAAP picture for the Life company now and prospectively.

D. Craig Mense
Chief Financial Officer and Executive Vice President

When you separate what businesses are in there, correct.

Operator

And we will take a follow-up question from Amit Kumar with MacQuarie.

Amit Kumar
Macquarie Research

Just quickly going back, sort of just a broader discussion on reinsurance rates, can you refresh us when does your reinsurance treaty renew and remind us what the limits are?

Thomas F. Motamed
Former Chairman and Chief Executive Officer

We renewed -- the cat treaty was renewed in January, Amit.

Amit Kumar
Macquarie Research

And what are the limits on that?

Thomas F. Motamed
Former Chairman and Chief Executive Officer

We have like 600 -- the retention is 300, and we bought 6x3.

Amit Kumar
Macquarie Research

Got it. Okay. That's helpful. And the only other question I have is, obviously, there has been this broader discussion on the economic recovery, and you alluded to it briefly. Maybe just refresh us. I mean, obviously, you've seen these market conditions for a long time. What are your views on a market turn going forward? And do you think that the increase in reinsurance pricing would sort of filter down to the primary level and could lead to a market turnaround?

Thomas F. Motamed
Former Chairman and Chief Executive Officer

I think our belief is that what's going to happen on property cat reinsurance pricing will affect property cat business. We do not see it as being a harbinger of a broad market turn. So I think you have to put that kind of on the side. What we are very encouraged about is that if you look at exposures, exposure continues to improve in Commercial, and in fact, that is slightly positive, so that's one of the best things we've seen in quite a few quarters, even probably a few years in Commercial. If you look at Specialty, we are getting about one point in exposure growth, so that's obviously very positive. So I'd say on exposure, which is connected to the economy at least the way we insurance geeks look at it, we're feeling that it is stabilized and hopefully moving in a positive direction. If you look at rates, we got 2 points of rate in Commercial. That's been -- I guess we've had about 6 quarters of positive rate. Again, if you go back probably over back to 2006, that's the highest rate that we've seen in that time period. So rates in Commercial look good. On the Specialty side, rates are flat, and that's kind of an improvement as well. So when you look at rate and exposure, which is really your pricing dynamics, we're feeling pretty good with where the market is and where we are, and I think you've heard comments similar to that. So I would say this is the glass is half full. Maybe a year ago we were saying it was a half-empty glass. So I think we're seeing some improvement, but does that mean that there'll be a broad turn in rate increases? I can't predict that, and I wouldn't predict it.

Amit Kumar
Macquarie Research

That's actually quite helpful. And then just related to that, and this is sort of the final question, do you think that the competition sort of agrees with where you are? Or are there still some companies which are being aggressive? And I guess related to that, if the economy improves, are you sort of seeing a commensurate increase or change in the loss cost inflation?

Thomas F. Motamed
Former Chairman and Chief Executive Officer

I think the first thing is that the market appears to be acting rationally. There is always evidence of a rogue trader, but we're seeing less of those out there today than we would have seen 6 or 9 months ago. So I think the market is a more rational market. It's still competitive. It's always competitive, but we don't see real craziness out there like we may have seen a while ago. I think people are falling into a comfort zone. They like their book of business. They're trying to retain their book. They're pushing rate a little bit. Exposure is helping us all. So I think the market is fairly stable, to use a term.

Amit Kumar
Macquarie Research

And then on the loss cost inflation?

Thomas F. Motamed
Former Chairman and Chief Executive Officer

Well, we always look at inflationary trends and quite honestly the one that concerns us most because we rank workers comp and general liability is medical inflation, and our actuaries have adjusted that a little bit upwards. And overall, we are anticipating there will be some inflation out there, probably good for us on the investment side. On the claims side, you don't like to see claims inflation, but for us, our new arising activity is going down in claims, and we think that's very positive. So with less frequency, hopefully it will have less of an impact should it go up.

Operator

[Operator Instructions] We'll take a follow-up question from Jay Cohen with Bank of America Merrill Lynch.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

If you could just clarify something. I think you said there was dividend capacity of $1 billion from the insurance subs up to the holding company. Has -- that hasn't been paid then, yet?

D. Craig Mense
Chief Financial Officer and Executive Vice President

No.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

So no dividend in the first quarter?

