S&P Global
Market Intelligence

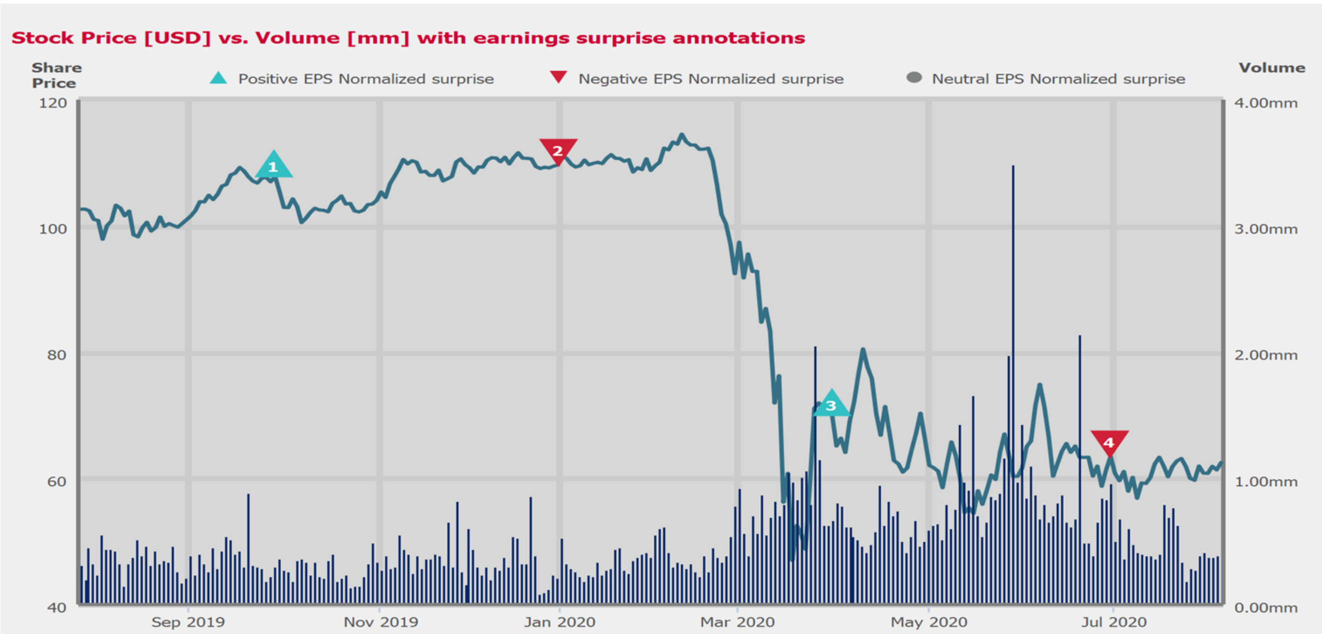
American Financial Group, Inc. NYSE:AFG
FQ2 2020 Earnings Call Transcripts

Wednesday, August 05, 2020 3:30 PM GMT

S&P Global Market Intelligence Estimates

	-FQ2 2020-			-FQ3 2020-	-FY 2020-	-FY 2021-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	1.34	1.05	▼ (21.64 %)	1.48	6.87	NA
Revenue (mm)	1301.00	1184.00	▼ (8.99 %)	1274.00	4756.00	NA

Currency: USD
Consensus as of Aug-05-2020 9:45 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ3 2019	2.00	2.25	▲1 12.50 %
FQ4 2019	2.26	2.22	▼2 (1.77 %)
FQ1 2020	1.85	1.88	▲3 1.62 %
FQ2 2020	1.34	1.05	▼4 (21.64 %)

Table of Contents

Call Participants

EXECUTIVES

Brian S. Hertzman
Senior VP & CFO

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

Diane P. Weidner
Vice President of Investor & Media Relations

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

ANALYSTS

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

Jon Paul Newsome
Piper Sandler & Co., Research Division

Ronald Paul McIntosh
Lomas Capital Management, LLC

Presentation

Operator

Ladies and gentlemen, thank you for standing by and welcome to American Financial Group's 2020 Second Quarter Results. [Operator Instructions] Please be advised that today's conference is being recorded. [Operator Instructions]

I would now like to hand the conference over to your speaker for today, Diane Weidner, Vice President, Investor Relations. You may begin.

Diane P. Weidner
Vice President of Investor & Media Relations

Thank you, Towanda. Good morning, and welcome to American Financial Group's Second Quarter 2020 Earnings Results Conference Call. We hope you and your loved ones are healthy and safe as we continue to navigate the challenges of the pandemic.

