S&P Global
Market Intelligence

The Hanover Insurance Group, Inc. NYSE:THG

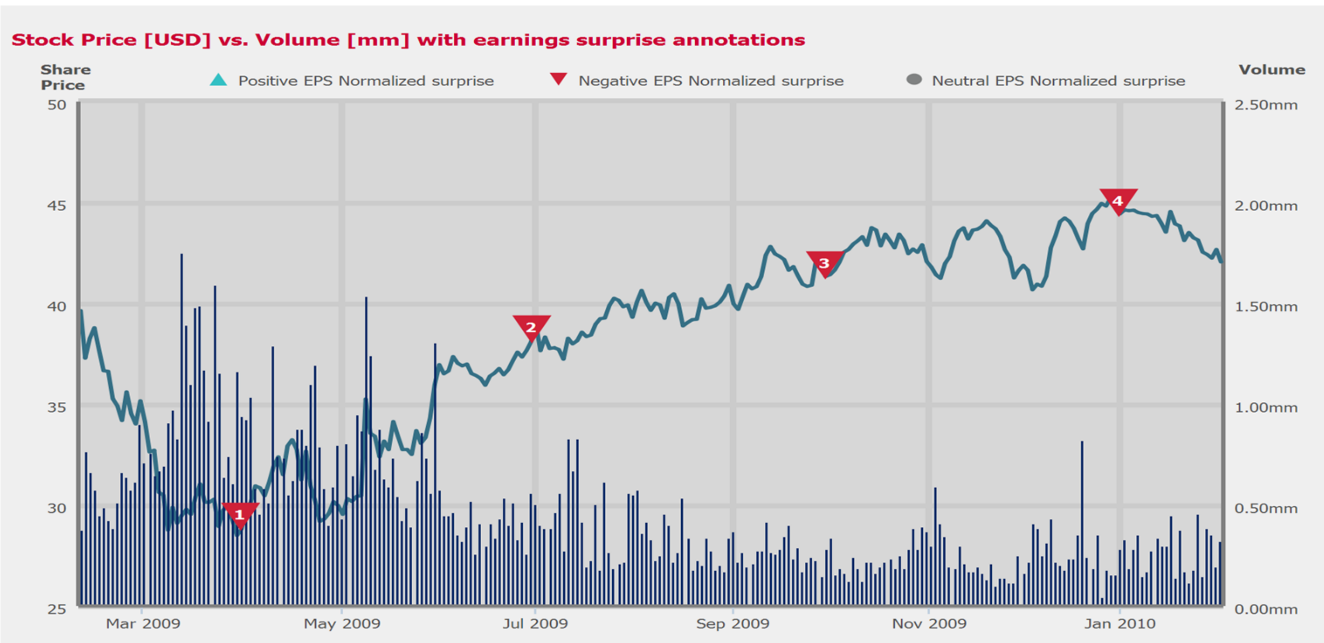
FQ1 2010 Earnings Call Transcripts

Friday, May 07, 2010 2:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ1 2010-			-FQ2 2010-	-FY 2010-	-FY 2011-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.77	0.66	(14.29 %)	0.96	3.53	4.36
Revenue	-	-	1.77	-	-	-
Revenue (mm)	712.60	725.20	-	739.40	2961.60	3139.55

Currency: USD
Consensus as of May-07-2010 7:01 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ1 2009	0.44	0.39	(11.36 %)
FQ2 2009	1.02	0.86	(15.69 %)
FQ3 2009	0.98	0.89	(9.18 %)
FQ4 2009	1.01	0.83	(17.82 %)

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Call Participants

EXECUTIVES

Bob Myron

Frederick Henry Eppinger
Former President & CEO

Marita Zuraitis
Executive VP, President of Property & Casualty Companies

Steve Bensinger

ANALYSTS

Cliff Gallant
KBW

Larry Greenberg
Langen McAlenney

Michael Phillips
Stifel Nicolaus

Sam Hoffman
Lincoln Square Capital

Presentation

Operator

Good morning and welcome to The Hanover Insurance Group first quarter 2010 Earnings Call. All participants will be in listen-only mode. (Operator Instructions). Please note this event is being recorded.

I would now like to turn the conference over to Bob Myron, Senior Vice President, Finance. Please go ahead.

Bob Myron

Good morning and thank you for joining us for our first quarter conference call. Participating in today's call are Fred Eppinger, our President and Chief Executive Officer, Marita Zuraitis, President of Property & Casualty Companies and Steve Bensinger, our Executive Vice President and CFO.

Before I turn the call over to Fred for a discussion of our results, let me note that our earnings press release statistical 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 facts, include forward-looking statements. These include statements regarding expectations of segment earnings, after-tax segment earnings per share, pricing, accident year results, premiums, expenses, development of loss and LAE reserves, returns on equity and other projections for 2010.

There are certain factors that could cause actual results to differ materially from those anticipated by this press release, slide presentation and conference call. We caution you with respect to reliance on forward-looking statements and in this respect refer you to the forward-looking statement section in our press release, slide 2 of the presentation deck, and our filings with the SEC.

Today's discussion will also reference certain non-GAAP financial measures, such as total segment income, after-tax earnings per share, segment results excluding the impact of catastrophes, ex-CAT loss ratios and accident year loss ratios among others.

A reconciliation of these non-GAAP financial measures to the closest GAAP measure on a historical basis can be found in the press release or the statistical supplement, which are posted on our website as I mentioned earlier.

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

Frederick Henry Eppinger
Former President & CEO

Good morning everyone, and thanks for joining us. I will give you some context to our results for the quarter as well as discuss how I view our progress.

The first quarter of 2010 was particularly challenging for our industry due to an elevated level of catastrophe. While we incurred catastrophe losses of $34 million during the quarter, which was about $10 million or $11 million above our expectations, I'm nonetheless very pleased with our results.

