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S&P Global Market Intelligence Estimates**

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Presentation

Operator

Good day, and welcome to the Liberty Mutual 2022 Fourth Quarter and Full Year Earnings Conference Call.

[Operator Instructions]

Please note, this event is being recorded. I would now like to turn the conference over to Mr. Nik Vasilakos, Executive Vice President and Treasurer. Please go ahead.

Good morning, and welcome to Liberty Mutual's Fourth Quarter and Full Year 2022 Earnings Call. Hopefully, you have seen the earnings release posted on our website. Speaking on today's call will be Tim Sweeney, President and Chief Executive Officer; Jim MacPhee, President, Global Retail Markets; Neeti Bhalla Johnson, President, Global Risk Solutions; Vlad Barbalat, Chief Investment Officer; and Chris Peirce, Chief Financial Officer. They will provide an overview of our fourth quarter and full year results and discuss current market trends. Also participating on today's call is Damon Hart, Chief Legal Officer and Secretary.

As a reminder, today's discussions may contain forward-looking statements that represent the company's beliefs concerning future operations, strategies, financial results and other developments. Actual results may differ materially from those expressed or implied. Please refer to our website for a complete discussion of the risk factors related to this presentation and the company. Also, as a reminder, the company will not address any questions pertaining to market speculation or future capital plans. I will now turn the call over to Tim for his opening remarks.

Timothy Michael Sweeney
President, CEO & Director

Thanks, Nik, and good morning, everyone. I'm excited to be speaking with you for the first time as Chief Executive Officer this morning. Before we get into results, I want to first take a moment to thank David Long for his leadership and service to Liberty Mutual over the past 37 years. I've worked with David for many years, and I look forward to building on the progress and accomplishments of his tenure as CEO and our continued partnership as he stays on as Chairman of the Board. As an enterprise, we're well prepared to take on the challenges and opportunities ahead of us, and I look forward to sharing more about our strategy and ambition at our upcoming investor event on March 16.

Turning to results. Net income attributable to LMHC in the quarter was $612 million, down from $722 million in the prior year quarter. The decrease in the quarter was driven by lower returns in our limited partnerships portfolio compared to the extraordinary returns we experienced last year. Fourth quarter pretax operating income before limited partnerships was $759 million, up from $352 million, driven by higher underwriting income and higher fixed maturity net investment income. These drivers were partially offset by elevated catastrophe losses, principally related to winter storm Elliott in December, which amounted to $568 million.

Actual claims experience from Hurricane Ian and other catastrophe events occurring in the first 3 quarters has been favorable to initial expectations. As a result, we lowered ultimate losses from those periods, which reduced reported catastrophe losses in the quarter to $384 million. The combined ratio in the quarter was 96.9%, a 2.3 point improvement from the prior year. 1.4 points of favorable reserve development compared with 3 points of reserve strengthening in the prior year quarter and a 1.1 point decrease in the expense ratio more than offset higher catastrophe losses and attritional losses, primarily within U.S. Personal Lines. Loss trends in private passenger auto and homeowners remain elevated and the need for rate is still evident.

In 2023, we expect continued rate increases and rate achieved in 2022 to show up more meaningfully in underwriting margins. Top line growth in the quarter slowed compared to the first 3 quarters of the year. Net written premium was $11.5 billion, up 4.5% year-over-year. Higher premium as a result of our 2 acquisitions and the firm pricing environment across both personal and commercial lines were partially offset by the impact of reinsurance program changes in GRS. Our focus in U.S. personal lines is on rate adequacy and so true exposure growth continued to be limited, evidenced by a 1% reduction in private passenger auto policies in force and slower growth in property PIF. Absent the reinsurance changes, GRS top line was relatively stable with strong overall pricing, offset by underwriting actions to support continued profitability improvement. Jim and Neeti will provide additional color on the rate environment and their discussion of business results.

Pretax net investment income in the quarter was $792 million, down from $1.3 billion in the prior year quarter, principally due to lower returns in our limited partnerships portfolio. Net investment income, excluding limited partnership results, was up $202 million and continues to trend upward as we reinvest above current book yield. Net realized losses in the quarter were $32 million, down

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from $305 million in the prior year, which was impacted by one large transaction and natural resource investments, which has been described in detail in our disclosures.

With that, our teams tackled the industry-wide challenges we faced this year head-on and our business proved resilient. Aggressive pricing and portfolio management actions in 2022 have us well positioned to take advantage of more supportive market conditions in 2023. We remain cautious of elevated loss trends, pressure from natural catastrophes and macroeconomic risks, but our vision is clear, and we're on the right path with confidence in our ability to execute.

I'll now turn the call over to Jim for a discussion of global retail markets.

