S&P Global
Market Intelligence

CNA Financial Corporation NYSE:CNA

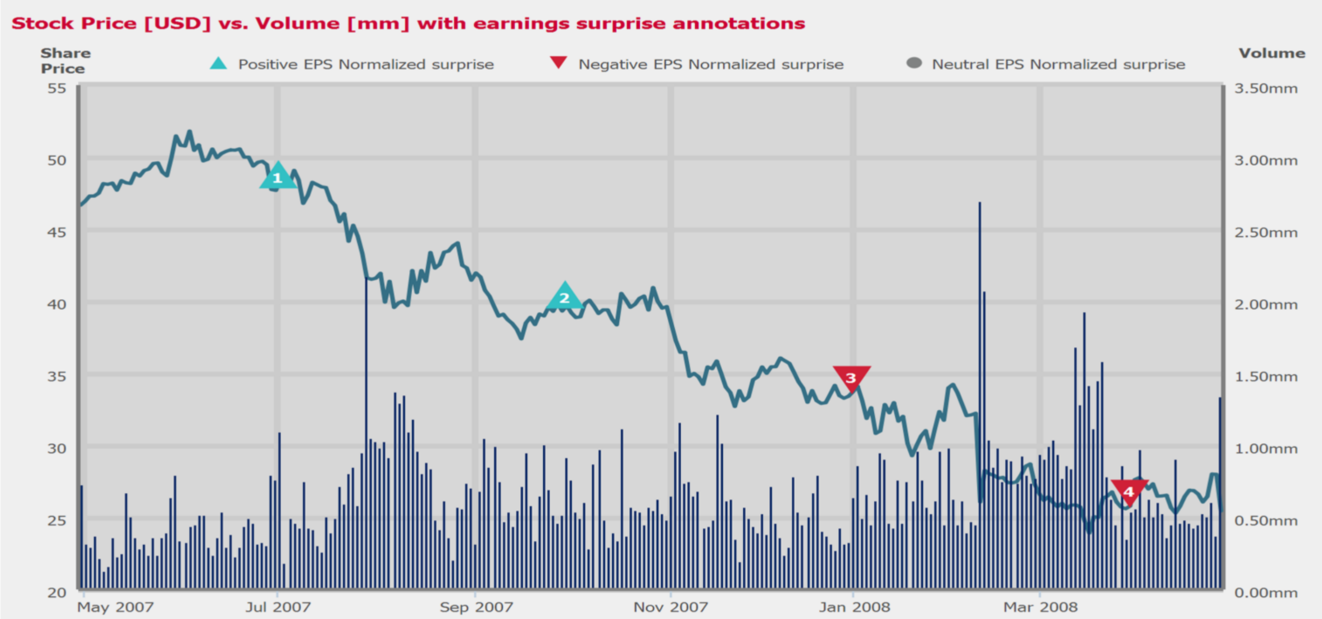
FQ2 2008 Earnings Call Transcripts

Monday, July 28, 2008 2:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ2 2008-			-FQ3 2008-	-FY 2008-	-FY 2009-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.96	0.93	▲(3.12 %)	0.94	3.56	3.66
Revenue	-	-	▲3.56	-	-	-
Revenue (mm)	1713.00	1774.00	-	-	6467.00	6312.00

Currency: USD
Consensus as of Jul-28-2008 2:34 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ2 2007	1.09	1.17	▲1 7.34 %
FQ3 2007	0.68	0.78	▲2 14.71 %
FQ4 2007	1.02	0.82	▼3 (19.61 %)
FQ1 2008	1.01	0.82	▼4 (18.81 %)

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EXECUTIVES

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James R. Lewis

Larry A. Haefner

Nancy M. Bufalino

Stephen W. Lilienthal

ANALYSTS

Dan Johnson
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Jay Cohen
Merrill Lynch

Robert Glasspiegel
Langen McAlenney

Unidentified Company Representative

William Wilt
Morgan Stanley

Presentation

Operator

Good day everyone and welcome to the CNA Financial Corporation's Second Quarter 2008 Earnings Conference Call. Today's call is being recorded.

At this time, I would like to turn the conference over to Ms. Nancy Bufalino. Please go ahead.

Nancy M. Bufalino

Thank you, Patrick, and good morning. Welcome to CNA's second quarter 2008 conference call. With us this morning to discuss our financial results are; Steve Lilienthal, Chairman and CEO; Craig Mense, CFO; and Jim Lewis, President and CEO of P&C Operations. Hopefully everyone get an opportunity to review the press release and financial supplements, which were released earlier this morning and can be found on the CNA website at www.cna.com.