As shown on slide 4, net income per share for the quarter was $0.87. Our operating EPS of $0.66 represents an increase over the prior year quarter, reflecting strong underlying trend.

As shown on slide 5, our book value per shared increased 3.8% in the quarter and 34% in the last 12 months, driven by our operating results, gains in our investment portfolio and our share buyback activity.

We have made good progress this quarter on all the leverage to improve our operating results that I discussed with you last quarter.

First, we had good momentum in growing our Specialty and Commercial Lines businesses and leveraging the investments we have made in these areas.

Second, we improved our geographic and business mix, which drive improved and more stable results in our future.

Third, we continue to get improved pricing in both Personal and Commercial Lines, and finally, we continue to take thoughtful capital management actions, so I'll briefly review each of these areas.

First, on reaching what I would call better scale in Commercial Lines, in the first quarter, we grew 33% driven by our renewals rights transaction with OneBeacon, as well as our growth with Specialty Lines.

While it is too early to give a forecast of how much the OneBeacon business will ultimately renew, we feel very good about how the arrangement has gone so far. The transaction began through a reinsurance arrangement with OneBeacon for January 1st and subsequent renewals, and we have been very pleased with the level of enthusiasm from the legacy OneBeacon agents to partner with Hanover. And with how many of these high quality agents are converting most or all of their OneBeacon books to us.

We have also hired many great people from the organization across multiple disciplines and we expect to leverage these hires over the course of 2010 in our future period.

Generally in the first three months, we are getting rate increases on the renewal rights transactions, similar to those that we are experiencing in our legacy Commercial Lines business. The quality of the renewals and how they have progressed thus far allows us to maintain our underwriting approach and discipline while achieving attractive retention rates.

I also feel great about the transaction that we are getting in our specialty businesses. We closed on our acquisition of Campania on March 31st and the integration of this company and its book of business into our suite of products is off to good start.

Our partner agents have expressed strong interest in Campania's healthcare offerings and we believe we will be able to cross-sell our core Commercial Lines products to Campania's client base. I believe we will be able to see some impact with our partners towards the second half of the year.

Separately, we have started writing business placed by our other recent acquisition, Benchmark, effective April 1. Benchmark has an experienced team of underwriters that offers coverages for architects and engineers and represents a very attractive addition to our professional line suite of products and our level of expertise in this area.

Lastly, we continue to have strong momentum at AIX evidenced by the recent announcement of our partnership with Barney & Barney in which we will underwrite two of their very attractive programs. It is particularly notable that in the first quarter our net written premiums in Commercial Lines exceeded our net written premiums in Personal Lines. This is a testament to all of the thoughtful actions we have taken throughout the course of our journey to diversify our company, improve our mix and expand the capabilities of our organization.

As I have previously indicated, our expense ratio, particularly in Commercial Lines is higher than our long-term target. As you know, we have expected that the Commercial Lines expense ratio would be high in the first half of this year. Much of the increase in expenses this quarter reflects upfront investments in the renewal rates deal and our western expansion efforts.

Additionally, we continue to ramp up our AIX and other specialty capabilities. With all of these initiatives including Campania and Benchmark acquisitions, there are significant upfront costs as we integrate operations, build new products, and make a policy, form and rate filing. We have put people and infrastructure in place ahead of the premium in order to provide the highest quality of the service through our partners.

The mechanics will work in favor prospectively as we earn in the growth we are achieving in net written premium in the later part of 2010 and into 2011. We expect the expense ratio to decrease. While net written premium in Commercial Lines increased 33% in the first quarter, unearned premium increased 12%. This percentage increase should be higher in future quarters.

Our principle objective in investing heavily in these new capabilities is to drive fundamental margin improvement in our overall book of business through geographic and mix shift, which is the second lever, I mentioned previously.

Our overall mix of business continues to improve. In core Commercial Lines, we are growing our segmented or niche businesses, much of the OneBeacon business we are renewing is also segmented or in niche. We are also diversifying our exposures in Commercial Lines after we entered the seven news western states on January 1.

So far most of the premium writings in the west are driven by OneBeacon renewal, but our reception from our new partners has been excellent and I expect we will see broader flow in the second half of the year as all our products are approved in the new states.

Lastly, specialty continues to make up a growing portion of our overall Commercial Lines book driven by our acquisitions and new product investments. I am also pleased with our Personal Lines mix improvement, as we continue to grow the percentage of our business that is in full account and our book continues to shift to more diversified geographic profile.

The improvement in our third profitability lever, pricing, is more notable in Personal Lines. However, we continue to achieve modest rate increases in our core commercial renewals as well. Pricing continues to be challenging in larger accounts, but in the small-to-middle market that we target, we are able to get positive rate increases this quarter.

Finally, we continue to take a very proactive approach to capital management. As a result, we decreased our company's overall cost of capital and increased book value per share through stock repurchases we should also drive our ROE and EPS higher in future periods.

We also increased our annualized dividend rate by 33% in the quarter. Steve will provide more detail on the capital management actions in his remarks.

It is still a tough investment environment with new money yields of level lower than a year ago as evidenced by our decreased book yield. However, we still believe our conservative investment philosophy is prudent and we don't have any intention of stretching for yield or taking more credit or duration risk.

So, as our first quarter results demonstrate, we made some important progress and are on track to improve our margins, return on equity through utilization of the leverage we have at our disposal and we will continue to make stride in future periods.

In conclusion, I would like to provide some perspective of what you can expect to see from us in the coming quarters as well as my views on the state of the market.

Next quarter, we will continue to drive Commercial Lines growth through our continued focus on the OneBeacon renewals and on our western expansion, which should begin to generate more new business growth. We have a substantial number of new product filings in the pipeline related to the broadening of our capabilities associated with our recent acquisition, and we also have products in new state launches for existing segments that when approved will generate growth in our specialty businesses.

