S&P Capital IQ

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Cincinnati Financial Corporation NasdaqGS:CINF

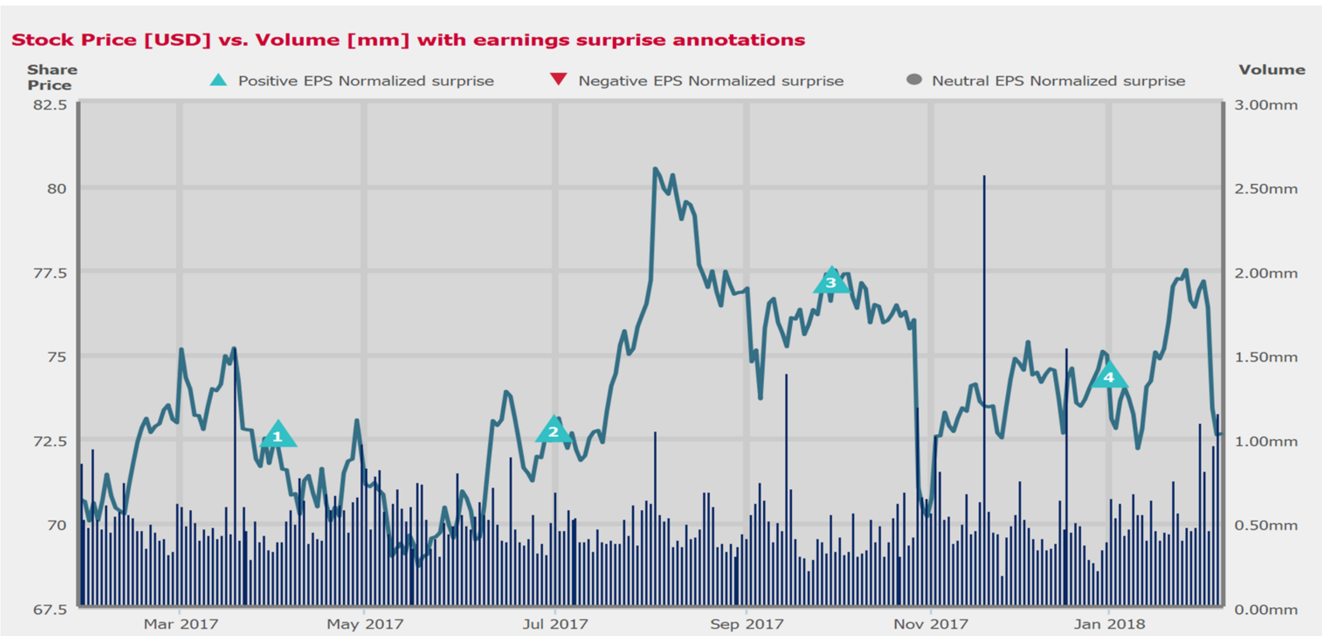
FQ1 2018 Earnings Call Transcripts

Thursday, April 26, 2018 3:00 PM GMT

S&P Capital IQ Estimates

	-FQ1 2018-			-FQ2 2018-	-FY 2018-	-FY 2019-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.80	0.72	▼(10.00 %)	0.58	3.27	3.49
Revenue	-	-	▼(14.87 %)	-	-	-
Revenue (mm)	1437.80	1224.00	-	1461.00	5878.00	6141.10

Currency: USD
Consensus as of Apr-26-2018 2:35 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ1 2017	0.51	0.59	▲1 15.69 %
FQ2 2017	0.50	0.64	▲2 28.00 %
FQ3 2017	0.51	0.58	▲3 13.73 %
FQ4 2017	0.85	0.93	▲4 9.41 %

Call Participants

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Executive VP & Director

Martin Francis Hollenbeck
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Martin Joseph Mullen
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Presentation

Operator

Good morning. My name is Emily, and I will be your conference operator today. At this time, I would like to welcome everyone to the First Quarter 2018 Earnings Conference Call. [Operator Instructions] Thank you. Dennis McDaniel, Investor Relations Officer, you may begin your conference.

Dennis E. McDaniel
VP & Investor Relations Officer

Hello. This is Dennis McDaniel at Cincinnati Financial. Thank you for joining us for our First Quarter 2018 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 far 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 in the call may ask questions. At that time, some responses may be made by others in the room with us, including Chief Investment Officer, Marty Hollenbeck; and Cincinnati Insurance's Chief Insurance Officer, J.F. Scherer; Chief Claims Officer, Marty Mullen; and Senior Vice President of Corporate Finance, Theresa Hoffer. 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. Now, I'll turn over the call to Steve.

