The Hanover Insurance Group, Inc. NYSE:THG

Earnings Call

Thursday, November 2, 2023 2:00 PM GMT

Call Participants

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Presentation

Operator

Good day, and welcome to the Hanover Insurance Group's Third Quarter Earnings Conference Call. My name is David, and I will be your operator for today's call.

[Operator Instructions] Please note this event is being recorded.

I would now like to turn the conference over to Oksana Lukasheva. Please go ahead.

Oksana Lukasheva
Senior Vice President of Corporate Finance

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 Dick Lavey, President of Agency Markets; and Bryan Salvatore, President of Specialty Lines.

Before I turn the call over to Jack, let me note that our earnings press release, financial supplement and a complete slide presentation for today's call are available in the Investors section of our website at www.hanover.com. After the presentation, we'll answer questions in the Q&A session.

Our prepared remarks and responses to your questions today, other than statements of historical fact, include forward-looking statements as defined under the Private Securities Litigation Reform Act of 1995. These statements can relate to, among other things, our outlook and guidance for 2023 economic conditions and related effects, including inflation, supply chain disruption, potential recessionary impact, evolving insurance behavior emerging from the pandemic, and other risks and uncertainties such as severe weather and catastrophes that could affect the company's 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 will begin today's call with my perspective on our third quarter results and a summary of the success we have achieved in our underlying margin recapture initiatives to date. A review of the actions we are taking to improve our catastrophe resiliency, including new initiatives we have underway. Jeff will review our financial and operating results in more detail, and then we will open the line for your questions.

I'll begin by acknowledging the heavy impact of CATs on our third quarter results and the great sense of urgency with which we are executing on our CAT resiliency actions. I'll expand more on this topic shortly.

Excluding catastrophes, we are very pleased with our third quarter performance. I'm happy to report that our third quarter ex-CAT results were slightly better than our expectations, in part due to the continued strong execution of our margin recapture plan, which helped to drive meaningful underlying improvement in all 3 of our business segments.

Our progress in the quarter reflects the inherent strengths of our company, including our distinctive strategy and business model, broad and innovative capabilities, strong well-managed balance sheet, experienced and committed team and deep mutually beneficial partnering relationships with many of the best agents in our business. The last of these are deep agency relationships is particularly important today as we and others are thoughtfully increasing prices, modifying terms and conditions and tightening underwriting requirements.

In keeping with our commitment to being a premier property casualty franchise in the independent agency channel, we are working closely with our agents and their teams to help them better respond to their customers and navigate today's challenges.

At the same time, we are further leaning into one of the hardest markets we have seen in property, particularly in Personal Lines as we deliver on our margin improvement initiatives. Those factors, along with many others, give us a very high level of confidence in our ability to drive disciplined execution further and enhance profitability over time.

Our third quarter ex-CAT results are a strong testament to the successful execution of our comprehensive margin recapture plan as well as the important work we are doing to get back to our expected performance levels. We continue to be focused on 3 main levers: Price increases, property underwriting enhancements, and loss control and risk prevention measures.

In Personal Lines, margin improvement is driven by robust and accelerating earned price increases. Earned pricing is outpacing loss trends helping drive a 1-point improvement in Personal Lines current accident year loss ratio in the third quarter compared to the second quarter this year, primarily driven by Personal Auto. Auto collision loss trends remain elevated but we are seeing an easing of inflationary pressures, while prior rate increases are beginning to help drive improvement in our overall loss ratio.

Homeowners loss pressure is proving to be an ongoing challenge. Having said that, we are confident continued price increases, on top of current increased earned rate and valuations, will bend the curve starting next quarter. Additionally, we are taking a more aggressive approach to homeowners nonrenewals based on specific underwriting criteria, including quality of ROOF Score, prior loss experience and age of construction.

Third quarter Personal Lines total price change in auto and home were up 14% and 23%, respectively. By the end of this year, we expect an average homeowners renewal price change upwards of 28%. Collectively, we expect Personal Lines to experience a dramatic profit recovery next year, and a return to our target profitability on a written basis at the end of 2024, based on a range of reasonable assumptions for loss trends.

We also continue to execute on our profit improvement plan in Core Commercial property lines in the quarter across all 3 focus areas: Pricing, underwriting and risk prevention. In terms of pricing, our core Commercial Property renewal price increased by 14.7% in the third quarter, up 2 points from 12.6% in the prior quarter. We've also made meaningful strides in addressing large loss volatility in middle market, completing nonrenewals and policy limit adjustments that have lowered our total property risks by 17% in constant dollars compared to 12 months ago.

