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Market Intelligence

Liberty Mutual Holding Company Inc.

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S&P Global Market Intelligence Estimates**

Estimates data is not available for this transcript hence the table is not generated.

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Call Participants

EXECUTIVES

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Executive VP & CFO

David Henry Long
Chairman, President & CEO

Dennis James Langwell
Executive VP & President of Global Risk Solutions

Edward Jose Pena
Senior VP & Treasurer

James Francis Kelleher
Chief Legal Officer & Executive VP

Neeti Bhalla Johnson
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Timothy Michael Sweeney
Executive VP & President of Global Retail Markets

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Presentation

Operator

Good day, everyone, and welcome to the Liberty Mutual Insurance conference call on its Second Quarter 2021 financial results. While this call is available online at the URL included in the Liberty Mutual Insurance press release, analysts should -- and participants should dial in by phone in order to ask questions.

To begin Liberty Mutual's presentation, Ed Peña, Executive Vice President and Treasurer, Mr. Peña, you may begin.

Edward Jose Pena
Senior VP & Treasurer

Good morning, and welcome to Liberty Mutual's Second Quarter 2021 Earnings Call. Hopefully, you have seen the earnings release and financial statements posted on our website. Speaking on today's call will be David Long, Chairman and Chief Executive Officer; Tim Sweeney, President, Liberty Mutual; Dennis Langwell, Vice Chairman; Neeti Bhalla Johnson, President, Global Risk Solutions; and Chris Peirce, Chief Financial Officer.

We will provide an overview of our results and market trends and discuss recent announcements. Also participating on today's call are Jim Kelleher, Chief Legal Officer; Damon Hart, Deputy Chief Legal Officer; Jim MacPhee, President, Global Retail Markets; and Vlad Barbalat, Chief Investment Officer.

Also as a reminder, today's discussion 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. The company does not intend and does not undertake any obligation to update these forward-looking statements, which speak only as of today's date.

Before I turn it over to our management team, we're going to make a quick comment on our proposed acquisition of State Auto. We will briefly address the transaction during our prepared comments, but given the ongoing regulatory filing and approval processes, we are not in a position at this time to provide any additional information or respond to any questions regarding the pending transaction. Thank you in advance for your consideration.

I will now turn the call over to David for his opening remarks.

David Henry Long
Chairman, President & CEO

Thanks, Ed, and good morning, everybody. Before we get into the numbers, let me comment on some recent announcements regarding leadership changes on our plans to acquire State Auto and Malaysian insurer, AmGeneral.

First, I'd like to recognize Dennis Langwell and Jim Kelleher, as both are set to retire at the end of 2021. Dennis has held multiple leadership roles in his 26-year career at Liberty Mutual. As Liberty's Chief Financial Officer for 15 years, Dennis helped grow Liberty's capital from $6 billion to $30 billion and premium from $15 billion to $40 billion. He was the driving force behind 18 acquisitions and numerous capital market transactions over that time and also established Liberty's Enterprise Risk Management and Investor Relations functions.

In 2018, Dennis was appointed President of Global Risk Solutions, growing GRS 20% since inception, while at the same time, dramatically repositioning our in-force book to improve profitability. Results aside, Dennis has been a champion for the organization's diversity, equity and inclusion efforts. And for that, we're truly grateful. Beginning July 1, Dennis now serves in an advisory capacity to me, as Vice Chairman of Liberty Mutual Insurance operations through the end of the year.

Jim Kelleher has had a stellar 38-year career at Liberty Mutual. Jim has managed the corporate litigation group, served as General Counsel of Liberty International and as Deputy General Counsel, oversaw the provision of legal services to all Liberty's domestic and foreign insurance operations. Finally, in 2013, Jim became Executive Vice President and Chief Legal Officer, overseeing an organization of 1,200 trial and corporate lawyers, several hundred paralegals and other professionals. I'd like to thank Dennis and Jim for their leadership and extraordinary contributions to Liberty and wish them the very best in their retirement.

