The Hanover Insurance Group, Inc.
NYSE:THG
FQ4 2013 Earnings Call Transcripts

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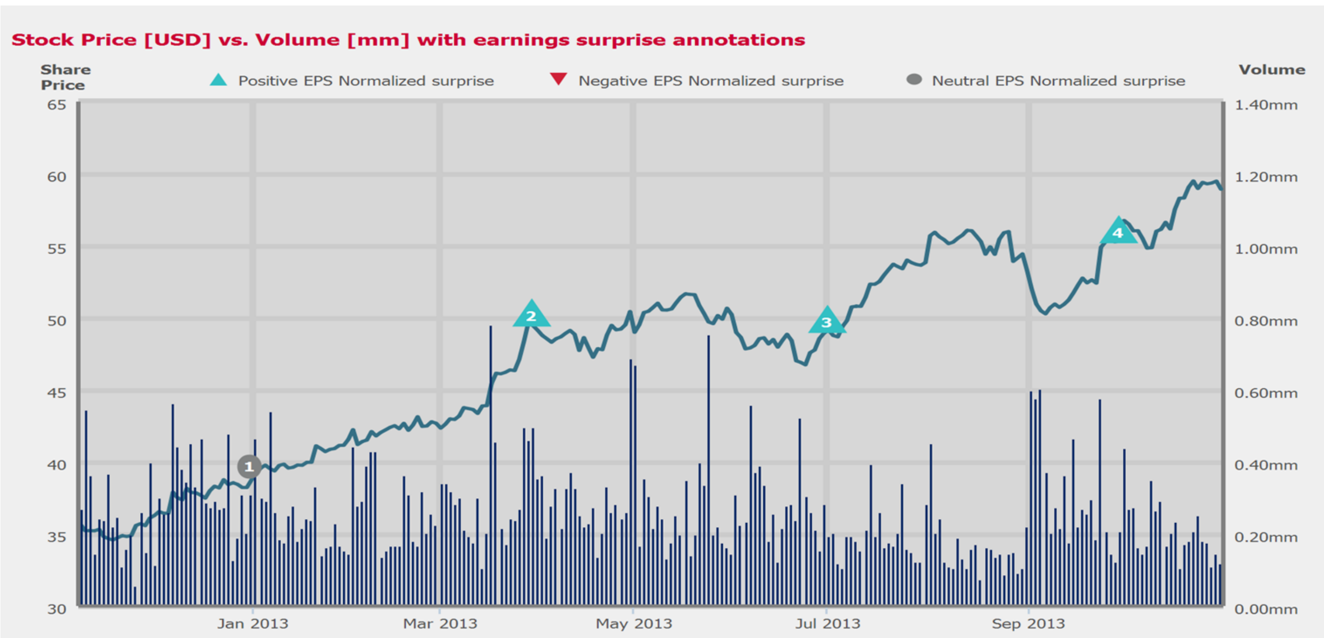
S&P Global Market Intelligence Estimates

	-FQ4 2013-			-FQ1 2014-	-FY 2013-	
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	ACTUAL
EPS Normalized	1.08	1.33	▲23.15	1.11	4.82	5.06
Revenue (mm)	1079.23	1051.50	▲(2.57 %)	1112.70	4580.30	4552.70

Currency: USD
Consensus as of Feb-06-2014 2:05 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ4 2012	(1.80)	(1.65)	NM
FQ1 2013	1.05	1.32	▲25.71 %
FQ2 2013	0.71	1.05	▲47.89 %
FQ3 2013	1.04	1.36	▲30.77 %

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Call Participants

EXECUTIVES

David B. Greenfield
Former Chief Financial Officer, Principal Accounting Officer and Executive Vice President

Frederick Henry Eppinger
Former President & CEO

Mark R. Desrochers
Former Senior Vice President and President of Personal Lines

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Robert Arthur Stuchbery
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Daniel D. Farrell
Sterne Agee & Leach Inc., Research Division

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Vincent M. DeAugustino
Keefe, Bruyette, & Woods, Inc., Research Division

Presentation

Operator

Good day, ladies and gentlemen, and welcome to The Hanover Insurance Group 2013 Fourth Quarter Earnings Conference Call. My name is Cilia, and I will be your operator for today. [Operator Instructions] As a reminder this conference is being recorded for replay purposes.

I would now like to turn the conference over to your host for today, Oksana Lukasheva, AVP, Investor Relations. Please proceed.

Oksana Lukasheva
Vice President, Investor Relations

Thank you, Cilia. Good morning and thank you for joining us for our fourth quarter conference call. We will begin today's call with prepared remarks from Fred Eppinger, our President and Chief Executive Officer; and David Greenfield, our Executive Vice President and CFO.