Before we get started, I'd like to advise everyone that during today's call there may be forward-looking statements made and references to non-GAAP financial measures. Please see the section of the earnings release available on CNA's website for further clarification of both. In addition, the forward-looking statements speak only as of today, July 28, 2008. CNA expressly disclaims any obligation to update or revise any forward-looking statements made during this call.

This call is being recorded and webcast. During the next week, the call may be accessed again on CNA's website. Following the conclusion of today's remarks by senior management, we will be happy to take questions from the investment community.

And with that, I will turn the call over to CNA's Chairman and CEO, Steve Lilienthal.

Stephen W. Lilienthal

Thank you, Nancy, and good morning, everybody. Thanks for joining us today.

In the second quarter CNA continue to move forward diligently and intelligently in the phase of very difficult insurance financial market, not to mention the issues presented by sluggish economy.

Consistent what we said, we would do when you change market again the soften our actions are matched by words.

We remain committed to underwriting discipline. Retention of existing profitable business is a priority as provided better margin than reckless perceive to new business. Accordingly, our retentions have persisted in low 80s. Since 2006, and new businesses is percentage of total production has come down incrementally is now about 70% exactly were we said it would be.

We continue to adjust and optimize our portfolio, as market conditions grow rather than attempt to simply maintain market share. This approach is evident in our investments in the so called standard specialty hybrid products such as; property, and the marine, boiler and machinery excess and surplus lines in a row [ph]. This is an addition to middle market segmentation initiatives and standard and specialty cross sell initiatives, which we have mentioned in previous calls, as well as strategic expansion of our specialty products.

We have managed, enhanced and build upon our distribution outreach, market excess primarily through preferred distributors, agents, and brokers who support our strategies, and with whom we've had a winning track record.

We have a very balanced multi-channel distribution network, which protects us from becoming overly dependant on any single channel, and allows us to optimize our segmentation and penetration strategies, as well as understand the total costs to serve our distribution network.

We're committed to adjusting and managing our expense structure to manage our business side. And we've shown an ability and willingness to do so consistently and aggressively over the last several years.

Overall, our strategies concerned... continued service well, as measured by 10 consecutive sub-100 combined ratios, and five out of six for the last quarters under sub-under 30 for an expense ratio.

While we don't underestimate the challenges, but with strong ratings a solid balance sheet, increased financial flexibility, and underwriting an expense discipline. We feel CNA is well-positioned to whether the storms in the insurance and financial markets, not to mention those of the meteorological variety.

Before I turn it over to Craig and Jim, I would like to touch on a few topics. First, our financial results: All-in-all I feel our second quarter was a very solid quarter attributable to our consistent and rational underwriting approach to a very competitive environment. It is reflected by our commitment to this... and commitment to and disciplined executions are previously stated underwriting strategies. Craig will provide more detail on this in a moment.

With respect to the underlying performance of the business, the core property and casualty operation continues to perform well. Second quarter combined and expense ratios were 97.7 and 28.2 respectively. As mentioned this make 10 consecutive quarters of sub-100 combined ratios.

Production metrics were consistent with selective control underwriting. And as mentioned we continue to shift our business mix to more profitable segments and product lines. Adverse selection well always a concern is not an issue as measured by positive spreads in renewable efficiency, and business been written and target classes. This is also they discussed in previous call.

Overall in a market that is testing our strategies and discipline, CNA is sticking to and delivering under fundamentals. And Jim will give you a little bit more detail on that in a moment.

In other topics of note, back in may, I announced my decision to retire in June '09, with Tom Motamed, The Chubb that are stepping into as my successor. He is an extraordinary individual and well known throughout the industry. We are thrilled to have Tom come our Board to take the helm, contractual requirements with Chubb present him from joining CNA sooner than June of next year.

This is an orderly succession plan, which was well received, internally and externally our ready agencies, our Board, agents, brokers and employees. There were no change in CNA's execution or operational focus is a business as usual approach and we have significant number of challenges at hand that are much of an immediate nature.

Finally a word about the commercial PC outlook; rates continues to drop slowly, but persistently. Certain parts of the market large Cat property and casualty for instance have soften to the point that many have the price well below our walkway price. And so, we do.

Terms and conditions are likewise eroding, including provisions related to Cat risk. We expect these conditions to continue through '08 and into '09.

As I have said before, we will play the market as it lies, but we will not recklessly fall it down. And in summary, with challenges and threats are bounding, we are executing well in all fronts with work on the fundamentals in the second quarter and well position to sustain our profitable force. Craig?

D. Craig Mense

Thanks Steve. Good morning, everyone. I'm pleased to share our second quarter results.

Net operating income of $250 million reflects solid underlying operating performance in a challenging environment. Second quarter operating ROE was 9.8%, an improvement from the first quarter, but still slightly below our target range at this stage of the cycle.

