S&P Global
Market Intelligence

The Hanover Insurance Group, Inc. NYSE:THG

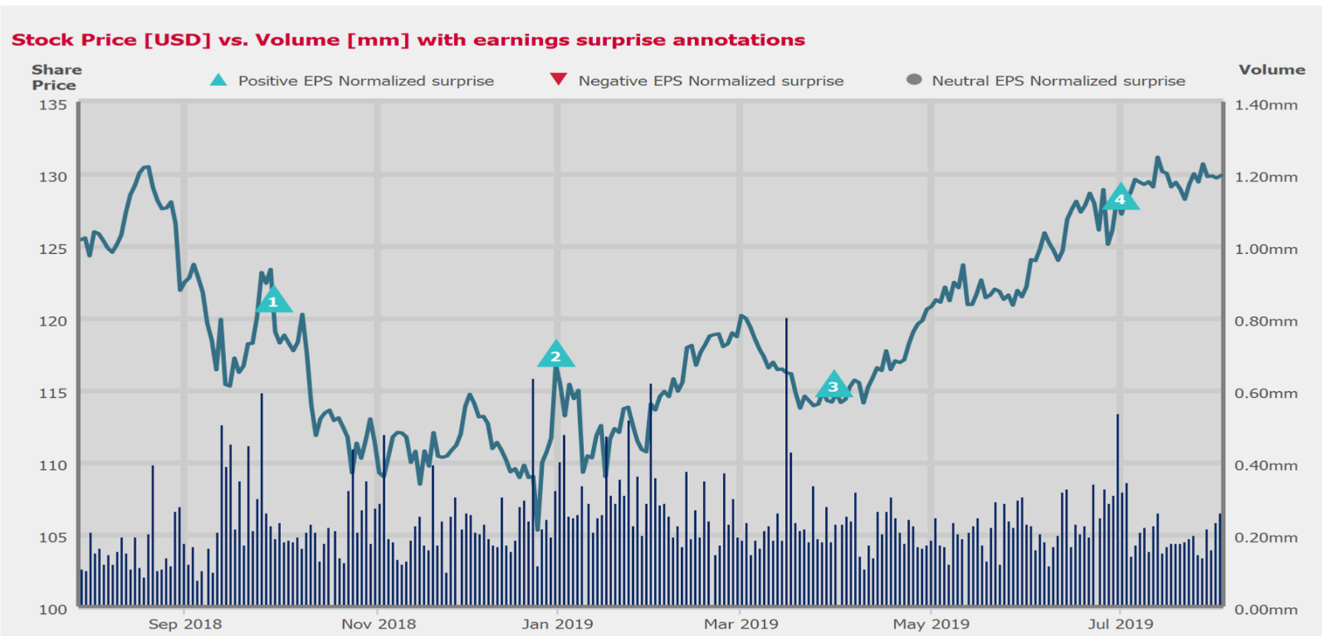
FQ2 2019 Earnings Call Transcripts

Thursday, August 01, 2019 2:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ2 2019-			-FQ3 2019-	-FY 2019-	-FY 2020-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	1.76	1.88	▲6.82	2.05	-	9.01
Revenue (mm)	1139.00	1137.80	▼(0.11 %)	1227.95	4554.75	4801.80

Currency: USD
Consensus as of Aug-01-2019 6:25 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ3 2018	1.84	1.97	▲1 6.49 %
FQ4 2018	1.47	1.51	▲2 2.72 %
FQ1 2019	1.74	1.96	▲3 12.64 %
FQ2 2019	1.76	1.88	▲4 6.82 %

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Call Participants

EXECUTIVES

Bryan James Salvatore
Executive VP & President of Specialty

Jeffrey Mark Farber
Executive VP & CFO

John Conner Roche
President, CEO & Director

Oksana Lukasheva
Vice President of Investor Relations & Financial Planning

Richard William Lavey
Executive VP & President of Hanover Agency Markets

ANALYSTS

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The Buckingham Research Group Incorporated

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

Jon Paul Newsome
Sandler O'Neill + Partners, L.P., Research Division

Lawrence David Greenberg
Janney Montgomery Scott LLC, Research Division

Presentation

Operator

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

I would now like to turn the conference over to Oksana Lukasheva. Ms. Lukasheva, please go ahead.

