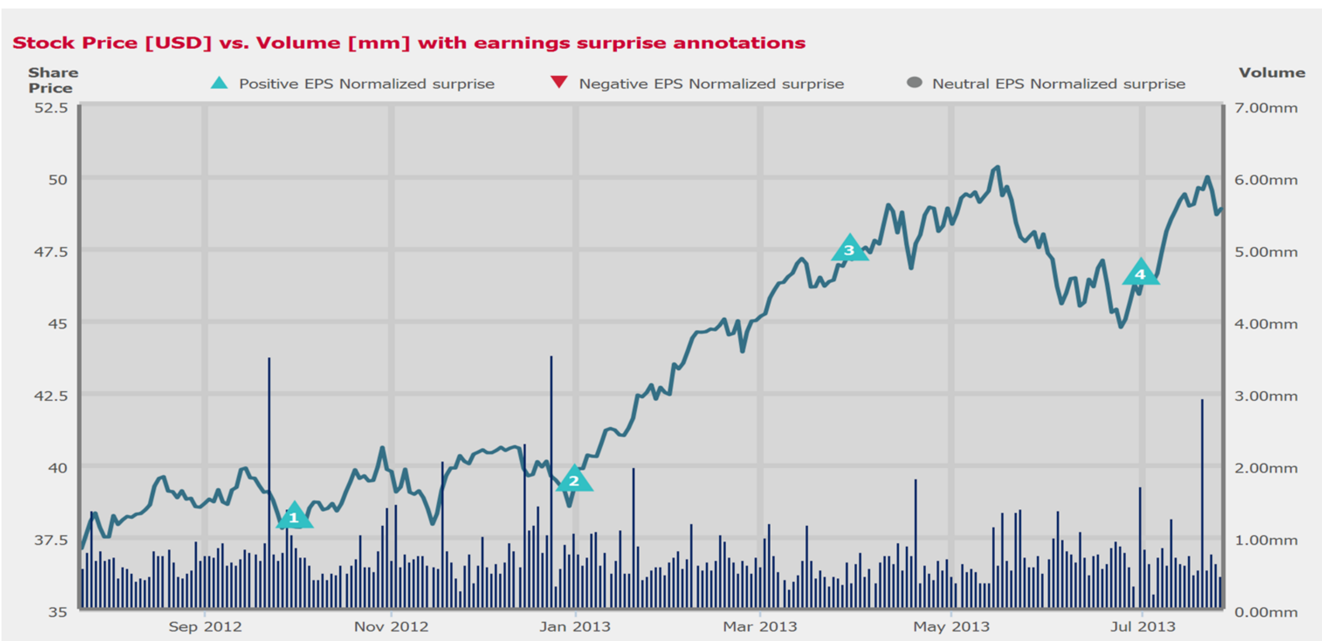
S&P Global
Market Intelligence

Cincinnati Financial Corporation
NasdaqGS:CINF
FQ3 2013 Earnings Call Transcripts
Friday, October 25, 2013 3:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ3 2013-			-FQ4 2013-	-FY 2013-	-FY 2014-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.62	0.70	▲12.90	0.69	2.80	2.60
Revenue (mm)	1127.94	1152.00	▲2.13	1101.82	4491.51	4818.32

Currency: USD
Consensus as of Oct-25-2013 2:38 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ3 2012	0.41	0.64	▲1 56.10 %
FQ4 2012	0.44	1.11	▲2 152.27 %
FQ1 2013	0.65	0.78	▲3 20.00 %
FQ2 2013	0.42	0.61	▲4 45.24 %

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Call Participants

EXECUTIVES

Dennis E. McDaniel
Vice President and Investor Relations Officer

Jacob Ferdinand Scherer
Former EVP & Chief Insurance Officer, Cincinnati Insurance Company

Kenneth William Stecher
Non-Executive Chairman of the Board

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

Marty Mullen

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

Steven Justus Johnston
President, CEO & Director

ANALYSTS

Ian Gutterman
Adage Capital Management, L.P.

Joshua David Shanker
Deutsche Bank AG, Research Division

Michael David Zaremski
Crédit Suisse AG, Research Division

Scott Gregory Heleniak
RBC Capital Markets, LLC, Research Division

Unknown Analyst

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

Presentation

Operator

Good morning. My name is Chris, and I'll be your conference operator today. At this time, I'd like to welcome everyone to the Third Quarter 2013 Financial Results Conference Call. [Operator Instructions]

Dennis McDaniel, Investor Relations Officer. You may begin your conference.

