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Presentation

Operator

Good morning, ladies and gentlemen, and welcome to the Liberty Mutual Insurance Conference Call on its Second Quarter 2020 Financial Results. [Operator Instructions] To begin Liberty Mutual's presentation is Ed Peña, Senior Vice President and Treasurer. Mr. Peña?

Edward J. Pena
Senior VP & Treasurer

Good morning, and welcome to Liberty Mutual's Second Quarter 2020 Earnings Call. Hopefully, you have seen the earnings release and the financial statements posted on our website. David Long, Chairman and Chief Executive Officer of Liberty Mutual Insurance, will begin his opening remarks by speaking to the results of the quarter. Following David, you will hear from Tim Sweeney, President, Global Retail Markets; Dennis Langwell, President, Global Risk Solutions; and Neeti Bhalla Johnson, Chief Investment Officer, on the results of their operations in the quarter. Chris Peirce, Liberty's Chief Financial Officer, will conclude our prepared remarks with a review of our year-to-date financial results. Also participating on today's call is Jim Kelleher, Chief Legal Officer.

Also, 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. 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.

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

David Henry Long
Chairman, President & CEO

Well, thanks, Ed, and good morning, everybody. I hope you're all safe and well during this unprecedented time. As to be expected, COVID-19 and the related economic downturn have significantly impacted our insurance and investment results. For the second quarter, we reported a net loss attributable to Liberty Mutual Holding Company of $320 million versus net income of $397 million in Q2 2019. In the quarter, we recognized $529 million of insurance losses related to COVID. These losses, which Dennis will cover in greater detail, reside entirely within our GRS business.

On the investment side, our partnership, LLC and other equity method investment portfolio generated a net loss of $350 million versus net income of $311 million in the prior year. This decline reflects losses in our private capital and energy investments. As a reminder, the results of these investments are generally reported on a quarter lag, so these results reflect market conditions as of the first quarter. And Neeti will discuss these results in greater detail and summarize how we responded in the current market environment.

Catastrophe losses were elevated in the quarter at $878 million, an increase of $384 million from the prior year quarter. These catastrophe losses largely stem from severe storms in the Southern and Midwest in the U.S. as well as $147 million of losses related to the recent civil unrest.

Turning to top line. Net written premium was $9.8 billion in the quarter, a decline of 2.6% from 2019. Excluding the impact of roughly $300 million of personal auto and small business premium refunds and the FX impact of the U.S. dollar strengthening primarily versus the Brazilian real, growth was positive at 1.7%. Premium refunds and FX were partially offset by ceded reinsurance program changes and strong growth in commercial property, homeowners and specialty insurance.

Notably, GRM saw a strong PIF growth in the quarter with homeowners up 3.2% and personal auto up 2%. The strongest gains came to our direct and digital channel. The combined ratio for the quarter came in at 105.2%, up from 101.2% in the prior year quarter. This increase is largely driven by COVID-related losses, which contributed 5.7 points to the combined ratio and elevated catastrophe losses, which added 9.5 points, an increase of 4.4 points over 2019.

Adjusting to COVID catastrophes and prior year incurred, core underwriting results were strong with a core combined ratio of 89.1% versus 93.7% in the prior year. The core loss ratio improved 5.2 points to 59.3% as stay-at-home orders around the country contributed to lower auto frequency and homeowners claim activity as well as lower loss adjustment expense in GRM. The expense ratio ticked up 0.6 points to 29.8%, reflecting lower-end premium as a result of the refunds in GRM, higher technology spend and higher commissions in GRS driven by changes in business mix.

In closing, despite current economic conditions, we're making good progress on the goals we outlined at the start of the year. First, the increase in policies in force in GRM is reflective of the growth we're targeting in U.S. personal lines. Second, the underwriting actions in GRS are beginning to manifest its improvements in our core combined ratio, and we continue to closely monitor trends in certain lines, including workers' comp and casualty. Lastly, proactive management of our fixed expense base is allowing us to make key investments in our business and our systems.

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 for the quarter was $6.9 billion, a decrease of 5.7% or 4.3%, excluding the impact of foreign exchange. The main driver of the decline was the premium relief program in U.S. personal lines and business lines as well as in select West region markets, fewer miles driven by our customers' reduced claims volumes, and we shared a large portion of this benefit back to our customers through partial premium refunds. Excluding the refunds and foreign exchange impacts, premium was essentially flat versus the second quarter of 2019.

Private passenger auto decreased by 6.4% due to the impacts of the premium relief refund and material changes to endorsement activity. We saw increased negative endorsements due to mileage and coverage changes and fewer positive endorsements as new car sales declined in the quarter. Despite this decline, we remain encouraged by strong new business production through the second quarter in U.S. personal lines, which was up 49.4% for auto and 28.8% for property versus the second quarter of 2019, resulting in an increase in policies in force of 2.3%.