Earned premium growth should pick up in the second quarter helping us to leverage some of our upfront expenses and expense ratio in Commercial Lines should start to decline. I believe we should continue to see improved profitability in Personal Lines.

Higher margins in the first quarter were a product of fundamental and persistent changes in the make up of our business, a dramatic mix shift to account business, stronger agency partnership and rate increases, therefore putting random weather aside; we should see these higher margins in P&L continue for the coming quarters.

From a pricing environment perspective, the market is generally supportive of our rate increases in Personal Lines. We are seeing similar trends from competitors, so we don't expect that achieving rate increases for the remainder of the year would put excessive pressure on our premium writings to retention level.

In Commercial Lines, the market is very competitive and we are again seeing a rationale pricing action from some of our competitors in the core commercial business. We intend to maintain our pricing discipline and not follow the market down in that respect.

Lastly, the state of the economy continues to generate headwinds, but thus far this has had a limited impact on the margins of our business. It does not change how I feel about our prospects going forward.

With that, let me turn the call over to Marita.

Marita Zuraitis
Executive VP, President of Property & Casualty Companies

Thanks, Fred. Good morning, everyone and thanks for listening to our call. I'm pleased with our results in the first quarter. While the insurance environment this quarter was as difficult as it has been for the past several quarters in terms of economic and pricing conditions, our underlying trends have improved. I would like to review the sources of that improvement and also touch on some areas of focus on our businesses, starting with Personal Lines on slide seven.

Our first quarter produced $34 million of pre-tax segment income compared to $3 million in the prior year quarter, driven by lower catastrophe losses, but most importantly driven by better underlying loss margins in both our auto and homeowners lines.

First, a couple of observations on catastrophes. Our cat losses in the quarter were lower on a relative basis than many of the other competitors in the industry. Our aggressive catastrophe management over the past has resulted in the reduction of our coastal risk in the Northeast, as well as in other parts of the country.

In addition, the tracks of the first quarter storm missed much of our Northeast footprint. Most of this quarter's winter storm activity was in the Mid-Atlantic where we have relatively modest Personal Lines market share. So despite the fact that we maintained a significant presence in the Northeast, our losses were mitigated.

We had our fair share of snow and freeze losses as we always have and expect to have in the first quarter, but we were spared from the excessive water and wind damage that affected many other companies. We realized the importance of continuing diversification and aggressive catastrophe management and we continue to make this a priority.

Excluding the impact of catastrophes, our Personal Lines combined ratio in the current quarter was 93%, compared to 99.3% in the prior year quarter. As far as non-catastrophe weather is concerned, we believe this quarter was more or less a return to the long-term average.

Excess snow storms in the Northeast were offset for us by a relatively quiet weather quarter in the Midwest. Our geographic mix usually results in elevated weather losses in the first quarter. Overall, we are comfortable with our pricing which takes a much more conservative view of the weather. We estimate that at least two to three points of the improvement in our Personal Lines underlying loss ratio was driven by changes in mix of business and price increases that we put through last year.

Frequency improved substantially at specialty and homeowners and auto physical damage coverages, while severity maintained relatively stable levels. The increase in auto liability severity that we saw in the latter part of last year in which we talked about on our call in February has moderated.

Turning to slide eight to discuss our Personal Lines growth in the quarter; in the first quarter of 2010, net written premium increased 1% compared to the prior year quarter, mostly driven by higher rates in both auto and home businesses.

Our average rate increase in the first quarter in both auto and home was 5% compared to the prior year quarter and our retention is improving, which we attribute to the mix of business shift that we undertook two years ago. We are building a book of multi-car total account business that tends to be less price-sensitive and as a result we were able to balance the need for additional rate without reducing retention.

Our homeowners net written premiums grew substantially in the quarter reflecting those rate increases, policy counts increased moderately, driven by growth in our newer states like Ohio, Wisconsin and Illinois and as we continued our account-rounding efforts and thus continue to build the foundation of total account business, which tends to drive higher retention.

Overall, our premium production in core states decreased 1.5%. We have seen aggressive pricing behavior from some of our competitors in their race to renew auto business in Massachusetts and New York. We continue to maintain pricing discipline and therefore have seen reduced new business in these and several other states.

In our growth states, net written premium increased 7% in line with our strategy of diversifying our Northeast and Michigan exposures. As we look to the rest of the year, we have visibility into continuing profitability in Personal Lines.

Our view is supported by investments in our product and ease of doing business enhancements, change in our business mix and our commitment to the independent agency channel, which we know is very important to our partner agents.

Moving on to Commercial Lines on slide nine, our pre-tax segment income for the quarter $23 million compared to $48 million in the first quarter of 2009. Catastrophes lowered our pre-tax earnings by $19 million in the current quarter compared to $11 million in the first quarter of last year.

We believe our losses this quarter were consistent with our concentration in the affected markets and reflect our growing presence in Commercial Lines in the Central and Mid-Atlantic regions.

On an ex-cat basis, our combined ratio in the first quarter of 2010 was 96.5 compared to 89.8 in the prior year quarter. Remember 2009 benefited from a higher level of favorable development.

Our ex-cat accident year loss ratio, which we believe is a better indicator of the quality of our Commercial Lines book was 49.1 or 1.7 points lower than in the first quarter of 2009. More typically, non-CAT weather this year contributed to the favorable year-over-year loss comparison. Underlying trends in our core Commercial Lines were also positive, especially in BOP and auto where frequency and large losses where substantially lower than in the first quarter of 2009.

Partially offsetting this positive comparison in our core lines with an increase in losses in our marine business. This being a Property Lines tends to be lumpy quarter-over-quarter and we don’t see anything alarming in the trends as we go through our analysis.

In general, we are pleased with our stable loss ratio trends in Commercial Lines, especially given our rapid expansion into new product capabilities and our acquisitions.