We also engaged in a range of risk prevention and mitigation initiatives designed to reduce both CAT and non-CAT losses in Core Commercial. We are successfully expanding the number of accounts enrolled in our IoT sensor program. We have increased the number of protected accounts by approximately 40% over the last 3 months and 175% since the end of 2022.

Additionally, through the end of September, 30% of the 600 targeted middle market accounts have been addressed through underwriting actions or sensor deployment, and we'll continue to address additional accounts through the fourth quarter. These actions are now delivering results, reducing large loss volatility and improving our Core Commercial current year loss ratio by over 5 points compared to the third quarter last year.

Turning to our Specialty business. We are very pleased with the performance across our portfolio, delivering a combined ratio of 83% for the quarter, ahead of our expectations. While market conditions in some of our segments are competitive, in particular for sectors like management liability. Our ability to deliver consistent profitability is a validation of our diversified specialty portfolio and disciplined underwriting and rate strategy.

Our Specialty growth in the quarter was somewhat muted due to the temporary impact of nonrenewals of a couple of underperforming programs. Despite ongoing excellent performance in Specialty, we expect all segments to contribute to the enterprise margin recapture plan, and we are also being proactive on any lines and segments that are sensitive to social inflation. Excluding programs, Specialty growth was 7.4% in the third quarter.

Longer term, however, Specialty continues to represent a robust growth opportunity for our company. This business provides important diversification for our overall portfolio, and consequently, reduces our property and CAT exposures, all while providing our agent partners with robust comprehensive product offerings, highly valued capabilities and additional growth prospects.

We fully expect our Specialty portfolio to return to upper single-digit growth starting in the first quarter next year, as we benefit from increased market penetration in most segments and growth in newer product offerings, including Specialty, GL and E&S business. We also expect additional lift from our newest initiatives, including expansion in the wholesale channel, which is already delivering solid growth.

Now turning to our efforts to manage our catastrophe exposures more effectively in Personal Lines. We made important progress on the CAT exposure management actions we discussed on our second quarter call. These actions include increasing all peril deductibles to specific minimum levels determined by coverage A limits, implementing wind and hail deductibles in additional states, and transitioning to an actual cash value schedule for roofs in certain states and on specific risks for new business policies.

As of September, the default for all payroll and wind and hail deductibles in the comparative raters for new business have been updated and our agents are supporting our efforts. These changes will be introduced in our TAP sales platform as a requirement on transactional new business as soon as next week.

We also are advancing the technology and regulatory processes that enable us to expand these product changes to policy renewals starting in February, with our key states starting with April effective dates. We expect we will roll most of our homeowners business into new terms by the end of 2024.

In addition, we are planning to introduce actual cash value for roofs in the comparative raters, starting in 2024 for new business in certain geographies and types of risks, thereby further reducing claims costs for older roofs. We expect these actions will enable us to better share loss costs with insureds, which should support loss prevention, decrease claim severity and minimize our exposure to aggressive roofer actions.

We expect to see significant improvements in our CAT vulnerability and loss experience once these product changes are fully in place. At an individual risk level, we could realize upwards of 30% to 50% reduction in hail and roof claims payouts. For example, a wind and hail deductible on a $1 million coverage A, depending on the roof age, will range between $10,000 and $20,000 against an average roof claim cost of $35,000 to $40,000. At the same time, we expect to see the benefit of reduced claims frequency as the higher deductibles will ensure that only legitimate claims are filed.

In addition to product and pricing changes, we are also reviewing our geographic exposures, and reevaluating our property micro concentrations. While we continue to believe some of the recent CAT losses for Personal Lines in the Midwest were aberrant, we are taking steps to reduce our property exposure in certain areas across these states, including but not limited to Michigan.

We have updated our models and are reassessing our property aggregations to ensure we are not overly exposed in specific geographic areas in light of the increased property valuations and changing weather patterns. Additionally, we are achieving substantial decreases in exposure beyond PIF reduction from the product changes and risk prevention actions we are implementing.

Longer term, we will continue our diversification efforts to emphasize Personal Lines growth in lower-concentration states. We also expect small commercial and Specialty exposure and policy counts to grow much faster than Personal Lines, and ultimately, to reduce the relative share of Personal Lines business in our overall mix.

