S&P Global
Market Intelligence

American Financial Group, Inc. NYSE:AFG

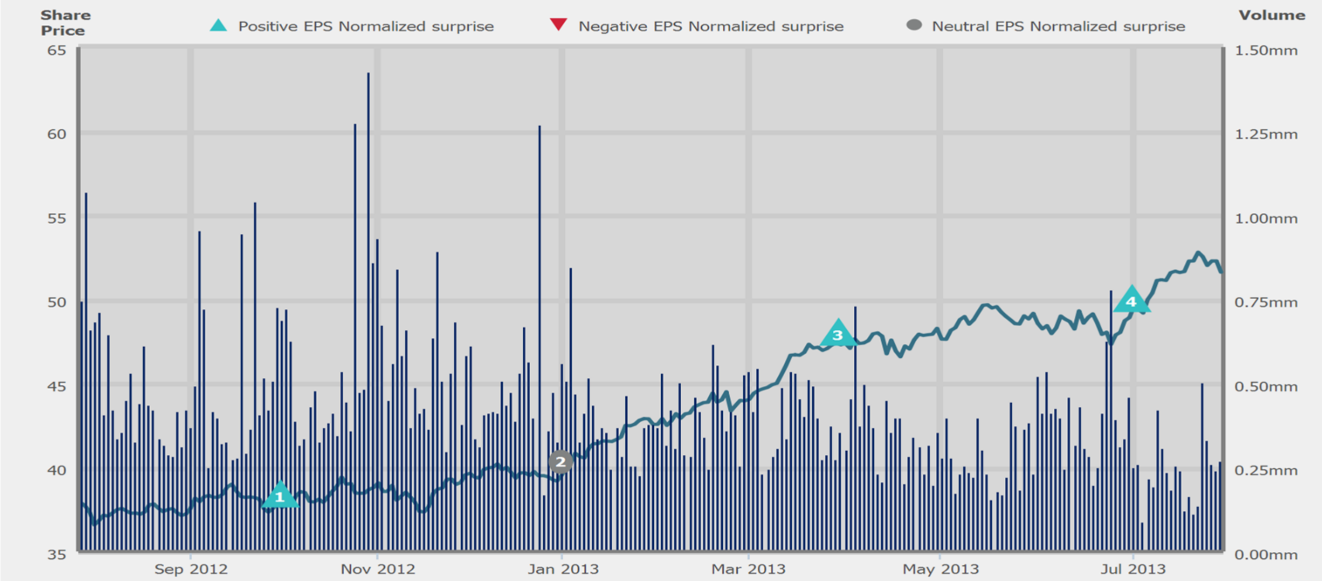
FQ3 2013 Earnings Call Transcripts

Wednesday, October 30, 2013 3:30 PM GMT

S&P Global Market Intelligence Estimates

	-FQ3 2013-			-FQ4 2013-	-FY 2013-	-FY 2014-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	1.06	1.06	▲0.00	1.21	4.13	4.48
Revenue (mm)	791.20	949.00	▲19.94	-	3078.00	3337.57

Currency: USD
Consensus as of Oct-30-2013 12:29 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ3 2012	0.60	0.82	▲36.67 %
FQ4 2012	0.67	0.67	●0.00 %
FQ1 2013	0.81	0.92	▲13.58 %
FQ2 2013	0.86	0.96	▲11.63 %

Table of Contents

Call Participants

EXECUTIVES

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

Diane P. Weidner
Assistant Vice President of Investors Relations

Joseph E. Consolino
Executive VP, CFO, Principal Accounting Officer & Director

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

Unknown Executive

ANALYSTS

Amit Kumar
Macquarie Research

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Ryan J. Byrnes
Janney Montgomery Scott LLC, Research Division

Vincent M. DeAugustino
Keefe, Bruyette, & Woods, Inc., Research Division

Presentation

Operator

Good day, ladies and gentlemen, and welcome to the American Financial Group 2013 Third Quarter Results Conference Call. [Operator Instructions] As a remainder, today's conference is being recorded. I would now like to turn call over to Diane Weidner.

Diane P. Weidner
Assistant Vice President of Investors Relations

Good morning and welcome to American Financial Group's third quarter 2013 earnings results conference call. I'm joined this morning by Carl Lindner III and Craig Lindner Co-CEOs of American Financial Group; and Jeff Consolino, AFG's Chief Financial Officer. If you are viewing the webcast from our website, you can follow along with the slide presentation if you'd like.

Certain statements made during this call are not historical facts and may be considered forward-looking statements and are based on estimates, assumptions, and projections, which management believes are reasonable, but by their nature subject to risks and uncertainties. The factors which could cause actual results and/or financial conditions to differ materially from those suggested by such forward-looking statements include, but are not limited to, those discussed or identified from time-to-time in AFG's filings with the Securities and Exchange Commission, including the Annual Report on Form 10-K and quarterly reports on Form 10-Q. We do not promise to update such forward-looking statements to reflect actual results or changes and assumptions or other factors that could affect these statements.

Core net operating earnings is a non-GAAP financial measure, which sets aside significant items that are generally not considered to be part of ongoing operations, such as net realized gains and losses, discontinued operations and certain non-recurring items. AFG believes this non-GAAP measure to be a useful tool for analysts and investors in analyzing ongoing operating trends and will be discussed for various periods during this call. A reconciliation of net earnings attributable to shareholders to core net operating earnings is included in our earnings release.