In conjunction with Dennis and Jim's retirement, we also announced several go-forward leadership changes effective July 1, 2021. Tim Sweeney, formerly the President of Global Retail Markets, was appointed President of Liberty Mutual. In Tim's new role, he will be responsible for all 3 business units: GRS, GRM and Liberty Mutual investments. Neeti Bhalla Johnson, former President and Chief Investment Officer of Liberty Mutual Investments, was named President of GRS; Jim MacPhee, former Chief Operating Officer at the GRM U.S., was appointed President of GRM; and Vlad Barbalat, formerly Co-Head of Strategy and Asset Allocation was named President and Chief Investment Officer of Liberty Mutual Investments. I look forward to working with Tim, Neeti, Jim and Vlad in their new roles, and I'm excited about the opportunity in front of us to provide more creative, complete solutions for our customers and partners.

Then on July 12, we announced our plans to acquire State Auto Group. Under the terms of the agreement, State Auto Mutual members will become members of Liberty Mutual, and Liberty Mutual will acquire all publicly held shares of common stock of State Auto Financial for $52 a share or approximately $1 billion in cash. State Auto Group's capabilities and product expertise are an ideal complement to our independent agent-distributed personal and small commercial business in the U.S., and we're excited to welcome 2,000 talented associates to the Liberty family. We believe that both companies share similar values and that State Auto enhances Liberty's purpose to help people embrace today and confidently pursue tomorrow. We're expecting this transaction will close in 2022, pending the appropriate member, shareholder and regulatory approvals.

On July 19, we announced our plans to apply for regulatory approval to acquire Malaysian insurer, AmGeneral. AmGeneral is currently 51% owned by AmBank Group and 49% owned by Insurance Australia Group. Subject to regulatory approvals, Liberty Insurance Berhad will acquire 100% of the shares of AmGeneral. AmBank's group share of the sale will result in AmBank Group holding 30% of the interest in the combined entity to be formally merged at a later date. The combined entity will become the largest auto insurer and the second largest P&C insurer in Malaysia. And we view expanding and investing in our international insurance markets is paramount to becoming a leading P&C insurance company and look forward to the merger of creating a best-in-class insurance operation in Malaysia.

And now on to second quarter results. Net income attributable to Liberty Mutual Holding Company for Q2 was $769 million, an increase of nearly $1.1 billion from Q2 2020. As you may recall, Q2 2020 was when we recognized the first material impact of COVID-19 losses and the related economic downturn, resulting in a net loss in the quarter of $320 million. The favorable results in Q2 2021 reflects strong investment results within our partnership, LLC and other equity method investment portfolio and the absence of COVID-19 losses. This strong performance was partially offset by $510 million of impairments on our natural resource investments, which Neeti will discuss shortly.

Turning to top line. Net written premium was $10.8 billion in the quarter, up nearly 11% from 2020. As a reminder, in Q2 2020, we issued $305 million of premium relief refunds in response to the pandemic. Adjusting for the refunds, growth was 8%, reflecting strong new business results across both personal auto and property, continued rate momentum across most lines of business within Global Risk Solutions and a positive FX impact of $141 million as many international currencies strengthened versus the U.S. dollar.

The combined ratio for the quarter came in at 98.1%, down from 105.2% in the prior year quarter. The improvement is driven in part by the absence of COVID-19-related losses, by lower current year catastrophe losses and by favorable prior year development versus unfavorable development in 2020. Partially offsetting this was a core loss ratio of 62.9%, up 3.6 points from 2020 as we experienced lower home and auto frequency in the prior year due to the pandemic. The expense ratio decreased 0.9 points to 28.9%, driven primarily by higher end premium.

In closing, I'd like to reiterate how much I look forward to working with Tim, Neeti, Jim and Vlad in their new roles. They're all exceptionally talented leaders, and I'm confident in our entire team's ability to continue to make progress towards our goals.

Growth in GRM remains strong and will be bolstered further when we welcome State Auto and AmGeneral into the organization. GRS continues to make great progress on the path to achieving target returns. And finally, we continue to drive expenses in the right direction.

And with that, I'll turn it over to Tim to discuss GRM results.

Timothy Michael Sweeney
Executive VP & President of Global Retail Markets

Thank you, David. Moving on to business results. Global Retail Markets net written premium in the quarter was $7.5 billion, an increase of 9% from prior year. Last year, second quarter results included $305 million of premium relief refunds in U.S. personal lines and business lines as well as in select West region markets in response to COVID-19. Excluding these items, growth is 4.8%. The main drivers of the increase was strong new and renewal business results in the U.S. as well as organic growth in both our East and West international operations.