As we look ahead, we believe we have what it takes to succeed in a rapidly changing and challenging marketplace. We are very encouraged by our strong ex-CAT performance and the progress we have made on our margin recovery plan during the year. We look ahead with resolve and a high degree of conviction that we are executing the right set of initiatives to move our company forward.

We have a proven strategy, 1 refined to meet the moment, 1 that will benefit our agent partners and customers, and 1 that positions our company to deliver sustainable, profitable growth and long-term value creation for our shareholders and other stakeholders.

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

Jeffrey Mark Farber
Executive VP & CFO

Thank you, Jack, and good morning, everyone. I will start with a high-level overview of our third quarter results, then review our segments and investment performance in more detail, and finally, provide some thoughts on our outlook.

We experienced elevated catastrophe losses of $196 million or 13.7%, resulting in an overall combined ratio of 104.4% for the quarter. Catastrophe losses in the quarter were primarily the result of severe convective storms concentrated in the Northern Midwest, primarily in Michigan, triggered by damaging hail, severe wind and heavy rain, approximately 75% of all losses occurred in Personal Lines.

Outside of the Midwest, our cat experience was relatively benign across the rest of our geographies. We are confident the broad range of pricing and underwriting actions we are taking will reduce our CAT exposure and optimize our portfolio in the long term. Our CAT experience in Q3 masked what was otherwise a very strong quarter for the Hanover. We delivered in improved combined ratio, excluding cats of 90.7%. That's slightly favorable to our expectations, 3.5 points better than the third quarter of 2022 and an improvement of 2 points sequentially.

Current accident year loss ratio, excluding catastrophes, improved 1.7 points on a sequential basis, demonstrating the power of rate increases and underwriting actions underway in all 3 of our business segments.

We posted an expense ratio of 30.2%, 20 basis points below 2022 third quarter and slightly better than our third quarter expectations. Prior year development was slightly favorable overall and we continue to maintain a strong reserve position. Finally, net investment income was slightly ahead of expectations for the quarter and year-to-date periods as higher interest rates continued to fuel our earnings power.

Turning now to our segment review, starting with Personal Lines. The ex-CAT combined ratio was 96.4% for the third quarter, improving 1.8 points over the third quarter last year. The third quarter of 2022 included some year-to-date reestimations to the loss ratio in Personal Lines, and therefore, is not a very useful comparison. Because there is a little less seasonality in the middle quarters of the year, we believe the more informative comparative is sequential, which saw approximately 3.6 points of improvement in Q3, driven by both the underwriting loss ratio improvement as well as lower expenses.

Auto current accident year loss ratio, excluding catastrophes, of 77.5% in the third quarter improved 1.6 points sequentially, driven by the benefit of earned rates. While loss severity in auto remained elevated, we are seeing some signs it is beginning to ease. We continue to be cognizant of potential severity increases in bodily injury coverages and are selecting our loss picks prudently.

Homeowners' current accident year loss ratio, excluding catastrophes, was 63% in the third quarter, consistent with the second quarter as the benefit of earned pricing was offset by prudent ultimate severity assumptions due to the volatility of recent loss patterns in this line.

Personal Lines generated net written premium growth of 9.5% in the third quarter, driven by accelerating pricing increases. Renewal price change was 18% in the quarter, versus 15.9% in Q2, or an improvement of over 2 points. Customer retention remains strong at 84.6% despite the level of pricing increases.

PIF shrank slightly on a sequential basis, primarily driven by a slowdown in new business. We expect PIF will continue to decline and retention will tick down slightly as we introduce even higher prices and increased deductibles. However, we fully expect our Personal Lines premiums to continue to increase due to the substantial pricing increases.

Turning to our Core Commercial segment. We delivered an ex-CAT combined ratio of 90.1% in the third quarter, an improvement over the third quarter last year and an improvement compared to our expectations. The core commercial underlying current accident year loss ratio, excluding catastrophes, improved by 5.4 points year-over-year to 56.3%, and was consistent with the second quarter 2023, as large loss experience in middle market commercial multi-peril remained stable for the third consecutive quarter. This segment performance was a direct result of our strong execution against our margin recapture plan, highlighting both accelerating pricing actions and effective underwriting actions in middle market property.

