S&P Capital IQ

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Kemper Corporation NYSE:KMPR

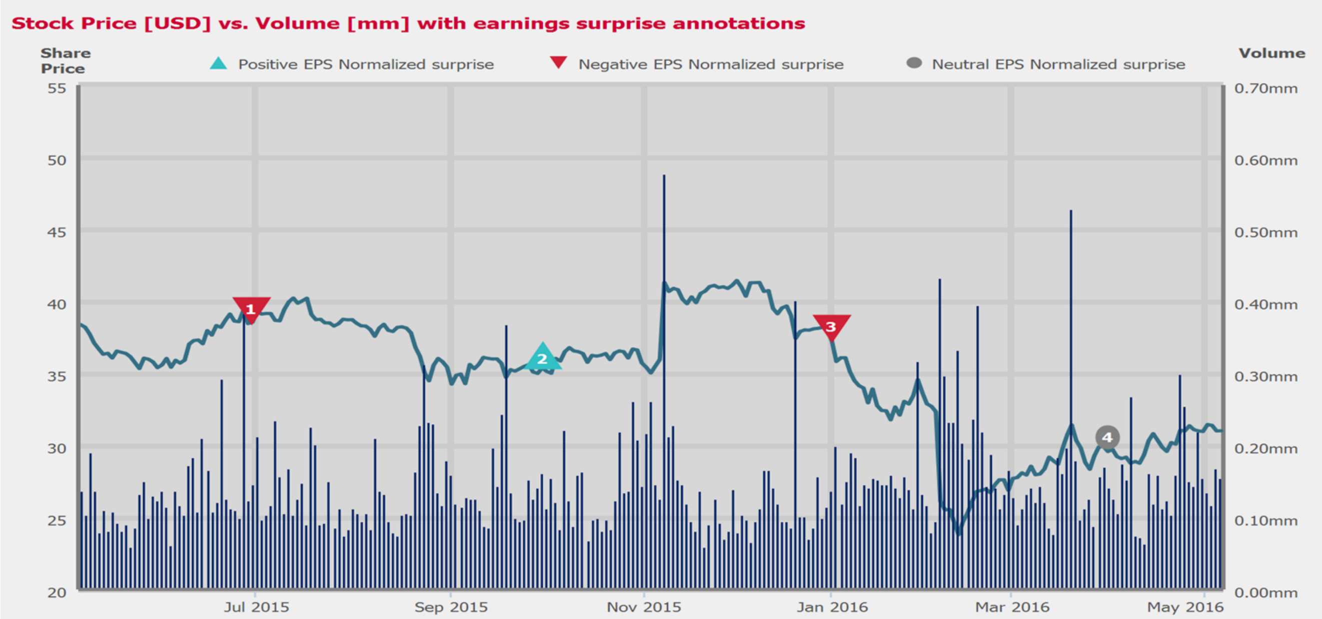
FQ2 2016 Earnings Call Transcripts

Friday, August 05, 2016 3:00 PM GMT

S&P Capital IQ Estimates

	-FQ2 2016-			-FQ3 2016-	-FY 2016-	-FY 2017-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	(0.15)	0.09	NM	0.50	0.90	2.02
Revenue (mm)	610.01	628.00	▲2.95	617.90	2456.10	2437.54

Currency: USD
Consensus as of Aug-04-2016 11:12 PM GMT



- EPS NORMALIZED -	CONSENSUS	ACTUAL	SURPRISE
FQ2 2015	0.49	0.13	▼1 (73.47 %)
FQ3 2015	0.56	0.71	▲2 26.79 %
FQ4 2015	0.59	0.09	▼3 (84.75 %)
FQ1 2016	0.03	(0.01)	NM

Call Participants

EXECUTIVES

Diana J. Hickert-Hill
Vice President of Investor Relations & Corporate Identity

Frank Joseph Sodaro
Former Senior Advisor

Joseph P. Lacher
Chief Executive Officer, President and Director

ANALYSTS

Amit Kumar
Macquarie Research

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

Ryan J. Byrnes
Janney Montgomery Scott LLC, Research Division

Presentation

Operator

Good morning, ladies and gentlemen, and welcome to Kemper's Second Quarter 2016 Earnings Conference Call. My name is Keth, and I'll be your coordinator today. [Operator Instructions] As a reminder, this conference is being recorded for replay purposes.

