S&P Capital IQ

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The Hanover Insurance Group, Inc. NYSE:THG

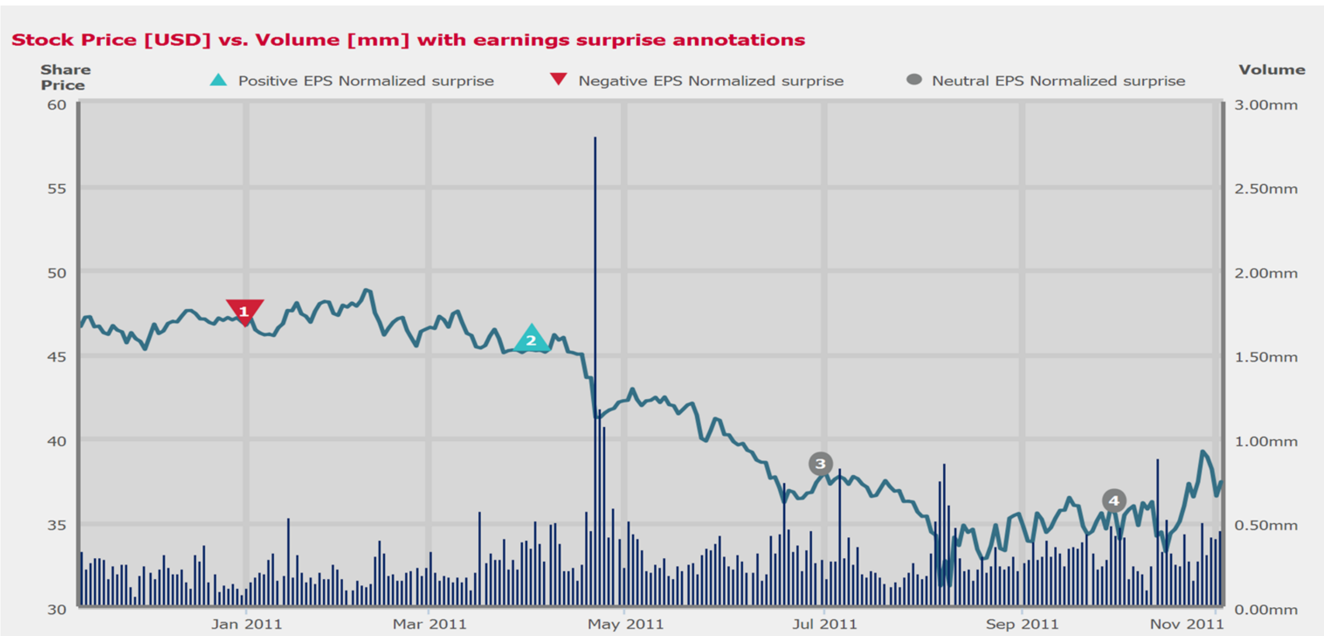
FQ4 2011 Earnings Call Transcripts

Thursday, February 09, 2012 2:00 PM GMT

S&P Capital IQ Estimates

	-FQ4 2011-			-FQ1 2012-	-FY 2011-	
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	ACTUAL
EPS Normalized	0.81	1.00	▲23.46	0.93	0.16	0.32
Revenue (mm)	1038.34	977.10	▼(5.90 %)	1105.59	3664.30	3593.40

Currency: USD
Consensus as of Feb-09-2012 6:00 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ4 2010	1.05	0.95	▼1 (9.52 %)
FQ1 2011	0.50	0.53	▲2 6.00 %
FQ2 2011	(0.56)	(0.84)	NM
FQ3 2011	(0.44)	(0.41)	NM

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Presentation

Operator

Good day and welcome to the Hanover Insurance Group Fourth Quarter Earnings Conference Call and Webcast. [Operator Instructions] Please note this event is being recorded. I would now like to turn the conference over to Oksana Lukasheva, Investor Relations. Ms. Lukasheva, the floor is yours, ma'am.

Oksana Lukasheva
Vice President of Investor Relations

Thank you, Mike. 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. Also in the room and available to answer your questions after our prepared remarks are Marita Zuraitis, President, Property and Casualty Company; Andrew Robinson, President of Specialty 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, statistical supplements and a complete slide presentation for today's call are available in the investor's section of our website at www.Hanover.com.

Our prepared remarks and responses to your questions today, other than statements of historical fact include forward-looking statements such as our such as our guidance for segment income per share for 2012. 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 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 total segment income, after tax earnings per share, segment results excluding the impact of catastrophes and development, ex cap loss ratio, and combined ratio among others. A reconciliation of these non-GAAP financial measures to the closest GAAP measures on a historical basis can be found in the press release or the statistical supplement which are posted on our website as I mentioned earlier.

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

Frederick H. Eppinger
Former Chief Executive Officer, President and Director

Thank you, Oksana, and good morning, everyone, and thanks for joining our call today. Our fourth quarter results represent a strong finish to an otherwise financially challenging year. Our performance in the quarter clearly reflected the benefits of our efforts to improve the quality and distinctiveness of our product portfolio.

For the quarter, we generated a solid statement income of $45.2 million, or a dollar per diluted share, in line with our expectations in spite of the elevated level of global catastrophes. Losses from catastrophes this quarter totaled $56 million and included $38 million related to the floods in Thailand and $16 million from the late October snowstorm in the northeast.

For the year, even as we experienced the worst year of catastrophe losses in our company's history of $362 million, or 10 points of our combined ratio, we generated modest after-tax segment earnings of $15 million. We are also pleased that our focus on risk management and our thoughtful approach to growth has enabled us to maintain a strong balance sheet.

Despite this year's challenges, we were able to grow book value by almost 3% to $56.24 at the year-end 2011 reaching the highest point in our company's history. As I discussed at Investor Day, 2011 was a very challenging year for us and the industry given the severe weather and the economic pressure, but it was

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a year where we continued to make significant progress on improving the earnings power of the company and position it for excellent returns through the cycle.

