S&P Global
Market Intelligence

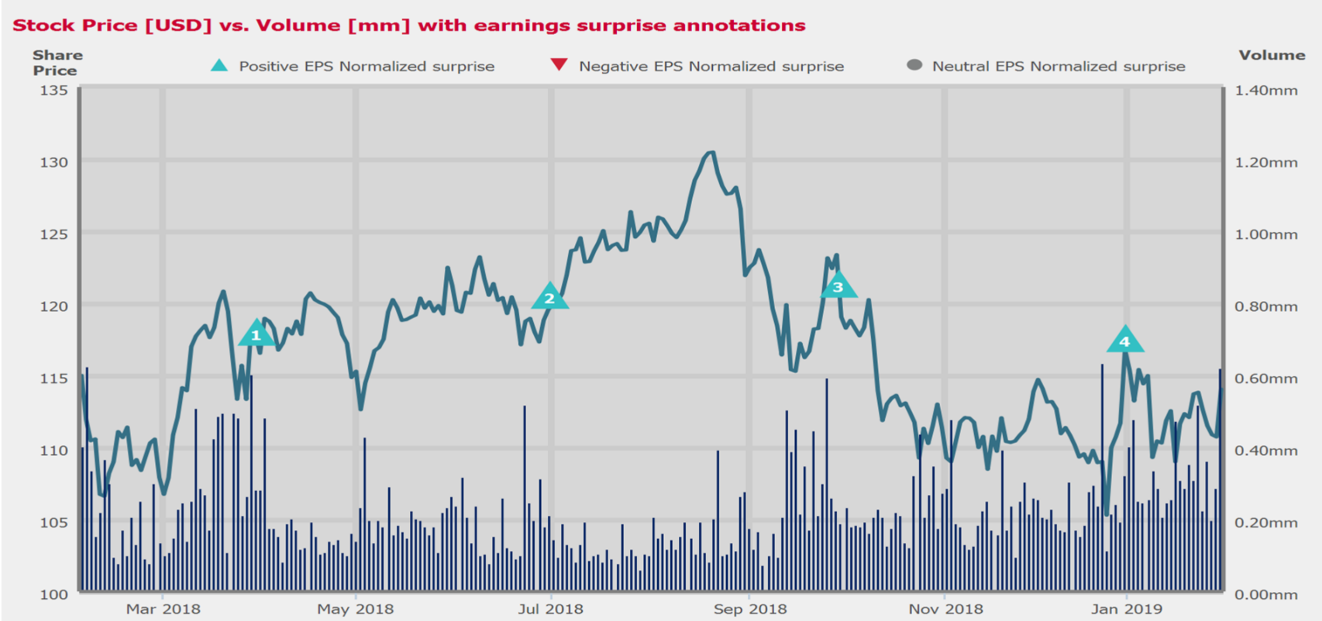
The Hanover Insurance Group, Inc.
NYSE:THG
FQ4 2018 Earnings Call Transcripts

Thursday, January 31, 2019 3:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ4 2018-			-FQ1 2019-	-FY 2018-		
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	ACTUAL	
EPS Normalized	1.47	1.51	▲2.72	1.75	6.71	6.79	
Revenue (mm)	1042.47	1044.70	▲0.21	1132.70	4693.00	4384.80	

Currency: USD
Consensus as of Jan-31-2019 6:55 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ1 2018	1.67	1.95	▲16.77 %
FQ2 2018	2.07	2.20	▲6.28 %
FQ3 2018	1.84	1.97	▲6.49 %
FQ4 2018	1.47	1.51	▲2.72 %

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Call Participants

EXECUTIVES

Bryan James Salvatore
Executive VP & President of Specialty

Jeffrey Mark Farber
Executive VP & CFO

John Conner Roche
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Presentation

Operator

Good day, and welcome to The Hanover Insurance Group's fourth quarter earnings conference call. My name is Chad, 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
Vice President, Investor Relations

Thank you, operator. Good morning, and thank you for joining us for our quarterly conference call. We will begin today's call with prepared remarks from Jack Roche, our President and Chief Executive Officer; and our Chief Financial Officer, Jeff Farber.

Available to answer your questions after our prepared remarks are Dick Lavey, President of Agency Markets; and Bryan Salvatore, President of Specialty Lines.

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

Our prepared remarks and responses to your questions today, other than statements of historical facts, include forward-looking statements, including our guidance for 2019. There are certain factors that could cause actual results to differ materially from those anticipated. We caution you with respect to reliance on forward-looking statements and, in this respect, refer you to the forward-looking statements section in our press release, Slide 2 of the presentation deck and our filings with the SEC.

Today's discussion will also reference certain non-GAAP financial measures, such as operating income and accident year loss and combined ratios, excluding catastrophes, among others. A reconciliation of these non-GAAP financial measures to the closest GAAP measure on a historical basis can be found in the press release, the slide presentation or the financial 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 our call. This morning, I will provide an overview of our strategic accomplishments in 2018, highlights by business and our focus for 2019. Jeff will review our fourth quarter and full year results in detail and provide guidance for 2019, and then we will open the line for your questions.

In many respects, 2018 was a defining year for our company, marked by solid results and important strategic accomplishments. By selling Chaucer, we intensified our focus on our distinctive domestic P&C business, building out capabilities for our agents and customers while delivering strong returns to our shareholders. Overall, we are very satisfied with our 2018 financial results. We posted a full year operating EPS of $6.79, operating ROE of 9.9% and, importantly, an adjusted ROE of 12.6%. Recall that operating income for the year does not include Chaucer earnings, but we still have excess capital from the sale.

Our ex-cat consolidated combined ratio at 91% was in line with our original guidance and consistent with our 2017 performance. Though we are satisfied with our 2018 results, overall, we are not immune to our share of industry-wide challenges. First, the industry sustained elevated catastrophe losses from several California wildfires, winter storms, hurricanes and other events. While the magnitude of these events was severe, we fared relatively well, a testament to our risks and underwriting practices.