Oksana Lukasheva
Vice President of Investor Relations & Financial Planning

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 our Chief Financial Officer, Jeff Farber. 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, including our guidance for 2019. There are certain factors that could 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, 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 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 supplements, which are posted on our website, as I mentioned earlier.

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

John Conner Roche
President, CEO & Director

Thank you, Oksana. Good morning, everyone, and thank you for joining our call. This morning, I'll begin with comments on our consolidated financial highlights for the quarter, market dynamics in our Personal and Commercial Lines business and the continuing progress we've made on our strategic initiatives. Then Jeff will provide an in-depth review of our financials, and we'll open the line for your questions.

We are pleased with our result in the quarter and with progress we continued to make across the organization, advancing our key priorities and strategic initiatives. Our performance is a reflection of our distinctive strategy as well as the inherent strength of our unique agency distribution capability, which supports our goal to generate superior shareholder returns over the long term.

Starting with the overall highlights for the quarter. First, our strong results are demonstrated by our adjusted operating return on equity of 12.2%. Second, we generated net written premium growth of 4% while making thoughtful underwriting decisions. Our improved growth demonstrates the strength of our market position and the successful agency partnerships that serve us so effectively. We are intently focused on strategically growing products and classes of business that meet or exceed our target returns. At the same time, we are vigilant in managing our broader portfolio. This year, we made some deliberate choices to pull back on some lower-performing business, including Commercial Auto and components of our Program business, as we maintained our focus on our goal to deliver top-quartile return on equity this year and going forward. Excluding these profit improvement actions, consolidated growth in the quarter was 5.7%, up from 4.3% on a similar basis in the first quarter. We expect to maintain this growth trajectory as we monitor this dynamic market environment. Third, we delivered a very strong underwriting performance. Overall, cats were fundamentally in line with our expectations. We continued to be diligent in our approach to reserves. To the extent we see localized pressure in certain lines, as we have in auto, we respond appropriately, consistent with our committed reserving philosophy. Our second quarter ex-cat current accident year results were largely in line with expectations despite some large loss activity in the inland marine business. It is important to emphasize that we see these losses as normal volatility that can occur from time to time. Our Marine business is extremely profitable as it has been for several years. Even with the second quarter losses, this business is delivering a combined ratio of 90.5% year-to-date. Fourth, we continued to provide strong value for our shareholders driven by the combination of consistently strong results and our active capital management program. In late June, we entered into a second accelerated share repurchase agreement. This $150 million ASR program followed the completion of a $250 million program announced late last year. Jeff will discuss this in more detail in his remarks. The key takeaway is that we are very committed to allocating our capital in a diligent and discerning manner and to create shareholder value.

Now turning to our main business highlights by segment. In Personal Lines, we delivered growth of 6%. We are seeing solid new business momentum, including from our new agency appointments. Retention and rate levels remain stable. Our strong market position and differentiated product offerings allowed us to take needed rate in selected areas, achieving an overall rate increase in the quarter for Personal Lines of 5%. We continued to round out our Personal Lines product set in support of our account-focused strategy. During the quarter, we completed the launch of Hanover Prestige across all 18 of our Personal Line states. Our Prestige brand provides high-value coverage and service for customers with broader, more complex personal insurance needs. In addition to Prestige, we continued to enhance our Personal Lines product offering, including the launch of our improved watercraft product.

In Commercial Lines, our top line growth in the quarter reflects our continued emphasis on profitability. We remain focused on our most profitable and specialized segments, including Professional and Healthcare Lines, as well as Small Commercial. And we remain confident we will drive a steady, positive growth trajectory in the second half of this year. The commercial market, overall, is behaving rationally in our various segments with some pricing improvement in the second quarter. Core Commercial generated average price increases of 6.4%. The market remains fragmented, however, and profit pools continue to be very dynamic. For example, in workers' compensation, we continue to see negative rates, but the line remains very profitable. However, in Commercial Auto, where we and the industry are taking significant price actions, the line continues to be well below target returns. This dynamic market is a great environment for strong underwriting franchises like The Hanover with agility and expertise to grow in the most profitable segments to implement more granular pricing segmentation and to take disciplined approach to risk selection at an account level.