We released our 2020 second quarter results yesterday afternoon. Our press release, investor supplement and webcast presentation are posted on AFG's website under the Investor Relations section. These materials will be referenced during portions of today's call.

I'm joined this morning by Carl Lindner III; and Craig Lindner, Co-CEOs of American Financial Group; and Brian Hertzman, AFG Vice President and Controller.

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

We may include references to core net operating earnings, a non-GAAP financial measure in our remarks or responses to questions. A reconciliation of net earnings attributable to shareholders to core net operating earnings is included in our earnings release. If you're reading a transcript of this call, please note that it may not be authorized or reviewed for accuracy. And as a result, it may contain factual or transcription errors that could materially alter the intent or meaning of our statements.

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

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

Good morning. We're pleased to share highlights of AFG's 2020 second quarter results and respond to your questions. Since we reported our first quarter results in May, we have had the opportunity to more thoroughly understand the impact of the COVID-19 pandemic on our business, our insurance industry, the financial markets and the global economy. Our thoughts and prayers remain with all those affected by the virus and the individuals caring for them. These exceptionally challenging circumstances have highlighted the resiliency and commitment of our AFG employees who are the foundation of our success. Our comprehensive business continuity plans, coupled with flexible and effective workplace policies and practices have enabled us to focus on providing the secure, trusted service and support on which our agents and policyholders rely, while keeping the well-being of our employees as our top priority.

Craig and I continue to be pleased with AFG's strong financial position. We have the liquidity and excess capital that afford us the flexibility to effectively address and respond to the uncertainties presented by COVID-19 as well as the ability to act on business opportunities.

Now I'd like to turn to an overview of our second quarter results on Slide 4 of our webcast. AFG reported second quarter core net operating earnings, excluding losses from alternative investments, of $1.53 per share, a decrease of $0.13 per share from the comparable period in 2019. Core net operating earnings were $1.05 per share in the second quarter and included a $44 million loss or $0.48 per share on AFG's $2.2 billion portfolio of alternative investments, which are marked-to-market through core operating earnings. This compares to $41 million in earnings or $0.46 per share in the

2019 second quarter. The returns on these investments reflect the widespread financial and economic impacts of the COVID-19 pandemic and a significant decrease in both the equity and credit markets in the first quarter. The returns on these investments are typically recorded on a quarter lag.

Our second quarter 2020 core operating earnings included approximately $85 million or $0.75 per share in losses for claims reserves and IBNR designated for estimated COVID-19-related losses. These losses are reported separately from our cat losses.

Turning to Slide 5. You'll see that the second quarter 2020 net earnings per share of $1.97 included after-tax noncore items aggregating $0.92 per share. Last quarter, we provided full year 2020 core net operating earnings per share guidance, excluding earnings or losses from alternative investments due to the uncertainty of the implications of COVID-19 and a resulting volatility in the financial markets.

Based on results through the first 6 months of the year, AFG now expects its 2020 core net operating earnings per share, excluding alternative investments, to be in the range of $6.60 to $7.40, an increase of $0.15 a share from the midpoint of our previous guidance. Craig and I will discuss our guidance for each segment of our business in more detail later in the call.

We're very pleased with the performance of our core operating businesses during the second quarter of 2020 amid the challenges presented by the COVID-19 pandemic. We believe our underlying results demonstrate the strength of our portfolio of diversified specialty insurance businesses and the contributions of our exceptional employees. We thank God, our talented management team and our employees for helping to achieve these results.

Now I'd like to turn our focus to our property and casualty operations. Please turn to Slide 6 and 7 of the webcast, which include an overview of second quarter results. Our Specialty Property and Casualty Group performed exceptionally well during the quarter, with excellent underwriting margins and very strong renewal pricing that's exceeding our expectations. As you'll see on Slide 6, gross and net written premiums were down 8% and 11%, respectively, when compared to the second quarter of 2019, primarily as a result of the runoff of Neon. Excluding the impact of the Neon runoff, the gross written premiums were up 2%, and net written premiums decreased 1% year-over-year. Core operating earnings in the AFG's property and casualty insurance operations, excluding alternative investments, was $129 million in the second quarter of 2020 compared to $152 million in the prior year period, a decrease of 15%. Lower property and casualty net investment income was the driver of the lower year-over-year earnings.