Our consistent results are validation of our thoughtful approach to growth in the soft market, our underwriting discipline and our prudent risk management.

As Fred has already discussed with you in some detail, our elevated Commercial Lines expense ratio this quarter is a result of our upfront investment in the people and infrastructure needed to serve our agents and customers in our expanded territories and on our new product capabilities. We expect the ratio to come down as we bring this business into our portfolio.

I'll now move on to a review of our Commercial Lines growth on slide 10. In line with our specialization focus, our growth in Commercial Lines reflects the impact of the OneBeacon renewal rights transaction, growth in our AIX businesses as well as growth in professional liability and other specialty businesses.

Approximately 24% of our overall 33% Commercial Lines growth this quarter is attributable to the renewal rights agreement with OneBeacon.

This was in line with our expectations. However, going forward it may be more difficult to maintain this pace of renewal retention as competition around this book may intensify. A large portion of the OneBeacon business is in segments and niches consistent with our small and middle market strategic focus.

Typically, this segmented business is similar to that covered on a standard commercial policy, but there is enough differentiation in servicing, loss control or policy language to set them apart from regular flow business. This differentiation and product delivery with appropriate modifications and coverage historically drives higher margin and helps with retention of the business.

Over 70% of the premium we've renewed so far falls within these targeted segments and niches. In the middle market space, we're adding new segments like cultural institutions and additional professional services to our portfolio. In small commercial, we've added several affinity programs.

We are pleased that we are getting the expected traction with our new western footprint with 30% of the renewals written from OneBeacon renewal rights transaction in the first quarter coming from these new western states. This validates our western expansion investment as well as diversifies our portfolio.

Outside of the renewal rights transaction, growth in our core Commercial Lines was somewhat dampened by increase in competitiveness in the middle market space. While our rate changes in small and middle market accounts were positive in the current quarter, our conservative underwriting approach put additional pressure on our new business volumes.

We are being selective and conservative with respect to new business at this point in the cycle. However, we are fortunate to be able to access high quality business from the renewal rights arrangement to supplement our continued growth. Our Specialty Lines also continued to gain momentum. AIX is making significant strides with our key partner agents while maintaining profit margins.

Our Hanover professionals unit has been bolstered with added capabilities of our architects and engineers and miscellaneous professional liability products. We are seeing a lot of interest in our new specialty capabilities from our partners. Not only in the products we offer today but also in those under development.

Overall, catastrophes aside, Commercial Lines produced results in the quarter in line with our expectations as well as our long-term strategy. Going forward, we expect to continue to improve the quality of our business mix while growing at double-digit rates as we leverage the breadth of the business opportunities that we have created over the last couple of years.

With that, I will turn the call over to Steve

Steve Bensinger

Thank you, Marita. Good morning, everyone and thank you for joining our call. This is my first conference call with The Hanover and I am very pleased to be here. Today, I will be reviewing the company's financial results, referencing the slide presentation and starting with slide 12. I'd like to provide some color on reserve development and touch on a couple of non-segment earnings items on our income statement before I move on to discussing our balance sheet.

Our pre-tax P&C segment earnings of approximately $58 million this quarter included $24 million of favorable loss reserve development. This compares to favorable loss development in the first quarter of 2009 of $32 million which included adverse development from 2008 year-end non-cap other events.

Accordingly in line with our expectations, we are experiencing lower favorable loss development than we have seen in the recent past. We expect this trend to continue as we take favorable development from prior years into consideration when making current accident year selections.

Also included in the current quarter result was approximately $10 million of favorable LAE development related to the decrease in the cost factors utilized for establishing unallocated loss adjustment expense reserves. We had not updated these factors for several yeas.

Accordingly, we do not have an expectation that we'll have an adjustment of this magnitude in future periods, but the first quarter of 2010 also benefited from realized investment gains of almost $11 million, resulting from some portfolio repositioning.

Turning to slide 13, I'd like to briefly touch on our investment portfolio and yields. At the end of March, we held $5.1 billion in cash and invested assets. Cash and fixed maturities represent 99% of our total invested assets, roughly 93% of our fixed income securities are investment-grade. The average duration of the portfolio is 4.1 years. The composition of our portfolio remains largely the same as in the prior year period as well as in the sequential quarter, so I will not cover all of the investment slides.

Net investment income in the first quarter was $61 million compared to $65 million in the prior year quarter. This decrease is due in large part to the utilization of fixed maturities to fund stock repurchases of $274 million in 2009 and 2010, repurchases of corporate debt of $180 million and $100 million pension plan contribution, while this lower level of investment assets produced lower net investment income. These capital management actions also reduced our interest in pension expenses. The decline in net investment income this quarter also reflected lower new money yields.

The yearend yield on our fixed income portfolio this quarter was slightly lower, 5.48% compared to 5.81% in the prior year quarter. New money yields were 4.19% in the first quarter of 2010 compared to 4.65% in the first quarter of 2009.

As we look to the remainder of the year, we expect our NII to remain stable despite the lower yield environment. Strong growth in our insurance operations should drive a moderate increase in invested assets. We are also looking to selectively invest in areas currently undervalued by the market, while not significantly adding duration and credit risk to our portfolio.

Let's turn to Slide 17 for discussion of our capital management actions. During the quarter, we successfully executed $200 million 10-year senior debt offering with a 7.5% coupon. As a result, we estimate the new run rate for the pre-tax interest expense will be about $11.5 million per quarter.

At March 31, 2010, our consolidated corporate debt stands at $632 million. This equates to debt-to-total capital ratio of 21.5%, which is well within rating agency thresholds. In the first quarter of 2010, we bought back 610,000 shares for a total value of $25 million through open market repurchases.

We also implemented $101 million accelerated stock repurchase transaction under which we've repurchased 2.3 million shares, plus over the last 12 months, we've repurchased 6.5 million shares or about 13% of our shares outstanding at the end of last March.