Available to answer your questions after our prepared remarks are Jack Roche, President of Business Insurance; Andrew Robinson, President of Specialty Lines; Mark Desrochers, President of Personal Lines; and Bob Stuchbery, President of International Operations and Chief Executive Officer of Chaucer.

Before I turn the call over to Fred, let me note that our earnings press release, financial supplements and a complete slide presentation for today's call are available in the Investor 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, including our earnings guidance for 2014. There are certain factors that could cause actual results to differ materially from those anticipated by this press release, slide presentation and conference call. We caution you with respect to reliance on forward-looking statements and in this respect refer you to the forward-looking statement section in our press release, Slide 2 of the presentation deck and our filings with the SEC.

Today's discussion will also reference certain non-GAAP financial measures, such as operating income, operating income per share, operating results excluding the impact of catastrophes and development, accident share loss and combined ratios 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 or the financial supplements which are posted on our website, as I mentioned earlier.

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

Frederick Henry Eppinger
Former President & CEO

Good morning, everyone, and thank you for joining our fourth quarter earnings call. I am very pleased with our strong performance in the quarter and for the year. Our net income per share of $5.59 was the strongest bottom line results we have delivered since becoming a public company in 1995. Operating income per share was $5.06 in 2013 yielding an operating ROE of 10%. Results for the fourth quarter were also solid with an operating income of $1.33 and an ROE of 10%. The underline earnings momentum in our organization is evident. Our ex-cat earnings before taxes were $533 million, which is 20% higher than 2012 and the highest results we produced so far. Equally as important, we delivered our expectation of a 94% ex-cat combined ratio for 2013, an improvement of more than 2 points over 2012.

Our financial progress for the year was strong but we are equally pleased with the progress we made on our strategic priorities that position us for further margin expansion in 2014. We entered 2014 with momentum in the market with our partners and solid pricing trends in a strong well diversified and improving portfolio.

I will now turn the call over to David to review our financials but I will come back to discuss our outlook and thoughts on the current market. David?

David B. Greenfield
Former Chief Financial Officer, Principal Accounting Officer and Executive Vice President

Thank you, Fred, and good morning, everyone. The fourth quarter results were excellent and capital record year for us. Net income in the fourth quarter was $70 million or $1.57 for diluted share compared to a net loss of $55 million or $1.24 per diluted share in the prior year quarter. Operating income was $60 million in the quarter or $1.33 per diluted share, compared to an operating loss of $73 million or $1.65 per diluted share in the fourth quarter of last year. The fourth quarter of 2012 was marked by losses from Sandy, which totaled a $129 million after taxes. Because Sandy losses and certain other underwriting items impacted the fourth quarter of 2012 results, direct quarter-over-quarter comparisons are less meaningful, but I reason our current quarter and full year results in context by comparison to our full year 2012 performance and will reference fourth quarter of 2012 where appropriate.

Our 2013 combined ratio of 96.7% compared to 104.4% in 2012. The lower level of catastrophe losses in 2013 contributed more than 5 points to the improved underwriting results. The remaining 2 points of improvement are attributable to an increase in the ex-cat underwriting margin in our domestic business while Chaucer continued to deliver very strong results in 2013 in line with the prior year. In our domestic business the accident year loss ratio excluding catastrophe losses improved from 64% to 62%.

We also reported an improvement in unfavorable prior year loss reserve development, which was 0.5 point for the year compared to 1.7 points in 2012. These items drove a meaningful increase in our ex-cat underwriting loss margin of over $100 million compared to 2012 with both personal and commercial lines contributing to this improvement. In commercial lines, virtually all businesses noted improved accident year loss trends, which resulted in an overall loss ratio of 60% compared to 62% in 2012. Strong workers compensation and commercial multi-parallel results this year continued to benefit from our focus on smaller accounts, mix management initiatives and rate increases. In auto, we continue to take a more cautious view of loss trends, given our recent experience in the developing industry trends. Of note, our commercial auto loss ratio declined for the second consecutive quarter, indicating a moderation of recent trends.

Given significant pricing increases in this line, we believe we will see continued improvement in 2014. Our accident year loss ratio and other commercial lines which includes surety and other domestic specialty business improved by approximately 2 points in 2013, driven by our previous and ongoing mix management and pricing actions. Additionally, as these businesses become more mature and gain organic growth momentum, we expect to see a compounding effect of better mix and pricing levels flowing through our margins in 2014.

In personal lines, we generated a 63% underlying loss ratio for the year compared to nearly 66% in 2012. We continue to earn-in strong pricing increases while also taking actions to improve the overall quality mix of the business. The homeowners' ex-cat margin improved by approximately 5 points this year compared to the full year 2012 as a result of the active rate and mix management strategy. Only about a point or so of this margin improvement is attributable to more favorable non-catastrophe weather in the current year.