We continue to accelerate our growth in U.S. personal lines as PIF growth was 5.5% in the second quarter, up 2 points versus last year. Normalizing for the impact of the premium relief refunds, U.S. personal lines premium growth was 4.8% over the second quarter of 2020. This growth was primarily driven by strong personal property and personal auto results and rate increases in both new and renewal business.

U.S. business lines net written premium fell slightly lower than the prior quarter, driven by renewal business shortfalls from lower retention.

In our international operations, we saw growth across many of our markets, which resulted in organic net written premium increases of 16% and 5% in the East and West regions, respectively.

In the East region, growth was driven by strong accident and health results in China, as well as an increase in private passenger auto in the Asia market. In the West, the increase was driven by private passenger auto results in the Western Europe market, in Brazil. Growth was further positively impacted by foreign exchange as the U.S. dollar weakened relative to many global currencies, most notably versus the euro and the Chinese yuan. GRM pretax operating income for the quarter was $274 million, up $72 million versus the second quarter of 2020. This increase was primarily driven by lower catastrophe losses due to a decrease in frequency of events in the quarter. This was partially offset by an increase in non-catastrophe losses as auto frequency and homeowners claims activity have returned to near pre-pandemic levels.

Turning to loss trends. In U.S. personal lines, collision frequency increased in the second quarter and is now just 5% to 10% below 2019 levels, driven by a rebound in vehicle miles driven as American start to travel again. While miles driven is near pre-pandemic levels as of June, roads continue to be less congested during commuting hours with mid-day and weekend miles seeing the biggest rebound. Collision severity has increased rapidly as well, driven by increasing used car prices.

Similar to collision, auto bodily injury frequency trends have rebounded as the economy recovers and driving increases. Bodily injury severity remains high as fatality rates are elevated and increased uninsured and underinsured motorist activity is putting upward pressure on loss trends. Increasing medical costs are also expected to contribute to higher severity trends.

For property, pure premium trends are elevated in the second quarter, driven by rising material and labor costs. For U.S. business lines, similar to personal lines, commercial auto frequency is rebounding in the second quarter, driven by more vehicles on the road. Severity remains elevated, driven in part by pressure from social inflation with medical cost uncertainty posing additional risk. General liability frequency remained low and slightly below pre-COVID levels due to lower than typical foot traffic. Severity trends in general liability are expected to remain high due to the aforementioned pressure from social inflation and medical cost uncertainty.

Workers' compensation frequency trends remain below pre-pandemic levels, but are expected to rebound as workers begin to reenter the workforce. Commercial property pure premium trends are elevated with upward pressure on severity from rising material and labor costs. The combined ratio in the quarter was 98.4%, down 0.5 point from the prior year quarter. The decrease was driven by a 5.2 point reduction in the catastrophe loss ratio as we saw fewer weather events in the quarter versus the second quarter of 2020. Partially offsetting the decrease was the claims and claims adjustment ratio as auto frequency and homeowner claims have returned to near pre-COVID levels.

Looking at our expense ratio, we were 1.3 points favorable quarter-over-quarter driven by earned premium growth, partially offset by an increase in advertising and variable expenses in the U.S. due to top line growth.

I'll now pass it off to Dennis to discuss GRS.

Dennis James Langwell
Executive VP & President of Global Risk Solutions

Thank you, Tim. Global Risk Solutions net written premium was $3.4 billion in the second quarter, an increase of $430 million or 15% over the prior year and 12% excluding foreign exchange. The aggregate renewal premium rate increase in the quarter, including terms and conditions changes, which we include when we referred a rate increase was 14%, excluding workers' compensation and 12% in total. The rate increases in the quarter exceeded loss trends in all lines, except workers' compensation. And while we've seen some deceleration in the pace of rate increases, we expect the aggregate rate increase to exceed the aggregate loss trend for the foreseeable future.

Liberty Specialty Markets net written premium for the quarter was 47% higher than the prior year. Excluding the impact of foreign exchange, net written premium was 40% higher than the prior year. The nonrenewal of an internal reinsurance program contributed roughly 10 points of the increase. Additionally, retention was consistent with the prior year, but renewal rates increased 13%, well in excess of loss trends. Nonrecurring premium, primarily warranty and indemnity business contributed nearly 10 points of LSM growth and reflects demand resurgence in 2021 versus the prior year's second quarter.

