S&P Global
Market Intelligence

American Financial Group, Inc. NYSE:AFG

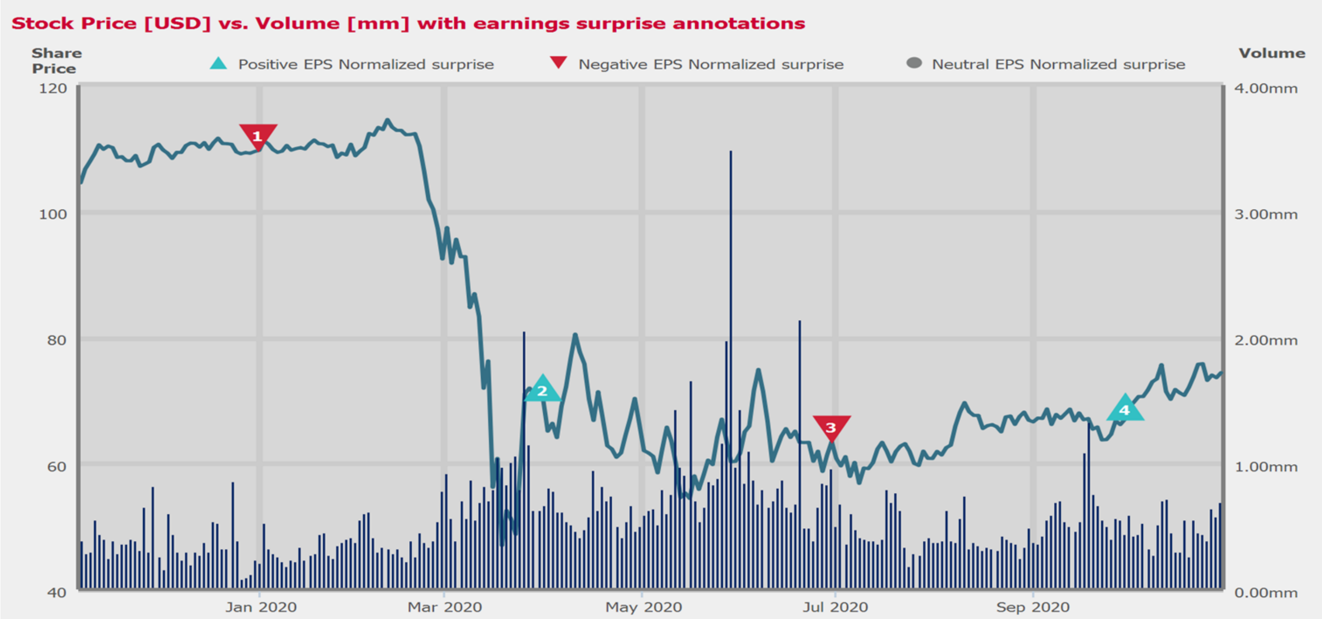
FQ3 2020 Earnings Call Transcripts

Thursday, October 29, 2020 3:30 PM GMT

S&P Global Market Intelligence Estimates

	-FQ3 2020-			-FQ4 2020-	-FY 2020-	-FY 2021-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	1.70	2.45	43.27	2.16	7.12	NA
Revenue (mm)	1274.00	1381.00	8.40	1238.00	4868.50	NA

Currency: USD
Consensus as of Oct-29-2020 7:57 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ4 2019	2.26	2.22	1 (1.77 %)
FQ1 2020	1.85	1.88	2 1.62 %
FQ2 2020	1.34	1.05	3 (21.64 %)
FQ3 2020	1.70	2.45	4 43.27 %

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Call Participants

EXECUTIVES

Brian S. Hertzman
Senior VP & CFO

Carl Henry Lindner
Co-President, Co-CEO & Director

Diane P. Weidner
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Stephen Craig Lindner
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Presentation

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the American Financial Group 2020 Third Quarter Results Conference Call. [Operator Instructions] Please be advised that today's conference is being recorded. [Operator Instructions] I would now like to hand the conference over to your speaker today, Diane Weidner, Vice President of Investor Relations. Thank you. Please go ahead, ma'am.

Diane P. Weidner
Vice President of Investor & Media Relations

Thank you. Good morning, and welcome to American Financial Group's Third Quarter 2020 Earnings Results Conference Call. We released our 2020 third quarter results yesterday afternoon. Our press release, investor supplement and webcast presentation are posted on AFG's website under the Investor Relations section. These materials will be referenced during portions of today's call. I'm joined this morning by Carl Lindner III and Craig Lindner, Co-CEOs of American Financial Group; and Brian Hertzman, AFG's CFO.

Before I turn the discussion over to Carl, I would like to draw your attention to the notes on Slide 2 of our webcast. Some of the matters to be discussed today are forward looking. These forward-looking statements involve certain risks and uncertainties that could cause actual results and/or financial condition to differ materially from these statements. A detailed description of these risks and uncertainties can be found in AFG's filings with the Securities and Exchange Commission, which are also available on our website.

We may include references to core net operating earnings, a non-GAAP financial measure, in our remarks or in responses to questions. A reconciliation of net earnings attributable to shareholders to core net operating earnings is included in our earnings release.

And finally, if you are reading a transcript of this call, please note that it may not be authorized or reviewed for accuracy. And as a result, it may contain factual or transcription errors that could materially alter the intent or meaning of our statements.

Now I am pleased to turn the call over to Carl Lindner III to discuss our results.

