S&P Capital IQ

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The Hanover Insurance Group, Inc. NYSE:THG

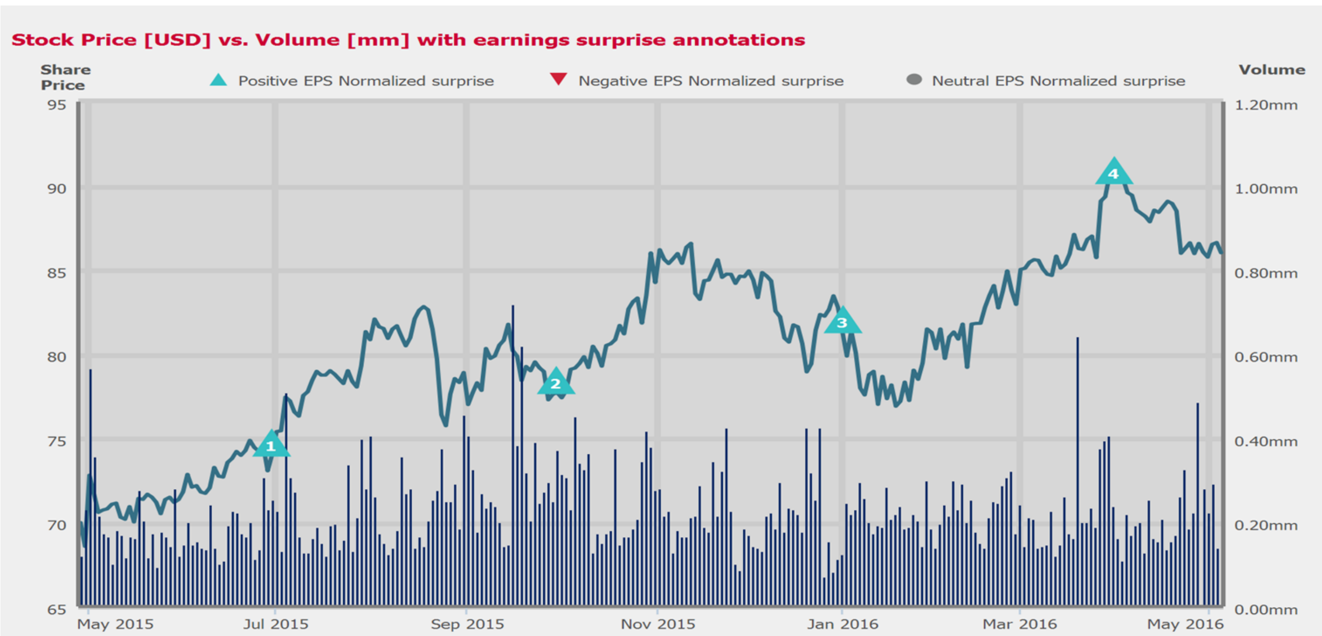
FQ2 2016 Earnings Call Transcripts

Friday, July 29, 2016 2:00 PM GMT

S&P Capital IQ Estimates

	-FQ2 2016-			-FQ3 2016-	-FY 2016-	-FY 2017-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	1.19	1.24	▲4.20	1.56	6.05	6.98
Revenue (mm)	1234.50	1221.60	▼(1.04 %)	1229.00	4678.80	4851.30

Currency: USD
Consensus as of Jul-29-2016 1:30 AM GMT



- EPS NORMALIZED -	CONSENSUS	ACTUAL	SURPRISE
FQ2 2015	1.40	1.56	▲1 10.64 %
FQ3 2015	1.45	1.61	▲2 11.03 %
FQ4 2015	1.60	1.82	▲3 13.75 %
FQ1 2016	1.60	1.64	▲4 2.50 %

Call Participants

EXECUTIVES

Andrew S. Robinson
Former Executive Vice President of Corporate Development and President of Specialty Insurance

Eugene M. Bullis
Former Interim Chief Financial Officer and Executive Vice President

John C. Roche
President of Hanover Agency Markets

Joseph M. Zubretsky
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Presentation

Operator

Good day, ladies and gentlemen, and welcome to The Hanover Insurance Group Second Quarter Earnings Conference Call. My name is Whitley, and I will be your operator for today. [Operator Instructions] As a reminder, this conference is being recorded for replay purposes.

I will now turn the conference over to your host for today, Oksana Lukasheva, Vice President of Investor Relations. Please proceed.

Oksana Lukasheva
Vice President of Investor Relations

Thank you, Whitley. Good morning, and thank you for joining us for our second quarter conference call. We will begin today's call with prepared remarks from Joe Zubretsky, our President and Chief Executive Officer; and our Interim Chief Financial Officer, Gene Bullis. Available to answer your questions after our prepared remarks are Dick Lavey, President of Personal Lines; Andrew Robinson, President of Specialty Lines; Jack Roche, President of Business Insurance; and Johan Slabbert, Chief Executive Officer of Chaucer.