Now, I'm pleased to turn the call over to Carl Lindner III to discuss our results.

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

Good morning. We released our 2013 third quarter results yesterday afternoon. I will assume that our participants have reviewed our earnings release and the investor supplement posted on our website. We're pleased to report an adjusted book value per share of $45.36 as of September 30, 2013 that represents a growth of 7% for the year. Net earnings were $0.92 per diluted share and include $0.40 per share of realized gains and a special charge of $0.54 per share to strengthen reserves for asbestos and other environmental exposures within our property and casualty operations and related to our former railroad and manufacturing operations. Jeff will talk about the special A&E charge in more detail later in the call.

Our core net operating earnings of $1.06 per diluted share were 29% higher than the comparable prior year period and include a 59% increase in pretax core operating earnings in our property and casualty insurance segment and a 13% increase in pre-tax core operating earnings in our Annuity segment.

Annualized core return on equity was 9.7% for the third quarter compared to 8% for the third quarter of 2012. Based on AFG's results in the first 9 months of the year, we have increased net written premium guidance and improved and narrowed combined ratio guidance for our overall Property and Casualty Group. We also have increased our core pre-tax operating earnings guidance and premium guidance in our Annuity and runoff segments, the details of which Craig and I will share later in the call. Additionally, we've increased our core operating earnings guidance for AFG to $4 to $4.20 per share from our previous estimated range of $3.70 to $4.10 per share.

Now let me begin with a review of our Specialty Property and Casualty results summarized on Slides 4 and 5 of the webcast. On Slide 4, you'll see summary results for our Specialty, Property and Casualty Group. Property and Casualty specialty insurance operations recorded an underwriting profit of $62 million, compared to $16 million in the third quarter of 2012, with each of our Specialty Property and Casualty sub segments achieving higher underwriting profitability.

Catastrophe losses in the third quarter were only $1 million or one tenth of a point on the combined ratio compared to $4 million or $0.06 of a point in the third quarter of last year. Favorable prior year reserve development was $13 million or 1.4 points in the third quarter of 2013 compared to $9 million, 1.1 points in the same period of 2012.

Gross and net written premiums were up 17% and 18% overall when compared to the 2012 third quarter. Double digit growth in net written premiums in our Specialty Casualty and Specialty Financial Groups along with the late acreage reporting in our crop operations contributed to these results. Excluding our crop business, growth in gross and net written premiums for the third quarter was 13% and 18% respectively when compared to the 2012 period.

Almost 2/3 of our Property and Casualty businesses reported pricing increases during the third quarter, resulting in about a 4% overall renewal rate increase. This follows 5% increases in both the second and first quarters of this year and as the eighth consecutive quarter that we reported overall price strengthening. Loss cost trends continue to be stable and appear to be relatively benign across all of our Property and Casualty businesses.

On Slide 5, you will see a few highlights from each of our Specialty, Property and Casualty business groups. Property and Transportation Group, our largest sub-segment by premiums reported an underwriting profit of $16 million in the third quarter compared to a slight underwriting profit in the comparable 2012 period. Improved results in our agricultural operations and lower catastrophe losses were partially offset by lower year-over-year profitability in our transportation businesses.

With respect to our crop operations, corn and soybean harvests are winding down and should be completed by mid-November. Reports from the field indicate that yields are favorable although we won't know for sure until the harvest is completed. Strong yield estimates however have been tempered by a lower commodity pricing particularly for corn. Current average harvest prices are tracking down 22% from base prices for corn while soybeans are tracking about flat.

We recorded a modest underwriting profit for our crop operations in the third quarter of 2013 compared to the $12 million drought-related loss we recorded last year, in last year's third quarter. While it's still too early to predict our crop underwriting profits with any degree of certainty, we expect to have positive crop results for the year. While our transportation businesses reported lower underwriting profits in the third quarter of 2013 compared to the same period of 2012, I'm pleased with the improvement from the second quarter this year. Improved results are mainly due to decreased claim severity and sequential price increases.

Gross and net written premiums were up 17% and 10% during the third quarter of 2013 due primarily to higher crop premiums. If you exclude crop insurance, 2013 gross and net written premiums grew by 5% and 4% respectively when compared to the 2012 third quarter. Overall renewal rates in the Property and Transportation Group increased 5% on average for the quarter following increases of 6% in the second quarter and 5% in the first quarter of this year.

Our Transportation and Property and Inland Marine businesses reported sequential price increases for the quarter, consistent with our goal to improve the profitability of these operations. Our National Interstate Subsidiary and our Property and Inland Marine businesses achieved 6% rate increases.

Specialty Group recorded the third quarter underwriting profit of $19 million, $11 million higher than the 2012 third quarter. The improvement was due primarily to higher profitability in our workers' compensation and excess and surplus lines businesses as well as less adverse reserve development in our run-off program business when compared to the third quarter of last year. Most of the businesses in this group produced strong underwriting profit margins during the first 9 months of 2013.

Gross and net written premiums were up 23% and 34% respectively for the third quarter when compared to the same prior year period. While nearly all businesses in this group reported growth, our workers' compensation and excess and surplus lines were the primary sources of higher premiums. New business opportunities increased exposures from higher payroll on existing accounts, strong retentions and higher renewal pricing have contributed to the strong growth in our workers comp business.

