The Hanover Insurance Group, Inc. NYSE:THG

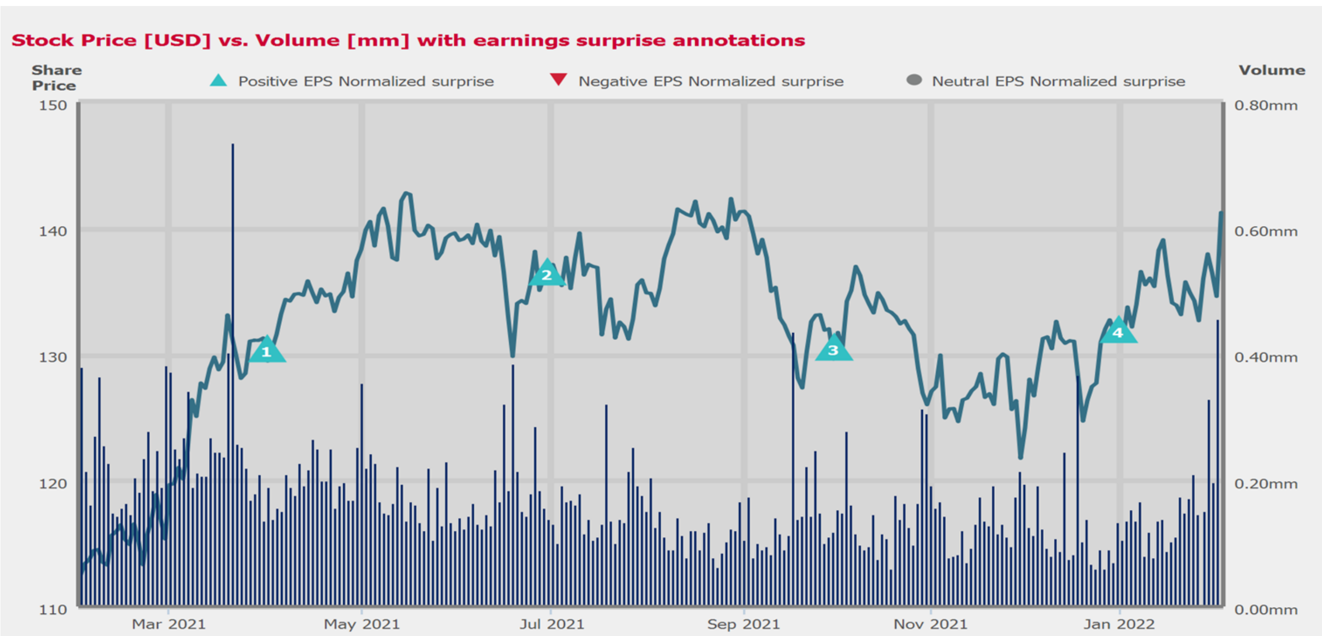
FQ4 2021 Earnings Call Transcripts

Thursday, February 03, 2022 3:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ4 2021-			-FQ1 2022-	-FY 2021-			-FY 2022-	
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	GUIDANCE
EPS Normalized	2.54	3.38	▲32.55	2.70	7.91	8.73	▲10.37	10.68	NA
Revenue (mm)	1198.77	1214.90	▲1.35	1281.70	4977.27	4993.40	▲0.32	5301.33	5293.00

Currency: USD
Consensus as of Feb-03-2022 8:50 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ1 2021	0.78	1.66	▲112.82 %
FQ2 2021	2.31	2.85	▲23.38 %
FQ3 2021	0.62	0.85	▲37.10 %
FQ4 2021	2.54	3.38	▲32.55 %

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Call Participants

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Executive VP & President of Specialty

Jeffrey Mark Farber
Executive VP & CFO

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Presentation

Operator

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

I would now like to turn the conference over to Ms. Oksana Lukasheva. Please go ahead, ma'am.

Oksana Lukasheva
Vice President of Investor Relations & Financial Planning

Thank you, operator. Good morning and thank you for joining us for our quarterly conference call.

We will begin today's call with prepared remarks from Jack Roche, our President and Chief Executive Officer; and Jeff Farber, our Chief Financial Officer. Available to answer your questions after our prepared remarks are Bryan Salvatore, President of Specialty Lines; and Dick Lavey, President of Agency Markets.

Before I turn the call over to Jack, let me note that our earnings press release, financial supplement and a complete slide presentation for today's call are available in the Investors section of our website at www.hanover.com [Operator Instructions]

Our prepared remarks and responses to your questions today, other than statements of historical fact, include forward-looking statements as defined under the Private Securities Litigation Reform Act of 1995 regarding, among other things, our outlook and guidance for 2022, the ongoing impacts of the COVID-19 pandemic, economic conditions and related impact and other risks and uncertainties that could affect company performance and/or cause actual results to differ materially from those anticipated. We caution you with respect to reliance on forward-looking statements, and in this respect, refer you to the forward-looking statements section in our press release, the presentation deck and our filings with the SEC.

Today's discussion will also reference certain non-GAAP financial measures such as operating income and accident year loss and combined ratios, excluding catastrophes, among others. A reconciliation of these non-GAAP financial measures to the closest GAAP measure on a historical basis can be found in the press release, the slide presentation or the financial supplement, which are posted on our website, as I mentioned earlier.

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

John Conner Roche
President, CEO & Director

Thank you, Oksana. Good morning, everyone, and thank you for joining us.

I'll begin today's call with a discussion of our fourth quarter performance and full year financial highlights in the context of the current business and economic environment. I'll then provide an overview of our strategic and business accomplishments for the year and our high-level expectations for 2022. Jeff will review our financial results in more detail and discuss our 2022 guidance, and then we'll be happy to take your questions.