As a result of our significant investments, our product portfolio is now very attractive and each of our businesses is well positioned to capitalize on the changing market environment. We believe the quality of our new business today is as good as anyone in the industry and we can see real progress in all the key profitability levers, as we discussed with you on Investor Day.

We also mentioned that we see 2012 as somewhat of a transitional year. While we believe our performance will significantly improve, as we discussed as we shared our 2012 outlook, we believe that it is prudent to assume that the more difficult weather trends we’ve seen will continue. Therefore, we are planning to take additional pricing and underwriting actions in 2012 to achieve our ultimate returns that will not be fully realized this year, but we are very optimistic about where we are and what we are now accomplishing in the marketplace around pricing, mixed management and profitable growth.

We are encouraged by our fourth quarter operating performance and by our financial results in the next cat basis. We continue to make progress toward our long-term target returns and to execute on our priorities. In particular, successfully raising rates while maintaining the quality of our business, enhancing our business mix by growing the more attractive lines and segments, engaging in targeted mix management and re-underwriting in certain lines and regions, successfully building out our new businesses and geographies, enhancing margin by reaching required scale and solidifying our shelf space and competitive position with the best independent agents and positioning ourselves for profitable growth.

Let me begin by talking about the progress in commercial lines. In poor commercial lines, we continue to accelerate the pace of growth, which resulted in fourth quarter growth of over 10%. We achieved pricing improvement in virtually all lines for an overall pricing increase of 4% during the fourth quarter. Our pricing in small commercial and middle markets not only improved as compared to the third quarter, but also as the months progressed within the quarter, and January was better than December.

At the same time, our retention improved 2 points sequentially and 4 points from the fourth quarter of 2010, which suggests that we are implementing a successful pricing strategy and business model. We also believe on a product line and count size adjusted basis we are achieving price increases in line with our better competitors. We believe our strong agency relationships and our consistent pricing message over the years is what’s now helping us navigate through the inevitable disruption that happens when a market turns.

Our partner agent focus and our local market knowledge enables us to achieve the proper balance between quantitative and qualitative underwriting processes resulting in needed rate increases while maintaining or increasing the quality of our book. This approach, coupled with our ever-broadening product suite, allows us to minimize the disruption and, quite frankly, improve our position with the best agents and brokers.

With more normal weather in the fourth quarter, we were able to demonstrate the earnings potential of our company as we generated stable underwriting loss ratios. Commercial line loss trends remained relatively stable. We attribute this in part to our targeted approach to growth. Concurrently, we improved our expense ratio by 2 points for the quarter and over 3 points for the year. The improvement in our expense ratio is tied to our operating model work, our maturing investments and increasing scale in commercial lines as we solidified our national footprint in the U.S.

Given the completion of the OneBeacon renewal rights deal and our geographic expansion, we now have a more balanced and mature book of business with over $300 million of core commercial out west with our partner agent. We also continue to improve our business mix as we grew our specialty businesses by 15% for the quarter and 16% for the year as we further improve the quality and diversification of our portfolio.

Our growth in the fourth quarter came largely from our program business and the maturing of our newer businesses, including private company DNO, management liability and miscellaneous professional liability. We are successfully bringing these products directly to our retail distribution through a very efficient operating platform and, in many cases, displacing the wholesaler in these specialty markets.

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Overall, we believe we have strong and sustainable momentum for growth and improved profitability in commercial lines as we start 2012. In personal lines, we continue to accelerate premium growth in the quarter. We filed rate increases of 5% in auto and 7-plus percent in homeowners'. Our retention in this business continues to improve and now stands at 81%, up 2% from the fourth quarter of 2010, even though we continue to achieve industry leading rate increases and to actively manage our property concentrations. We believe this is a testament to our strong market position and our account focus strategy.

Obviously, personal lines has been greatly impacted by the increased weather activity over the last 3 years. We believe we are somewhat ahead of the market recognizing the impact of weather on results as potentially more permanent. We have been driving rate increases in homeowners' in the upper single digits since the end of 2008.

As you know, we are supplementing our disciplined pricing actions with a strategy of surgically reducing our exposure through changes in policy terms and not renewing certain business associated with areas of high concentration. We believe a combination of all these measures will help mitigate exposures and improve our returns in 2012 and beyond.

Before I turn the call over to David, I'd like to make a couple of comments about our international specialty business and our outlook. Chaucer generated net rate and premiums of $207 million in the fourth quarter. More importantly, in this difficult catastrophe quarter for international insurers, it continued to be accretive to our earnings reducing pre-tax segment income of $12 million for the quarter and $32 million since we acquired them on July 1.

The Thailand floods exceeded our normal cat loss estimate for the quarter; however, the current underlying business trends and prior year loss trends are very favorable, increasing the profit for the year. Additionally, we've made some adjustments to the portfolio to reduce volatility and manage our risk appetite in certain lines, for example, lowering our capacity in global green excess of loss and facultative coverage in the U.S.

We continue to be impressed with Chaucer's experienced and talented underwriting team, and Chaucer's specialty focused platform with lead positions in numerous attractive segments provides multiple areas of opportunity for us, especially in an improving market environment.

Finally, I'd like to comment on the market trends and our outlook for 2012. While we believe 2012 will continue to be challenging with historically low returns on invested assets and still meaningful economic pressures, we think Hanover is well positioned to navigate through this environment. Given our pricing trends we saw in the U.S. and globally in the fourth quarter, we continue to be very optimistic about 2012. There are strong indications that the overall market is becoming more reasonable and more underwriting focused than it was just 6 months ago, and certainly much more than it has been in recent years.

We are very well positioned to improve our financial returns using the levers we discussed and to capitalize on this market environment. All of this has increased our confidence in the 2012 outlook. We believe the earnings power of the organization will continue to increase as the year progresses culminating in even stronger returns in 2013.

In conclusion, clearly the fourth quarter with annualized ROE of 8%, we still have work to do to meet our long-term financial goals, but with the acquisition of Chaucer, the maturing of our national footprint and the ever improving composition of our product portfolio, 2011 was a very important year on our journey to build a top quartile insurance company that returns 11% to 13% ROE through the cycle.

