S&P Capital IQ

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Cincinnati Financial Corporation NasdaqGS:CINF

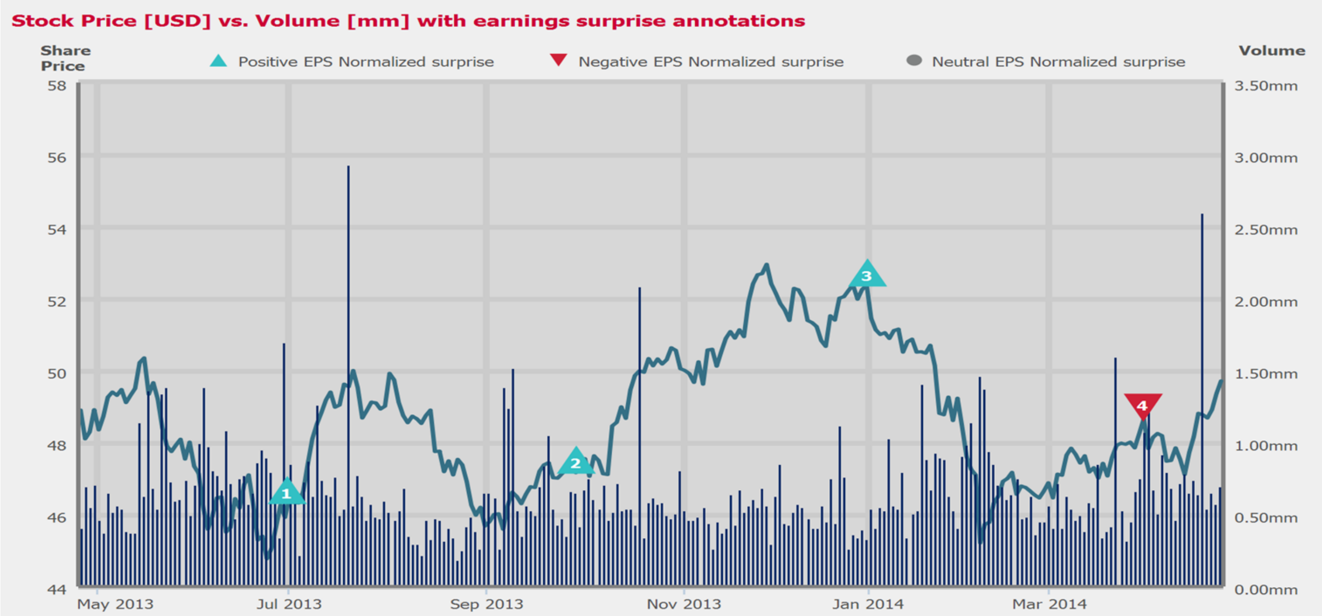
FQ2 2014 Earnings Call Transcripts

Wednesday, July 30, 2014 3:00 PM GMT

S&P Capital IQ Estimates

	-FQ2 2014-			-FQ3 2014-	-FY 2014-	-FY 2015-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.51	0.46	(9.80 %)	0.58	2.30	2.86
Revenue (mm)	1163.75	1214.00	4.32	1175.70	4708.70	5079.73

Currency: USD
Consensus as of Jul-30-2014 4:24 AM GMT



- EPS NORMALIZED -	CONSENSUS	ACTUAL	SURPRISE
FQ2 2013	0.42	0.61	1 45.24 %
FQ3 2013	0.62	0.70	2 12.90 %
FQ4 2013	0.69	0.72	3 4.35 %
FQ1 2014	0.54	0.46	4 (14.81 %)

Call Participants

EXECUTIVES

Dennis E. McDaniel
Vice President and Investor Relations Officer

Jacob F. Scherer
Former Chief Insurance Officer

Martin J. Mullen
Chief Claims Officer of the Cincinnati Insurance Co. and Senior VP of the Cincinnati Insurance Co.

Michael J. Sewell
Chief Financial Officer, Senior Vice President and Treasurer

Steven J. Johnston
Chief Executive Officer, President, Director and President of Cincinnati Life Insurance Company

ANALYSTS

Bijan Moazami
Guggenheim Securities, LLC, Research Division

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Sandler O'Neill + Partners, L.P., Research Division

Joshua David Shanker
Deutsche Bank AG, Research Division

Michael Zaremski

Scott Gregory Heleniak
RBC Capital Markets, LLC, Research Division

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

Presentation

Operator

Good morning. My name is Mike, and I will be your conference operator today. At this time, I would like to welcome everyone to the Second Quarter 2014 Earnings Conference Call. [Operator Instructions] I will now turn the call over to Dennis McDaniel, Investor Relations Officer. You may begin your conference.