We also continued to execute and build out our new commercial product capabilities with significant profit potential, particularly in our life sciences, financial institutions, cyber and retail E&S businesses. We are regularly expanding the E&S pilot to new agents as we gain more confidence in our agents' readiness and our ability to identify the available market and penetrate effectively. Our results through the first half of 2019 speak for themselves. What is less visible to our investors is the way we are bringing the dialogue with our agency partners to the next level and the work we are doing behind the scenes to continue to modernize our business. Among our best agents, we are observing an increased focus on the operational efficiency and implementation of new business models. This new dynamic plays to our advantage as we leverage our unparalleled analytical insights across the distribution landscape and the strong relationships we've built over the years. There is a material difference in the ways we engage with our agents compared to our other insurers. We have developed a truly consultative partnership approach. We've invested over the years in tools to help our agents manage their books of business effectively and gain operating efficiencies, thus, creating growth opportunities for both of us. We also are committed to helping our agent partners modernize their businesses as we modernize ours. We evaluate and react to new customer preferences and leverage innovation in data and digital capabilities. We continue to evolve our organization, being flexible and agile, in order to drive strong growth and sustainable top-quartile performance. On the customer acquisition front, we are helping our agents acquire and retain business through new digital platforms, including Insurago, our new online platform, connecting digitally inclined customers with our partner agents. We are investing in new underwriting and binding capabilities, including business re-platforming and leveraging third-party data to streamline our interactions with agents and customers. Also, in order to address changing customer preferences and new ways customers want to interact with their insurance company, we are investing in digital service capabilities. We have launched an upgrade to our Hanover mobile app and continue to enhance digital claims handling, photo-appraisal platforms and self-service tools for customers and agents. These are truly dynamic and exciting times in our industry, and we've never been more energized by the potential of our company to grow and prosper. Our vision is a simple but powerful one: to be the premier property and casualty franchise in the independent agency channel that delivers relevant and innovative risk management solutions and helps agents transform the way customers value and experience our products and services. We have the financial and strategic momentum that should enable us to deliver on our performance targets and emerge as one of the real winners as the industry transforms.

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

Jeffrey Mark Farber
Executive VP & CFO

Thank you, Jack. Good morning, everyone. For the second quarter, we generated net income of $74 million or $1.79 per fully diluted share compared with $99.3 million or $2.31 per share in the second quarter last year. After-tax operating income was $77.7 million or $1.88 per diluted share compared with $76.2 million or $1.77 per diluted share in the prior year quarter. Our combined ratio was 96.1% in the second quarter of 2019 compared with 95.5% in the prior year quarter. Current accident year catastrophe losses totaled $66.6 million in the quarter or 6% of earned premium. This is a very solid outcome given an active catastrophe experience for the industry in the quarter. Our efforts to diversify and manage concentrations over the years are clearly demonstrating benefits. We also recorded favorable prior year catastrophe reserve development of $7 million. Excluding catastrophes, our combined ratio was 90.7% versus 89.9% in the prior year quarter. The increase was driven by higher current accident year losses partially offset by lower expenses in the current quarter. The expense ratio improved 50 basis points to 31.5% from the prior year quarter as we continued to benefit from the leverage on our fixed expenses from premium growth and the timing of certain items. At the same time, we continued to fund investments in our businesses from expense reductions across our organization. We remain committed to deliver the expected expense ratio improvement of 20 basis points moving forward.

I will review loss ratio drivers as part of the discussion of our 2 main businesses. As a reminder, we increased our loss selections in our auto businesses in the third and fourth quarters of last year. Therefore, the second quarter comparisons between years may not be as helpful this quarter. Our 2018 full year ratio may be a more useful point of comparison. Starting with Personal Lines. We delivered a combined ratio, excluding catastrophes, of 88.9%, down from 89.6% in the same period last year. The improvement was driven by lower unfavorable prior year reserve development and reduced expenses. Our Personal Lines current accident year loss ratio, ex cat, increased 0.9 points from the prior year to 61%. Our homeowners' current accident year loss ratio, ex cat, of 47.8% was in line with the prior year quarter. Personal Auto current accident year loss ratio, ex cats, was 69.1%, slightly below full year 2018. 2019 claims activity remains quite favorable. However, we are maintaining our cautious view with respect to auto bodily injury loss selections given some unfavorable development we continue to see in bodily injury coverages. We achieved rate increases in this coverage of 9% while the overall Personal Auto rate increased 5%. Personal Lines net written premiums increased 6.1% in the quarter driven by higher rates, stable retention and robust new business growth. As Jack referenced, this is a testament to our strong market position with agents and our differentiated product offerings, coupled with selected new agency appointments.