We did not repurchase any additional stock after the ASR transaction on March 30th, so as of today, we still have about $65 million of capacity under the $400 million stock repurchase authorization.

As Fred said, this quarter we moved to a quarterly dividend payment schedule and paid our first quarterly dividend of $0.25 per share, which represents an increase over the prior year of 33% on an annualized basis. We expect to generate additional capital in 2010, and as always, we'll be thoughtful about its optimum utilization.

Turning to slide 18, our balance sheet remains very strong. Our GAAP equity decreased $57 million during the quarter, reflecting the open market repurchases and ASR for a total of $126 million as well as dividends of $12 million. On a per share basis, however, book value increased 3.8% in the quarter to $51.59.

At the end of the first quarter, our statutory surplus was $1.75 billion and at 1.6 to 1, our premiums to surplus ratio remains more than acceptable for our current ratings and mix of business.

Holding company cash and investment securities were $348 million at March 31. Additionally, on January 4th of this year, The Hanover Insurance Company made $100 million contribution to the company's qualified pension plan, and as a result, the plan was fully funded as of that date.

The liquidity for this funding occurred within The Hanover Insurance Company. It did not affect holding company liquidity or shareholders' equity. The decision was driven by asset liability matching considerations.

Finally, couple of thoughts on our outlook. Because pre-tax catastrophe losses in the first quarter were about $10 million to $11 million higher than our expectations, we are reducing our guidance range for the full year 2010 by $0.15. Thus, our new guidance range for after-tax operating earnings is $3.70 to $4.05 per share. The other assumptions for our guidance remain intact.

With that, let me turn the call back over to Bob.

Bob Myron
Thanks, Steve. Operator, could you please now open the line for questions?

Question and Answer

Operator

(Operator Instructions) The first question comes from Michael Phillips of Stifel Nicolaus.

Michael Phillips
Stifel Nicolaus

I was going to ask if it safe to assume that the $67 million from OneBeacon could be annualized? Well, it sounds line from Marita's comments, she said something about expect increased competition there, it sounds like that might not be the case, is it safe to do that?

Frederick Henry Eppinger
Former President & CEO

I think that the point is that if you look at traditional renewal rate fields, they tend to come in about 50%. Clearly, we're running better than that right now and I feel very good about what's happening with our agent partnerships and how well they are working with us. We are just cautious about obviously that Mike we are going to watch pricing and we are going to still get the pricing we need to get to make sure that the margin is good and we are obviously always watching competition as it kind of price to compete for that business as well.

We are cautiously optimistic about it continuing, but wouldn’t be surprise if it didn’t, but are managing this as we said when we did the deal through March and getting our rate increase just like we are getting rate increase through rest of our book and we are trying to keep the business that has attracted to us as we look forward, but again I would tell you we are optimistic about what's happening.

What's important I think is the fact that I feel wonderful about the partnerships we've built with these agents already. We have gone out and we've met every single one of them. We've had great conversations. They are our kind of guys and so when you look at the 500 in total and the 300 new, this is a terrific step forward for us particularly in the new geography is going to help us for long now. We are going to be in a good place with them. I don’t know, Marita, if you want to add any color to that.

Marita Zuraitis
Executive VP, President of Property & Casualty Companies

Yes, the only thing I'd add is obviously we really pleased with the way its going. This is business that we know, in classes that we know well, with agents that we know well. So we are pleased with the way its going. The only thing I’d add is because of the way we did this with closing and announcing virtually at the same time, we got a nice jump on this. So, as natural competitiveness starts to occur, we can see that trail off a little bit, but we are very pleased with the ways it’s going in bullish that we have done a good thing here.

Michael Phillips
Stifel Nicolaus

If I can turn to personal auto for a second, I have got the impression that some of the stuff you talked about before in terms of re-underwriting that to get it more out of focus had largely been done and so that with new stuff you did last year like the Think Hanover initiatives and things like that, would've maybe seen a better turn in shift than we saw for personal auto than we did. So, why don’t you talk about that? It's still negative. In fact, more negative than the last quarter. So, I was surprised by that?

Marita Zuraitis
Executive VP, President of Property & Casualty Companies

Yes, one thing I would say that you have to keep in mind that Massachusetts and potentially New York may have lagged that a little bit as managed competition came to Massachusetts, but you are right the majority of our heavy listing, our shift of mix, our focus on multi car, multi account business, our ability to push rate is also is certainly paying off in the profitability, but you got to remember that there is a couple of states there that are lagging a little bit in that turn. We are pleased with the profitability of that line and where it's going.

Frederick Henry Eppinger
Former President & CEO

I think it's a good observation. On the Think Hanover and the Hanover Household, a lot of the ease use stuff that has been rolling out in the first quarter, it is starting to work in a growth state. So I do feel that we'll hold our own there as we go forward, particularly in the growth states and I would just tell you that because of the way the weather unfolded last year in the non-Cat weather, we've been really aggressive, even with our full account on pricing in our core state, and I think we're seeing the result of that a little bit in the Northeast.

Again, I'm comfortable with that. If you look at our partner agent retention, it's better than our general agent retention and the mix of businesses is equitation. We are working hard and as I said in the last call, what we've done in Hanover Household is very powerful. We're going to start get more into what I call new influences. We're going to continue to have a better and improved mix in our growth states, and so I feel that we're not giving up on Personal Lines. I just think it was important for us to make sure we mange profitability right now, and we'll continue to get the mix better going forward.

Michael Phillips
Stifel Nicolaus

Last one for me now. Speaking of lagging states. In Massachusetts, does the fact the new direct guys coming in are now right are now in a triple digit loss ratios. Does that help you? Or is it the customer base is too different?

Steve Bensinger

Yes. No, it is a great observation.