Dennis E. McDaniel
Vice President and Investor Relations Officer

Hello. This is Dennis McDaniel of Cincinnati Financial. Thank you for joining us for our third quarter 2013 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 on the call may ask questions. At that time some responses may be given by others in the room with us, including Executive Committee Chairman, Jack Schiff, Jr.; Chairman of the Board, Ken Stecher; Chief Insurance Officer, J.F. Scherer; Principal Accounting Officer, Eric Matthews; Chief Investment Officer, Marty Hollenbeck; and Chief Claims Officer, Marty Mullen.

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

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

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

Steven Justus Johnston
President, CEO & Director

Thank you, Dennis, and good morning. And thank you for joining us today to learn more about our third quarter results. We are pleased to report our best third quarter operating results ever, adding to a solid first half 2013 performance.

We believe the improvement is largely attributable to ongoing initiatives that aim to improve insurance profitability and drive premium growth, helping to create shareholder value over time.

With our third quarter combined ratio of 93.7% and our year-to-date combined ratio of 93.8%, we continue to operate in the sub 95% range that we are aiming for. While catastrophe losses remained lower than in 2012 and helped our results, our combined ratio before catastrophe losses was under 89% for both the third quarter and year-to-date periods of 2013. The ratio of our catastrophe losses for the first 9 months of 2013 at 5.1% is a full percentage point under our full year historical average of 6.1% for the past 10 years.

Our premium growth was as we expected for the first 3 quarters of the year. Each of our property casualty segments grew at a double-digit pace, as they benefited from greater pricing precision and higher overall pricing.

We continue to believe that our overall pricing trends are ahead of our loss cost trends and probably more importantly, we believe we are making progress on getting more rate on lower margin policies and retaining higher margin policies. This action results in shifting our mix of business in a favorable direction.

On an average renewal price increase basis, commercial policies that renewed during the third quarter had estimated average price increases in the mid-single digit range. That's consistent with recent quarters, with the exception of commercial casualty, our most profitable major line of businesses.

Increases on average per commercial casualty trended slightly lower as expected due to the level of price adequacy indicated by this line's 45% 9-month loss and loss expense ratio.

Increases for our smaller commercial property policies averaged in the high single-digit range. Personalized policies that renewed in the third quarter also averaged in a price increase in the mid single-digit range, with homeowners policies continuing in the high single digits. Our excess and surplus line segment also experienced renewal price increases in the high single-digit range.

As in recent quarters, we believe that our new business written premium growth is a reflection of both higher pricing we are able to get in the marketplace and the cumulative effect of growth initiatives.

Our pricing analytics and modeling tools continue to give us confidence in the level of our new business pricing. Again this quarter, there was a nice balance between growth from newer agencies and growth from those who have represented us for several years.

In our life insurance segment, earned premiums for term life insurance, the largest product in that segment also grew in a double-digit rate during the third quarter. For all of our insurance segments, we're careful to grow premiums only when we believe profitability is adequate.

Another area of growth was third quarter investment income, up slightly and increasing for the first time this year. Finally, our primary measure of financial performance, the value creation ratio, was another positive aspect for the quarter.

Our Chief Financial Officer, Mike Sewell, will now discuss that further along with other financial items.

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

Great. Thank you, Steve, and thanks to all of you for joining us today. As Steve said, results so far this year have been quite satisfying. Importantly, our 9.8% year-to-date value creation ratio remains on track to reach our annual target range.

In addition, the third quarter again demonstrated the benefit of our equity investing strategy to improve when rising interest rates or when investment income is pressured by the low interest rate environment. The stock portfolio continued to grow with third quarter pre-tax net unrealized gains up $90 million to over $1.5 million.

Dividend income grew 7% for the third quarter and first 9 months of 2013. Dividend income growth in the upcoming fourth quarter will be a challenge. Our levels of dividend income for the third quarter was approximately $4 million, or 12% below the fourth quarter of 2012.

Last year, we received about $5 million of special or accelerated dividend in the fourth quarter in response to anticipated tax law changes. During the third quarter of 2013, the bond portfolio's pretax unrealized gains declined $28 million, following a $282 million decrease during the second quarter.