Dennis E. McDaniel
Vice President and Investor Relations Officer

Hello. This is Dennis McDaniel from Cincinnati Financial. Thank you for joining us for our Second Quarter 2014 Earnings Conference Call.

Late yesterday, we issued a news release on our results, along with our supplemental financial package, including our quarter end investment portfolio. To find copies of any of these documents, please visit our Investor website, cinfin.com/investors. The shortest route to the information is the Quarterly Results link in the navigation menu on the left.

On this call, you'll first hear from Steve Johnston, President and Chief Executive Officer; and then from Chief Financial Officer, Mike Sewell. After their prepared remarks, investors participating on the call may ask questions. At that time, some responses may be made by others in the room with us, including Cincinnati Insurance Company's Executive Committee Chairman, Jack Schiff, Jr.; Chairman of the Board, Ken Stecher; Chief Insurance Officer for the Cincinnati Insurance Company, J.F. Scherer; Principal Accounting Officer, Eric Mathews; Chief Investment Officer, Marty Hollenbeck; and Chief Claims Officer for Cincinnati Insurance Company, Marty Mullen.

First, please note that some of the matters to be discussed today are forward-looking. These forward-looking statements involve certain risks and uncertainties. With respect to these risks and uncertainties, we direct your attention to our news release and to our various filings with the SEC.

Also, a reconciliation of non-GAAP measures was provided with the news release. Statutory accounting data is prepared in accordance with statutory accounting rules and, therefore, is not reconciled to GAAP.

With that, I'll turn the call over to Steve.

Steven J. Johnston
Chief Executive Officer, President, Director and President of Cincinnati Life Insurance Company

Good morning, and thank you for joining us today to hear more about our second quarter results. The quarter included several indicators of good performance and successful execution of our agency-focused strategy. While we're not satisfied with the property casualty combined ratio over 100%, on a before catastrophe loss basis, it was 90.4% for the first half of 2014. We intend to improve upon that in the second half.

Our second half catastrophe loss ratio has averaged 4.0 points over the past 10 years. If that average holds in the second half of this year, the full year catastrophe effect would be about 7 points or 1 full point above our full year average over the past 10 years.

Absent weather effects from catastrophes and noncat weather, our combined ratio for the first 6 months of 2014 improved over the same period in 2013.

Moving forward, we continue to work hard on initiatives to improve underwriting performance and be even more diligent in risk selection in pricing on a policy-by-policy basis. We continue to be confident that our initiatives will drive long-term profit and will steadily grow our insurance operations.

Our net income per share for the first 6 months of 2014 was down $0.54 and was 1/3 less than a year ago. Taking a closer look at the numbers, one separate way to isolate the weather effect is from the net income reconciliation we provide near the end of our news -- earnings news release.

After-tax insured losses related to weather were $0.63 worse. So before catastrophe and noncatastrophe weather losses, operating income was up $0.17 or 9% better than a year ago.

Even with the weather effects, our Commercial Lines segment and our Excess & Surplus Lines segment reported an underwriting profit for the second quarter and first half of 2014. That is the eighth consecutive quarter of underwriting profit for our Commercial Lines segment, and the seventh in a row for our Excess & Surplus Lines segment.

For the second quarter, we again reported healthy premium growth for each insurance segment, including ongoing renewal price increases on average for each property casualty segment.

In addition to profit improvement and premium growth benefits from more precise pricing, our premium growth was aided by continuing to appoint outstanding agencies to represent us. In the first half of 2014, we appointed 50 new agencies. All of our appointed agencies continued to do a great job, helping us retain profitable accounts. Our policy retention measures have been steady for several quarters. For Commercial Lines, our retention rate continued toward the high end of the mid-80s, and for Personal Lines, it remained in the low to mid-90s.

For the second quarter, average renewal price increases for Commercial Lines were in the low single-digit range. As a reminder, that average includes the muting effect of 3-year policies that were not yet subject to renewal pricing during the second quarter.

We also continued to obtain more than the average where we believe it is warranted. Smaller commercial property policy saw second quarter average increases near the upper end of the high single-digit range. In commercial auto policies, average increases toward the upper end of the mid single-digit range.

For both our Personal Lines and Excess & Surplus Lines segments, second quarter 2014 renewal price increases averaged in the mid single-digit range.

Next, let's look ahead to Commercial Lines written premium for the third quarter. We report a 16% growth in the third quarter of 2013 in part due to a higher-than-usual estimate for premiums of policies in effect, but not yet processed at that time. Business in the pipeline, so to speak. We'll be challenged to report year-over-year growth for that segment in this year's third quarter.