Our personal auto rate and profitability management strategy yielded a 3 point lower accident year loss ratio for the quarter and 1 point lower for the year. We continue to be diligent in how we approach rate and risk selection. Given our prior experience and the industry trends in particular in BI severity, we continue to be cautious in our evaluation of this line. Moving onto discussion of expenses, our current quarter expenses for both personal lines and commercial lines included the higher level of performance based compensation and commissions reflecting strong full year results.

The full year personal lines ratio would have been flat excluding this increase in employee and agency payouts. While commercial lines would have yielded an improvement of 1 point driven by growth leverage and operating model efficiencies. All-in the 2013 expense ratio was up 0.5 point in personal lines and about flat in commercial lines compared to 2012. We maintain a keen focus on expenses and believe we can further expense, gain further expense leverage in our domestic businesses in particular in commercial lines. This however will be partially offset by continued shift in business mix to commercial lines which carries a higher expense load than personal lines.

Chaucer continued its 2013 trend of positive results with the combined ratio of 90% for the quarter and for the year. The accident year combined ratio of 95% in the current quarter was higher in the prior year quarter due to lower than usual attritional and large losses last year. The results this quarter are in line with our longer term expectation for this business. Overall, 2013 was another strong year for Chaucer that included a lower level of catastrophe activity and increased favorable prior year reserve development partially driven by foreign exchange movements.

However we entered 2014 expecting results will return to more normal levels with an overall combined ratio of around 95%. Chaucer's expense ratio is 38% for the year in line with our expectations for this business. Moving on to the top line, net written premium growth of about 2% in the quarter reflected premium growth in commercial lines of 8%, 1% growth in Chaucer and a 6% decline in personal lines as we continue to execute on our strategy of exposure management and profitability improvement actions.

Chaucer growth this quarter was somewhat lower than expected due to further premium reductions in the energy line from lower activities in the sector as well as lower premium writings in other lines. Overall, each of our business segments continue to perform well this quarter and we are pleased with the improving underwriting trends. We will continue to maintain our focus on what we must do to sustain the combined ratio improvement momentum and drive the organization to achieve our target returns.

Moving onto investment results, at December 31, 2013 cash and invested assets were $8.1 billion with fixed income securities and cash representing 92% of the total. Roughly 94% of our fixed income securities are investment grade and the average duration of the portfolio is 4.1 years. Our investment portfolio remains high quality and well laddered. Net investment income this quarter was $68.1 million compared to $70.1 million in the prior year quarter. Our full year net investment income was $269 million, representing a decline of 3% over 2012.

The negative impact of lower new money yields was partially offset by a higher level of assets invested in fixed income from positive operating cash flows and redeployment of operating cash into the portfolio. The earned yield on our fixed maturity portfolio was 3.86% in the quarter and 3.95% for the year compared to 4.1% in the prior year quarter and 4.6% for 2012. While we continue to counter balance the pressure from lower interest rates by opportunistically investing in higher yielding classes, we estimate net investment income will decline by approximately 2% in 2014 before it returns to growth in 2015.

Before I update you on our balance sheet and capital, I'd like to provide some information on our January reinsurance renewals. The overall market conditions provided us the opportunity during our one-one renewal cycle to strengthen our program of reduced volatility in a cost efficient manner. For our cash-free program we extended the program to an 18 month period as well as expanded our northeast only layers to cover countrywide risks, sinking up all of our renewal base and geographic coverage. Additionally, for certain liability and pro-risk treaties, we were able to adjust terms to better manage volatility without significantly impacting the overall pricing. Chaucer being both the buyer and seller of reinsurance had a modest overall net benefit from this year's renewals.

I'll finish up with a few comments on the strength of our balance sheet and capital position. We ended the quarter with a total capital position of $3.5 billion. At December 31st, book value per share was $59.43, up 2% in the quarter and 1% since December 2012. Excluding net unrealized investment gains, the book value grew 8% in 2013, reflecting strong earnings throughout the year as well as the impact of capital management actions. For the full year, we repurchased approximately 1.6 million common shares for $78 million or an average of $48.26 per share, which represents approximately 4% of our shares outstanding at year-end 2012.

We did not repurchase any stock in the fourth quarter. However, since year-end we repurchased $5 million given recent market fluctuations. We have $132 million remaining in our stock repurchase program. We will continue to actively and opportunistically manage our capital structure. During the quarter, we also realized an opportunity to repurchase $34 million of senior debt, which carried a coupon of 7.5%. Our total outstanding debt was $904 million at year end, translating to a 26% debt to capital ratio. We will continue to optimize our capital structure and its efficiency as opportunities arise.