Frederick Henry Eppinger
Former President & CEO

Whatever we had leftover that was single auto with non-core partners I can tell you.

Marita Zuraitis
Executive VP, President of Property & Casualty Companies

It's bound to haul.

Frederick Henry Eppinger
Former President & CEO

It's bound to haul, right. They are being very aggressive, and now what's encouraging? It happens everywhere. You watched New Jersey, three years ago, four years ago, when I went to competition, there's a 10% of the market that's truly is what I call is self-served market that goes back.

It's the guys that have just one car not a lot of substance as far as other assets, and what we've seen is that's gone quickly to the players. Now, what you've also seen, to your point, that these guys are registering triple digit kind of the results, and so you've seen Progressive take pretty significant rate increases and we expect to see it settle in.

Now, we don't have a big auto on the book. We have seen the hit more aggressively in our competitors that are various due to auto. There is a couple, as you know guys that are at Massachusetts are only players that are very, very heavy in auto and they have lost quite a bit of share.

So we did. We lost. If you look at it, we lost some auto that we had, particularly without outside best agent partners but I do think that will settle because I do see rate increases coming and expect it and I feel good about it where we are.

Michael Phillips
Stifel Nicolaus

Okay. Thanks, Fred. I appreciate it.

Operator

The next question comes from Cliff Gallant of KBW. Please go ahead.

Cliff Gallant
KBW

Just a couple of questions on investment income and how we should think about that over the next year, year and half. They are in two parts. One is, as the OneBeacon book grows and accrues you, how much investment income benefit would that get us next year? And then secondly, with the cash that you are spending or how we view the risk profile, the investment portfolio, would you consider trying to improve the yield or increase the yields with a higher risk appetite?

Frederick Henry Eppinger
Former President & CEO

Okay. Well, let me take the last question first, if I may, Cliff. In terms of the quality and the risk nature of our portfolio, frankly, I think its just right for the current environment. It's very conservative. I think it has the right balance of mix right now in terms relatively small components of high yield and equity but principally focused on conservative fixed maturities. I think the duration is about right given where we are and the lettering of the book is right.

So, I would say, overall, I don’t think you should expect to see much. The environment right now is sort of back to where you really not getting paid very well for the risk that you are taking if you go further out on the yield curve or if you go into higher risk issuances. So I really don’t think that's prudent for us at this point in time and it served the company very well to be as conservative as it has. So we'll maintain that.

As I said in my remarks in response to your first question, its hard to give specific components of what's going to add what to new invested asset creation. It’s a mix of many, many factors but right now they've seen everything we see. We think that the gradual build-up for the investment portfolio in response to our growth shows us that what we see right now as declining yields and no money and as we said we think the first quarter is relatively good indicator for the rest of year right now.

Operator

The next question comes from Sam Hoffman of Lincoln Square Capital.

Sam Hoffman
Lincoln Square Capital

I just had a couple of questions. On the pension, I just wanted to clarify when you say that its fully funded, does that mean that there is no risk to the company either if interest rates go down, equity markets go down and that there shouldn’t be any expense going forward in the other expense line?

Frederick Henry Eppinger
Former President & CEO

No. You can never say there is no risk in defined benefit pension plan. It is because it depends on exogenous factors that are outside of our control, but based upon all of the factors that we were able to consider, in January at that point in time and I would say it's still probably the case right now, but that $100 million contribution created a fully funded situation.

If there is dramatic changes in market conditions again where you see losses in value in securities, in the future if that were to happen on a significant basis that could certainly change those assumptions.

Sam Hoffman
Lincoln Square Capital

Should we assume that under a normal market scenario there is a longer any charge or expense for that item going forward?

Steve Bensinger

No, you should not assume that I think in the first quarter we had a little over $3 million of total pension expense and that should be the ongoing quarterly run rate based on the current assumptions.

Sam Hoffman
Lincoln Square Capital

Second question is on the debt capital risk. This on your comment on the call, should we assume that you are going to be maintaining roughly the same amount of debt going forward or is that meant for refinancing the existing debt at some point.

Steve Bensinger

I think what I said was that, our current debt to capital ratio of 21.5% is well within rating agency tolerances and guideline. That doesn’t mean that it couldn’t fluctuate higher or lower depending on the circumstances and the activities that we need to.

Frederick Henry Eppinger
Former President & CEO

And Sam, if you think about what we did, if we can’t go back full 12 months, we took advantage of the disruption in the market place and once we got the upgrade we refinanced a bunch of our older debt and we were able to go to the Federal Home Bank Board and get attractive capital that we put in the insurance company. It is above 5.5% or so, but we only put up about 125 because I wanted to make sure that some of debt was with the holding company and I think about it as getting our debt level at about the place we wanted to be the second tranche of debt.

So, I feel very good about this 20 plus percent where we are and I like the mix of what it is, but if you think about it from 12 months ago, we obviously took about $30 million gain from the refinancing. I like our mix now and obviously in the same time we released and bought back a lot of shares. So that our cost of capital is a little bit more like the best companies now. I just thought we were little bit out of wreck, and now I think we're back in wreck.

To Steve's point, depending on how we grow and how you think about potential future transactions, we will keep in mind kind of rating agency guidelines, but we're at the low end within our ratings structure, so we have plenty of room, if you will, if we had to we thought it was needed, but I'm very comfortable with the current structure. It's very typical than some of the better companies relative level.

Sam Hoffman
Lincoln Square Capital

Can you give the holding company catastrophe under the core there and comments on your priorities for the use of it?

Frederick Henry Eppinger
Former President & CEO

Yeah, it's about $348 million and obviously, we have gone to a quarterly dividend now, so we'll obviously have a commitment to that. We have our debt and our debt payment that we typically do out of the holding company as well, but I think your broader question is do I feel that we are still adequately capitalized or have excess capital.