Through the first 9 months of 2023, our Core Commercial current year ex-CAT loss ratio improved 1.8 points from the same period in 2022 with a reduction in CMP large losses in each of the last 3 quarters of this year. CMP loss ratio year-to-date reflected 4.5 points of improvement over the first 9-month period last year.

On the top line, Core Commercial delivered net written premium growth of 4.2%, paced by small commercial, partially offset by lower growth in middle market, in line with our expectations, and the result of targeted property nonrenewals. Retention of 83.8% was down somewhat year-over-year, specifically as a result of middle market underwriting actions, while pricing increased to 11.8%, an increase of 50 basis points compared sequentially to Q2.

We delivered outstanding third quarter results in our Specialty segment, generating an ex-CAT combined ratio of 81.3%. The underlying loss ratio improved 5.8 points year-over-year to 47.8%, which included the benefit of earned price changes above loss trends and lower large losses in our property business. We continue to target a low 50s loss ratio in the Specialty business.

Specialty net written premium growth of 2.9% was right in line with our expectations. Our specialty businesses are prioritizing margin improvement over growth. Accordingly, while Specialty has been posting strong profits overall, we have areas of underperformance, where we are non-renewing specific programs, which impacted our growth for the quarter. Retention across our Specialty portfolio is very healthy at 79.7%, considering deliberate nonrenewal actions.

Moving on to our investment performance. Net investment income was strong at $84.2 million for the third quarter, driven by higher bond yields. We expect that the interest rate environment will continue to provide an accumulating benefit to net investment income over the long term, allowing us to reinvest in high-quality fixed income assets at attractive yields.

Looking at our equity and capital position. Book value per share decreased 5.4% on a sequential quarterly basis to $59.21 per share, reflecting an increase in unrealized losses and payment of a quarterly dividend. We have a strong insurance company capital position with $2.5 billion of statutory surplus at the end of the third quarter. This dynamic operating environment requires us to prioritize our capital uses to provide financial flexibility, liquidity and the resources necessary to support business growth opportunities.

With strong pricing and growth, continued volatility in interest rates and an active quarter for catastrophes, we remained on the sidelines for repurchases this quarter. However, we have a long history of returning capital to shareholders through dividends and opportunistic share repurchases. Our philosophy hasn't changed and both levers remain key tools for our future.

Turning to outlook. Our full year 2023 guidance remains unchanged. We continue to expect our ex-CAT combined ratio to be at the higher end of our original guidance range of 91% to 92%. As I discussed on our Q2 call, we are deep in the process of conducting a comprehensive reevaluation of our modeled catastrophe losses, our historical experience and supplemental non-modeled risks. This will augment the detailed modeling and risk analysis process we conduct each year. We will discuss the results of that effort with you early next year but we would like to share the following 3 observations at this point.

First, each point of CAT load increase represents a much more substantial increase in catastrophe severity dollars. For example, with the expected level of personal and commercial property earned price increase next year of around 15%, each point of higher CAT load allows for an approximate 37% increase in CAT losses, or 37% implied loss trend.

Second, given the pricing, underwriting and terms and conditions work underway, we fully expect our CAT load next year to be a high watermark, from which we expect to decline somewhat as our CAT resiliency actions are implemented.

Third, considering the current interest rate environment and resulting increase in net investment income, we can absorb a very substantial increase in planned CAT severity and continue to have full confidence in our ability to achieve our return on equity targets.

In conclusion, we have made substantial and measurable strides in executing on our margin improvement plan across all segments of our business and we are seeing tangible improvements in our underlying performance as a result. We have a very solid foundation to build on for the future, supported by a well-diversified enterprise, strong market position and superior team, which will allow us to execute on our long-term strategies.
Operator, please open the line for questions.

Question and Answer

Operator

[Operator Instructions] The first question comes from Paul Newsome with Piper Sandler.

John Conner Roche
President, CEO & Director

Paul?

Jon Paul Newsome
Piper Sandler & Co., Research Division

Sorry about that. Hopefully, you can hear me. I wanted to ask about further levers you have yet to pull with respect to CAT management in both the Personal Lines and Commercial Lines businesses, and if there are pieces there that we still can pull if it turns out we need to do even more.