Overall, we feel our capital is best deployed in support of our growing business needs and initiatives as we capitalize on our opportunities and the dynamic marketplace we are operating in right now. We are entering 2014 with the strongest balance sheet in several years. Our reserving position is solidified, providing a stronger foundation for business growth opportunities.

And with that I'll turn the call back to Fred.

Frederick Henry Eppinger
Former President & CEO

Thanks, David. As we reflect on our progress, we believe we have taken a strong step forward as a company in 2013. At fourth quarter call last year we emphasized that taken together our 2013 priorities were about leveraging a more distinctive and balanced portfolio to achieve higher and more consistent earnings and returns. Today as we look back on the year, we are pleased with our progress and believe we have built a solid foundation for 2014 and beyond.

Every major business in our franchise improved broadly. We achieved expanded margins in each quarter throughout the year in virtually all segments, and we substantially improved our portfolio mix. Although we made significant financial progress in 2013, there is no doubt that the further margin expansion is required and available to us. And we believe the actions we took in 2013 and are continuing to take into 2014 will help us capture it.

As a reminder, we had 3 major priorities for this year; first, continue to improve our portfolio mix and property concentration; second, increasing pricing in our domestic businesses; and finally to continue to realize the benefits of our Chaucer franchise. I would like to briefly update you on the progress with these goals and discuss why are we confident they will continue to improve into 2014. As far as our portfolio work is concerned, we continue to pursue targeted actions to reduce property concentration, in particular, in the southeast, northeast and Midwest regions.

To respond to the more volatile weather patterns experienced recently and to better balance our portfolio. The magnitude of the work we have done over the past 2 years has been substantial. In aggregate our various exposure management initiatives reduced domestic premiums by about $40 million or 5% in the fourth quarter and approximately $200 million or 6% for the full year 2013. These premium reductions come on top of approximately $120 million of policies we exited for strategic reasons in 2012. As we look forward into 2014, we have some remaining work to do. Roughly 80 million primarily focused on personalized property in the first 6 months of the year. As we complete this work, our remaining reductions will be quite modest.

In addition to the exposure management initiatives, we also continue to improve the quality and earnings potential of the portfolio we built over the last several years. We continue to shift our mix to higher margin segments and businesses and continue to target surgical underwriting actions reducing some of the lower margin business. We believe the benefits of all our ex-management issues are only starting to earn in. And we should see a positive impact on profitability and earnings resiliency in 2014 and further into the future. We believe that these actions -- when these actions run their course our momentum in the marketplace driven by our breadth and distinctiveness of products, our local delivery in alignment with agents will translate into above industry growth rates. Our franchise value with our partner agencies is excellent as we enter 2014 and will create a significant number of opportunities.

We see confirmation of our underline growth momentum in numbers, excluding the target underwriting actions we grew our domestic business by 7% in the fourth quarter and the full year. Additionally, retentions remain strong at 80% personal lines and 85% in core commercial when adjusted for our mix management initiatives. Finally, new business premium is showing positive momentum, growing at an accelerated pace for the third consecutive quarter and particularly in core commercial. In personal lines as expected growth was impacted more significantly by our exposure management actions in 2013, resulting in a premium decline of 3% for the year. However, we achieved the portfolio improvement we set out in terms of geographic exposure, quality of mix and a continued shift in the account business.

Given our stable voluntary retention metrics and new business dynamics we are confident that this line will return to growth starting in the middle of 2014. As you know, we rolled out the new value added account focus product Platinum in 8 states, our agents are very enthusiastic about this new value added offering which helps us drive account business growth.

The second area we have been focused on is improving pricing across our domestic business. We continually focused on the rate dynamics of our business. Overall the impact of pricing remain positive in the quarter across all domestic businesses. In core commercial lines, pricing increases were in line with recent periods at 9% while retention ticked up favorably by 1.5 points to 84%. The rate increases continued to be broad based but led by middle market commercial auto and worker's comp. We believe our relatively small size policy book and our focus on selling value has good momentum and we have not seen any significant rate deceleration or any meaningful shift in market trends.

In our specialty businesses, pricing remains strong in high single-digits in the quarter and we're confident we will continue to see meaningful rate going forward. In personal lines we are beginning to clearly see the cumulative benefit of past pricing actions on loss ratio trends. Our rates have moderated to 8% from a high mark of 10% last quarter and in line with our expectations as we stated in our third quarter call.

Turning now to Chaucer, this year we delivered pre-tax operating income of $150 million in premium growth of 13%, which is primarily from the non-renewal of the Flagstone share. We have built a very strong franchise and continue to enhance the breadth of our specialty capabilities; specifically in 2013 we added some additional capabilities around our casualty team and our marine and property line. We feel good about the distinctiveness of our position at Lloyds [ph] and our broad base portfolio is enabling us to manage our response to a somewhat challenging market conditions very effectively.