Steven Justus Johnston
President, CEO & Director

Good morning, and thank you for joining us today to hear more about our first quarter results. Operating results for the first quarter of 2018 were better overall than a year ago and reflect improvement in several important areas. Although net income was a negative amount for the quarter, operating income rose 22%. New accounting requirements this quarter resulted in recognizing in net income, the change in unrealized gains for equity securities. In the past, these would have been reported in other comprehensive income, and Mike will comment further on that. Our 97.9% property casualty combined ratio for the first quarter of this year was nearly 2 points better than a year ago. While the effects of lower catastrophe losses through the end of March helped the combined ratio by 4.8 percentage points, other noncatastrophe weather effects increased by 3.5 points and weakened results in our commercial lines and personal line segments. Before the combined effect of both of these weather-related effects, our first quarter 2018 combined ratio decreased by 0.5 percentage points compared with first quarter of 2017. We saw results improve for our auto lines of business, while our excess and surplus lines and life insurance segments as well as Cincinnati Re continued to report solid results. At the same time, premium growth initiatives continued as planned and we reported another quarter of higher investment income. Our commercial lines segment reported a 1% decrease in net written premiums in the first quarter of 2018. Timing of processing several larger policies reduced what we report as renewal premiums, although most of those policies ultimately renewed during the first few weeks of the second quarter. As we noted several times in the past, written premium trends can be very -- can vary significantly for larger policies. That variation also contributed to new business premiums a year ago growing at an unusually high rate of 18% and creating a tough comparison for this year. Maintaining underwriting discipline can also cause short-term variation in written premiums, but we remain confident in our agency-centered model to produce profitable, long-term growth. As many of you know, we have the opportunity to meet with many of our appointed agencies in the first part of each year at our sales meetings. As we traveled around the country, one message came through loud and clear, our agents are eager to do business with us and our various service enhancements are making it even easier for them to place their best accounts with us. We also know from history, that new agency appointments provide growth over many years. We typically earn 10% or more of an agency's business within 10 years of a new appointment. That is powerful, especially considering that new appointments over the past 5 years collectively represent agencies that write more than $24 billion from all companies they represent. Our associates will remain focused on supporting the outstanding local independent agents who represent Cincinnati Insurance, as they carefully underwrite each policy and provide personal service to agents and their clients. Pricing remained generally steady as overall commercial lines estimated average price increases were similar to the fourth quarter with commercial auto remaining in the high single-digit range. Our personal lines segment continued its pattern of renewal and new business premium growth with high net worth premiums leading the way in new business. Estimated average premium increases for personal lines in total were similar to the fourth quarter of 2017 with personal auto average rate increases remaining in the high single-digit range. Our excess and surplus lines segment experienced another outstanding quarter with a combined ratio of 68.8% and premium growth of 15%. Cincinnati Re had another quarter of profitable underwriting and premium growth, including the combined ratio of 81.8%.

Our life insurance subsidiary continued its steady contribution to net income with first quarter 2018 matching the year ago, despite a decrease in investment gains and it grew term life insurance earned premiums by 8%. We continue to see benefits of diversifying our business over time through growth of our life company, our E&S company and our reinsurance assumed division. Our primary measure of long-term financial performance, the value creation ratio was negative 2.7% for the first quarter. While net income before investment gain or losses contributed 1.5 percentage points, rising 0.1 percentage points compared with the first quarter of 2017, lower investment valuations during the quarter resulted in the investment gains or losses component contributing negative 4.0 percentage points compared with the positive contribution of 2.7 points a year ago. We're keeping our focus on what we can influence, the profitable growth of our insurance business. By doing that, we create a steady flow of cash that our experienced investment professionals can put to work. While the market will have natural variations, we believe our strategy of investing in high-quality bonds and dividend-yielding stocks, combined with managing premium growth [to mine] healthy underwriting profits will help us create value for shareholders far into the future. Next, our Chief Financial Officer, Mike Sewell, will highlight other important aspects of our financial performance and financial condition.

Michael James Sewell
CFO, Principal Accounting Officer, Senior VP & Treasurer

Great. Thank you, Steve, and thanks to all of you for joining us today. First quarter 2018 was our 19th consecutive quarter of investment income growth, with an increase of 1%, including 8% for dividend income. Following several quarters of increases in unrealized gains for our investment portfolio, the first quarter experienced a decrease in total investment gains of $412 million before tax effects and nearly equal contributions from the bond and equity portfolios. Despite that decrease, we ended the quarter with a net appreciated value of nearly $3.1 billion, including more than $2.9 billion in our equity portfolio. During this quarter, we adopted the new accounting pronouncement ASU 2016-01, which effectively requires the change in unrealized gains and losses on equity securities to be reported in net income versus in other comprehensive income. Our value creation ratio continues to represent total return and was not affected by the new accounting. Because we hold a larger amount of equities, our reported net income will be more volatile, but our non-GAAP operating income will still exclude realized and unrealized gains and losses on investments, which we believe best reflects our core operating performance. To illustrate that volatility, consider that net income swung to a negative position in the first quarter 2018, reflecting a decrease of $156 million for the change in fair value of equity securities. Had the accounting standard been effective one quarter sooner when stock market valuations were generally rising, our fourth quarter 2017 net income would have increased by $256 million. Taking a closer look at the 1% growth in investment income, the bond portfolio's pretax average yield was 4.26% for the first quarter of 2018, down 23 basis points from last year's first quarter. That yield decline continues to reflect the effect of higher-yielding bonds that are called or that mature. Taxable bonds purchased during the first 3 months of 2018 had an average pretax yield of 4.11%, 27 basis points lower than we experienced a year ago. Tax-exempt bonds purchased averaged 3.32%, down 14 basis points from a year ago. Cash flow from operating activities continued to provide funds for our investment portfolio. Funds generated from net operating cash flows for the first 3 months of 2018 totaled $154 million, up $18 million or 13% from the same period a year ago. We continue to carefully manage expenses, while at the same time investing strategically in our business. Our first quarter 2018 property casualty underwriting expense ratio rose 0.6 percentage points from first quarter 2017, primarily due to a refinement in our deferred acquisition costs estimates and slower premium growth. As reported in our 10-K, we evaluate our capitalization of costs throughout the year. Absent amounts deferred, total first quarter 2018 underwriting expenses relative to premiums were consistent with the year ago.