Book value per share was $34.74 at the end of the second quarter, relatively unchanged from the first quarter.

Our first quarter dividend payment had an adverse change in unrealized investment gains and losses, which was mainly driven by a credit market condition slightly exceeded net income.

Our core property casualty operations delivered solid performance was measured by combined and expense ratios. Our balance sheet is strong. Operating cash flow is positive, and we enjoy our relatively low level of financial leverage and a high degree of liquidity in our investment portfolio.

Our financial flexibility continues to improve as measured by additional debt capacity and holding company liquidity, where we have now accumulated over $715 million of cash and short-term investments.

During the first six months, we moved approximately $700 million from the insurance subsidiaries through dividends and other capital transactions to the holding company.

Finally, we are pleased to continue to return capitals to our shareholders via our quarterly dividend of $0.15 per share.

Now I'd like to give your bit more detail on financials. For the second quarter, net operating income from continuing operations was $250 million or $0.93 per diluted share, compared with $318 million or $01.17 per diluted share in the prior year period.

Net income for the quarter was includes the impact of realized investment gains and losses, as well as discontinued operations was $181 million or $0.67 per diluted share compared with $217 million or $0.80 per diluted share last year.

Year-to-date, net operating income from continuing operations was $471 million or $1.75 per diluted share compared with $625 million or $2.30 per diluted share in the first half of 2007.

Year-to-date net income was $368 million or $1.36 per diluted share compared to $513 million or $1.89 per diluted share for the prior year period.

Property and casualty operations produced second quarter net operating income of $269 million compared with $325 million in the prior year period. The primary drivers were a lower net investment income, decreased current act near underlying results and higher catastrophe losses partially offset by lower expenses.

After-tax catastrophe losses were $31 million this quarter, which compares to $8 million in the prior year period. Year-to -date Cat losses were $65 million after-tax. This compares the $51 million after-tax in all of 2007.

With respect to the non-core segment, Life & Group produced the second quarter net operating loss of $30 million compared with the $13 million net operating loss from the prior year period.

The primary drivers of this second quarter decline in this segment were adverse investment performance on a portion of our pension deposit business, and unfavorable experience in long term care.

The corporate segment has second quarter net operating income $11 million compared with $6 million of income in the prior year period. We continue to closely manage these run off operations to mitigate earnings risk.

Second quarter of pretax investment income was $576 million down from $671 million in the prior year period. These results include trading portfolio gains and losses, which are largely passed on to contract holders.

The comparison excluding the trading portfolio is $580 million this quarter versus $631 million in the prior year period. The primary drivers were decreased income from fixed income and short-term securities due to lower interest rate on short-term holding, as well as unusually strong LP income in the prior year period. LP income this quarter was $46 million a 2% return, which did rebound from first quarter result. And you recall it, second quarter of '07, LP income was $71 million at 3.6% return.

After-tax net realized investment losses were $71 million this quarter compared with losses of $91 million in the prior year period. After-tax impairments were $111 million this quarter or the write-downs of subprime and Alt-A investments accounted for $64 million of that total. These impairments of $111 million were offset by $40 million of gain, primarily driven by derivatives.

I'll characterize our investment portfolio was liquid, well diversified and of high quality. The portfolio continues to have an overall average credit quality of AA minus. The effective duration of the total portfolio was 5.3 years. You recall that I appointed out previously that our investments or separated into two distinct portfolios.

A larger portfolio approximately 75% or $27.8 billion of our interest rate sensitive securities, report the PC in corporate segment. That portfolio had 3.6 year period duration.

Second smaller portfolio approximately 9.1 billion or 25% of our interest rate sensitive securities or segmented and align for certain long-term liabilities primarily in the life group non-core segment. That portfolio had 10.6 year duration.

We continue to find a limited number of attractive opportunities in subprime market and had purchases net of principal pay downs of $140 million this quarter. Additional subprime and Alt-A purchases made this year have an eight point.... little more than 8% total return year-to-date.

Given a recent attention the Fannie Mae and Freddie Mac credits, I thought you'll also be interested in our direct exposures to Fannie and Freddy. Our combined basis that book value, we have $321 million in preferred stock and $83 million in debt. We've also held Freddy discount notes at June 30th, but all about the matured over sold it gain as of last week.

Turning to expenses; the second quarter property and casualty operations expense ratio of 28.2%, with more than a point better than prior year period, and slightly better than the first quarter of 2008.

These sub-30 loss expense ratios are clear reflection of our determined efforts to sustain competitive expense levels. Second quarter ratio had a benefit of our favorable change in our estimates in certain insurance related assessments. And you should expect to see continue our focus on expense management, but recognize that market pressures will challenge these ratios for the rest the year and beyond.