Before I turn the call over to Joe, 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 will 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, including our 2016 outlook. There are certain factors that could cause actual results to differ materially from those anticipated by this press release, slide presentation and conference call.

We caution you with respect to reliance on forward-looking statements, and in this respect, refer you to the forward-looking statement section in our press release, Slide 2 of the presentation deck and our filings with the SEC.

Today's discussion will also reference certain non-GAAP financial measures such as 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 or the financial supplement, which are posted on our website, as I mentioned earlier.

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

Joseph M. Zubretsky
Chief Executive Officer, President and Director

Thank you, Oksana. Good morning, and welcome to our second quarter earnings call. I'd like to start by saying how pleased I am to have the opportunity to lead The Hanover. I have a deep appreciation for the work my predecessor and the entire team have done to build one of the most respective franchises in the independent agency space.

The company has developed a broad and innovative product portfolio. A disciplined underwriting acumen and a reputation for responsive service that has driven improved earnings over time. While certainly successful in the past, the organization also presents significant prospects for margin expansion, growth and superior shareholder value creation. I look forward to working with all of you who have invested in our future.

This morning, I will provide the highlights of second quarter results, Gene will review our financial performance and business results by segment, I will then offer my initial observations about our strategic position and value creation, and then our entire management team and I will take your questions.

We reported net income of $2 million or $0.05 per fully diluted share, which included a onetime charge for the debt retirement we announced in April. Operating income was $54 million or $1.24 per fully diluted share, generating an operating return on equity of 8%.

Overall, net written premiums were flat, excluding the impact of the U.K. motor sale in June of last year. This reflected a very good growth in Personal Lines, moderate growth in Commercial Lines and a decline at Chaucer, where we are taking advantage of reinsurance prices to proactively manage the risk profile of the book.

Our consolidated combined ratio of 97.3% reflects the impact of previously announced large losses in catastrophes, and the current accident year at Chaucer as well as unfavorable development in certain liability coverages, in domestic Commercial Lines. These impacts were partially offset by lower property losses, including catastrophe activity in all of our domestic businesses as well as favorable development of prior year catastrophe losses at Chaucer.

In addition, the volatility of the pound sterling surrounding the Brexit vote resulted in some foreign exchange losses at Chaucer, which are not reflective of the long-term earnings power of this business.

While we are generally pleased with the underlying performance of our business, across most of the portfolio, there were a few areas in which our results did not meet our expectations. So let me now discuss the highlights of each of our businesses, starting with Commercial Lines.

Commercial Lines posted a combined ratio of 98.9%, which reflected improved accident year results in Property Lines, partially offset by prior year loss reserve development in certain areas within commercial liability coverages. The unfavorable development related to late reported claims and increased severity, specifically related to activity in 3 litigious states in our middle market multi-peril business, as well as in previously terminated business in AIX. Our small Commercial account business continues to perform well.

We believe our pricing of new and renewal business has captured the underlying trends we are experiencing, as we strive to stay ahead of the loss curve. As new information emerges, we include a conservative estimate of long-term cost trends in our pricing and loss picks.

The 2% Commercial Lines growth in net premiums written reflects the impact of pricing increases on our core middle market and small commercial businesses, which generally kept pace with our long-term loss cost assumptions, and improved core retention. Commercial growth is offset somewhat by a slowdown in new business and lower premiums at AIX as underwriting adjustments and pricing decisions were made prudently.

We expect to continue to leverage our strong distribution partnerships and business consolidation expertise to generate profitable growth going forward.

Turning now to Personal Line. This business posted a combined ratio of 91.3%, representing an approximately 4-point improvement over the prior year quarter. This was driven by lower than usual catastrophe losses and lower weather losses in the homeowners line. Our combined ratio continues to benefit from the increased mix of total account in platinum business in the book, which tends to have better performance than model line business over time. The growth in net premiums written 4.5% is attributed to rate increases, improved retention and increased new business, which was up 16% compared to the second quarter of last year, as we drove significant growth in our account-based platinum product.

Account business now comprises 81% of our total book and 88% of new business. Our commitment to being a bundled account provider continues to produce stronger customer retention and ultimately higher lifetime customer profitability. It also allows us to effectively address the needs of our agents and customers, and to successfully compete with the ever-increasing number of new offerings available in the Personal Lines marketplace.

We are confident we can continue to grow this business, generating more revenue through our existing agency plan; expanding our market reach by entering new states, starting with Pennsylvania in December; and actively targeting the attractive $6 billion to $8 billion emerging affluent market in our current footprint.

Now turning to Chaucer. Chaucer's combined ratio at 103% was higher than planned and reflected elevated industry-wide man-made large losses, catastrophe events and lower favorable reserve development due to foreign exchange movements. Given the nature of the Lloyd’s business, we expect periods of elevated industry loss experience to impact our underwriting performance from time-to-time, as it did in the second quarter.