Moving to Commercial Lines. Our combined ratio, excluding catastrophes, was 91.1% in the quarter, up from 90% in the prior year quarter. The increase was driven by higher current accident year losses partially offset by favorable development and lower expenses. During the quarter, we recorded favorable prior year reserve development of $4 million or 0.6 points of the combined ratio. This was driven primarily by continued favorability in workers' comp. Our chosen mix of smaller-sized accounts, lower risk profile insureds and generally favorable industry loss experience continues to drive our excellent performance. In addition, CMP prior-period activity was favorable. We also experienced some unfavorable development in Commercial Auto, as well as minor adjustments in other Commercial Lines. Our Commercial Lines current accident year loss ratio, excluding catastrophes, increased 1.6 points to 58.1% compared to the prior year quarter, which was driven, in part, by some large losses in our Marine business. Despite large loss activity in the quarter, we remain very satisfied with the longer-term profitability and performance of our Marine segment. We are one of the top players in the market based both on the size of our book as well as the caliber of our underwriting talent. The business continues to be very profitable, and we will continue to support its growth with capital as needed. Autos current accident year, ex cat, loss ratio of 69.7% improved compared to the full year 2018 ratio as a result of substantial earned rate increases and a more favorable mix from our underwriting activities. We believe our 2019 estimates are solid.

Turning now to workers' comp. We posted a current accident year loss ratio of 61%, flat to full year 2018. Our loss selections properly recognize the rate pressure in this line. They also consider the continued favorability we are seeing in our prior year experience. We're pleased with the continued strong performance in workers' comp. However, because of ongoing pressure on rate, we are monitoring this line closely. Commercial Lines net written premiums grew 2.4% for the quarter, reflecting the previously mentioned profit improvement actions in Commercial Auto and programs. We reduced net written premium in both businesses by approximately 7% each and replaced it with growth in more profitable areas, including professional liability, marine and small commercial. Excluding these profit actions, Commercial Lines growth in the quarter was 5.2%, up from 3% in the first quarter.

Moving on to our investment performance. Net investment income was $69.6 million for the quarter, 6.1% higher than the prior year period due to the continued investment of cash flows from operations and the investment of undeployed equity related to the Chaucer sale. This was partially offset by slightly lower partnership income. Lower interest rates have reduced yields on the reinvestment of fixed income assets. However, it is currently having a minor impact on our overall NII given the low turnover of the portfolio. Cash and invested assets were $8 billion at June 30 with fixed income securities and cash representing 85% of the total. Our fixed maturity investment portfolio has a duration of 4.2 years and is 95% investment grade. Our well-laddered and diversified portfolio remains high quality with a weighted average of A+. Our operating effective tax rate for the quarter was 20.5%, lower than the statutory rate due to the net favorable impact of excess tax deductions on certain stock compensation. We anticipate the effective tax rate going forward will approximate the statutory rate of 21%. During the quarter, we had some nonoperating items in net income, including those related to a true-up for Chaucer. When we recorded the gain on the sale of Chaucer in the fourth quarter of 2018, we had to estimate the contingent consideration that would ultimately be adjusted based on the level of 2018 Chaucer cats as updated through June 30, 2019. Based on some well-documented industry increases and the impact on Chaucer's reserves from Hurricane Michael, Typhoon Jebi and the Colombian dam, we decreased the gain on sale by approximately $13.5 million before tax. Combined with the gain on sale of the Australian entity, which closed in April, the after-tax true-up in the quarter was $9.9 million. In addition, based on a June 2019 federal tax law change that was applied retroactively, the tax on the overall gain on the sale of Chaucer was increased by $5.6 million. On the positive side, included in net income but not operating income were unrealized gains on equity securities of $12.1 million.