Carl Henry Lindner
Co-President, Co-CEO & Director

Good morning. Before we begin our remarks, Craig and I would like to take a moment to honor the passing of AFG Board member, Ken Anbrecht, who passed suddenly in September. Ken served on AFG's Board of Directors for 15 years. He was a tremendous resource to me and Craig for many years and will be remembered as a trusted adviser and friend.

Well, we released our 2020 third quarter results yesterday afternoon, if you'd please turn to Slide 3 of the webcast slides for an overview, you can see that AFG reported core net operating earnings of $2.45 per share in the third quarter of 2020 compared to $2.25 per share in the third quarter of '19. Third quarter 2020 annualized core operating return on equity was in excess of 17%.

Turning to Slide 4, you'll see that the third quarter 2020 net earnings per share of $1.86 included after-tax noncore items aggregating to a $0.59 per share loss. Last quarter, we provided full year 2020 core net operating earnings per share guidance, excluding earnings or losses from alternative investments due to the uncertainty of the implications of COVID-19 and the resulting volatility in the financial markets. Based on results through the first 9 months of the year, AFG now expects its 2020 core net operating earnings per share, excluding alternative investments, to be in the range of $7 to $7.50, an increase of $0.25 a share from the midpoint of our previous guidance. Craig and I will each discuss our guidance for each segment of our business in more detail later in the call.

We're very pleased with the performance of our core operating businesses during the third quarter amid the challenges presented by the COVID-19 pandemic. We believe our underlying results demonstrate the strength of our portfolio of diversified specialty insurance businesses and the contributions of our exceptional employees. We thank God, our talented management team and our employees for helping to achieve these results.

Now I'd like to turn our focus to our Property & Casualty operations. If you would, please turn to Slides 5 and 6 of the webcast, which include an overview of third quarter results. Our Specialty Property & Casualty Group performed exceptionally well during the quarter, especially taking in mind with higher frequency of catastrophe losses across the industry and continued uncertainty from the COVID-19 pandemic.

As you'll see on Slide 5, gross and net written premiums were down 5% and 8%, respectively, when compared to the third quarter of '19, primarily as a result of the runoff of Neon. Excluding the impact of the Neon runoff, gross and net written premiums decreased 1% and 3%, respectively, year-over-year. Core operating earnings in the AFG's P&C operations were $205 million in the third quarter of 2020 compared to $194 million in the prior year period, an increase of $11 million or 6%. Higher year-over-year property and casualty underwriting profit and higher earnings from alternative investments were partially offset by lower other property and casualty net investment income, primarily the result of lower interest rates on cash balances and floating rate investments.

Specialty Property & Casualty insurance operations generated an underwriting profit of $104 million in the 2020 third quarter compared to $88 million in the third quarter of last year. Higher year-over-year underwriting profits in our Specialty Casualty and Property & Transportation groups were partially offset by lower underwriting profits in our Specialty Financial Group.

The third quarter 2020 combined ratio of 92.1% was 1.9 points lower than the 94% reported in the comparable prior year period and includes 2.7 points in catastrophe losses. By comparison, catastrophe losses in the third quarter of last year added 1.6 points. Third quarter 2020 results included 3.7 points of favorable prior year reserve development compared to 3.1 points in the comparable prior year period.

We continue to carefully monitor claims and loss trends related to the COVID-19 pandemic, numerous legislative and regulatory actions as well as the specifics of each claim contribute to a highly fluid evolving situation. AFG didn't record any additional reserve charges for COVID-19 in the third quarter. Given the uncertainty surrounding the ultimate number or scope of claims relating to the pandemic, approximately 82% of AFG's COVID-19-related reserves from the $95 million in charges recorded in the first half of 2020 are held as incurred but not reported. These reserves represent the company's current best estimate of losses from the pandemic and related economic disruption. Our claims professionals and those who support them are working tirelessly to review claims with the care and attention each deserves.

Turning to pricing. We continue to see strong renewal rate momentum and have achieved broad-based pricing increases in the quarter with exceptionally strong renewal pricing in our longer-tail liability businesses. Our average renewal rate increases year-to-date are the highest we've achieved in over 15 years. And in the quarter, average renewal pricing across our entire Property & Casualty Group was up approximately 13% for the quarter. And if you exclude our workers' comp business, renewal pricing was up approximately 16% in the third quarter. Both measures reflect an improvement from rates achieved in the first half of 2020.

We believe the current market conditions reflect a continuation of the meaningful renewal pricing increases achieved prior to the pandemic, which had been in response to the low interest rate environment, trends in social inflation, elevated loss experienced following heavy industry cat experience in 2017 and '18, now '19, and higher expected reinsurance pricing, among other factors. We expect current market conditions to continue into 2021.

Now I'd like to turn to Slide 6 to review a few highlights from each of our Specialty Property & Casualty business groups. Property & Transportation Group reported an underwriting profit of $47 million in the third quarter of 2020 compared to $38 million in the comparable 2019 period. Higher underwriting profitability in our non-crop agricultural and ocean marine businesses and improved results in our aviation business in Singapore branch were partially offset by lower year-over-year underwriting profits in our transportation and property & inland marine businesses. Catastrophe losses for this group were $18 million in the third quarter of 2020 compared to $8 million in the comparable prior year period.

Third quarter 2020 gross and net written premiums in this group were 5% and 4% lower, respectively, than the comparable 2019 period. The decrease was largely the result of lower year-over-year crop premiums resulting from delayed premium reporting in 2019 due to the late planting of corn and soybean crops. Excluding the impact of crop insurance, third quarter 2020 gross written premiums increased 1%, and net written premiums decreased 2% when compared to the last year's third quarter. Lower premiums in our transportation business due primarily to the return of premiums and reduced exposures as a result of COVID-19 were tempered by growth in new business opportunities in our property & inland marine and ocean marine businesses.