Given our strong position with agents and brokers, the growth we've achieved in recent years as well as the additions we have made to our team, our products and our business portfolios, including access to the large platform, we are now in a position to fully capitalize on the changing market environment and achieve our financial goals through a focus on the financial levers we discussed. We are optimistic that we will take a very strong step forward in 2012.

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

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Thank you, Fred, and good morning, everyone. I'm very pleased with our fourth quarter results, which reflect our strong and diversified earnings power, the strength of our franchise and how well we are positioned for the future. Equally important, as Fred mentioned, our results demonstrate progress on the key profitability levers we discussed at our Investor Day last November.

Our fourth quarter segment income was $45.2 million, or $1.00 per diluted share, compared to segment income of $43.7 million, or $0.95 per diluted share, in the prior year quarter. For the year, segment income was $14.6 million, or $0.32 per diluted share, compared to $122.2 million, or $2.64 per diluted share in 2010.

As you know, 2011 was marked by the frequency and severity of weather losses that affected the industry and us. In the fourth quarter, we saw fewer catastrophes compared to the first 3 quarters of 2011, although we still experienced 2 sizable cat events this quarter—the October snowstorms in the northeast of the United States and the flooding in Thailand. Our fourth quarter catastrophe losses were $55.6 million, or 5 points on the combined ratio, compared to $16.8 million in the prior year quarter, or 2 points on the combined ratio.

Offsetting the impact of catastrophe losses this quarter was improvement in our overall accident year loss ratio due to a better mix of business in our domestic P&C operations and inclusion of Chaucer, which we acquired in mid-2011. We also saw continued improvement in our expense ratio. I'll touch on these in more detail in a moment.

For the year, catastrophe losses totaled $362 million compared to $160 million in 2010. Despite the record level of catastrophe losses this year, an addition of more than 4 points to our full year combined ratio over the prior year, we were still able to produce positive results for the year.

We also benefitted in the fourth quarter from a lower effective tax rate as compared to the fourth quarter of 2010. There were 2 reasons for the favorable tax rate this quarter. First, the lower overall earnings for the year given the above-mentioned cat losses drove our quarterly tax rate down as we chewed up the full year effective tax accrual.

Secondly, given the mix of earnings, a portion of our international profits, which is taxed at a more favorable rate, provided a greater benefit to the effective tax rate. In more normal circumstances, we expect our effective tax rate on segment income to be in the 34% range.

Fred has already provided commentary about our top line growth and pricing environment, so I'll focus on our segment results for the quarter. Starting with commercial lines, our combined ratio was 97% in the quarter compared to 99% in the fourth quarter of 2010. The 2 points of improvement was primarily driven by an improved expense ratio due to the benefit of higher earn premium and continued progress on our operating model.

The current accident year loss ratio, excluding catastrophe losses and prior year favorable reserve development, was fundamentally flat as compared to the prior year quarter as we experienced more favorable severity trends in CMP and worker's compensation lines, which were offset by a higher frequency in commercial auto and a higher incidence of large losses in other commercial lines. We are continuing to improve our underlying loss ratios in commercial lines given improved pricing and a continued shift to a more profitable mix including specialty business.

In personal lines, the combined ratio was 100% in the quarter compared to 96% in the fourth quarter of 2010. Breaking down the movement in the combined ratio this quarter compared to the prior year quarter, we had a 2 point higher impact from catastrophe losses this quarter, primarily associated with the October snowstorms in the U.S. as well as prior year reserve releases, which impacted the comparison by roughly another 2 points.

Fourth quarter accident year loss ratios in personal auto and homeowners' increased driven by the development of weather impacts from earlier quarters, primarily in property, in homeowners' and physical damage in auto. This was somewhat offset by favorable loss experience in umbrella and other personal line coverages.

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Finally, we experienced a 1 point improvement in the expense ratio due to lower contingent commissions. If you look at this on a full year basis, the accident year loss ratio in personal auto improved 1 point over 2010 while the homeowners' ratio increased 4 points. The entire margin decline in homeowners' is directly attributable to the higher non-cat weather losses. The personal lines expense ratio for the full year 2011 was 27.1% compared to 27.8% in 2010.

Moving on to Chaucer, this segment delivered a second profitable quarter as part of our organization generating $12 million of segment income before taxes. The combined ratio of 100% was impacted by $36 million of catastrophe losses, or approximately 14 points. The flooding in Thailand accounted for $38 million of catastrophe losses this quarter. We also experienced net favorable adjustments from prior catastrophe losses, which overall resulted in a positive impact of $2 million this quarter.

Prior year favorable reserve development improved the Chaucer combined ratio by 7 points this quarter, a comparable level to last quarter. The favorable development came mostly from recent accident years related to non-catastrophe property, U.K. motor and marine business.

Chaucer's expense ratio for the fourth quarter was 33%, somewhat lower than a normal run rate of about 37%. The variance here is mostly explained by a couple of items. First, the timing of certain expenses between the third and fourth quarters resulted in a 2 point improvement. As we previously mentioned, we expect the integration process and timing of certain expenses could cause some modest variability quarter to quarter.

Secondly, there will be some impact from foreign currency movements in this line, which will be mostly offset by movements in other income statement items such as incurred losses. In this quarter, we saw a positive 1 point impact compared to our run rate expectations.

As Fred mentioned, the outlook for Chaucer's business is very positive with rates now increasing for both North American and international property exposed risks. In response to heavy 2011 losses, the forecast for the property division is encouraging. In fact, pricing levels are rising in most of Chaucer's businesses, which will be helpful to growth going forward.

That said, we are taking the opportunity of market improvement to rebalance our portfolio and manage our risk profile. While this would provide for less volatility and more sustainable earnings, it will result in only modest growth in 2012. We continue to be pleased with the disciplined underwriting and more favorable market trends evident in the Chaucer segment, especially in an overall challenging underwriting environment.