The Specialty Property and Casualty Insurance operations generated an underwriting profit of $54 million in the 2020 second quarter compared to $60 million in the second quarter of 2019. Higher underwriting profitability in our Property and Transportation Group was more than offset by lower underwriting profits in our Specialty Casualty and Specialty Financial groups. The second quarter 2020 combined ratio of 95.2% benefited from 7.6 points of favorable prior year reserve development, while catastrophe losses added 2.3 points. In addition to catastrophes, losses attributed to COVID-19 added 7.6 points to the combined ratio for the second quarter of 2020.

We continue to carefully monitor claims and loss trends related to the COVID-19 pandemic. Numerous legislative and regulatory actions as well as the specifics of each claim contribute to a highly fluid evolving situation. Year-to-date, we've recorded approximately $95 million in COVID-19-related losses, approximately 90% of which established reserves for claims that have been incurred but not reported. Given the uncertainty surrounding the ultimate number and/or scope of claims related to the pandemic and the changing economy, these charges represent the company's current best estimate of losses from the pandemic and related economic disruption. Our claims professionals and those who support them are working tirelessly to review claims with care and attention each deserves.

Like other insurers, we have received confirmation of subrogation benefits in connection with the PG&E bankruptcy and the 2017 and '18 Northern California wildfires. Our gross recovery was in line with expectations. AFG expects to record approximately $8 million in benefits pertaining to these recoveries in our third quarter results.

Turning to pricing. We continue to see exceptionally strong renewal rate momentum. In fact, our average renewal rate increases year-to-date are the highest that we've achieved in over 15 years. Average renewal pricing across our entire property and casualty group was up approximately 9% for the quarter. And if you exclude our workers' comp business, renewal pricing was up approximately 13% in the third quarter. Both measures reflect an improvement from rates achieved in the first quarter.

Now I'd like to turn to Slide 7 to review a few highlights from each of our Specialty Property and Casualty business groups. The Property and Transportation Group reported an underwriting profit of $33 million in the second quarter of 2020, primarily the result of higher favorable prior year reserve development in our transportation businesses. Results were adversely impacted by $15 million of catastrophe losses in the quarter in addition to $3 million of COVID-19-related losses. We continue to be very pleased with the profitability in our transportation businesses.

Crop year is shaping up nicely. Crop conditions are very favorable and significantly improved our conditions last year at this time with industry reports of 72% of corn and 73% of soybean crops in good excellent condition. Current yield projections for both are slightly above their respective yield trends, which has put some pressure on both corn and soybean pricing. Commodity futures for corn and soybeans are approximately 17.5% and 4% lower, respectively, than the spring discovery prices. While pricing is currently within acceptable ranges, we're closely monitoring the corn commodity pricing, in particular.

Second quarter 2020 gross and net written premiums in this group were 6% and 1% higher, respectively, than the comparable prior year period. The late acreage reporting from insureds adversely impacted crop premiums in the second quarter of last year. Excluding crop insurance, 2020 gross and net written premiums in this group decreased by 3% and 5%, respectively, when compared to the 2019 second quarter. Decreases in premiums due to return of premiums and reduced exposures as a result of COVID-19 were partially offset by new business opportunities in our transportation, cropping and inland marine and ocean marine businesses. Overall, renewal rates in this group increased 7% on average in the 2020 second quarter, an improvement from renewal rate increases achieved in the first quarter of 2020.

I'm especially pleased with the rate strengthening in commercial auto liability, aviation and in our Singapore branch, all of which continue to achieve substantial increases.

Our underwriting profits in our Specialty Casualty Group were lower year-over-year and were adversely impacted by $52 million in COVID-19-related losses, primarily in our workers' compensation and executive liability businesses. These losses, in addition to lower year-over-year underwriting profits in our alternative markets and social services business were partially offset by higher favorable prior year reserve development, higher profitability in our excess and surplus and excess liability businesses and the impact of underwriting losses at Neon in the second quarter of last year.

I'm really pleased with the improved market conditions in our excess and surplus lines and excess liability businesses, which have achieved significant renewal rate increases and acted on new business opportunity as the markets harden. Gross and net written premiums in this group for the second quarter of 2020 decreased primarily due to the runoff of Neon. If you exclude the impact of Neon, gross written premiums increased 2% and net written premiums decreased by 5% in the second quarter of 2020 when compared to the same period in 2019.

The COVID-19 pandemic has resulted in lower payrolls in our workers' compensation businesses, which when coupled with renewal rate decreases, significantly impacted premiums. Now gross and net written premiums in this group, when excluding both Neon and workers' comp, grew by 9% and 2%, respectively. Renewal pricing for this group was up 12% in the second quarter. And excluding our workers' comp businesses, renewal rates in this group were up 21%, an improvement from the rates achieved in the first quarter.