Additionally, ultimate premium related to prior years across a number of lines of business, primarily reinsurance, was revised upwards. This was due to the COVID economic impact not having been as negative as originally estimated and higher rate increases in prior periods than originally estimated. And finally, new business growth was 28% higher than the prior year, due in part to the economic rebound.

GRS North America's net written premium was 15% higher than the prior year. Renewal rates, including changes in terms and conditions, increased approximately 11% overall and 14% excluding workers' compensation, which had a 1.3% renewal rate increase. The aggregate rate increase exceeded our expected loss trend. Retention improved 5 points over the prior year as North America is retaining more of its improved portfolio.

Liberty Mutual Surety's net written premium increased $14 million or 5% over the prior year and reflects improvements in the economy.

Other Global Risk Solutions net written premium declined $264 million or 60% from the prior year, primarily due to the previously mentioned nonrenewal of an internal reinsurance contract.

As regards to profitability, excluding the impact of catastrophes, COVID-19 and prior period loss development, pretax operating income was $510 million in the quarter, a $169 million or 50% improvement over the prior year. Including the impact of catastrophes, COVID and prior year development, pretax operating income was $361 million versus a pretax operating loss of $290 million in the prior year. The combined ratio before the impact of catastrophes, COVID and prior period incurred losses was 91.8%, a reduction of 3.2 points from the prior year. This reflects a 1.9 point reduction in the loss ratio and a 1.3 point reduction in the expense ratio.

The loss ratio improvement reflects rate increases in excess of loss trends in nearly all lines and improved risk selection. The expense ratio improvement reflects operating efficiencies and growth coupled with general expense control. The combined ratio, including catastrophes, COVID-19 and prior year incurred losses decreased 19.9 points to 96.3%. 2020's COVID losses contributed 18.1 points of the loss ratio, that did not recur, but was partially offset by higher natural catastrophe losses in 2021 due to the first quarter's winter freeze losses. Overall, we are pleased with the progress made on our core operating performance.

The loss ratio reduction reflects improved risk selection, limits management, higher rates in excess of loss trend and an improved business mix. We expect these factors, combined with our expense ratio focus will drive continued improvement in the combined ratio going forward.

And now I will turn the call over to Neeti to discuss investment results.

Neeti Bhalla Johnson
Executive VP, President & Chief Investment Officer of Investments

Thank you, Dennis. Overall, the investment portfolio had one of its best quarters ever in Q2, generating just over $1.4 billion in net investment income. The portfolio had realized losses of $191 million in the quarter, reflecting $510 million of impairments and natural resource investments, partially offset by $183 million of unrealized gains on equity securities and $120 million of net gains on fixed maturity sales.

Overall, the economic backdrop remains supportive. While virus variants may lead to near-term spikes in cases, we think that economic activity is unlikely to be significantly disrupted at the aggregate like it was last year. We maintain a constructive view on risk assets as global monetary policy is still very accommodative. The fiscal impulse remains relatively strong and the default environment is quite benign. However, we acknowledge that stretched valuations and uncertainty about the timing and scale of potential said intervention could lead to episodic volatility.

In the fixed income portfolio, the focus in the second quarter was on a modest up-in-quality rotation in recognition of historically tight spread levels in the market. On the margin, we reduced investment-grade corporate and public ABS exposure in favor of treasuries and highly rated, predominantly single A and higher, senior lending opportunities in the structured product space. These offer more favorable economics compared to public markets.

In the equity, or as we refer to it, the growth portion of the portfolio, we saw very strong results. Liberty's private equity portfolio has now seen double-digit unannualized returns for 4 consecutive quarters for the first time in its 30-plus year history. Quarter-to-date, the portfolio has recorded $796 million of net investment income, bringing full year results to $1.56 billion. For comparison, in 2020, previously the best full year from private equity resulted in $766 million of net investment income.

Results in 2021 have been driven largely by our venture capital portfolio due to several key relationships and exposures to IPOs in Q4 of 2020 and Q1 of 2021. Due to the quarter lag in reporting of private investments, these results do not yet reflect the continued rise in equity markets and additional IPO activity in Q2.

The positive Q2 developments in the PE book saw a partial offset from the Natural Resources portion of the portfolio. We took a $454 million impairment on the largest remaining asset in the metal and mining portfolio. The metals and mining program has been in wind down since 2018 when we decided to curtail activity in this space. In accordance with Liberty's accounting policy, the impairment was triggered by changes in long-term cash flow expectations resulting from adjustments to mine production projections.