Finally, the bulk of our integration activities is nearly complete. Chaucer's risk governance, evaluation and monitoring structure is now integrated with our corporate ERM program. Shared services have been successfully aligned to achieve expected synergies amongst business areas including IT, Finance and Sourcing, among others, so we are beginning 2012 business as usual.

Moving on to a discussion of our investment portfolio. At December 31, 2011, we held over $7.5 billion in cash and invested assets. Fixed income securities represented 83% of our total cash in invested assets. Roughly 94% of our fixed income securities, our investment grade and the average duration in our portfolio is 3.9 years. The remaining parts of the portfolio are cash of approximately 11%, which we are carefully deploying into the investment portfolio to improve returns, and 6% of other assets, including allocation of 3% to equity securities.

As we mentioned last quarter, we have negligible exposure to European sovereign debt. Our exposure to European banks, excluding the U.K., is only $124 million, or 1.6% of our total portfolio, while exposure to corporate credit in non-bank sectors is 3.9% of the portfolio. These securities are high quality and diversified by issuer, sector and country.

Net investment income was $69 million for the fourth quarter, up nearly 10% compared to the $63 million earned in the fourth quarter of 2010. This increase was driven primarily by the increase in cash and invested assets associated with the acquisition of Chaucer.

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For the fourth quarter, the overall earned yield on our fixed maturity portfolio was 4.48%. The Hanover's fixed maturities yielded 5.28% and the Chaucer assets delivered 2.19%. The fixed income earned yield for the full year of 2011 was 4.84% compared to 5.46% for 2010. The majority of the decline in yield reflects the addition of Chaucer's shorter duration portfolio at mid-year, and to a lesser extent, lowered new money yields on reinvested assets.

To mitigate historically low new money yields, our current strategy for the portfolio is to continue to emphasize corporate debt and other credit spread sectors while maintaining a high quality, well laddered portfolio. We also invested approximately $45 million in stable large cap equities with attractive dividend yields during the fourth quarter and an additional $55 million in January of this year.

Our balance sheet remains strong providing excellent financial flexibility. We ended the quarter with over $2.5 billion in shareholders' equity. Our book value per share at December 31, 2011 was $56.24, up almost 3% from $54.74 at December 31, 2010. During the quarter, we repurchased 51,000 shares of common stock. We also increased our quarterly dividend by 9% to $0.30 per share. In 2011 we repurchased 625,000 shares of common stock for $22 million and we have $135 million remaining in our share repurchase program.

Whether through share repurchases or debt management, we've been disciplined about identifying and acting on capital management opportunities and we will continue to be diligent going forward. Our debt to capital ratio was 26.6% at year end, which continues to be well within rating agency thresholds for our current ratings.

Holding company cash and investments were $207 million at December 31, which is moderately above our target level. We also have in place a $200 million credit facility that provides additional flexibility to meet liquidity and capital needs.

I'd just like to give a few comments on our reinsurance program. On January 1, we renewed our main U.S. property catastrophe treaty with modest changes to the overall structure at a cost we found to be reasonable. The majority of our reinsurance treaties at Chaucer also renewed on January 1. Our 2012 reinsurance program was placed according to plan with the pricing coming close to our budget.

Before we open the lines for questions, I'd like to mention a couple of items related to our 2012 guidance that we provided at our last quarterly call and Investor Day meeting in November. Our business trends and the market dynamics we've seen this past quarter provide additional confidence in our 2012 earnings guidance of $3.85 to $4.15 segment income per share.

I'd like to comment on a few assumptions that support our outlook. We believe a combination of rate increases, strong momentum in our newer states and continued exposure thinning actions in personal lines will result in relatively flat growth in 2012 with some notable downward pressure in the second and third quarters.

Although we are encouraged by our top line commercial lines growth of 12% in the fourth quarter, we are still maintaining our outlook of overall mid-single digit growth in 2012 as we remain diligent in our underwriting and achieve the right balance between rate and retention. We assume a full year interest expense on debt to be at approximately $63 million.

That said, a portion of our debt has variable rates; therefore, some fluctuations of our interest expense are possible. And finally, we assume weighted average shares outstanding for the year to be approximately 45.5 million shares.
Mike, I think we're now ready to open the call for questions.

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Question and Answer

Operator

[Operator Instructions] The first question we have comes from Ray Iardella of Macquarie.

Raymond Iardella
Macquarie Research

I guess the first question relating to catastrophe losses in Chaucer and some re-estimation downward of losses in the first 3 quarters. Let me ask you, how comfortable are you guys with that estimate, and maybe another good time to revisit Chaucer's reserving philosophy and how that might have differed from yours.

Frederick H. Eppinger
Former Chief Executive Officer, President and Director

Yes, again, given the mix of business, and I'll ask Bob to comment on this, and the type of business they have and the access world, their philosophy, and we talked about it at the close, we talked about it at Investor Day, they've been very conservative. They always are very conservative the way they make their initial estimates, so what you've seen historically is they don't have the kind of credence that you get from some of the other folks that you saw, particularly this year. What we have seen this year, as you see, is we're counter to the industry a little bit. We haven't had creep, we've had the net. We've had a little bit the opposite, but it is clearly a philosophy that they've consistently had. It's typical with what we try to do as well. We try to take a little bit longer to come up with our estimates and then be as thoughtful as we can versus getting out very quickly with the first indication. Bob, I don't know if there's anything else you want to comment on.

Robert Arthur Stuchbery
Former Chief Executive Officer and Executive Director

No, just commenting on the titles in particular. That's a difficult loss to assess but we have taken a realistic view about that and, as you said, our past experience at releasing has been prudent on reserves, so demonstrates that approach.

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

We're actually quite comfortable where we are and what we've done in the past and I think it helps us.

Raymond Iardella
Macquarie Research

Okay, that's helpful. Does the Thailand loss estimate assume any industry loss or is that ground up or is it based on a number of different factors?