In addition, new business opportunities and general market hardening have generated increased premiums in several of our excess and surplus lines businesses. Renewal pricing in this group was up approximately 5% for the third quarter following increases of 5% in the second quarter and 6% in the first quarter of this year. Our California workers comp business achieved double-digit rate increases for both third quarter and first 9 months of 2013.

Now the Specialty Financial Group recorded an underwriting profit of $22 million in the third quarter of 2013 compared to $1 million in the prior year period, due primary to higher underwriting profit in our financial institutions business, primarily from growth in our lender-placed mortgage property insurance as well as improved results in our surety and trade credit operations. Results for the third quarter of 2012 include losses from a run-off book of automotive-related business. Almost all of the businesses in this group continue to perform well, achieving an overall combined ratio of 82.3%.

Gross and net written premiums were up 5% and 15% respectively for the 2013 third quarter compared to the comparable 2012 period. Net written premium growth exceeded gross premiums as net written premiums were impacted by a change in the mix of business and higher reinsurance reinstatement premiums in the prior year period. Growth in our lender-placed mortgage property insurance business contributed to these results. Despite experiencing some pricing pressure, we benefited from changes in the competitive marketplace in this book of business. Renewal price in this group was down 1% for the third quarter and is about flat on average for the first 9 months of this year.

Now if you would turn to Slide 6 for an overview of the 2013 outlook for the Specialty, Property and Casualty operations. We have adjusted our 2013 expectations for the Specialty, Property and Casualty operations. We now expect to achieve a combined ratio between 91% and 94%, slight improvement from the range of 91% to 95% estimated previously. We now anticipate net written premiums will be 11% to 13% higher than last year's levels and that was an increase from 8% to 12% increase in our previous guidance. We expect the overall average renewal rates in 2013 for the Specialty Group to be consistent with the first 9 months of this year.

We expect the Property and Transportation Group to produce a combined ratio in the 96% to 99% range from our previous estimate of 95% to 99%. We estimate this group's net written premiums to be up 2% to 5%, slightly lower than the 2% to 6% estimated previously.

We expect the Specialty Casualty Group to produce a combined ratio in the 89% to 92% range, a slight improvement from the range of 89% to 83% estimated previously. And we now anticipate net written premiums will be up 21% to 24% based on strong growth in the first 9 months of the year and indications of market hardening and continued growth in our workers' comp and E&S businesses. This is an increase from the 15% to 19% increase in our previous guidance. And we expect the Specialty Financial Groups combined ratio to be between 85% and 88%, an improvement from the 87% to 91% estimated previously.

We project net written premiums to be up 14% to 17% in this group, primarily the result of growth in our financial institutions business and that's an increase from the 11% to 15% increase in our previous guidance. Finally, our current expectation is that 2013 Property and Casualty pre-tax net investment income will be about 6% lower than 2012, a slight decrease from the 5% estimated previously.

Now, I'd like to turn things over to Craig to review the results in our Annuity segment and investment performance.

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

Sorry, we had a technical problem there. Thank you, Carl. The Annuity segment reported core pre-tax operating earnings of $78 million in the 2013 third quarter compared to $69 million in the comparable 2012 period as you'll see on Slide 7. Annuity premiums of $1.2 billion in the 2013 third quarter were 61% higher than the third quarter of 2012. This record premium reflects successful distribution channel expansion particularly in banks as well as new product offerings.

Year-to-date, 2013 annuity premiums were up 9% from the comparable 2012 period. The focus on our Annuity business is to maintain appropriate spreads on our base of invested assets. On Slide 9, you'll find a comparison of averaged fixed annuity investments, average fixed annuity reserves, the net interest spread earned and the net spread earned. Our net interest spread earned, which represents the difference between net investment income earned and interest credited was 289 basis points during the third quarter of 2013, a decrease of 36 basis points from the comparable prior year period.

The lower net interest spread earned in the 2013 third quarter was due primarily to the run-off of higher yielding investments. The net spread earned represents our net interest spread less expenses plus or minus any impact of fluctuations in the stock market and interest rates have on the accounting for our fixed indexed annuity assets and liabilities.

For the third quarter of 2013, the net spread earned was 150 basis points, only a slight decrease from the third quarter of 2012 is a negative impact that sharply lower interest rates had on AFG's fixed annuity business in the prior year period substantially offset the lower net interest spread in the current period. Our net spread earned narrowed from results achieved in the previous quarter consistent with our expectations. Additional information about the components of these spreads for AFG's fixed annuity operations can be found in AFG's quarterly investor supplement posted on our website.

Please turn to Slide 9 for an overview of the 2013 outlook for the annuity segment as well as the run off long-term care and life segment. Our average Annuity investments and reserves grew approximately 5% during the third quarter, a trend we expect to continue through the fourth quarter of 2013. We expect net interest spreads to narrow as higher yielding investments and our portfolio continue to run-off. Furthermore, we expect net spreads which are impacted by stock market performance and interest rates to be between 130 basis points to 140 basis points in the fourth quarter as compared to 158 basis points earned in the first 9 months of the year and 150 basis points earned in the third quarter.

Based on our performance in the third quarter of 2013 and assuming no major fluctuations in interest rates or the stock market, we now expect 2013 full-year core pre-tax operating earnings and our combined annuity and run-off long-term care and life segments to be 17% to 21% higher than the $252 million reported for the full-year of 2012, up from the range of 13% to 18% previously estimated. Based on record sales during the third quarter, we now believe that annuity premiums will be 28% to 32% higher than the $3 billion reported last year, an increase from the 5% to 10% estimated previously.