I would now like to introduce your host for today's conference call, Ms. Diana Hickert-Hill, Kemper's Vice President, Investor Relations and Corporate Identity. Ms. Hickert-Hill, you may begin.

Diana J. Hickert-Hill
Vice President of Investor Relations & Corporate Identity

Thank you, operator. Good morning, everyone, and thank you for joining us. This morning, you will hear from 2 of our business executives, starting with Joe Lacher, Kemper's President and Chief Executive Officer; followed by Frank Sodaro, Kemper's Senior Vice President and Chief Financial Officer. We will make a few opening remarks to provide context around our second quarter results. We will then open up the call for a question-and-answer session.

During the interactive portion of our call, our presenters will be joined by John Boschelli, Kemper's Senior Vice President and Chief Investment Officer; Chip Dufala, Kemper's Property & Casualty Division President; and Mark Green, Kemper's Life & Health Division President.

After the markets closed yesterday, we issued our press release and financial supplement. In addition, we filed our Form 10-Q with the SEC. You can find these documents on the Investors section of our website, kemper.com.

Please note that our discussion today may contain forward-looking statements. Our actual results may differ materially from these statements. For information of potential risks associated with relying on forward-looking statements, please refer to our 2015 Form 10-K filed with the SEC as well as our second quarter 2016 earnings release and Form 10-Q. This morning's discussion includes non-GAAP financial measures that we believe may be meaningful to investors. In our supplement and earnings release, we defined and reconciled non-GAAP financial measures to GAAP where required in accordance with SEC rules. And finally, all comparative references will be to the second quarter of 2015 unless we state otherwise.

Now I will turn the call over to Joe.

Joseph P. Lacher
Chief Executive Officer, President and Director

Thank you, Diana. Good morning, everyone, and thanks for joining us for today's call. I'll start with a few high-level comments and then go through our results. I'm pleased to have some new members of our senior leadership team in place now with Mark Green, Chip Dufala and our new Chief Information Officer, Charles Brooks, joining Kemper. These 3 are working closely with Frank, John and myself as well as with our other senior leaders to finalize our strategy. I also want to thank Joe Metz for partnering with me to lead the Property & Casualty business over these past several months. With his help, we continued our actions to improve our results, analyze options for our overall strategy. Now that Chip is here, Joe can return to his focus on leading the Kemper Personal & Commercial lines business.

As for our strategy, we plan to host a conference call in mid-September. While I acknowledge some of you may have been hoping to have this discussion earlier, I wanted to get our leadership team in place first. I believe it's important to have our senior leaders involved in shaping our strategy, and these executives will be instrumental in delivering the plans we convey. We'll announce a specific timing and logistics for the mid-September call in the next few weeks.

Today, we'll focus our discussion on our second quarter results. Overall, we earned $4 million in net income and $5 million in net operating income during the quarter. Revenues increased to $627 million, largely driven by Alliance United, which we acquired at the end of April last year. And we're partially offset by a lower level of realized gains this year. In addition to the increased level of catastrophe losses we announced earlier, Alliance United losses remain elevated. While we have a long way to go, we're making progress on the underlying legacy business, and we remain diligent on implementing the steps we need to improve our overall bottom line.

Our company catastrophe losses in the quarter increased $13 million to $51 million pretax, with about $2 million of that coming from our Life & Health business. Like much of the industry, we saw a high volume of storm activity during the quarter with 14 catastrophic events. The most significant occurred during April in Texas, which we mentioned during our first quarter earnings call. While the cat losses exceeded our historical annual average, we're comfortable with our long-term pricing expectations. At this point, we do not anticipate fundamentally changing our pricing or underwriting actions in the impacted areas for our Property, Casualty or Life & Health businesses.