Robert Arthur Stuchbery
Former Chief Executive Officer and Executive Director

A number of factors. We've gone through the portfolio, looked at where we've got exposure, broken that down by sector and put a number on it, so there's a wide range out in the marketplace and I would say that we're being realistic about what the outcome of that loss is. Having said that, it's a very complicated loss to put a number on and we've still yet to receive many of the notifications of losses, so this is just after a portfolio assessment.

Raymond Iardella
Macquarie Research

Okay, that's helpful, and then, I guess, Fred, you had mentioned a big part of the thesis with Hanover is the changing mix of business and how that's going to drive improvement of the actual loss ratio. I'm just

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curious why worker's compensation within commercial lines has stayed pretty consistent as an overall percentage of the business. Is that audit premiums? Is it rate? Is it a combination? And where would you think that is going forward?

Frederick H. Eppinger
Former Chief Executive Officer, President and Director

I'll let Marita answer some of it, but let me just go back on our comp because our comp results have improved when others are going to opposite way. Historically, when we first started the journey, we were a provisional company and we had some high hazards, some contractor. We took our percent of comp as a percentage of our business. We were the lowest in the top 20 companies. Because our philosophy was that that is a line, particularly in middle market and model line comp is a dangerous line and was dangerous over the last 4 or 5 years, and we have focused our attention on building our competency, which we did, and focusing on small comp, which we like quite well, and rounding out our small account business and really having a much more attractive portfolio of comp. So we feel very good about it. We feel very good where we are. We are now growing a little bit, but it's, frankly, as much in price and in exposure. There isn't that much -- there's some in units but it's as much about exposure and price as units. I don't know, Marita, if there's something else we should make sure we comment on.

Marita Zuraitis
Former Executive Vice President and President of Property & Casualty

No, Fred, I think you said that extremely well. Although the percentage has remained about the same, there is a fair amount of mix movement under that and in the quarter, with the growth that you saw in the quarter, all of that growth is coming from small commercial and it's coming from the risk rates and the size that we're very comfortable with, so although the overall percentage has stayed the same. There's been a fair amount of mix to the mix that we feel much better about.

Operator

The next question we have comes from Dan Farrell from Sterne Agee.

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

You still carry a fair amount of cash on the balance sheet and I'm just wondering if you could talk about how much of that, given that we still seem to be in a prolonged low rate environment, and how much of that you'd be considering deploying into other investments, the sort of pace of deployment into other fixed income securities, and then, also, if you could just talk about the difference between your current yield and new money yields.

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

Sure. Just in terms of the cash balance, and we've said this now for the last quarter and at the Investor Day, we are going to deploy more of the cash into the fixed income portfolio. We're about 11% at this point in time. We're certainly going to take that down, I would expect, during the course of the first quarter. We're also being very careful about doing it. Obviously, the rates for moving around a fair amount, particularly the underlying treasury rate, so we're being thoughtful about when we deploy it and how we deploy it. And as I mentioned in the script, we're also looking to put beyond just the fixed income investments, we are putting some money away into equity securities, which will help from a diversifying standpoint, Dan. In terms of the new money yields and the overall rate, we've talked about the fact that rates are going to come down. New money is being invested in lower rates given market conditions, but if you think about our overall portfolio and the asset position we have, The Hanover, traditionally, has had a very high rate and a longer duration. We added the Chaucer assets at a shorter duration, and as we extend the Chaucer asset duration to be more comparable to Hanover, you'll see somewhat of an offsetting impact there, but we still project, if you will, the new money rates will come down and we're currently at around 3% on a blended basis overall.

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

And then could you just go into a little bit more detail about your strategies to manage the catastrophe risk on the personal line side? You talked about some of the premium impact that's going to have in the second and third quarter, but on the levers rate, how you're managing geographic exposure, policy design, things like that.

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

That's a good question. Our biggest Achilles heel as a company, and when I first got here in '03 and '04, was our geographic concentration. Now we've gone through a decade of calm weather, but the reality is that we were a very concentrated and a very property-centric company, so we have worked really hard in the last 5 years to both spread that risk appropriately, but also to get adequate price per property, but to diversify into a more balanced portfolio. If you look at property specifically, we've done a number of transactions where we've actually sold books of business in areas that we were uncomfortable with from a cat exposure point of view. We did in Florida, we did it in Louisiana, we did it in Rhode Island. We've done it a number of times, so one category we always look for is we look at geographies we think are overly concentrated, and the way I talk about it is that our marginal cost of capacity, particularly in cat areas, is higher than everybody else's, so your ability to get that rate and get that 12%, 13% return is reduced because other people you're competing with have a different cost of capital and we constantly do that. What happened with our math and, I think, some of this volatility, what we said at the Investor Day is that I believe that we've done a lot of good things and I really like where we are, but what I see, if it's true in what's happening with the volatility, we took our cat estimates up, but it also changes our perspective, so you will see additional thinning in areas and particularly in micro geographies where we believe that we can't get to the returns we want and that's what we're talking about. I mentioned about $150 million of underwriting business in both personal and commercial. Now that is both cat-oriented and also just, in my view, some places where the volatility is a little bit greater, so it's a little bit less than that. One lever is this, what I call re-underwriting, shrinking, thinning. I feel very good about it. We do it. We continually do it. I'll do a little bit more here. I call it it's going to be surgical but it's going to be real. The second thing is pricing and we have been very aggressive and very thoughtful about pricing, and again, where we are now and what I like about it is the vast majority -- Marita has showed you the statistics over the last few quarters. The percentage of our business that's with partners and is all accounts is huge. So our ability to get rate and retain retention and pick the stuff we want is the best it's ever been, so we have been able to get this 6%, 7% rate increase and we feel really good at where we are. What I believe is that we're going to continue to see the improvement. Now it's masked a little bit in my view because of this non-cat weather that we've experienced in the last 2 or 3 years, and what we need to do is continue to get ready to overcome that. But I think the combination of those 2 things are really important. Now there's a third point that you've heard others talk about that we did a lot of and we're doing more of, which is actually changing limits, deductibles, features within the products. Because of the non-cat and the cat weather and the volatility the market is receiving, much better than it ever has, limits for adjusting things like homeowners' and roofs. There's all kinds of features and we are aggressively implementing that in every place that it makes sense, which, again, essentially, gets your pricing more aligned with the risk if you believe that the volatility is up. So I feel, actually, very good about it. I'm actually not worried about our property portfolio because of all the work we've done. We have a nice geographic mix now. We have a nice quality of business now. The retention balance and price increasing has been very good. Personal lines, by the way, has been ahead of commercial, as you know, a little bit. Again, this was a tough year for us as it was for other people and it was a broad-based tough year, but remember for us, this was a particularly tough year because we had 3 major events in New England/Massachusetts. We had a snowstorm, we had a tornado that we haven't had since the '50s, and we had Irene, so we're pricing for this. We think it's broad based. We think it's a real issue, but we also think this year was a little bit extraordinary in a lot of cases, so we feel very good about where we are in product portfolio, but we've got to get through this year to get the rate we need to get where we want to be. Marita, is there anything else?