As far as crop, the month of October serves as the discovery period for the majority of our corn and all of our soybean businesses. Corn and soybean harvest pricing is averaging about 3% and 15% higher, respectively, than the spring discovery pricing. Potentially record-setting national yields for both corn and soybeans were adversely impacted by the Iowa derecho and dry conditions across much of the Midwest that accelerated crop maturity and the pace of harvest. But despite these conditions, both crops will exceed their respective trend yields. Knowing what we know at this point, we expect to have a normal to slightly below normal crop year. Overall renewal rates in this group increased 6% on average for the third quarter of 2020 with continued strong renewal rate momentum.

Now moving on to the Specialty Casualty Group. We reported an underwriting profit of $53 million in the 2020 third quarter compared to $23 million in the comparable 2019 period. Higher year-over-year underwriting profits in our excess and surplus and excess liability businesses and the impact of underwriting losses at Neon in the third quarter of last year were partially offset by higher adverse development in our general liability business and lower underwriting profits in our targeted markets and workers' comp businesses. Now underwriting profitability in our workers' comp business overall continues to be very strong.

I'm very pleased with improved market conditions in our excess and surplus lines and excess liability businesses, which have achieved significant renewal rate increases and have acted on new business opportunities as the market has hardened. Gross and net written premiums in Specialty Casualty Group decreased 5% and 14%, respectively, for the third quarter of 2020 when compared to same period last year primarily due to the runoff in Neon. Excluding the impact of Neon, gross written premiums increased 6%, and net written premiums decreased by 1% in the third quarter of 2020 compared to the same period in 2019.

The COVID-19 pandemic has resulted in reduced exposures in our workers' comp businesses, which when coupled with renewal rate decreases, also were significant contributors to the lower year-over-year premiums. Gross and net written premiums in this group grew by 13% and 5%, respectively, when you exclude both Neon and workers' comp. Significant renewal rate increases, coupled with new business opportunities and our excess and surplus, excess liability and executive liability businesses contributed to this growth. Renewal pricing for this group was up 17% in the third quarter. And if you exclude our workers' comp business, renewal rates in this group were up 25%, an improvement from the rates achieved in the first half of 2020.

Specialty Financial Group recorded an underwriting profit of $13 million in the third quarter of 2020 compared to $26 million in the third quarter of '19. Higher catastrophe losses in our financial institutions business were the primary driver of the decrease. Third quarter 2020 gross and net written premiums were 11% and 8% lower, respectively, when compared to the same 2019 period. Lower premiums resulted primarily from the impact of various state regulations regarding moratoria on policy cancellations and the placement of force coverage in our financial institutions business, heightened risk selection, also that's reduced new business in our trade credit business, and COVID-related economic impacts on our surety businesses. These decreases were partially offset by year-over-year growth in our fidelity and crime business. Renewal pricing in this group was up 7% for the quarter and is an improvement from the renewal rate increases achieved in the first half of this year.

Now if you would please turn to Slide 7 for a summary view of our 2020 outlook for the Specialty Property & Casualty operations. In light of the challenges and uncertainties presented by COVID-19 pandemic, we've conducted a detailed review of our expectations and other key financial and operating items for each of our specialty P&C businesses. Based on the results of the first 9 months of the year and our current expectations of the impact of COVID-19, we now expect Property & Casualty pretax core operating earnings, excluding the impact of alternative investments, in the range of $650 million to $690 million, a meaningful increase from the $615 million to $675 million indicated in our previous guidance. And we continue to expect the 2020 combined ratio for the Specialty Property & Casualty Group overall between 92% and 94%. Our revised premium guidance overall and within each of our specialty subsegments reflects an improved outlook from our previous guidance.

Excluding the impact of the Neon runoff, we expect net written premiums to be 1% lower to 3% higher than our prior year results. And when we exclude Neon and workers' comp, we expect net written premiums to be 1% to 5% higher than what we reported in 2019.

You'll see on the slide also that we adjusted our combined operating ratio and premium guidance within each of our Specialty Property & Casualty subsegments to reflect our most current view of the impact of the COVID-19 pandemic. We now estimate a combined ratio in the range of 90% to 93% of Property & Transportation Group, narrowed a bit from our previous range. We now expect net written premiums for this group to be 1% lower to 3% higher than last year, an improvement from the previous estimate.

And our Specialty Casualty group is now expected to produce a combined ratio in the range of 90% to 93%, an improvement from our previous estimate. We now expect net written premiums for this group to be 5% to 9% higher than last year's results when excluding Neon and workers' comp.

We continue to expect the Specialty Financial Group to produce a combined ratio between 91% and 95%. And we've improved our premium expectations for this group to be 2% to 6% lower than 2019 results. Given the uncertainties of the implications of COVID-19 and the resulting volatility in the financial markets, we're not providing guidance for P&C net investment income.

Now with regard to pricing, we now expect overall property and casualty renewal rates in 2020 to be up 10% to 12%. And excluding workers' comp, we expect renewal rate increases to be in the range of 13% to 15% as indicated by the significant momentum we're seeing through the end of September.

Now I'm going to turn the discussion over to Craig to review the results in our Annuity segment and AFG's investment performance.