We remain committed to accelerating growth in U.S. personal lines throughout this year to help offset some of the recessionary impacts that we are experiencing in our business lines portfolio. We have experienced new business and retention shortfalls in business lines of 31.4% and 4 points, respectively, driven primarily by pricing actions we have taken in addition to negative audit premiums due to the economic downturn. The underwriting actions we have taken span several lines but are focused primarily on auto and umbrella who targeted nonrenewals to improve our long-term profitability.

In our international operations, we have also seen significant impacts from COVID-19 as well as slowing GDP in key growth markets, which resulted in organic net written premium decreases of 12% and 10% in the West and East regions, respectively. Within the East region, 6 points of the decline was driven by the sale of our Russian operation earlier in the year. Growth was further negatively impacted by the U.S. dollar strengthening relative to global currencies, most notably against the Brazilian real. GRM pretax operating income for the quarter was $202 million, down $63 million from the second quarter of 2019. This decrease was primarily driven by higher catastrophe losses due to elevated severity and frequency.

The 2 largest events were Southern tornadoes and Midwest severe storms, which each had a direct loss ultimate over $100 million. Additionally, the second quarter results were further impacted by an increase in reserves for payment forbearance programs.

Turning to loss trends. In U.S. personal lines, collision frequency was down 30% to 40% in the second quarter driven by significantly fewer miles traveled due to the implementation of stay-at-home orders. The significant rebound in both miles driven and auto frequency that we saw in the second half of Q2 have since slowed down as several states see increases in infection rates, causing the states to slow down or pause reopening plans.

Collision severity was elevated to high single digits driven by a shift to higher speed accidents causing more damage, partially offsetting the low frequency. We also continue to see more total loss claims. Auto bodily injury frequency trends were also down 30% to 40% due to the implementation of stay-at-home orders. However, severity was up double digits due to higher speed accidents causing more severe injuries. Delayed medical treatments and more pressure on medical costs are also expected to contribute to higher severity trends.

Recognizing the significant impact that the stay-at-home orders had on customers' driving behaviors, we returned 15% on 2 months of customer premium. For property, trends remained stable at around 5%, which was in line with long-term averages.

For GRM U.S. business lines, auto frequency was also low in second quarter, offset by elevated severity trends and driven by the same pressures that we saw for personal lines. General liability frequency was also down in the second quarter driven by less foot traffic in businesses, but again, offset by higher severity trends with impacts from delayed medical treatment and pressure from medical cost trends.

Commercial property trends were in line with long-term averages around 6% to 8%. Workers' compensation trends are expected to be higher in the near term. Increasing medical costs and impacts of delayed medical treatment are expected to drive higher severity trends and offset the lower number of claims.

The combined ratio in the quarter was 98.9%, up 0.1 points from the prior year quarter. The impacts of the premium refund drove over a full point deterioration in the combined ratio. However, this was offset by a reduction in noncatastrophe losses driven by lower auto frequency. Adding to our unfavorability year-over-year were catastrophe losses, which were unfavorable 5.7 points quarter-over-quarter.

Looking at our expense ratio, we were 1.4 points unfavorable quarter-over-quarter. However, if we normalize for the impact of the premium refunds, we're essentially flat compared to the prior year despite making investments in our technology and advertising.

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

Dennis James Langwell
Executive VP & President of Global Risk Solutions

Thank you, Tim. GRS' net written premium was $2.9 billion in the quarter, an increase of $255 million or 9.5% over the prior year primarily driven by our GRS North America operation as well as the nonrenewal of a quota share reinsurance agreement.

The aggregate renewal rate increase in the quarter was 16%, 18% excluding workers' compensation. GRS North America's net written premium increased 17% over the prior year. Second quarter renewal rates increased approximately 17% on all lines and 21% excluding workers' compensation, which had a 3% renewal rate increase. While loss trends in liability lines remain elevated, the rate increases in the quarter exceeded loss trends, although only marginally in workers' compensation. We anticipate that this rate activity will continue for the foreseeable future and expect that the impact of COVID-19, coupled with the low interest rate environment, will serve as a catalyst for more meaningful rate increases in workers' compensation going forward.

GRS North America's retention was slightly above the prior year, although we continue to target nonrenewals in unprofitable or nonstrategic segments, such as the high-value homeowners program from the legacy Ironshore business. We have also seen a decrease in exposures due to the lockdown and the resulting downturn in the global economy.

Liberty Specialty Markets' net written premium was 1% lower than the prior year, but renewal rates increased 15% in the quarter, well in excess of loss trends. Retention was 6 points below the prior year due to reunderwriting and the result in nonrenewal of unprofitable business.

Global Surety's net written premium increased $15 million or 6% over the prior year. The increase was primarily attributable to the AmTrust acquisition in 2019. However, we saw a small decline in our domestic small surety business due to the economic contraction.

Before the impact of catastrophes, COVID-19 and prior year loss development, pretax operating income was $341 million in the quarter, a 25% increase over the prior year. After the impact of catastrophes, COVID-19 and prior year development, we had a pretax operating loss of $290 million versus $45 million of pretax operating income in the prior year.