2021 was an outstanding year for our company. I am extremely proud of the way our talented team navigated the challenges of an exceedingly complex market environment and executed on our key business imperatives, building even more on the strong strategic, operational and financial momentum we have established over the past several years.

Considering what was an extremely active catastrophe year for our industry and our company, we are very pleased with our financial performance, highlighted by operating income per share of $8.73 and an operating return on equity of 11.2%. We achieved a sub-90s ex cat combined ratio for the year and generated record net written premium of $5 billion, reflecting the success of our distinctive and winning strategy. For the fourth quarter, we delivered outstanding results, posting our best ever quarterly operating earnings performance.

In the face of higher inflation and evolving loss trends, we took advantage of the opportunities presented by a particularly dynamic market, fully leveraging our strong agent partnerships, broad and innovative capabilities and organizational agility, posting a 16.8% operating return on equity and a combined ratio of 92.9%.

Our results continue to demonstrate our ability to drive broad-based profitable growth through strong market awareness, excellent portfolio management and financial discipline. Looking first at growth, we gained considerable momentum over the course of the year, capping 2021 with a 9.2% net written premium increase in the fourth quarter and 8.6% for the full year.

Each of the growth levers we discussed last September at our Investor Day: agency penetration, specialized products and a focus on innovation, contributed to our growth momentum. Additionally, each of our major segments exceeded our original growth expectations, demonstrating the strength of our market position, the appeal of our select agency strategy and the effectiveness of our customer-centric strategy.

We believe our high-quality product portfolio, in combination with our consistent and segmented pricing strategy, position us exceptionally well to continue to deliver sustainable, profitable growth going forward. From an underwriting perspective, 2021 included some of the most dynamic loss trends we've ever experienced in the P&C industry, from property volatility, inflation and severe weather to changes in auto loss trends and court delays.

In the face of these and other challenges, we posted an 88.6% ex cat combined ratio for the year, one of the best on record while also outperforming the guidance we had provided to The Street. Our underwriting and pricing discipline, combined with our diversified portfolio, has enabled us to deliver broad-based profitability across our business.

The investments we have made in data analytics and our cross-functional collaboration inspire additional confidence in our ability to anticipate loss trends and adjust our underwriting and pricing accordingly, providing significant agility while focusing on long-term value creation. Our strong results for the fourth quarter and for the full year reflect earning in of rate increases above loss trends in Commercial Lines and a thoughtful pricing strategy in Personal Lines. As we close out 2021, we are delivering higher margins compared to pre-COVID levels, which demonstrates our ability to successfully navigate market dynamics and to continue to increase the earnings power of our organization.

Turning to our strategic accomplishments for 2021. We continue to strengthen our relationships with our agent partners, delivering even more value to them and helping them meet the constantly changing needs of our mutual customers. We continued as well to support our agents with an array of product innovations and technology investments designed to enhance the customer experience and give our agent partners the tools they need to achieve their business results.

We also made further enhancements to our Agency Insight tool, providing our agents with unparalleled market insight and helping them drive their business strategies forward. As Dick Lavey illustrated at our Investor Day, this tool also plays a critical role in the increasingly important agency appointment process. In 2021, we made more than 350 agency appointments across Personal Lines and Small Commercial, helping to further drive new business production and geographic diversification.

On the technology and analytics side, our new claims system and Small Commercial TAP Sales platform are among the 2021 accomplishments that are poised to deliver meaningful benefits going forward.

Turning to Core Commercial. Strong renewal retention, a healthy rebound in exposures and robust rate increases helped drive growth in this segment. We gained significant traction in Small Commercial with the launch of our TAP Sales quoting platform, which has helped fuel new business growth. Our Small Commercial business benefited during the year from an upward rate trajectory throughout the year, and we delivered growth of 8.3% for the year and 9.3% in the quarter.

We also made great strides in middle market as we continue to grow our most profitable segments and manage underwriting profitability in more challenging areas. Targeted industry verticals such as technology, human services and financial institutions are among the areas where we continue to drive strong profitable growth.

In 2022, we believe our granular pricing capabilities will allow us to continue to push robust rate to less profitable lines and cultivate the most profitable sectors of our Core Commercial business.

We expect the firm market to continue into the year as drivers of rate increases persist, most notably the rising costs of materials and labor. Those catalysts, combined with our outstanding data and analytic capabilities, underwriting discipline and unique strategy, should enable us to generate additional strong profitability and mid-single-digit growth in Core Commercial this year.

Our Specialty business delivered stellar results in 2021, exceeding $1.3 billion in direct premiums written for the first time and $1.1 billion on a net basis, growing 11% for the year. This performance underscores our strong product portfolio, distribution relationships and market position.

For the full year, we achieved very robust growth with our most profitable specialty lines, including professional and executive lines, marine and Hanover specialty industrial. At the same time, we continued to gain significant momentum in our newer specialty businesses, including the specialty coverages in the financial institution sector and retail E&S.

To further round out our portfolio, in 2021 we launched a new specialty general liability product for our agents. This exciting new product introduction fills the casualty space between Core Commercial and E&S and advances our total Hanover initiative, making our specialty offerings accessible to more Core Commercial customers.

With 11% net written premium growth for the year, we are on track to deliver on the specialty target of 10% long-term CAGR that we shared with you at Investor Day. And even with the increase in weather-related property losses across the industry during 2021, our specialty book delivered a 92.9% combined ratio all-in and 87.9% excluding catastrophes, beating our ex cat expectations for the year.