Please turn to Slides 10 and 11 for a few highlights regarding our investment portfolio. AFG recorded third quarter 2013 net realized gains on securities of $35 million after-tax and after deferred acquisition costs compared to $55 million in the comparable prior year period. Unrealized gains on fixed maturities were $449 million after-tax, after-DAC at September 30, 2013, a slight decrease from June 30 of this year.

As you'll see on Slide 11, our portfolio continues to be high-quality with 86% of our fixed maturity portfolio rated investment grade and 96% with an NAIC designation of 1 or 2, the 2 highest rating categories. We provided additional detailed information on the various segments of our investment portfolio and a quarterly investor supplement on our website.

I will now turn the discussion over to Jeff, who will wrap up our comments with an overview of our 2013 consolidated third quarter results.

Joseph E. Consolino
Executive VP, CFO, Principal Accounting Officer & Director

Thank you, Craig. Slide 12 shows highlights of our consolidated income statement for the 3 month period ended September 30, 2013 and 2012 by sources of earnings. This table summarizes the segment results Carl and Craig just reviewed with you and highlights other key items impacting AFG's consolidated operating results. Starting with core net operating earnings per share; AFG generated a 29% increase in core net operating earnings per diluted share to $1.06 per diluted share in the third quarter of 2013, as compared to $0.82 in the third quarter of 2012.

Core net operating earnings for the 2013 third quarter were $97 million as compared to $78 million in the prior year's quarter, increasing by 24%. Weighted average diluted common shares are 4% lower, $91.0 million in the third quarter of 2013, down from $94.6 million in the year ago third quarter.

Looking at our segment results. Our P&C segment operating earnings were $113 million in the third quarter of 2013 compared to $71 million in the comparable 2012 period, an increase of $42 million or 59%. Carl has discussed the factors impacting underwriting income in the Specialty P&C group, which consists of higher underwriting profitability in each of our Specialty P&C sub-segments, lower levels of cat losses year-over-year, and higher levels of net favorable reserve development for the Specialty P&C Group. P&C pre-tax net investment income declined by $2 million year-over-year. As Craig described, Annuity segment earnings were up $9 million or 13% during the third quarter to $78 million.

Earnings contributed by other operating segments declined year-over-year by $16 million. As a reminder, the third quarter of 2012 included $10 million in pre-tax earnings from our Medicare supplement and critical illness business. This business was sold effective August of 2012. The remainder of the year-over-year variance is attributable to worse than expected claims experience in both the run-off life and long-term care operation.

Interest expense was $17 million, $2 million less than in the prior year period. Other expense increased by $4 million in the 2013 third quarter. And finally, annualized core operating return on equity was 9.7% for the 2013 third quarter compared to 8.0% in the third quarter of 2012.

Having done through the components of core earnings, you'll see on Slide 13 that net earnings of $83 million, or $0.92 per share, were impacted by $35 million, or $0.40 per share, in after-tax realized gains and a special A&E charge of $49 million, or $0.54 per share. The bottom of Slide 13 details the split of the special A&E charge. The components of the special A&E charge are further outlined on Slide 14.

AFG recently completed a comprehensive study for asbestos and environmental exposures relating to the run-off operations of our P&C Group and exposures related to former railroad and manufacturing operations. Such external studies have been periodically undertaken generally every 2 years with the aid of specialty actuarial engineering and consulting firms and outside counsel. In the intervening years, we perform an in-depth internal review.

As you can see on Slide 14, the P&C Group's asbestos reserves were increased by $16 million and its environmental reserves were increased by $38 million. At September 30, 2013, the P&C Group's insurance reserves include A&E reserves of $341 million, net of reinsurance recoverables. The increase in P&C asbestos reserves was driven primarily by slightly higher than expected loss experience, higher defense costs and some increased claim severity. As the overall industry exposure to asbestos has matured, the focus of litigation has shifted to smaller companies and companies with ancillary asbestos exposures. AFG's insureds with these exposures have been the driver of our P&C asbestos reserve increases. The increase in P&C environmental reserves was attributed primarily to a small number of claims where the estimated costs of remediation have increased.

The chart on the right side of the Slide shows the 3-year survival ratio to our P&C Group. As of September 30, 2013, these ratios were 15.2x paid losses for asbestos reserves, 6.2x paid losses for environmental reserves and 10.4x paid losses for total A&E reserves. These ratios compare favorably with data published by A.M. Best. As of the year end 2012, A.M. Best reports 3-year industry survival ratios of 10.0x for asbestos, 5.8x for environmental and 8.8x for total industry A&E reserves.

In addition, our study encompassed reserves for asbestos and environmental exposures of our former railroad and manufacturing operations. AFG increased its liabilities for the asbestos and environmental exposures in these operations by $22 million, this is due primarily to slightly higher estimated operation and maintenance costs at sites where remediation is underway, coupled with estimated higher cleanup costs at a limited number of sites.

Turning to Slide 15, AFG's adjusted book value per share increased 7% during the first 9 months of 2013 to $45.36. Tangible book value on an adjusted basis at September 30, 2013 was $43 even. Our capital adequacy, financial condition and liquidity remained strong. We maintained sufficient capital in our insurance businesses to meet our commitments to the rating agencies. Our excess capital was approximately $900 million at September 30, 2013. This included cash at the parent company of approximately $200 million.