For the year, we reported a catastrophe ratio of 5.2%, approximately 0.5 point above our domestic catastrophe expectation. Though this was not a significant variance, we continue to focus on exposure management and portfolio diversification given the elevated catastrophe activity in the industry.

Second, loss trends in auto have continued to put pressure on industry profits, including ours, particularly in Commercial Lines, where we increased our current year loss ratio selections by 4 points in 2018, based solely on the prior year severity.

Loss trends changed in our business. And as we said before, our objective is to recognize these changes and react to the information we have as quickly as possible.

The auto bodily injury trends continue to have our full attention. We're taking additional actions to improve auto profitability and to help offset the increased severity through price increases and various underwriting actions that Jeff will address in more detail.

Strategically, 2018 was a very important year for us. We focused our resources to build on our unique distribution platform, enhance the organization's technological and analytical capabilities and capitalize on emerging market opportunities. We had several noteworthy strategic accomplishments in 2018.

First, we conducted a strategic review of our Chaucer segment, resulting in a very successful sale of this business. As I highlighted a few weeks ago, the transaction enables us to focus entirely on our differentiated domestic agency strategy while simultaneously reducing our volatility and exposure to global catastrophe events. The sale also provides us with additional capital flexibility as we seek to balance profitable and disciplined growth with capital return to our shareholders.

Second, we continue to build out our specialty business, enhancing our product offerings, further strengthening our market presence and making several key strategic hires throughout the year, including senior talent in cyber, financial institutions and excess and surplus lines. We have established a strong market position with the top retail agents and brokers and have set the stage to capitalize on attractive growth opportunities, building out our position as a specialty leader in our chosen markets.

Third, we increased business investments across the enterprise while maintaining our rigorous expense discipline. We actively explored new business models and added capabilities on the technology and digital landscape. For example, we deployed a new agency quoting platform across most of our personal lines footprint, giving us greater underwriting and rating flexibility as well as the ability to improve our homeowners and watercraft product offerings. We launched a new customer acquisition platform in micro, professional and general liability products for sole proprietors. We also leveraged telematics in personal auto, expanded the use of drones in the underwriting process and increased the use of robotics, analytics and automation in many of our back-office functions. Most notably, we are self-funding these innovative solutions by maintaining expense rigor and reallocating resources and capital to attract these strategic opportunities.

Fourth, we've strengthened our position as a carrier of choice for our agents across each of our business segments. Our products and service enhancements, combined with our unique consultative approach to agency partnerships, enables us to gain additional shelf space with our agents. In fact, over the last couple of years, we saw a 17% increase in the number of franchise agents who write over $5 million in premium with us. These agents combined now write approximately 57% of our overall premiums. The business they place with us is typically spread across 2 or 3 business units. For example, Specialty, Small Commercial and Personal Lines, helping us and them gain efficiencies across the P&C product spectrum. We also strengthened our market presence in some underpenetrated geographic markets with select new agency appointments. This year, we appointed approximately 200 new agency locations, many agents we already do business with, to build out some of our less-concentrated states, notably in Texas, Pennsylvania, Ohio, Illinois and Virginia.

Finally, we appointed some additional high-quality specialty agents to our platform to expand distribution points for products such as professional liability, management liability and inland marine. These high-profit margin products continue to make a meaningful contribution to our bottom line.

Moving on to highlights by business, starting with Personal Lines. Our Personal Lines combined ratio for the year was 95.5% and 91%, excluding catastrophes despite the impact of higher-than-expected personal auto bodily injury losses and some elevated non-catastrophe property activity. Though above our original expectation, these results demonstrate the value of our balanced book of business, which continues to deliver above-target returns.

Differentiation of our offering remains key to our Personal Lines strategy as we continue to build an increasingly strong brand in the account business segment. Account business now represents 84% of our Personal Lines book. In 2018, we built on this differentiation with several business initiatives. We expanded our successful agency quoting and service platform, originally piloted in Pennsylvania, to virtually all of our Personal Lines footprint. This platform features more pricing sophistication, improved ease of use and coverage enhancements to customers with more complex insurance needs. It also is reflective of our commitment to modernizing our infrastructure and investing in our agency partnerships.

Additionally, with its launch in Massachusetts last quarter, our flagship Hanover Platinum product is now available in all states. We also have added a telematics and online coaching product, SafeTeen, in 9 states and plan to roll it out across our entire footprint in 2019.

Deeper agency relationships and very strong renewal metrics drove our 2018 Personal Lines growth to nearly 8%. New business growth was also strong, supported by our new Personal Lines initiatives, with the momentum coming from our account-based Platinum and Prestige products, driving PIF growth of 3.5% for the year.

Going forward, we will continue to balance rate and retention, pursuing higher rate increases in certain states, particularly in areas with elevated auto bodily injury severity. Bodily injury coverage rates are now tracking at 9%, and we have plans to achieve higher increases, going forward.

Overall, we are pleased with the strategic progress made in Personal Lines, and we have confidence in its ongoing profitability.

In Commercial Lines, we generated a combined ratio of 96.4% for the year and 90.8% ex cat, delivering a meaningful improvement over 2017. We grew our Commercial Lines book by 6% during the year, emphasizing highly profitable lines of business and industry segments. Our broad product offering in small commercial, industry specialization in middle market and continued investments in specialty capabilities allows our agents the flexibility to provide a wide array of insurance solutions to their customers.

Growth in our Small Commercial segment reflects the positive impact of both strong renewal metrics and new business. Specialty growth was strong throughout the year. This business is now hitting target returns. Many of our newer lines are gaining scale and are producing double-digit profitable growth, in particular, professional and health care lines, which continue to contribute to our overall performance. Additionally, our Specialty businesses continue to further leverage the strength of our agency-facing capabilities, driving even more coordination at the agent and customer level. This helped us achieve our growth plan and adds to our relevance with agent partners.