Our Specialty business is optimally positioned to deliver significant and meaningful value to retail agents for small to midsize customers with a very diverse and unique offering. With 8 different businesses, including 18 product areas, we have a breadth of product capabilities that agents need and that typically are available through large nationals or specialty carriers, oftentimes through the wholesale channel. Simultaneously, we provide the high level of visibility and service agents often expect from top regional carriers, enabled by local market presence in coordination with Core Commercial lines.

Our strategic focus is on continuing to advance the use of technology and specialty to meet the needs of our agents for greater efficiency and coverage placement and servicing of customers, as well as improving our own efficiency. We'll also continue to build on our existing core commercial relationships while thoughtfully executing our targeted wholesale strategy to complement our retail distribution, as not all large and midsize agents place some of this business directly.

We expect to continue to leverage our strong Specialty platform through our best agents, to deliver excellent growth and strong profitability in 2022 and beyond. We are confident this business will be a significant contributor to our overall growth in the years ahead.

With that in mind, I am pleased to share with you this morning that beginning in the first quarter of 2022, we will break out our Specialty business as a separate financial segment, giving you much greater detail into the growth and profitability drivers of what has become our fastest-growing business. Jeff will discuss our process and thinking shortly.

Moving on to Personal Lines accomplishments. Our team delivered strong earnings and top line growth in an especially complex market during 2021. Given the changing loss trends and competitive environment over the last 2 years, we invested a significant amount of time, energy and resources to achieve the right balance of rate adequacy and consistency, enabling strong retention and profitability.

We are uniquely positioned in Personal Lines. Our geographic mix and focus on customers with complex insurance needs continue to deliver a remaining frequency benefit that helped offset the increases in property severity.

Additionally, our consistent and thoughtful approach to pricing continued to represent an important competitive edge, contributing to our high single-digit growth, strong retention and excellent profitability in our personal auto book in 2021, including the fourth quarter considering our typical seasonality. Recall that our fourth quarter generally reflects more elevated winter losses due to our northern Personal Lines footprint.

We also continued to gain further traction with our Hanover Platinum and Prestige total account offerings in Personal Lines. Platinum accounts for 62% of our Personal Lines book while Prestige now represents about $150 million or 7.5% of the book. With very strong reception in the market, we believe Prestige premiums will double in the next 3 years.

As we contemplate 2022, we expect to steadily increase home insurance pricing, including exposure increases, to address the continuation of rising material severity and labor costs.

In auto, we will seek rate to keep up with the increased property severity, but we feel good about our auto profitability as it stands today. At the same time, we believe we will generate additional growth and new business as a result of much more aggressive and potentially disruptive rate increases being implemented by the industry to restore profitability.

We believe our thoughtful approach to pricing and the anticipated longer-term persistence of some frequency benefit strengthen our competitive standing in the industry. Our growth might slow a bit as we increase prices in both home and auto throughout the year, but we are well positioned to deliver mid-single-digit growth at target returns in Personal Lines in 2022.

I want to acknowledge the commitment and contributions our employees made during 2021 to drive our continued success. We are extremely proud of and appreciate our talented and committed team. The Hanover success in 2021 is a result of our team's hard work and dedication to meeting the needs of our agents and customers. The level of talent we have assembled is on par with the best in our business and constitutes our single greatest competitive advantage.

While much has been written about what economists refer to as the Great Resignation, I'm extremely proud that we came through 2021 with robust employee retention rates. And we have a full talent pipeline and continue to attract the talent we need at all levels of the organization. Additionally, our employee engagement remains high as well. As part of our ongoing company listening strategy, we recently engaged an outside firm to conduct an employee survey and assess [an] employee engagement across the organization. While we are still working through the full analysis, we are very pleased with the initial feedback from that survey.

Our ability to attract and retain top talent and keep our workforce engaged speaks to the strength of our culture. At The Hanover, our employees' actions and behaviors are guided by our CARE values: collaboration, accountability, respect and empowerment. Underlying these values is the belief that a highly engaged, inclusive and empowered workforce positions us to compete effectively in a dynamic market and to drive top quartile growth and returns.

In 2021, we worked on a number of initiatives to advance that principle. These initiatives include expanding the number of business resource groups supporting women and underrepresented populations within the company, expanding recruitment efforts to help us attract employees for more diverse talent pools, and creating more opportunities for women and other underrepresented populations in leadership roles.

While there certainly is more work to be done to advance inclusion and diversity goals across our organization, I am inspired by our accomplishments to date and eager for us to build on those efforts this year. Our overall strategic imperatives for 2022 center on maintaining our profitable growth momentum, investing in products, services, data and innovation to embrace the change around us, and continuing to attract and retain the industry's best talent.

In conclusion, we begin 2022 with great optimism. We look to the future from a position of strength, confident in our ability to deliver sustainable profitability and growth momentum. We look forward to taking our company to the next level and making our vision a reality as the premier property and casualty company in the independent agency channel, one that delivers value for its shareholders and other stakeholders.

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

Jeffrey Mark Farber
Executive VP & CFO

Thank you, Jack, and good morning, everyone. I will first begin by reviewing our consolidated results and discussing our segment operating performance in more detail. I will then provide our typical update on our investment portfolio and capital position. I will close my prepared remarks by providing our guidance for 2022.

Turning to our consolidated results. We reported excellent net and operating income per share in the fourth quarter, with both metrics beating our quarterly records. Furthermore, our fourth quarter operating ROE of 16.8% reflected outstanding underwriting and investment performance.