Stephen Craig Lindner
Co-President, Co-CEO & Director

Thank you, Carl. Before I start with a review of our Annuity results for the third quarter, I'd like to highlight A.M. Best's announcement yesterday that it upgraded the financial strength ratings of our Annuity subsidiaries to A+ from A. These A + ratings reflect the quality of our balance sheet, strong operating performance, appropriate enterprise risk management and a strong risk-adjusted capital position. We are very proud of the work of our Annuity associates, which has helped us to achieve these upgrades.

Now please turn to Slide 9. Gross statutory Annuity premiums were $871 million in the third quarter of 2020 compared to $1.08 billion in the third quarter of 2019, a decrease of 19%. Annuity sales were lower in all channels in the 2020 third quarter due to factors related to the COVID-19 pandemic that has significantly impacted our access to distribution partners as well as their access to current and prospective clients. Although sales in the quarter declined from the comparable year ago period, 2020 third quarter sales were up 27% from the second quarter of 2020. And September sales in our financial institutions channel actually exceeded monthly sales in September of 2019. Overall, we're finding that competitor pricing is becoming more rational. We're encouraged by the trends that we are seeing.

Turning to Slide 9, you'll see the components of pretax Annuity core operating earnings. Third quarter 2020 pretax Annuity core operating earnings before earnings or losses from alternative investments increased 8% year-over-year, reflecting growth in Annuity assets, higher onetime investment income and the impact of a strong stock market, lower expenses and a reduction in the cost of funds due to renewal rate actions we've taken. These favorable items, which may include items that may not necessarily recur, were offset by a decline in overall investment yields.

We were pleased that returns on alternative investments in the third quarter of 2020 increased sharply from the previous quarter. The average return on these investments over the past 5 calendar years was nearly 10%, and the annualized return in the third quarter of 2020 was nearly 14%. This return was exceptionally high, however, and we expect a significantly lower return on these investments in the fourth quarter.

In total, the Annuity segment achieved an operating return on equity of nearly 15% in the third quarter of 2020 compared to 12% in the comparable quarter last year. In addition, we're pleased we've been able to achieve targeted returns on our new sales in 2020 despite the low interest rate environment. We believe that the Annuity segment's third quarter increases in comparable returns and core operating earnings, both before and after the impact of alternative investments, demonstrate the strong fundamentals of our business, our pricing discipline and the success of our operating model.

Turning to Slide 10. You'll see that AFG's quarterly average Annuity investments and reserves both grew approximately 6% year-over-year. On the bottom half of the slide, you'll see information about our annuity spreads, starting with our core net interest spread, which takes into account our net investment yield and our cost of funds. Primarily as a result of continued declines in short-term and longer-term interest rates throughout 2020, the Annuity segment's net investment yield in the third quarter of 2020, excluding alternative investments, was 27 basis points lower than the comparable 2019 quarter.

In the third quarter of 2020, our cost of funds and other benefit expenses was 256 basis points, which included amortization of bonuses and accretion of withdrawal benefit reserves. This compares to a cost of funds and other benefit expenses of 269 basis points in the third quarter of 2019. This 13 basis point decline partially offset the lower net investment yield.

In the first quarter of this year, we began taking more proactive measures at adjusting renewal rates, particularly on those products near the end or out of the surrender charge period. For indexed annuity -- for fixed indexed annuities, these adjustments occur on the policy anniversary. So we expect to continue to see our cost of funds come down several basis points each quarter over the next several quarters as a result of these adjustments. As a result of these changes in the net investment yield and cost of funds, the Annuity segment's core net interest spread before alternative investments was 14 basis points lower in the third quarter of 2020 compared to the third quarter of 2019. However, due primarily to lower expenses, growth in reserves and lower acquisition expenses, the Annuity segment's core net spread earned before alternative investments remained the same as last year.

In the third quarter of 2020, we performed our annual detailed review or unlocking of the actuarial assumptions underlying our Annuity operations. Due to the significant decrease in both long-term and short-term interest rates throughout 2020, this review resulted in a net after-tax unlocking charge of $36 million or $0.41 per share. The primary driver of this charge was a decrease in the assumed ultimate 10-year U.S. Treasury rate. We are now assuming that the 10-year U.S. Treasury rate will increase over 10 years to 2.75%, down from our previous assumption of 3.5%. This lower interest rate assumption resulted in negative impacts related to lower expected future investment income and changes in assumed persistency outside the surrender period on policies without guaranteed withdrawal benefits. These negative impacts were partially offset by lower expected costs for fixed indexed annuity renewal options as a result of anticipated renewal rate actions.

Earlier this week, we announced the execution of a block reinsurance agreement that became effective on October 1, 2020. This transaction presented an exceptional opportunity for AFG to further strengthen its already significant amount of excess capital. The agreement freed up between $300 million and $325 million of statutory capital in our Annuity operations, most of which will be paid as a dividend to AFG. In total, the transaction is expected to create between $375 million and $400 million of additional excess capital for AFG. At the same time, the transaction is expected to result in modestly higher operating earnings in both the Annuity segment and AFG.

As shown on Slide 11, under GAAP, certain items are recognized immediately in the financial statements, while other items are recognized over time. The net of these noncore items is after-tax earnings of $55 million to $105 million or approximately $0.60 to $1.15 of EPS and book value per share. The agreement will have no impact on AFG's relationship with and commitments to our Annuity policyholders and distribution partners. And AFG will continue serving the annuity market as a leading provider of fixed and indexed annuity products.

In addition to the block reinsurance agreement, the Annuity segment entered into a flow reinsurance agreement in May of 2020, as shown on Slide 12. Under this agreement, the Annuity segment has the option to cede up to 50% of new premiums from the sale of select products. In the third quarter of 2020, the Annuity segment ceded new premiums of $168 million or nearly 20% of its $871 million of production. Both the block reinsurance agreement and the flow reinsurance agreement serve to reduce the statutory capital committed to AFG's Annuity business while enhancing the returns on both our in-force and new business.