We continue to focus our efforts on areas of the business where we have strong underwriting capabilities and known leadership positions, including specialty areas within marine where we are still seeing attractive opportunities and casualty which is again to benefit from the strong rate increases in the U.S. Overall we are pleased with Chaucer's strong performance and the opportunities we are capturing together. Given the current market environment, we expect more limited growth in 2014 and return more in line with historical levels.

In conclusion 2013 was a very successful year for our company as we made substantial progress on all our strategic priorities and delivered on our financial commitments. We recognize we still have work to do to deliver target returns. However the progress is obvious and ongoing. We put a great deal of effort into properly balancing our portfolio and believe that work is substantially behind us. Today, we have the products and the operating model to help our agent partners grow profitably and win. And we have the capital strength and infrastructure to support above average industry growth, more importantly we have the talent and the commitment of our people delivering to our agent partners and their customers thereby enabling us to grow shareholder value.

As a result, we're in the strongest position we have ever been in and are poised to deliver increasingly improved returns in 2014. Before we open the line for questions, I would like to provide some financial information relating to our 2014 outlook. Our operating earnings expectations for 2014 is in the range of $4.80 to $5.20 per share. As a basis of this outlook we anticipate written premium growth of the mid-single digits, a decrease in the net investment income of approximately 2% compared to 2013 and an overall combined ratio between 96% and 97%. This includes catastrophe losses of approximately 5% of earned premium.

Our preliminary estimate for January losses from 2 declared cat debts is approximately $30 million to 35 million. These losses reflect severe winter weather and unusually low temperatures over a wide geographic area. With 2 months still remaining in the quarter, it is likely our first quarter catastrophe loss ratio to be higher in recent years. However we see no reason to change our overall catastrophe loss assumption for the year at this time.

In closing, I would like to iterate how good we feel about our current strategic position and our prospects for 2014. We look forward to continuing to execute on our strategy to position ourselves as a profitable account competitor. Operator, can you please open the line for questions? Thanks you.

Question and Answer

Operator

[Operator Instructions] The question comes from the line of Vincent DeAugustino, KBW.

Vincent M. DeAugustino
Keefe, Bruyette, & Woods, Inc., Research Division

The conversation around some of the portfolio mix changes and the exposure management actions was really helpful and just I guess to kind of frame that both looking forward and looking kind of backwards. If I am looking at the 4Q ’13 year-over-year domestic personal and commercial lines core loss ratio improvement. I was hoping that you guys might be able to call out, how much of that improvement roughly would have come from some of these non-REIT oriented initiatives [indiscernible] you have gone through?

Frederick Henry Eppinger
Former President & CEO

Yes, I think it’s a little bit tricky to identify exactly how much is REIT versus non-REIT because one of the interesting things is that there was some good improvement from underwriting actions but a lot of the stuff that we are getting offered for concentration of volatility purposes actually has a drag for a couple of quarters because of the marginal contribution that you get from that are too expensive. So what I would tell you is that the mix improvement to me is something that’s going to linger and continue to help in ‘14 actually more than ’13 but it’s meaningful. And I would also say that the volatility aspects of that, while it’s hard to pinpoint to me as why you saw some improvement like in the second quarter this year from the tornadoes, et cetera. We are going to have less volatility in the book because of that as well. So I think it’s going to be meaningful but I think it’s more in the out kind of in the future than it was this year.

Vincent M. DeAugustino
Keefe, Bruyette, & Woods, Inc., Research Division

Okay. And then you has mentioned that as far as just seeing pricing resiliency, it's been kind of interesting this quarter because we have some insurers having a similar message and then you also have some insurers telling us that there is a deceleration. The rates were increasing competition. Do you have any thoughts on what kind of might be the defining characteristics that ensures your point?

Frederick Henry Eppinger
Former President & CEO

It’s a great question. I mean obviously if you look at some of the national accounts and the large accounts particularly in the property area and comp, my guess is you are seeing some moderation in price increases. What's happening in our book because of our small average policy size and how we play the game with accounts and personal lines et cetera, we haven’t seen any really dramatic shift yet. My guess is you will have pockets where you are going to see some change but we have not seen any kind of what I would say material change. Now the small accounts are a lot less and come down less, so I mean you don’t, we also don’t, you don’t get the spikes as much. But for us both the fourth quarter and January have performed pretty nicely as far as getting rate increases. But I fully expect that there will be pockets that we'll moderate through the year but we feel very good about our assumptions and being able to get, achieve rate this year.