I would tell you in a normal world, I think we still have excess capital, and by the end of the year, we're going to have more excess capital even with our current growth rate, and so that as always the first priority for the company is to have profitable growth beat the cost of capital and if there is opportunities to continue to do that, we'll do it.

If not, we'll think about other ways to make sure we use the capital appropriately, and as we decided in the last couple of years, we've given some back, and I always think about that and we will think about that going forward, because I do think we're at a point where we still have some room here as we look at the future.

Now I would tell you that the market is playing out just like we expected it, people are talking about the market being little a rough ride. I never expected it to turn quick. I think that a lot of the financial disruptions was a sideshow to the underlying structure in the industry and I think as the market turns in the next 12 to 18 months, weaker players are going to have problems.

You are going to have significant underwriting. I think we are going to have significant opportunities, and I think we have positioned ourselves to capitalize on that, so some of this capital I would like to make sure we have enough powder dry so we have a lot of capabilities we now built, and so as the market turns and when it turns and people stub their toe, we will be ready, so some of it, as we get closer to the turn is to make sure that we have excess capital to capitalize on the opportunities that present itself.

As always, Sam, we try to be soft about the balance between the business opportunities in front of us and then given shareholders the money back, if we feel we don’t have appropriate use.

Sam Hoffman
Lincoln Square Capital

Okay, and finally, given the soft market, given net interest rates, it sounds like your yields are going to continue to be low and you are taking a conservative investment posture. What can you update us on the timeframe that you think you can achieve your corporate ROE objective?

Steve Bensinger

Well, again, it’s a great question. I still am very focused, as I said last quarter. I have got this six quarter view of we are going to move forward and improve every single quarter. These yields, as you mentioned, that affects perhaps your thought process, but it also affects your cost to capital, obviously, if it's permanent and as many people are worried about inflation as lower yields.

My view is that we are improving. If you look at what we have done, both on the capital side and on our mix of business and if you look at our percentage with the partners, if you look at the kind of quality of business we re bringing on, I am very focused on improving every quarter and I believe we can get to our targets in that six-quarter timeframe.

Again, if we see opportunities that present themselves to us that I make the case to our shareholders, I am going to do it. If I think there are additional opportunities that are presented to ourselves that we want to invest in, but right now I feel very good about it and if you think about our plan, this plan has more improved in quarter-to-quarter then typically at least in the six-and-half years I have been here, but I would say that purposely this way, because of these opportunities we saw that we took advantage of in the fourth and the first and second quarter and I think we are in a good spot to kind of continue to improve performance through the year and we got to do that. We got to demonstrate that.

Operator

The next question comes from Larry Greenberg of Langen McAlenney.

Larry Greenberg
Langen McAlenney

With the OneBeacon and even going back over the last couple of years, there has been so much noise in the expense ratio line, I am just wondering as you look at the company now positioned with more Commercial than Personal Lines business. If you could just look out and try to normalize the expense structure, what type of expense ratio, do you think the company is ultimately moving towards?

Frederick Henry Eppinger
Former President & CEO

Great question. Obviously I talk about this a lot, and it's odd this year, because we are going to improve probably our expense ration almost every line and it could go up because the mix is going to be so skewed towards commercial versus personal but if you kind of normalize it for mix of business, what I have said is that I believe we are about a 1.5 point heavy.

Again, you got to normalize it for mix of business, because as we go up, our bonds business, our marine business obviously they all have different expense, but if you look at the total thing, I have it purposely invested 1.5 point, that was by the way 2.5 at the beginning of our journey, because we are so commodity-driven as a business.

It’s a 1.5 or so I would say and this year I believe that we will make progress somewhat in the individual lines of business, but we are very top heavy in the first couple of quarters in particular on expenses and again people can work right you can't you get last, but remember also [washy] looking Personal Lines is going to be account-oriented, near fluent, total account writer, and then the same thing in commercials there will be a lot of niche, it's going to be a lot of fragmented business and so we actually look at this line-by line-by-line and I got additional expense in some geographies of upscale, I have some additional expense in these merging businesses and we have additional expense because of leaders, I will call real leadership because of our strategy and our conversional partner or agent.

Those were the big categories and within that, if you look at it there is still a bit of infrastructure cost. In the last 12 months, we have filed 1,500 policies, okay? We have launched 1,500 policies if you look at all of states and all the products. Well, cost a lot of money, so there was a startup that we have gone through building the businesses.

There's also been infrastructure cost in our Professional Lines and some other things, but it's about 1.5. Your point is right. It's a little noisy. That was clearly noisy in the first quarter of this year with so many new things going on, but we have a lot of leverage to go on the expense ratio, and I feel we can get it and I believe, if you look at our competitors by the way, what you've seen there is a lot of regional companies have its high expense ratio as we have, but they are not investing. They are gating because they are shrinking and so they have an infrastructure they got up. We don't have that issue. We have explicit investment. We know exactly, where it is. We know exactly what we're getting.

Now I’d also tell you the other thing that I’d say is underlying all this the variabilization of our expenses is 100% better than it's ever been, and our technology area, some of the data entry. So the operating models are much better in all our businesses and so much more of this excess expense today is this upfront cost, the startup cost and its lack of scale that we have in a number of geographies and a number of businesses. So, it's a great question, because we think about it obviously as one of the important levers as we go forward. Again, I'd rather variable lever, because these are the controls in some of the other levers, right? That we can manage, but it it's a good question. I appreciate it.

Operator

There are no more questions at this time. However, we now see a follow-up from Michael Phillips of Stifel Nicolaus.

Michael Phillips
Stifel Nicolaus

One more follow-up, if we have a second here.

Frederick Henry Eppinger
Former President & CEO

Sure.

Michael Phillips
Stifel Nicolaus

Part of your strategy is always confusing me, if you can talk about it. When you do the Verlan thing and you get into a specialty business like Verlan, and when you do PDI how you get into that, but then later, I guess when you first talk about PDI. This is for a certain niche the lawyers and then benchmark comes along, and it's certain niche for our Architects and Engineers.