Next, I'll comment on loss reserves, where our consistent approach to setting overall reserves again resulted in first quarter 2018 property casualty net favorable development on prior accident years. The favorable reserve development benefited our combined ratio by 3.9 percentage points, 4/10 of a percentage point higher than what we averaged over the past 3 calendar years. It was again spread over most of our major lines of business and over several accident years, including 30% for accident year 2017, 15% for accident year 2016 and 55% for 2015 and prior accident years. Our commercial auto and personal auto lines of business each experienced a modest amount of favorable reserve development. For commercial casualty, our largest line of business, we maintained a prudent overall reserve position. And we have disclosed in several recent periods, rising paid losses prompted us to estimate the IBNR reserves at levels more likely to be adequate. For most prior accident years, we left IBNR reserves at levels that resulted in relatively small amounts of favorable or unfavorable prior accident year development during the first quarter of 2018. Accident years 2016 and prior in total represented net favorable development, while accident year 2017 was unfavorable due to several factors, including case reserve estimates for umbrella claims, that rose more than we expected and drove the total prior accident year on favorable development of $5 million. Commercial casualty paid loss amounts for the first quarter of 2018 were slightly less than a year ago on both a current accident year and prior accident year basis, but we prudently established IBNR reserves for the current accident year approximately 10 percentage points higher than a year ago. In terms of capital management, we continue an approach consistent with the past. Both financial strength and financial flexibility were in excellent shape at the end of the quarter. During the first quarter, we repurchased a total of 200,000 shares at an average price per share of $73.72. As usual, I'll conclude with a summary of first quarter contributions to book value per share. They represent the main drivers of our value creation ratio. Property casualty underwriting increased book value by $0.14. Life insurance operations added $0.08. Investment income, other than life insurance and reduced by noninsurance items, contributed $0.42. Net investment gains for the fixed income portfolio decreased book value per share by $1.04. Net investment gains and losses for the equity portfolio decreased book value by $0.94 and we declared $0.53 per share in dividends to shareholders. The net effect was a book value decrease of $1.87 during the first quarter to $48.42 per share. Now, I'll turn the call back over to Steve.

Steven Justus Johnston
President, CEO & Director
Thank you, Mike. While the first quarter had some noise in it, I'm encouraged by the steadiness of our results over the long term. The key to these consistent results lies with our associates, who continue to deliver outstanding service to our agents and their clients, deepening our relationships with them. This spring, we've hosted associates from our commercial and personal lines field marketing departments and our loss control department at headquarters for training. I've enjoyed the opportunity to speak with them and their enthusiasm for our company and our industry is catching. Hearing their stories of success and the innovative approaches they take to overcoming challenges, enhances my belief that we have the people, the tools and the strategies in place that will lead to long-term success. 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, Dennis and me today, are J.F. Scherer, Marty Mullen, Marty Hollenbeck and Theresa Hoffer. Emily, please open the call for questions.

Question and Answer

Operator

[Operator Instructions] And your first question comes from the line of Arash Soleimani with KBW.

Arash Soleimani
Keefe, Bruyette, & Woods, Inc., Research Division

Just wanted to -- you may have mentioned this, I think, in the prepared remarks was that decline in bond and interest income simply just through the lower yields?

Martin Francis Hollenbeck
Chief Investment Officer, Senior VP, Assistant Secretary & Assistant Treasurer

Yes, this is Marty. Yes, lower reinvestment yields in the wake of the financial crisis 2008, 2009, we really loaded up in a lot of 10-year noncallable corporate paper at very attractive credit spreads. A lot of that paper is now kind of working its way back out of the portfolio. So while we got some relief on purchase yields, we're still getting hit pretty hard on what we're losing to redemptions.

Arash Soleimani
Keefe, Bruyette, & Woods, Inc., Research Division

So with that said, should we expect bond interest income to be down year-over-year for quarters 2, 3 and 4 this year?

Martin Francis Hollenbeck
Chief Investment Officer, Senior VP, Assistant Secretary & Assistant Treasurer

It's going to be a challenge. I wouldn't go and kind of predict that just yet one quarter into the new year. We're putting more money into the taxable end of the bond market. So it's going to be a fight. But it won't be much if we do get any increase. It also depends on what interest rates continue to do.

Arash Soleimani
Keefe, Bruyette, & Woods, Inc., Research Division

Okay. And my next question is, you'd mentioned that the decline in commercial premiums stemmed from the timing of renewals, but you also mentioned some underwriting discipline. So I guess, what I wanted to ask was to what extent did the decline stem from conservatism in commercial casualty premiums? And can you actually be selective in that line given that you're a package underwriter, or does that make it a bit more challenging to be selective there?