Please turn to Slide 13 for a summary of the 2020 outlook for the Annuity segment. Pretax core operating earnings, excluding earnings from alternative investments, are expected to be in the range of $310 million to $325 million, an increase from our most recent guidance of $300 million to $320 million. By comparison, annuity core operating earnings, excluding alternative investments, were $298 million in 2019. Our guidance reflects the continued negative impact of low short-term interest rates on the Annuity segment's approximately $5 billion of net investment in cash and floating rate securities.

Our guidance also reflects the favorable impact of more aggressive renewal actions taken on policies near or after the end of their surrender charge period. Once fully implemented and depending on surrender activity, we estimate that our current renewal rate strategy will result in annualized crediting rate savings of $40 million to $60 million before DAC, which is the equivalent of reducing our overall cost of funds by 10 to 15 basis points. Some of these savings have already been reflected in our reported results, and our guidance reflects expected additional savings. The guidance also assumes that the stock market and longer-term interest rates remain relatively flat for the remainder of 2020.

While AFG continues to expect an attractive return on its alternative investments over the long term, due to ongoing volatility and uncertainty, it's difficult to forecast these returns for the remainder of 2020. However, as I previously mentioned, we currently expect that fourth quarter returns on these investments will be significantly lower than what we achieved in the third quarter of 2020.

The Annuity segment's actual and forecasted 2020 core operating earnings include several favorable items, which may not necessarily recur in future years. Following the block reinsurance transaction, we have the ability to lower credited rates on $26 billion of annuity reserves by an average of 108 basis points, giving us a great deal of flexibility and helping us manage returns on our in-force business. Importantly, our business continues to have a very strong balance sheet with unrealized gains on our annuity bond portfolio of $2.7 billion at September 30, 2020, before taking into account the block reinsurance transaction. This represents an unrealized gain of 7.3% on the annuity bond portfolio at the end of the third quarter.

As noted earlier, we are clearly seeing positive momentum in premiums, and as a result, we are raising our premium guidance. Our current best estimate is for 2020 gross annuity premiums in the range of $3.7 billion to $4 billion compared to our previous guidance of $3.4 billion to $3.9 billion, which will result in growth in average assets and reserves of 5% to 7% in 2020. This growth also reflects higher persistency in 2020 compared to 2019, which we attribute in large part to the low interest rate environment.

Please turn to Slide 14 for a few highlights regarding our $58.1 billion investment portfolio. AFG recorded third quarter 2020 net realized gains on securities of $35 million after tax and after deferred acquisition costs. This compares to net realized losses on securities of $14 million in the third quarter of 2019. Approximately $17 million of the realized gains recorded in the third quarter of 2020 pertained to equity securities that AFG continued to own at September 30, 2020.

As of September 30, 2020, pretax pre-DAC unrealized gains on AFG's fixed maturity portfolio were $3 billion. We believe our investment portfolio is appropriately positioned for this uncertain economic environment. As you can see on Slide 15, our portfolio continues to be high quality with 90% of our fixed maturity portfolio rated investment grade. In addition, the percentage of fixed maturity investments rated noninvestment-grade by the NAIC remains at less than 3% of total fixed maturity investments at September 30, 2020.

I will now turn the discussion over to Brian, who will discuss AFG's financial position and share a few comments about capital and liquidity.

Brian S. Hertzman
Senior VP & CFO

Thank you, Craig. Please turn to Slide 16, where you will find a summary of AFG's financial position at September 30, 2020.

We repurchased $96 million of AFG common stock during the quarter at an average price of about $66 per share. Share repurchases, especially when executed at attractive valuations, are important and effective component of our capital management strategy. During the quarter, in addition to our share repurchases, we returned $40 million to our shareholders with the payment of our regular quarterly dividend. As you may recall, we recently increased our annual dividend by 11% effective with this past Monday's payment. This was also our 15th consecutive annual dividend increase.

In September, we completed the issuance of $200 million and 4 1/2% subordinated debentures due 2060. A portion of the proceeds from this offering will be used to redeem AFG's $150 million and 6% subordinated debentures due in 2055 at par in November. Even with the capital transactions in the third quarter, AFG had just over $1 billion of excess capital at September 30, 2020. This number includes parent company cash of approximately $580 million.

We expect to have -- to continue to have significant excess capital and liquidity throughout 2020 and beyond. Specifically, our insurance subsidiaries are projected to have capital in excess of the levels expected by rating agencies in order to maintain their high current ratings, and we have no required debt maturities before 2026.

Slide 17 provides a view of the components of AFG's excess capital as well as details supporting the proforma impact of the October annuity block reinsurance agreement and the November 2020 scheduled redemption of AFG's 6% subordinated debentures.

Excess capital on a proforma basis would have been $1.2 billion at September 30, 2020, with consideration of these 2 transactions. Our management team reviews all opportunities for deployment of capital on a regular basis.

Slide 18 is a single-page presentation of our updated 2020 core earnings guidance. Our guidance assumes an effective tax rate of approximately 20% on core pretax operating earnings. AFG's expected 2020 core operating results exclude noncore items, such as realized gains and losses, annuity noncore earnings and losses, and other significant items that may not be indicative of ongoing operations.
We will now open the lines for any questions.

Question and Answer

Operator

[Operator Instructions] Your first question comes from the line of Mike Zaremski from Credit Suisse.