With that I will turn it over to Jim.

James R. Lewis

Thanks, Craig, and good morning, everyone.

Property and Casualty operation continues to hold a steady profitable course. You've heard us talk about focused underwriting and the controls we have in place for navigate in the market cycle. These strengths we're clearly seen in the second quarter as measured by 10 consecutive quarter with sub-100 combined ratio.

We continue to optimize our portfolio by selective growth segment and sub-segment our book of business, focused on better driven decision-making, work close to with our distributors to be their go through the market and chosen classes, cross sell to get a bigger piece of each customers' insurance dollar and aggressively managed our expenses.

Market conditions are challenging very much so in sub-segments and worst mistake is trying to win in the wrong way and aim for it later. I'll prefer our course focused in... on the opportunities, we are moving around the issues and coming out even stronger on the other end.

Now let's turn to a few of our key operating metrics. Property and casualty operations net written premium volume decreased 4% for the quarter and 5% year-to-date. Standard Lines was down approximately 6% for the quarter and 9% year-to-date. For our Specialty Lines were essentially flat for the quarter and year-to-date.

Giving the current environment, we do expect downward pressure on the top line. And we also expect the pressure to be the greatest on Standard Lines. As I have said before, while we pay attention to the top line, we are not top line driven. The key issues for us are the quality of our portfolio and whether we're maximized in our risk adjusted returns.

In Specialty Lines the numbers speak to are focused on portfolio optimization. I'm also encouraged by the progress that we're making in Standard Lines. I have mentioned our small business momentum in the past, the business that is historically delivered attractive returns.

Well we are also building momentum in our 1.6 billion little market business, perhaps the toughest battlefield or battleground in the softening market. We are improving the quality of our business mix, as measured by positive renewal efficiency, segmentation and sub-segmentation strategies are gaining traction as measured by submissions hit ratio and new business mix. Our initiative specific programs have already made us a preferred market in many construction segments. And we are applying the same approach to our general industry programs.

We are also on the move with the Standard Specialty hybrid products, Steve mentioned in his remarks. In property and he marine, boiler and machinery, are excess and surplus lines and umbrella. We are building out whether already possible operations.

Overall we've done a great deal to revitalize our Standard Lines business. We've reorganized, want to focus prices, enhanced coverages, upgraded predictive models, partnering with our distributors and much more. What we're building here is sustainable platform that will serve CNA for years to come.

Now let's look at strong rate and retention metrics. During the Second quarter our average ratio declined by a bit less than 5% in line with our rich trends in the past few quarters. Standard Lines, which has been given up by rate a little faster saw rate decreases of approximately 6% in the second quarter, and Specialty Lines rate were also about 4%.

With respect to market conditions many carriers continue to show a degree of discipline. There are some exceptions though in just about every territory and every line of business.

Against this backdrop we are holding our renewal book together, and we continue to find opportunities to write quality new business.

Speaking our renewal retention, we have been running in the low 80s since 2006, and we've maintained those levels in the second quarter. Since the out trained at approximately 82%, Standard Lines retention was at 80%, and specialty was over 83%.

Our underwriters have been very effective in getting ahead of renewals and locking them in before the accounts get, are put into the marketplace. We also benefit from clients and risk control services that our customers appreciate and value.

Now let's turn to new business. We wrote approximately 290 million of new business during the second quarter of approximately 17% of total production. This compares with approximately 328 million of new businesses in the prior year period, our 18% of total production.

As we have said, new business is right for or it should be on the current market conditions. And most of it continues to come from our target classes. I won't pretend it's easy. When you won't call the market down you have to work harder. However, we do enjoy three big advantages. One, the diversification and breathe of CNA's product portfolio. Two, the local presence of our branch networks; and three, very active disciplined approach we take to new business opportunities.

For instance, we've focused on cross-sells, selling additional products to every customer. During the second quarter cross-sell generated about 103 million in premium or 35% of our total new business. Much more there is still a lot more opportunities out there. In the past year we focused our 10-K [ph] announced several high potential cross-sell opportunities, management liability, cyber liability, and international products.

Along with cross-sell, controls on adverse selection are our key cornerstone of our new business strategies. We monitor the differential between new and renewal pricing, as well as the used of discretionary pricing modification.

We also watch this spread between played [ph] and case loss ratios the new business and renewals. Our buck line [ph] underwriters are well aware of the importance of keep in this spread in a relatively narrow range.

Now let's turn to loss ratio. For the second quarter the property and casualty net count and year loss ratio was approximately 69%, up four points from prior year period.

Standard Lines came in at just under 74%, up five points, and specialty came in at approximately 65%, up four points. Our loss ratios were impacted by the same two factors that impacted our first quarter, catastrophe losses and the continued pressure on rate.