Our second quarter 2014 new business written premium slowed compared with a year ago, reflecting pricing and underwriting discipline. For our Commercial Lines and new business in particular, we're generally seeing fewer agency admissions. We believe that's an indication that the commercial market, in general, is approaching price adequacy.

Lower personalized new business premiums were as expected. That reflects our underwriting profitability actions that began around the middle of last year. Those actions included higher premium rates, greater precision in our pricing and changes in our policy terms, such as more use of actual cash value coverage for older roofs.

Our Excess & Surplus Lines new business, premiums grew substantially in part due to placing more underwriters in the field to help convey our value proposition to agents. Steady profitability in that segment provides confidence that our growth has been healthy.

Our life insurance subsidiary, including income from its investment portfolio, produced another quarter of solid earnings and premium growth. Investment income was another bright spot for the second quarter. We reported investment income growth for the fourth quarter in a row.

Finally, our premium -- our primary measure of long-term financial performance, the value creation ratio, continues to be on pace to reach our objective. At the halfway point for the year, VCR stood at 6.6%, more than halfway toward our target of an annual ratio averaging 10% to 13%.

I'll now ask our Chief Financial Officer, Mike Sewell, to elaborate on our investment performance and financial items.

Michael J. Sewell

Chief Financial Officer, Senior Vice President and Treasurer

Great. Thank you, Steve, and thanks to all of you for joining us today. I'll start by adding a few details about our investment portfolio. The second quarter of 2014 was another one where shareholder value benefited from our equity investing strategy. In addition to our book value increasing from appreciation in our stock portfolio valuation, the bond portfolio also increased significantly. Our stock portfolio's pretax net unrealized gains eclipsed $2 billion, and dividend income from the portfolio registered another strong increase, up 13% for the quarter.

Yields for our bond portfolio again moved slightly lower as the second quarter 2014 pretax average yield reported at 4.76%, was 16 basis points lower than a year ago.

Taxable bonds representing nearly 70% of our bond portfolio had a pretax yield of approximately 5.26% at the end of the second quarter of 2014. The average yield for new taxable bonds purchased during the quarter was 4.31%. For the same period, our tax-exempt bond portfolio yield was 3.83%, and purchases during the quarter yielded 3.17%. Our bond portfolio's effective duration measured 4.4 years at the end of the second quarter, down slightly from 4.5 years at year end.

Cash flow from operating activities continues to help boost investment income at $351 million for the first half of 2014. Net operating cash flow was $100 million or 40% higher than the same period a year ago.

Carefully and consistently managing expenses helped to reduce the second quarter and 6-month underwriting expense ratio by more than 1 point compared to a year ago. We also continue to follow a consistent approach in setting loss and loss expense reserves, seeking to remain well into the upper half of the actuarially estimated range.

For the first half of 2014, favorable development on prior accident years at 4.8% was basically in the middle of the 5.6% from the first half of last year and the 4.1% full year 2013 ratio.

Our 6-month 2014 net favorable development was again spread over several accident years, including 35% each for accident years 2013 and 2012 and 30% for all order accident years.

Our financial strength and liquidity remains steady and strong. We did not purchase additional shares during the second quarter of 2014. We previously reported a first quarter repurchase of 150,000 shares as a maintenance-type action, intended to partially offset the issuance of shares through equity compensation programs.

Cash and marketable securities at the parent company edged up to $1.6 billion at the end of the second quarter, rising slightly from March 31 and 4% from year end.

Our property casualty premiums-to-surplus ratio was still 0.9:1, giving us plenty of capital to support continued premium growth of our insurance business.

I'll conclude my prepared comments as usual by summarizing the contributions during the second quarter to book value per share.

Property casualty underwriting decreased book value by $0.03. Life insurance operations added $0.06. Investment income other than life insurance and reduced by noninsurance items contributed $0.45. The change in unrealized gains at June 30 for the fixed income portfolio, net of realized gains and losses, increased book value per share by $0.38. The change in unrealized gains at June 30 for the equity portfolio, net of realized gains and losses, increased book value by $0.62, and we declared $0.44 per share in dividends to shareholders. The net effect was a book value increase of $1.04 during the second quarter to $38.77 per share.

And with that, I'll turn the call back over to Steve.

Steven J. Johnston
Chief Executive Officer, President, Director and President of Cincinnati Life Insurance Company

Thanks, Mike. In closing our prepared remarks, I'll note that our financial strength ratings were affirmed during the second quarter by Fitch Ratings and Standard & Poor's. And S&P now has a positive outlook on our ratings.