Our losses were generally proportionate to our underwriting appetite and market share, and were appropriately reinsured.

Within our political risk business, the global collapse in commodity prices is projected to cause contractive falls in the trade credit line of business. In response, we have significantly reduced exposures in the affected commodity areas, countries and regions. We also have imposed significant rate increases and more stringent terms and conditions, while reducing risk retentions. Trade credit coverage is strategically important to the writing of political risk business where we have been a leader for a very long time.

Since The Hanover purchased Chaucer in 2011, it has consistently produced excellent results, a testament to the enduring strength of the business and sound risk management. We believe the long-term outlook for this business is very attractive, as we continue to leverage our underwriting intellectual capital, strong distribution partnerships and durable reinsurance relationships. Our underwriting and risk management philosophy was reflected in our second quarter top line results, as we reported gross premiums written excluding the impact of the U.K. motor business in line with the prior quarter, while net premiums written declined 8%, reflecting a more extensive use of reinsurance capital.

We believe the Brexit separation will have very little financial or strategic impact on our business, and it should not affect our ability to retain and attract talent. In addition to Lloyd’s efforts to retain passporting rights to Europe, we are in the process of establishing direct access to the region through our own non-Lloyd’s platform in Dublin. We have received preliminary agreement from the Central Bank of Ireland to proceed with the application.

We continue to maintain our longer-term combined ratio outlook of mid-90s for this business, and our commitment is to grow only as market conditions will allow us to do in a responsible way.

A few comments on investments in our capital position. Our investment portfolio is conservatively managed. The yield on the portfolio will continue to be pressured by the low-interest rate environment, which we anticipate to continue for some time. To partially offset this impact, we are selectively deploying alternative asset classes, including equities and commercial mortgages without adding any duration risk.

Our capital position is strong. In the quarter, we executed a well-priced oversubscribed debt refinancing and took advantage of general market volatility to repurchase approximately $19 million worth of common stock.

Overall, we are very optimistic about our top line trajectory and long-term earnings growth, despite some performance challenges in the quarter. We are maintaining our original outlook for the second half of the year of a 95% to 96% combined ratio. However, we are revising our earnings per share guidance to $6 to $6.15, primarily to reflect first half earnings and growth performance.

Gene will provide further detail related to our guidance in his remarks. Gene?

Eugene M. Bullis
Former Interim Chief Financial Officer and Executive Vice President

Thank you, Joe, and good morning, everyone. On a consolidated basis, second quarter 2016 net income was $2 million or $0.05 per diluted share compared to a $120.7 million or $2.68 per diluted share in the second quarter of last year. Current quarter net income included a nonoperating charge of $56 million after-tax associated with the redemption make-whole provisions of a 7.5% and 6.375% senior debt, which we refinanced in April.

Second quarter 2015 net income included the $40 million realized gain on the sale of the U.K. motor business. So $96 million of the swing is attributable to these 2 unusual items.

Operating income was $54 million or $1.24 per diluted share compared to $70.4 million or $1.56 per diluted share in the second quarter of last year. The overall combined ratio was 97% compared to 96% in the prior year quarter.

I'll begin by providing financial color on our second quarter underwriting results by business segment, starting with commercial lines. We realized over 2 points improvement in the current accident year loss ratio, excluding catastrophes to 55%, which -- with contributions from all core lines of business. We remain focused on executing disciplined underwriting within our well-defined risk appetite and achieving targeted pricing.

Workers' compensation was a source of meaningful improvement with consistent accident year loss ratio performance and favorable reserve releases. We continue to benefit from our focus on smaller policy sizes and business classes with lower risk profiles.

Moving on to commercial auto, the accident year loss ratio improved by 1 point in comparison to the prior year quarter. Although improved, the lines still remain below our target profitability. Due to some continuing claim development in prior accident years, we added to prior year bodily injury ultimate loss picks.

As a whole, we remain encouraged by our recent progress and are confident in our ability to return this line to acceptable profit levels.

Commercial multi-peril benefited from unusually benign property loss activity, which resulted in the overall accident year loss ratio of 47%, down from 51% in the prior year quarter. Our current accident year loss ratio selection for CMP liability coverages remain consistent with our pricing assumptions and reflected our updated view of loss trends. We have increased our ultimate picks for prior accident years in response to unfavorable actual to expected experience in CMP liability.

Similar to prior quarter's activity, this reflects an elevated number of litigated cases associated with slip and fall claims, particularly in major metro areas, in states with higher rates of litigation and slower reporting patterns.

We have implemented more stringent underwriting and claims management guidelines over the past several quarters related to these coverages, and we will continue to carefully monitor trends.

Despite the unfavorable liability activity, we expect CMP to remain one of our most profitable lines of business. The underlying loss ratio at other Commercial Lines was over 2 points lower than in the prior year quarter, driven by unusually low incidence of property losses in the quarter. Nevertheless, we saw a continued unfavorable loss development in previously terminated business at AIX, primarily in accident years 2013 and prior.