I'll turn now to discuss our Property & Casualty segment results, which provided trends similar to what we saw in the first quarter of this year. Earned premiums for the segment totaled $403 million in the second quarter, up $53 million from last year. Excluding the $64 million lift from Alliance United, earned premiums decreased by $11 million as a lower policy count offset a modest increase in average earned premium. Our net operating loss of $9 million was down $6 million, driven by a deterioration in the Alliance United results and the elevated catastrophes I mentioned earlier. It overshadowed some improvements in our legacy underlying loss ratios and a higher level of favorable loss reserve development. With only 2 months of results for Alliance United included in the second quarter of 2015, year-over-year comparisons are challenging. So we'll talk about Alliance United results separately.

Alliance United had a net operating loss of $12 million in the quarter. Results included adverse development from the first quarter as well as elevated frequency, which drove the increase in the second quarter underlying loss ratio. Frequency patterns continue to pose a challenge, consistent with what we've seen in the past few quarters. I'll take a few moments to update you on the 4 key factors we discussed last quarter relative to Alliance United. Elevated frequency levels and need for increased rates, high levels of new business volume, and a claims department that was understaffed to handle the growing business.

Starting with frequency, the California nonstandard auto market continues to experience elevated frequency across the industry. Our experience parallels what many of our competitors have reported. Frequency, particularly in liability, remains pressured.

Our second factor is rate. We implemented a 7% rate increase effective on new business and renewals beginning in April for our Millennium product, which represented about half of the book of business. We also filed for another 7-point increase on the Millennium product in June, and that refiling is pending approval. Additionally, in March, we filed for a 7% rate increase on our gold product covering the other half of the book. That filing is still pending, and we expect to get approval and begin implementing rate increases in the fourth quarter. As we've repeatedly said, the process of achieving rate adequacy on both products will take several pricing cycles to complete. In the meantime, we're implementing various underwriting and agency management actions to further improve profitability.

Turning to the third factor, production. These underwriting and agency management actions delivered the desired effect. New business is down 20% sequentially and down modestly on a monthly production basis from last year. We'll continue to manage new business flows, we implement needed profitability improvement actions.

And finally, our fourth key factor, we remain focused on improving our claims operations. We made substantial progress adding claims adjusters this quarter. Since acquiring Alliance United, we've added 134 claims personnel and an increase of 36%. We believe we will be adequately staffed based on our staffing models by the end of the third quarter. We plan to hire beyond these needs, to reduce our pending claim count as quickly as possible. We mentioned last quarter that we implemented Guidewire for handling Alliance United claims. We changed from the Alliance United claims system and claim processes to a Kemper claims system and processes. This change is a necessary part of combining these businesses.

As expected, it will result in pattern changes in our actuarial data. As a result, we'll experience at least several quarters, we're interpreting our loss reserving data will be a bit more challenging for Alliance United. This technology integration and operational integration is an important step to position the business for long-term scale and profitability.

Turning now to our legacy P&C business. We had an underlying loss ratio of 65.8%, more than a 1-point improvement from last year. In our legacy nonstandard auto line, we continued to see improvements, earning $3 million in the quarter versus a $3 million loss last year. Earned premiums increased about $1 million to $79 million with an increase in average earned premium outpacing the decline in policy in force. The underlying loss in LAE ratio improved 6 points to 75.8% as our profit improvement actions take effect. While we're pleased with our progress, we still have work to do. We continue to implement rate and underwriting actions.

In our preferred auto line, operating earnings declined $8 million from last year. The current quarter had $3 million higher catastrophe losses and a $3 million lower level of favorable reserve development. The balance of the year-over-year variance was due to a 2-point uptick in the underlying loss ratio to 71.3%.

As we've discussed previously, we've seen a shift in the risk profile of our preferred auto book to lower risk business and a related decrease in overall frequency. The industry has experienced increased frequency. Our team is engaged in a deeper review of our mix change, the impact of industry frequency changes, our current claim operations and the adequacy of our pricing in individual risk layers. We're committed to improving the profitability and growth prospects for our preferred auto line.