Marita Zuraitis
Former Executive Vice President and President of Property & Casualty

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No, I think you said it well. I think we have excellent property DNA as a company. I think we have very good tools to analyze all the things you talked about, and whether it's the appropriate rate, whether it's the restructure of terms and conditions, if we can't get the rate and we can't restructure, there are limited places where we'll need to exit and I think we have the tools necessary to manage those components well.

Operator

The next question we have comes from Larry Greenberg of Langen McAlenney.

Lawrence David Greenberg
Langen McAlenney

Can you just remind us what kind of cat load is embedded in the 2012 guidance?

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

Sure. I think at the Investor Day, I actually said a number, so I'll say a number. We said roughly we took it up quite a bit on both. For Chaucer, I took it up and for us. In total, it's $225 million. I think it's $150 domestically and the rest being in Chaucer, both of which are significant upticks because I think it's over a half a point. It's almost a point domestically, but remember, our mix is much more casually than it was before, too, so it's a meaningful take up. Again, the reason I did it is I look at the last 2 or 3 years. One of you guys did a really nice piece on median and mean and stuff, and obviously, it's above our median and mean, but I think it's prudent given what we saw in the last couple, 3 years. Now again, we haven't sat on our hands on that. We've worked hard in the Northeast for thinning and we've tried to do a good job managing our exposures as well, but I thought it was just a prudent thing to do. The other thing is like the quarter to quarter perspective. With Chaucer it's a little bit more evenly spread than it would have been just for us, those numbers. Obviously, the third quarter tends to be a little higher, and because we're a northeast company, the first quarter goes back and forth based on drive time storms, but again, it's a little more balanced than it has been historically as you think about it quarter to quarter as well, so we took it up and we balanced it a little bit as well.

Operator

The next question we have comes from Cliff Gallant of KBW.

Clifford Henry Gallant
Keefe, Bruyette, & Woods, Inc., Research Division

Just a couple clarity questions from David. The mid-single digit growth, that's excluding Chaucer, I assume?

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

Yes, that's when Chaucer normalizes.

Clifford Henry Gallant
Keefe, Bruyette, & Woods, Inc., Research Division

Okay, and then Dave, when you were talking about -- I think you mentioned severity trends being favorable, I mean workers' comp. Do you think it was a one-off thing in the quarter or is that more of a trend that you're seeing?

Marita Zuraitis
Former Executive Vice President and President of Property & Casualty

This is Marita. One of the things you have to keep in mind when you're comparing year over year in the comp results is we have a favorable comparison this year because of the shock loss we had last year from Connecticut, distributors that we disclosed, so there really are no underlying severity trends that we're seeing, either on a quarter over quarter basis or year over year in the comp line.

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Clifford Henry Gallant
Keefe, Bruyette, & Woods, Inc., Research Division

Okay. And then, Fred, in the past, you've talked about the marketplace and how it's evolving and regards to larger competitors versus small. I'm curious as you grow and take share, where do you see it coming?

Frederick H. Eppinger
Former Chief Executive Officer, President and Director

That's a great question. What's fascinating right now, obviously, between the model changes and the volatility, clearly, the small companies are under a tremendous amount of pressure. There's a big percentage of them that have to grow to protect -- have the strength to protect their surplus. So what you're seeing from them is a lot of across the board actions because they're not as sophisticated on how to do it or just basically withdrawing from agents, et cetera. There is some places where we're—I don't want to say cherry picking—but we're taking the better business from those actions because of the way they're having to act and do what they need to do. But in addition, again, because of our portfolio and the attractiveness of our business model, our view is that we have a very unique -- I'll give you an example. Small commercial. Our small commercial operating model value proposition with our franchise agent, who's very attractive under $50,000 because we have now distributed local underwriters on top of our automation and point of sales, so if anybody does across the board pricing or they re-underwrite in a broad-based way, our ability to cherry pick or get good house accounts and get preferred shelf space is real. I tell people in the turn, yes, it's a lot about pricing, but it's just as much about re-underwriting because what ends up happening is people have to shrink to protect capital or they look at some things in exposures and they basically can't take the risk, so that's why the ENS market takes off because a lot of these smaller companies don't know they have certain types of risks until they have a problem. So what we're seeing right now is our ability to take business from a lot of people as people have chosen to make us a more preferred partner and give us chunks of business, so most of our growth right now is coming in chunks as people are shifting share. On the specialty side, again, just like you've seen some of the commentary of people who talk about ENS markets going, we've also seen in the industry solutions and in the specialty areas, that as these companies get burned or they have stress, there are exposures that they're covering that they don't know they're covering -- I'll give you an example. Our Hanover Industrial, which is our HPR business, a lot of that business is with regional companies that either don't know they have that kind of volatile exposure or they don't price for it, so we're seeing a lot of that business now being more appropriately re-priced and the coverage being recognized, so there's opportunities there as well. So in my view, we're going through a classic turn where people are re-underwriting. The difference between this turn, and it's not dramatic, and a lot of people would say it's gradual, but it is a combination of balance sheet driven because of the yields and because of all the pressure they have on comp and on weather. I don't think, besides weather, that those other 2 features have been fully capitalized or realized, so what we see is a momentum in rate increases and a momentum in disruption that we think is going to get worse before it gets better. We think there's going to be more opportunity in the coming months, not less. Again, for me, I feel like we're going to get really good business from the right agents from a lot of sources. Again, we just have to be patient, we have to be conservative and we've got to make sure that we're enhancing our margins along the way.