The combined ratio before the impact of catastrophes, COVID and prior year incurred was 95%, a reduction of 3.1 points from the prior year. This reflects a 2.6 point reduction in the loss ratio and a 0.5 point reduction in the expense ratio. The loss ratio improvement reflects reduced large loss activity primarily in U.S. energy and rate increases over the past year.

The expense ratio improvement reflects operating efficiencies and growth partially offset by higher technology spending on strategic projects to drive future operating efficiencies and also the impact of the AmTrust acquisition in 2019.

The combined ratio, including catastrophes, COVID-19 and prior year incurred losses, increased 10.2 points to 116.2%. The improvement in core results was more than offset by higher catastrophe losses primarily due to the civil unrest throughout the United States in May and June and the impact of COVID. COVID-19 losses were $529 million, adding 18 points to the loss ratio. The largest driver of the COVID impact was our event cancellation product line, which contributed approximately 9 points.

Our estimates reflect known and potential exposures and will be continually reviewed and updated. We also included anticipated litigation costs. The comparison of the combined ratio between years was also impacted by almost 7 points of adverse prior year reserve development in 2019 that did not recur in 2020.

Overall, we are pleased with the progress made on our core operating performance. And exclusive of COVID and the resulting impacts on premium volume, we expect ongoing improvements in core underwriting results driven by rate increases, exceeding loss trends and operating efficiencies.

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

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

Thank you, Dennis. Let me start with some comments on the current macro backdrop as well as our investment strategy and positioning that informs the investment results for the quarter and year-to-date. First and foremost, we are dealing with an extraordinary global public health crisis. The swift unprecedented monetary and fiscal response has helped mitigate the left tail risk of the concurrent economic and financial crisis. However, the evolving nature of the health care crisis and its resultant impact on business and consumer behavior creates a high level of uncertainty regarding the depth and duration of this recession.

Our investment strategy and positioning is informed by a range of scenarios, an acknowledgment of the ongoing uncertainty and the almost binary nature of some of the major events that could significantly shape the path forward, particularly the prospect of an effective, widely distributable and easily administered vaccine.

As described in our last earnings call, we came into 2020 with a high quality, defensively positioned portfolio. Within fixed income, we had a higher weight to U.S. Treasury, and we're underweight investment-grade and below investment-grade corporate credit. Public equity exposure was sub-2%, and we were well advanced in our multiyear efforts to rightsize and diversify our private asset portfolio. Our conservative positioning has served us well during the COVID market dislocation.

During the early phase of the dislocation, we quickly undertook a comprehensive portfolio review, further trimming our most at-risk industry position in corporate credit. Even though airlines, leisure, lodging and restaurants, et cetera, represent a small part of the portfolio, we sold issuers we saw as the most highly impacted from a protracted COVID-induced economic slowdown. As markets stabilize in the second quarter, we continue to lighten up in sectors where we saw limited upside, like auto ABS and commercial mortgage loans and began rotating into high conviction corporate credit position funded from U.S. Treasury and cash.

From an asset allocation perspective, we are of the view that credit assets offer better risk-adjusted value over equity. Credit assets offer meaningful income and total return potential while enjoying significant downside protection through the Fed's various programs. Our bottom-up underwriting capabilities also enable us to capture some alpha.

In contrast, we believe equity markets are trading at the high end of their potential range, pricing in very optimistic outcomes for earnings and the broader economy. We believe spreads will continue to tighten gradually with interest rates remaining low and have positioned the portfolio accordingly.

Our public equity exposure now stands at less than 1% of the overall portfolio. The repositioning of the fixed income book in the first half of the year resulted in $672 million in realized gains. While we remain underweight public equity, we continue to focus on diversifying our private asset exposure.

I would like to make 2 comments on this front. First, the private investment portfolio is behaving in line with expectations. As David noted, our private investments are recorded on a 1 quarter lag. Q2 results, therefore, reflect market conditions at the end of the first quarter. Ex energy, the private capital portfolio declined by about 3%, reflecting the impact of the COVID-19 crisis in Q1 valuation.

Over the same period, the public equity market was down approximately 20%. Year-to-date, the private energy portfolio, which includes funds and nonoperated direct exposure, was down 28%, while the S&P Energy Index was down about 37% over the same period. While it is hard to predict the trajectory of near-term valuations of our private assets, given weak underlying economic fundamentals, we anticipate our partners will take a measured approach to valuation through the rest of the year.

Second, let me take a moment to comment on a transaction in our energy private asset portfolio. As noted in the financial statements, the company entered into an agreement with an investment firm whereby both parties will contribute various energy assets into a new joint venture vehicle. This joint venture will leverage the capabilities of an experienced partner with a strong ESG commitment along with the benefits of providing greater diversification and the potential for enhanced liquidity.

Of note, this shift is not intended to grow our private energy exposure. In fact, Liberty has taken aggressive steps in recent years to reduce its private energy exposure, which includes both funds and direct investments. For example, unfunded commitments have been reduced from nearly $3 billion in 2016 to approximately $100 million today. It is also worth noting that the overall portfolio energy exposure across both public and private assets is approximately $3.7 billion today, reduced by nearly 50% since 2015.