In our home line, where we saw the bulk of our elevated catastrophe losses, we had a $6 million loss in the quarter despite benefiting from $9 million of prior year favorable reserve development. Earned premiums were $68 million, down 6%, however, we are encouraged by a number of important factors. Our underlying combined ratio improved more than 5 points to 77.3%. Our policy retention percentage increased 2 points and our new net written premium increased 7%.

I'll turn now to the Life & Health business.

We reported net operating income of $16 million, up $2 million, driven by decreased expenses offset by a lower level of net investment income. Expenses were down in the Life line as last year's legal expenses were $8 million higher.

So looking at Kemper's performance overall, in the Property & Casualty business, we saw high catastrophe levels. We continue our work to improve Alliance United's performance and we expect it to take a few more pricing cycles at a minimum to resolve, and we're keeping our close eye on preferred auto line and we're encouraged by the underlying trends in our legacy nonstandard auto and home lines. The Life & Health business continues to produce stable earnings and cash flow to the parent company.

With that, I'll turn the call over to Frank to cover Kemper's consolidated performance, capital and parent company liquidity.

Frank Joseph Sodaro
Former Senior Advisor

Thanks, John. Good morning, everyone. For the second quarter, Kemper's net income was $4 million or $0.08 per share compared to $30 million or $0.57 per share. Net operating income was $5 million or $0.09 per share compared to $7 million or $0.13 per share. Catastrophe losses impacted earnings by $0.64 per share in the second quarter of 2016 compared to $0.46 last year. Results included $1 million of net investment losses in the current quarter compared to $21 million of gains last year. Last year, results also included a charge of $7 million or $0.14 to write off previously capitalized software. Total revenues increased $18 million or 3% as higher earned premiums were offset by lower realized investment gains. Earned premiums at the Property & Casualty division increased $53 million, driven by $64 million of higher earned premiums from Alliance United, partially offset by lower earned premiums from our legacy P&C lines. Earned premiums were stable in the Life & Health division. Net investment income decreased $3 million for the quarter, primarily from the impact of our alternative investments. Alternative investment income was positive for the quarter, but down due to the lower performance of our hedge fund portfolio and underperformance of a few large investments that are winding down. The total return for the quarter was strong at 3.1%, driven by increased values of our fixed maturities related to the drop in interest rates. The pretax equivalent annualized book yield was 5% for the second quarter of 2016 compared to 5.4% last year, driven by the lower income from alternative investments.

The Property & Casualty segment reported a net operating loss of $9 million for the quarter compared to $3 million last year. Both periods were severely impacted by catastrophe losses. Additionally, Alliance United's results were far below expectations. Although Alliance United's prior year reserve development was marginally favorable, the first quarter of this year developed unfavorably by about $6 million pretax. Further deterioration in our expected loss ratios led to a $3 million pretax charge to recognize policy acquisition costs that would normally be deferred.

Excluding Alliance United and the write-off of our capitalized software last year, P&C results were flat as better underlying results and higher levels of favorable development offset higher catastrophes. About half of that development came from our more volatile homeowners line, and included development from 2014 and 2015 catastrophes. The legacy P&C underlying loss ratio improved more than 1 percentage point to 65.8%, legacy nonstandard auto underlying loss ratio improved 6% -- percentage points from rate increases, underwriting actions and agency management steps. Homeowners underlying loss ratio improved 5 percentage points, primarily from lower frequency while preferred auto's underlying loss ratio increased 2 percentage points as loss trends outpaced rate actions.

Net operating income from the Life & Health segment was $16 million for the quarter compared to $14 million last year. Results increased primarily from lower legal expenses at the home service companies offset by a lower net investment income. Net operating loss from Corporate & Other improved to $2 million, primarily from lower pension expense, partially offset by lower net investment income from hedge funds and the recognition of a tax benefit last year from closing out some open tax years.