Operator

The next question we have comes from Meyer Shields of Stifel, Nicolaus.

Meyer Shields
Stifel, Nicolaus & Company, Incorporated, Research Division

One big picture question and one detail question if I can. Let me start with the smaller question. Can you quantify the change in reserve releases at Chaucer on a year-over-year basis?

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

As I said in my comments, we had about a 7 point benefit to the combined ratio for the releases. That was consistent with where we had in the third quarter as well, and I think maybe to put it in perspective

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for you, on a longer-term basis as I look at the history, roughly 7% is below their average annual release level.

Robert Arthur Stuchbery
Former Chief Executive Officer and Executive Director

Yes, that's right.

Meyer Shields
Stifel, Nicolaus & Company, Incorporated, Research Division

Okay, and Fred, you talked recently about the changing environment for small—I'm going to assume Midwestern insurers that have been under significant weather pressure. Is there any uptick in companies looking to be acquired relating to that?

Frederick H. Eppinger
Former Chief Executive Officer, President and Director

Yes, I think, again, what you're seeing in mutuals in particular is a significant trend of mutuals talking to each other and getting together. Obviously, the big Harleysville is the obvious one that you guys think about, but if you look underneath it, the amount of discussions among small mutuals and, actually, the merging among mutuals is probably at the highest I've ever seen. So it's quieter, it doesn't get as noticed, but it's real and what it does is, obviously, when you tape 2 stressed companies together and you put them together, that often doesn't make a great company. So there's a lot of turmoil that comes from that. There's a lot of disruption that comes from that. In my view, it's a significant thing to think about. Now it takes longer because one of these things. What's common among a lot of mutuals and smalls is they're rated by best, so it's quieter. You can't see it. You don't know what the private conversations were. The debt rating agencies, everything's much more visible. You can feel it. You can see it. Public companies in particular, you can see it, so it's hard to get underneath it, but there's no question what we're seeing is more of those conversations, and we know it because of the personnel that we hire and people that are interviewing with us because of the ramifications of that. We can also kind of see it in the blanks, but in my view, that is a real trend. I think a more important trend, even, is share shift. I talk about this a lot. If you go back over the last 40 or 50 years in our industry, what you typically see, one of the biggest trends you see during a cycle like this, is share shift from the weaker people to the stronger people. So in the next 2 or 3 years, there will be share shift to the folks that have the flexibility and the capital and the capabilities. It just always happens. What's unique about this one, in my view, is that typically a lot of the small regional companies sit out this kind of share shift because the returns there, it affects them a little, but not a lot. The difference on this one is this combined strain, I believe, that is created by their cost of capital going up because of the reinsurance cost that they're faced with because of the volatility we're seeing, and the cost of capital issues that come from yields being so low, and their availability of capital is as low as it's ever been. The access to surplus notes and all that stuff that we had for the last couple decades, it was quite easy to get at. It's not easy, so, again, my view is we're going through a very interesting period. Again, because we focus our businesses mostly mid to small, we tend to live in it more than some of the big guys that don't talk about it as much, but it is prevalent among a lot of our players. The other thing you're seeing, which we talked about a little bit at Investor Day, is also the consolidation of agents, which also has an implication, so you're seeing, again, the volume of the better agents consolidating other agents has increased. Why is that important? They also want fewer, stronger carriers as partners. The bigger they get, the more sophisticated they get, which lends themselves to the bigger guys having preferred shelf space because, again, the bigger, more sophisticated agents that want value and want fewer markets is also a trend that we believe will continue for some period of time and both of those help us if we stay focused. Those trends help us.

Meyer Shields
Stifel, Nicolaus & Company, Incorporated, Research Division

Okay, I think that makes perfect sense. I'm just wondering, when you shift gears and look at the personal line side, then, are you big enough now to be considered one of the big guys?

Frederick H. Eppinger

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Former Chief Executive Officer, President and Director

Yes, I believe so. Again, you've heard me talk about this. There's a whole valuated seventh segment to personalize that people don't really quite understand that 65% of the business that want more of an account focus, the umbrella matters, and a lot of the direct guys don't get access to it. A lot of that good business is in the captive control. The problem with all this volatility, again, is you need spread of risk, so what you're seeing is some share shift from the captives to the independent agency channel around this account orientation. The other good thing that has occurred in the last 3 or 4 years is that pricing levels for property in the Midwest has gone way up. Why? Because the regional companies haven't suppressed it. They can't suppress it because of their issues. So we look at our geographic spread. You've seen what we've done. We've worked from the 4 states that were a lot of our business to we have a nice portfolio of 20 states, and we believe that both our scale locally and our scale generally is very, very competitive. There's very few people bigger than us in the independent agency channel right now, it's ample. Again, we would argue that our momentum is good.

Now what masks our information is that, as Marita has said every quarter, we have a lot of concentration in 3 or 4 states so we manage that, as we talked about in earlier questions, slowly down. In total, I feel very good about our ability to maintain good margins in personal lines. Again, I would argue that as the consolidation occurs with the more sophisticated agents and brokers, they need a lead player that's more geographically spread that adds value so the Wells of the world and some of these other companies that we match up well with lends us as being a lead player for them as they get more consolidated as they build their business as well, so I feel good about it. Again, it is what it is as far as it's been part of our history, but I like the business right now quite well to get to the returns we need to.

Operator

The next question we have is from Christine Worley of JMP Securities.

Christine Amanda Worley
JMP Securities LLC, Research Division

I notice that your accident year x cat loss ratio in the multi-peril line came down significantly in the fourth quarter from the 9-month run rate. I know you said you were seeing some favorable trends in the CMP book, so I'm just wondering if this is more of a go-forward number or sort of a just true up for the year.