We remain confident with our most recent accident year performance. While the unfavorable development in prior accident years results is disappointing, the activity came from lines we have been carefully monitoring and have been actively addressing through underwriting and claims initiatives.

Expense ratio for the quarter was 36%, in line with the prior year quarter. We are benefiting from growth leverage as our operating platforms are scalable and do not require growth in operating expenses at the same rate as premium growth. Accordingly, we remain confident with our target of about 0.5 point of improvement for 2016.

In Personal Lines, the underlying loss ratio for the quarter was 61%, representing an approximately 2-point improvement over the second quarter of 2015, driven by favorable property loss experience in homeowners.

Most of the improvement was associated with lower non-catastrophe weather losses compared to the elevated weather-related loss activity in 2015. In addition, we are seeing the impact of prior underwriting initiatives and favorable pricing across our book.

Our personal auto accident year loss ratio remained about flat compared to the second quarter of last year and improved year-to-date, reflecting stable frequency and proactive pricing actions. We continue to monitor bodily injury and collision severity trends, which we believe are appropriately reflected in our current auto pricing

Second quarter 2016 personal lines expense ratio was 27%, 0.5 points lower than the second quarter of last year, as it benefited from a onetime premium tax adjustment. We continue to leverage our cost base with growth and make investments in product, platform and marketing expansions to create further premium growth and efficiencies. Longer-term, we expect our Personal Lines expense ratio to be approximately 28%.

Turning to our Lloyd’s business, Chaucer's combined ratio was 103% for the quarter, up from 88% in the second quarter of 2015, excluding the impact of the U.K. motor business. Second quarter catastrophes, including the Alberta wildfires and earthquakes in Ecuador and Japan, together had a combined impact of approximately $26 million. This activity was partially offset by $12 million of releases of prior year catastrophe losses, notably hurricanes Odile and Sandy as well as the 2015 earthquake and floods in Chile.

We also experienced further loss activity in the trade credit class of business, which is within the marine line, and an increase in loss provisions for 2 notable large man-made events that occurred in the fourth -- in the first quarter, namely the Jubilee Oil Field turret malfunction and the Brussels Airport terrorist attack. Present attritional losses at Chaucer remain stable and in line with our expectations.

I'd now like to review the impact of foreign exchange movements on our second quarter results. The weakening of the GDP against most other currencies in the second quarter suppressed Chaucer's pretax earnings by approximately $9 million. Revaluation of loss reserves in certain currencies to pound sterling, notably the euro, Swiss franc, Australian dollar and Japanese yen, had an adverse impact of $15 million, which mainly flowed through the reserve development line. This was partially offset by a positive revaluation of investments in overseas deposits and cash of $4 million, which reduced expenses as well as an adjustment to premiums receivable of $2 million, which in turn increased earned premiums in the quarter.

Additionally, we recorded unrealized foreign exchange gains from euro-denominated investments of $3 million. These gains flow through AOCI within the equity line of the balance sheet. Net-net, the overall negative impact on foreign currency movements in the quarter, including the equity offset was $6 million before tax and $4 million after tax.

While we actively manage our currency risk, endeavoring to match assets and liabilities, a certain level of net exposure persists, which [indiscernible] unusually wide foreign exchange moments, as experienced with Brexit, and have an impact on our earnings at any given quarter.

Our total net premiums written was flat for the -- with the prior year quarter, putting the U.K. motor business sale aside.

Personal Lines grew 4.5%, maintaining strong rate increases in the 5% range. Strong new business flow that improved retention. Commercial Lines premiums increased 1.9% as we continue to balance our new business appetite with the pursuit of profitable business mix and healthy pricing. Price increases in Commercial Lines were essentially in line with those experienced in the first quarter, with core commercial tracking at approximately 4%, while retention continue to improve to approximately 84%.

Chaucer's net premiums written reduced -- reduction of 29% over the prior year quarter reflected the sale of the U.K. motor business. Adjusted for the U.K. motor impact, net premiums written declined 8%, while gross premiums written remain relatively flat with the second quarter of 2015. Given the competitive market at Lloyd’s, we actively use reinsurance to manage our risk appetite, while retaining leadership and influence in our chosen specialty classes. The highly cyclical nature of Chaucer's business makes a continued focus on underwriting margins and profitability our primary objective.

Turning to investment results. Cash and invested assets were $8.5 billion at the end of the quarter with fixed income securities and cash representing 88% of that total. Our fixed maturity investment portfolio has a duration of 4.0 years, and is roughly 94% investment-grade.

Portfolio remains high quality and well-laddered. Net investment income in the second quarter was $69 million or $2 million lower than the prior year quarter, but up sequentially, reflecting a lower average investment asset base due to the transfer of the U.K. motor business, prior capital management activity and continuing pressure from lowered money yields. This impact will partially offset -- was partially offset by the investment of higher operational cash flows and additional income from prudently growing risk asset classes, such as commercial mortgage loan participations and yield-oriented equities.