John Conner Roche
President, CEO & Director

Yes, Paul, this is Jack. We obviously have continued to accelerate our -- evaluation of our CAT overall AALs and PMLs consistent with the increased models and some of the actions that we've already taken. And I hope what you heard from our prepared remarks is that we've accelerate that further, particularly in looking at where are the new or elevated micro concentrations presenting themselves. Some of that is looking at the experience that we've had this year but in our business, obviously, we have to depend on enhanced models to show us where that catastrophe exposure is most likely to present itself.

So what we've already done is tried to move forward on adjusting our growth in those micro concentrations, particularly in the Midwest and in Michigan. But I would say, categorically, the next set of actions, if we believe that we need to go further, would just be an acceleration of that. And the forms work that we've done will have been in place. The pricing, obviously, we'll be earning in, but we are going to be very agile in terms of new business growth and nonrate actions, particularly in the Midwest, and our teams are very much aligned around that, and that would really be our primary focus.

Jon Paul Newsome
Piper Sandler & Co., Research Division

I guess 2 related questions. Is there a potential reinsurance solution? And I guess, related to that, is there some issue with spread of risk given the concentration in Michigan? Or is that not part of the issue?

John Conner Roche
President, CEO & Director

I'll let Jeff comment specific to some of the continued work we do to look at reinsurance options. It is our hope over time that the pricing and terms and condition changes make some of the reinsurance options more viable and more available, and we continue to look at, whether it be aggregate covers or other ways to address kind of caps below our CAT -- our large CAT threshold.

But Jeff, do you want to comment further about how we're pursuing that?

Jeffrey Mark Farber
Executive VP & CFO

Paul, as you know, reinsurance does provide a useful solution where you have situations in which the business is very profitable over a long period of time. But from time to time, you have volatility. And that's what we believe we have, particularly as you review the pricing that we're getting and the terms and conditions. So as we always do and in particularly the circumstances, we're actively looking at solutions, which would benefit us, particularly in those in those heavy property CAT locations.

Operator

The next question comes from Mike Zaremski with BMO.

John Conner Roche
President, CEO & Director

Mike?

Michael David Zaremski
BMO Capital Markets Equity Research

Sorry. My first question, and I might [indiscernible] a few minutes late and missed this there on prepared remarks but there's been some, I guess, legislation passed -- not fully passed on a rollback of some of the no-fault laws in Michigan. I know you guys have historically a little bit of a reserve release there after the reforms, which have helped a lot. Any -- how should we think about what's going on there?

Richard William Lavey
Executive VP & President of Hanover Agency Markets

Mike, this is Dick. Let me maybe explain a little bit what the situation is. So the bill that you're; referencing in question would amend parts of the medical fee schedule that was part of the -- key part of the 2019 no-fault reforms. More specifically, it's pushing to increase the reimbursement to providers for the long term of care -- the long-term attendant care. Piece of it, so really for catastrophically injured claimants.

So mostly, this impacts the claims that are handled into the MCCA. Where is this bill now? It's passed by the Senate in mid-October, moved to the House, which now would reset, so it's not moving. Obviously, we can't predict the income -- the outcome, excuse me. But I can share that the Insurance Commissioner, who is appointed by the Governor, has written a letter of opposition to the bill in support of the merits of overall paper form, which, of course, we support too. That's encouraging to us. So we can't say exactly when this will be settled. But for us, we -- as we evaluate it, we don't anticipate necessarily a big impact.

Michael David Zaremski
BMO Capital Markets Equity Research

Okay. And then just as a follow-up. With this -- if it was passed -- and I appreciate all the color but would it impact your forward view materially or more just on tough prior year reserves?

John Conner Roche
President, CEO & Director

Mike, this is Jack. We obviously are constantly evaluating what the implications are of the reform itself and any possible retraction of portions of that. So it's hard to say exactly what the immediate implications would be. Some of that depends on how much of those claims are already above the threshold that we're responsible for and how much that ends up being just additional reimbursement through the MCCA.

I think the biggest kind of issue that we believe is important is that we have materially, as an industry, reduced the surcharges to policyholders, which was a big part of the intention. I think the Governor still very much feels like that's important. And it would be really politically disappointing, if you will, if this legislation was unwound in a way in which those surcharges needed to be reinvigorated.

So I think at the end of the day, you should have confidence that we know how to make money in Michigan. We know how to work around this. We made money back when PIP was not reformed and will make the appropriate adjustments. But I think, right now, what you should see is that there's some real opposition to this -- the fee schedule reform, in particular being modified.