Vincent M. DeAugustino
Keefe, Bruyette, & Woods, Inc., Research Division

Okay, good. And one for David, just last one and you had mentioned just some of the repurchase activity year-to-date and I am just kind of curious what 2014 and ’15 looking to be more on track, I am just curious with the kind of repurchases in this year and kind of just looking forward, if we should maybe start to think about Hanover returning to a more normal capital management environment here in ’14 and in 2015?

David B. Greenfield
Former Chief Financial Officer, Principal Accounting Officer and Executive Vice President

Well you'd have to define normal for me to be able to answer it that way, Vince. But I would tell you is we are very conscious of capital management as part of our strategy. I think I have been fairly clear over the course of last year. Our first effort is to put our capital to work in our growth opportunities which Fred talked to and we have been talking about. Where it makes sense for us and where pricing in the market for example is attractive, we will put more money towards share repurchase or other things like a debt repurchase. Just to maybe give a little more color, we didn’t do any repurchasing in the fourth quarter because the share price was at a pretty nice level and we felt that it was more valuable to put our capital to work in the growth opportunities we see. Obviously in January we have seen a little bit of disruption in the marketplace which created an opportunity for us. I would tell you in our planning, we have a modest amount of repurchases each year that we execute, which I usually refer to as maintenance level type repurchasing. And we're going to continue to do that throughout the year and if we have opportunities like we saw last year where we had a capital markets transaction that allowed us to free up some of our capital to put more towards share repurchase, we'll continue to do things like that as well but you should expect we will have modest amounts of share repurchase in line with kind of the last number of years that we have been executing the strategy.

Operator

Next question comes from the line of Matthew Carletti, JMP Securities.

Matthew John Carletti
JMP Securities LLC, Research Division

Vincent covered actually 2 of my questions, so I have 1 left and that was just, could you provide a little more color on the January losses you mentioned just kind of which states it was more southern and northern and whether it was a bigger impact on auto or home?

Frederick Henry Eppinger
Former President & CEO

Yes, it's actually a commercial loss, its broad based, so the weather it's cold and freezes. And it’s mostly commercial, frankly for us and what I would also say in January we didn’t see non cap weather act any was in spite it was really those events that created the losses. So the rest of the month is more normal except for those events the 2, and the second one was obviously bigger than the first event. And let me just mention quickly on the cat estimates for our company too because I think it’s important. In the last couple of years the first quarter has been lower. But given our company profile typically our first 3 quarters are pretty similar around our estimate and it’s only the fourth quarter that’s a little less on a cat basis. So we think about cats at this 5% level as being pretty stable in the first, second and third. So I know it's more than on a relative basis the last couple of years that were down but it’s to me having this kind of weather in the first quarter is not unusual at all particularly for people that have a mix like we do that is northeast and mid-western.

Operator

The next question comes from the line of Dan Farrell, Sterne Agee.

Daniel D. Farrell
Sterne Agee & Leach Inc., Research Division

Just another question around the cat, I think you said your sort of full year target or guidance for cat was 5 points but I think you also said that first quarter you thought could be higher. Does that imply that incrementally you think that maybe cat load, normalized cat load, could be coming down slightly given all of the exposure management stuff you’ve done or some of the improvements in --

Frederick Henry Eppinger
Former President & CEO

Yes, I mean obviously Dan we've done a lot on our mix over the last few years. We have balanced the commercial cutting to casualty is much different than it was 3 or 4 years ago. Our geographic spread is much better. In the same vein though the last 5 years the cat -- the [indiscernible] of weather has gone up in the world so recent domestically and so we feel very good about the 5% as the right number we think it's a thoughtful number we think we're conservative and appropriate but it's the right number given what we've seen activity over the last few years. And my only point on the first quarter is that the last 2 years have been very low. We've had kind of no winter and even last year what was weird about last year we didn't have really winter what we had is tornadoes in March. And what in my view is this is a little bit of a return obviously these are big events but this is a return to more normal kind of winter profile of storms albeit, it's just one month. So that's why I don't think it's -- the 5% to us for the year is right and there is no reason to adjust it at this point given what 1 month and to the year.

Daniel D. Farrell
Sterne Agee & Leach Inc., Research Division

Great, and then a question in the other commercial segment, your loss ratio over the last few quarters has trended on a core basis between 58, 59, you've also continued to have some adverse development there. I was curious is some of that being driven still by any surety? I was just kind of curious what the trends are there, maybe an update on that and just as for any leverage for improvement going forward there as well.

David B. Greenfield
Former Chief Financial Officer, Principal Accounting Officer and Executive Vice President

Sure. Dan its David, there is surety that the development you're seeing there is primarily the surety account and I think I've talked in the past it's sometimes allocating losses between current and prior accident years is more an art than a science. So as we're continuing to close down cases and claims, we'll typically pick up in some cases some prior year development as a result of that. But those numbers are steadily declining and our exposures at the end of 2013 are very-very low going forward. So we don't really anticipate much activity in the going forward periods there. Fairly nowhere near like we had in '12 and '13 performed pretty much in line with what we thought it was.