Let me close with a final thought. It is during times like these that clarity of investment mandates and processes, combined with the ability to be nimble and flexible, become critical to navigating volatile asset markets. I feel that we are well positioned in this regard. We remain vigilant and laser-focused on striking a prudent balance between risk management and capturing opportunity while remaining humble about the range of uncertainty globally.

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. For the 6 months ended June 30, net income attributable to LMHC was $199 million, down from $1.1 billion in 2019. Earnings through the first half of 2020 are reflective of the material impact COVID has had on both the insurance and the investment side of the business, which my colleagues have discussed in detail.

Despite top line pressure from the pandemic and resulting economic contraction, year-to-date net written premium of $19.8 billion was up slightly from prior year. Positive rate momentum and changes to the structure of our ceded reinsurance program contributed to growth within GRS but were mostly offset by the personal auto and small business premium refunds previously discussed. Foreign exchange also negatively impacted growth due to U.S. dollar strengthening primarily against the Brazilian real.

Pretax operating income before partnership, LLC and other equity method investment income was $378 million, a decline of $490 million from 2019. Improvement in our core underwriting results through the first half of the year was more than offset by COVID losses, higher catastrophe losses, profit margin returned to policyholders through premium refunds and higher expenses, which I will detail shortly.

Total COVID losses year-to-date were $565 million pretax. While we certainly feel good about our estimate for ultimate losses, the evolving and uncertain nature of the pandemic will require an ongoing review of the ultimate exposure to COVID.

On a current accident year basis, excluding catastrophes and COVID, the core combined ratio improved 2.7 points to 90.8%, reflecting a decrease in the core loss ratio from lower auto frequency and homeowners claims activity partially offset by a higher expense ratio. The expense ratio increased 1.3 points to 30.2% driven by lower earned premium due to the premium refunds in GRM as well as increased operating expenses, including investments in technology, higher advertising spend in GRM and increased commissions due to business mix and growth in GRS.

The total combined ratio for the first half of the year was 100.6%, up 1.9 points from 2019. Losses related to COVID contributed 3 points while catastrophe losses contributed 6.2 points compared to 4 points in the prior year.

Year-to-date pretax losses for partnerships, LLC and other equity method investments were $250 million, reflecting unfavorable valuations primarily in private capital and energy as a result of the market downturn in late March. As David mentioned, these results are primarily booked on a 1 quarter lag. Realized gains year-to-date were $156 million, down from $312 million in 2019. $672 million of net gains from fixed maturities were partially offset by unrealized losses in equity securities and impairments on direct investments in natural resources.

Cash flow provided by continuing operations was $2.1 billion, up $573 million from the prior year driven by favorable timing of reinsurance payments and lower taxes partially offset by unfavorable investment results.

Shifting to capital. During the quarter, we continued our efforts to opportunistically improve our capital structure. In early May, we issued $500 million of senior notes due 2060 to prefund $330 million of notes maturing in 2021 and exchanged $246 million of other senior notes with higher coupon rates into the same security.

As a result of this transaction, we no longer have any unfunded commitments until May 2022. We ended the second quarter with financial leverage of 26.7%, well within the requirements for our ratings. As of June 30, GAAP equity was $24.5 billion, an increase of $838 million over the prior year-end primarily due to unrealized investment gains as a result of falling interest rates and net income of $199 million. Statutory surplus was $20.6 billion at the end of the quarter, up from $20.5 billion at year-end as statutory net income was mostly offset by affiliated and unaffiliated unrealized losses.
This concludes our prepared remarks and we'll now open it up for questions.

Question and Answer

Operator

[Operator Instructions] We will now take our first question from Jeff Bernstein of Insight Investors (sic) [Insight Investments].

Jeffrey Bernstein

Regarding COVID -- future COVID losses, if any, could you tell us a little bit more about the nonevent cancellation losses? Number one. And number two, on the event cancellation losses, how far forward looking are they? So are there additional events yet to be canceled, that you will be on the hook for?

Dennis James Langwell
Executive VP & President of Global Risk Solutions

Jeff, this is Dennis. So as mentioned, the contingent lines were roughly half of the total that we recorded. There's roughly $100 million of property-related losses, including anticipated litigation costs, and that includes affirmative grants of coverage situations and a bit of reinsurance. There's a smattering of reserves across a number of specialty lines and casualty and reinsurance of personal accident that we do out of London, and then $100 million of IBNR provision within the $565 million. So again, it's roughly $260 million of contingent lines or event cancellation, roughly $100 million of property and $100 million of IBNR and then amounts across a number of lines, as I said.

As far as the contingent volumes or event cancellation, there's very little left that would run off in 2021, pretty immaterial. We applied exclusions for the pandemic beginning in January of 2020. So it's just a bit of runoff, as I said.

Jeffrey Bernstein

Did you say very little left in 2021?