Starting with underwriting, consolidated net premiums written increased 9.2% in the fourth quarter compared to the prior year quarter. The primary drivers of the increase were robust rate, positive exposure growth and near-record high retention levels in addition to strong new business in Personal Lines.

Given the impact of COVID in 2020 and some meaningful seasonality in our results in the fourth quarter due to our predominantly northern footprint, we believe it would be helpful to ground some of the following underwriting analysis to pre-COVID profitability, particularly for the lines of business that had been impacted by meaningful frequency benefits in 2020, including most substantially auto.

Accordingly, I will provide some comparisons to 2019 where appropriate. We delivered a combined ratio of 92.9% in the fourth quarter, which is modestly above the prior year quarter but reflects an improvement from the relevant pre-pandemic period of 2019. The combined ratio in the fourth quarter 2021 included 3.1 points of catastrophe losses, which was below our catastrophe assumption of 3.9 points.

We recorded favorable prior year reserve development, excluding catastrophes of $14.4 million or 1.2 points of the combined ratio for the fourth quarter. For the full year, we recorded favorable prior year reserve development, excluding catastrophes, of $56.1 million or 1.2 points of the combined ratio, with favorability in most lines and with the largest releases in Personal Auto and workers' comp.

These results illustrate the success we have had in building a very strong balance sheet over the years. We enter 2022 in a strong position, and we remain vigilant in assessing ultimate loss costs, maintaining a prudent level of reserves due to the uncertainties within the current environment.

The expense ratio improved 0.7 points to 31.4% for the fourth quarter and helped contribute to the 30 basis point improvement we targeted and delivered in the full year expense ratio. The improvement reflects the impact of expense leverage from growth as well as our rigorous expense discipline and ability to drive operational efficiencies across the business by leveraging technology and advanced data and analytics. These investments will further enhance our expense performance in the future. As we look ahead, we expect to continue to improve our expense ratio as a result of growth leverage and operational efficiencies.

Turning to a discussion of our underwriting results by segment, starting with Commercial Lines. Our combined ratio, excluding catastrophes, improved 1.4 points to 88.6% for the fourth quarter and 1.3 points to 89.6% for the full year. The improvement in both periods primarily reflects the benefit of robust rate increases on the current accident year loss ratio, the impact of favorable development, and a lower expense ratio.

Commercial multi-peril current accident year loss ratio, excluding catastrophes, increased by about 1 point in the fourth quarter compared to the prior year quarter. However, the result reflects a strong sequential improvement from the third quarter of 2021 and are relatively in line with the fourth quarter of 2019, as large loss pressure meaningfully subsided in the fourth quarter.

We are also seeing the benefits of our rate increases and targeted underwriting actions. Our Commercial Auto loss ratio continued to steadily increase throughout the year as the observed frequency benefit lessened. Our loss experience in Commercial Auto is comfortably below pre-COVID levels due to prior rate increases earning in and remaining frequency benefit.

With some lingering court delays, delays in medical procedures and all of the drivers of social inflation still present, it is critical to be especially prudent in setting loss picks in this line. And we continue to assume that the impact of social inflation on claim costs is consistent with pre-pandemic levels.

Our workers' compensation loss ratio in the fourth quarter improved slightly from the prior year period. We benefited throughout 2021, though mainly in the second half, from earned but unbilled premium adjustments. Our underlying loss picks remain in line with prior quarters, and we remain cautious in our reserving approach, particularly considering the rate environment and potential new risks posed by the increase in the use of less experienced and newly skilled labor in U.S. companies.

In other Commercial Lines, which is a proxy for our Specialty business, the loss ratio improved 2 points for the quarter and 1 point for the year, primarily due to strong rate increases earning in and the effectiveness of targeted underwriting actions. Throughout the year, we achieved rate increases well above trend and our plan, culminating in rate of 8.9% in the fourth quarter.

There is certainly some seasonality to our rate change quarter-to-quarter, but rates have been holding firm. And we expect this to continue in the near future. This business has exceptional growth prospects and is well positioned to continue to deliver strong profitability.

Looking ahead, we expect our Commercial Lines loss ratio to improve in 2022 as the rate increases implemented over the past year earn-in. Core Commercial should also benefit from the normalization of property large losses. We expect Specialty, which, as Jack mentioned, will be reported as a separate segment starting in Q1, to continue to deliver strong above-target profitability.

Reporting Core Commercial and Specialty separately will allow us to show more complete financial views for each segment. This reporting structure will also better align to how these 2 businesses are currently underwritten and managed.

Within Commercial Lines as it stands today, most of what is currently reported under Other Commercial Lines, plus small components of other lines will be rolled into Specialty, and we will complete the rest of the P&L lines to give you a full picture of the Specialty income statement, including expenses, allocated NII and other items, summing to pretax operating income.

The rest of the statutory lines within Commercial Lines will be rolling up and reported in Core Commercial as a complete P&L as well. We will also share more leading indicators of growth within each of the segments, including subsegment net written premiums, price change measures and retention.

The new Specialty segment is completely consistent with how we have discussed and presented Specialty in our investor presentations from time to time. In March, we expect to share historical financial results for the last 3 years under the new segmentation, leaving our investors and analysts enough time to study the results and new definitions and to adjust their models. At the beginning of May, our first quarter 2022 results will be reported under the new segment definition.

Turning to Personal Lines. We reported a combined ratio, excluding catastrophes, of 91.5% for the fourth quarter and 87.1% for the year, both reflecting an increase from 2020, driven primarily by Personal Auto as the comparative prior year periods included very substantial frequency benefits related to the pandemic. However, our Personal Lines results continue to track favorably compared to 2019, underscoring our unique position and broader optionality going forward.