I will now cover book value, capital and parent company liquidity. Book value per share was $41.17 at the end of the quarter, up 6% from year-end, largely from the impact of lower market yields in our fixed maturity portfolio, partially offset by dividends paid. Book value per share, excluding unrealized gains on fixed maturities was $34.78, down 1% from year-end, primarily from dividends paid. Statutory surplus levels in our insurance companies remain strong and we estimate that we will end the year with risk-based capital ratios of approximately 400% for our Life & Health group and 320% for our legacy P&C group. This week, Kemper's Board of Directors authorized a dividend of $0.24 per share. We were not in the market repurchasing shares this quarter, we'll review capital allocation priorities as part of our overall strategy discussion next month.

Our estimate of excess capital remains above $225 million and from a liquidity perspective, the parent company held cash and investments of about $340 million while our $225 million revolver remained undrawn.
I will now turn the call over to the operator to take your questions.

Question and Answer

Operator

[Operator Instructions] Our first question comes from Paul Newsome with Sandler O'Neill.

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

I wanted to actually ask about the reserve development that happened, a little bit more about the reserve development that had happened excluding United Alliance. And you gave a little bit detail on the [indiscernible] home, but seems like a big number relative to what you've historically done in that line. And maybe we can talk about the stuff in both the homeowners piece as well as whatever else was driving that result?

Joseph P. Lacher
Chief Executive Officer, President and Director

Sure, Paul. Thanks for the question. And it was a little garbled, so let me just repeat it to make sure we got it. You want some more detail on the reserve development excluding the impact from the Alliance United on the more legacy business, because it seemed a little larger than what we'd seen normally, correct?

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

Yes. Yes, please.

Joseph P. Lacher
Chief Executive Officer, President and Director

Okay. Great. I'm going to ask Frank to dig into some of those details.

Frank Joseph Sodaro
Former Senior Advisor

Paul, about half of that development came on homeowners and a lot of that related to catastrophes from the 2014, 2015 year and if you think about it, we've had a lot of activity in cats and storms, and those are just harder to peg from a reserve perspective. Other than that, there was a lot of -- it was within a reasonable range and mostly positive. So they kind of added up to a larger positive for the quarter. The other thing I would call out is that umbrella which is reported in our other line is also up and that was really just due to a few large claims, but still within a reasonable range. So it's all within a reasonable range and the outlier that we spoke about really was homeowners.

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

Then second question, probably bigger picture. Any update on the strategic plan, the development and maybe timing on when we hear from you folks?

Frank Joseph Sodaro
Former Senior Advisor

Yes, Paul, we'll get back with specific timing. We'll do something in mid-September. We wanted -- I wanted particularly to have the new senior team members on board and engaged in the process. They're going to be responsible ultimately for delivering these points to you. I think they're strong individuals with strong points of view, and will be helpful in shaping that. They're here now, they know where the bathroom is, they know where the coffee machine is, and they've got a strong view of the operations already inside of their businesses. We'll have much of that in a good shape in the middle of September. We'll come back with the timing and specific logistics around the call in a couple of weeks.

Operator

Our next question comes from Amit Kumar with Macquarie.

Amit Kumar
Macquarie Research

Just a few questions. Maybe just starting with the rate discussion. You talked about the 7% in April and some other rate actions in June. Have there been any actions taken in July and in August or not?

Joseph P. Lacher
Chief Executive Officer, President and Director

The rate actions, Amit, and thank you for your questions and for being on the call. The rate actions we talked about were specific to Alliance United. They're California, so they're all obviously 6.9% something, we're talking about them at 7%. The first 7% was related to the Millennium product, which is about half the book. We had a follow-on filing quickly after that one was implemented. And then we had a filing in for again that same 6.9% in our gold product. We would anticipate once that filing is approved, we'll follow on with gold as well. So we're going to keep those coming. When one is implemented, we'll look at the data and follow quickly along. We obviously have rate filings going in states all across the country in all of our product lines and those are significant. We typically don't go state by state, filing by filing in these calls, in this disclosure. We're doing a little bit more on Alliance United just because there's a little bit more hair around that business and a little more challenge and we want to be fulsome in terms of how we're attacking it. We are consistently looking at all of our businesses, looking at their current profitability position, their current position in the marketplace, what we're seeing with frequency and loss trend. And then moving appropriately in each of those jurisdictions. So there have been plenty of filings in the last 2 quarters.