The Cats had 2.9 points to the P&C off loss ratio and 5.9 points to Standard Lines. These factors more than offset approximately one point of favorable developments in P&C ops.

On a net estimate year basis, the 2008 loss ratio for property and casualty operations was approximately 70%, a 3 point increase reflecting the same two factors.

Given the state of the market, we expect upward pressure on our loss ratio. This underscores the importance of our strategies to protect this key metrics. I've already mentioned some of them, portfolio optimization, segmentation, and predictive modeling. To these, I would add a few positives... I would add a very positive impact from our claims and also risk control services.

In claims, we are moving foreword on a strategy that we'll take our award winning claims handling for these higher levels. In risk control, we do thousand of assessments of clients and prospects every year. All this data is now integrated with our price and model. Given our underwriters have very objective evaluation of the count quality?

Turning to combined ratios, property and casualty operations came in at approximately 98%, versus 95% in the prior year period. This is our 10th consecutive sub-100 quarter.

Specialty Lines continues to perform well, with a second quarter combined of 93%, or Specialty Lines... or Standard Lines came in at approximately 103%. Bringing down our Standard Lines combined ratio remains our major challenge. And as I have mentioned, we're addressing the loss ratios at our many tranches.

As for the expense ratio side, we continue to challenge every dollar spend, and we're pleased that we report in a second quarter expense ratio of 28.2%. Our expense ratio can vary a bit from quarter-to-quarter. We are unaware and high over when it comes to expense management, it was, is and will continue to be a cornerstone of our operations.

In summary, property and casualty operation is holding a steady course in the phase of challenging market conditions. I have mentioned that things that are trying win in the wrong way.

Let me close my saying we look forward to winning in the right way; easy to say, hard to do. But, with selective underwriting, solid retention, appropriate new business, and aggressive expense management, I continue to feel we are on the right path.

With that, I will turn it back to the operator.
Question And Answer

Question and Answer

Operator

Thank you, sir. [Operator Instructions]. We'll take our first question from Jay Cohen with Merrill Lynch.

Jay Cohen
Merrill Lynch

Yes, thank you, and good morning. I've got number of questions. First is the transaction between CCC and the holding company on the surplus, I guess mostly through dividend. What was the rationale from moving that much money up to the holding company?

D. Craig Mense

Jay, it's Craig. With just the desired to really optimize the liquidity at the holding company and improve our financial flexibility.

Jay Cohen
Merrill Lynch

Okay. You didn't need approval to get that, right?

D. Craig Mense

We actually did speak approval of the transaction. The majority of the money move was actually of stock redemption transaction, and we did get approval from state regulators to do it.

Jay Cohen
Merrill Lynch

Okay. Secondly, I remember in the first quarter you had bought back some stock as I recall, I didn't notice any in the second quarter, could you confirm that and what you're thinking about that as a form of giving money back to shareholders, given the valuation?

D. Craig Mense

I could confirm we did not. We bought back 70 million of the stock in the first quarter. We did not buyback any stock in this second quarter. And I will tell you that really our thinking here is that given... you know, what you call it prudence or conservatism or whatever, we've just decided that it's given the financial markets, and given we're also facing storm season, it was why to accumulate cash at present, and we can decide later when and how to put it to use.

Jay Cohen
Merrill Lynch

Okay, fair. Two other points unrelated, on the life non-core business you had mentioned some adverse experience in the long term care business, if you could quantify and discuss what's happening there and how do we get comfort that, that won't be a continuing drag on earnings.

D. Craig Mense

The long term care, claim impacts with that $7 million after-tax in the quarter. And that was a... this quarter we had a little higher than usual claim, and that's $7 million after-tax on pretax incurred claims of about $106 million for the quarter in long term care. And last year second quarter of '07 it was a very low, unusually low number. So I don't think it's only been a couple of months, and we don't see anything that will suggest a long term trend, but let's see.

Jay Cohen
Merrill Lynch

Okay. And then a last question, you guys in the property/casualty operations, you break out sort of other revenues and other costs. We kind of just take the difference and call that other, but that number, that difference, was a lot better than it have been running. And I am wondering if there's anything unusual flowing through there?

D. Craig Mense

Not unusual, but it's really our non-insurance revenue, which really relates to warranty operations. So it's really their earnings and income from... majority of it is from our warranty operations.

Jay Cohen
Merrill Lynch

Okay just so happened, good quarter this quarter?

D. Craig Mense

You know, that's been have a good year and it's kind of... it has been a very good little business for us for a while.

Jay Cohen
Merrill Lynch

Okay. That's all I got. Thanks a lot.

D. Craig Mense

You're welcome.