Michael David Zaremski
BMO Capital Markets Equity Research

Okay. Great. And I would say that's a tough question given the uncertainty. Switching gears just to prior year reserve development. I mean, many of your peers have been -- including yourselves, have been showing a little less reserve development year-over-year. Is this -- has that -- is that changing your view of loss trend at all, considering your, obviously, pricing power is in a good spot?

Jeffrey Mark Farber
Executive VP & CFO

So Mike, we had overall favorable developments. We have a very strong balance sheet. We did have some unfavorable development in Core Commercial. It was limited largely to some commercial auto and CMP. In total, I think it was $2.7 million. So it was really a drop in the bucket. And importantly, the improvement in our Core Commercial last few quarters has really been around property. So we've been very prudent on our current loss picks, and we've been thoughtful about prior year development to deal with things quickly. So I don't really see that as a trend that I'm particularly concerned about.

Michael David Zaremski
BMO Capital Markets Equity Research

Okay. Great. Yes. And definitely was just a drop in the bucket. Okay. Lastly, you gave us a lot of great data points on how you're thinking about the comprehensive reevaluation of your catastrophe profile and just gave us a lot of good data points. But just curious, is -- the reason to the way to give us the catastrophe load guidance till later, even though you've started this deep dive months ago, is it -- is there anything to do with just you need to see how your agent partners kind of react to everything you're doing? Or is it just more -- this is just a comprehensive study and you just need more time?

John Conner Roche
President, CEO & Director

Yes. I would tell you that the agent reaction is not unimportant, but it is not an area that we're most concerned about. I think we have the appropriate level of humility based on the way catastrophes have impacted our book of business this year. And so what we're trying to do in addition to our normal rigorous drill that, frankly, has served us well on particularly hurricane exposures and other catastrophe management areas, we're spending more time reevaluating and getting the updated RMS and air models, particularly for secondary perils and convective storms and seeking some outside input to figure out how much we should consider climate influence versus cyclical weather patterns.

So I would think of it as more as we understand this is a really important issue for investors to believe that we know how to set those CAT loads going forward, and importantly, how we know how to reduce our CAT vulnerability into the future based on what we've learned this year. That's really the primary reason for our time line.

Operator

Our next question comes from Bob Farnam with Janney.

Robert Edward Farnam
Janney Montgomery Scott LLC, Research Division

Yes. Just to continue that conversation with the agency reaction. So how are they reacting to the rate increases? Because that's kind of a big ask especially in the homeowners business, when you're looking at 28% rate increases. So are you getting pushback from the agency force just on their ability to push those off to customers?

John Conner Roche
President, CEO & Director

Yes, Bob, this is Jack. I want to say a couple of things and then let Dick give you some reaction because he's been on the road pretty regularly, making sure that we have those conversations in person and make sure we really handle this appropriately. But I think the headline I would tell you is that just about everybody understands that the inflationary effects, combined with the type of weather that we've experienced, requires pretty dramatic action. And the competitive landscape is as firm as I've seen in my entire career, at least on the Personal Lines side. So I think the landscape is pretty firm.

And we're not really seeing a lot of pushback. Is there anxiety? Is there challenges in terms of delivering these messages to consumers and explaining it? Absolutely. But I can't tell you that we've experienced any material pushback at this point.

Richard William Lavey
Executive VP & President of Hanover Agency Markets

Jack, well said. Yes, generally, very supportive. I've been out in 6 states in the last 4 weeks, including Michigan. We feel strongly to be right out in front of this. We think more so than any other market, frankly, being transparent, explaining, giving good rationale. There's anxiety, no doubt. They're working really hard and their customers are asking for choices. We've done a great job with talking points, videos that sort of help explain the environment. They're just -- they're happy, frankly, that we're going to remain as available capacity.

So they accept the changes because as they go to market that many -- there are -- in every state, there's actions being taken by a mutual or regional where they're withdrawing or asking to stop all new business entirely. So the fact that we remain under different conditions and with higher prices, frankly, they're quite pleased with that.

Robert Edward Farnam
Janney Montgomery Scott LLC, Research Division

Okay. And just to set expectations on the Personal Lines book. You're saying you're going to get back to target profitability on a written basis by year-end 2024. That kind of means on an earned basis, you're looking at -- you're going through 2025 as it hits the bottom line? So in reality, if you're looking at achieving your targeted ROE overall, you're probably looking more like 2026.

Is that the right way to think about it?