Frederick Henry Eppinger
Former President & CEO

Yes it's an interesting gel to your question, when I look at the '14 improvement we're planning for domestic it's broad based and so there is -- it's really you're going to see because the actions are pretty much across the businesses that we're going to improve in each of the business base nicely. So you will get some in that category as well for sure.

Operator

Question from the line of Vincent DeAugustino, KBW.

Vincent M. DeAugustino
Keefe, Bruyette, & Woods, Inc., Research Division

Just one quick one, I was curious if you guys happen to, to see any changes in personal auto frequency in the last quarter or 2 that might be noteworthy.

Mark R. Desrochers
Former Senior Vice President and President of Personal Lines

We haven't really seen anything from a frequency standpoint that's out of what we've been seeing over the last couple of years it's pretty flat.

Operator

Question from the line of Larry Greenberg, Janney Capital.

Lawrence David Greenberg
Janney Montgomery Scott LLC, Research Division

Just a few looking out to 2014. The expected normalization for Chaucer to a 95 combined, is that a combination of attritional caps and reserve development? Or how would you weigh those pieces in the normalization process? And then when you think about underlying margin improvement domestically, can you just compare personal versus commercial?

Robert Arthur Stuchbery
Former CEO & Executive Director

When you're looking at that [indiscernible], when you look at that normalization, it's really to reflect on market conditions that we're seeing and that's on top of a couple of good years where we've seen excellent results, so I wouldn't expect the makeup of that to necessarily change that much. It's more driven by underlying market conditions that we're seeing and trends particularly we've seeing around, one that we expect to continue into 2014.

Lawrence David Greenberg
Janney Montgomery Scott LLC, Research Division

Okay, so that would suggest to me more just attritional losses.

Robert Arthur Stuchbery
Former CEO & Executive Director

Yes, that's it. That's because we do have within our portfolio, there is an exposure to what we would call large losses and attritional, so we've got the larger [indiscernible] will go down on some of those specialty lines of business as opposed to just pure attritional, we break it down into 3 territories. So there is a bit of volatility also around the large losses. But you're right that the underlying trend would just be driven by market conditions in '14 versus '13.

Frederick Henry Eppinger
Former President & CEO

Larry, I'll just jump in on that too, because there's a lot of moving pieces in there and what Bob said is obviously correct, but I would also tell you cats have been lower than expected over the last few years and prior year development has been higher. Those 2 probably can offset for the most part but as you're looking at the components there's a lot of moving parts to get you to the 95.

David B. Greenfield
Former Chief Financial Officer, Principal Accounting Officer and Executive Vice President

And on domestically, you asked about personal versus commercial, again what we believe is that we'll see both improve, personal got a little bit ahead in the improvement because of the way it earned and quickly for them but I think they will both -- you're going to see significant improvement in all of the different lines this year. There really isn't any one that strikes out above the others this year.

Lawrence David Greenberg
Janney Montgomery Scott LLC, Research Division

So if you're thinking of getting -- you've been getting price 8%, 9%, so roughly to think about it, loss trend in both are maybe pretty close and your margin, your pricing above loss trend is relatively similar, is that fair?

Frederick Henry Eppinger
Former President & CEO

Yes. Some of the places like home in particular we were catching up to this non-weather phenomenon we talked about as a higher percent, so we had a spike in personal lines that we talked about moderating a little bit, so we spiked all the way up to 10 across the auto and home and that will moderate a little bit quicker because of that spike but our margins against those 2 factors will be pretty similar to business.

Lawrence David Greenberg
Janney Montgomery Scott LLC, Research Division

And then anything different on the tax rate for 2014?

David B. Greenfield
Former Chief Financial Officer, Principal Accounting Officer and Executive Vice President

No, it should remain relatively consistent going forward.

Operator

The next question is from the line of Sarah DeWitt, Barclays.

Sarah Elizabeth DeWitt
Barclays Bank PLC, Research Division

In your primary issue of guidance of 96 to 97 for 2014, does that include any reserve development?

Frederick Henry Eppinger
Former President & CEO

It includes a little bit of development, positive development in Chaucer in the 95 that we talked about as a much more moderate than where we've been over the last few years, but in terms of domestic. We don't estimate any development in our guidance there.

Sarah Elizabeth DeWitt
Barclays Bank PLC, Research Division

Okay, so I guess that would imply that excluding cats in prior year development to combine the underlying combined ratio to an improved to say 92-92.5 from 95.5 in 2013, what gives you confidence that you can improve it that significantly, I know you've taken exposure actions but they are pretty big improvement.