Operator

We'll take our next question from Bob Glasspiegel with Langen McAlenney.

Robert Glasspiegel
Langen McAlenney

Good morning. I was very interested on your recruitment of Mr. Tom Motamed and it's very unusual of this one year sabbatical, I guess to recharge his batteries as the non-compete work its way through. Is there been any negotiations with Chubb to accelerate that and will that be have interest?

Stephen W. Lilienthal

We certainly would not add any comments on that and Tom's 12 month period is not sabbatical, it is a... it comes about by virtue of some very strong non-compete.

Robert Glasspiegel
Langen McAlenney

Right.

Stephen W. Lilienthal

That he had with Chubb and we were mindful of them when we recruited him, and we were mindful of them when we've hired him. And they reminded us of them and we run [ph] agreement that how things would be. And we look at this Bob, as a very orderly logical high quality transition. And there was no issue here with respect to any breach in stewardship [ph]. It was the ability to get a very, very high quality individual and the timing of it worked out just fine.

Robert Glasspiegel
Langen McAlenney

Well I understood, so you say you don't have any desire to accelerate the process from year-end?

Stephen W. Lilienthal

No, the process is with the process is. We hire a guy with a 12 month non-compete, and it was very firm non-compete. And we respect that as we'd effectively respected, if the situation reverse.

Robert Glasspiegel
Langen McAlenney

Understood. What's the size of your long term capital... of your long term care book?

D. Craig Mense

I'm sorry, say it again Bob.

Robert Glasspiegel
Langen McAlenney

What's the size of our long term care book currently?

D. Craig Mense

Long term care book is about $5 billion in reserve.

Robert Glasspiegel
Langen McAlenney

And premium?

D. Craig Mense

And premium it was a little over $100 million this quarter.

Robert Glasspiegel
Langen McAlenney

Okay, it's scaling down slowly?

D. Craig Mense

It's scaling down, well we should say the revenue is scaling down slowly...

Robert Glasspiegel
Langen McAlenney

Right.

D. Craig Mense

But the reserves we will continue to grow over some period of time, very long pay out on the reserve.

Robert Glasspiegel
Langen McAlenney

Understood. And the dividend to the parent was $700 million, did you say, I didn't get the exact number?

D. Craig Mense

I said we move $700 million from the insurance sub to the parent.

Robert Glasspiegel
Langen McAlenney

Okay. And last question. Could you remind me what your buyback factors in, is it to grow book value long term returns, what drives the buyback valuation parameters?

D. Craig Mense

WhatI said in the past drove buyback parameter is just really the value, the relative value of the stock at certain point in time. But, what also was a factor obviously is our desire to accumulate cash, which is very precious commodity at present. And so, we are really looking for the, how we could return the debt value for shareholders over the long term.

Robert Glasspiegel
Langen McAlenney

Okay. I have more, but I'll go back in the queue.

Operator

We'll take our next question from William Wilt with Morgan Stanley.

William Wilt
Morgan Stanley

Hi, good morning. Few questions, the... I am looking a page 4 of the press release there, exiting your loss ratios measured overtime. The specialty loss ratio on a gross basis the accident year '07 to accident year '08 deteriorated by about 360 basis points. The net loss ratio by far or less I think only 110 basis points. So I was curious if there was... if you could add some color on why the net specialty loss the ratio showed far or less deterioration than the gross. It didn't look like caps or reserved development from this side?

James R. Lewis

No. This is Jim Lewis. What's driving that is within our specialty portfolio. We do have a large cell phone captive that shows up... in gross premium it doesn't show up in the net. And then as you look at the overall loss ratio itself, the accident year loss ratio for that particular program did increase. But, from a net perspective the overall impact was really 0.1.

William Wilt
Morgan Stanley

Okay. And I am sorry, that was what kind of program?

James R. Lewis

It's a cell phone; it's a captive program for cell phones.

William Wilt
Morgan Stanley

Okay. It shows up in the gross, not in guidance. Okay, the... thanks for that, the acquisition expense ratio decreased a numbers. It was in Standard Lines, the acquisition expense ratio decreased pretty meaningfully from the year... earlier period, so I was going to ask, for some color behind that?

James R. Lewis

Yeah, on the acquisition expense we did get a benefit from some guarantee funds. There were some rate changes there, that had went up the previous year that actually went down this year. And that was the kind of the biggest driver of the change, desire from the fact outside of that we are still seeing pressure on overall commissions. And I think we'll probably still can see continue to see pressure in the future on that piece especially of the hurricanes [ph] that occurred in New York, have any positive translates. But what's driving the favorable results is really the guarantee funds, and also secondary [ph] funds.