Turning now to equity and the capital position. Our book value per share was $74.39, up 3.4% for the quarter compared with $71.95 per share at the end of the first quarter. The increase was largely attributable to earnings. Unrealized gains from fixed and equity investments were partially offset by the payment of quarterly dividends and the impact of the accelerated share repurchase agreements, including normal dilution and the timing of the share count reduction. As Jack referenced, on the end of June, we announced the completion of the first $250 million ASR program we entered into at the end of 2018 and received delivery of the remaining 280,000 shares. Additionally, we executed a new $150 million ASR. As a result, the total $150 million for the new program was taken out of shareholders' equity as of the settlement date of June 30, and 80% of the total shares expected to be repurchased or approximately 950,000 shares were delivered. Due to this timing issue, the full impact of the initial share delivery on our weighted average shares outstanding won't be seen until the third quarter. The ASR will finish in 2 to 4 months depending upon the purchasing pattern with Scotiabank delivering the remaining shares at that time. As a reminder, our purchases are at VWAP over the period that the ASR program is ultimately completed. We expect weighted average shares for the third quarter to be approximately 40.1 million. Our remaining deployable equity related to the sale of Chaucer is now approximately $250 million. We will continue to apply our existing capital management framework, allocating the remaining deployable equity among business investments, share repurchases and other capital-return options, all with a view toward the best interest of our shareholders. Annualized operating return on equity was 11.1% for the quarter or 12.2% after adjusting for the remaining undeployed equity and net investment income related to the Chaucer sale proceeds. Our strong second quarter results reflect our clear strategic focus, financial discipline and commitment to delivering sustainable top-quartile results. Looking ahead, we are comfortable with our initial outlook for the year and note that our third quarter catastrophe assumption is set at 4.8%.

With that, we will now open the line for your questions. Operator?

Question and Answer

Operator

[Operator Instructions] The first question today comes from Amit Kumar with Buckingham Research.

Amit Kumar
The Buckingham Research Group Incorporated

Can you hear me okay?

John Conner Roche
President, CEO & Director

Yes. Go ahead.

Amit Kumar
The Buckingham Research Group Incorporated

Perfect. Just a few questions. The first question is the discussion on capital deployment. I know you cannot comment on the trade press and the discussion on the CapSpecialty. But maybe can you just refresh the thought process, how you would look at external opportunities and maybe the size of them? I know -- I think that you've given us a number in the past, which I thought was on the lower end of what CapSpecialty might have been. So maybe just refresh us on any bolt-on acquisitions, et cetera, what size they could be.

John Conner Roche
President, CEO & Director

Yes, Amit. Thanks for that question. This is Jack. I think we continue to be active in terms of our corporate development activities. We have consistently had resources working with not only the banks but also provoking different ideas that we've had. It's been a big part of our success in the past in terms of bringing in some smaller inorganic opportunities into the portfolio and so we continue that pursuit. But as you're referencing, we have some pretty strict criteria related to any M&A pursuits that we make. And so that guides us, both in terms of the size of the opportunity and really the quality of the properties that we would look at. They include being accretive to ROE in a relatively short period of time, and that is somewhat shaped by the opportunity itself. Any opportunity that we would pursue have to have some relationship to our distribution strategy which distinguishes us in the market. And last but not least, any people that come with any acquisition have to have the opportunity to join our culture and really be part of the company that we worked so hard to build. So when you put those criteria on top of the real inventory that's out there, it is -- it limits us in an appropriate way towards high-quality properties. So we are active, but we are, I think, particularly excited about organic opportunities these days. I think the valuations that are out there for the better properties are still pretty robust. And frankly, the organic opportunities that are emerging as the market evolves are -- really got the vast majority of our attention.

Amit Kumar
The Buckingham Research Group Incorporated

Yes. So that's a good point. And so the $257 million remaining undeployed, is it fair to say, based on your comment right now, maybe the focus is more on deploying it organically based on the pricing discussion changing from Q2 versus Q1? And maybe a much smaller piece on anything in organic, is there any way to think about those pieces?

John Conner Roche
President, CEO & Director

Well, I can let Jeff comment on this additionally, but we're -- as you know, if we continue to generate the type of returns that we are today, we generate a reasonable amount of capital for deploying it against our organic opportunities. So we're bullish on our growth and believe that, that will -- the trajectory will improve in the second half of the year and certainly into 2020, but we're also conscious of the fact that we have plenty of capital to fund the organic activities that we have in front of us. So we go back to the framework and, Jeff, that you can articulate for our analysts, investors.

Jeffrey Mark Farber
Executive VP & CFO

So we've delivered about $600 million of the $850 million of deployable capital back to shareholders in a pretty short period of time. In fact, I think it's about 6 months. So I feel pretty good about honoring the commitments that we've made to shareholders, and we've done that really without identifying in advance of doing it what we were going to do specifically. So we're going to continue with that model. And -- but I will tell you that we will redeploy that capital in our framework. We'll look at organic opportunities. We will consider other alternatives to return capital, if and when necessary and available. So we'll finish this ASR. That'll be 2 to 4 months, and then we'll move on from there, Amit.