Total portfolio pre-cash yield was 339 compared to the 348 in the second quarter of last year. We expect continuing pressure from prevailing low interest rates, likely for a prolonged period, which will have a slight impact on our overall outlook for 2016.

I'll finish with a few comments on the strength of our capital position. Book value per share was $70.58, up 2% in the quarter and 7% year-to-date. Excluding unrealized gains on investments, book value was relatively unchanged, as accretion from operating earnings was offset by the charge related to the debt refinancing as well as dividends.

This refinancing action enabled us to increase the overall tenor of our debt capital and create a larger more liquid lower price benchmark going forward. At 21%, our debt-to-total capital leverage ratio is comfortably within our target range. In the quarter, we repurchased approximately $19 million worth of common equity. Our appetite for share repurchases continues to be influenced by our capital priorities as well as prevailing trading multiples.

Overall, we are confident in our current balance sheet strength and believe it will continue to provide a solid foundation on which to grow our business.

In regards to our guidance, our 95% to 96% combined ratio outlook for the second half of the year includes an aggregate 5 percentage points of catastrophe losses, with a split of 6% and 4% for the third and fourth quarters, respectively.

Based on the first 2 quarters of actual results, including the impact of lower-than-expected first half written premium on full year earned and incorporating a slightly lower estimate for net investment income, we now expect earnings per share to be in the range of $6 to $6.15 for the full year 2016.

With that, I'll turn the call back to Joe.

Joseph M. Zubretsky
Chief Executive Officer, President and Director

Thanks, Gene. Though it has only been a few weeks, I would like to share my initial observations on our company's strategic position and value creation potential.

We have a very strong operating platform, supported by loyal distribution relationships and talented professionals with knowledge of their markets. Through our ample opportunities to be harvested from this platform, focusing on 3 main areas, in particular. First, is the opportunity to further penetrate our existing 2,200 independent agents with our high-touch model and increase market share with them. Our relevance with these agents increased markedly over the last several years.

However, many of these relationships are still suboptimized. Gaining share and becoming a top 3 to 5 carrier on more agents' shelves would lead to higher quality growth and expense leverage, as a significant portion of the agency operating expense is fixed.

Second, is the opportunity to more effectively and broadly leverage our existing domestic specialty products and evaluate adjacent capabilities. For instance, we have developed businesses in high growth industries such as technology and health care. We have excess and surplus lines platforms to take advantage of the expanding and contracting nature of the admitted market, and we have yet to import any of Chaucer's vast capabilities to the U.S. We have considerable upside in these often higher margin lines to generate above-average growth and to create additional expense leverage, while taking advantage of emerging industry demand in some of the highly technical underwriting classes.

Third are the opportunities embedded in the high intellectual capital platform represented by Chaucer. Its underwriting capability sets the business apart as a leader in some of the most complex risk classes in the London market. Looking forward, we can expand existing regional platforms and develop regional partnerships such as our partnership with AXA in Africa, to get closer to distribution in targeted regions. Additionally, we are already on the path of establishing a non-Lloyd's platform to increase underwriting flexibility and open additional avenues for growth.

These are just a few examples of substantial opportunities that exist in both domestic and international businesses, and I am optimistic about our prospects.

A few closing comments related to investments, capital management and value creation. Our investment philosophy is consistent with that of our investment management team. We have an appropriately conservative investment portfolio with durations reasonably aligned to liabilities, and a good balance of managing to total return and book yield. You should not expect any material changes to our investment approach aside from a more active participation in the tax exempt asset class, which will be triggered by changes in our tax status starting at the end of this year.

I believe the best use of capital is to invest in profitable business growth. As in the past, any excess capital should be moved to the parent company allowing for management flexibility. At the parent company level, you can expect we will hold a cushion of liquidity. We will use a mix of dividends and share buyback programs on a targeted basis as a means to return capital to shareholders, with payout targets reevaluated from time-to-time.

The best measures of shareholder value creation are growth and book value per share and increasing our return on equity. We are committed to achieving this goal by increasing returns on our business without creating additional volatility. We are very much aware of the pressure caused by a prolonged low interest rate environment, and we will not attempt to compensate for this by lowering our underwriting standards. We plan to capitalize on the multiple leverage available to us, including gaining share of wallet with distribution partners, leveraging our expense base and further developing underwriting intellectual capital and specialty, all while returning appropriate levels of capital to shareholders.

Over the next 6 months, together with the team, we will complete the strategic overview of the company and convert our learnings into specific business strategies to drive our company forward. We will plan to hold an Investor Day to bring all of you on board likely in the first quarter of 2017.

Oksana Lukasheva
Vice President of Investor Relations
At this time, operator, we would like to open the call for questions.

Question and Answer

Operator

[Operator Instructions] Our first question comes from the line of Charles Sebaski with BMO Capital Markets.