Our Personal Auto ex cat current accident year loss ratio was 74.1% in the fourth quarter, representing an increase of 6.9 points from the prior year quarter, but an improvement of 2.8 points compared to the fourth quarter of 2019.

Mobility trends indicate driving volumes in 2021 were above pre-pandemic levels, likely driven by higher discretionary travel, while commuting remains lower. This bodes particularly well for our personal auto book, given its higher concentration of office workers, and has positioned us for a more persistent, if not permanent, longer-term frequency benefit.

Of note, we added a disclosure to our earnings deck demonstrating the sustained difference between the industry experience as it relates to miles driven and The Hanover's persistent frequency benefit. This disclosure also showcases our differentiated pricing approach over the last 2 years and our change in claims mix away from rush hour claims.

The improvement in our fourth quarter Personal Auto loss ratio from the comparative pre-COVID periods of 2019 speaks to our thoughtful pricing strategy and provides a favorable starting point for 2022. We expect severity pressures in Personal Auto to continue into 2022, along with a lingering frequency benefit, although not at the same level of benefit that we saw in the first half of 2021.

We believe persistent lower frequency, combined with some measured price increases, will allow us to maintain our Personal Auto loss ratio around pre-COVID levels. We are seeing the current Personal Auto market firming from a position of relative strength as it increases our pricing ability while allowing us to grow market share.

In homeowners, the ex cat current accident year loss ratio was 50.6% for the quarter, up 2.7 points from the prior year quarter and 1.5 points from the full year 2020. These results are also elevated compared to the pre-COVID periods, driven by higher labor and material costs as well as more severe noncatastrophe weather.

We in the industry are seeking rate increases in response to these pressures. Even though our rate did not increase substantially in the quarter, we saw robust renewal price change, which includes inflation of 6.9% in homeowners, up from 5.9% in the third quarter. This price change will continue to increase throughout 2022.

Importantly, we continue to achieve historically high retention levels within homeowners, ending the fourth quarter with retention of 89.4%, a strong indication that the market can accept additional needed price increases in the future. With this in mind, we expect to achieve around 8% renewal price change in homeowners by mid-2022.

The key takeaway in Personal Lines is that we have a clear line of sight to target profitability levels in this business in 2022. In addition, we believe that our customer-centric approach and whole account focus represents sustainable and profitable competitive advantages.

Turning to our investment performance. We generated net investment income of $79.5 million for the fourth quarter and approximately $311 million for the year, up 17% compared to 2020. This was well ahead of our guidance for 2021 and reflective of exceptional results from our investment partnerships, which outperformed our expectations by $40 million.

Lower fixed income yields continued to pressure our portfolio, a trend we expect to persist into 2022, but should be largely offset by growing cash flows. Therefore, adjusting for outsized partnership returns in 2021, we expect net investment income in 2022 will be approximately in line with 2021 results.

Our investment portfolio remains very well positioned. Fixed income securities and cash represent 85% of the total $9.4 billion portfolio. We have a high-quality, well-laddered and diversified portfolio with a weighted average rating of A+. We are positioning our portfolio for the increasing rate environment by limiting duration extension and maintaining diversified exposure to less interest rate-sensitive asset classes like equities, partnerships and leveraged loans.

Moving on to our equity and capital position. we thoughtfully managed our capital throughout 2021, successfully weathering the market uncertainty and economic volatility. We remain committed to our capital management priorities and being strong stewards of our capital.

In December, we increased our quarterly dividend by 7.1% to $0.75 a share, underscoring the confidence we have in our long-term strategy and growth opportunities. In total, we returned approximately $265 million to shareholders in 2021 through dividends and share repurchases.

As shown at Investor Day, we are targeting an operating return on equity of 14% or higher over the longer term, supported by the tenets of our financial strategy: broad-based profitability, profitable growth, expense discipline and effective capital allocation. Our book value per share of $88.59 as of December 31, 2021, increased 1.8% from the end of the third quarter, driven by net income, partially offset by a decline in unrealized gains in our fixed-income portfolio and the payment of our regular quarterly dividends. Excluding net unrealized gains on fixed maturity investments, our book value per share increased 4.4% from September 30, 2021 and 9.4% from the end of 2020.

Turning to our guidance for 2022. We expect overall consolidated net written premium growth to be on the higher end of mid-single digits, driven by growth in our most profitable businesses. In Specialty, we anticipate very strong growth overall for the year, but premium increase in the first quarter will be somewhat impacted by a challenging comparison to 12% growth in first quarter 2021.

First quarter 2022 growth overall should be very solid. We expect net investment income to decline as partnership income returns to more consistent historical levels.

Normalizing for partnership outperformance in 2021, NII should be flat in 2022 as the pressure from lower reinvestment yields will be offset by growing cash flows. Our expense ratio should decrease by approximately 20 basis points in 2022 to 31.1%.

The combined ratio, excluding catastrophes, should be in the range of 89.5% to 90.5%. Cat load for the year is 5.0%. First quarter cat load is 4.8%. And we expect an effective tax rate to approximate the statutory rate, which is 21%.

In conclusion, we begin 2022, the year of our 170th anniversary, in a very strong financial position. The road ahead holds tremendous opportunity, and we are poised to capitalize on it. Our accomplishments over the past several years position us to deliver sustainable, long-term top quartile profitability and execute on the targets presented last September at our Investor Day.
With that, we will now open the line for questions. Operator?