There were no share repurchases during the third quarter of 2013. As of October 29, there were approximately 6.1 million shares remaining under our repurchase authorization. In addition to share repurchases and dividends, AFG looks to invest its excess capital, where we see potential for healthy profitable organic growth or opportunities to expand our specialty niche businesses through acquisitions and start-ups to meet our targeted return thresholds. The growth in our Annuity and P&C Specialty Casualty businesses serve as examples.

On Slide 16, you'll find a recap of 2013 guidance for AFG's core net operating earnings, as well as the guidance discussed earlier in the call for key financial measures in the Specialty, Property and Casualty operations and in the Annuity segment. These 2013 expected results exclude non-core items such as realized gains and losses as well as other significant items that may not be indicative of ongoing operations.
With that said, we would now like to open the line for any other questions.

Question and Answer

Operator

[Operator Instructions] The first question comes from the Amit Kumar from Macquarie.

Amit Kumar
Macquarie Research

Just a few quick questions. First of all, just going back to the discussion on the annuity book, you talked about the expansion in the bank channel. I'm curious, do you have some metrics, some numerics to maybe expand on that in terms of how many perhaps banks you might be in Q3 versus the past few quarters?

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

Yes, I can, I can talk generally about changes there. First of all, we've had continuing very strong sales in the banks that we've had longer-term relationships with, specifically P&C bank, Regions Bank, BB&T. We have added some new relationships though that have really come on strong here recently and some larger banks. Wells Fargo is really coming on well for us now and producing a significant amount of premiums, U.S. Bank, Citizens Bank to name a few. So, it's a combination, Amit, of adding some new banks as well as the bank market just being very strong generally. The majority of our growth has come from sales, from bank sales.

According to LIMRA, industry sales of annuities through banks and broker dealers were up 25% to 30% in the first half of 2013 and we believe this trend has continued or even grown in the third quarter. So the combination of banks really growing at a very good clip in terms of sale of annuities, as well as us adding some new great partners and several new major banks has resulted in very strong premium growth.

Amit Kumar
Macquarie Research

And who can you compete against like currently?

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

We compete against a long list of companies. New York Life is a significant player. I mean, I could get you a list. What I will tell you is one thing that we really like about the bank distribution is that the sub-A rated companies, which are by far the most aggressive pricers, have not been very successful in getting into the bank market. The banks, especially, the larger banks, at least up until now have required strong ratings to be eligible to sell in the banks. So in the non-bank markets, by far the most aggressive pricers have been the sub-A rated companies and they generally are not in the banks where we sell.

Amit Kumar
Macquarie Research

Got it, I guess that was the answer I was looking for. And if you look at the size of the book, I mean, do you get the sense that perhaps it's approaching the optimum level, or how should we sort of think about this going forward?

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

Amit, what I would say is if we continue to grow the business at the rate of return then we welcome the growth. But as you know, we're very disciplined in our pricing and we expect to get the appropriate rate of return. So, yes, we can grow the business. Jeff just talked about our excess capital position, so if we can, if we can put capital to work at the right rate of return then we welcome the growth. If we can't, then we'll put our capital elsewhere.

Amit Kumar
Macquarie Research

Got it. But perhaps the related question and then this is for all of you. In terms of capital management, I know that you've talked about this in the past, are we perhaps looking at the wrong way when we are thinking about the consolidation pipeline versus perhaps, we should be focused more on the capital sort of being deployed on the annuity side. Is that fair that the market is anticipating some sort of consolidation down the road versus buy-back?

Joseph E. Consolino
Executive VP, CFO, Principal Accounting Officer & Director

Amit, I'm not real clear on your question. I mean, what we do when we're looking at allocating capital is we're looking at the many businesses that we are in and looking at the ones that have the best prospects to grow and deploy capital at the right rate of return.

Amit Kumar
Macquarie Research

I guess what I was asking was, has the consolidation pipeline changed in any way over the past few quarters?

Joseph E. Consolino
Executive VP, CFO, Principal Accounting Officer & Director

I'm not sure I understand what you mean by...

Unknown Executive

If you are asking about acquisition opportunities...

Joseph E. Consolino
Executive VP, CFO, Principal Accounting Officer & Director

Or perhaps start-ups.

Amit Kumar
Macquarie Research

Candidates, yes.

Joseph E. Consolino
Executive VP, CFO, Principal Accounting Officer & Director

We of course are always looking at that kind of opportunity. We are seeing a very good flow. I think the Great American brand and the culture we have here makes us a very attractive place for people to come and build their businesses and build their careers, but we are quite selective and with the growth we're seeing in the Specialty business, especially the Specialty Casualty business, and our ability to grow our annuity business quite substantially, we are seeing really great opportunities to deploy our capital internally. That would mean for the right opportunity to bolt on or start a new division, that we wouldn't be enthusiastic. And we have met some great people over time, but we're really going to wait for the right opportunity before moving ahead with that and not just make acquisitions or bring people in for the sake of doing that. It's all about trying to make the right return on our capital.

Amit Kumar
Macquarie Research

Got it. And the only other quick question I have and I'll stop is you do the LTC, so the long-term care study and reserve study and assumption study in Q4. Do you have an early view on that?

Unknown Executive

As you know, we did the study last year.

Amit Kumar
Macquarie Research

Yes.