David B. Greenfield
Former Chief Financial Officer, Principal Accounting Officer and Executive Vice President

Yes, I think, I mean it's a combination of all the things we talked about, the exposure actions we're taking the pricing that we've been getting in the book, the underwriting that we're putting in place in the various lines of business and the waning of some of the issues we talked about in 2012, early part of 2013.

Frederick Henry Eppinger
Former President & CEO

And again for example we recognized the auto issue really early and have tacked it pretty aggressively, built up the balance sheet around it and a lot of that stuff is, the impact of that is as we do seem relatively dramatically. So there is a combination here.

Operator

Next question comes from the line of Robert Paun, Sidoti & Company.

Robert Paun
Sidoti & Company, LLC

I wanted to follow up on the personal lines business. Fred I believe you said that growth in the top line should start in the second half of this year. So can we expect to see premiums tail off in the first half similar to what we saw in 4Q about 5% to 6% decline?

Frederick Henry Eppinger
Former President & CEO

Let me comment and then Mark should add. We have -- what happened in the fourth quarter we have been fortune to working these [indiscernible] and getting rid of the concentration. Part of our focus has been on some model lines and legacy model line property. And we were able to -- we have an arrangement with a couple of companies where we are -- it's not a literally rights but it very much acts like that where we are transferring business and that accelerated at the tail end of this year and will continue into the first and a little bit less in the second quarter. The actions we're taking around that is about $80 million between personal line and commercial is a little bit in commercial too but they are mostly into the first half of the year. So you are going to see first quarter similar to the fourth quarter because those things -- those transactions are occurring and are efficiently moving forward, and then they come back after that market. Is there anything that we should…

Mark R. Desrochers
Former Senior Vice President and President of Personal Lines

No, I think that's about right. It will temper I think a little bit in the second quarter then will be in the first quarter and then we should turn the corner again the second half of the year.

Frederick Henry Eppinger
Former President & CEO

Yes, and we are very pleased about these transactions. As you know our legacy books are in regulatory environments where it's very hard to get out them, legacy business and we created some really nice win-win situations with some partners so that we can move this model line business. And our strategy around really going after the account business has really taken off now, and so most of our businesses with a full account and then it really is -- it makes it look terrific as we look forward for our business, so we're glad to get this behind us.

Robert Paun
Sidoti & Company, LLC

That was helpful. And just final question as far as the Chaucer business, you spoke about reducing premiums in the energy lines. On the other side of that where are you seeing opportunities to grow in that business? Are there any segments that are showing more favorable conditions?

David B. Greenfield
Former Chief Financial Officer, Principal Accounting Officer and Executive Vice President

If you recall, the opportunities that we are seeing around some of the areas that we've got within our marine portfolio, there is good opportunities there where we're a leader in certain of the classes around [indiscernible]. But across the board and energy is a classic example of where you had a good couple of years now, excellent results people who ride Gulf of Mexico windstorm exposure with a new energy portfolio had a couple of the 9 years. So I think it is very, very difficult to get rate and that's where we're seeing reductions. But few opportunities the opportunities where we have got specific lines of expertise, good quality under-writing teams here that can just work their way around that marketplace.

Frederick Henry Eppinger
Former President & CEO

On '11 we had a really solid '11 and what we had is a nice broad portfolio, so as we said we're very comfortable maintaining the profitability and the margin in that business we just think it's prudent to think about that as flat to low single-digit growth this year because what we need to do is make sure we maintain our position and maintain our margins and it's very good. We're demonstrating the strength of the franchise right now, so we feel good about the overall results. But you won't see a lot of growth out of that business this year.

Operator

The next question comes from the line of [indiscernible] Capital Returns.

Unknown Analyst

I just had a question about the guidance, I was wondering how much favorable development from Chaucer is embedded in the guidance?

Frederick Henry Eppinger
Former President & CEO

We normally plan for them to be in the low end of the single-digits, probably in 3 or 4 point range, I don't want to be too precise about it.

Unknown Analyst

But the range is fine enough. So I am sorry, you said 2 or 3 or 3 or 4?

Frederick Henry Eppinger
Former President & CEO

Probably closer to 3% to 4%.

Unknown Analyst

And that's against a combined ratio, right? Sorry, on their combined ratio or the company -- no on their combined ratio?

Frederick Henry Eppinger
Former President & CEO

On their separate business.

Operator

[Operator Instructions] If no further questions at this time, I will turn the call back over to Oksana Lukasheva for closing comments.

Oksana Lukasheva
Vice President, Investor Relations

Thank you to all of you for your participation today and we're looking forward to speaking to you next quarter.

Operator
Ladies and gentleman, this concludes our conference. Thank you for your participation, you may now disconnect. Have a great day.