I had thought that when you did PDI, the idea was to expand that somehow within that current framework and not find somebody else like the benchmark. Its clearly I was wrong, and I guess I'm missing something there.

Frederick Henry Eppinger
Former President & CEO

It’s a great question. I confuse a lot of people, including my wife, so. What we did? DPI is the platform four our Professional Lines. What benchmark is essentially is a group of accounts that underwriters. That’s all it is. We didn’t buy for its infrastructure. We didn’t buy. So what we have done is, we have built PDI and the LTL, use that infrastructure and then we are going to tag on, architects, engineers, accountants, where you will see us do that. You will see us do miscellaneous and sometimes that takes the form of just hiring a team of four people.

In this particular case, there was an MGU that had six very talented underwriters that came together that we chose to do it and get a little bit of business to leverage the infrastructure we have invested in, but it’s not like we had to reinvent the wheel on our IT or our infrastructure, our rating and etcetera.

Now, obviously, I have to extend those rating. Every time you go to EPA or you do a little bit of difference, but you are absolutely right. "We didn’t necessarily have to buy a company" to get into Architects and Engineers. So every time we make a choice.

Now, for instance, I didn’t talk about, when we got into the private company B&L that we bought a company, but we bought a team. We brought in and in that case, six people and we tag that on to some other infrastructure we bought.

Now, we could have just easily bought of group of six they call themselves something. So because, as you know most of the acquisitions we talk about our team from a premium point of view. These aren’t big, but they are fill-in to our strategy around some of these areas of expertise.

You are absolutely right. As you look out, I talked about how I want to expand transportation. We have already limos and we have moving in storage and we have some expertise. If I thought that we could get a company that brought great claims expertise and infrastructure that’s supplemented that, I would buy the company, but I don’t have to. We could do the couple of categories, especially that we are after right now and we are interviewing individual’s etcetera. So I could either extend it with just hiring a team or we could buy somebody. It’s an individual economic assessment and it’s not like we have to buy companies to do it.

We've got most of our framework in place. You will see the same thing in E&S. We have been building out our capabilities in some of these lines to round out our excess and surplus capability. If we thought that it was more efficient to do a team or opportunity presented ourselves to us that came with good premium with all kind of agents, which is always the trick. We might think about it, but we don’t need to do that.

We can go out and get some expertise to leverage with our partner agents because if you think about the core of our strategy, its really our partner agents and providing with them the specialties that they have that are connected that we can extend from our capabilities today. So some could be fill in. Some could be just change, but it’s a great question because it is I book as you know, I talked to 50 various companies probably in the last six quarters because there are so many people out there for sale. We often don’t believe we need to do it or it doesn’t make any sense, but we are always looking for an opportunity to look at adjacent specialties that our partners are asking for us to have the capabilities to provide and we can either go at it organically or inorganically.

That's why we are pretty excited about where we are. We have good momentum. People clearly think about us in this way now and so not only new companies come to us, but agents come to us with ideas. So I feel very, very good about that. I apologize for the confusion because it isn’t one or the other. It’s trying to do it in the most efficient way in front of us. As I have always said, I don’t need to do a lot of acquisition and I don’t need to do big ones. We believe we are in a place now that we can continue to gain share with the shelf space, the best agent in this country because of the breadth of capabilities that we built.

Michael Phillips
Stifel Nicolaus

That’s helpful. Actually confusion just from my part, but as you expand Verlan in to the specialty industrial these guys are used to be property only, does that mean you are hiring casualty on risk?

Frederick Henry Eppinger
Former President & CEO

Risk on trade let’s go in there. So what’s great about in our industrial is that, that was Verlan right, but within their business they were in cosmetics, they did a little bit out, but they had limited capacity. We have spent last 18 to 24 months building that capacity and that expertise that extends from coding. So that we can in to all kinds of plastics etcetera, it still it is hard small HPR industrial risk that we are good at and it properties stop to blow ups.

Now the casualty side of that, we actually broker out. We don’t do it ourselves and we build a value proposition to our agents, where we bundle the both, but we actually are brokering out the liability portion for the most part. So we build a brokerage capability within it and we are now providing full solution with those small accounts. All the side we have a broader portfolio and a more complete portfolio, but it was based on the expertise that we acquired and then we have extended that through a few hires. Rita, I don’t know if there any.

Marita Zuraitis
Executive VP, President of Property & Casualty Companies

The only I would add to sum it up, when you think about Verlan, PDI, now Engineers and Architects. It’s all very consistent with our total account strategy to give our partner agents one stop shopping to right their best submit a market accounts and it works quite well for the partner agents be able to have one place to go for those capabilities and very consistent with what we have been saying from the very beginning.

Steve Bensinger

In that particular case, some times we don’t like high severity lifes. We like small base value, more consistent because I want people to see that we are building an earning power that’s very consistent. So, we often outsource "if you will", and in that particular case, we don't want to take on that severity that the Causality Lines tied to those lines present.

They're a much better people than us that specialize in that business and I rather access them, but what we do is? We assemble. We assemble our small account in efficient way and deliver it to these top thousand agents in this country and it gives them the ability to maximize their earnings and retention, while we don't take on volatility we're not comfortable with.

Again, what we've been talking about long is really starting to come together for us; you're starting to see us as a pretty nice alternative to some of the national companies. We were at our partner's club this week and a lot of our agents are talking about that the national company with regional approach, right. The broad capability, but know them well and think of them as a partner and so its starting to come together.

Operator

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

Bob Myron

Thanks very much to everyone for participating. We'll talk to you in a quarter's time.

Operator
The Hanover Insurance Group first quarter 2010 conference call has now concluded. Thank you for attending today's presentation. You may now disconnect.