Michael David Zaremski
Crédit Suisse AG, Research Division

I guess, first got a question or 2 on the life reinsurance transaction. Maybe first, you can kind of help us understand, you expect core operating earnings to increase because of the deal. Are you able to kind of quantify how -- what the increased run rate is? And maybe explain to us how that's the case unless the portfolio is unprofitable. I know there's a lot of moving parts that you show us in the slides. It looks like you're taking some charges as well, which might be part of the answer of why it's going to lift profitability.

Stephen Craig Lindner
Co-President, Co-CEO & Director

Mike, this is Craig. I'll start off by saying we are precluded or restricted from giving some details related to the transaction per our agreement with the reinsurance partner. But since we've been getting a lot of questions on the transaction, let me take a few minutes and kind of give you the history of the whole thing and a few more details that I think will help you understand the economics.

So when the pandemic hit, we were feeling very fortunate to be in the strong financial condition that we were in. But Carl and I met and explored a couple of different options to further bolster the excess capital position and the cash position of the parent, just for a couple of reasons, kind of given the uncertainties of the pandemic and also given what we consider to be tremendously undervalued stock price at American Financial Group.

So we decided to explore doing a block reinsurance transaction, which if completed successfully would accomplish our objectives of increasing the excess capital, increasing the cash in the parent and, frankly, also unlock some of the value in our Annuity business. So starting about 5 months ago, we began discussions with 4 reinsurers to see if there was a transaction that would make sense to us and make sense to them. We ended up choosing Global Atlantic to kind of hopefully get to the finish line and do something that made sense for us and something that made sense for them. They were fantastic partners. They really helped us kind of custom-design a transaction that worked well for us and also worked for them.

So Mike, we chose reserves that have a higher GMIR and a higher credited rate than the average of our total reserves. We also chose assets that had a substantially lower yield than the overall yield on our investment portfolio. So when you match those 2 up, and you also take into consideration the maintenance expenses that they're going to be reimbursing us for to oversee this block of business, that business actually produces a small loss. And that's why our earnings actually go up by a modest amount as a result of this transaction. It was because we picked reserves and assets that had different characteristics than the balance of our block.

Now Global Atlantic is a very good company, obviously, a very smart management team. They generate excellent returns on their capital. They obviously plan to change the mix of investments. We gave them investments that, at current market, generate like a very low yield. They obviously plan to, over time, change that mix and increase the yield on those investments. They also are able to create a significant amount of the capital needed to do the transaction from the unrealized gains on the bonds that we're giving them. And our assumption is that they're going to do this at a tax-advantaged fashion. So anyway, at the end of the day, it was a transaction that worked out incredibly well for us, worked out well for them. So I hope that, that explains a little bit better what we were doing.

Michael David Zaremski
Crédit Suisse AG, Research Division

If I -- based on my -- my next question was going to be how we should potentially think about whether you would entertain future transactions. And I think you talked about 2 things. One was there was a lot of uncertainty during the onset of the pandemic. So maybe that's one of the things we should think about whether you think there's as much uncertainty. And the other thing was the undervalued stock price, which you probably still think it's undervalued. Are those the 2 main to think about whether you would pursue additional deals? Are those the 2 main things we should think about?

Stephen Craig Lindner
Co-President, Co-CEO & Director

Yes, Mike, they really are. I mean, we continue to think that our stock is tremendously undervalued. And as a management team, we have an obligation to look at all the different alternatives to maximize the long-term value creation for our shareholders.

Michael David Zaremski
Crédit Suisse AG, Research Division

And next question is sticking with the Annuity portfolio. In terms of the annual study resulting in the DAC unlocking charge. Thanks for the color. You brought the 10-year assumption down to -- I wrote it down somewhere to 2.7% from 3.5%. Is it -- so if I look at just what the capital markets say about the 10-year a bond in 10 years, I'm sure it's wrong, but the Bloomberg says it's 1.98%. So is it a linear direction, linear relationship if you were to -- had to assume that the 10-year went to -- only went up to 1.98%, would it be kind of double directionally the charge you took this quarter?

Stephen Craig Lindner
Co-President, Co-CEO & Director

It is a linear projection, Mike, yes, it is. And I'm not sure that when you look at Bloomberg projections, or I'm not sure that when you get out past a couple of years that it's terribly meaningful. You would know better than I because you follow so many different insurance companies. But as I have reviewed companies that have reported so far this quarter and given details on their unlockings, our assumptions are clearly among the more conservative of companies that have already reported.

Michael David Zaremski
Crédit Suisse AG, Research Division

Okay. Yes, definitely. Okay. And just lastly, just stepping back thinking more high level on the property and casualty operations. You're getting a lot more rate than the marketplace, and part of that is due to the business -- your business mix. But top line, even x Neon, I think, is still kind of shrinking a little bit is, are you seeing -- are your retention ratios falling a little bit? Or are they -- do you expect them to start improving or just kind of want to understand the competitive dynamics at a higher level?

Carl Henry Lindner
Co-President, Co-CEO & Director

Yes. I think when you compare us to some of our peers in that, we have a higher mix of commercial auto and workers' comp and lender-placed property and crop. And the pandemic has impacted the commercial auto lines on the premium side, things like school buses, passenger transportation in a way that's a bigger impact than other lines, and the same with workers' comp payrolls as workers are laid off and that.