James Michael MacPhee
Executive VP, President of Global Retail Markets & Director

Thank you, Tim. 2022 proved to be a very challenging year for U.S. personal lines insurers in particular, driven by inflation affecting loss costs that remained elevated over historical levels through the fourth quarter. We have taken significant action to overcome these adverse trends, including substantial rate and tighter underwriting and media spend reductions to strategically slow policy growth, particularly in the most profit-challenged markets. The impact of these actions has grown throughout 2022, and we have momentum to build on here for 2023.

Starting with loss trends for U.S. personal lines. In 2022, personal auto frequencies continued their rebound from pandemic lows in the early part of the year and then moderated with fourth quarter results relatively flat year-over-year and slightly below pre-pandemic levels. Trend impacts were more notable in the severity of claims, with physical damage severity trends of 16% to 18% for the full year 2022 that moderated somewhat in the fourth quarter. Drivers remain higher parts prices and labor costs, along with used car prices that moderated through the year, but remained significantly higher than historical levels.

Personal auto injury severities were up 7% to 9% for the year and continue to be pressured by higher levels of distracted driving and fatality rates and increased attorney involvement. Personal Lines property per premium trends improved throughout the year, but remained elevated to long-term averages in the fourth quarter, driven by material and labor costs impacting severity. For U.S. business lines, frequencies across lines generally remains below pre-pandemic levels. Severity trends remain elevated for casualty lines, driven by social inflation and for property lines, reflecting higher construction material and labor costs.

In the West region, inflation remains elevated, but is stabilizing or moderating across the majority of our markets. In our East markets, severity trends have generally been moderate, although frequencies returned as pandemic-related travel restrictions were relaxed.

Shifting now to growth. Net written premium in the quarter was $8.4 billion, an increase of $1.2 billion or 16% from prior year, driven by rate actions in our acquisitions of State Auto and AmGeneral. Excluding these acquisitions and the impact of foreign exchange, GRM net written premium increased by $503 million or 7%. The U.S. accounted for $326 million in the fourth quarter growth, driven by our renewal rate actions that grew through the year to 12.6% for personal auto and 11.1% for personal property. West region was up $159 million, fueled by significant earlier than market rate in auto. East region growth came in at 24.2% in the quarter, driven by the acquisition of AmGeneral in Malaysia.

Turning to profitability. GRM had a pretax operating income in the quarter of $218 million compared to $403 million in the prior year, driven by overall loss trends and elevated catastrophe losses of $485 million, which were up $109 million year-over-year, driven by Winter Storm Elliott. Partially offsetting these results was higher earned premium driven by the significant rate activity I mentioned earlier. The total combined ratio in the quarter was 99.5%, up 2.8 points from the prior year quarter, which includes the impact of Winter Storm Elliott.

The underlying combined ratio was up 1.9 points to 96%, driven by the higher non-catastrophe loss trends. We had a 0.3% increase in expense ratio for the quarter compared to the prior year, but realized nearly a full point of expense ratio improvements for the full year, driven by scale benefits of our top line growth and our continued focus on expense management.

While 2022 presented us with a challenging market environment, we took action to drive our U.S. personal lines towards target profitability, continue to improve our U.S. business lines and west region performance and strategically built scale in the East region.

And now I'll turn the call over to Neeti to discuss GRS results.

Neeti Bhalla Johnson
Executive VP, President of Global Risk Solutions & Director

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Thank you, Jim. We continue to make progress in delivering underwriting profitability in Global Risk Solutions despite challenging loss trends. Macroeconomic challenges include high-monetary inflation, tight labor markets, increased geopolitical risk, supply chain disruptions and the potential for an economic recession globally.

As quarts reopen, social inflation trends remain elevated as do losses from catastrophes and new emerging risks. As of end of year 2022, our loss trend was 5.5% versus end of year 2021 loss trend of 4.6%. And while we have seen some deceleration in the pace of rate increases, it will be important for rate increases to keep pace with rising loss trends. The aggregate renewal premium rate increase in the quarter was 6.6%, excluding workers' compensation and sharing economy. This is consistent with the full year with rate increases of 7.5%, excluding workers' compensation and sharing economy. We expect aggregate rate increases to exceed the aggregate loss trend in 2023, though not as positive or as uniform as in recent years. We also know that rate alone is not sufficient to deliver consistent underwriting profitability as the cycle turns.

We will continue to implement needed actions, including an intense focus on risk selection, de-risking the portfolio where needed and reviewing terms and conditions to ensure we deliver target profitability. We are focused on retaining our best accounts and driving remediation where necessary, resulting in annual retention of 85%, which is consistent with the quarter of 84% or approximately 2 points better than the prior year. Overall, net written premium in the fourth quarter was $3.3 billion, a decrease of $548 million or 14.3% less than the prior year.