Middle market growth was tempered due to continued pricing challenges in lines like workers' compensation and profit actions taken in some underperforming risks, including auto. We believe that strong underwriting execution and continued shift to more profitable industry segments will help us expand our profit margins in this business.

Core Commercial Lines pricing improved throughout the year, reaching 6% in the fourth quarter. Overall, core renewal price increases were led by the rate we were achieving in auto, while our workers' compensation pricing was pressured based on low industry losses. We expect these pricing dynamics to continue in 2019 as we prioritize earnings over growth.

Overall, we enjoy a strong market position in our core Commercial and Specialty Lines and have confidence in their continued performance.

As we look forward, we believe our prospects are strong. We have what it takes to further distinguish our company in the marketplace, positioning the Hanover as a premier property and casualty company in the independent agency channel. We have the right strategic focus to deliver on our promise to all of our stakeholders. We will continue to leverage the strengths of our agency distribution, providing our partners with more capabilities and applying proprietary market analytics and insights to enable us to grow profitably together. We will further expand our specialty capabilities and drive further specialization into our core lines of business. We will achieve this through selective appetite expansion and continued product build-out.

Finally, we will continue to drive innovation across the firm and deliver new solutions to enhance customer acquisition opportunities for our agents and our company as well as enhance our data analytics and drive process efficiencies. We are determined to deliver consistent top-quartile industry performance and to take advantage of these dynamic trends in our business, leveraging our great talent, superior distribution model and unique culture, enabling us to deliver strong shareholder value, over time.

With that, I will now turn the call over to Jeff for a review of our financials and 2019 guidance. Jeff?

Jeffrey Mark Farber
Executive VP & CFO

Thank you, Jack. Good morning, everyone. For the quarter, we reported net income of $123.6 million or $2.88 per diluted share compared to $51.5 million or $1.20 per diluted share in 2017. After-tax operating income for the quarter was $64.9 million or $1.51 per diluted share, compared to $65.8 million or $1.53 per diluted share in the prior year quarter. As a reminder, we have restated our prior year results to remove Chaucer from operating results.

The difference between net income and operating income per share in the quarter primarily reflects the gain on the Chaucer sale of $3.08 per diluted share, partially offset by declines in fair value of our equity portfolio of $0.92 per share as well as a loss from the early repayment of FHLB debt of $0.48 per share. For the year, net income was $391 million or $9.09 per diluted share, compared to $186.2 million or $4.33 per diluted share in 2017. For the year, operating income was $292.1 million or $6.79 per diluted share, compared to $192.6 million or $4.48 per diluted share in 2017. Our annual earnings reflected a combined ratio of 96.1%, an improvement from the 97.3% in the prior year due to lower catastrophe losses and expenses. The combined ratio for the quarter was 97.4% compared to 95% in the prior year quarter.

During the quarter, catastrophes totaled $50 million or 4.6% of earned premium, 1 point above our assumption. The largest drivers of catastrophe losses were the California wildfires and Hurricane Michael. Full year catastrophes totaled $219.2 million or 5.2% of earned premium, above our 4.6% assumption. The magnitude of our catastrophe losses, overall, was consistent with or better than our market share would indicate, which is a testament to prior diversification and underwriting actions.

Excluding catastrophes, we delivered a full year combined ratio of 90.9%, in the range of our original guidance of 90% to 91% and consistent with our 2017 ex cat combined ratio of 90.9%. Our underwriting results in the quarter reflected both heavier current period property losses and reserve adjustments to position our full year liability loss selections, making quarterly comparisons between periods more challenging. Taking this into consideration, I will largely focus my comments on full year results, mentioning quarterly movements where appropriate and relevant.

Based on our 2018 reserve reviews, we remain confident in our overall reserves. The cumulative impact of prior year development was 0. However, we continue to make reserve adjustments in specific areas for prior year to reflect our current judgments by line.

I will now review our underwriting results by business. Our Personal Lines businesses continued to perform well, posting a 95.5% combined ratio for the year. We delivered a full year combined ratio, excluding catastrophes, of 91%, up from the 89% posted last year. The increase for Personal Lines was driven by both unfavorable prior year development and, to a lesser extent, an increase in current accident year losses. During the quarter, we increased our Personal Lines prior year reserves by $15.4 million or 3.5 points of the combined ratio related to both homeowners and personal auto.

For homeowners, the increase was due primarily to a small number of large claims, including umbrella endorsements reported in our homeowners line of business, primarily from the 2017 accident year. Auto development reflected continued elevated severity of bodily injury losses in recent prior years, most notably in the 2016 accident year. We are seeing higher medical cost inflation and increased attorney involvement in this line. However, the impact of this trend is mitigated in personal auto by relatively low policy limits. Though early indications of 2018 personal auto accident year loss activity are actually favorable, we increased our 2018 full year estimate in our bodily injury coverage as we are reacting early to trends seen in prior periods. This drove an increase in the 2018 current accident year loss ratio of 0.4 points for the year and 2.5 points for the fourth quarter.

Personal Lines fourth quarter current accident year results were also affected by the impact of non-catastrophe weather in our homeowners line. Non-cat weather was driven by frequent and heavy rainfalls in the Northeast and in the Midwest. We do not believe that the spike in property claims activity in the second half of 2018 is a systemic issue, but we are watching our own trends and industry data intently for factors such as replacement cost inflation and will seek additional rate increases in 2019 if needed. Our loss ratio for homeowners for the full year of 2018 was remarkably consistent with the last 5 years' average. These factors led the Personal Lines full year current accident year loss ratio to increase by 0.8 points to 61.2% compared with the prior year.