Dennis James Langwell
Executive VP & President of Global Risk Solutions

Pardon me?

Jeffrey Bernstein

I'm sorry. Did you say there was very little left for 2021 on the contingent?

Dennis James Langwell
Executive VP & President of Global Risk Solutions

Events in 2021.

Jeffrey Bernstein

So just to be really clear. So events that get canceled through all of next year is very little of that left and is not already provisioned for?

Dennis James Langwell
Executive VP & President of Global Risk Solutions

We haven't provided for 2021 because they're not canceled yet. We don't know what's going to happen in '21. But our estimate would be about $50 million, if there are additional cancellations in '21.

Operator

[Operator Instructions] We will now take our next question from Rob Hauff of Wells Fargo Securities.

Robert Glenn Hauff
Wells Fargo Securities, LLC, Research Division

Thanks very much for the clarification on that event cancellation. That was very helpful. I wanted to ask on the underlying margin improvement for both the quarter and year-to-date. I mean 90% or sub-90% is probably one of the best levels I've seen for you guys. I understand there's some frequency benefit in there. It's clearly on the auto lines. But I'm curious how we should be thinking about where the underlying loss or combined ratio should shake out in here. What do you see as a more normalized level, especially given where interest rates are in this market?

David Henry Long
Chairman, President & CEO

Rob, this is Dave. I'll start, and then I can have Dennis and Tim chime in if you want. But you mentioned that the sort of decline in interest rates is really driving this. So if you targeted, not too long ago, a combined ratio somewhere in the upper 90s, you're probably pretty close to a 10% return, a double-digit return. And I think as you see interest rates go down and the yield on the portfolio continues to come down, I think we need to chase that combined ratio down. And so I would say now, if you're sort of looking for a double-digit return, you need to be somewhat in the mid-90s creeping lower.

And to your point, if you really think about new money rates of 80 basis points and you take this out to a 0 interest rate environment, in order to get a double-digit return, you probably need to be in the pretty low 90s. And then you sort of have to ask yourself the question, what's a realistic expectation of a return when you're in a 0 interest rate environment?

So -- and as to your question, Neeti can address how quickly do we think sort of investment income will continue to sort of drop off the portfolio as we move forward. But I think we're on a path now to be targeting sort of combines in the mid-90s and then maybe push them a little lower as interest rates go down. But I think it's sort of where -- we have to move as quickly with underwriting pricing as we can, given the interest rate environment and how much investment income will be disappearing over the course of the next couple of years.

So I don't know if that answers your question, but that's kind of the path that we're on here, and we need to keep pushing on the pricing side. The good news is that the market's helping us on the commercial side, and we think that's going to last into 2021 at least. But yes, pretty soon the difference between long-tail lines and short-tail lines disappeared if interest rates are 0.

Robert Glenn Hauff
Wells Fargo Securities, LLC, Research Division

Yes. No, that's helpful. And you guys -- it looks like you're making some good underlying progress in GRS. You guys have been working hard to reunderwrite some of that business, and you're getting some more significant price increases there. Is that the segment that you have to pull the lever the hardest on to get that combined down to the targeted level? Or how should we think about that?

David Henry Long
Chairman, President & CEO

Yes. Well, again, I won't dominate, and I'll invite the guys to hop in here. But I would say 2 things. One is that that's absolutely the place where we need to drive profitability. The other component -- the other components where we need a little help, one would be in the business lines in GRM, which is not performing at the level that we want. And then our business out in Asia, which is an investment that's not generating those candidate plans, but we're getting a lot of good growth.

So I would say that's the place where we need to improve profitability. It's a little bit different than U.S. personal lines, which is we're doing a better job of balancing profit and growth over there because we think that portion of our business is actually pretty profitable, and we want to maximize growth, subject to a level of profitability that we're comfortable with. And I'll let the guys expand on it, but that's generally the position that we're in.

I think it's a little frustrating that COVID arrived on the scene because we are making good progress on the underlying book in GRS, and we need to continue to drive that improvement to get to where we need to get to.

Robert Glenn Hauff
Wells Fargo Securities, LLC, Research Division

That's great. Wanted to shift gears, actually kind of keep with the personal lines business here. A very large competitor of yours on our -- announced a deal in the personal line space. Part of the focus seems to be growing on the independent agent channel where you guys have a substantial presence already. I'm curious if you see this altering the competitive landscape at all. And just as a follow up to that, I'd be curious to hear your outlook on the M&A environment for P&C in general and how Liberty fits into that mold.

David Henry Long
Chairman, President & CEO

Yes. So we respect the competitor that made the acquisition and we understand why they did it. And it's definitely a play in the independent agent space. But there's challenges there, and they'll have to figure out the challenges of multiple brands and/or sort of moving that book of business into mainstream to have the impact that they want to have. And I know they're a capable company, but I think that there's challenges associated with that. But having said that, I understand why they did it. Tim, do you have any comments?