Jacob Ferdinand Scherer
Executive VP & Director

Arash, this is J.F. Yes, it does make it tougher and the same would be true on the auto line. We have to weigh the entire package. So there may be lines of business where the auto is unprofitable the rest of the package is profitable and the same could be true for casualty. In addition to the timing, and it can be big at times. Some of our largest accounts renew in the first quarter of the year. So the timing issue that Steve mentioned in the remarks played into it. I think relative to casualty, there is also some aggressive underwriting that we've been doing, for example, in nursing homes, for example, and they do represent, in some cases, the largest policies in the company. We've seen some negative trends there. And so we've nonrenewed a fair number, including the largest we had. And the accounts we're keeping that we're comfortable with, we're getting larger increases on those upwards of 20%. Opioid distributors or drug distributors is also a class of business, I should say just general drug distributors. But some states now are attacking the manufacturers of opioids as well as the distributors of opioids, drawing them into levels of responsibility that we wouldn't have contemplated. So we're getting off some of that business. So relative to your question on the casualty side, there are some pretty drastic steps that we're taking that affect our growth rate in commercial lines. If I could just take the time just to talk a little bit of just in general growth of commercial lines, we've also taken a look at certain states, for example, where the weather has been uncharacteristically bad. So we're getting off some risks that have large footprints of roofs. For example, one-story lessors risk only types of buildings that are more of a target, a disproportionate target for hail. Auto, in general, across the country is an area that we've been working very hard on. As was mentioned, our net rate increases in commercial auto is in the upper single digits, even mid double digits on some of the larger auto fleets that we have that are the most competed for. Yet we're retaining some of those double-digit increases. We measure the dollar inadequacy of our entire book of business, not only by a percentage, but just the total of dollar inadequacy, for example, on our commercial auto book of business. We've improved that by 53%, that inadequacy, but in the course of being aggressively priced, some of our commercial auto accounts have left, and that impacts growth. An interesting statistic is, we actually increased our new business in commercial auto by 1.1% in the quarter. And that was following a 12.9% increase from '16 to '17, but the interesting thing was that we insured 33% fewer vehicles, still got a 1% increase and the vehicles that we wrote fewer of were the heavy trucks, that are causing most of our loss ratio problems. So that scenario once again it affected the growth. Workers' comp as is widely reported, NCCI, base rate declines on our book of business amount to a negative 6.2%. Our net rate changes are not that bad, but still that's a headwind that affects the growth in commercial lines. In the positive area on growth, we continue, as Steve mentioned in his remarks, appointing more agents. Just in the last 3.25 years, we've appointed 287 agencies that represent $5.5 billion in total premium that they write. Submissions are up. The first quarter was a bit of a tough headwind as far as new business. We were up 19 -- or 18% in new business in the first quarter of '17. But another positive that we would also point out is that our strongest growth in new business is in our lines of business that have the best margins. Management liability, for example, was up 28.6%, surety up 19.4%, inland marine was up 10% in the first quarter. That's carrying a low 70s combined ratio. And that's following a 17.6% increase in 2017. So I hate to get wordy on you and on everything. But there's just -- there really were some positives, a really great sign from our viewpoint is that in Ohio, our most profitable state, we grew 3.1% in commercial lines and new business was up 21%. So we're confident about the growth of commercial lines.

Arash Soleimani
Keefe, Bruyette, & Woods, Inc., Research Division

That was very thorough. And you had mentioned commercial auto a bit, are we at somewhat of a turning point there because I also noticed that this was the first time since early 2014 that you guys had favorable development in that line. So are we seeing some more stability there?

Steven Justus Johnston
President, CEO & Director

This is Steve, and yes, I would agree with that.

Arash Soleimani
Keefe, Bruyette, & Woods, Inc., Research Division

Okay. And on the workers' comp that you mentioned, do you have any comments, just -- there's some reports of the NCCI pushing for rate decreases related to tax reform in several states, just wondered if you have any comments on that, how much more pressure you think that could add to existing rate pressure in workers' comp?

Steven Justus Johnston
President, CEO & Director

I can't say that I could give you any real true color on that. We've read the same things you've read. I haven't -- and we haven't -- I haven't been in any conversations around here as to exactly how much of an effect it could have. A lot of reforms, obviously, with the kinds of decreases we're seeing in base rates, we have to be careful. In the industry, some carriers are paying incentive commissions, going after comp very aggressively. And I think we're consistent year in and year out talking about comp is that we approach that line very conservatively. The headwinds of the rate decreases certainly aren't helping loss ratios, and so we're just going to continue to be conservative and make sure our underwriting guard doesn't go down.

Arash Soleimani
Keefe, Bruyette, & Woods, Inc., Research Division

And just one more, if I can slip it in before requeuing. You had said in the release that large losses over $1 million were down, but the commercial casualty core loss ratio also increased by a large amount as well, more than I'd expected. So I just wanted to [think], how do you reconcile those 2 where the large losses were down but the core loss ratio was way up?

Steven Justus Johnston
President, CEO & Director

Yes, I would say, as we look at -- you've seen some of the adverse development in that particular line of business. And as our actuaries make their pick for the most recent accident year, they are taking that into consideration and it was up. I think it was up about 7.2 points over the pick for the first quarter of '17, but we think that's prudent given just what we're seeing in the general trends in the line.

Operator

Your next question comes from the line of Paul Newsome with Sandler O'Neill.

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

I was wondering if you can give us a little bit more detail on the noncat weather. And I'm a little bit -- I've seen [news] here and couple of the other regions I cover have also had kind of sort of similar issues, and I'm wondering if it's more small commercial issue, if it's more middle market commercial issue, because we didn't see some of these problems at the large -- at least the companies, the large companies that have reported so far?

Steven Justus Johnston
President, CEO & Director

Yes, Paul, I think it may just be around the geography and so forth. Because we did have freezing weather in January, there was a cat. But we noticed that while we had a couple of cats in January, that totaled $18 million, the January noncat weather was $27 million and they were in areas that were, let's say, adjacent, but not within the designated cat. So in areas where we're big, such as Ohio, Indiana, Michigan, Pennsylvania, New York about 57% of those noncat weather losses were in those states. So I think, it's as much we go by the PCS definition of a cat in terms of everything from dates to geography, to cause of loss, and we just had losses, the majority of them being of the freezing and collapsed type that were just around that definition, but not in it.