Yields for our bond portfolio continue to move lower but at a slower pace as its third quarter 2013 pretax yield of 4.91% was 19 basis points lower than a year ago. At the second quarter of this year that decline was 23 basis points.

Taxable bonds represented about 70% of our bond portfolio at a third quarter end 2013 pretax yield of approximately 5.41%. The average yield for new taxable bonds purchased during the quarter was approximately 4.9%. For the same period, our tax-exempt bond portfolio yield was approximately 3.94% and purchases during the quarter yielded approximately 3.32%.

Cash flow from operating activities continues to benefit investment income. At $538 million for the first 3 quarters of 2013, net operating cash flow exceeded the same period a year ago by $105 million despite paying an additional $161 million so far this year in income taxes.

Moving to loss reserves. We continue to emphasize a consistent approach. We seek to remain well into the upper half of the actuarially estimated range of net loss and loss expense reserves.

For the first 9 months of 2013 on a non-catastrophe loss basis, favorable development at 4.2 percentage points was 5.8 points less than a year ago. About one quarter of that decrease is attributable to workers' compensation as reserves were added during the third quarter for older pre-2009 accident years.

That addition reflects recent paid lost data indicating it is taking longer to pay off order claims. Because some open workers' compensation claims extend beyond 30 years, a small assumption change for the average life of a claim can add up to be a considerable reserve amount recognized in a given quarter.

About another 40% of the favorable development decrease is attributable to commercial casualty. That line benefited more in 2012 from umbrella reserve releases and that was also experienced more favorable loss trends in 2012 than in 2013 for general liability coverages.

There was a relatively small amount of adverse development during 2013 on general liability loss reserves on a per case or specific claim basis, particularly for accident years 2002 through 2005. So we are exercising prudence by maintaining IBNR reserves at a higher level as of September 30.

Prudently managing expenses is another area with ongoing effort. Our Property Casualty underwriting expense ratio for the first 9 months of 2013 is just below the 2012 level in spite of a 0.5 percentage point increase for commissions to agents. We continue to maintain excellent financial strength and liquidity.

Cash and marketable securities at the parent company reached more than $1.5 billion at September 30, 1/3 higher than the end of last year. Property Casualty premiums to surplus ratio remained at 0.9 to 1 reflecting strong capital in capacity to support continued premium growth in our insurance segments.

I'll conclude my prepared comments by summarizing the contributions during the third quarter to book value per share. Property casualty underwriting increased book value by $0.24. Life insurance operations added $0.06. Investment income other than life insurance and reduced by non-insurance items contributed $0.47.

The change in unrealized gains at September 30 for the fixed income portfolio, net of realized gains and losses, lowered book value per share by $0.09. The change in unrealized gains at September 30 for the equity portfolio, net of realized gains and losses increased book value by $0.42, and we declare $0.42 per share in dividends to shareholders. The net effect was a book value increase of $0.68 during the third quarter to $35.51 per share.

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

Steven Justus Johnston
President, CEO & Director

Thanks, Mike. Our performance in recent quarters continues to be a source of encouragement along with various ways the company has been recognized. Most recently, Cincinnati Insurance was awarded the 2013 Pinnacle Award from Applied Systems. We're the first carrier to receive a Pinnacle Award, which recognizes innovation in technology deployment, the power of partnership and the ability to deliver proven intangible business results to our organization and the insurance industry.

As always, we see continuous improvement in all aspects of performance, whether it be providing outstanding service to agents and policyholders or adding value for shareholders, diligence and excellence and work by our independent agents and our associates continued to be reflected in our operating results and I salute them.

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

Question and Answer

Operator

[Operator Instructions] Your first question comes from the line of Mike Zaremski from Credit Suisse.

Michael David Zaremski
Crédit Suisse AG, Research Division

I guess first question, the expense ratio showed a good amount of improvement. I know you guys have just talked about the expense ratio being an area of focus. I believe 3Q of last year there were some -- kind of it was pushed a little bit as well, so I am not looking year-over-year. But anything unusual in the expense ratio or we just think about this as continued gradual improvement towards your goal of closer to 30?