Now turning to Specialty Financial. Specialty Financial Group results for the second quarter of 2020 included COVID-19-related losses of $30 million, primarily related to trade credit insurance. Second quarter 2020 gross and net written premiums were both down 7% when compared to the prior year period. Lower premiums in our financial institutions business, which resulted from the impact of various state regulations regarding moratoria on policy cancellations and the placement of force coverage in our financial institutions businesses. Renewal pricing in this group was up approximately 6% for the quarter and an improvement for the first quarter -- from the first quarter of 2020.

Now if you would turn to Slide 8 with me for a summary view of our 2020 outlook for the Specialty Property and Casualty operations. In light of the challenges and uncertainties presented by the COVID-19 pandemic, we've conducted a detailed review of our expectations and other key financial and operating items for each of our Specialty Property and Casualty businesses. Based on our results for the first 6 months of the year and our current expectations of the impact of COVID-19, we now expect property and casualty pretax core operating earnings, excluding the impact of alternative investments, in the range of $615 million to $675 million. This guidance is $15 million lower than the midpoint of our previous guidance and reflects an equal measure of lower expected underwriting profitability based on reported pandemic losses and lower expected property and casualty net investment income. We continue to expect the 2020 combined ratio for the Specialty Property and Casualty Group overall between 92% and 94%.

Our revised premium guidance overall and within each of our specialty subsegments reflects an improved outlook from our previous guidance. Excluding the impact of the Neon runoff, we expect net written premiums to be 4% lower to 2% higher than our prior year results. And if we exclude Neon and workers' compensation, we expect net written premiums to be 2% lower to 4% higher than what we reported in 2019.

You'll see on the slide that we adjusted our combined operating ratio and premium guidance within each of our Specialty Property and Casualty subsegments to reflect our most current view of the impact of the COVID-19 pandemic. The estimate for the combined operating ratio in our Property and Transportation Group improved 2 points, and we've increased our premium expectations. We have increased our combined operating ratio guidance in our Specialty Casualty and Specialty Financial groups to reflect the estimated impact of COVID-19. Given the uncertainties of the implications of COVID-19 and the resulting volatility in the financial markets, we're not providing guidance for property and casualty net investment income. And based on the results through the end of June, we'd expect overall property and casualty renewal pricing in 2020 to be up 7% to 10%, an improvement from the range of 5% to 8% estimated previously. And excluding workers' comp, we expect renewal rate increases to be in the range of 10% to 13%, an increase from the range of 8% to 11% estimated previously.

Thank you. And now I'll turn the discussion over to Craig to review the results in our Annuity segment and AFG's investment performance.

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

Thank you, Carl. I'll start with a review of our annuity results for the second quarter beginning on Slide 9. The gross statutory annuity premiums were $687 million in the second quarter of 2020 compared to $1.35 billion in the second quarter of 2019, a decrease of 49%. Annuity sales were lower in all channels in the 2020 second quarter as a result of stay-at-home orders and other factors related to the COVID-19 pandemic that significantly impacted our access to distribution partners as well as their access to current and prospective clients.

Turning to Slide 10. You'll see the components of pretax annuity core operating earnings. Second quarter 2020 pretax annuity core operating earnings, excluding alternative investments, increased by 12% year-over-year. There were several factors contributing to the improved results, including growth in annuity assets, higher-than-expected persistency, lower-than-expected expenses related to guaranteed benefits, a strong market and a reduction in the cost of funds. These favorable items, which include items that may not necessarily recur were partially offset by a decline in investment returns. We believe these results demonstrate the strong fundamentals of our Annuity business.

The financial and economic implications of COVID-19 adversely impacted the returns on the Annuity segment's $1.3 billion of alternative investments during the second quarter of 2020. Although the return on these investments was a negative 3% in 2020, the cumulative return on these investments over the past 5 calendar years has been nearly 10%.

Turning to Slide 11. You'll see AFG's quarterly average annuity investments and reserves grew approximately 7% and 6%, respectively, year-over-year. On the bottom half of the slide, you'll see information about our annuity spreads, starting with our net interest spread, which takes into account our cost of funds. In the second quarter of 2020, our cost of funds and other benefit expenses was 253 basis points, which included amortization of bonuses and accretion of withdrawal benefit reserves. In the first quarter of this year, we began taking more proactive measures in adjusting renewal rates, particularly on those products near the end or out of the surrender charge period.