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

Is there anything to the thought that it does seem like everyone at least in small commercial wants to be in small commercial. Again, another theme I've heard this quarter is just a lot of companies saying they want to increase the size of their small commercial business, is it -- are we seeing something new and different on a competitive perspective in small commercial?

Steven Justus Johnston
President, CEO & Director

Well, I think, small commercial is always been competitive and it's certainly something that we compete for. And over time, I don't know that I pick up a general increase right now in appetite for small commercial. But that's not to say it isn't there because as I've said, over time, everyone has always competed for small commercial. So it's a very competitive space. And I think it will -- it always has been and it will continue to be.

Operator

Your next question comes from the line of Mark Dwelle with RBC Capital Markets.

Mark Alan Dwelle
RBC Capital Markets, LLC, Research Division

Just a few questions. Mike, I think, you had commented in related to the expense ratio that there was a change in the DAC estimate. That's just a one -- that's a onetime impact to this quarter, is there an ongoing impact to kind of the run rate in that?

Michael James Sewell
CFO, Principal Accounting Officer, Senior VP & Treasurer

Yes, that's a great question. And -- but it is something to begin with that we do look at our -- the deferred amounts or deferred acquisition costs and how we calculate that on a quarterly basis, and I think we've indicated that in our 10-K. But we did have a refinement in this period. We do survey our people, and so forth, look at where time is being spent. We do that throughout the year. So with the adjustment this quarter, you're right, it's almost an adjustment refinement in this period, it really should be smooth for the rest of the year because we're capitalizing less, so we'll amortize less and so it should be a little smoother throughout the year. I haven't really done an estimate of where we think we'll be at the end of the year. However, I think the 31.9% is high and we'll probably end up towards the end of the year, slightly higher than where we ended up the full year 2017. So I'd look for it maybe in the 31.3%, 31.4% area. But we're going to have to update that throughout the year.

Mark Alan Dwelle
RBC Capital Markets, LLC, Research Division

Okay. That's very helpful. Second question, still staying in the commercial lines area. So the overall increase in the accident year loss ratio was about 5 points. And if I understand right, 3.5 of that was sort of noncat, weather-related losses which is reasonably understandable. And so then the remaining 1.5 points, that's just getting the IBNR's right and making a good solid loss pick or is there some element of mix or other change in there that's elevating that relative to last year?

Steven Justus Johnston
President, CEO & Director

No, that's a very astute observation, Mark. And I think as we look at what we alluded to a little bit earlier in terms of that higher pick for the commercial casualty as it went up by about 7.2 points for the current accident year, that had an impact of 2.4 loss ratio points for the entire commercial auto current accident year. So I think that particular pick right there -- I'm sorry, commercial casualty, that makes up the difference right there and then some.

Mark Alan Dwelle
RBC Capital Markets, LLC, Research Division

Okay, that's what I thought. And then the last question I had really just more of an environmental kind of question. In the current market environment where kind of lowish single-digit rate increases seem to be the broad prevailing theme, is your 3-year policy, is that a relative advantage or relative disadvantage in this sort of a market?

Jacob Ferdinand Scherer
Executive VP & Director

Mark, this is J.F. I think it's a relative advantage. Contrary to popular belief people don't like to renew their insurance every single year. So I think, we view it year in and year out, slightly soft market, slightly hard market is an advantage for the company. It's a lot more stability in the rates. We -- so overall, when you consider all things, retention of the kinds of accounts we want to keep, the 3-year policy is a real positive.

Operator

[Operator Instructions] Your next question comes from the line of Ian Gutterman with Balyasny.

Ian Gutterman
Balyasny Asset Management L.P.

Mark just got one of my questions. So just to confirm that, J.F. So basically, the pressure on the IBNR and commercial casualty is -- probably continues throughout the year, right, unless something in the environment changes. So if I'm trying to think about year-over-year comps until you, sort of, get to Q4, we should be expecting pressure on the accident year all else equal, obviously forgetting what noncat or fires may do in the quarter?

Steven Justus Johnston
President, CEO & Director

This is Steve, and good question, Ian. But we look at those every quarter just based on their merits and just try to pick our best estimate at that particular point in time. And so we think we have right now a best estimate for the reserve position for commercial casualty as well as the other lines. And for the current accident year, we'll see how the paid losses and claims reduce themselves as we roll through the year.

Ian Gutterman
Balyasny Asset Management L.P.

Okay. But when you've put up this extra IBNR, I guess, I'm trying to understand maybe, sort of, the actuarial process. I guess, what I'm trying to differentiate is, I guess, maybe between sort of a look at prior year reserves, right, where if you see a problem, you could put up extra reserves and that hopefully puts it in the past versus I would think if you're putting up more IBNR and new business, that probably needs to continue at this higher level until the claims trend changes or is it where -- or you just sort of put up extra IBNR of such a magnitude to sort of cover the full 12 months as opposed to the quarter?

Steven Justus Johnston
President, CEO & Director

I would not say that we put up extra IBNR to cover the full 12 months. I think we just pick it the way we see it. And then as we see the second quarter unfold, we'll adjust accordingly.

Ian Gutterman
Balyasny Asset Management L.P.