Marita Zuraitis
Former Executive Vice President and President of Property & Casualty

Yes, on a quarter over quarter basis, it's hard to draw any trend conclusion from that. We feel good about the rate that we're getting. We feel good about the mix. I wouldn't overestimate any trend in a quarter. It's everything that Fred and David said in their script. We feel good about the rate. We feel good about the mix and we're confident in the type of business that we're writing.

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

Yes, and again, one of the interesting things about that line for us for a lot of that is in our niche business, too, and what we've seen is really nice growth in our industry solutions where we have a little bit higher margins in our view and more retention, so to Marita's point, we're very happy. We've kept good rate levels, have had for a number of quarters and we've got that mix toward the niches that's just helping us in so many ways, and again, I think that it's going to continue.

Marita Zuraitis
Former Executive Vice President and President of Property & Casualty

And to your point, nice retention because of the type of business that it is.

Operator

The next question we have comes from Sarah Dewitt of Barclays Capital.

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Sarah Elizabeth DeWitt
Barclays PLC, Research Division

What are your assumptions in 2012 for the earnings contribution from Chaucer?

Frederick H. Eppinger
Former Chief Executive Officer, President and Director

We didn't explicitly give a breakout of the earnings contributions by business. I talked about how I felt about Chaucer at the Investor Day and I think you've seen 2 quarters that kind of range. The first quarter we had them, the cats were a little light. The second quarter, the cats were a little heavy, but I think that they're going to be a very good, consistent contributor to our returns. Again, I think you have some indications when you look at that and what we've guided for cats on what we see coming out of there. But we haven't specifically identified in every business what the contribution is. We believe that Chaucer is in the range of target returns today. We look forward. We believe that the market environment, the portfolio, we believe that Chaucer can return target returns for us based on our investment right out of the gate. So that's another way to think about it. Again, I can't emphasize, we worked for 2 years to really make this happen. This is a fantastic world-class team. It fits us well. The portfolio we're going forward with is very good. It helps us as a portfolio in a number of ways. You just think about it. We just went through both the negotiation for the close and the close, the worst year in history in international cats, and what it's proven to me is how darn good they are, because to go through this kind of year and have this kind of certainty about our outlook tells me that what we did was good and the advantages that it brings to us, so again, I'm very, very pleased with where we are.

Sarah Elizabeth DeWitt
Barclays PLC, Research Division

Okay, and then should we expect any share buybacks in 2012?

Frederick H. Eppinger
Former Chief Executive Officer, President and Director

Yes, again, what we said, we got it on the share numbers. Right now, my view is we did a little opportunistic stuff in the third and fourth quarter because our stock price was so low, but our belief right now from I think what I've said today is what we see is real opportunity for us. We've got to be thoughtful. We've got to be targeted. But if we can continue to increase our rate increases, because again, if you look at our retentions, what it tells me is we have more momentum in rate increases. We can do a little more so we have really good momentum there. It's virtually in all our businesses. The mix is good. We're getting momentum with underlying growth and pretty much in most of our businesses, so what I want to do is be very thoughtful about capital right now and making sure we're using capital to places that have the kind of returns that can get us to our target returns through the cycle, so I believe right now it's prudent to maintain that capital and think about deploying it at the places where we have the greatest opportunity. Now again, we're always thinking about it. Look at it. If the market backed up or if we felt that there was an opportunity, could we change our perspective because we do have some excess capital? Sure, absolutely, but right now, my view is that it's better deployed in a targeted way to watch this market, see where the opportunity is and make sure we capture every opportunity we can to enhance our margins, and that's where I'd use my capital right now.

Operator

The next question we have is a follow-up from Ray Iardella of Macquarie.

Raymond Iardella
Macquarie Research

Fred, you spoke about personal lines and I guess you know the importance it plays in a lot of the agencies that you guys partner with. How is the reaction from their point of view with you guys maybe thinning out some of your concentration risk? Is there any pushback from your agents?

Frederick H. Eppinger

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Former Chief Executive Officer, President and Director

That’s a great question. This is the beauty of our strategy. When you go through a turn like this, the issue always is when you put price increase, are you losing the better business? What we do, which is a little bit different, is that because we have a partner agent strategy, when we thin out, we eliminate agents. Remember, where we have concentration is we have legacy agents from when we were just a personal-oriented indurates [ph]. We have a lot of agents that are not at the level of partnership. They’re fine agents, but when we thin out, we essentially give our capacity to our partners. So not only do we have a better chance of getting rate increases with partners because you have more with them in your line incentives, it is easier for us to thin because literally, we will get rid of, we will shed partners and our partners will react positively to that because their franchise value is greater. Regulatory-wise, it’s the reason why, by the way, we’ve been able to do renewal rights and targeted pockets, because what we do is we identify agents’ dedicated business and do a renewal rights deal and find people to give us something for that business. So again, one of my views is that it’s harder to get started with fewer agents and better agents, but it’s beautiful at the turn because the ability to get rate increase, the ability to grow, the ability to shed is so much easier when you’re talking about a strategy like we have. Again, remember, where we have some concentration issues I worry about, we did have some legacy agents that, again, they’re fine, it’s just that they don’t have a lot of upside. They’re not -- have the broad portfolio that we now match up with, so we try to find them another market. Again, I’m not worried at all about the surgical actions we’ve taken. In commercial, most of the actions we’ve taken are very surgical, so it’s really the personal lines, to your point, where we’ve had more volume, and remember, the legacy agents tend to be 80% personal. It’s our history, right? So again, it’s a little bit easier than others to do what we’re trying to do without affecting the quality or nature of our business.

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. Ms. Lukasheva?

Oksana Lukasheva
Vice President of Investor Relations

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

Operator
We thank you, ma’am, and to the rest of management for your time. The conference is now concluded. We thank you all for attending today’s presentation. At this time, you may disconnect your lines. Thank you.

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