Personal Lines net written premiums increased by 7.7% for the year and 7% for the quarter. This growth was driven by strong retention of 83.7% and rate of 4.6% in the quarter. Going forward, this growth may moderate as we continue to increase rates for BI coverages and closely monitor trends for all of Personal Lines. We will react with price and underwriting actions as needed. Overall, at a 95.5% all-in full year combined ratio and 89% on an ex cat accident year basis, our Personal Lines business continues to perform well and delivers results above our target returns. Although we may see a slight increase in our 2019 accident year loss ratio versus our 2018 results, we are confident this book will continue to exceed return targets.

Moving to Commercial Lines. We delivered an all-in combined ratio of 96.4% for 2018, compared with 99.3% for 2017. Excluding cats, the combined ratio improved by 1.4 points, helped by favorable reserve development, lower expenses and a stable underlying current accident year loss ratio. The Commercial Lines' favorable development of $16 million or 2.5% for the quarter was primarily driven by reserve releases in workers' comp and general and professional liability lines, partially offset by reserve additions in commercial auto. The continued emergence of adverse trends in our commercial auto book remains disappointing. Industry commentary attributes this pervasive trend primarily to attorney involvement and increasing medical costs. Our experience confirms that medical costs are on the rise, and lawyers are now involved in more cases, increasing severity and the time to close for such cases.

Consistent with our reserving philosophy, we raised our loss assumptions for prior accident years and aligned our current year selections to the updated view of these trends where appropriate. We continue to take aggressive actions, including obtaining rate increases, improving pricing segmentation and increasing deductibles. We achieved a 9% price increase in the fourth quarter in auto, and we believe further increases are achievable. It's important to note that the majority of our $300 million of commercial auto premium is account-driven, with the overall account remaining profitable. However, we continue to aggressively manage our small remaining monoline business, actively re-underwriting this book. Auto aside, the rest of our Commercial Lines businesses are performing well, with strong profitability gains in other Commercial Lines.

CMP also delivered a relatively strong loss ratio despite being somewhat elevated due to property volatility in the second half of 2018. We are particularly pleased with our profitability in our specialty businesses as evidenced by our performance in other Commercial Lines. On a full year basis, our current accident year loss ratio improved 1.7 points, helped by mix and underwriting actions as well as the general maturation of the book. Overall, our specialty businesses now exceed our target returns.

Our workers' compensation portfolio continued its strong performance during the year, improving the accident year loss ratio by 0.7 points. We continue to watch for emerging trends in this economy, with very high employment and rate declines, but we remain very pleased with the ongoing strong performance in this line.

The Commercial Lines expense ratio improved by 0.7 points compared to the prior year, helped by earning in the benefit of the cost initiatives executed in 2017 and leverage on fixed expenses from growth. Commercial Lines net written premium grew by 6% for the year. This growth was driven by strong retention of 84.5% and accelerating pricing increases throughout the year, which culminated in an increase of 6.1% for core commercial lines in the fourth quarter. Importantly, growth stemmed from higher-margin businesses, including small commercial lines, professional lines, marine and specialty property, increasing the quality of our portfolio mix and profitability.

Overall, Commercial Lines performed well despite the market headwinds during the year. We are confident in our ability to grow this business responsibly, while maintaining stable underwriting profits.

On to our investment performance. Net investment income was $69.4 million for the quarter and $267.4 million for the year, increases of 10.9% and 9.6% for the quarter and year, respectively, over 2017. The increase was primarily driven by higher operational cash flows and strong partnership income.

Cash and invested assets were $8.3 billion at the end of the year, with fixed income securities and cash representing 86% of the total. Our fixed maturity investment portfolio has a duration of 4.5 years and is 95% investment grade. The well-laddered and diversified portfolio remains high quality, with a weighted average of A+. The operating effective tax rate for the quarter was 20.8%, largely in line with the statutory rate. We anticipate that the effective tax rate going forward will roughly equal the statutory rate of 21%.

Moving on to equity and the strength of our capital position. Our book value per share was slightly down for the quarter on a reported basis. It increased by 5.9%, giving consideration to the special dividend of $4.75 we declared at the end of December. More specifically, book value per share for the quarter declined by $0.59. This was driven by dividends of $5.35 per share, both special and ordinary, partially offset by net income of $2.88 per share and the additional economic gain on the Chaucer sale of $1.39 per share. The economic gain reflected the impact of Chaucer's historical unrealized losses and other AOCI items that have previously been reflected in the book value.

As a reminder, the $250 million accelerated share repurchase agreement that we announced in conjunction with the close of the Chaucer sale was executed on December 31, 2018, but had a settlement date of January 2 and will be accounted for in our first quarter results. On January 2, we retired 1.8 million of outstanding shares, which will bring the first quarter average share count down to approximately 41.5 million. The ASR will conclude in the second quarter, with the remaining shares to be retired at that time.

We remain committed to diligently deploying capital through either investment in profitable business opportunities or capital return to shareholders. In the aggregate and including the accelerated share repurchase agreement in progress, the Hanover returned to shareholders approximately $600 million of capital in 2018 or 20% of the beginning equity for the period. Our current balance of Chaucer-related deployable equity is approximately $400 million.

All in, our operating return on equity was 9.9% for 2018. After adjusting for deployable equity related to Chaucer, operating return on equity for the year was 12.6%.

Before opening the line for questions, we want to share with you our guidance for 2019. We anticipate overall net written premium growth in the mid-single digits, driven by growth in our most profitable businesses. NII should increase by mid-single digits, driven by both increased cash flows and a higher interest rate environment. Our domestic expense ratio should improve as we benefit from a fixed expense leverage, with increased investments in our business funded through expense savings. Our combined ratio, excluding catastrophes, should be approximately 91% to 92% plus a catastrophe load of 4.6% for the year. The catastrophe load is consistent with our prior year domestic assumption. Again, we expect an effective tax rate of 21%.