LMI continues to explore strategic alternatives, including a sale for the asset. Post the impairment, the metals and mining portfolio contains 5 assets and is valued at just about $130 million. So overall, it was a very strong quarter and year-to-date results have exceeded our expectations. The investment portfolio continues to achieve its long-term objective of generating capital for Liberty Mutual.

And now, Chris will conclude our prepared remarks with a discussion of year-to-date financial results.

Christopher Locke Peirce
Executive VP & CFO

Thanks, Neeti, and good morning, everyone. Results through the first half of the year have been strong, with net income attributable to LMHC of $1.6 billion, up from $199 million in 2020. Robust performance in our partnership, LLC and other equity method investment portfolio drove the increase for the first 6 months of the year as private equity valuations have been strong year-to-date, a stark contrast to last year when overall weakness in equity markets dampened our results.

Earnings also benefited year-over-year from the non-recurrence of $565 million of COVID-19 losses booked in the prior year, partially offset by a higher level of natural catastrophe losses and $510 million of impairments on natural resource investments, which Neeti discussed.

Net written premium increased 7.2% to $21.2 billion, with growth in both businesses above 7%. Within GRM, private passenger auto grew 9.1% and homeowners grew 10.2%, each reflecting strong new business production and rate increases in our domestic book. Private passenger auto growth is also bolstered by the non-recurrence of premium refunds we issued in 2020 in response to the pandemic.

Within GRS, specialty insurance led the way with 31% growth, driven by favorable rates, strong new business and retention. Foreign exchange also contributed to top line growth due to broad U.S. dollar weakening. Year-to-date, pretax operating income before partnership, LLC and other equity method investment income was $524 million, up $146 million from 2020, primarily due to COVID-19 losses in the prior year that did not recur.

While we continue to monitor the impact of the pandemic, we've booked no additional COVID-19 losses this year compared to the $565 million booked through Q2 last year. This was partially offset by elevated catastrophe losses of $1.7 billion, up $516 million from the prior year, primarily related to the February winter ice storms that impacted Texas and other states in the first quarter. The all-in combined ratio for the first half of the year was 99.8%, a 0.8 point improvement from 2020. This was primarily due to 3 points of COVID-19 losses last year that did not recur, as well as 0.3 points of favorable reserve development compared to 0.6 points of unfavorable reserve development last year.

Partially offsetting this was the elevated level of catastrophe losses, which contributed 8.4 points to the all-in combined ratio, up 2.2 points from the prior year. Excluding catastrophes, COVID-19 and prior accident year development, the core combined ratio ticked up 0.9 points to 91.7%, reflecting the increase in vehicle miles driven and homeowners' claims activity, partially offset by improvements in GRS as rate is outpacing loss cost trends. Higher earned premium resulted in a 1 point improvement in the expense ratio to 29.2%. And we will continue to diligently manage our expenses over time.

Performance in our partnership, LLC and other equity method portfolio has been outstanding, as I mentioned. Year-to-date, this portfolio has produced $1.8 billion in pretax operating income compared to a $250 million pretax operating loss in the prior year, driven by private capital investments. As a reminder, these results are booked on a 1-quarter lag.

Realized gains were $63 million, down from $156 million in the prior year due to the $510 million of impairments previously mentioned, which more than offset a combination of equity unrealized gains and gains from the fixed maturity portfolio.

Cash flow provided by continuing operations was $2.9 billion, up $749 million over the same period in 2020, driven by higher premium collections from both businesses and favorable paid loss activity in GRS. This was partially offset by unfavorable paid loss activity and expenses paid in GRM. We ended the second quarter with financial leverage of 25.3%. This level is well within the requirements for our ratings.

GAAP equity as of June 30 was $26.8 billion, an increase of $877 million over the prior year-end, driven by $1.6 billion of net income, partially offset by $817 million in unrealized losses on fixed maturities due to the rise in interest rates since the start of the year. Statutory surplus was $25.3 billion at the end of the quarter, up from $22.8 billion at year-end, reflecting $1.2 billion of affiliated unrealized gains, $820 million of net capital contributions from LMGI, principally related to the hybrid security we brought to market in Q1 as well as $388 million of statutory net income.

We anticipate minimal impact to our capital leverage and coverage metrics upon close of the State Auto and AmGeneral acquisitions and expect to fund both with cash on hand.
With that, we're happy to take your questions.