Joseph E. Consolino
Executive VP, CFO, Principal Accounting Officer & Director

We have said previously that our expectation is that over a long period of time, that we don't expect that line to produce any significant earnings or losses and at this point in time, we feel the same way. What I will tell you is there can be blips and claims, or other items that affect profitability in a given quarter. But over the long period of time, we still expect to have an operating result of something around zero. We don't expect any significant profits or losses out of the line.

Unknown Executive

Amit?

Amit Kumar
Macquarie Research

Yes.

Unknown Executive

A little bit on that, the long-term [indiscernible]

Joseph E. Consolino
Executive VP, CFO, Principal Accounting Officer & Director

In the annuity business, you have to study your assumptions and see if you need to do an unlocking, which can be a positive or a negative. The adjustment that AFG took in the fourth quarter of last year for the long-term care business was a loss recognition adjustment, which is different. You don't have the opportunity to have positive unlockings. So the major change in the environment since that loss recognition charge for the long-term care business has been an increase in interest rates, which improves our reserve position and the profitability of that business. So I would say the underlying trends since the last recognition charge, generally have been running in our favor with the caveat that Craig mentioned that you can see what's in claims from time-to-time in the loss recognition charge -- Annuity unlocking.

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

I do have a list of some of the other companies we compete with in the -- in the bank market and I'll just name a few, a few of the large ones certainly AIG through Western National, Jackson Life, Midland, New York Life to name a few. But it's some -- there are a number of highly rated companies that sell through banks.

Operator

The next question comes from Jay Cohen from Bank of America Merrill Lynch.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

A couple questions. First, in the Specialty Casualty business, you talked about that growth being driven by workers' comp and the E&S business. I'm wondering if you could drill down in the E&S business, because that obviously encompasses a lot of different lines of business. Where specifically are you seeing the opportunities? The second question, if you look at both the Specialty Casualty and Specialty Financial business, it appears you are retaining more business. And I know quarter-to-quarter, that can jump around. But is there a change in the reinsurance strategy that changes the net to gross equation there relative to a year ago?

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

Good morning, Jay. This is Carl. First of all, I would say that we are excited about the opportunities for growth in almost all of our Specialty Casualty lines. When you look at the actual dollars, the biggest dollars are coming from workers' comp and our various E&S subsidiaries in that. But we have opportunities in almost all of our Specialty Casualty businesses that we are enjoying right now. As far as the E&S opportunities, in a couple of our subsidiaries we've been taking advantage of kind of our market hardening in New York contractors, that's been a focus. But besides that, we are really just seeing, as others, quite a bit of business of all sizes coming back to the E&S marketplace from the standard market. So we are getting more looks on a broad array of business also. In worker's comp, that's primarily driven by opportunities in the California comp marketplace right now driven by opportunities competitively with things that are going on there, and I think things to come, and rate increase and all. And then our large deductible business, the strategic comp business, we are seeing quite a few opportunities because of the pullback by some of the larger national markets in that particular business. So we are enjoying opportunities in lots of our Specialty, Casualty businesses right now. As far as the -- would you repeat the second question as far as, was that a retention question?

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Yes, in both Specialty Casualty and Specialty Financial it appears relative to a year ago, you're retaining more of the premium rather than ceiling it into reinsurance companies. And again, I know things can just change year-over-year depending on business mix, but is there any strategic shift to keeping more of that business and reinsuring less of it?

Joseph E. Consolino
Executive VP, CFO, Principal Accounting Officer & Director

Jay, this is Jeff. You're right. If you look at the Specialty Casualty sub-segment, our retention ratio is 70% net to gross this quarter versus 65% in the year-ago quarter. The dollars are pretty stable at 136 million seeded this quarter versus 133 a year ago and since we've had differential growth rate within that each of those units within the sub-segment have different reinsurance buying philosophy. What you're seeing is a change in mix rather than a change in philosophy. Likewise, Specialty Financial, the retention ratio is 77% this quarter to growth versus 71% a year ago, and again, that reflects mix plus also some modest change in reinstatement premiums that would have been flowing through that a year ago. So that's what's driving that.

Operator

The next question comes from Ryan Byrnes from Janney Capital Markets.

Ryan J. Byrnes
Janney Montgomery Scott LLC, Research Division

My question was the Property and Transportation segment, I kind of calculate the underlying loss ratio kind of deteriorating a little bit year-over-year, but then I can look at some of the pieces already National Interstate, it looks pretty stable year-over-year then you guys also mentioned the crop has been booked at a better actually this year versus last year. Just want to see what else would be pushing that deterioration year-over-year on underlying basis?

Joseph E. Consolino
Executive VP, CFO, Principal Accounting Officer & Director

This is Jeff Consolino again. I think the place you've got to start is what you mentioned last which is crop; we booked a significant amount of premium this quarter. And as Carl said we've been very conservative in terms of booking profit emergence. And so the underlying accident year combined ratio on that is very close to breakeven. Once you strip that out, we do have as you said National Interstate being relatively stable year-over-year. We do have continued erosion and our Property and Inland Marine business which they're working on. And some as Carl mentioned adverse movement year-over-year and non-National Interstate, Transportation business but overall far and away the biggest contributor to that is the dynamic of the crop premium coming through this quarter, which has a disproportionate impact.

Ryan J. Byrnes
Janney Montgomery Scott LLC, Research Division

Okay, great. I just wondered with the crop as well and I know you guys tend to earning more in the third and fourth quarters, but this quarter did you guys -- did the third quarter loss pick elevated off from adjusting the first half of the year loss pick as well?