Question and Answer

Operator

[Operator Instructions]. And the first question will come from Matt Carletti with JMP.

Matthew John Carletti
JMP Securities LLC, Research Division

I wanted to start on a question related to kind of the severity trends that you're seeing in Personal Lines. I guess, could you help us on the outside as we look at various indicators. What are the best indicators or the mix of indicators we should look at? Like, let's take auto, right? And is it used car values? Is it labor cost/shortage? Is it parts cost, rental car days? As we think about kind of the items that are changing, can you give us kind of a rough mix of how you look at it in terms of what is driving the severity pressures?

John Conner Roche
President, CEO & Director

Yes, Matt, this is Jack. Thanks for the question. And obviously, it's the topic of the day. So we're happy to kind of give you our view on that. Before I pass it over to Dick to give you maybe some specifics, I would tell you that I think what makes it a little different for us is our strategy and our portfolio.

As we articulated in our prepared remarks, we have an account business, and we have a different customer base. And frankly, the complexion of the losses that we see do change how inflation impacts our book of business versus maybe low limits, more physical damage-oriented competitors.

So -- but with that, we clearly, as we said, are experiencing some inflation. And we're separating, if you will, what we think are some short-term phenomenons (sic) [phenomena] from the longer-term trend analysis that we still think is important and to keep focus on.

So with that, I'll turn it over to Dick.

Richard William Lavey
Executive VP & President of Hanover Agency Markets

Yes. So Matt, just to kind of go right at the heart of your question, the leading indicators that we look at. The first thing to do is to look at the mix of losses, meaning is it a total loss or is it a repairable loss? And this won't surprise you, but with the total loss scenario, that's really where the biggest element of severity is being driven from, because of the actual cash value increases in used cars, right? So if we look at our -- all of our indicators, that's what we would say is the biggest one to watch for, offset a little bit by salvage prices, right? So you've got to keep an eye on what's going on in the salvage market, too.

And then on the repairable side, it is about number of parts, cost per part and labor per part. So those indicators we watch closely. We have seen an uptick in the number of parts, some -- from more increased speeds and more severity. Cost of parts is up. But labor, interestingly, is not up as much. There is some additional labor, of course. When you have more parts to repair, it takes longer time. So you put all those together, right, and with the appropriate percentages then you get to your total severity. So that's hopefully helpful to you in how we track it.

Matthew John Carletti
JMP Securities LLC, Research Division

Very helpful. Can you give a rough break -- and I understand this might be your book and other people's books could be different. Clearly, yours has performed certainly well versus peers. When you talk about a total versus repairable on just a number of accidents basis ballpark. If you have 10 accidents, how many are a total versus repairable? And has that changed at all recently?

Richard William Lavey
Executive VP & President of Hanover Agency Markets

It's a good follow-up question because when you look at the total dollars, it's a bigger percentage than it is in terms of incidents. So it's around a 20-ish percent incident of a total loss.

Matthew John Carletti
JMP Securities LLC, Research Division

Frequency, got you. Great. That's incredibly helpful. And then just one, probably a question for Jeff. On the investment portfolio, obviously interest rates are starting to inch up here a little bit. Can you help us with where kind of new money is, what you're investing in versus where the book yield is, how that spread has moved?

Jeffrey Mark Farber
Executive VP & CFO

Yes. So certainly, with interest rates rising it makes that gap smaller, but there still is a gap. So the new money is still below the roll-off of the earned yield on the book. But we're closing it, and we're comfortable that the cash flows will offset the diminished yields that we have in the portfolio in '22.

Matthew John Carletti
JMP Securities LLC, Research Division

Congrats on a nice quarter.

Operator

The next question will come from Paul Newsome with Piper Sandler.

Paul Newsome
Piper Sandler & Co., Research Division

I want to beat the auto inflation issue a little bit harder again. But I was actually hoping if you looked across your commercial book versus your personalized book, it just hasn't -- nobody's has behaved the same. Just curious if you have any thoughts about why you're seeing it so much more in Personal Lines versus [for private passenger loss your part] maybe than you are in Commercial Lines?

John Conner Roche
President, CEO & Director

I want to make sure I clarify the question, Paul. Seeing -- you said seeing more. You're seeing more...

Paul Newsome
Piper Sandler & Co., Research Division

Well, we see this rapid increase in [pre] claim frequency and severity in private passenger much more than we have in the commercial auto side of the house. And you write both. So you're in a pretty good position to look at it, sort of the differences that we've seen over the last, just call it couple of quarters between the two.

John Conner Roche
President, CEO & Director

I think at the highest level -- and we'll certainly let the business guys chime in here. At the highest level, think about what we're going through, right? We have, frankly, a lot less people going to work and a lot more people working from home. And so I suspect at the highest level, we just have a change in activity level.

Within our Personal Lines book, we also see changes as we suggested, that might advantage us over some other Personal Lines markets. But in aggregate, it seems quite logical that you would see more of that in the Personal Lines side.

I think the other thing is, is that when you look at how rate hits the book over time, it influences a lot of kind of the ultimate dynamics of the book. And we've been at Commercial Lines price increases for many years and Personal Lines went through a competitive period that now is going to rebound pretty substantially. So I don't know if either of you want to chime in on that.

Richard William Lavey

Executive VP & President of Hanover Agency Markets

Interesting question. I don't have a perfectly clear answer for you, Paul. I do -- we did see -- picking up on what Jack said, the frequency declines in Personal Lines was a greater phenomenon than in the Commercial Lines side. So you might think that, that would be a benefit to the PL side. But the severity on the Personal Lines side, I think it is related to what I was just talking about, around total losses versus repairable losses on the Commercial Lines side. So I think the severity is probably coming though more acutely on the Personal Lines side.