The Ward Group also recently announced its annual top 50 property casualty insurers based on 5-year performance, and we are pleased to, again, qualify for that honor.

We appreciate this opportunity to respond to your questions and also look forward to meeting in person with many of you during the remainder of the year.
As a reminder, with Mike and me today are Jack Schiff, Jr., Ken Stecher, J.F. Scherer, Eric Mathews, Marty Mullen and Marty Hollenbeck. Mike, we're ready for you to open the call for questions.

Question and Answer

Operator

[Operator Instructions] The first question is from Bijan Moazami with Guggenheim.

Bijan Moazami
Guggenheim Securities, LLC, Research Division

In some of your product lines, you guys have tremendous amount of reserve releases. For instance, workers' compensation, commercial casualties, specialty package, surplus lines. You've been getting a fair amount of rate increases as well. What I fail to understand is why quarter-over-quarter the accident year loss ratio assumption on these lines of business aren't going up? So is there anything in particular going on? Is there any kind of seasonality or just conservatism?

Steven J. Johnston
Chief Executive Officer, President, Director and President of Cincinnati Life Insurance Company

Bijan, thank you. Good question. I think in terms of seasonality, workers' comp might be one line where there is seasonality. But I guess just in general, our actuaries do a good job, I think, of making the best pick they can for each of the accident years. I think we are prudent in terms of the current accident year in terms that there is more variability involved in those years, and several of those lines that you mentioned were casualty lines so we want to make sure to be respectful of the variability in the current accident years. So I think, I always just want to comment that it's a very consistent approach that we use and that, overall, when we take out the noise, we were pleased to see that the core loss ratio or the core combined ratio when we remove the effects of favorable development and weather improved both for the quarter and for the half year.

Bijan Moazami
Guggenheim Securities, LLC, Research Division

If I look at your lines of business, I guess the only line that had an adverse loss reserve in the Commercial Lines segment was commercial auto. Any types -- I mean [ph] a problem for the industry travelers pointed out that they have problems there, too. Could you walk us through what's going on in there? Is it a frequency issue, severity issue? How you're dealing with it? And should we be expecting a significant improvement in accident to your calendar year loss ratio for that line going forward?

Steven J. Johnston
Chief Executive Officer, President, Director and President of Cincinnati Life Insurance Company

That's a good question, Bijan. And I do think you're right on target in terms of pointing out commercial auto. My feeling is for our company, as we came out of the financial crisis -- during the financial crisis, I think a lot of business activity slowed down. Some business was -- went out of business. And so there was a reduction in business activity, which I think favorably impacted some of that reserving on commercial auto. We released some reserves to reflect that. And I think the -- with the uptick, with the recovery, we were a little slow right off the bat to recognize that in terms of our loss picks. And so I think we're in a little bit of a catch-up mode there. But I do believe that we do need to improve that line, particularly the physical damage side of commercial auto, I think, has been a bit problematic lately. And so we are -- we do assure you that we are working hard to improve that line of business.

Bijan Moazami
Guggenheim Securities, LLC, Research Division

Okay. And one last question on your distribution. Of course, Marsh has been quite aggressive in expanding Marsh agency in making acquisitions, I guess they purchased a number of your agents. Is there any kind of pressure? And I haven't been seeing any of it on your commission pay. But how is that impacting your production, your commission? And what's your outlook in terms of distribution as these agencies are consolidating?

Jacob F. Scherer
Former Chief Insurance Officer

Bijan, this is J.F. Scherer. The question you're asking is are we getting pressure on having to pay higher commissions from -- as a result of those?

Bijan Moazami
Guggenheim Securities, LLC, Research Division

Yes. And are you seeing better production with some of those agencies now that they're owned by the corporate giant?

Jacob F. Scherer
Former Chief Insurance Officer

Relative to commission, our commission levels are really the highest in the industry when you combine base commission with profit-sharing commission. All of the acquirers recognize that. In terms -- and so I would say that no, we really haven't gotten any real pressure to raise commissions. I think they already appreciate the fact that we've -- we're already very generous from that standpoint. To answer your question though in terms of more business as a result of the large, if you will, the giant agencies, the answer really would be no on that. We've -- and that changes from location to location. We've, for the last 15, 18 years, measured our activity level as a result of a lot of the M&A activity that's occurred with banks, brokers, things to that nature. What we see is that the profitability that we enjoyed in the agencies before the merger continues, perhaps even gets a little bit better. However, what we also see is that as you might expect, there's a certain amount of dislocation that occurs when a local agent is purchased, sometimes producers leave. There might be slightly different strategies that the acquirer might want to implement. So we see only a slight, but a slight tail-off in the level of production, generally, when all of these occurs. So nothing that we're seeing now with Marsh agencies. And frankly, all of the other acquirers that are out there is really must different than what we've seen in the past. We do enjoy a great relationship with the management of those organizations. They recognize the value Cincinnati brings. They're interested in Cincinnati agents in large part because, I think, of the partnership that our agencies, and we have enjoyed and it's resulted in a success. So it's a -- they're different, slightly different strategies sometimes with the larger guys, but there are strategies that we're adapting to.