So I think because our mix in those businesses is probably a bit higher, I think that's one reason why our premium's not as robust as some of my peers and that. I think if there's good news, I think, in the same way, as the economy recovers and you have a vaccine and you enter into a post-pandemic type of economy, my guess is the opposite starts to happen. And as the economy picks up, probably there's a little bit more tailwind behind commercial auto and workers' comp and lender-placed premiums, in particular.

So I think that's my take. I don't -- we don't see any big things happening on lower retentions and renewal retentions of our businesses and that, in general, on an overall basis. I hope that helps.

Operator

Our next question comes from the line of Greg Peters from Raymond James.

Charles Gregory Peters
Raymond James & Associates, Inc., Research Division

And I have to say thank you for all the information in your slide deck. I find that quite helpful, especially as it relates to the background on the Annuity transaction.

If we pivot to the investment side, you did provide some color there. And obviously, you would give us a lot of disclosure in your supplement. Some of your peers in the annuity business have identified or called out loans, values that are -- loans that are possibly in special servicing status or early forbearance. And I was wondering if you could take a moment and tell us about any areas of troubled investment performance you have within your portfolio?

Stephen Craig Lindner
Co-President, Co-CEO & Director

Greg, this is Craig. We're generally very pleased with how our portfolio has held up. And I think the unrealized gain number is a pretty good indication of how things have held up. So let me look at -- let me see if I can put my hands on some stats here, Greg, on some areas that might be considered higher risk. So we do have some commercial mortgage loans. We have $250 million of loans on office buildings, but we have leases with very strong tenants so that the largest of that $250 million is a $75 million loan on an office building with 100% of the building leased to ConEd. The second largest is a $42 million loan. It's 100% leased to Ancestry.com. The third biggest is $28 million to -- on an office building that is 100% leased to a subsidiary of Verisk Analytics. So we actually feel very good about the position that we're in on the office loans. We do have some hospitality loans, and we have given forbearance. Brian, do you have the numbers on forbearance on real estate loans?

Brian S. Hertzman
Senior VP & CFO

[indiscernible]

Stephen Craig Lindner
Co-President, Co-CEO & Director

It's a fairly modest number, Greg, and we feel very good about the collateral that we have. We do have some loans on hotel properties, but they're great properties. The largest one is a property that we used to own. It's Chatham Bars Inn, and we have a loan. When the loan was made, it was probably a 55% or 60% loan-to-value. It's a great property. I think that our loan amount on that property is something like 60% of what we sold the property for some 10, 12 years ago. So we actually feel very good about the collateral position that we have in the hospitality loans that we have.

Brian S. Hertzman
Senior VP & CFO

The number you're looking for, Craig. On the mortgage loans, there's $124 million that are under forbearance agreements, so not a large percentage of our $58 billion in investment.

Charles Gregory Peters
Raymond James & Associates, Inc., Research Division

Exactly. Immaterial, right, relative to your total portfolio?

Stephen Craig Lindner
Co-President, Co-CEO & Director

Yes.

Charles Gregory Peters
Raymond James & Associates, Inc., Research Division

So I mean, I guess, I need to -- the questions before about consideration of other reinsurance transactions. One of your competitors is out there engaging in similar reinsurance transactions. And it seems like the ultimate goal is to turn the Annuity business model more into a fee-based structure more than anything else. And is there -- do you get a sense that the appetite in the reinsurance market for this -- for your deposits is growing? Or I'm just trying to understand why there's all this interest in the annuity market right now from a reinsurance standpoint?

Stephen Craig Lindner
Co-President, Co-CEO & Director

Greg, there's no doubt about it. The interest has grown tremendously. I can't tell you the number of contacts that we've gotten since we announced our reinsurance deal of substantial companies that are asking us if we would consider them if we would decide to do another reinsurance transaction. The market is very, very robust. And I can tell you, we were incredibly pleased with the economics of the transaction that we just closed.

Charles Gregory Peters
Raymond James & Associates, Inc., Research Division

Right. It does look compelling. I wanted to pivot back to the property casualty operations. I guess, Carl, I'm always trying to get information -- more information about your crop business than you're willing to provide. And in your comments, you said you expect this year to be normal to slightly below normal. And then in the context when we think about last year, I think last year was a bad year. Does this mean that when we think about the earnings from crop for the first half of next year that you'll see a positive variance because of this year's results?

Carl Henry Lindner
Co-President, Co-CEO & Director

I can't predict that, but there's always a portion of the crop business that you -- until things like citrus or different types of products or -- and that you don't know what the answer is until you get into December, January, et cetera, et cetera. So there always is a piece. There always is some unknown on part of the crop year. So there's always a potential that an estimate could change upwards. It's the same -- I mean, the estimate can stay the same. So usually, we correct that for the accident year crop year in the first quarter, generally. But we don't have -- we're generally more conservative in how we report. We never -- we take very little -- in a current crop accident year, take very little generally, well, almost usually nothing for the current crop year in the first half of a year. And then we look at the third quarter and then the fourth quarter is generally the main quarter that we report most of the crop income in.

Charles Gregory Peters
Raymond James & Associates, Inc., Research Division

Got it. And then I just -- I guess I wanted to try and get one question in around just the outlook. I know you provided the 2020 outlook for specialty PC. And I guess what I'm interested in is, does 2021 look to be from a revenue, a net written premium basis, does that look to be back to normal where you're actually growing the top line? Or do you expect some spillover effect across your businesses to linger in through the first quarter and possibly the second quarter next year? That's my last question.

Carl Henry Lindner
Co-President, Co-CEO & Director

Yes. I mean, Greg, we're currently into the fourth quarter. We generally give guidance early in the next year. I think part of that answer has to do with what you -- what each person thinks on what happens with the pandemic and when you get a vaccine and those types of questions, particularly as it relates to workers' comp or some of those lines.