John Conner Roche
President, CEO & Director

I think what is important, though, related to yours is that the high-quality companies have enhanced claims analytics working with actuarial, working with the businesses to keep an eye on all those frequency and severity measures relating them back to the complexion of the claims. And I can tell you, we have a lot of confidence based on the real investments we made in the claims department on analytics that are now really enhancing our ability to anticipate loss trend, not just reflect on it.

Paul Newsome
Piper Sandler & Co., Research Division

Focusing on the Commercial Line side of the house. Obviously, trends are going in the right direction. Who -- you're gaining share in Specialty. What are the kinds of companies that you think you're gaining share from? Because one of the interesting things about this hard market is everyone is reporting very high retention rates, and nobody seems to be losing share. Who do you think is the classification for the type of company that you're gaining share from?

Richard William Lavey
Executive VP & President of Hanover Agency Markets

Paul, just a quick one there. The -- most of the increase in premium comes from rate and exposure, but we are gaining share, and I think Bryan is a good person to...

John Conner Roche
President, CEO & Director

Yes. So let's start with Specialty and then I think we can give you a little bit of commentary on kind of Small Commercial and some dynamics that are playing out there. But Bryan?

Bryan James Salvatore
Executive VP & President of Specialty

Yes. So I think what I would share with you is, our growth is pretty broad-based. Jeff hit it right, good deal of growth from rate and retention that's better than planned. But our portfolio for a long time has been pretty balanced. Balanced with, I would call, specialist brokers and producers, right, and are increasing growth from our Hanover agents that we've really invested in our technology, in our field to be more coordinated. So we're really in a bit of a fortunate position that we're doing well in that specialist broker market, and we're doing well with The Hanover agents that value having that sort of total Hanover engagement with us.

So from us, I think there's a number of different carriers. I wouldn't single them out. I think it's our strategy. I think it's the combining of the specialist brokers, the wholesalers as a complementary source, and then our Hanover agents.

John Conner Roche
President, CEO & Director

Maybe just a quick comment on Small Commercial because I think in that area, there is quite a difference in terms of the winners and the losers. And at the macro level, I think you know we compete quite competently against the national carriers in the BOP account market, and we also compete against the regional carriers on kind of the package Small Commercial accounts that aren't necessarily delivered through a point-of-sale system.

And I think with that breadth of appetite, we are clearly seeing more and more business getting pulled out of the regional carriers to the better nationals or the better, more capable Small Commercial players by just pricing efficacy and targeted strategies. So Dick?

Richard William Lavey
Executive VP & President of Hanover Agency Markets

Yes. No. I think that's well said. I mean our -- it's always about ease of doing business in Small Commercial for the BOP and associated lines. Our new investment in TAP Sales now out in 37 states is just giving us an incredible tailwind, and we're winning business against the nationals, against their systems, the regionals who don't have as strong technology. And the agent population, of course, is getting smarter and more strategic about how they place their Small Commercial business. So we're right in the mix on all those strategic discussions.

Paul Newsome
Piper Sandler & Co., Research Division

Congrats on the quarter.

Operator

The next question will come from Meyer Shields with KBW.

Meyer Shields
Keefe, Bruyette, & Woods, Inc., Research Division

Two really quick questions, if I can. First, is there a material difference in the loss trends between Specialty and Core Commercial?

John Conner Roche
President, CEO & Director

Well, again, we've got multiple businesses inside of Specialty. And so there's quite a difference, frankly, even within Specialty on what the loss trend looks like in our Hanover Specialty Industrial versus, say, our professional liability and management liability businesses.

So in aggregate, I would imagine that the variance isn't dramatically different. But I think when we get down to the business unit level, we even see a pretty good difference between Small Commercial and middle market and the Core Commercial. So there's a full array of where inflation, how property-centric is the book of business.

I think we all know that people are worried about some of the liability trends. But in the short term, some of that's been suppressed by the pandemic environment and the courts opening and closing and reopening. So I think some of this will change over time. But in aggregate, I don't think there's a major difference in those trends.

Bryan James Salvatore
Executive VP & President of Specialty

The only thing I would add is, to Jack's point, we measure this across each of our individual books. And then we look at our rate versus loss trend against each of those books. So when we say we're getting rate maturity above loss trend, it's right down to the specific area. And that's why I think we have a lot of confidence in how that's developing.

Meyer Shields
Keefe, Bruyette, & Woods, Inc., Research Division

Oh no, completely understood. I was just trying to sort of get a sense as to the baked-in loss ratio improvement for Specialty versus Core Commercial. It sounds like it's greater, if I understand your comments correctly.

John Conner Roche
President, CEO & Director

I would say in the short term, that's true.

Meyer Shields
Keefe, Bruyette, & Woods, Inc., Research Division

Okay. Perfect. Second question, and I'm not sure what to do with this, but the PIT count growth in both auto and home accelerated from the third quarter, which makes sense because most of the industry is raising rates. Is that anything to be worried about? Is there any adverse selection that we're -- any risk of adverse selection in that?

John Conner Roche
President, CEO & Director

I would tell you, we feel terrific about the quality of the new business that we're writing and the historically high retention ratios. But I'll let Dick speak to that.

Richard William Lavey
Executive VP & President of Hanover Agency Markets

Yes, no, absolutely. We have all the quality indicators that we watch around liability limits and full account. I think you know 87% of our business is a full account, which speaks to the quality that we attract. So there's nothing at all in the new business trajectory that you see that gives me concern. It's of the highest quality that we've had in the past.