Moving to our segments. GRS North America's net written premium increased $164 million or 9.7% over the prior year. The biggest driver of the favorability in the quarter was due to a loss portfolio transfer with an existing customer. In addition, renewal rates increased 8.4%, excluding workers' compensation and sharing economy. Partially offsetting the increases were lower retention of 84% or approximately 3 points lower and lower new business, both intentional actions to support an improvement in underwriting profitability.

Liberty Specialty Markets' net written premium for the quarter decreased by $132 million or 11.5% from the prior year. Foreign exchange rates, change in reinsurance terms and casualty business and reduced capacity on binder business negatively impacted net written premium, partially offset by a higher retention of 83% and renewal rate increases of 2.1 points.

Liberty Mutual Reinsurance, which is our assumed reinsurance business, net written premium for the quarter decreased by $79 million or 14.7% from the prior year. Retention of 79% was lower by 2 points due to targeted derisking of the portfolio and unprofitable products. In addition, FX and reinstatement premiums negatively impacted net written premium. This was partially offset by a renewal rate increase of 9.4%.

Global Surety's net written premium increased by $22 million or 8.9% over the prior year due to volume in our international business. In GRS Other, there was an adjustment to our casualty quota share and XOL treaties. This change reflects a more complete view of the business, subject to this treaty. The adjustment in the quarter was approximately $500 million. GRS posted underlying pretax operating income of $406 million in the quarter, a $110 million or 21.3% decrease from the prior year.

Including the impact of cats and prior year activity, pretax operating income was $596 million, a $318 million improvement over the prior year. The underlying combined ratio was 92.1%, an increase of 0.8 points from the prior year. This increase was driven primarily by the claims and claim adjustment expense ratio, driven by higher current year losses. The total combined ratio decreased 10.7 points to 87.5%. The decrease was driven by favorable catastrophe loss development on events occurring earlier in the year and prior accident year weakening in Q4 2022 versus strengthening in Q4 2021.

And now I'll turn the call over to Vlad to discuss the investment results.

Vlad Barbalat

Thank you, Neeti. Moving on to investments. Results for the quarter reflected a highly dynamic macroeconomic environment with the portfolio generating $792 million of net investment income, primarily driven by higher reinvestment yields. Partnership income, a component of net investment income continues to slow as expected, generating $148 million of income in Q4 of 2022 compared to the outstanding returns in Q4 of 2021 of $861 million.

Inflation, rapid global monetary tightening and geopolitical stress exerted significant pressure on the global economy in 2022. These factors led to a very challenging backdrop for capital markets and substantially tighter financial conditions. Interest rates rose dramatically, credit spreads widened and equity valuations declined, leading to a negative return across virtually all public asset classes. To add further context to these shifts, interest rates rose at the fastest pace in 40 years. U.S. investment-grade fixed income had its worst performing year on record, and public equities experienced their greatest drawdown since the great financial crisis.

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This quarter's mark-to-market gains of $1 billion followed prior quarter's losses from a rising rate environment. Despite an unrealized loss position of $6.6 billion on our fixed income portfolio at the end of 2022, realized losses from portfolio turnover were limited. Credit impairments were immaterial and investment income increased meaningfully. Broadly, our portfolio was resilient and the team took advantage of market dislocations to redeploy capital in a very attractive environment for reinvestment yields. In fact, yields across our fixed income assets are at the highest levels we've seen in more than a decade and offer strong go-forward return potential.

Throughout 2022, we were well positioned for market volatility by actively managing risk, building higher cash levels and targeting high-quality fixed income sectors. In the fourth quarter, we increased our cash holdings by $2.1 billion to end the year with a $13.1 billion balance. As bond markets stabilized, we made new purchases with an open quality bias to increase the portfolio's resilience given the volatile macro backdrop. These portfolio shifts resulted in a 3.46% portfolio yield for year-end compared to a 3.05% yield at September 30, driven by a 5.4% average purchase yield in the quarter. Due to our active portfolio management approach, our portfolio duration remains at our liability-aware target.

Overall, Liberty's partnership returns were in line with expectations given current market dynamics. As a reminder, these investments are reported on a quarter lag. We are underweight public equities as risk-adjusted relative value remains unattractive in our view. And over the last few years, we have increased the breadth and depth of our capabilities across private asset markets, equity and credit. While marks on private equity investments broadly followed public market declines in 2022, strong returns in private real estate, private credit and private infrastructure more than offset these adjustments, resulting in positive results for both the quarter and the year. This diversification across strategies, sectors and capital structure drives value despite market volatility as demonstrated in the fourth quarter results.