Question and Answer

Operator

[Operator Instructions] We'll first hear from Jeffrey Bernstein of Insight Investments.

Jeffrey Bernstein
Insight Investment Management Limited

Two quick questions or actually 2 questions. The State Auto rationale makes a lot of sense. Can you comment on the purchase price? And I know you reminded that you're funding it from cash, but will you eventually issue a bond? And actually, I think you said there'll be minimal impact on leverage. And what that means in terms of issuance or not? And secondly, will there be an impact on the run rate savings that you had estimated on our last call with the additional restructuring costs?

Christopher Locke Peirce
Executive VP & CFO

This is Chris Peirce. In terms of State Auto, I'd just stand by the statements we made. We will fund the purchase with cash on hand and wouldn't go any further than that. In terms of -- we look at the impact on leverage ratios and capital ratios, be it RBC or S&P, and it will not have a material impact on those.

And your second question, yes, run rate. So restructuring, the charge we have in there this year is related to the early retirement program that we did last year. So if you remember, we took a significant charge in Q4 last year, which was really incremental costs related to the additional retirement benefits. The charge that's running through this year is really just an acceleration of pension expense based on the elections that the retiring people make. So we've had people that are taking lump sum retirements. So it's not incremental cost. It's really just an acceleration of embedded pension costs as we pay out amounts and reduce the liabilities in the pension plan. So that will not impact at all our expected run rate savings.

Operator

[Andrew Schiappa] of [indiscernible].

Unknown Analyst

Congrats on the quarter. I just had a couple here. And I don't know if I just missed it at the end of the call. Did you disclose the purchase price for the Malaysian P&C business or auto business?

Christopher Locke Peirce
Executive VP & CFO

This is Chris. Yes, we did not. It's relatively immaterial overall to Liberty.

Unknown Analyst

Okay. And then in the investment portfolio, I heard some de-risking actions in the fixed income portfolio. And we've had really fantastic results out of the private equity portfolio, and I haven't heard anything there. Just kind of curious, as that's grown in the portfolio, what's the long-term, kind of, percentage of the portfolio or general account that I should think of private equity LPs and below investment-grade or risk assets being? And how are you thinking about the size of that portfolio as the performance is just all set to grow fantastically?

Neeti Bhalla Johnson
Executive VP, President & Chief Investment Officer of Investments

Yes, I think that's a really good question. Thank you for asking. The -- so maybe a few comments I would make on broadly the private equity portfolio. One, I would say, it's -- currently the carrying value is just about $5 billion, and that has grown. As you mentioned, most of that growth has really come through our venture capital portfolio. In the prepared remarks, I mentioned that the full year results from the private equity portfolio, call it, about $1.56 billion. The venture capital portfolio is just over half of that. And so it really is this accelerated IPO activity that we're seeing and really investing in this book over 30 years and always, sort of, focused very much on manager selection and our key relationships there.

So with respect to the broader question on how big is this and where do we see it going, broadly, I would say it's about -- it's sized about right, if you look at, sort of, the overall allocation across LPs and LLCs as we classify them, that's about 10%, 11% of the portfolio. We've discussed this in previous calls. We continue to think that private assets, both credit and equity, continue to provide attractive risk premium relative to where public assets are. And so we remain comfortable with the positioning. We'll continue to look closely at any strategic actions we do need to take. But at this point, I would say the portfolio is broadly aligned with where we see our strategic asset allocation, sort of, between public and private growing. Hopefully, that answers your question.

Operator

Next, we'll hear from Chad Stogel of Spectrum Asset Management.

Chad Stogel
Spectrum Asset Management, Inc.

My first question refers to -- and I may have missed it. Did you cite a loss trend number that you're seeing maybe by certain pockets of business in commercial and also maybe in your property segment, just given the uptick in inflation and materials costs and so forth, but also on the long tail stuff?

David Henry Long
Chairman, President & CEO

Thanks, Chad. This is Dave. Dennis, do you want to talk a little bit about commercial? And then Tim can talk about property costs and homeowners in particular.

Dennis James Langwell
Executive VP & President of Global Risk Solutions

Yes, sure. I would say in commercial auto, we're thinking of a loss ratio trend or estimating in the high single digits and workers' comp is, kind of, mid-single, offset by exposure run rate trend. So there's a natural hedge there, as you know, as far as payroll is increasing and the premium that it generates. So that leaves us around 2% in terms of net loss ratio. Of most concern, as Tim had mentioned in his comments, is social inflation impact, particularly on Excess and Umbrella where you have a leveraged impact. And there, we're thinking of the loss ratio trend in terms of the low teens, 12% to 13%.