Charles Joseph Sebaski
BMO Capital Markets Equity Research

Joe, congratulations on first quarter here with Hanover.

Joseph M. Zubretsky
Chief Executive Officer, President and Director

Thank you very much.

Charles Joseph Sebaski
BMO Capital Markets Equity Research

I guess, the question and where I'd like to focus is on the commercial business and the reserves. Having pretty good quarter along the way and exiting year results, this is kind of third quarter in a row where we've seen some true-up on back years. And I guess, just hoping to get a little bit more clarity on helping investors get comfortable that there -- it isn't leading up to a large charge. I guess, you kind of see this happen $20 million a quarter for a few in a row and all of a sudden -- or may be it does need to be done, and there's a $100 million charge or something. But I guess, what you guys are going through and what you're seeing if it's from different lines -- why we should not think of it that way, or not?

Joseph M. Zubretsky
Chief Executive Officer, President and Director

Well, Charles, let me start up by making some framing comments. Clearly, the all-in result was unfavorable development, but if you adjust for the ForEx embedded in the Chaucer development, it is favorable, quarter-over-quarter. And -- we shouldn't ignore the $12 million of favorable development time on Chaucer catastrophes as well. The real issue we are focusing on is the commercial line of business, both in CMP and other. I'm going to kick it to Jack in a minute to talk about the liability of a component of CMP, which is causing distress, which is slip and fall claims in 3 major metro areas, giving rise to soft tissue injuries and attorney involvement and is causing some late-reported claims and some increased estimates on existing case reserves. Yes, we continue -- the CMP line of business is still very profitable. The property piece is performing very well. And it's the mainstay of our commercial product in the agency business. But these isolated areas really are causing distress, and I'm going to turn it to Jack to talk about it from a pricing underwriting and claims management prospective, what we're doing about it.

John C. Roche
President of Hanover Agency Markets

Okay. Thanks, Joe. Chuck, as we said in the past, we're trying to address these claims trends early to avoid big surprises. And our philosophy has moved aggressively in that fashion over the last few years, as you know. In terms of the news of the quarter, there really isn't anything new in terms of the type of claims or what we're seeing other than slightly larger level. As we said in the past, we have some isolated spikes and large losses that are resulting -- resolved -- excuse me, resulting from slip and fall cases in the major metropolitan areas like New York City and Los Angeles. The good news is we don't have outsized penetration in those areas, so we are addressing the performance gap relatively quickly. And as you've said, a few quarters ago, we saw something that looks like the duration of those claims was drawing out. It looked different than our development patterns had traditionally have been. So we went to work and start to recognizing some of that in our results and also getting more aggressive about some of our underwriting actions. So we adjusted pricing and underwriting appetite in those geographies. We took steps in the claims department to better identify and monitor these claims, and quickly move specific claims into our major case unit for handling. In particular, we saw some labor law and sidewalk law type claims in New York that we're better served in that large claim unit earlier in the process. And so we are doing so with the expectation that we'll get better outcomes into the future as we've gotten better at identifying those cases. And then, last but not least, we did have some specific larger accounts that quite frankly, given the new trends, pose an opportunity to either retire or be more aggressive with regard to our pricing and underwriting actions. So net-net, we're pretty confident that we have our arms around this. And while we're disappointed that we had a little bit more activity in the quarter, we feel good about the fact that we can keep the CMP line performing as one of our top lines.

Joseph M. Zubretsky
Chief Executive Officer, President and Director

I want to address the last part of your question too about charges, et cetera. We have a lot of confidence in the strength of our balance sheet at June 30. We obviously will be conducting our annual exhaustive bottoms-up reserve analysis, either in the third or fourth quarter, depending on the arrival of a new CFO. It'll be overseen and reviewed by an independent actuarial consultant. And of course, you can't speculate as to whether that's going to result in an increase, decrease or rebalancing of the reserve portfolio. We have to wait for the results of the study. But that's an annual review, nothing special, but bottoms up, and it will be exhaustive and it will overseen by a permanent CFO when he or she arrives.

Charles Joseph Sebaski
BMO Capital Markets Equity Research

All right. I appreciate all that color. It's certainly helpful. I guess just 2 clarifying backups to that I have is, I think Gene mentioned that, obviously, the ultimates have been taken up. Can you give us an idea of what the mark is now and what it's adjusted from? I'm trying to at least get my head around the size of this move and what the -- what that means in actual expected ultimate loss for the pick? And then also if the development was all case development or was there some IBNR development due to things you've learned in this true-up?

Eugene M. Bullis
Former Interim Chief Financial Officer and Executive Vice President

Well, the activity that produces the difference between actual to expected is all case incurred, which flows into the reserve analysis. And as a result of that, we've -- we responded to that in our picks for all those accident years and the outcome of that is what you see reflected in the stats up. We feel confident that our reviews are thorough and that we're being responsive to all those changes. When you get down to actual loss picks for accident years, I'm not sure I have that off the top of my head, but I would say, all of them are responsive to the activity that we're seeing, and we're trying to stay ahead of it. We think we're in pretty good shape.