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

We look at things different than our competitors on our booking approach, Ryan. We generally don't book anything until the third quarter and then usually the third quarter is not very much respectively compared to the whole year. And then it's really the fourth quarter is when we book most of the accident year, the current crop year type of profits. You'll find, sometimes you'll find in the first quarter some adjustments related towards the crop hail part of our business, which reserves are held back or you don't know what you really have until you get through some of the winter freeze types of exposures in that. So or if there is -- sometimes you don't know on the even the main harvest, so you settled all the claims exactly what you have. So I know in the past years there have been -- in the first quarter there has been some true-up once we really know what the answer is for the previous crop year, but generally on the current crop year we don't book usually anything in the first half of the year usually a small piece in the third quarter and then the biggest part in the fourth quarter.

Ryan J. Byrnes
Janney Montgomery Scott LLC, Research Division

Okay, and then just one last just a mechanical one there as well, I guess with the delayed planting in this year versus last year, I guess the crop earned premium mix be as opposed to last year be a little more weight to the fourth quarter versus the third quarter again just comparing it year-over-year just because of that delayed planting?

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

Possibly, I think most -- again most of the premiums are recorded by the end of the third quarter. So there is not when you look at how we record our premium. Second and third quarters would be the big quarters when we record premium in that. So the catch-up you see is somewhat related to the delayed planning and reporting this year, the catch-up in the third quarter.

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

Major change in our earnings pattern. What you did see a change in our writings pattern with the delay in the premium coming through.

Operator

[Operator Instructions] The next question comes from Vincent DeAugustino from KBW.

Vincent M. DeAugustino
Keefe, Bruyette, & Woods, Inc., Research Division

Carl, one of the things that you had mentioned was the loss cost trends have been rather benign across the various units. And I'm curious if that holds true even if we look down to AFG's transportation book excluding our National Interstate. And then the second kind of related question to that would be, if you look at the industry, from your guys' opinion, do you think the industry is beginning to establish reserves and pricing based off of expectations for this benign environment to continue. And whether or not that potentially sets the industry up for some issues even if loss cost trends only normalize from here?

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

I think your first question was in the Property and Transportation, overall loss cost trend and then Property and Transportation kind of excluding National Interstate. Our overall loss cost trends are in the range of 2% to 4% in that when you -- I guess if you look at the Property and Transportation Group, overall -- I don’t know probably the Property and Marine might be 3% or 4% somewhere around in there and our trucking outside of National Interstate probably somewhere in the same category now. So, I’m not sure there are huge differences from the overall.

Vincent M. DeAugustino
Keefe, Bruyette, & Woods, Inc., Research Division

It’s good. I was just curious that some of the severity issues that the industry has been kind of talking about on the commercial auto but was an issue, but it seems like things are pretty benign. So on the industry kind of aspect though, do you guys maybe just don’t want to talk about kind of competitors’ books, but at least from an overall reserving and ultimately a pricing implication kind of angle. Do you think that that’s something that’s going to ultimately stress reserves if we see some normalization in loss cost trends especially on the medical side?

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

Are you relating to future pricing or future reserve adequacy?

Vincent M. DeAugustino
Keefe, Bruyette, & Woods, Inc., Research Division

More on the future reserve adequacy, ultimately moving the needle on pricing.

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

Yes, I mean any tick-up, major tick-up in loss cost trends, definitely can have an impact on existing reserves. I don’t think any of us in the industry are blind to the possibility of loss cost trends changing, and I know, we look at each of our businesses as we set pricing. We generate pick loss cost trends that maybe a slight bit more conservative versus benign, and particularly in the lines of business that aren’t doing as well. And I don’t know what each of our competitors’ approach is, but I think that they also probably are using more conservative loss trend picks as they are trying to set their pricing also.

Vincent M. DeAugustino
Keefe, Bruyette, & Woods, Inc., Research Division

Okay, that’s definitely good to hear on the conservative side. One of the things that National Interstate had talked about last month at our conference was some dynamics with the litigation trends and I’ll kind of insert my own commentary here, but kind of the angle was is that there is as bit of a populous mentality contributing to some litigation pressure in more economically hard hit areas. And so I’d be mixing apples and oranges a bit in comparing to asbestos but with the note on higher defense costs, I’m just curious if you are seeing this same kind of issue with higher words and therefore, and if it is to more vigorously defend claims and then even beyond asbestos. I’ll be really happy to hear if you have any insights on just broad litigation trends in the go-forward type P&C businesses?

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

In worker’s compensation is that was your...

Vincent M. DeAugustino
Keefe, Bruyette, & Woods, Inc., Research Division

I mean, just with the note in the press release on the sense cost kind of being a contributing factor to the higher asbestos reserves. I'm just curious of the litigation trends both within asbestos and then more broadly in the other P&C units, but worker's comp would clearly be one of the more ripe lines for that type of issue?

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

Yes, I mean outside of A&E, I don't think. Overall, I don't see any -- too many disparaging undercurrents or trend changes with regards to litigation that we are seeing, you go state-by-state, sure. There's issues that you identify that you adjust your claims handling approach or your pricing approach and that. But in general, overall, there is not lots of -- not very many overall trends or issues that are disturbing to us right this second.