Timothy Michael Sweeney
Executive VP & President of Global Retail Markets

On personal lines -- this is Tim. On personal lines, on the profit. So year-over-year, particularly for auto year-over-year, trend for frequency is a little bit misleading because it was -- the trends were so far down last year. But so year-over-year on auto frequency, we're seeing something in the plus 15 to plus 20 range. But what we really look at is the comparison to 2019. And if you look at the second quarter, we were at about minus 5% to minus 10% frequency versus 2019 pre-pandemic. June was about flat in July is about plus 5%. So we are seeing a bit of a summer surge in auto -- personal auto frequency, but it's been down for the first half of the year.

And once the dust settles after summer surge, we actually expect by year-end that auto frequency would settle at something like minus 5% compared to pre-pandemic because of more working from home. Now these are vehicle miles traveled. We're seeing more weekend and more mid-day travel than we are rush hour -- and the density of traffic during rush hour correlates more to claims frequency. So we think the actual claims frequency will be a little bit muted compared to the vehicle miles traveled that I'm citing.

On severity for auto, we're seeing something in the vicinity of 10% to 12% increase in severity year-over-year; parts, labor and then the big spike in used cars. We do think the used car prices is a temporary situation that will work its way out probably by early 2022, but that would be the severity number. And then on property, we're seeing something in the vicinity of 20% increase year-over-year in construction costs. That's both labor and materials.

You saw lumber prices spike for a bit, but they're starting to moderate a little bit. The difference between the auto line and the property line is we've got inflation protection built into our rating plans for property insurance. And so we're seeing 20%

inflation in the property costs, both labor and materials, but we're getting the effect of about an 18% increase in the rate that our customers are paying because that inflation is built into the way that our rates work.

Chad Stogel
Spectrum Asset Management, Inc.

That's very helpful. And my follow-up question, I don't know how much you can answer with regard to this because it's ongoing litigation. But any comments you can provide on reviver, specifically as it refers to the boy scouts, I think among the long list. There's 2 names there, 2 companies that are most public in that dispute. But I think I saw in the press that your name was in there as well and a handful of others.

James Francis Kelleher
Chief Legal Officer & Executive VP

Yes. So it's Jim Kelleher. I think as we talked about in the past, we are closely watching the contingency events like the reviver statutes that are being put into place. As part of our IBNR reserving process. It's too early to really speak to how this is going to translate into insured losses. We have seen an increase in the number of notifications, but thus far, that has emerged. What has emerged has not given us a significant case reserve activity. So we'll closely monitoring each situation with the appropriate legal review.

With respect to the boy scouts way, I won't talk too much about a specific case. But we're obviously closely monitoring that situation as well. Our policies are in the later period as to what the plans that are being made. So we feel as if we're in good shape there. But obviously, it's evolving, and we'll closely monitor it and make reserve adjustments as matters develop.

Operator

David Eller of Wells Fargo.

David Eller

On the AmGeneral's acquisition, you said that was an immaterial acquisition. But is it right to think of that as you're going to be paying roughly half in cash and half in equity? And then just given the 2 acquisitions, can you give a little bit more context on overall, what you're seeing in the M&A market in terms of valuations or potential targets and remind us just, of what geographies or products or distribution areas you'd be most interested in acquiring on a go-forward basis?

Christopher Locke Peirce
Executive VP & CFO

This is Chris. I can -- I won't say much, but I can address the AmGen a little bit and then maybe Dave can jump in on the more general stuff. Yes, we're not -- I mean we're not going to disclose any of the specific details. But you're right that we are, sort of, combining our existing operation in Malaysia with this to create a bigger entity that will [indiscernible] and so it's partially funded with cash, partially funded with the contribution of our existing operation. And so that's as much detail as what we'd give.

David Henry Long
Chairman, President & CEO

Yes. And as regards M&A with our 2 specific transactions, I think I've said in the past that we're in a position whereby we need to do an acquisition for a reason. Pricing out there is pretty rich. We felt fortunate in the State Auto acquisition that we were in a position to do something that was pretty unique. We like the culture of the organization. It solidifies our position as a leader in independent agency markets. It adds to scale in personal lines, it adds to scale in small commercial. And so we felt as if it was a good deal all around for our members and their members, and it made a lot of sense. I don't think you'll see us active in a transaction that wasn't so, sort of, specifically aligned to what we would do. I think the prices in the U.S. are pretty high.