Timothy Michael Sweeney
Executive VP & President of Global Retail Markets

No. Just to say that it clearly puts our competitor in the top 5 in the independent agent channel. We're in neck and neck kind for the #2 spot in the independent agent channel. So we still feel very good about our position in that distribution channel. And there'll be -- we've seen other competitors come upmarket in the independent agent channel effectively, but it takes a while, right? And so it's taken other folks quite a while to go from kind of the nonstandard where this particular acquisition target does a lot of their business and then to come upmarket.

So no doubt, there'll be some effectiveness, but I think it will take a while. It certainly catches our attention, but we still feel very good about our market share of the independent agent channel. We're still bullish on the channel. We still like our growth and profitability trajectory in the channel. But when a competitor that you respect makes such a move, you obviously pay attention.

David Henry Long
Chairman, President & CEO

Yes. And Rob, on the broader issue, I would say that there's not really a lot of holes in our portfolio to the extent that we -- if you see us in action, it wouldn't be heading into a new country, but it might be solidifying a leadership position in one of our international operations and/or sort of domestically. I think book rolls are a good opportunity, but acquisitions of smaller entities here, I don't really think it's going to gain as much. So from that perspective, you might see us do some of those kind of things, but nothing in the short term that we think that we have a hole in our product set.

Robert Glenn Hauff
Wells Fargo Securities, LLC, Research Division

That's great. And then last one for me. On the Liberty Energy transaction. I'm just trying to understand just kind of in layman's terms, like what does this mean for you guys from a volatility standpoint? I mean are you transferring the $863 million in oil and gas wells and the $284 million of natural resource partnerships in there? How do the unfunded commitments work with this deal? And what is the net impact on a go-forward basis to how these investments impact your financial statements?

David Henry Long
Chairman, President & CEO

All right. I'll let Neeti close that one.

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

Great. Thanks, Rob. Thanks for the question. So let me answer it sort of in the following ways. One, as I mentioned at the prepared remarks, this is not intended in any way to increase our energy exposure. What this is, is effectively taking some of the nonoperating direct oil and gas wells that we have and contributing them into a joint venture with another investment organization. It does not transfer our LP interests, but it's the nonoperated direct oil and gas wells, so roughly that $863 million number that you talked about.

Secondly, it's -- what this does for the unfunded commitments is on the operating wells, we didn't have any unfunded commitments. Those are the ones we had extinguished a few years ago when they reduced from nearly $3 billion to about the $100-ish million today. This will reduce the unfunded by just a little bit more. And really, what remains in that $100-ish million is going to be the unfunded commitments to some of the LP investments that we still have but do not plan to add to.

The last thing I would say with respect to the volatility question, maybe just finishing up on the last one. The new transaction does not create any new unfunded commitments for us as well. So that's sort of just tying it back to not looking to increase our exposure at all but just manage it. It could be managed by an experienced oil and gas partner. It creates a more diversified portfolio. It creates an independent company that hopefully will give us a greater ability to create liquidity down the road. But it also mitigates the volatility point that you make because, one, the overall portfolio becomes more diversified. Two, it's off-balance sheet now for us. It's going to be effectively as an equity method accounting going forward. So hopefully, that answers your question.

Robert Glenn Hauff
Wells Fargo Securities, LLC, Research Division

That's helpful. And then the $231 million impairment that will be reflected in Q3, is that how I should think about that?

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

It will be -- it's reflected in Q2 actually. It's reflected in Q2. And so in my prepared remarks, when I talked about how our aggregate energy -- private energy portfolio was down, call it, 28-ish percent versus the S&P Energy Index down 37%, that 28% down reflects the $231 million impairment that we took in the second quarter.

Operator

[Operator Instructions] We will now take our next question from Chad Stogel of Spectrum Asset Management.

Chad Stogel
Spectrum Asset Management, Inc.

I take -- just going back to Jeff's question earlier, I take that the $100 million IBNR, so that's about 20% of the total number that you've booked so far. Does that -- can you comment on what that contemplates? And maybe comment if there's any indication from the U.K. test case as to the kind of direction you see that going. There just seems to be more ambiguous wording around those business interruption policies outside the United States. So any color you might be able to provide there would be helpful.

David Henry Long
Chairman, President & CEO

Dennis, do you want me to start and you can hop in? Yes. Chad, I don't have any update on what's going to happen in the U.K. What I can tell you on that is our exposure there is not something that we're overly concerned about. So I'm not quite sure why they entered into the process they did. It seemed a little odd to me, but they did it nonetheless. But our exposure is in the tens of millions even if they come back with something that's not in our favor. Dennis, do you want to talk a little bit about IBNR?

Dennis James Langwell
Executive VP & President of Global Risk Solutions

Yes. Yes. The U.K. property issue was less than $20 million. We just don't rate property in the U.K. or certainly very much of it. And IBNR, it certainly contemplated the potential for additional event cancellation losses as well as just a general margin around the other lines of business. In workers' compensation, we've seen some losses come in, but not a lot. And what we've also seen is a massive drop-off in reported losses during the lockdown period.