William Wilt
Morgan Stanley

Okay, great. And then I'll squeeze in a quick third one. The Fannie Mae, the Freddie Mac preferred stock of current valuation of $321 million. Can you just... how has that changed overtime for instance, what was that a quarter ago or two quarters ago?

James R. Lewis

Are you talking about the amount sells?

William Wilt
Morgan Stanley

The amount, yeah the amount held the caring value of that. How has that changed?

James R. Lewis

The amount held is approximately about the same. We haven't really added or track actually down a little bit in terms of book. The market value declined at the quarter about... let's say about 25%, from where they were past and since the quarter they've fluctuated some, the fair values have gone down a little bit more, but then rebounded.

William Wilt
Morgan Stanley

Got it. Thanks for that, I'll requeue.

Operator

[Operator Instructions]. We'll go next to Dan Johnson with Citadel.

Dan Johnson
Citadel Investment Group

Great. I want to talk a little bit about the LP performance in the quarter. I know you referenced had tough comparisons a year ago. But, the numbers were still pretty good especially compared to the first quarter. Can you give us a little more detail about what sort of underlying fund performance you saw and whether not you thought there is any outliers till the upward or the downside? Thank you.

James R. Lewis

Dan, there weren't any outlier for the downside. And as we've said before I think you actually were characterized, many people look at these alternative investment even though we call them healthy if so they are very much like hedge funds, and they cover a multitude of strategies, and overall performance was... they all rebounded very solidly from nothing, I mean there was not anything unusual in the quarter from LPs.

Dan Johnson
Citadel Investment Group

Okay. And then just on the loss cost environment. And I realized you in a lot of lines and lot of geographic, so it's really hard to generalize. But, can you tell us what we're seeing as you through ex-Cat let's say, try to look through the loss cost environment that were in with there certainly been through a couple of years of pretty benign losses in general, is that environment persisting, is it normalizing to history or how would you describe that?

Unidentified Company Representative

All right. I'm sorry.

Larry A. Haefner

Okay. This is Larry Haefner, and I would characterize that it's still fairly benign. I mean we're still seeing favorable frequency trends, severity is still fairly modest. We haven't been impacted like some of the... I think trend sets that maybe personal line letters have seen in terms of severity. So we feel very comfortable with the environment is it that there is not adverse trends from whole hedging the last several years.

Dan Johnson

Citadel Investment Group

Thank you very much.

Operator

[Operator Instructions]. We have a follow-up question from William Wilt with Morgan Stanley.

William Wilt
Morgan Stanley

Well thanks for that. I guess following up on the last question on loss cost trends, another large commercial later this quarter commented that they had not seen, I guess with reference to commercial property specifically had not seen any notable ramp up in cost of raw materials. cement, steel, plastics presumably all the stuff that goes into building or repairing a building, I take it from your comments the same would be true and if that true, why do you think that is? It would seem from the outsider's perspective that you would have begun to see some inflationary pressures in those areas. So any thoughts on not would be appreciated?

Larry A. Haefner

Yes. We really haven't seen a drive up in severity from building material costs. I am not sure, I don't know but certainly thinks like copper costs have gone up significantly. The flipside of it, it's been a pretty benign rebuilding environment from a Cat perspective over the last couple of years; and compared to the rebuilding in Florida and the Golf Coast after 2004, 2005 that maybe leaving some of that pressure on a broader basis.

William Wilt
Morgan Stanley

Okay. Thanks for that. And I will ask one other broad question if I may, I think in couple of folks maybe see with the outside and Jim referenced use of term hybrid a couple of times in describing a new strategy. I apologize if I have missed something or maybe asking is it just a retrace perhaps you've already going over, but I missed the reference to a hybrid strategy, reference boiler machinery and some other coverages and maybe just taking and step back and describing that would be helpful for me anyway?

James R. Lewis

Yes, this is Jim Lewis. As we look at that standard specialty hybrid strategy, since there is a pressure in the middle market, and that seems to be one of the most competitive areas right now in the marketplace. And we've talked a lot in the past about the sub-segmentation and segmentation that we're doing. We really optimize that part of the portfolio. There are also some still better performing or high performing ROE businesses that are in the Standard Lines, but we actually created more lines, Specialty Lines of business. And that's in the marine, which is a very strong high performing ROE business for us and it's about $100 million book of business. We're investing our resources within the marine specialist then also products to really attack that market. We've actually see the opportunity to take that book from $100 million to $150 million. We've got a very solid performance, the book of business, which is about $100 million. It does complement what we're doing on the marine and also the property part of our portfolio. We are making investments to grow that piece of the portfolio. And in umbrella business is about $200 million book of business for us. We've got dedicated umbrella specialist throughout the marketplace, and we see significant opportunities to grow the monoline part of that portfolio.