Operator

Our next question is from Paul Newsome with Sandler O'Neill.

Jon Paul Newsome
Sandler O'Neill + Partners, L.P., Research Division

First, an easy one. Do you think the 10-year average is really the right number for us to be looking at for the cat load? And I guess, the -- sort of the piece to that question really is it does seem like we have an upward trend in weather-related losses over the last decade. And if that's the case, then maybe we shouldn't be looking for the 10-year average because that would always be behind the ball.

Steven J. Johnston
Chief Executive Officer, President, Director and President of Cincinnati Life Insurance Company

That's a good question, Paul. I think we put those averages in there just so that you kind of have a baseline, a feel for what's going on. You can look at it by year and so forth. When it comes to the actual pricing that we use, we get more granular than that obviously. And we're using modeled results that we use from either RMS, AIR, both, and I think it has the advantage when you use the modeled results that you can take your current book of business where it's located today and run the tens of thousands of scenarios of possible storms to get a good estimate or at least the best estimate of what we feel the catastrophe losses are. I will say that in areas where we have faced severe convective storm losses, and sometimes we'll judgmentally view that the models are a little bit too low or a little bit too favorable, and we'll also look at our more recent experience and adjust our estimate accordingly. And when it comes right down to it, rate-making pricing is prospective. And so we're just doing our best bet to make our best estimate of what we think the cat losses, the weather losses will be in the upcoming rate period and then price for it accordingly.

Jon Paul Newsome
Sandler O'Neill + Partners, L.P., Research Division

So are you in the camp of like, Travelers, for example, has been very vocal about the view that it's just getting worse? And are you taking a much more -- are you taking a different approach?

Steven J. Johnston
Chief Executive Officer, President, Director and President of Cincinnati Life Insurance Company

I'm not as familiar with Travelers' approach. But in terms of ours, we're just trying to do our best to estimate what we feel the losses will be in the prospective period. I know for homeowners, the weather percentage that we use is about 26 loss ratio points. And we just feel based on all the information, whether it will be modeled looking at our own experience, that's the best estimate for us.

Jacob F. Scherer
Former Chief Insurance Officer

Paul, this is J.F. I guess, I might add that relative to underwriting actions though, I mean we've recognized -- and 2011 was a particularly bad year for us. 2013 was a really good year. So there's a lot of -- has been a lot of volatility even within the last 5. But in addition to what Steve mentioned on rate-making relative to underwriting actions that we're taking, we're approaching it from an underwriting standpoint, which just makes sense as though the hailstorms that are more prevalent with larger hailstones landing at higher speeds, tornadoes, things of that nature, would continue. So relative to the actions we've taken, for example, in Personal Lines to make sure that we're insuring roofs that are more substantial. Same would be true for Commercial Lines. We're pushing percentage wind and hail deductibles. We're inspecting more buildings. We're inspecting more roofs. We're taking a much more aggressive approach from an underwriting standpoint, not necessarily from a pricing standpoint, to anticipate the possibility that, that kind of weather could continue.

Jon Paul Newsome
Sandler O'Neill + Partners, L.P., Research Division

Putting aside the weather-related or normalizing for weather, are we at the place still where rates are exceeding what you believe is the underlying cranes [ph] inflation?

Steven J. Johnston
Chief Executive Officer, President, Director and President of Cincinnati Life Insurance Company

This is Steve. And yes, I believe we're at that point. I think as the market is competitive that, that gap may be narrowing a bit. But I do feel that we are exceeding our loss cost trend with our premium increases. I think just as important, maybe more so, is the work that we're doing on segmentation and making sure to go policy by policy to feel that we're getting the appropriate rate for the next risk that we write no matter where it is and that we consider all the rate-making forecast that we do, all the underwriting actions that J.F. mentioned and more. And so we feel that we are continuing to make progress, continuing to make improvement and expect for that to continue.

Operator

The next question is from Josh Shanker with Deutsche Bank.

Joshua David Shanker
Deutsche Bank AG, Research Division

I wonder if you can give me some regional perspective on where you're seeing the greatest growth in your business, where you're you seeing the toughest competition and where you expect the best opportunities are for you in the next 24 months.