For fixed indexed annuities, these adjustments occur on the policy anniversary. So we'll continue to see our cost of funds come down over the next several quarters as a result of these adjustments. We believe it's difficult to compare cost of funds between different companies because the presentations are not consistent. For example, AFG's cost of funds in the second quarter of 2020 included 6 basis points for the cost of bonuses and the cost of guaranteed withdrawal benefits. These items are not consistently reported as a component of cost of funds by others in the industry. We have noted that companies that sell significant amounts of products with bonuses and guaranteed benefits that do not include a charge for these features and their cost of funds or net interest spread calculations. We believe these costs could be as high as 50 to 100 basis points in some cases. As a result, this can create an unrealistic picture of the cost of generating business and make comparisons difficult between annuity providers particularly when comparing AFG to companies whose business model relies on high commissions or upfront bonuses to generate sales.

While net interest spread is an important financial measure for annuity companies, we believe that a helpful measure for investors to consider is return on equity. The Annuity segment's operating returns on equity exceeded 12% in 2018 and 2019. Looking forward, as the returns on our annuity investments normalize, we would expect to produce returns at that level.

Please turn to Slide 12 for a summary of the 2020 outlook for the Annuity segment. While AFG continues to expect an attractive return on its alternative investments over the long term, due to ongoing volatility and uncertainty, it's difficult to forecast these returns for the remainder of 2020. Pretax annuity core operating earnings, excluding earnings from alternative investments, are expected to be in the range of $300 million to $320 million, an increase from our most recent guidance of $280 million to $310 million. By comparison, Annuity core operating earnings, excluding alternative investments, were $298 million in 2019. Our guidance reflects the continued impact of low short-term interest rates on the Annuity segment's approximately [Audio Gap] of net investment in cash and floating rate securities. We began more aggressive renewal actions with policies renewing in April. Once fully implemented, over 12 months, we estimate annualized savings of $35 million to $50 million depending on surrender activity, the equivalent to reducing our overall cost of funds by 8 to 12 basis points. Our guidance also assumes that the stock market and longer-term interest rates remain relatively flat for the balance of 2020.

As we noted when we announced our first quarter results, we anticipated a significant impact on annuity sales in the second quarter. This trend has continued into the third quarter. Despite the slowdown in sales, AFG's average annuity investments grew more than 7% over the comparable period -- comparable prior year period. And average annuity reserves grew by more than 6%. Our current estimate is that 2020 gross annuity sales will be between $3.4 billion and $3.9 billion and result in growth in average investments and reserves of 5% to 7% in 2020.

In addition to our strong capital position and our strong underlying fundamentals, we have the ability to lower credited rates on $32 billion of annuity reserves by an average of 114 basis points, giving us a great deal of flexibility and helping us manage returns on our inforce business. Furthermore, as a result of prudent pricing, AFG has sold fewer annuities with guaranteed living benefits than many of its peers. Earlier this year, we suspended sales of riders to afford us the opportunity to revise the terms to reflect the current interest rate and equity market environment.

At June 30, 2020, only about 12% of AFG's annuity reserves contained these guarantees, which is about half the industry average resulting in lower risk and earnings volatility arising from decreases in interest rates and the stock market.

Please turn to Slide 13 for a few highlights regarding our $56.7 billion investment portfolio. AFG recorded second quarter 2020 net realized gains on securities of $161 million after-tax and after deferred acquisition costs. This compares to realized gains on securities of $45 million in the second quarter of 2019. Approximately $124 million of the realized gains recorded in the second quarter of 2020 pertained to equity securities that AFG continued to hold at June 30, 2020.

As of June 30, 2020, pretax, pre-DAC unrealized gains on AFG's fixed maturity portfolio were $2.4 billion, the highest in AFG's history and an increase of $2.3 billion since the end of the first quarter. We believe our investment portfolio is appropriately positioned for this uncertain economic environment.

As you can see on Slide 14, our portfolio continues to be high quality, with 90% of our fixed maturity portfolio rated investment grade. In addition, the percentage of fixed maturity investments rated noninvestment grade by the National Association of Insurance Commissioners remains at less than 3% of the total fixed maturity investments at June 30, 2020, and was lower than the percentage at March 31, 2020. Last quarter, we added information to our investor supplement with more details about our fixed maturity portfolio, including NAIC ratings and detail on our industry exposures within our corporate bond portfolio. We also included information about our asset-backed securities portfolio by collateral type and rating. This quarter, we added an additional page to our investor supplement that highlights our real estate-related investments.

We're extremely pleased with the performance of our portfolio of multifamily investment properties. Through June 30, these properties reported occupancy rates of approximately 95% and collection rates of approximately 98%. Our portfolio is geographically diversified. We do not own any properties in the large metropolitan areas that have been identified as most at risk from lifestyle changes resulting from the pandemic.