John Conner Roche
President, CEO & Director

And remember that our growth is substantially coming from our Platinum Experience and the Prestige product, and that's our highest quality business.

Operator

[Operator Instructions] Our next question will come from Bob Farnam with Boenning and Scattergood.

Robert Edward Farnam
Boenning and Scattergood, Inc., Research Division

I have 2 questions. One is on Personal Lines. You've been raising rates there for a few years. You're really profitable. I understand you may not be raising rates as much as peers at this point. But my question is, are you -- have you seen or do you expect to see some pushback from the regulators about the rate increases there? And probably the same question, have you seen rate increase fatigue from agents or customers at this point?

John Conner Roche
President, CEO & Director

I think the high-level answer is no, that we have -- we -- because of the approach that we're taking, we have not had to have excessive rate increases. Our strategy is to try to generate good returns so we can be more consistent. But -- yes, Dick, do you want to respond to that?

Richard William Lavey
Executive VP & President of Hanover Agency Markets

Yes. Love this question. It really comes down to your starting point and how much you're asking for in terms of what kind of pushback you get from the states. And hopefully, you appreciated the disclosures we gave on Page 9. But you can see, if I could just point out on that upper right-hand chart, where we have for the last several quarters, and Jeff had this in his prepared comments, last couple of years, been above the industry in terms of taking rate. We -- you can see the industry taking rate down, even negative. We've never gone negative.

So we've always kind of been sort of steady, and we're now at a low-water mark. But we will be adding rate in the next coming quarters, but we don't have as much of a substantial need. So when you approach a state and your need is not as great, and you've been steady, we've had no problems at all getting our rates approved.

John Conner Roche
President, CEO & Director

Yes. And I think the agents, as you could imagine, love a market that isn't up and down and all over the place. That consistency is what allows us to generate the agency experience that is expected of our partners.

Richard William Lavey
Executive VP & President of Hanover Agency Markets

And on your second question of customer fatigue or agent fatigue, we're not seeing that. And we anticipate, with the hardening market, that our strategy will be well-received. Our retentions are at some of the highest levels we've seen. So we believe that there's still room to kind of increase our rates modestly from what we have today.

So -- but we'll watch that closely, right? Understanding the rate we push and the elasticity that comes through from customer-agent reaction and what happens to our retention, I feel very confident about it.

Robert Edward Farnam
Boenning and Scattergood, Inc., Research Division

Great. The second question I have is on the reserves, and you and most of your peers have talked about being prudent or conservative with the social inflation, economic inflation impact that's going on. Can you tell us kind of how that works in practice? And if there's ways that we, from the outset, can actually see data about those trends?

John Conner Roche
President, CEO & Director

Bob, I think it's difficult really from an outsider to see it. I was talking to another analyst, and they were saying, can we look at the paids? And I said, well, if you're going to look at the paids, they're going to be down quite a bit because, a, they're down; and b, they're delayed a little bit.

I think when you get the schedule Ps, I'm confident that you'll see, conservatism will show itself in those schedules. We've been as prudent as one possibly can, and you're starting to see a little more meaningful prior year development from a lot of different years, not just 2020. So prior years as well.

So we're feeling as good as we can, and we're feeling as good as we've ever been about our balance sheet coming out of '21.

Robert Edward Farnam
Boenning and Scattergood, Inc., Research Division

Okay. I get it, I -- we'll take a look at the Schedule Ps when they come out, but I was just kind of curious if there's a way to even compare prudency or [conservativecy] between all the -- all your peers.

Operator

The next question will come from Grace Carter with Bank of America.

Grace Helen Carter
BofA Securities, Research Division

I was wondering, looking at the kind of varying frequency and severity trends that we've seen in Personal Auto recently, is there any difference in the Platinum book versus the Prestige book? Or do the trends look pretty constant across those two?

Richard William Lavey
Executive VP & President of Hanover Agency Markets

Yes, there's not meaningful differences in our auto frequency or severity. It's -- I would say nothing to speak of.

Grace Helen Carter
BofA Securities, Research Division

I think the guidance from the Investor Day assumed flat loss ratios. Given kind of the earn-through of the recent rate increases in Commercial Lines and some potential margin improvement there maybe, I mean I was just kind of wondering. I guess, the level of conservatism [that's] baked into the ROE guidance and just if there's any sort of change in the outlook there?

John Conner Roche
President, CEO & Director

So clearly, we've talked about the rate that we're getting above loss trend across Commercial Lines. And that will bode well for all of our Commercial Lines businesses where we're seeing some margin improvement. On a short-term basis, in

Personal Lines for example, clearly the loss ratios will go up from 2021 because we had that enormous frequency benefit in the first half of the year. So no one could continue with a 60% loss ratio or a 62% loss ratio in the first and second quarters. And as those move up a little bit to normal levels, that will be just fine for us.

As you think about the Investor Day, Grace, that's a really long-term strategy where it's over a 5-year period. So over that particular period, we're assuming that loss ratios will be constant. Within any given period or any given year, there are going to be situations or times where they move up, they move down, where we get more benefit from expenses or claims activity starts to jump in at certain points. So a little hard to answer. But over a 5-year period, we're comfortable that there'll be an equilibrium between price and loss trends.

Operator

This concludes our question-and-answer session. I would like to turn the conference back over to Ms. Lukasheva for any closing remarks. Please go ahead.

Oksana Lukasheva
Vice President of Investor Relations & Financial Planning

Thank you, everybody, for your participation today, and we're looking forward to talking to you next quarter.

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