Amit Kumar
The Buckingham Research Group Incorporated

Do you get the sense that all the return would happen by year-end 2019? Or could some of it spill over into early 2020?

Jeffrey Mark Farber
Executive VP & CFO

Amit, I know you're trying to build a model, so I can appreciate the sensitivity, but it's hard to say, for sure. I think it's certainly entirely possible that it completes in '19, and it's entirely possible that it spills into '20 depending upon how we see opportunities and where the stock trades and a whole variety of different cost-benefit analysis that we do for shareholders.

Amit Kumar
The Buckingham Research Group Incorporated

The only last question I have, and I'll stop, just going back to the discussion on Commercial Auto. I think you flagged bodily injury, and it's interesting. I feel like every other company has a slightly different take on this issue. Do you get the sense -- I think you mentioned some very strong pricing numbers. What is your outlook on Commercial Auto achieving underwriting profitability on its own?

John Conner Roche
President, CEO & Director

Yes, Amit. This is Jack. We have worked hard on the Commercial Auto line of business in the context of our overall portfolio. And as you know, we've now elevated our pricing in the Commercial Auto line now to double digits. We believe that's well in excess of any even short-term loss trend that seemed to be exacerbated. We also have taken that next level of underwriting action to ensure that we bend the curve on Commercial Auto loss ratios. That's evidenced by our lower retentions in this line, while the other lines tend to be holding. So we're able to take action on auto-centric business or specific auto business without compromising the growth of the overall portfolio and drive meaningful rate against some of the loss trend that is evidencing itself. So we are really confident that we can move this line closer to profitability, but it's going to take a while given the overall industry results.

Operator

The next question comes from Paul Newsome with Sandler O'Neill.

Jon Paul Newsome
Sandler O'Neill + Partners, L.P., Research Division

Congratulations on the quarter. I want to ask a little bit more about how you do your Commercial Auto. How closely do you adhere to the ISO forms and the ISO pricing versus how much you use your own internal forms and pricing data?

John Conner Roche
President, CEO & Director

This is Jack again. For the most part, we are an ISO-based company in the Commercial Auto line. Certainly, from a forms perspective, we have some modifications based on certain industry sectors that customize for the verticals. But from a rating perspective, we have a starting point with the ISO loss costs, but we also have a proprietary model that allows us to add in different factors and allow us to shape the pricing appropriately. So we've been, I think, in that model for somewhere around 7 or 8 years and have a blend of ISO and some proprietary pricing.

Jon Paul Newsome
Sandler O'Neill + Partners, L.P., Research Division

And then unrelated question. I was wondering if you could focus a little bit on your ongoing efforts on the expense line. The expense ratio has come down pretty consistently for the last couple of years and looks like it's maybe coming down again this year. How far do you think you can extend that given the progress you've already made?

Jeffrey Mark Farber
Executive VP & CFO

So Paul, this is Jeff. We've committed to delivering 20 basis points per annum, largely out of the leverage on our fixed costs. And underneath that, we are actually taking out a lot more cost than that and making investments that we need to around data and analytics and tools to make our business even better and easier to do business with. This particular quarter, in fact, this particular year-to-date, we have had some things that have lowered that to 50 basis points lower than it was a year ago. I don't think that will turn around later in the years, but we're committed to get the additional 20 basis points. Over the longer run, we're committed to really be focused on expenses, and there are probably some businesses over, really, the longer term that we can really focus on -- more on expenses. But for now, I think 20 basis points is a good modeling pace going forward.

John Conner Roche
President, CEO & Director

Yes. This is Jack. I -- the only thing I would add to that is that we are still growing into some relatively new businesses and new geographies. So on a relative basis to many of our competitors, we have a lower marginal expense ratio than we do in our current expense ratio. So that's the leverage that we keep trying to play to. Some of that has to be watched on a mix-adjusted basis. If we grow certain lines or classes of business, they bring with them a little different expense quotient. But that said, we are very confident that over the next few years, we can continue to scale this business and further lower that expense ratio.

Operator

[Operator Instructions] The next question comes from Christopher Campbell with KBW.

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

I guess starting with the commercial rate increases, like is there any chance you can break down what you're seeing in like GL, Commercial Auto, Property and then workers' comp?