Jacob F. Scherer

Former Chief Insurance Officer

Josh, taking a look at our new business activity across the country, I can't say that there's any one particular area that's either any more or less competitive than others. I think breaking it down in the Midwest, South and Southeast for that matter, despite what you read in terms of property rates going down, we see, still see, quite a firmness in property rates, and I think it's a direct result of the storms and the weather activity. I think all carriers are recognizing that. We're continuing to push for growth, and it is improved growth out West and in less cat-prone areas. So that's where the area of focus is. Now having said that, our most profitable state is Ohio. And so we like to write business here, and so we'll look to grow in Ohio. But we are working on much more aggressive geographic diversification. By way of commentary on new business, it is more competitive than it has been. I think what we would recognize is that, as Steve mentioned in his remarks, that there are fewer, I guess you might call layouts, really good account that are being shopped. Last year this time, there were still carriers announcing their desire for across the board fairly significant increases that drove a lot of shopping in the marketplace of all accounts, not just underpriced accounts and as a result, there are more opportunities for us. We're seeing interestingly enough a bit more aggressiveness from the marketplace in workers' comp, which is an odd line of business to get aggressive about, at least from our viewpoint, it is. So we do see that. Our new business is holding up with the exception of workers' comp, and that's mainly due to what I just mentioned and the fact that we've written some a bit fewer larger accounts in comp. Commercial auto for us, those 2 lines really is what drove the lack of growth in new business for us. If you take the package business, we're basically flat, but very pleased with the -- still the opportunities that we're getting. We just have to be more careful about what we get. More scrutiny, more inspections, more loss control, leveraging the predictive models and the analytics that we have. And we're comfortable that we're going to be able to continue to grow where we want to grow.

Joshua David Shanker
Deutsche Bank AG, Research Division

That's very helpful. When you said that Ohio is your most profitable state, do you mean by margin or by dollar volume?

Steven J. Johnston
Chief Executive Officer, President, Director and President of Cincinnati Life Insurance Company

It would be both.

Operator

The next question is from Vincent DeAugustino with KBW.

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

One of the things that I guess I noticed on your website here more recently is that you had a blog post about some vacant adjacent building fires in the Commercial Lines side. I think you posted that last week. And then to that point, a few of your peers have commented on elevated fire losses this quarter. And if I kind of go step further, I'm seeing some elevated Commercial Lines, large loss activity in both the greater than $500,000 and then the $1 million to $5 million buckets. I'm kind of curious between strangulating on those 3 observations if you guys have might have had some elevated commercial fire losses as well?

Martin J. Mullen
Chief Claims Officer of the Cincinnati Insurance Co. and Senior VP of the Cincinnati Insurance Co.

Thanks, Vincent. This is Marty Mullen. You're absolutely correct. Our second quarter kind of mimics some of the other peers in the industry as far as increased and large losses. We saw the same in commercial fire and actually commercial auto losses. A review of those losses don't indicate any exact trends in lines of business or territories kind of spread out across our footprint. As you might guess, the frequency hit more of our larger states of Ohio, Pennsylvania and Indiana. But it's a unique quarter for large losses, but we've seen it both in commercial auto and commercial property. And frequency was up in both.

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

Okay. That's good to know. And then since we're on commercial auto, clearly, this has been a line that's been giving industry a lot of trouble and it dumped. I guess for me, it doesn't feel like it's purely medical in part because I guess I would expect to see maybe similar pressure on workers' comp medical. So I'm just curious if the factors facing commercial auto -- just what those factors are that you're tackling on the claims side? And then generally, is there's anything noteworthy that would be helpful, I guess for us, in understanding, how long this drags out? Because at the same time, we're seeing some of your competitors simply back away from the line. And to me, that would imply that this really isn't a quick fix rate problem. So I'm just curious on any thoughts that you might have on auto.

Michael J. Sewell
Chief Financial Officer, Senior Vice President and Treasurer

I'll just make a comment in regards to the claim question there, Vincent. On the claims side, I think you're right. It's not so much of a medical spend issue. It's the types of vehicles on the road and the types impact in collisions driving the severity issues. I do think there's a lot to be gained by the underwriting and commercial auto piece on the MVR on drivers and knowing what your business make up is. If the economy has come back, we need to make sure that the drivers being hired have the best MVRs and so forth. So I think there's a lot to be done on the claims and the loss control piece of the commercial auto. And I know J.F. has commented before about our focus on that very respect of it.