We would also like to remind you of the seasonality of our business. While our first quarter catastrophe load of 4.4% is in line with the full year average, our more northern footprint tends to show higher non-catastrophe weather losses in the first quarter. In addition, first quarter Commercial Lines growth will be negatively impacted by specific non-renewals.

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

Question and Answer

Operator

[Operator Instructions] The first question will come from Matt Carletti with JMP Securities.

Matthew John Carletti
JMP Securities LLC, Research Division

Jeff, maybe if I could just pick up where you left off on the guidance. Can you help us take it one step further? And with -- there's been a lot of, obviously, changes in 2018. A lot of capital changes, Chaucer gone. A lot of rating agency impacts and otherwise. Can you help us kind of translate some of those changes into kind of stable state, all else equal? How should we think about capital changes and the impact on ROE? So if combined ratio were stable, would you expect ROE to be stable? Or would you see improved ROE because you're getting better capital leverage, post deal or post those changes?

Jeffrey Mark Farber
Executive VP & CFO

So thank you, Matt. I appreciate it. So first of all, we wanted to raise our 2019 [picks] based on the loss trends we were seeing, and we wanted to be a little more conservative. I think it's also important when you look at the midpoint of the 91% to 92%, the ROE on that basis, including the excess Chaucer equity and assuming that, for this purpose only, that we don't do any other capital management actions in 2019 other than that, that have been announced. And again, that's just for this purpose only. The ROE would be 11%. If you adjust for the equity, that's for the undeployed equity of $400 million, the ROE is nearly 13%. So I feel pretty comfortable with those results. I think nearly 13%, even though we're raising our PIFs, to be more conservative, is pretty darn solid.

Matthew John Carletti
JMP Securities LLC, Research Division

Yes, absolutely. You actually lead me to my next question, which was on the deployable capital. Obviously, with the ASR active, my understanding is that should wrap kind of 4 to 6 months in. Can you help us just with the -- kind of remind us of the timing and the kind of thought process as to that remaining $400 million or so when we get to that point and how you will address it?

Jeffrey Mark Farber
Executive VP & CFO

Sure. So we've spent the last 4 months or so talking with investors and analysts about Chaucer sale, excess capital and the deployment. And upon day 1 of the closure of the Chaucer deal, we redeployed $450 million of $850 million of deployable excess capital. So I believe that's really a nice installment and really demonstrates that we're going to do what we say we're going to do. So the ASR itself will complete in May or June, depending upon how quickly J.P. Morgan buys stocks. So some point in the second quarter, the ASR will complete. The rest will be redeployed through investment and/or capital management in a very reasonable time frame in the best interest of our investors. And we will communicate timely about our actions, but we want to maintain a little bit of flexibility at this point to give us the options to deal with that in short order.

Operator

The next question comes from Amit Kumar with Buckingham Research.

Amit Kumar
The Buckingham Research Group Incorporated

Maybe I'll take these in reverse order, going back to Matt's question on capital management. You mentioned a reasonable time frame. Is that -- is it fair to say that the reasonable time frame will translate into getting most of this or all of it done by, let's say, early 2020? Or could some of it be spread over 2020?

Jeffrey Mark Farber
Executive VP & CFO

Amit, thanks for the question. I think it's early for us to conclude on that. It is certainly not out of the realm of possibilities that it's finished in '19. And it's not out of the realm of possibilities that it spills over into 2020. We understand what shareholders are interested in, and they want us to use it in the best interest of the company and holders, and we will do that. And so as we finish the ASR in the second quarter, we will come back to investors and talk with you about our thoughts and our actions and the opportunities.

John Conner Roche
President, CEO & Director

Amit, this is Jack. I would just say that as we go throughout the year, the framework that Jeff has outlined in the regular communication is our commitment that we'll be transparent about what deployable capital is left if we've made any use of the capital. And we have no intentions of dragging out excess capital on our balance sheet with no use that is really accretive or would be helpful to building this company in a way that shareholders would appreciate. So that is our complete commitment. What we don't know is what opportunities could emerge, and so we want to maintain a little bit of flexibility, as Jeff stated.

Amit Kumar
The Buckingham Research Group Incorporated

And does that mean -- I know in the past you talked about how efficient an ASR or buyback is. So does that mean we should not take off the possibility that there could be another special dividend? Or am I getting ahead of myself?

John Conner Roche
President, CEO & Director

I think you should not take the possibility -- or triple negative. I think it is certainly possible that there could be a special dividend later in '19, but it is entirely possible that we have other more effective uses for the capital, depending on what investments there are or depending on what -- how we feel about buying back stock and those sorts of things. So we have flexibility to do either, but certainly not off the table.

Amit Kumar
The Buckingham Research Group Incorporated

Got it. Moving on to the commercial auto discussion, and I know Matt asked this. In terms of the guidance and net-net, all else equal, how much of that is -- what exactly would be the points translation from the commercial auto loss pick for the 2019 number? Is that 100 basis points? How should we think about that?

John Conner Roche
President, CEO & Director

I don't think we have that detail in front of us at the moment on the specifics. Certainly, commercial auto for us is not a large line, right? We have $300 million of premium. It's -- we believe it's improving in 2019 because we're getting such substantial amounts of rate. But Oksana can work with you after they go through some of the details on the triangle and the information there.

Jeffrey Mark Farber
Executive VP & CFO

Yes. This is Jeff. I would tell you that -- I'm sorry. Amit, go ahead.

Amit Kumar

The Buckingham Research Group Incorporated

No, please continue answering. Just go ahead.