Got it. Okay. And then can you just talk about related to just sort of, what's causing these, you talked about, sort of, types of cases and so forth. But I was hoping, maybe, you could talk, sort of, about the, I guess, call it litigation environment. But are we seeing -- is it just that as the economy has gotten better there's been more incidence of things or is it really more of -- there's been some surprise settlements and -- I'm sorry, surprise judgments and therefore, the next settlement ends up being higher than in the past or is there more fraud coming through -- debatable fraud, I guess, maybe you can't prove it, that, that's forcing claims up where it's harder to get in front of them. Just, sort of, on the ground, I guess, I'm wondering, sort of, what the trends are. Basically, are there bad actors out there and, sort of, what are their tactics is, I guess, what I'm trying to get at.

Steven Justus Johnston
President, CEO & Director

Ian, I think speaking to the commercial casualty, I think, is where we are here in the question. I think, part of it is that -- well, it's all of the above. There are a lot of different aspects of it. But if we look at it, say, an umbrella over commercial auto policies. And as we've seen issues with commercial auto over a period of time, that is going to then manifest itself in development on the umbrella. And so, I think, that's some of what we saw here in the first quarter. We -- you might have a late reported December type of a commercial auto claim, there's an umbrella attaching, you find out later that the magnitude of it here in March as we investigate the claim and then you're kind of in the position do you really want to take down that IBNR this early in the year for a known event or keep it up, so that you would have what you would expect to be a sound and prudent estimate. So I think, it's more just looking at the individual circumstances and there are many of them of which you named a few, but I don't think it's any one particular driver.

Ian Gutterman
Balyasny Asset Management L.P.

Okay. So it's not like there's some new legal theory that plants are running with to try to poke holes. I mean, there always are, right? But something that's been more successful, I guess, and normal that's poking holes in coverage or like you hear these stories about litigation funding, I don't know if that's causing more aggressiveness. So there's no sort of story like that, it's more sort of the normal stuff and it's just more elevated than usual?

Martin Joseph Mullen
Chief Claims Officer & Senior VP of The Cincinnati Insurance Company

This is Marty Mullen. No, actually everything has been pretty steady on the litigation environment as far as coverage interpretations and litigation breakdowns. Our book is pretty broad. So the claims on the commercial casualty range from the umbrella over the auto and commercial auto, which is a little volatile. As you see in the increase in commercial auto, the natural increases on the commercial casualty umbrella over that auto kind of walks along with that. But we're in about almost 40 states commercially and the litigation environment stayed pretty consistent as far as the pitfalls. But really no adverse liability changes in the venues that -- of any significance.

Ian Gutterman
Balyasny Asset Management L.P.

Okay, good. That was my main concern. So if I -- I was going to move to investment, but I have one quick numbers question. The decline in the other premiums in the commercial was bigger than usual, could you just remind me what causes that?

Michael James Sewell
CFO, Principal Accounting Officer, Senior VP & Treasurer

For the most part in the other, so that's reinsurance and then also just some other minor changes. So when you look at it in total, the 1%, the real driver was the renewals and the new premiums, but it's primarily reinsurance that's in the other.

Ian Gutterman
Balyasny Asset Management L.P.

Okay. And is that mostly a Q1 event or should we expect a bigger drag from that other throughout the year?

Michael James Sewell
CFO, Principal Accounting Officer, Senior VP & Treasurer

I'd say that's probably a little bit more of a Q1. I mean, it's kind of -- those numbers are so small that they kind of bounce around a little bit. So yes, I wouldn't focus too much on it.

Ian Gutterman
Balyasny Asset Management L.P.

Okay, just making sure. And then so switching to the investment side, I guess, first, the accounting change. I get the impact in the quarter on the income statement. I just wanted to make sure on the balance sheet it looks like $2-plus billion went from essentially unrealized gains to retained earnings, is that the right way to think about it?

Michael James Sewell
CFO, Principal Accounting Officer, Senior VP & Treasurer

Yes, it is. So we moved $2.5 billion from accumulated other comprehensive income to retained earnings. And you really didn't see any other effect. And that was a kind of a 1/1/2018, an adjustment that you make at the beginning of the period. So there's really no other effect that you will see on the balance sheet.

Ian Gutterman
Balyasny Asset Management L.P.

Okay. And that $2.5 billion, that was sort of a cumulative translation, I guess they call it, is that right?

Michael James Sewell
CFO, Principal Accounting Officer, Senior VP & Treasurer

Yes, that's right. And that was net of tax. And so if you look back at our 10-K, in Footnote 2, it was about $3.2 billion, I believe, of gross unrealized gains related to our equity security. So net of tax, that's how you get to the $2.5 billion.

Ian Gutterman
Balyasny Asset Management L.P.

Okay. So the funny thing about...

Michael James Sewell
CFO, Principal Accounting Officer, Senior VP & Treasurer

Just to -- oh, I'm sorry -- and realize that that's just, I'll say, recognizing it for GAAP purposes. We've not recognized a, I'll call it, a tax gain for IRS purposes.

Ian Gutterman
Balyasny Asset Management L.P.

Exactly. Exactly. So the funny thing about this, Mike, if I'm understanding it is, I think, for a long time, we've all gotten used to sort of book value ex AOCI being sort of stable and book value having swings because of unrealized. Now I guess, we're going to have 2 sources of swings, we're going to have bond swings the traditional way in AOCI and then equity swings that will be essentially through, I mean, they'll go through, I guess, comprehensive but they'll end up in retained earnings. So the book value ex AOCI will have volatility too going forward, is that the right way to think about it? Doesn't make sense but is that what's going to happen?