Amit Kumar
Macquarie Research

So just to understand this clearly that the rate discussion was on Alliance United, but excluding that what you're saying is, if I understand this correctly, the other pieces, the non-Alliance United are also seeing rate increases on a state-by-state basis. Is there like, many companies give like a net rate number, do you have anything to share on that regards or is it too early pending your strategic update?

Joseph P. Lacher
Chief Executive Officer, President and Director

We don't have one right now to share with you, Amit. We'll take that into our advisement and perhaps give you something with more specificity in September or going forward. In general, if you look at the filings for us, they're in the high single-digit range. It's a more nuanced conversation. Our legacy nonstandard business has had more profitability challenges, so those are at the higher end of that range. Our homeowners business still is, it's seen the most improvement. They're in the single digits as well. There's a couple of states where we feel pretty good, so they're lower. There's a couple of states that need a lot more improvement so they're at the higher end of that range, so it varies. The right way to think about them in general would be high single digits.

Amit Kumar
Macquarie Research

And those are realized rates, the actual rates, right, not the filed rates?

Joseph P. Lacher
Chief Executive Officer, President and Director

Well, the comment I'm making is about filed and approved. Realized, you got to dig underneath it. That the challenge on realized is there's a mix change that comes with these things as well. So we could give you a realized rate that might not be the appropriate nuanced way to look at this as you're well aware. If we took a lot of rate on one segment that was particularly profit challenged and that business left, that might actually be a better answer if the actual yield on the rate was lower than filed. It might have better profitability improvement. So I think the right way to think about it, for us at least is, the filed rate is giving an indication of where we think we're moving from a profitability perspective.

Amit Kumar
Macquarie Research

Okay. Fair point. The other question was, you sort of briefly mentioned that the frequency and severity challenges and you also alluded to the industry. Can you sort of flush that comment out a bit more? The reason why I ask is, I was hoping to get a better understanding as to and this is all x Alliance United, how your book is performing on the lost cost trends side, in terms of, I guess, paid claim frequency and severity for bodily injury and physical damage. Maybe just talk about the trend line, because obviously you've seen Allstate, you've seen Progressive and obviously, you saw what happened with the Hartford. I'm just trying to figure out where you sort of stack up in that matrix?

Joseph P. Lacher
Chief Executive Officer, President and Director

Yes, I think what we're seeing, Amit, is trends generally consistent with what we're seeing -- we're hearing others talk about. The complicated piece comes for us and we talked about it a little bit in our preferred auto line. We firmly believe that we're in the industry and we're seeing, we're experiencing the same issues that others are with more miles driven, with more distracted driving, with all of the other macro trends that are occurring. We had a fairly significant mix change in the last couple of years, which when we look purely at year-over-year data, might give us the impression that frequencies are down or pushed so the aggregate frequency is less than what we're seeing. As an example, if you went from having a book that was 90% nonstandard to 90% preferred, the frequency for the book year-over-year will be way down, but the frequency for just the preferred cohorts would be up, and the frequency for just the nonstandard cohorts would be up. Our aggregate number right now would probably be somewhat misleading to you if we were giving you that, because we're seeing these forces on the individual cohorts working them up, but the aggregate is somewhat down if that makes any sense on the frequency. We would expect our loss trends to be very consistent in aggregate for the individual cohorts to be consistent with what others are describing. We're not big enough and we haven't been so effective in our underwriting or pricing sophistication that we would expect to be meaningfully favorable to the market.

Amit Kumar
Macquarie Research

Got it. And the final question, I'll reach you after this. That the strategic update, and I know Paul was also asking, I guess, this thing. Should we anticipate once we sort of look at it, is it more sort of a scalpel approach, which comes out of it? Or are we going to see -- should we be preparing ourselves for a materially different outline as to how things will function from September? I'm just trying to get an early view, I mean, is everything on the table or is it more like let's actually get behind the data, let's understand what's going on, maybe build up a better data sort of snapshot, but that's a bad word to use, data analytics and then figure out what is needed. Can you sort of give us some more color as to what exactly is coming up in September?