Jacob F. Scherer
Former Chief Insurance Officer

Yes. Vincent, this is J.F. Just go along with Marty's comments. Certainly, we're pushing rate, but we're also doing a lot of work on just making sure that the vehicles in our fleet are properly classified. Marty mentioned heavier trucks, for example, being out more. And the business and the economy is improving, contractors, for example. More trucks out there, heavier trucks that got a little bit more work. And that's confirmed by our increase in our audits, our payrolls and sales for the company. But in addition to rate, we're doing more in loss control, and we're also verifying classification of vehicles, making certain that in the physical damage side of things, that we've got the correct cost news on vehicles, the correct gross vehicle, weight of the vehicles and then going back to the agencies and verifying the usage of the vehicles and the radius of operation. It's basically Insurance 101 there. There's nothing unusual about it, but what we see is that there's more -- a lot of room for improvement in those areas.

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

Okay. And then I just had one last one. Just on the ongoing discussion of rates. I mean, I think we tend to be a little too myopic at times. But -- so just in the sequential change from first quarter, just as we think about that in -- over the last few quarters for that matter, I'm just curious if there's been any change in, I guess, the bid-ask spread between what you're kind of asking for, and what's you're actually getting from a rate increase standpoint. Just I guess, help us understand if most of the change here is just because more accounts are hitting target hurdles, and that just shifts your focus to retaining those profitable accounts. Just to get some color on the dynamic.

Steven J. Johnston
Chief Executive Officer, President, Director and President of Cincinnati Life Insurance Company

I think it would be the latter. No, I can't -- I don't have the total metrics to dispute that first point in terms of the bid-ask. But in terms of the way we feel about it, we feel that we have been making improvement, that we have been not only getting ready ahead of loss cost trend, but we've been retaining the ones that we want and that we have been getting more increase or shedding those that we want as well, particularly with workers' compensation. I'd say that would be kind of a shining star in that regard in terms of working both. The overall rate increase and the segmentation and all the other attributes, the other parts of underwriting inspection claims, the whole team approach, I think has been working pretty well in workers' compensation.

Jacob F. Scherer
Former Chief Insurance Officer

Yes, Vincent, I guess -- this is J.F. I would stress that the conversation here isn't -- and you mentioned myopic, it isn't just about rate increase, and I just confirming what said Steve said about the bigger picture of how we're trying to underwrite every single account case by case. Most important thing we can do is make an informed decision. And you can rely on the model in a lot of cases. But there's so many attributes of the risk that if you're not up-to-date on them, if they're not -- if the buildings haven't been reinspected, if we're not 100% certain about rent rules on tenant-occupied buildings, or whether or not a contractor now that's enjoying some success is getting into areas of construction that they hadn't been before. Those are all equally important. And you can't attack the problem with rate alone. It just -- it won't work, and so we're-- we've got a multi-faceted approach to things. We're working pretty good right now.

Operator

The next question is from Scott Heleniak with RBC Capital Markets.

Scott Gregory Heleniak
RBC Capital Markets, LLC, Research Division

Yes, reinsurance against [ph] prices are continuing to decline. Just -- obviously, there's an opportunity for your savings or better terms and conditions. And just wondering if you guys can just kind of give us an update on your reinsurance buying strategy, how you see that playing out? Obviously, it's more favorable for primary cares like Cincinnati. But if you have any thoughts on where you kind of see the heading for you guys?

Jacob F. Scherer
Former Chief Insurance Officer

Well, this is J.F. Most of our treaties are all January 1 renewals. And I think we've mentioned maybe on the last conference call that we did enjoy some reasonable savings there. It was -- would be in line with what you're reading in the marketplace. So really, we're just in the process of beginning our discussions with our reinsurers. And then also cat cover guys, we're very fortunate in that last year, we did raise our retention from $7 million to $8 million on a pro-risk basis that's part of the strategy. We've been very fortunate in that we really haven't given any losses to our reinsurers. So I think they'll be pleased with, knock on wood, that, that will continue for the rest of the year. We read the same things you do, although we haven't had any negotiations with anyone about the fact that rates continue to go down. Our cat bond was placed last year. We were pleased with the pricing that we got on that. Once again, no losses have been ceded there. So I suspect we'll go into the negotiations this fall as a continued desirable client for all of our reinsurers. And we would hope to enjoy, for them and us, fair pricing, whatever that may turn out to be.

Scott Gregory Heleniak
RBC Capital Markets, LLC, Research Division

Okay. That's helpful. Just -- I know this was covered a little bit on Q1. The expense ratio was down, I think 60 basis points in the first quarter, was down 150 or so in the second quarter. And I'm just wondering if that kind of 30% to 31% range, is that sustainable for the second half of the year, that kind of improvement?