Our mortgage portfolio has also performed well throughout the pandemic with only 7 loans with a total principal balance of $193 million or approximately 13% of our portfolio being currently subject to forbearance agreements. We believe these loans are adequately collateralized and expect full repayment. We believe these additional exhibits highlight the high-quality of our investment portfolio.

I'd like to take a moment to highlight AFG's financial position and share a few comments about capital and liquidity. On Slide 15, you'll find a summary of AFG's financial position at June 30, 2020. We expect to continue to have significant excess capital and liquidity throughout 2020 and beyond. Specifically, our insurance subsidiaries are project to have capital in excess of levels expected by ratings agencies in order to maintain their high current ratings, and we have no debt maturities before 2026. We returned $41 million to our shareholders in the second quarter with the payment of our regular quarterly dividend. We repurchased $76 million of AFG common stock during the quarter at an average price per share of $63.71.

Share repurchases, especially when executed at attractive valuations, are an important and effective component of our capital management strategy. Parent cash was $500 million at the end of the second quarter and AFG maintains an undrawn $500 million credit facility. Our excess capital stood at approximately $850 million at June 30, 2020.

I'd like to take this opportunity to introduce Brian Hertzman, AFG Vice President and Controller, who has been appointed to serve in the interim role of Principal Financial and Accounting Officer. He has served as Vice President since 2014 and controller since 2012. Brian, thanks for joining us this morning. I will now turn the discussion over to Brian, who will walk through the components of our excess capital calculation.

Brian S. Hertzman
Senior VP & CFO

Thank you, Craig. Please turn to Slide 16. Here at AFG, we define excess capital as a sum of holding company cash, excess capital within our insurance subsidiaries and borrowing capacity up to a 22% debt to total adjusted capital ratio. For purposes of this calculation, subordinated or hybrid debt, which has preferred stock type features is excluded from debt and our debt-to-capital calculation. In calculating insurance company excess capital we use the most stringent rating agency capital model among Moody's, which is based on the NAIC's model, Standard & Poor's and A.M. Best. For our Property and Casualty business, the most stringent model is S&P. Here, we measure capital in excess of what is required to maintain an A+ S&P rating.

For our Annuity business, excess capital is based on the Moody's or NAIC capital requirements. Here, we measure capital in excess of what's required for a 375% risk-based capital ratio. This target is based on Moody's indication that a ratio at this level or higher is a factor that could lead to an upgrade for our annuity companies. It also provides a sizable cushion over Moody's indication that RBC ratio of less than 325% could lead to a downgrade.

RBC targets vary by annuity company. Our RBC threshold takes into account several favorable factors cited by Moody's, including the Annuity segment's efficient expense structure, our ability to lower our cost of funds and our relatively simple product designs that also provides surrender protection. Because we use the most stringent capital models, the capital levels that we target in our excess capital calculation result in statutory capital, well in excess of what is expected by the other less stringent rating agencies for AFG's Property & Casualty and Annuity segment ratings. Our management team reviews all opportunities for deployment of capital on a regular basis.

I will now turn the discussion over to Craig for concluding remarks.

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

Thank you, Brian. We've included a single page presentation of our updated 2020 core earnings guidance on Slide 17. Our guidance assumes an effective tax rate of approximately 20% on core pretax operating earnings. AFG's expected 2020 core operating results exclude noncore items such as realized gains and losses, annuity noncore earnings and losses and other significant items that may not be indicative of ongoing operations.

In conclusion, I'd like to add that Carl and I are very pleased with our financial results over the last 6 months as we have faced unprecedented challenges. We are financially strong and well positioned to respond to the challenges and opportunities presented by COVID-19 and to produce excellent financial results in the second half of 2020 and beyond. We will now open the lines for any questions.

Question and Answer

Operator

[Operator Instructions] Our first question comes from the line of Paul Newsome with Piper Sandler.

Jon Paul Newsome
Piper Sandler & Co., Research Division

I was hoping to get a little bit more detail on the pandemic-related charges. I know you said it was primarily an IBNR increase. But one of the things that we've been discussing about amongst the investment community is whether or not this is an ongoing potential claims issue, given that some of these stay-at-home issues have continued. And it seems to be some differences in how people are accounting across the industry. So maybe you could address those issues.

Brian S. Hertzman
Senior VP & CFO

Paul, this is…

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

I think, just overall, I'll let Brian run through the breakdown of the $85 million that we've posted. But overall, based off of the facts and the knowledge that we have today, that's kind of our best estimate in that, 90% IBNR and that. But conditions can change. The world can change, things can get better. Things could go longer. So I don't -- in some ways, I don't know how anybody running an insurance company can talk about what the ultimate loss is. But Brian, why don't you walk through or...