Joseph P. Lacher
Chief Executive Officer, President and Director

Sure. I'll give you a little bit, the 62nd version of it. We suffer right now, in our organization from -- a fair amount of execution challenges. And in some cases what I might describe is deferred maintenance. And our businesses from an execution perspective are perhaps challenged somewhat by environmental issues, but in many cases by self-inflicted wounds. For -- you won't -- you shouldn't expect to see something that is so wholesale radically different that you're saying, boy, on October 1, I can't recognize these guys compared to what I saw on August 1. There is a lot of near-term work that will add a lot of value by stopping the self-inflicted wounds, improving the execution and sharpening our pencils around the businesses we have. We will ultimately, 2 years from now, not look exactly the way we look today. And there will be components around that, but the last thing you do when you get businesses that are dealing with some self-inflected wounds and deferred maintenance is unload them in that condition. There's a significant amount of improvement we can do to get them ready, we can deal with that, and there's great performance opportunities inside of these businesses that we haven't dealt with, so we're going to work on all of those.

Amit Kumar
Macquarie Research

And then could that also include looking at, I guess, the employee base and the sense that, do we have the right people running sort of all the pieces of this ship? Or is the management as well as, I guess, the leadership structure as it sort of percolates down the company, is that sort of all set for now?

Joseph P. Lacher
Chief Executive Officer, President and Director

Amit, the obvious answer in this is, we're going to sit down and we're going to look at how to get ourselves structured and positioned to execute better to add value to build competitive advantages, and to ultimately build shareholder value. So we're not going to be stuck and locking anything in place that would inhibit that ability. So I appreciate your question, it's perhaps asking it with a lot of precision out of context of the other components. What I can assure you is, we're not going to lock anything in ahead of time that is a tactical decision ahead of understanding what we're trying to do overall.

Operator

[Operator Instructions] Our next question comes from Ryan Byrnes with Janney.

Ryan J. Byrnes
Janney Montgomery Scott LLC, Research Division

Just had a -- obviously, cat losses in the homeowners segment have been elevated the first half of the year, and I think you guys mentioned, you got in just more unluckiness than anything else. But if you -- and you're not going to underwrite the book, but if you looked at maybe buying more tactical reinsurance programs to maybe take out some of the volatility?

Joseph P. Lacher
Chief Executive Officer, President and Director

We have, Ryan and we always look at it. The issue on some of that is, it's an insurance transaction. We could do that and take out some of the volatility and we'd also be taking out some of the profitability in that component. Somebody on the other side of the trade is going to be looking for that. So our view all the time as good underwriters and good stewards of capital is to say, okay, what volatility can we take, what's the risk reward of the insurance transaction we're taking, and are we getting paid for the risk. Long-term, when we're dealing with any particular component, I would expect to have a -- as an example, and it's a -- perhaps, a good example, because we're not doing homeowners business in Florida, but you'd expect your x cat Florida homeowners to make a lot more money than you would, an x cat Minnesota homeowners book. And you're getting paid for the risk and you're getting paid for the volatility. So we look to deal with that overall and then our bigger issue in some cases may need to be spreading the risk. We have some pockets of concentration that individual trade might be a good trade, but we actually would be much better served by growing in some other geographies with comparable risk profiles to leverage that capital base more effectively. I think that's a better way for us to handle this rather than laying off low levels -- coming down to low level attachment points on tactical reinsurance and pushing the profitability lower.

Ryan J. Byrnes
Janney Montgomery Scott LLC, Research Division

Got you. And then the other question I had was, in the 10-Q there seems like there's some updated commentary on Death Master File issue, where it says that you guys may even voluntary use -- or so use it voluntarily in some states on a retroactive basis. Just wanted to see if you could give more color on that?