Vincent M. DeAugustino
Keefe, Bruyette, & Woods, Inc., Research Division

Okay, great. And then one last one for Craig and it's a -- really just a follow-up from earlier question. On the annuity business, when we think about having over $1 billion in sales in the quarter. If we think about there being a split between new distribution partners and new products versus just improved demand from the legacy products through kind of the existing channels, would we have a breakout just roughly and kind of how that $1 billion would get allocated to those different drivers?

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

I mean, the biggest part of it is from existing relationships, but it is nice to be bringing on new partners who helped to fuel the growth at the right rate of returns.

Joseph E. Consolino
Executive VP, CFO, Principal Accounting Officer & Director

Those of you who want, by the way, to follow-up on Vincent's question, Page 14 of the investor's supplement, does split the statutory annuity premium, by source, year-over-year, the annuity premium grew by about $450 million. And you'll see the split, indexed annuities in banks grew by $280 million, indexed annuities through retail grew by about a $100 million and fixed annuities in financial institutions grew by about $70 million. So those 3 really account for 100% of the dollar growth, with the lion's share being in fixed annuities and financial institutions.

Operator

The next question comes from Amit Kumar from Macquarie.

Amit Kumar
Macquarie Research

Just 2 quick follow-ups. Going back to I guess that slide, which you were just referring to, can you talk maybe about, I guess the relative to commission levels which are paid on these premiums versus the competition?

Unknown Executive

Amit, what I can tell you is we move to consumer centric model probably 3 or 4 years ago, and I would say on average, our commissions would be below the average of the industry.

Amit Kumar
Macquarie Research

Got it. So the reason you're growing is because there are others who are not growing because of their rating structure, that's what you said right?

Unknown Executive

In the bank market, there is a barrier to entry generally. The sub-A rated companies have not been able to penetrate the bank market at least to date. [indiscernible] away from fixed income and -- yes. There are several things that have -- that we believe have really helped our growth this year, certainly the stability of ownership of our business, the stability of ratings, the rise in interest rates has been a positive thing. We began the year with 10-year treasury at 190 and that popped up above 3% and now it is around 250. But I think bond investors were a bit surprised when they got their statements and saw that they were way under water on the bond holdings and clearly, some of the money that moved out of bond funds moved into annuities.

Principally, the indexed annuities where they had the chance to earn a significantly higher rate if the market perform well, but they had downside protection, you can't go below zero at a given year. So I think we were the beneficiary of some money that was moving out of bond funds. I believe that -- our belief is that banks have not had strong demand for loans.

So as CDs were maturing at banks, they were not very competitive. They really didn't care about retaining those funds by selling new CDs, so I think some of that money is rolled into annuities, the banks get an interest in not just seeing the money go out the door. They can earn a fee by selling annuities. So I think we've done a beneficiary there also, and there are number of things that I think if benefited the industry. Our principal product is a fixed-indexed annuity product that's our biggest seller. And that product is -- sales of that product have just grown very significantly over the last couple of years.

Joseph E. Consolino
Executive VP, CFO, Principal Accounting Officer & Director

This is Jeff Consolino, if I could add one thing, elaborate on Craig's commentary. First thing as we state that we expect acquisition expenses as a percent of average annuity benefits accumulated to be in the range of 70 basis points to 80 basis points. You can see that in our disclosures. In terms of commission levels, when we measure up our annuity products against the industry as a whole, typically we have shorter products in the industry, and that gets to what Craig was referring to consumer centric. Now, we really don't play in the high commission, long surrender penalty period in our market, and the bank markets tend to have shorter products, where you have the lower upfront commissions and therefore lower acquisition expenses. And so the very nature of where we position ourselves versus the industry, we'll drive a differential in both maturity profile and the commission profile of our product.

Amit Kumar
Macquarie Research

Got it. That's actually very helpful. The only other sort of clean-up question I had and I don't know if I missed this. I think in the opening remarks there was a comment that 2/3 of the P&C business is getting rate increases. Can you talk a bit about the remaining 1/3?

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

Yes, I think probably, one of the major businesses that placed mortgage property for our business there have been a number of states, California, Florida...

Amit Kumar
Macquarie Research

I'm losing you, I can't hear you.

Joseph E. Consolino
Executive VP, CFO, Principal Accounting Officer & Director

Yes, the lender-placed mortgage property business would be one of our larger businesses where we are not achieving an increase because of California, Florida, New York where there been some rate declines that have been filed within the industry. That would be one place where we're not achieving rate. A little business, equine mortality, we are not achieving a stated renewal rate increase that we, for instance there our approach with that business has been to eliminate health insurance and medical insurance for horses under at smaller values and that's the way that we've achieved rate there.

So on our price sheet, it doesn't show -- it shows up as no rate increase but through another means we've gotten some rate there. On smaller business, our environmental liability business continues to be pretty competitive and we wouldn't be achieving any rate there. It's really kind of the exception rather than the rule in that we have a kind of a specialty equipment warranty service oriented business where we don't have any, we're not showing any rate. Crop-hail, we include crop-hail as zero kind of in our overall renewal rate kind of data. So those would be a few of the businesses that we're not achieving rate.

Operator

I'm showing no further questions. I would now like to turn the call back over to Diane Weidner.

Diane P. Weidner
Assistant Vice President of Investors Relations

Thank you for joining us this morning. We look forward to talking with you again when we report our results for the fourth quarter.

Operator
Ladies and gentlemen, that does conclude the conference for today. Again, thank you for your participation. You may all disconnect. Have a good day.