I can't be -- overall, from a big-picture standpoint, with the pricing trends we have and the growth that we're seeing in some businesses like excess liability and D&O and different pockets of our business, I'm very excited about how we're postured in that. I mean, as I said before, I think when you do get to a more normal non-pandemic type economy in the same way that workers' comp and commercial auto may have gotten hurt more than usual or lender-placed property, the opposite might happen at the point that you reach that.

So I'm very excited about how we're positioned, the businesses we're in, our prospects, the pricing. We're positioned very well to take advantage of the opportunities that will present themselves and have plenty of excess capital also. So...

Operator

Our next question comes from the line of Paul Newsome from Piper. Our next question comes from the line of Meyer Shields from KBW.

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

Am I coming through?

Carl Henry Lindner
Co-President, Co-CEO & Director

Yes.

Diane P. Weidner
Vice President of Investor & Media Relations

We can hear you.

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

Okay. Fantastic. So I want to talk a little bit about loss trends. I saw the acceleration in expected pricing, which is, I think, a huge positive. How have your expectations for loss trends across the P&C portfolio changed over the course of the year? And I guess, maybe some particular focus on your discussion of general liability reserves strengthening in the third quarter.

Carl Henry Lindner
Co-President, Co-CEO & Director

Meyer, this is Carl. Amazingly, our overall loss ratio trend continues to be right around 1.7%. If you exclude comp, that moves up to about 3.2%, still a reasonable type of number. The loss -- the areas where loss costs increases or loss ratio trends are above that are in the ones that you read about in the industry, in the commercial auto liability side or commercial auto, in parts of the public D&O, particularly in that part of our business. And because of the commercial auto claims bumping up into excess liability and umbrella, for that reason, the loss ratio trends would be a little over 4%. Or in our Great American custom business, which is more geared towards Fortune 1000, you see those loss ratio trends more in the 8% to 9%. So kind of tracks with what our other peers have been saying as far as where the hot spots are and that.

Now the good news in those areas where the loss ratio trends for us are higher than our average, they also have to be in areas that we're getting -- continue to get pretty significant rate. So in commercial auto, the third quarter, commercial auto liability, we got a 10% rate increase in D&O -- lines like D&O. We got 16% increase in renewal rate price in the quarter. So -- and then when you look at excess liability, we're getting really major pricing in those businesses and that. So I think the good news is, is the areas we're seeing higher loss ratio trends were getting pretty significant rate.

I think also, in our case, different than some of our competitors, we're already making great returns in our excess liability business. We're making solid returns in our D&O business, which has generally been more focused towards private and nonpublic and other than the public company type of sector and that.

So we're already earning good returns in some of the businesses where there's lots of activity. And for that reason, that means we're also growing in some of those businesses at a healthy rate, which I'm very excited about. As I mentioned before, commercial auto, we're meeting our return objectives in our commercial auto business. Commercial auto liability, we're making a small underwriting profit. We're continuing to take rate because we'd like to have that underwriting profit be larger, but we're really positioned well considering we're already making money. And I think with the rate and with the market conditions, I'm very excited about how we're positioned and the prospects as we look forward.

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

Okay. No, that's very thorough. That's very helpful. I have...

Carl Henry Lindner
Co-President, Co-CEO & Director

In the quarter, with -- I think there's probably a record number of catastrophes that I saw in the quarter compared to any other time in my career. And with the COVID uncertainty, some of the social inflation, I can't tell you how excited that I was that we were able to have a 92% combined ratio for our group in a quarter that's pretty messy.

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

No. Absolutely. Yes. I definitely put the same conclusion. I've got Ryan Kruger online. I thought you wanted to ask question or 2 on the Annuity side.

Ryan Joel Krueger
Keefe, Bruyette, & Woods, Inc., Research Division

Yes, I just -- you talked about your current crediting rate strategy for the Annuity business and how that will play out over the next few quarters. I guess my question is, as we look beyond that, assuming interest rates remain very low, would you expect to continue to be pretty active lowering future crediting rates beyond the current program? And do you think you can maintain spread levels at that pretty constant rate going forward?

Stephen Craig Lindner
Co-President, Co-CEO & Director

Yes. So this is Craig. So because of our model, we have not needed to make significant adjustments to credited rate on in-force up until very recently with the huge drop in investment rates. And the result of that is the difference between our current credited rates and our GMIRs are very, very wide.

If you look post-reinsurance deal that we just announced, we have a -- we could lower credited rates another 108 basis points on $25.9 billion of reserves. So that gives us tremendous flexibility to make adjustments if needed. We want to be fair to our customers. And so my hope is that we don't need to make a lot of additional adjustments beyond what we have already started to implement. But it's going to be a function of what interest rates do. It's going to be a function of -- we have the ability to manage the credit rate on in-force to hit our targeted rate of return.

So it's a balancing act. We're in this for the long term. I think we get a lot of credit from our distribution partners for being very fair with our customers and not being overly aggressive in reducing credited rates. But we have the margin there, and we have the ability to continue to hit targeted rates of return even if we stay in a low interest rate environment for a prolonged period of time.

Operator

At this time, I'm showing no further questions. I would like to turn the call back over to Diane Weidner for closing remarks.

Diane P. Weidner
Vice President of Investor & Media Relations

Thank you all for joining us this morning, and we look forward to talking with you again next quarter. Have a great day.

Operator
Ladies and gentlemen, today's conference is now over. You may all disconnect. Thank you.