Joseph P. Lacher
Chief Executive Officer, President and Director

Sure, sure, happy to. We've already started using the DMF on a prospective basis for new business. And our sense is, for maybe 2 main points: one -- maybe it's 3. There's a clear recognition that you shouldn't go back, the government should get involved in retroactively changing contracts. That's bad for business overall. It's clearly unconstitutional. It's not a good way to move around. Point two, is the folks in the industry, the businesses -- the companies in the industry who were using the DMF asymmetrically to stop paying annuities, but at the same time, weren't paying life claims to the same insured. That's just -- whether it was an accident, whether they didn't know it, whatever it is, you can't look at that and do anything else other than say that's sort of an unworthy behavior, unworthy of our industry and it makes the whole process for all of us look bad and we understand why those folks entered into settlements, we understand why they were punished and get it and that seems appropriate. We also -- the third point, understand that there are databases, there are tools, there are items which on a relatively simple basis could be used to see if a benefit -- if an insured had passed away and died, and there would be a benefit available to pay for a beneficiary. I don't think we've ever been fundamentally opposed to exploring that concepts. What the challenge has been is, we've been dealing with many regulators or treasurers or legislators, who we're looking for a one size fits all approach. Let's deal with everybody the same way that we were dealing with a group who was getting punished. And that we struggle with. I'm fine if you get a speed -- you're caught speeding and you get a speeding ticket, you paying the fine. I'm not so fine that if we weren't speeding, we also pay the fine. So I think there's an opportunity here and we've been exploring it, but having some challenges, getting anybody to agree to a solution that works for folks who aren't causing or didn't do the unworthy behavior. And we'll continue to explore and look at these and very -- may well come -- may very well come to the conclusion that we're just going to do what we think makes sense for the business and for consumers, and work with that.

Ryan J. Byrnes
Janney Montgomery Scott LLC, Research Division

Got you. That was a great answer. And then quickly, just if I can sneak in one additional one. Can you maybe just break out what the lost cost trend is at Alliance Union, I realize you're getting nearly 7% rate and you're pushing for more. But maybe just want to see where lost cost trend is in that book so we can see what kind of impact those rates should get for you guys.

Joseph P. Lacher
Chief Executive Officer, President and Director

The frequency trends are running high single digits. The severity trends are almost hard to read right now. We've had and we've described a fair amount of noise in our claim department. And we've had staffing issues, we've been getting it to work the backlog, claims backlogs have been rising. We're closing in on being fully staffed, we plan to overstaff that claim department to reduce those. We shifted to a new claim system so that we could leverage our resources across the organization, but that also causes a little bit of the data to be farbled. My sense is that if all we were getting was 7 points a year, we might see a little deterioration for a while, which is why we're going for a couple of rate changes at a time. We do firmly believe that when we get fully staffed from a claim department perspective, we can actually have favorable loss cost trends from the claim activity we're putting forward. So we believe that, that will provide positive earnings volatility or earnings improvement, all of these won't have to be done with rate. Yes, the improvement will start to accelerate back part of this year and into next year, that's when we'll be at full staff and overstaff and start working the pendings down.

Operator

And I'm not showing any further questions at this time. I'd like to turn the call back over to Mr. Lacher.

Joseph P. Lacher
Chief Executive Officer, President and Director

Terrific. Thank you, operator. And thank all -- thanks to all of you for engaging today with your ears and with your questions. We continue to work through our actions systematically to drive improvements.

Our Life & Health segment continues to deliver solid performance. We're seeing tangible progress in our legacy nonstandard auto and home lines. We're addressing the issues in Alliance United, and we know what to do, we know it takes time to see the results from our actions, and we're optimistic about what we'll see there. We're very much watching the preferred auto lines. And catastrophes were high in the first half of the year, but that's a normal part of the Property & Casualty business. Something we expect from time to time, so we're not overly concerned with those volumes. I've said this before, but I'll say it again, I'll remind you that we're a company in transition. It will take some time to see all the improvement levels that we seek, but we remain confident in our ability to deliver significantly improved results over the longer term. We look forward to sharing with you our updated strategy in September, and in the meantime, you can be assured that we're focused on delivering improved results for the near term and the long term.

Thanks, again, for your time today, and look forward to talking to you soon.

Operator
Ladies and gentlemen, this does conclude today's presentation. You may now disconnect, and have a wonderful day.