Brian S. Hertzman
Senior VP & CFO

Sure. So for AFG, like all insurance companies, it is a difficult calculation to make. As Carl mentioned, 90% of our reserves are for IBNR at this point. We took a very hard look at each individual line of business. Looking at our exposures, basing everything we know through June 30 and booked our best estimate of what that number would be. So it's not a pay as you go or anything like that. But on the other hand, it's not a number that we just put out of the air. So for us, we hope that it is a number that covers everything that we have, and it definitely is what we believe is a prudent number for what we know through the end of the second quarter. So I would say it's a fully-baked number for everything that we know through this date.

Jon Paul Newsome
Piper Sandler & Co., Research Division

Fantastic. Turning to the alternative investments, which are obviously the hot topic of last quarter, should we expect a full rebound in some of these losses given that they had a pretty substantial rebound in the equity markets or something less? Or any indications about what could happen with that -- those performance bonds investments prospectively would be great.

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

Sure. Paul, this is Craig. I think the first thing people need to understand is kind of the makeup or breakdown of the marked-to-market assets. Let me run through that with you. So the marked-to-market assets total around $2.2 billion. 7% of that number is in CLOs, both debt and equity that we marked-to-market. 40% is in real estate investments, where our focus is pretty much on multi-family, which has held up extremely well. 40% is in more traditional private equity funds, 9% in private debt funds, and then kind of miscellaneous for the balance. By the way, around 85% of our mark-to-market assets are recorded with a 1 quarter lag.

So as I look at the various components, certainly, the traditional private equity returns are somewhat related to the stock market. Typically, the private equity firms don't mark investments up as much as the overall stock market and a strong period. And so typically, in a weaker period, they don't -- also don't rate them down as much as the stock market.

Our real estate investments, as I mentioned, 40% of the total exposure is really focused on multifamily. It has held up extremely well. Both the occupancy and collection rates are very similar to what we experienced prior to the pandemic. We're in excellent markets, frankly, in quite a few markets that are kind of benefiting from people fleeing certain urban areas. Our biggest markets in multifamily are: Denver and Colorado Springs; Florida; Phoenix, Arizona; Dallas, Texas; Atlanta, Georgia. They've held up extremely well. We have not had to give any rate reductions to keep strong occupancy. If anything, what we have experienced is a decline in cap rates on those types of multifamily properties, given the decline in interest rates. So that piece, at least at this point in time, we would expect to hold up very, very well. So that kind of gives you some idea of how I view the major components of marked-to-market on a go-forward basis.

Operator

[Operator Instructions] Our next question comes from the line of Greg Peters with Raymond James.

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

I wanted to switch back to the commentary that you provided, Carl. I wanted to focus on 2 things: first, the crop commentary; and then the trade credit commentary. When you provided the guidance for the full year for the Property Casualty business, did you assume that crop was going to be better, the same or lower than the previous year? Because in your comments, it certainly seemed to suggest that you had some degree of caution, as it relates to your outlook there.

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

I think it was just the opposite, frankly, Greg. In our guidance, I think I always tell people that we kind of build in an average crop year and average means an average over time in that. I think this year, as I mentioned, shaping up very nicely. Crop conditions are real favorable. There's -- when you look at the percent of corn and soybeans in good excellent condition, that really looks good. I think the one thing that we're watching as the biggest part of the [modal apparel] part of the book is revenue based, which is a function of yield and price. We're keeping our eye on the corn prices, in particular. I think as I had mentioned in the past, our insurers choose up deductibles. They're kind of -- they take the first layer of losses if there are losses on a revenue basis. So I think the average deductibles farmers choose -- if somebody has a 15% deductible, then they're taking the first 15% of losses. So we're keeping our eye on corn prices. Soybean prices are really in good shape at this point. And if the prices on corn start to be above, you get to the 20% level and yields aren't good, that's when you kind of worry a little bit in that. But right now, I think our crop here is shaping up very nicely.

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

Great. On the trade credit piece, can you just -- on very simple terms lay out the nature of the losses there. I suppose the logical follow-up to that would be the effect of COVID and the dramatic impact on the economy is obviously going to extend beyond the second quarter results. And so just curious where our risks are for that business as we think about the balance of the year and certainly next year?