So the frequency is yet to be determined, but all indications are, overall, frequency is down quite a bit. So that needs to be sorted out over the next quarter. But most of the claims we've gotten in on workers' comp has been either third-party administrative claims or large dollar deductible claims. So it hasn't been material. So to the extent there's any movement in that, the IBNR would contemplate a provision.

Chad Stogel
Spectrum Asset Management, Inc.

Okay. That's helpful. And would you say that the current estimate or the current number because -- given that IBNR, is that an attempt at ultimate? I mean you've been hearing different commentary from different companies. Some companies say, we've tried to incorporate everything we think we had exposure to at this point. And others have said, we kind of have to take it as it comes. I mean the overall industry loss number is probably in the $20 billion right now from -- if you tally everybody up. And maybe the estimates prior to this thing were multiples of that. Some companies have said largest cat ever. Do you think it kind of edges towards that low end? Or do you feel like there's going to be a lot more to come that were not yet -- not necessarily from yourselves, but just in general, that we're not yet aware of? Obviously, this is an ongoing situation. I understand that, yes.

Dennis James Langwell
Executive VP & President of Global Risk Solutions

Yes. I think our provision is a very reasonable ultimate indication. But this isn't over. So we don't know how work comp will play out for additional exposures in subsequent periods. We're comfortable with what we have for exposures that have occurred, for instance, in workers' comp. And on other lines, we feel very comfortable with it. But how you define the event is important too because in the line like surety or maybe some of the financial lines, the economic downturn will play out over time as far as any impacts there. We don't anticipate anything material. But there will be impacts in terms of business slowdowns and premium shortfalls. But from a loss standpoint, we don't anticipate anything coming out of there.

Chad Stogel
Spectrum Asset Management, Inc.

Okay. That's great. If I could sneak a quick one in, one more on liability, third-party liability, general liability. There's been congressional discussion on trying to protect businesses. Any color there? Just given the potential for -- we're in an aggressive tort environment coming into this thing, coming out of it, maybe it ramps up. I don't know if you can share anything there.

Dennis James Langwell
Executive VP & President of Global Risk Solutions

Yes. That might be something Jim is better equipped to comment on, Jim Kelleher.

James Francis Kelleher
Chief Legal Officer & Executive VP

Yes. Yes, it's Jim Kelleher. So we're a supporter of liability protections for businesses and particularly during the reopening phases that I think all are going to go through. So we're advocating the support of that. And I think it's -- who knows whether it will come through or not? A lot of it is tied into the ongoing discussions in Congress regarding additional funding. So we're waiting to see, but we're also supportive of it.

David Henry Long
Chairman, President & CEO

Yes. We're obviously in favor of it as it exist today. It's a liability shield. It's contained in -- on one-size deal, and it's not in the other, and it would be probably easy for you to guess which side it's in and which side it's out. We just don't have a good sense on how important it is that you decide. But if you're trying to open up the economy here, it just makes logical sense for me to have some kind of protection there. Hopefully, folks would see it the same way.

Operator

[Operator Instructions] We will then take our next question from Reed Eckhout of Legal & General.

Reed Eckhout
Legal & General Investment Management America Inc.

Can you just help me understand perhaps how much more compelling the economics to you are through utilizing independent distribution channel in personal lines versus alternative channels? Just kind of piggybacking on that question about a competitor's play to try and gain share there, and what competitive dynamics might mean for not necessarily share, but just kind of the economics you extract from that.

David Henry Long

Chairman, President & CEO

Tim, given we probably have more channels than most, do you want to hop in?

Timothy Michael Sweeney
Executive VP & President of Global Retail Markets

Yes. I think there are different economics to each distribution channel. When you're distributing direct, you're spending a lot of money on advertising and lead generation. When you're talking about the EA channel, you've got a lot of upfront fixed costs, and thus, need to be supported by higher retention, which we get in that distribution channel. And then in the independent agent channels, you have variabilized your cost through paying new and renewal commission. I suppose I'm stating the obvious.

But as I think about the economics and the lifetime value of new business in the direct channels and our exclusive agent channel and in our independent agent channel, we feel good about the economics of all 3. There are different levers to pull in each of those. There are different categories of cost, different level of fixed and variable, but we optimize for each channel based upon those different levers to pull.

I would say with the exclusive agent channel, which the recent transaction that's been referenced is clearly a play into the IA to diversify away from the EA, the exclusive agent channel. And I think the exclusive agent channel, we're still very confident in and the economics are still good for us. Having said that, we're offering choice to that channel now, and we're making other adjustments to make sure that the economics of that channel remain viable go forward.

So hopefully, I'm answering your question, but the economics of each channel are quite different. We pull the levers that we need to pull to make sure we're getting the lifetime return in each of those channels. I think the exclusive agent channel with its high fixed cost needs to change over time, and we are doing that through a choice model and other levers. But to me, as I look across, the direct and digital channel is clearly growing the fastest, but we're committed to both the EA and the IA channel because the economics are working for us, and it's just different math.

Reed Eckhout
Legal & General Investment Management America Inc.