D. Craig Mense
Chief Financial Officer and Executive Vice President

No dividend in the first quarter.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Is there a -- seasonally, is there a typical time where you do pay a dividend?

D. Craig Mense
Chief Financial Officer and Executive Vice President

Really, only when we need the cash. So recall that we still have a $500 million surplus note that the holding company owns from the operating sub. So if we were going to go look for cash to fund debt payments, then the common dividend likely will come first from repayment of the surplus note or a portion of it because that will have less of an impact on dividend capacity. So more than likely, sometimes it's in the coming quarter, perhaps a little bit of state [ph] from the surplus note and usually then sometime in the fourth quarter of the year. As a pattern we've -- actually, there's no real pattern to it.

Operator

We'll take our next question from Ron Bobman with Capital Returns.

Ron Bobman
Capital Returns

I have a question, I guess, for Tom. When you see the market improving in the -- you mentioned exposure is increasing, reflecting, I guess, largely the economy improving. And then maybe related to that -- or unrelated to that, you see some improvement, maybe it's just stabilization in rate, but you see some improvement in rate. Do you sort of instruct the underwriters any differently, or they just basically keep doing the same thing that they were doing 3, 6, 9, 12 months ago?

Thomas F. Motamed
Former Chairman and Chief Executive Officer

We wouldn't tell them to do what they did 12 months ago because we kind of push them every quarter to get more rate and write quality new business. So it's not a static plan. It's a dynamic plan. So depending on what the opportunity is in the marketplace, by line of business, by geography, we will push them to either write more new business or just push rate on the renewal and not write new business. So it changes. And that's one thing by having a pretty robust field operation, we're constantly in conversation with them as to where they see the opportunity or where they don't. So that's kind of always a moving target. But right now we're instructing our underwriters to make sure they're getting the exposure numbers, make sure we're getting that and also to be pushing rate, where it's appropriate to push rate, by line of business, by account, by geography.

Ron Bobman
Capital Returns

So is it more emboldened -- emboldening them to that more, it sounds like.

Thomas F. Motamed
Former Chairman and Chief Executive Officer

Yes.

Operator

[Operator Instructions] We'll take our next question from Peter's Sues [ph] with Surveyor Capital.

Unknown Analyst

I was just wondering if you could provide little bit more color on the improvement potential in the accident year x cat combined ratio on Commercial because you're still re-underwriting the book, but now I guess you're also getting 2% rate increases. So I'm wondering if the re-underwriting could actually improve the accident year ratio from here?

Thomas F. Motamed
Former Chairman and Chief Executive Officer

Well, that's our desire. We're focused on improving our accident year results in Commercial and every line of business within Commercial. When you re-underwrite a book, you do a few things. Number one is you take your renewable book, you decide what you want to keep, what you want to get rid of and then when you decide what you keep, you decide what you got to get in pricing, that's great. So that's kind of the first step. But the other thing is when you write new business, you want to be writing new business at adequate rates and also in the industries that you think can provide better accident year and calendar year results over time. So it's really a mix-of-business issue as well as industry issue as well as pricing issue as well as what we call underwriting actions relative to terms and conditions, covers, grants, et cetera. So there are a lot of moving pieces, and all of those are in process, and they certainly have not ended.

Unknown Analyst

And what inning would you say we're in with the underwriting -- re-underwriting?

Thomas F. Motamed
Former Chairman and Chief Executive Officer

What's that? I didn't get your question.

Ron Bobman
Capital Returns

What inning would you say that we're in with respect to the re-underwriting of the book?

Thomas F. Motamed
Former Chairman and Chief Executive Officer

Well, you're always underwriting the book. You never stop underwriting the book. But I think we're a good ways into the process, but you don't get your achieved objective on every account the first time around. So it takes a while to get the book where you want it, but we're clearly gaining on it, as evidenced by the improvement in accident year loss ratio, and the ability to get rates as well as exposure. So we think it's moving along, but I wouldn't give you a percentage.

Operator

Thank you. And that concludes the question-and-answer session today. I'll turn the conference back over to our speakers for any additional or closing remarks.

Thomas F. Motamed
Former Chairman and Chief Executive Officer

Thank you very much. See you next quarter.

Operator
Thank you. Ladies and gentlemen, this does conclude today's presentation. We appreciate your participation. You may now disconnect.