John Conner Roche
President, CEO & Director

Yes, I think what we're -- it's hard to -- sometimes it's hard to work through a roll forward view, and a line with the loss trend is obviously moving. And that said, we have a point of view on how loss trend is developing. And we've made some material adjustments in pricing. You saw that throughout the year. Heading into '19, we've made some additional adjustments to try to get on top of the BI severity in particular. And we have made some adjustments from an underwriting standpoint on business that tends to be a little bit auto-centric or in the wrong geographies, which is why we qualified a little bit our Commercial Lines growth in the first half of the year because we want to make certain that we are addressing this concerning loss trend in the business. That said, as Jeff said, we're an account writer in specific sectors of the business. So auto, in and of itself, doesn't drive our results, but we realize, we've got to got on top of this one, as does the industry.

Amit Kumar
The Buckingham Research Group Incorporated

That's fair. Last question. On Slide 10, you talked about the pricing increases of 6%. I would imagine half -- roughly half of that is real pricing, and the remainder is account exposure. But when you think towards 2019, are you assuming a flat level of pricing and loss cost trends on an underlying basis? Maybe just talk about that. The 3 versus 3? Or ex commercial auto, the remainder gets better? Maybe just expand on that.

John Conner Roche
President, CEO & Director

Yes, thanks. So this is Jack again. Overall, I would characterize both our pricing view and loss trend view as reasonably flat. We're going to have to continue to watch that very carefully as we make some adjustments and see if the improvement that we're anticipating shows up and that bends the curve, if you will, a little bit on loss trend for us, but we project into the year a relatively stable kind of situation with some slight accident year improvement in the commercial auto area, in particular. That said, we know that workers' comp is continuing to drive through negative pricing for the industry. We've made some adjustments to minimize the effect of that on us. And so we're watching -- there's been discussion about frequency in that line of business that we haven't seen a lot of movement on. But overall, the puts and takes puts us in a pretty kind of stable environment.

Operator

Our next question comes from Christopher Campbell with KBW.

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

I guess my first questions are just on the guidance. I think, just going through a few of the items, the net written premium seems like that's in line with last year at mid-single-digits. And Jeff, I think you mentioned in your opening script about focusing on the most profitable lines. I guess, could you kind of rank that for us just in terms of how you're thinking about growth across Personal, Commercial and Specialty Lines, just where they're at in terms of, I guess, excess return above your targets for each of those broader groups? And then I guess, how does that -- how does -- the relative performance now, how does that feed into your view of if you want to use some of the Chaucer proceeds for accelerating growth in each of those?

Jeffrey Mark Farber
Executive VP & CFO

Thank you, Chris. The areas that we feel strongest about in terms of profitability and, therefore, growth are really Personal Lines, overall, on account business, Small Commercial and many areas of our specialty business.

John Conner Roche
President, CEO & Director

Yes, this is Jack. I would build on that, in that what you're seeing is our portfolio is maturing and where we have frankly more opportunities to look across our business and look for where profitable growth can come through and balance that against some of the dynamics that are going in the market. Even as we talk a little bit more cautiously about the middle market business, we have sectors within our middle market portfolio that are producing returns as good as any other part of our portfolio. So it is truly a portfolio management process for us inside the firm. And with that, I'd love to just give Bryan Salvatore a minute here because we probably haven't stated kind of our confidence in our momentum that's been building in the specialty commercial lines side enough. So Bryan, if you would, maybe you can give a flavor of that for your businesses.

Bryan James Salvatore
Executive VP & President of Specialty

Sure, Jack. Thanks. I'll start by saying that the specialty business that we built is now in excess of $1 billion in premium, and it did perform quite well for us in '18. If you'll refer back to Jeff's comments on the Other Commercial Lines accident year loss ratio, ex cat last year, that was 52.6. That did achieve our target returns. It's over 1.5 better than the year before. And I use the OCL because it does meaningfully overlap with our specialty businesses. I would say that we have built out a pretty broad offering in the specialty space. That offering is very much connected to the needs and the books of our agents. And so we like the relevance that, that brings to our agents. But as we're driving growth, what I would really sort of call out is that what you'll see is that we're going to be continuing to drive growth in what we would look at as our most profitable areas, our best-performing areas, including professional liability in health care, marine, our commercial, these are areas that performed quite well for us, and I think those are the areas that will continue to drive growth, and I think that really adds value for Hanover.

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

Just another question on the health care. You brought that up. And I know there was like an E&S competitor that's kind of pulling out of health care, I guess. What's attractive about that line right now for the Hanover?

Bryan James Salvatore
Executive VP & President of Specialty

Yes, I'll start. So for us -- I think it's important to remember, our book is a bit different, right? We are focused on what are our agents' books of business, and that really brings us to our smaller accounts. It's focused more on the Allied space. You won't see us in the hospital, the large health care system space. And so I think the way it performs is a bit different, and we're very comfortable with it.

John Conner Roche
President, CEO & Director

Yes, and this is Jack. I think that is the -- the professional liability space both in health care and more broadly is a good area to spike out and suggest that there is quite a dichotomy, right? You can see, on the higher end, and particularly in certain sectors like medical, there's a bit of a hard market and there's some real challenges going on. On the low end of the spectrum, there's some terrific returns. And so what we try to do is segment that in terms of where we think the profitability is and where our agents are most advantaged and bring those together. But it is -- it's a portfolio management exercise within the broader portfolio management that we do as a firm. But that's a great example of -- that's one of our most profitable areas in the company. But on the other end of the spectrum, there's some folks that are having some real problems on the med mal side.

Jeffrey Mark Farber
Executive VP & CFO

The only other thing that I would add, Jack, is that we're also achieving -- our pricing that we're achieving in that space is really in line with trends, so we feel good about that as well.

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

That's very helpful. And then another one for you, Jeff, on the guidance. The expense ratio, I think you said that's going to improve year-over-year. I mean, I think it was 50 bps year-over-year last year, just in terms of like the growth that you're forecasting. I guess what's the potential for your expense ratio improvements in 2019?