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

I think the COVID charge that we took in the second quarter, I think, fairly represents our feelings about the exposures there and that today. It's -- trade credit has to do with whether if you're ensuring the ability of a U.S. exporter to receive payment on the other side. So it would be uncollectible types of issues around trade credit. And as Brian said, we thoroughly kind of gone through and reviewed that line of business in that. And I think the reserve we've put up for that line of business adequately reflects what we think the exposures are today.

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

Great. And then the question on capital and the Annuity business, and I appreciate your increased disclosure around capital. One of the challenges I was struggling with last quarter was trying to identify exactly how much capital is required in your Annuity business to generate the -- to maintain that 375% RBC. And I was coming up with a number of around $3 billion to $3.1 billion of capital. But if you could provide any sort of additional color for us on how we should think about the capital that's required on the Annuity business. And then if the alternatives do rebound because of the changes in the market conditions in the second quarter, will we see the capital levels increase?

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

Greg, this is Craig. Certainly, if the alternatives rebound, you will see an increase in capital? Yes. So as Brian was explaining, we target an RBC level of 375%, which is actually well above what Moody's expects of us. Moody's has stated that they expect us to maintain an RBC level of 350% and they've indicated that if we would go below 325%, then that would be a possible reason to put us on a negative watch or have a possibility of a downgrade. To kind of size that for you, though, Greg, the difference between 375% and 325% RBC is something in the neighborhood of $425 million. So there is a huge cushion between kind of what Moody's expects of us for a level at which we would need to put more capital into the business. The 375% is just provides a very sufficient, very large cushion to what's expected by Moody's, which, as Brian said, has the highest threshold for capital for the Annuity business.

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

Okay. I guess, you bought back stock in the second quarter. Maybe you can just give us an update on how much is remaining in your authorization. Obviously, the price of stock remains at around the same level where you're buying before. So I guess you're still in the market. But maybe you could give us some updated perspectives on that in the context of your comments around capital?

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

I don't have the exact amount left on the authorization. I don't -- maybe Diane can find that for me. I don't know how significant that is. All we have to do is get an authorization for additional shares, Greg, and that certainly would be our intention. We think that the stock at these prices is a very attractive use of our excess capital. And so certainly, it's our intention to continue to be a purchaser of our shares.

Brian S. Hertzman
Senior VP & CFO

If we have 2.8 million shares left under our current authorization. As Craig said, it's as simple as a Board approval to acquire more shares. Obviously, we're going to look at all different ways to use our capital. We're in a very strong capital position. So we're always looking at acquisitions and then also at returns to shareholders as ways to go about. That's plenty of room under our current authorization.

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

Got it. All right. Well, thanks for the comments around your cost of funds and the comparison with the peer group. It's appreciated.

Operator

Our next question comes from the line of Ron McIntosh with Lomas Capital.

Ronald Paul McIntosh
Lomas Capital Management, LLC

Diane, congratulations on your well-deserved promotion. 2 questions. One on the life business. You talked about a 12% ROE sustainable in this environment looking out. Does that -- when we think about that 12%, do I allocate 60% of the debt and -- 40% of the debt and 60% of the alternatives to get to that 12%? And do I put a 10% return on the alternatives or 0?

Stephen Craig Lindner

Co-President, Co-CEO & Director

Yes, Ron, so that's an unleveraged return. And our historical return has been -- our alternatives has been something in the neighborhood of 10% over a long period of time. And so yes, when we said we expect to, in the future, be able to earn that 12% plus return -- after-tax return on capital, that's assuming a normal return on alternatives. If you take a look at the second quarter, if we had earned that 10% annualized rate on alternatives in the second quarter, the return on the Annuity business would have been 13% after tax.

Ronald Paul McIntosh
Lomas Capital Management, LLC

Perfect. And just a question on the property casualty side and rate increases. A couple of companies have given us the amount of rate, the raising rates to account for lower interest rates, lower net investment income. I think Swiss Re uses 2 points rate. I think Hartford has talked about 2 to 3 points. I realize you don't want to give us NII guide in the property casualty biz, but would you at least want to talk to how much rate you think you're putting in for the -- for future lower interest rates?

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

I don't have an answer on that right off the top of my head. We could probably calculate that if that's important to you and get back to you on that. Bottom line at -- in the quarter, with a 9% increase overall in rates and excluding comp, 13%, we love the momentum in that. And our underwriting result already is very strong. So we're loving it.

Operator

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

Diane P. Weidner
Vice President of Investor & Media Relations

Thank you, Towanda, and thank you all for joining us this morning. Please feel free to reach out to the Investor Relations team should you have any additional questions. And we hope you all have a great rest of your day.

Operator
Ladies and gentlemen, this concludes today's conference call. Thank you for your participation. You may now disconnect.