John Conner Roche
President, CEO & Director

Well, I tell you what. Overall -- I'm going to let both Dick and Bryan speak a little bit about this because there is some improvement. And probably excitingly, we're seeing some real improvement in the specialty lines. But across the core lines, I think, as we said, we are really pushing hard on Commercial Auto, as the industry is, and we're making sure that we get at least our fair share there. But as you know, on the other side of the coin, workers' comp, generally driven by statutory rate changes, the pressure is going the other way. All in, we're very pleased with the levels we have. But, Dick, if you want to maybe build on those?

Richard William Lavey
Executive VP & President of Hanover Agency Markets

Yes. No. I think you answered that well. We were seeing low double-digit rate -- or pricing in auto line. As we've said, mid -- low single negative pricing in work comp and low to mid-single-rate increases in the Property and GL lines. So on balance, we're pushing ourselves towards covering the loss cost.

Bryan James Salvatore
Executive VP & President of Specialty

Yes. So this is Bryan, Chris. What I think I would add to Dick's comments is we are also similarly focusing on driving rate where we need it most. Now I would say that some of the things and some of the themes we've seen in the large account market for specialty is being felt somewhat in the segment, the smaller account segment that we're in. So we are being able to and pushing on pricing in our liability lines, our D&O lines, our E&S lines and some of our property lines. And so I think, net-net, what you'd see is that we're really achieving price that would -- I would say is at or even certainly better than trend.

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

Great. That's very helpful. Now just diving into workers' comp a little bit. I was like looking back, and it looks like the core loss ratios have declined like quarterly, I think maybe only one quarter since, like, late 2016 or something like that. And then even this quarter, there was like a 63 bps year-over-year improvement. I guess just with rates declining, can you just give us color with rates declining, industry chatter about increased competitiveness. Why aren't your loss picks going up? So what's happening under the hood in terms of like frequency and severity trends that gives you confidence in the current accident years are still developing favorably given the dynamics of the industry?

John Conner Roche
President, CEO & Director

Chris, this is Jack. Listen, you've been consistent on this point, and it's a fair question to ask of anybody in this pretty dynamic environment. And I think the best way to explain it is that we are seeing unprecedented low and even negative loss trend in this line. As we explore and stress test our picks and our roll forwards, there's -- I think the 2 majors things that drive us towards the performance levels that you're seeing are that we have moved our portfolio meaningfully to small commercial, technology sector and other more advantaged sectors of the business over time. The frequency levels are really moving in a very favorable position. There's evidence that there's even some specific loss types that are meaningfully getting pulled out of the system, if you have the analytics to follow that and understand what exactly is happening kind of below the overall loss trend level. So it's really a combination of we think we are driving optimal mix and getting the benefit, frankly, of the shifts that we've made in the past that are taking favorable industry frequency numbers and making our book, I think, even further advantaged. All of that said, we are watching this very carefully because we are cognizant of the pricing trends, and we are making sure that we don't miss a turn here, either because of loss trends normalizing or because of the cumulative effect of pricing.

Jeffrey Mark Farber
Executive VP & CFO

Chris, our current picks for the last 2 years are still meaningfully higher than our developed picks for the years before that. So we think we're still comfortably conservative with the level of picks in the last couple of years.

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

Okay. Got it. And then just in workers' comp, in general, I mean, what are the impact that you're seeing from like opioid and prescription drug? Like how big of a driver are those just in terms of your severity?

Richard William Lavey
Executive VP & President of Hanover Agency Markets

Yes. This is Dick. That's something we're watching closely in the -- our loss trends, and we haven't seen it specifically spiked out, so it's hard for us to put an exact number on it. But it's one, obviously, that as we look at medical cost and the management of that, we'll keep a close eye on it. We put in place an increasingly larger numbers of just cost management capabilities in our claims area, so it's one that will -- we've got an eye on.

John Conner Roche
President, CEO & Director

Yes. This is Jack. If you were to get inside the company and understand the level of investment that we've made on the claims side of the house and particularly in workers' compensation, including nurse case management and a lot of the follow-through on prescription meds, we are as diligent as anybody to make sure that when prescriptions are being made liberally or there's an opportunity for opioid abuse. So I am really proud of the improvement we've made within our claim department to attack this really critical issue. But at the end of the day, this is another area where our mix helps us. We are substantially in the small commercial business and the tech sector, and we're not really in the middle-market, day-to-day manufacturing construction business where a lot of that is residing.