Charles Joseph Sebaski
BMO Capital Markets Equity Research

Okay. But this is case adjustment on the development, right? As opposed to -- we've got a different view of exposure, and so we're going to increase IBNR in these back years, because this is how it -- what's happening, that's what I'm trying to understand.

Eugene M. Bullis
Former Interim Chief Financial Officer and Executive Vice President

Well, it's [indiscernible] case and then that bleeds into your ultimate -- well, that accident years. So it's -- the activity that you see is driven by case. And then that affects your estimate of how much IBNR you need to hold. And that all blends into a full loss pick, an ultimate. Not only case incurred but paid all flows into your ultimate for that accident year.

Charles Joseph Sebaski
BMO Capital Markets Equity Research

Okay. I appreciate that. I guess, just another on the Personal lines, obviously, a really strong quarter, and fortunate and less property events in the quarter. But I guess, otherwise, what the pricing is? Any other commentary on the loss and loss trend in pricing outside of the property event that obviously turned up pretty well, would appreciate.

Joseph M. Zubretsky
Chief Executive Officer, President and Director

Yes, I'll make some framing comments on that. The Personal Lines did have a really, really good quarter. Everything sort of clicked. You saw premiums up 4.5% and a 91.3% combined. We were able to get rates at about 5% of the market, which are still above loss cost, and we focus on that a lot. We had stable discounts that are now turned positive. We had retention increase by 100 basis points. We had benign weather affecting the property line, which came in positive. And of course, you could see the cat line as being favorable quarter-over-quarter. So all things hit in the quarter. We're not saying this is a 91% business for ever, it's probably a mid-90s business. That's our target combined to produce some -- really good low teens ROE. So everything worked really well in the quarter. I'll turn it to Dick to talk about specific pricing phenomena you're seeing in the market.

Richard W. Lavey
Chief Growth Innovation Officer

Yes, Chuck, thanks, and I think we covered it well with those comments. But just a little more color. We're pleased that we're not seeing the frequency trends that our competition is seeing as we discussed that in the past. It's really been flat for several quarters, down in some, really across all coverage parts in auto -- collision, PD and BI. And certainly, some of that's driven by the mild winter that we had in the first quarter. But going back prior quarters, we're seeing the same phenomenon. So we're cautiously optimistic. There's nothing endemic in our book that is going to pop that frequency. Year-over-year comparisons, of course, next year could see slight increases, but we're really pleased, and we've talked before about sort of what the -- sort of the drivers of that may be certainly our quality mix of business, our account mix, we believe provide us some insulation to the employment and low price -- gas price trends that you see that increase your miles driven. But net-net, as Joe said, our pricing is covering our loss cost trend. Our severity is ticking up to low mid-single digits, but we explain that with the new model cars and the cost of technology and some large losses that we've seen in BI out of Michigan. So we feel really good about our pricing and our ability to maintain those kind of stable 5% rates. We're opportunistically looking for places where we can increase auto rates, and that may provide a bit of a headwind to our growth for the remaining part of the year, but net-net, all the KPIs feel really, really solid to us.

Operator

Your next question comes from the line of Meyer Shields with KBW.

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

I guess, 2 broad questions. First, in general, we're seeing modest deterioration in the commercial rate increases. Is that a function of improved performance or intensified competition? Is there any way of teasing that out?

John C. Roche
President of Hanover Agency Markets

This is Jack. If I heard you correctly, you're talking about the market environment itself versus our results?

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

Yes.

John C. Roche
President of Hanover Agency Markets

Yes, I think what you heard from some of our competitors is consistent with our belief that the market environment is somewhat stabilizing, but also a touch schizophrenic in that, the larger account market still tends to be pretty aggressive, and logically so based on the returns that are probably being generated in that sector. And on the lower end of the scale, you see pretty substantial price stability, even though -- at least for us, the small commercial portfolio is performing well. So there is somewhat of an overall stable -- stabilization in the pricing, but in any one line for any one carrier, that can change. So you're seeing some bumping around. Related to that, there is always stress on new business versus the renewal book. I would argue that the new business differential to renewals is still -- it's more stable than I predicted. And so we're enjoying some stability there also. But I will say that part of our view is somewhat influenced by our strategy to stay in the small to midsize account range, to work with select distributors to tighten that dialogue and to leverage the product work we've done over the last 5 years to make our business more sticky. So I think we're -- we continued to show pretty favorable pricing in commercial lines based on those 3 major attributes of our strategy.

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

Okay. No, that's very helpful. Joe, you talked a little bit about importing underwriting skill sets from Chaucer into the U.S. and that seems to sort of align with critically painful [ph] timing for specialty businesses. What time frame were you talking about, I guess?