As regards to Malaysia, again, as I said in the past, we would do an acquisition for a particular reason. And so internationally, if you see us active, it will be along the lines of something that we did in Malaysia, which is to solidify ourselves as a market leader in a particular country or add to our position in a particular country, but I doubt that you'll see us planting new flags anywhere. It did also solve a regulatory issue for us in Malaysia, which relates to ownership, and we were in a position where we needed to address that, and this transaction does that, too. But generally speaking, we think prices are pretty rich, and we'll be -- we'll carefully look for opportunities that bring us something that's of value to us. And I think both of these transactions do just that.

Operator

Brett Gibson of JPMorgan.

Brett G. Gibson
JPMorgan Chase & Co, Research Division

Just one quick one for me, and it's an investment-related question. We talk less about the bond factor changes for P&C companies, but I wonder if you can just talk about what that means for the company. You have, like, an estimate of what that means for your capital? And then more specifically, does it -- do the new factors change the way that you think about the asset classes that you invest in? Are there certain classes that now look more attractive? Or will this change the way that you approach your investment portfolio?

Neeti Bhalla Johnson
Executive VP, President & Chief Investment Officer of Investments

Thank you for that question. What I would say, the short answer is, no changes at all for the following reasons: We've always looked at things from a risk perspective and not necessarily invested purely from a capital efficiency or the NAIC factors. And so because our view of risk, actually, in some ways, I would say the factors have come to where, we would think broadly, the risk factors are, there's no change at all in -- overall in how we're thinking about either the areas of the sectors that we're investing in or any material impact broadly on capital overall of the portfolio. Hopefully, that answers your question.

Operator

[Operator Instructions] And now we hear from [Andrew Schiappa] of [indiscernible].

Unknown Analyst

I had a question in your prepared remarks, I think you mentioned that you will increase your risk retention as you've underwritten some of the portfolio. And I just wanted to get a little bit more color there. Kind of, how much more risk are you retaining? And are you changing your reinsurance purchasing at all or -- especially as it relates to cats? Or is this just kind of changing the amount of ceded business that you have out of some of the lines?

David Henry Long
Chairman, President & CEO

Dennis, I think that was in your remarks. Do you want to take this one?

Dennis James Langwell
Executive VP & President of Global Risk Solutions

Yes. The reinsurance change that we made was basically an opportunity we had taken advantage of a few years ago with third-party capital that we didn't renew last year. So then this year, the business unit that generated the premium that went into that arrangement ceded it internally last year even though it was canceled externally. And then this year, we just treated it consistent for the business unit [and to us]. As the quality and rates on the business improved, we didn't see a need to utilize third-party capital to reinsure that business. So we simply retained it, and that was an event that occurred last year for Liberty Mutual purposes. And internally, it occurred this year. But it's quality property cat-exposed business that we retained.

Unknown Analyst

I'm sorry, that's the last part I just didn't catch. It was property and cat-exposed business?

Dennis James Langwell
Executive VP & President of Global Risk Solutions

Yes.

Unknown Analyst

Okay. And no other larger changes to the reinsurance purchasing, kind of, that you guys have done in the past, which was just, kind of, those discrete business lines?

Dennis James Langwell
Executive VP & President of Global Risk Solutions

Well, it's in GRS. Yes, Chris, do you want to...

Christopher Locke Peirce
Executive VP & CFO

Yes, I was just going to jump in and I'll piggyback on Dennis' answer. From the group perspective, we've not made any real material changes to our risk retention on cat or other lines. We've made some optimization moves within the cat program, but we're not retaining more risk.

Operator

[Operator Instructions] At this time, it appears there are no further questions. Mr. Peña, I'll turn the call back over to you for any additional or closing comments.

Edward Jose Pena
Senior VP & Treasurer

Thank you, and thanks, everyone, for your questions today. If you have any follow-up questions, as always, please reach out to us via our Investor Relations contact info. Thank you very much.

Operator
Thank you. And this does conclude the Liberty Mutual Second Quarter 2021 Financial Results Presentation. Thank you for participating. You may now disconnect.