Jeffrey Mark Farber
Executive VP & CFO

No, I don't think so. We can hit our target ROE for the whole firm without getting to target profitability fully in Personal Lines. Bob, I think you'll see very rapid, steady, substantial improvement in Personal Lines over the course of '24 on an earned basis, of course. And when you couple that with where Core is performing and some potential improvement and where Specialty is performing on a year-to-date basis, where the NII sits and where it goes for next year, I think you're going to see a very, very strong 2024. And I don't want to give guidance for '25 but I think you'll see an even stronger 2025.

Robert Edward Farnam
Janney Montgomery Scott LLC, Research Division

Okay. All right. And I guess a question for Bryan on the Specialty segment. So you're targeting a 50% loss ratio. Is that -- first off, is that before CAT or after CAT, or is that accident year? I'm trying to figure out what that 50% loss ratio target is? And then I wanted to talk about the competitive environment there based on you're trying to grow that business by every single digits next year. Are you seeing increased competition from E&S writers or admitted carriers? Just trying to get a feel for the competitive environment there and your ability to grow.

Bryan James Salvatore
Executive VP & President of Specialty

Yes, sure. Thanks, Bob. So yes, starting with the targeted loss ratio and I think that is an accident year ex-CAT loss ratio. And if you look at really the last 2 years, right, quarter-over-quarter, you'll see that we're pretty much in that lower 50 level. This quarter, we had some very, very good results overall but especially in our marine and our HSI book that just pushed that number lower but we feel very good about that low or lower accident year loss ratio. And you'll see for 2 years, '22 and here today '23, that's where we are.

Robert Edward Farnam
Janney Montgomery Scott LLC, Research Division

Yes. So there's really low accident year loss ratio in the third quarter, and that's not kind of -- that's kind of an abnormal in other words. So I'm not going to look at that as it go forward, that's more the 50% that you're looking for going forward.

Bryan James Salvatore
Executive VP & President of Specialty

Yes. I'd like not to call it abnormal but I'd like to call it just particularly good. But yes, I just think the thing to focus in on is lower-50 type loss ratio for Specialty overall.

John Conner Roche
President, CEO & Director

So let's -- Bob, let's try to address the competitive landscape question. I'll just say 1 quick thing. This is Jack, and then Bryan, you can elaborate on it. I think -- I always remind myself and our investors that we are very much excited about the Specialty place -- the Specialty sector but we play in very specific areas within the Specialty business across a number of products and sectors and lines but still a small to first-tier middle market player, which impacts kind of price sensitivity and also accessibility. And it clearly affects who we compete against in that marketplace.

So with that backdrop, Bryan, maybe you can give your view of how the competitive landscape is affecting our...

Bryan James Salvatore
Executive VP & President of Specialty

Yes. And maybe I'll just give you a couple of additional data points on what Jack is talking about in the smaller to middle, right? So if you think about our policies, right, 70% of our policies are with customers that have $5,000 or less premium, right? So these are smaller policies. We're just really, really good at servicing those policies and that's why we're able to accomplish this, right? That helps us a lot. That even helps us in the E&S space. We stay focused even in the E&S space, even with our wholesale business on middle to smaller accounts. And the volatility there has not been a significant and the ability to achieve rate has been quite good.

So when I think about our ability to achieve rate across our books, literally, I think almost every business area that we have, achieved rate at or above trend for the quarter, for the year. And frankly, areas obviously like surety don't get rate, right? And areas like marine, we measure it in terms of new money and that well exceeded our plans.

So in our space, in this environment, we're still able to achieve that rate and we do see our growth next year in -- moving up into the higher single digits as the underwriting actions that we take wind out in this year and we just have really good momentum. We have really good growth across our marine business, our health care business, our surety business and our E&S business, too. So I think we're in a good place.

Operator

Next question comes from Grace Carter with Bank of America.

Grace Helen Carter
BofA Securities, Research Division

Looking at the homeowners book. Obviously, it's had a little bit more volatility in the past few quarters than historically. But just kind of looking back over several years, I mean, in the mid-2010s this book -- the core loss ratio around in kind of the low- to mid-40s and that's gradually increased over the past several years. I guess I'm just kind of wondering how we should think about sort of the target run rate underlying loss ratio for this line? And I mean, I think if we looked at peer results, we would probably see a pretty similar trend and just kind of a slow increase over time. And just your thoughts on whether the run rate earnings power of homeowners for the industry has changed over time?