Michael James Sewell
CFO, Principal Accounting Officer, Senior VP & Treasurer

Right. Yes. And so it does add a lot more volatility, which probably doesn't make a whole lot of sense. But when we present our non-GAAP operating income, it's going to exclude the realized and unrealized, no matter if it goes through the income statement or other comprehensive income. That will make it challenging a little bit more in the future that you can't just go to the balance sheet, to equity and take out AOCI. So there is that split there. We did put into the Q this quarter, there is a new chart in there, where we thought it would be helpful to have investment gains and losses and then we stack that on top of the unrealized investment gains and losses, which, therefore, you've got your fixed equity -- your fixed maturities there and your change in unrealized in the equities would be up in the investment gains and losses. But then you can see the grand total, which for this quarter, was a negative $412 million. And then that you'll be able to see ties in with our VCR.

Ian Gutterman
Balyasny Asset Management L.P.

Okay. I'll take a look at that because, I think, that's the right way to look at it. And if I could -- I know I'm going long. If I could squeeze one more in for Marty. Can you tell me, and I could probably add it up, but you probably have it at the tip of your fingers. It seems like technology has become a bigger part of the equity portfolio, just when I look at the positions that have gotten bigger over time or new over time, do you have that handy and just sort of what your comfort level is of how much tech you're willing to have?

Martin Francis Hollenbeck
Chief Investment Officer, Senior VP, Assistant Secretary & Assistant Treasurer

Yes, I mean, it certainly it's grown from what was literally 0 probably 13 years ago to -- it's still below market level. As of the end of the quarter, we were at 20.6% in information technology versus 22.1% for the S&P. It's always been a tough sector for us to keep up with, based on the number of stocks in that sector that actually pay and grow dividends. That has improved some. But when you also have juggernauts like Amazon, which pays no dividend or obviously, that's actually a discretionary -- scratch that one but Netflix, Facebook, et cetera, a lot of these names we just can't own. So it's a limited pool, but we aggressively pursue trying to at least approach a market weight in that area.

Ian Gutterman
Balyasny Asset Management L.P.

Okay. And then one thing I noticed on it was it looks like -- so you had owned Qualcomm for some time, but it looked like you bought a bunch of Broadcom, was that a merger arb or was that trying to buy Qualcomm on the cheap through Broadcom? I'm just sort of curious what's the motivation was given there's a lot of news going on there?

Martin Francis Hollenbeck
Chief Investment Officer, Senior VP, Assistant Secretary & Assistant Treasurer

Yes, we actually entered in Broadcom just prior to that merger announcement. So we're -- it's -- we're still kind of shaking out where we want to end up with that -- those 2 positions.

Ian Gutterman
Balyasny Asset Management L.P.

Okay. Because I saw the combined position has become a big position, that's kind of what I -- what stood out to me. So.

Michael James Sewell
CFO, Principal Accounting Officer, Senior VP & Treasurer

Ian, before you go, just FYI, so if you look at Page 54, which is in the MD&A at your leisure, you'll see the new chart and we've broken it out in the details, and we actually indicate what is reported in net income and what's reported in OCI. So we thought that would be beneficial for everyone out there.

Operator

Your next question comes from the line of Josh Shanker with Deutsche Bank.

Joshua David Shanker
Deutsche Bank AG, Research Division

I wanted to ask a question about how your underwriters on the ground have flexibility with customers who buy more than one policy from you, to what extent are they pricing the rate change to the customer as opposed to the line of business, and would the pricing of a casualty product affect the pricing of a property product, if there's a collection of products within a single customer?

Jacob Ferdinand Scherer
Executive VP & Director

Josh, this is J.F. We model all aspects of the account, the property section, the casualty section, the auto section, the workers' comp section of the policy. So when the underwriter in the field would be on quoted on a risk, they're going to get a predictive model score price adequacy for all of those lines. And as you can imagine, when they're putting -- making a decision to put a piece of business on the books, there can be a little bit of for lack of better words, horse-trading between the lines of business. If you've got something that, for whatever reason -- we believe models very adequately priced -- 10%, 20% more than what we think as far as the pricing that we're looking at, it gives us flexibility to take away from, let's say, a line of business and give it back to an underpriced side. So it's -- we take a look at each individual account but by line of business. I hope that made sense.

Joshua David Shanker
Deutsche Bank AG, Research Division

And what kind of discretion is in the underwriter's hands on the spot to negotiate with the client?

Jacob Ferdinand Scherer
Executive VP & Director

A lot of it depends on the size of the account. If we're working on small business, the model pricing is awfully accurate and it's hard to really disagree with and so the underwriters really probably -- rarely make or make very little changes there. The larger the account, the less homogeneous the account, the more what you would call nonmodeled attributes enter into the decision-making process. So in any company, the model only knows certain variables. So if you get a large account, that has uniquenesses to it, that aren't contemplated in model pricing then the underwriter has flexibility to change the pricing and be more aggressive, for example, than what the model pricing might indicate. And by the same token, we have certain classes of business, certain risks that just because the underwriter has inspected the risk, worked with loss control on it. We actually don't like it that much. They'll increase what the model might say if we think it's satisfactory enough to write.

Joshua David Shanker
Deutsche Bank AG, Research Division

And has there been a technology rebuild in the last few years that's making that easier to happen or where are you in terms of the on the ground flexibility in the moment for the underwriter?

Jacob Ferdinand Scherer
Executive VP & Director

Well, our analytics area, our -- [PARM] we call it, pricing and analytics -- our actuarial department has done -- made great strides relative to models, the expansion of the granularity of models and our ability to communicate to our underwriters, both inside and out, the analytics necessary to make an informed decision. We model our entire book of business on a monthly basis. It's broken down by state, it's broken down by territory, it's broken down by agent and it's broken down by underwriter, and naturally, by policy. So I think, if you looked at us now versus 5 years ago, we've done -- we continue to make great strides there.