We remain confident in our strategy and capabilities and expect to actively deploy capital through the cycle as market dislocations create an attractive entry point. As we look into 2023, we are optimistic that the investments we have made in our talent and technology will continue to enable us to capitalize on the opportunities that uncertain market conditions create as we continue to deliver our goal to create capital for the enterprise.

And now I'll turn it over to Chris to discuss year-to-date results.

Christopher Locke Peirce
Executive VP & CFO

Thanks, Vlad, and good morning, everyone. Net income attributable to LMHC for the full year was $414 million, down from our $3.1 billion record performance in 2021. The decrease was driven by significantly lower returns from limited partnership investments, down 81% from 2021 and includes the impact of realized losses from the sale of equity ETFs midway through the year.

Pretax operating income before limited partnerships income for the year was $593 million, a decrease of $71 million from 2021. This was primarily driven by higher catastrophe losses, including losses from State Auto and was partially offset by lower severity and prior year reserve releases in GRM. Excluding the impact of catastrophes and prior year development, our underlying PTOI for 2022 decreased $292 million to $3.5 billion, reflecting elevated current year underwriting losses in U.S. personal lines, as previously discussed, partially offset by modest underwriting improvements within GRS.

Net written premium increased 10.4% to a record $48.2 billion for the year, primarily due to 16% growth in GRM. The overwhelming majority of growth came from significant rate actions in personal lines as well as the acquisition of State Auto. On the commercial side, GRS growth of 2.4% was driven by renewal rate increases across most lines of business. The underlying combined ratio for the year was 95.3%, 2 points higher than 2021 as the underlying loss ratio increased 3 points due to adverse U.S. personal lines liability trends, partially offset by a 1 point reduction in the expense ratio.

The total combined ratio for the year includes favorable prior year development of 1.5 points, bringing the total combined ratio to 101.6%, an increase of 0.8 points over 2021. Cash flow provided by continuing operations was $5.6 billion, up $6 million from 2021, reflecting favorable premium collections and overall lower paid losses, partially offset by unfavorable paid loss activity and expenses in GRM.

GAAP equity at the end of the year was $22.2 billion, a decrease of $5.6 billion over the prior year-end, primarily driven by unrealized losses on our fixed maturity portfolio. Excluding other comprehensive income and noncontrolling interest, equity came in at $29.8 billion. Statutory surplus ended the year at $26.7 billion, up from $26.5 billion in 2021.

Turning to our capital and capital structure. In the fourth quarter, we successfully issued EUR 500 million with a 4.625% coupon due 2030. The funds will be used to refinance our EUR 500 million notes due 2024. We ended the year with financial leverage of 26%,

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which is a level we're comfortable with. Our continued focus is on maintaining capital adequacy from multiple perspectives, including regulatory, economic and rating agency.

Looking forward to 2023, we expect our strong momentum and capabilities that will help us to navigate this uncertain economic environment, and we're excited for new initiatives for the year.
This concludes our prepared remarks, and we'll now open it up for questions.

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Question and Answer

Operator

[Operator Instructions]

Our first question comes from Ravi Prakriya with Junto.

Ravi Prakriya

One on private passenger auto, if I could. I guess, we kind of can't tell the rate of change on policies and how it might have trended quarter-over-quarter through the year, just having the year-over-year figures. I wonder if there's anything you could share on Q4 given the inflection to negative year-over-year?

And then maybe a second one, similar topic, kind of pleasantly surprised given the level of renewal rate acceleration, the retention really hasn't budged tremendously off of kind of your high 70s mode. I just wonder if you could narrate that a little further.

James Michael MacPhee
Executive VP, President of Global Retail Markets & Director

Yes. This is Jim. So on growth throughout the year, you did see in the materials we provided that growth declined quarter-over-quarter, most of that driven by new business reduction because you mentioned the retention not moving down that much. Retention is down a couple of points as we went through the year in auto, about 1 point than home. The bigger impact is to new business, which is down about almost 20% year-over-year by the end of the fourth quarter. So that's been a function of us strategically reducing our marketing spend and tightening our new business underwriting. So you've seen more there. In terms of why there hasn't been a bigger impact to retention generally, we have seen just industry shopping rates increasing as the year went on and as more carriers were increasing rates. And I would expect that to continue and to put further pressure on retention across the industry.

Operator

[Operator Instructions]

Showing no further questions, this concludes our question-and-answer session. I would like to turn the conference back over to Mr. Vasilakos for any closing remarks.

Nik Vasilakos

Great. Well, we want to thank folks for dialing in and listening to us to discuss our fourth quarter operating and financial results. As a reminder, we do have an investor event scheduled for March 16, and we hope you can join us for that and hear more about from Tim and what he plans with regards to the strategy of the company. Thank you.

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

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