Jeffrey Mark Farber
Executive VP & CFO

So the way we think about expenses, a company like us, there are a number of investments that we need to make around data and analytics and claims and ease of use for customers, and so we continue to make those investments. And we are committed to funding those investments with expense savings, but we're not going to have expense savings or fixed costs beyond that. But what we do get is leverage on our fixed costs as we grow. So I think on the order of 20 basis points is probably what you can expect on the expense ratio from the benefit of growth and levering those fixed costs a little bit better.

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

Got it. It's very helpful. And then just kind of my final one is more on auto. I think some of my peers have asked about this one as well. I guess, just in commercial auto, it sounds like you're accelerating your rate plan there and [assuming] it's basically constant I guess just what gives you confidence just in terms of the rate level you have, just given the problems we've seen across the industry about various competitors who have put in fairly aggressive commercial auto rates and then raised loss picks and done all that, and added reserves and it's still an issue in terms of taking enough rate to get off within -- or to get ahead of an accelerating loss cost trends. I guess just walk us through your process on that and why we should be confident in the rate level that you guys are taking.

John Conner Roche
President, CEO & Director

Yes. This is Jack. I would tell you that you're spot on, Chris. I think this is still a moving target for the industry. And so we are vigilant about watching this trend, looking at what the various contributors are. I think we have as strong a view as we've ever had about what's driving the severity increases. But I'll let Jeff maybe kind of talk to you in more detail about what we're doing and really our confidence level that we can bend this curve and make sure that the profitability delivers.

Jeffrey Mark Farber
Executive VP & CFO

Yes, thanks, Jack. So as stated, we were looking at this very aggressively and dissecting it as best we can with a multidisciplinary team with underwriting and claims and actuarial, as you'd expect, to really try to get underneath the loss trend. Our actions are pointed and specific, and we think aggressive. And we'll adjust should we need to -- driving rate across the entire book of business. As you saw, we ended the quarter at 9 points. We're going to push that to 10 into 2019. And when we look at our retention of the book and what we see happening in the industry, we're highly confident that we actually can push more rate. Working hard at reducing monoline auto, as was mentioned, shifting away from some of those heavy auto classes, not renewing some non-performing business. And Jack referenced this before, too, but geography is a really important element to this. We'll study where the losses are coming through at a state level, and we see certain states performing worse than others. So we're throwing our bodies at it, so to speak. And we think we have as a good a visibility as we can, and we'll make adjustments as -- with each passing month.

John Conner Roche
President, CEO & Director

I think this is -- the last thing that I would say about this, Chris, is that intuitively, there will be a point in which the delays in medical information coming through somewhat driven by some of the privacy laws that make it more and more difficult for adjusters to be able to obtain information about claims earlier in the process and understand which claims might erode on us. There's new tools in place to help with that, but there's also a maturation to that whole claims development. So I think, as an industry, at some point in time, much of the change that's happened over the last 5 or 6 years hits some inflection point. Hopefully, it eventually starts coming back down, but I think the combination of some pretty substantial pricing that is going on in the marketplace and some maturation of those trends should give you confidence that, eventually, this thing flattens out and starts to go back the other way.

Operator

The next question will be from Paul Newsome with Sandler.

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

Just a couple of follow-ups. One, if I missed it, I apologize. Could you give any color on that sort of Commercial Lines renewal pickup in the first quarter and why that's something that's onetime in nature?

John Conner Roche
President, CEO & Director

I'm not sure I understand the question.

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

I think you said something along the lines of net written premiums.

John Conner Roche
President, CEO & Director

In terms of, actually, some renewal retention drop in the first quarter that will affect our Commercial Lines growth? Is that what you're referring to?

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

Yes. That's what I'm referring to.

Jeffrey Mark Farber
Executive VP & CFO

There's just a couple of idiosyncratic things going on in the first quarter. The prior year had some reinsurance premium that was slipping the other way. There's a couple of accounts -- Jack mentioned the monoline accounts that are nonrenewed. So as we think about the full year, the year-over-year growth for Commercial Lines, specifically in core commercial, will just be a little bit slower than it has been over the past or for the full year. That's all we're just telegraphing. Nothing particular.

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

And then I'm just curious, is there much of a difference in the Personal Lines medical cost inflation issues between PIF states and non-PIF states in your book?

John Conner Roche
President, CEO & Director

Well, maybe to start with the first part of your question. I think the first part of your question is that what is different between personal auto in total is that, generally, even for a book like ours that's more account-centric and tends to have some nice characteristics to it, the limits on the business still are considerably lower than you would see, for example, in Commercial Lines. And so it contains, if you will, some of the loss trend that we are seeing. But Dick, I don't know if you have a point of view specifically on PIF [indiscernible].

Richard William Lavey
Executive VP & President of Hanover Agency Markets

I would add to that, in the PIF states, Michigan being the biggest one of them, we -- the nature of the claims, the fatalities, the delayed medical, legal, the lawyer involvement, I wouldn't say, is dramatically different. But we do an excellent job, as you know, of managing in Michigan -- managing our results in Michigan, where we have a 10-point advantage over the industry. We just have scale, and we have a lot of experience, a lot of feet on the ground, so we've done a great job there. But in terms of the dynamic of the loss, I wouldn't say it's dramatically different. It just shows up in a different line, shows up in the PIF as opposed to bodily injury.

John Conner Roche
President, CEO & Director

Yes, what is common -- this is Jack again, what is common is that the pushing out of the duration of some of these claims are part of the challenge, right? We have seen a meaningful kind of push out of the duration of the severity-based claims and whether that's a PIF claim that takes 18 to 24 months to develop and come back into our claims portfolio, or whether it's a BI claim that we're addressing. But what we're seeing is a consistent pattern in either avenue, if you will, where that delay is causing us to have to reflect a different development pattern.