Joseph M. Zubretsky
Chief Executive Officer, President and Director

We're in the very early stages of exploring how to leverage the intellectual capital of Chaucer here in the U.S., particularly through the excess and surplus lines market, and the reverse flow business. The business that actually is generated from the U.S. that ends up in the London market, Chaucer happens to get its market share, but why can't we work through our distribution system to not just let it happen, but to channel it? So Jack is actually working with Johan in a working group on -- looking for areas of potential where Chaucer can bring its underwriting capacity to the U.S. market and capture some more of that reverse flow business, all part of the strategic plan we're embarking upon, and we have ideas on that, you'll hear about it at our Investor Day in early 2017.

Operator

Your next question comes from the line of Larry Greenberg with Janney.

Lawrence David Greenberg
Janney Montgomery Scott LLC, Research Division

So on the Commercial Lines accident year loss ratio, excluding cats being down, I don't know, I calculate about 3 points versus the average of the last 4 or 5 quarters, and that's in the phase of this adverse development, kind of 2 pieces that don't usually go together. I hear you that the property losses are down, which I guess explains the lower loss pick in CMP. And then the small -- other small case Worker's Comp doing well, but can you give us a breakdown in the Commercial Lines pricing change between pure price and exposure change? And what you think the pure price is doing relative to loss trend?

John C. Roche
President of Hanover Agency Markets

This is Jack. I'll take the first shot at this and ask my colleagues to add in. We've been a little bit careful in the past talking about breaking down overall pricing. I would tell you now that across the core lines, while we're generating 4 points of what we call new money, which is that combination of rate and exposure, approximately half of the exposure, which is about 2.5 points of that in the small Commercial line is coming through as property insurance to value, less -- little less so in the middle market sector. So all in, we take our kind of rate plus insurance to value in the property side of the exposure. Put that together to give ourselves the best estimate of what we're getting in terms of price versus exposure that may translate into additional loss costs. So we're still performing right at about our long-term, maybe slightly below our long-term loss trend in Commercial Lines for the core lines and feel reasonably comfortable with that, given where we are in the market.

Andrew S. Robinson
Former Executive Vice President of Corporate Development and President of Specialty Insurance

Larry, this is Andrew. Just to sort of maybe cover a bit on the Specialty side. First, in terms of rate, for this past quarter on a written basis, while we don't disclose sort of the specifics, in aggregate, we're writing business -- renewing our business right around where loss cost trends are for the long term. And of course, on an earned basis, leading up to this quarter, we have been seeing a rate in excess of loss cost. So there's still some benefit that going to flow through. The other part of -- just kind of connecting sort of where we are with accident years relative to the adverse development. I think part of that is just to remind you that at AIX and within our program business, the adverse development is coming from terminated programs, '13 and prior. And so there is a tad bit of discontinuity of our active book relative to where those adverse trends are emerging from. And so, in addition to that, there was obviously a range of things that occurred since '13 that helped give us a good deal of confidence on our more recent accident years. And so therein lies just the connection between some of those other trends that you're seeing in this quarter.

Operator

Your next question comes from the line of Wayne Archambo with Monarch Partners.

Wayne J. Archambo
Monarch Partners Asset Management, LLC

You sort of alluded to considering acquisitions down the road. I mean, could you give us some better sense of the framework for what you're looking for? What type of multiples you're willing to pay, level of accretion, geographies, new lines of business, bolt ons? I mean, can you just give us little more details there?

Joseph M. Zubretsky
Chief Executive Officer, President and Director

Sure. I mean, obviously, M&A follows strategy and we're still developing our strategy. It will take a good 6 months. But I think you can remain confident that the cornerstone of our strategy would be highly leveraging the valuable agency plant that we already have. There is a lot of headroom there. There is a huge amount of expense leverage. There is market share gains to be had there. There is specialty penetration to take place there. So while we're not done with our strategic plan, I think you can remain confident that those will be tenets of our emerging strategy. So if you think about that, book of business purchases, renewal rights deals, like the commercial -- the OneBeacon deal we did a few years ago, agency partnerships and joint ventures. I would think broadly about business development and not just M&A. It could take the place of buying, managing general agencies, not only for their own revenue flow but for the underwriting capacity of whoever's on the paper. So think about business development more broadly than just raw M&A. But it's going to follow a strategy and our strategy surrounds the independent agency channel.

Wayne J. Archambo
Monarch Partners Asset Management, LLC

Do you think you'll have the strategic plan in place before the Analyst Day in beginning of the year?

Joseph M. Zubretsky
Chief Executive Officer, President and Director

That would be -- the primary purpose of having the Analyst Day in early 2017, is to showcase the management team and our emerging strategy.

Operator

There are no further questions in queue. I'll now turn the call back over to Oksana for closing.

Oksana Lukasheva
Vice President of Investor Relations

Thank you all for your participation today. And we look forward to speaking to you next quarter.

Operator
Ladies and gentlemen, that concludes today's conference. Thank you for your participation. You may now disconnect. Have a great day.