John Conner Roche
President, CEO & Director

Grace, this is Jack. I'll just make a couple of comments on that. First of all, you're right on top of this and thinking about it the same way we are that this homeowners used to be kind of the profit leader in our Personal Lines book. And as we addressed auto profitability and got that into a much better place pre-pandemic, clearly, there was some slippage in our home performance, some of which was driven by the environment and some probably driven by some relative pricing.

But going forward, our expectation is that we can, particularly given the pricing environment, get homeowners back in to the loss ratios that you're describing that would ideally make our account strategy really a true asset.

So do you want to build on that, Dick?

Richard William Lavey
Executive VP & President of Hanover Agency Markets

We are absolutely at an inflection point here in this line of business. It needs price, it's getting price. You can see [23%], [24%], going to [28%], we'll start to see pretty significant improvement quickly. It does raises questions for us like how do we feel about the underlying book. We still feel very good about the quality, the high-quality nature of the portfolio really hasn't changed over time, and we're also going to get better with the actions that we're talking about. It frankly -- it need the price that we're talking about.

And so we're -- that said, we're still very careful about new business, tightening our qualifications criteria for acceptability. We're using -- we use aerial imagery extensively through the book to help us understand the risk and places where we need reprice more potentially. So we're getting out in -- with -- in a multipronged approach. But I'm with Jack, this line business will get back to its historic level of profitability once this rate turns in.

Grace Helen Carter
BofA Securities, Research Division

And I guess, looking at Core Commercial, the underlying loss ratio there has obviously improved quite a bit this year with really good results in the middle of the year. I mean, I'm wondering the extent to which kind of 2Q '23, 3Q '23 results are sustainable, and the extent to which kind of the ongoing remediation in the middle market book has yet to earn in, and I guess, the degree to which we might even see some potential improvement there going forward?

John Conner Roche
President, CEO & Director

Grace, this is Jack again. I think that the efforts that we've made, particularly in middle market will continue to help us improve that book of business. If you look at our growth patterns, our small commercial growth is twice our middle market growth year-to-date. Our underwriting actions that we took in '22 and into '23 are clearly showing benefits. The pricing is still very firm. I think 1 benefit we have that goes along with some of the pain that we've suffered is that the more property in your mix, the more likely you are to get sustainable price increases and deductible improvement changes.

So we have a very deliberate plan to continue to improve that middle market book of business and grow a very profitable small commercial book of business. I think the combination of those 2 things plays very well into our projections that we'll obviously update after the -- on the Q4 call relative to guidance for 2024. But very bullish on Core Commercial into the future.

Operator

Our next question comes from Meyer Shields with KBW.

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

So I wanted to sort of compliment you because your report is not only detailed but it's really helpful. And under the principle that no good deed goes unpunished, I'm trying to understand the divergence between pricing increases and rate increases in Personal Auto because as far as I understand it the exposed unit is always just a car and a driver.

Jeffrey Mark Farber
Executive VP & CFO

Meyer, are you asking why the price is higher than the rate because of some actions like tickets and things like that? Why we get more renewal price change than rate for Auto?

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

Yes. In other words, why it's been such a significant gap over the last 1 or 2 quarters?

Richard William Lavey
Executive VP & President of Hanover Agency Markets

Yes. Yes. So just looking at the data, I think, that you're looking at. So there would be things like number of fractions, tickets, DUI, things that would hit a driver's record, which we would then, in part, surcharges on. That's one way that, that plays through. But also assembling years of the upgrades the -- losing my words, the -- as cars get older, as your fleet turns over, you're buying newer vehicles. And so that will play into your rate structure here, too. So those are some things that will be driving it.

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

Okay .That's very helpful. Second question, this is sort of like a broad industry issue, so we're asking everybody. Are you seeing any inflection in actually in the paid medical claims for workers' compensation?

Jeffrey Mark Farber
Executive VP & CFO

Not really. At this point, medical inflation across the book, and particularly in workers' comp has been very benign. And that really hasn't driven much increase in the paid so far. We're watching it. And as you know, we've been very conservative in how we've historically booked workers' comp and we've allowed that favorable development to come in slowly. And I think that has served us well and will continue to serve as well as we go forward, Meyer.

Operator

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

Oksana Lukasheva
Senior Vice President of Corporate Finance

Thank you, everybody, for your participation today. 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.