Operator

Your next question comes from the line of Mike Zaremski with Crédit Suisse.

Michael Zaremski
Crédit Suisse AG, Research Division

Just wanted to ask one question on workers' comp. So your comments, you mentioned that you're being cautious, and clearly that line is shrinking a little bit. But you also have done a great job turning that line around over the last number of years and it looks like it's throwing off a pretty good loss ratio. So I wanted to kind of clarify why you're being cautious and just also I know that -- I think there's some nuances with Ohio in terms of the workers' comp system there. So I wanted to better understand whether you are actually underweight workers' comp as a line of business for the company or it's just I'm looking at it, running the numbers the wrong way and I have to do it state-by-state?

Steven Justus Johnston
President, CEO & Director

Yes, Mike, Ohio is a monopolistic state. So we don't write workers' comp on Ohio insureds. We have some agents in Ohio that write risk outside the State of Ohio, that we write workers' comp for. So considering the size of Ohio relative to the overall company, that's going to create an underweighting for workers' comp relative to our entire book of business. We've also historically took a very conservative approach on comp. And up until the time and you make a good observation, we're doing pretty well in comp, thanks to some terrific claims initiatives what we put through, loss control initiatives. And as Josh mentioned earlier, the issue of modeling and analytics associated with the pricing of workers' comp, we've seen it go in the right direction. And when I say conservative, it's not as though we don't want to write comp, we do want to write comp, but we are seeing levels of aggressiveness in certain states and from certain companies that have us shaking our heads from time to time. So I guess the point that I wanted to make was that we're pretty pleased with the results we're getting in comp. But there was some mention in the, I think, in the industry, that it was -- comp was becoming soft and it was profitable, now it's closing in on soft and unprofitable. And we just don't want to follow it into the unprofitable side. So we're a writer and we'll continue to be, but we're going to be cautious.

Michael Zaremski
Crédit Suisse AG, Research Division

And just to clarify then, are you -- let's just remove Ohio completely, are you underweight in the line of business materially or no?

Steven Justus Johnston
President, CEO & Director

I would say, compared to the industry, we probably are. I don't know that number off the top of my head. But I think after having years of being especially conservative and not producing very good results, you could go back into the '90s, we would -- when we would work with our agents, we would happily write the package in the auto and we would suggest to the agent that if they wanted to put the comp with a monoline carrier, that was fine with us. As we -- since because of our capabilities in comp improved, we've also -- we've been more aggressive here in the last 10, 15 years. Florida is a state, for example, that because of the environment down there, we don't write any comp there. And we are not active in California, so -- in commercial lines. We write some accounts out there from out-of-state agents, but we don't have agents on the ground there. So we also don't write workers' comp in the State of California.

Operator

Your next question comes from the line of Arash Soleimani with KBW.

Arash Soleimani
Keefe, Bruyette, & Woods, Inc., Research Division

Just a quick follow-up on the comment you made on rates. Did you say that rates were stable from the fourth quarter to the first quarter or did you see any acceleration or change?

Steven Justus Johnston
President, CEO & Director

We said they were stable.

Arash Soleimani
Keefe, Bruyette, & Woods, Inc., Research Division

Okay. And then just wanted to make sure I understood the expense ratio comments properly. So you said 31.9% is high for the year, so it should come down from here, but the next 3 quarters should be -- did you say they should be pretty stable?

Michael James Sewell
CFO, Principal Accounting Officer, Senior VP & Treasurer

Yes, so it is high for the quarter, the 31.9% is high for the quarter. I think for the remaining 3 quarters, we'll see it a bit closer to where it has been back in 2017. If I were to look at the total, if I exclude what is being capitalized and deferred, total expenses dividing that by the premiums, it's pretty consistent from first quarter this year to first quarter last year.

Arash Soleimani
Keefe, Bruyette, & Woods, Inc., Research Division

Okay. So was this first quarter kind of you basically said you kind of did an analysis to see, hey, like, where are people spending their time and what do we need to capitalize or is this something that kind of on an annualized basis could cause some volatility, this kind of analysis?

Michael James Sewell
CFO, Principal Accounting Officer, Senior VP & Treasurer

It's something we actually do every quarter, we are doing that. And so when it looks like we should, actually then make an adjustment, we do it. But we do surveys every quarter to make sure we're deferring the correct amount.

Arash Soleimani
Keefe, Bruyette, & Woods, Inc., Research Division

Okay. I guess I was just asking because this quarter seemed like it was a bigger adjustment than expected. So I guess, I was just wondering what caused it to be a larger adjustment this time around?

Michael James Sewell
CFO, Principal Accounting Officer, Senior VP & Treasurer

It's just the result of when we're doing our survey. So I would not view it as extraordinary. I'd kind of focus on a low 31 kind of a run rate right now.

Operator

We have no further questions at this time. I'll turn the call back to our presenters.

Steven Justus Johnston
President, CEO & Director

Okay. Thank you, Emily, and thanks to all of you for joining us today. We hope to see some of you at our annual shareholders' meeting, which is Saturday, May 5, at the Cincinnati Art Museum. You're also welcome to listen to our webcast of the meeting available at cinfin.com/investors. We look forward to speaking with you again in our second quarter call. Thank you all very much.

Operator
And this concludes today's conference. You may now disconnect. Have a great day.