Michael J. Sewell
Chief Financial Officer, Senior Vice President and Treasurer

This is Mike Sewell. That's probably going to be my favorite topic. So we were very pleased with the movement in the expense ratio. We'll have to kind of wait and see how the rest of the year holds up. Some of what's causing the betterment there is the profit-sharing commission that we accrued for during the year related to the business with our combined ratio being up a little bit, the profit-sharing commission will be down a little bit. So we'll have to wait and see how the rest of the year pans out with that. But one thing that will stay -- you'll see the trend continue is that we are -- expenses, other expenses other than commissions are increasing, but we're increasing it at a moderate rate that is below the increase in premium. So we do monitor the expenses, have controls over it. And so I think as we continue through the rest of the year, premiums will outrun other expenses. I think the ratio will stay low, but let's watch the combined ratio and what the effects of our profit-sharing may be. It may be up a couple of tenths of a point, but it's not -- I don't think it's going to be matching the prior year.

Scott Gregory Heleniak
RBC Capital Markets, LLC, Research Division

Okay. And then just one other quick numbers question. You guys mentioned the Q3 '13, the premium impact from -- because that premiums were processed but not reported. And I was wondering if you had a dollar amount on what that -- what you estimate that might have been for Q3 last year?

Michael J. Sewell
Chief Financial Officer, Senior Vice President and Treasurer

Yes, here's -- yes, yes, that's a great question. And at times, it can be really difficult to judge 1 quarter written premium growth rate without thinking about the entire year. There could be some seasonality, timing of large policies written versus typical small commercial policies or other effects that can cause a premium to spike or dip in a given quarter. Now in the prior year third quarter, we experienced a written premium spike that was then really offset by a written premium dip in the fourth quarter, and you can actually see that on Page 17 of the supplemental financial data. But on a consolidated basis, written premiums for the third quarter of 2013 was $1,031,000,000 followed by a fourth quarter 2013 of $908 million. Now the average of those 2 periods is consistent with the first 2 individual quarters of 2013. So as we go into the third quarter of 2014 for written premiums, it will be a challenge to have a double-digit growth when compared to the prior year period. But there should be an opposite effect when we report the fourth quarter of 2014. So all this being said, and sorry for being a little long-winded here, but you will not see this movement in earned premiums as written premiums are earned over time, which can take up some of those spikes and dips.

Scott Gregory Heleniak
RBC Capital Markets, LLC, Research Division

All right. Okay. Just timing issue. So -- but you did say it will be challenge for them to be up year-over-year, right? Commercial lines, is that what you said?

Michael J. Sewell
Chief Financial Officer, Senior Vice President and Treasurer

Yes, that would be correct. But then when you look at the fourth quarter, we likely will be a very good comparison this year to the fourth quarter last year once you take out the spike and the dip.

Operator

[Operator Instructions] The next question is from Mike Zaremski with Balyensy (sic) [Balyasny].

Michael Zaremski

One question. As you guys continue deploying more sophisticated and thorough underwriting techniques and processes, is there any, I guess, subsequent change in the actual actuarial reserving process?

Steven J. Johnston
Chief Executive Officer, President, Director and President of Cincinnati Life Insurance Company

All those things would be considered. I think we are a little bit from Missouri in that regard, in that we tend to take a prudent wait-and-see approach to make sure that underwriting action that is described and that we feel would work. I still believe there's a little bit of a wait and see to make sure that we start to see it in the numbers. I just think that's consistent with our prudent reserving approach.

Operator

The next question is from Fred Nelson with Crowell, Weedon.

Fred Nelson
Crowell, Weedon & Co.

The Insurance Commission here in California said that the insurance companies are raising premiums and he wants more control over that increase in the premiums. I'm wondering, as a political risk, are you seeing anything across the country that matches the insurance commissioner in California?

Steven J. Johnston
Chief Executive Officer, President, Director and President of Cincinnati Life Insurance Company

Thanks, Fred. This is Steve. Good question. We're not active in California, but we do -- we are active in 39 states. Each state is a little bit different. We love state regulation, by the way, because that way the risk is kind of spread across 39 insurance departments. We feel very fortunate here in Ohio, our domiciliary state, to have a very good insurance regulation. We think that really results in great competition, which keeps the environment competitive, the rates competitive. And so all of our states vary a little bit, but I would say that we would not describe regulation at this point to be an issue and that we are supportive of state regulation.

Operator

There are no further questions at this time. I will turn the call back over to the presenters.

Steven J. Johnston
Chief Executive Officer, President, Director and President of Cincinnati Life Insurance Company

Okay. Thank you for joining us today. We look forward to speaking with you again on our third quarter call.

Operator
This concludes today's conference call. You may now disconnect.