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

Okay. Great. And then just one last one. Jack, I think Jeff mentioned in the opening script, just in terms of like the amount of, like, proceeds that you guys have deployed from Chaucer. So I guess just -- I'll pick the other side of that. Like have you -- what investments have you made internally in the business with those proceeds that, like, we haven't seen because they haven't had a press release on it?

John Conner Roche
President, CEO & Director

Yes. Thanks for the question. We clearly, as Jeff articulated earlier, have not only some expense reallocations that we've made, but we have a pretty good inventory of areas that involve accelerating any kind of legacy transformation work that needs to be done from a technology standpoint, any current software capabilities related to our platforms. I think we've been very transparent about the fact that we invested heavily in our Personal Lines platforms over the last couple of years. We're 1 year into a 3-year investment in our Small Commercial platform. These are tens of millions of dollars of investments that both improve our point-of-sale application to our agents but also modernize the infrastructure and allow us to be able to be much more contemporary with how we attach the APIs, bringing third-party data and set ourselves up for the future.

On top of that, we're building in the specialty businesses a financial institutions practice, a retail E&S business. We are building on our cyber capabilities, not because we're trying to go on the offense, but because we're trying to make sure that we are aware of this line of business and are prepared for how it becomes, really, the sixth line of business and a package account over time.

So we're making what I consider to be meaningful investments across the infrastructure of the company as well as the capabilities that allow us to grow and be increasingly relevant to our agents. And frankly, we're in the planning season right now, where we're asking our teams to bring forward the next round of those investments and push ourselves hard to not just spend more money but to not miss out on the opportunity to reallocate some costs and accelerate those investments.

Jeffrey Mark Farber
Executive VP & CFO

And for full clarity, we're using existing capital expenditure budgets and repurposed expense budgets from cost saves versus allocating equity that was created from the sale of Chaucer for those investments and expenditures.

John Conner Roche
President, CEO & Director

Yes. Maybe not to pile on here, but one last thing that we probably don't speak enough about is we are spending a lot of time building kind of the next generation of our Agency Insights tool. As you know, we have really a very unique partnering capability but also data and analytics capability that our agents have really grown to depend on, and we are working hard to build out an even more impressive set of benchmarking capabilities and triangulating with third-party data in order to bring them additional ways to serve their clients and improve their economics. So that's another area that we're heavily focused on going forward.

Operator

The next question comes from Larry Greenberg with Janney Montgomery and Scott.

Lawrence David Greenberg
Janney Montgomery Scott LLC, Research Division

You just touched on part of what my question was, which was really just to provide a little bit of an update on some of the initiatives you've made in the Specialty space. And I guess I'm curious, given what we hear are some dislocations in the E&S marketplace, does that help you accelerate some of the movement you're looking to make there? Just if you could talk about current conditions and what the opportunities are there.

John Conner Roche
President, CEO & Director

Yes. Let me tee this up for Bryan because he spent an awful lot of time on this topic. And I think there's 2 dynamics, Larry, that are affecting us. Obviously, there's some real disruption and change going on in the E&S sector and being able to segment that and understand what's moving and where the opportunities are is really important, and that's where our Agency Insights tool and our interactions with agents help us. But additionally, there is increasing evidence that retail agents, particularly consolidating ones, are determining what E&S business they plan to place directly versus through the wholesale channel. Wholesalers are not going away, but retail agents are building capabilities to place some of that business, particularly if it's attached to other lines of business. And so from that, Bryan can build on how we're really focused on this sector strategically to find out where our place is.

Bryan James Salvatore
Executive VP & President of Specialty

Yes. And so I think, Larry, what I would do is I would go back to what Jack just said, right? Our retail agents are getting increasingly determining when you want to come directly to us and use a wholesaler. And so whenever we build our Specialty products, the driver always is are we further differentiating, adding relevance to our retail agents on behalf of Hanover? And that is the driver of really all of our builds, so it's the driver of build in the financial institution segment, and it's the driver of our build in the retail E&S segment. We do see very positive feedback from what we're doing here, and I do think it's driven by some of that dislocation that you're mentioning. There is demand for this type of area from us. Now I will remind you that we are still very much focused on that medium to small segment. That's our sweet spot, but there is real demand there. And so we are building out on it, and we're getting good traction.

Operator

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

Oksana Lukasheva

Vice President of Investor Relations & Financial Planning

Thank you very much for your participation today, and we are looking forward to speaking to you next quarter.

John Conner Roche
President, CEO & Director

Thanks.

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