Okay. Got it. And then switching over to commercial lines just more broadly. I appreciate the additional disclosure on pricing across various lines. You talked about retention a little bit. It looks like it's kind of year-over-year in terms of the drop in retention range from like 5% to 15-ish percent. Could you just discuss kind of the dynamic between rate and retention as we move out into the future and where you think the steady-state retention is? I think you alluded to reunderwriting the book across certain lines, and I'm just curious to know like how much of sort of reunderwriting is required.

Dennis James Langwell
Executive VP & President of Global Risk Solutions

So I can address that on the GRS side first. We have been reunderwriting, and we've particularly been doing it in the middle market over the last few years, and the Ironshore book, and we're near the end of that. It's very disruptive for our trading partners being brokers and not something you want to have over a protracted period of time.

So we feel good about where we're ending up in terms of the quality of risks, but we still need to get the price necessary to get that combined ratio or loss ratio down, so we'll continue to push price. And it's a balance. There's no magic formula between retention and price, but we have pretty sophisticated models, and we know what we need to get on the risks, so that's what we push for. And then the loss...

David Henry Long
Chairman, President & CEO

That just -- I'd just add -- yes, sorry, go ahead.

Dennis James Langwell
Executive VP & President of Global Risk Solutions

I was just going to say that loss trends remain elevated in casualty lines and commercial auto. Yes. So on excess casualty and umbrella, we think loss trends are in the low double digits, 11% to 12% range. So that takes a lot of premium just to cover that.

David Henry Long
Chairman, President & CEO

Yes. It was my comment, Dennis, which was we're pretty far along and almost done with the risk quality component but we're still running pretty quickly as regards loss trends and decline in interest rates. So we like the quality. We just got to get the price reflective of a reasonable expectation of return.

Dennis James Langwell
Executive VP & President of Global Risk Solutions

Yes. And workers' comp is a line that -- it needs a lot of rate to cover the decline or collapse in interest rates. And we're starting to see movement on the larger end of that. We got roughly 3 points of rate in the second quarter, but we need more than that. On the smaller end, it's still negative overall for workers' comp. For Liberty, it's down 1%, and that's pretty consistent with what competitors have been reporting. GRS is the mid to large workers' comp where programs are large dollar deductible or retro programs. So there's more flexibility and more ability to move rate. But as I said in my comments, hopefully, the industry overall will start pushing comp harder.

Reed Eckhout
Legal & General Investment Management America Inc.

Okay. And then just the only other one to the extent you can with this pretty terrible explosion in Beirut, any way to think about ancillary exposure to that event?

David Henry Long
Chairman, President & CEO

To those 2 [SIEs?]

Dennis James Langwell
Executive VP & President of Global Risk Solutions

The Beirut explosion.

David Henry Long
Chairman, President & CEO

Beirut?

Dennis James Langwell
Executive VP & President of Global Risk Solutions

Yes. So our initial indications are, for us, we think it's a $25 million to $50 million sort of event depending on -- I mean, that's less than 48 hours later. So -- but we also need to understand what might have happened to haul ships in the area. So that could change, but that's our initial indication.

Operator

And we will now take our next question from Rob Hauff of Wells Fargo Securities.

Robert Glenn Hauff
Wells Fargo Securities, LLC, Research Division

Just one follow-up. I wanted to just ask quickly on the changes in your reinsurance program you mentioned several times throughout your opening remarks. It looked like you lowered retentions a little bit. Can you talk about the thought process here? Is this just a volatility control decision? Is it to support growth in certain targeted areas? Just kind of a high-level thought process around the reinsurance change.

Christopher Locke Peirce
Executive VP & CFO

Dave, I can -- this is Chris. I can jump in and take that. So Rob, there's kind of 2 major pieces when we talk about changes in reinsurance. And one is we did have a quota share out of our London business that went into sort of an alternative capital vehicle, and that was over the last couple of years, just leveraging some of the appetite in the alternative capital space. Just with changes in return expectations and experience, we decided to non-renew that this year. So that's put more premium back on our books, but that was really sort of an opportunistic play on our part.

On the other side, on our core property cat cover, we did actually buy down another $200 million. So we had been attaching at $500 million for hurricanes. And just given the profit pressures from COVID and cat earlier in the year, we decided to buy another $200 million layer. So we're now attaching at $300 million for hurricanes. So the first one is driving more premium onto our books, which is where we talked about it a lot. And then the second one, which doesn't have that material of an impact on our numbers but has given us significantly more protection in the case of hurricanes for this year.

Operator

Mr. Peña, it appears there are no further questions at this time. I'd like to turn the conference back over to you for any additional or closing comments.

Edward J. Pena
Senior VP & Treasurer

Thank you. We'll now conclude our second quarter earnings call. Thank you all for participating and for your questions. If you have any follow-up questions, please feel free to reach out to myself or our Investor Relations team. Thank you.

Operator
Thank you. And this concludes the Liberty Mutual Second Quarter 2020 Financial Results Presentation. Thank you for participating.