Operator

[Operator Instructions] The next question comes from Larry Greenberg with Janney Montgomery and Scott.

Lawrence David Greenberg
Janney Montgomery Scott LLC, Research Division

Most of my questions were answered, but just one simple one. Can you remind us in terms of your cat load, what the -- whether commercial and personal. Should we assume kind of similar loads, or is there a difference between the two?

Jeffrey Mark Farber
Executive VP & CFO

Larry, I don't think we've given that in terms of the cat load. I think if you look over time and you see how the 2 have performed, you can probably guess at that a little bit, but we haven't shared that yet. I guess we'll give some thoughts to whether we ought to break that out for people. But overall, 4.6% is the overall load.

Operator

Next question will be from Sam Hoffman with Lincoln Square.

Samuel Hoffman
Lincoln Square Capital Management

I'm just calling in to get a little bit more detail on the Commercial Auto. So can you give exactly what the loss trend is in that line for the full year 2018 and the fourth quarter of '18, and then right now what the run rate is?

John Conner Roche
President, CEO & Director

Yes, this is Jack. Unfortunately, we're not really at a liberty to kind of give by line loss trend, particularly on a short-term basis. And I think the last couple of years have proven why that's not prudent because nobody anticipated the auto trends to accelerate the way they did. But I think as we look over the long haul, we can definitely see that commercial auto trends have ticked up maybe as much as a couple of points over the last few years in terms of people's view of that in the mid -- short to midrange. But we've been adverse to try to put out specific loss trends by line of business and pretend like we have a crystal ball at that level.

Jeffrey Mark Farber
Executive VP & CFO

Sam, I think we're going at this hard. You can see be sure that we're getting price increases, as Dick mentioned, of 9%, moving into 10%. We're looking at segmentation. The very small portion of our $300 million that happens to be monoline, we're revisiting that small piece, and we're just not backing off these corrective actions.

Samuel Hoffman
Lincoln Square Capital Management

What is the earned -- price increase at this point like on a run rate basis heading into 2019?

Richard William Lavey
Executive VP & President of Hanover Agency Markets

Yes, this is Dick. In the fourth quarter, we saw 9 points of rate.

Samuel Hoffman
Lincoln Square Capital Management

That's the written or the earned?

Richard William Lavey
Executive VP & President of Hanover Agency Markets

That's written. It's written. That's applied. So it will take some time to earn that in. Because we've been getting close to 9% in the fourth quarter, close to 9% in the third quarter, the earned will not be substantially different than the written in -- by the time they get to '19. It will be a little bit slower in the first quarter. It will pick up with intensity.

John Conner Roche
President, CEO & Director

And I think we can safely say -- this is Jack again. We can safely say that the price that we will drive in 2019 in Commercial Auto will be meaningfully above even a conservative estimate of loss trends.

Samuel Hoffman
Lincoln Square Capital Management

Okay. So the loss trends in 2018 were in the high single digits, it sounds like?

John Conner Roche
President, CEO & Director

That's correct.

Samuel Hoffman
Lincoln Square Capital Management

Okay. And then my follow-up is, is there any reason to believe that Hanover's commercial auto business book as a whole is better or worse in terms of loss ratio than comparable companies -- comparably situated companies in the industry, given that the bulk of your business is account-driven? How should we think about that as we look at benchmarking and thinking about what your loss ratio should be?

John Conner Roche
President, CEO & Director

Thanks for that. This is Jack again. Dick, why don't you...

Richard William Lavey
Executive VP & President of Hanover Agency Markets

I mean, I think it speaks to the strategy we deployed at the marketplace, with playing heavily in the small commercial segment and the lower end of middle market, where, frankly, the commercial auto fleets are smaller, our classes tend to be more professional in nature. So I do think that there's an element of the nature -- the mix of business we have, both size and class, you could argue, is going to lead us to a better outcome than other companies that play in bigger spaces, bigger fleets, more complex class of business.

Jeffrey Mark Farber
Executive VP & CFO

And that's what we're alluding to earlier, that when you think about manufacturing firms that have big fleets or wholesale companies that tend to be auto-centric, we've made some meaningful repositioning in those kinds of classes or those kinds of businesses because frankly, you can't just overcome the odds. The mix, the line of business mix dominates your ability to make profit. So we've -- that's where we've made some real meaningful adjustments. And I think our portfolio, vis-à-vis the industry, it tends to be on the lower account size.

Richard William Lavey
Executive VP & President of Hanover Agency Markets

And lastly, the point I made earlier, the percentage of our book that's monoline auto is quite small and getting smaller. And so the monoline auto that we have remaining performs quite well, but that, in the past, has been the place where we needed to do some underwriting and [mitigate] loss ratio.

Samuel Hoffman
Lincoln Square Capital Management

Okay. And since you're focusing on smaller accounts, would you say that your expense ratios in that line would be higher than peers, and then therefore the combined ratio would be about the same? Or do you think, overall, your combined ratio should be somewhat better than the industry?

Jeffrey Mark Farber
Executive VP & CFO

Yes, I think it's hard to make a lot of comparisons because some of that can depend on -- go to the other extreme, or if you get into trucking businesses, where the commissions tend to be lower and so [does] the loss ratio profile. So it's hard to make a real general statement. I think the hypothesis of our firm is that by playing on the lower end of the Commercial Line space, we will have a slightly higher expense quotient and a lower loss ratio component in total. But again, what we caution people over time is as we get more specialized, then the account size versus the complexion of how much your business is specialty or specialized can also work against that same kind of expense-to-loss ratio quotient. So overall, we're quite comfortable at the returns we're delivering, show expense ratio improvement over time and a good stable loss ratio.

Operator

Ladies and gentlemen, 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
Vice President, Investor Relations

Thank you, all, 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.