Property which is about $300 million book for us; we think there is excellent opportunities to grow that part of the portfolio. And then our excess and surplus lines, excess and surplus lines for us is $180 million book of business, and we see opportunities to really grow from a program standpoint and also on an individual risk perspective over than our excess and surplus lines. So these are operations that are within Standard, but in reality because of the dedicated resources that we line up behind them whether it's the underwriting risk control or claim that we really treat these more or like specialty businesses, and from ROE standpoint they perform in that fashion.

William Wilt
Morgan Stanley

Thanks for that.

Stephen W. Lilienthal

Yes, Bill if I could just a follow-up on Jim's point, when you add up those five product lines that we talked and deliberately wanted to draw attention to these lines because, it gives more accretives for the whole area of diversification and our ability to shift at up just a totally on differentiated lines. You know, there is a limited number of players in the large property, the marine, umbrella, E&S and boiler, that as up to $1 billion in terms of investment, you may know all those numbers off, as we stand right now, that's about 1 billion bucks. You know, we add to a robust construction portfolio that's up in the 8, 900 range, you got lower end of the middle market and some segmentation going on down here and targeted classes you pick up are another couple of hundred million. You know, buck [ph] that up against the specialty business and you got a lot areas, so we can actually grow and shift this company into in order to offset the pressures that are on, the really truly undifferentiated product areas.

When we talk about hybrid specialty, although embedded in the standard area, these had this differentiation from a product standpoint as I mentioned limited players, Jim touched on services both on a risk control and a claim standpoint. The distribution often is differentiated and one of the additional benefits as we have flexibility of form and rate on this, so we can actually move around with a little bit more fluidity, then we can, then we could have on some of the Standard Lines that are really structured to form, file forms and rate. So we think... let's we keep talking about portfolio optimization and shifting, and this is just one of the areas and one of the major areas that we can actually take advantage of that portfolio, and they ran a good spot right now. And we are making accurate investments in terms of taking these things forward, so lot of good stuff going on here.

William Wilt
Morgan Stanley

Great perspective. Thank you.

Operator

We have a follow-up question from Bob Glasspiegel with Langen McAlenney.

Robert Glasspiegel
Langen McAlenney

How should we think about a recession impacting the calculus of your strategy, I reviewed to see a surety results which seemed pretty good, no impact from the Chubb impact of a big reserve hit. But, are there any business lines, workers' comp I know you cut-back, obviously that can get impacted by recession, but what you'll be thinking in terms of your business lines?

Stephen W. Lilienthal

Bob, you know Bob, I would I think you hit on probably the principle areas that I would be concern down. It would be the workers' comp portfolio associated with our construction of course, I think with the slowdown in the housing industry or some other commercial construction, which hasn't felt as bad as the housing industry, what we're concerned about there is the drop in rates that number the phase have put reforms in place and put anticipatory rate reductions. They reformed their benefit levels and put anticipatory rate reductions in place that may or may not workout and then see unemployment moving up, you will see payrolls drop and that could be an issue too.

So the good news is that we are not so loaded up in anyone part of that marketplace, and we have shrunk or our workers' comp go significantly from by all of it. I think we've cut it by 40% over the last several years. So we are spread out enough that while we certainly will feel, we're spread out enough that is not... I don't think it's kind of cusmic [ph] to us. And you've heard Larry Haefner mention before that we haven't seen a real run away in terms of the loss cost in some other areas that we are contribute to itself. So we we're respectful, we were mindful. I mentioned it in my opening remark, you know that we've got the insurance market is tough, the financial market is tough and the economy is not making it any easier.

So I come back to our ability to move and shift the other product lines that I mentioned to you that are looking to grow. And not a sensitive to some other recessionary influences that you might see on work comp or if we had a heavy manufacturing book a lot of product liability that runs through, I'd be more concerned. But, let's say we down play the comp. We're not a big manufacturing player and the alternative product lines and our specialty business is not though dependent on payroll and sales as those are.

D. Craig Mense

I think the other piece of that several years ago comp was getting up to about 25% of our books. It's now down to 12% of our books. So we have comp at a very manageable level and at the same time as we kind of shifted the profile of the book from larger accounts to the smaller and middle market and small business, I think that also helps the insulators [ph]. Incidentally that small business part of comp is the most profitable part of our overall word comp book.

Robert Glasspiegel
Langen McAlenney

Thank you very much.

Operator

And we have no additional questions at this time. I would now like to turn the call back over to Ms. Bufalino for any closing remarks.

Nancy M. Bufalino
Thank you, Patrick. And thank you all for joining us today. A taped replay of today's conference call be available for one week immediately following this call until August 4th. Please see the earnings release for replay details. We appreciate your participation in today's call, and thank you again for joining us.