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

Yes. That’s a great question. This is Mike. It is overall -- we’ve got -- we still have our general cost controls in place and how we manage our expenses. This year, we probably did see just a little bit of a downtick in some assigned risk pools that we expensed. But when you really offset that with the growth in premiums that are growing quicker than as we're growing expenses and controlling the expenses, you're really seeing the decline in the -- I’ll call it the non-commission expense part of the expense ratio. When you look at the commission side that side is up a little bit, but it’s primarily because we are more profitable and we are adding more expenses to our profit sharing that we pay out to our agencies.

Michael David Zaremski
Crédit Suisse AG, Research Division

Got it. So then as you guys work towards the goal of, I think, $5 billion or so of premiums, is that kind of the operating leverage the driver of bringing that expense ratio gradually down towards closer to 30?

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

That plays a significant role in that. We still need to keep investing in various areas in our business, whether it's IT, predictive modeling, et cetera, et cetera. We'll continue those efforts but we will do them at a managed pace with the growth on the premium side.

Michael David Zaremski
Crédit Suisse AG, Research Division

Got it. And lastly on investment income, so I think you broke out that some of the equities dividend gains won't recur next quarter. The portfolio yield looks like it's held up the last few quarters. Can you remind us -- should we expect pressure on the fixed income yield and maybe what is the new money versus existing portfolio yield?

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

Sure. This is Marty Hollenbeck. We think we’ve seen probably the worst of the pressure on the fixed income portfolio. As was mentioned, book yield for purchases in the quarter in total was $454 million versus $494 million and we broke that out taxable versus tax-exempt. We will have a very tough comp in the fourth quarter, again as was mentioned on the special one-time dividends were paid in the fourth quarter last year pulled from the first quarter of this year. We will look at much better comps once we get into 2014.

So we are starting to see a little bit improvement, obviously, with the rise in interest rates, in the kind of May, June timeframe. And the rate at which we are losing to calls has slowed somewhat, so...

Michael David Zaremski
Crédit Suisse AG, Research Division

Okay. And are you guys at your threshold for the amount of equities the composition of the entire investment portfolio?

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

Sure. We're just under 30%. The way we look at that is less as a percent to the total portfolio as we look at it from the ground up by entity, subsidiary, and we take into consideration regulatory and rating agency concerns, as well as tax considerations. Right now we could probably support up to or around the mid 30% level. So we have a little bit of room left.

Operator

Your next question comes from the line of Vincent D'Agostino from KBW.

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

One of the things that we've been hearing about is that there were some localized Midwest hailstorms that had caused some loss ratio pressure for some of your peers and that secondly that these weren't really large enough to be considered cat events and so I'm just curious if we're seeing any of that in your personal auto loss results?

Marty Mullen

This is Marty Mullen. Not particularly related to the third quarter at all. We had 8 cats in the quarter, 6 that we're tracking, only 2 of any significance and that was a hailstorm in Kansas in mid-July and then early September hailstorm, Minneapolis, but both of those are, I would say fairly moderate and not impacting personal auto any more than homeowners.

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

Okay. Perfect. And on your workers comp IBNR comment. I'm just curious if maybe what you're seeing, if there's any lingering impacts from the recession here as far as a late claim reporting kind of cycle?

Steven Justus Johnston
President, CEO & Director

This is Steve. Good question. I don't think it's so much that, I think back in 2009, we recognized we had a problem and we increased the worker comp reserves pretty substantially and that proved to be a wakeup call for all this. We realize we need to improve really every aspect of our workers compensation area. And every area in the company, from underwriting, claims, pricing, loss control, everybody lost into a series of initiatives that have resulted in considerable improvement. Improvement that we are recognizing in our accident year results and I think we were ahead of the industry in that action.

So as I saw what everybody seen here with some adverse development. I went back to our 2012 annual statement schedule P and from 2000 -- from December 31, 2009 through December 31, 2012, we actually recognized about $86 million in favorable loss in DCC reserve development on accident years 2009 and prior.

And approximately 99% of these claims are -- that were originally reported for accident years 2009 and prior are now closed. So, the roughly 9 million adverse development, we see for workers comp this quarter, is largely attributable to accident years 2009 and prior.

So, what we're seeing is appropriate caution in reserving of the 1% of claims, the tougher claims that are still open. I guess in the perfect world with the benefit of hindsight we would have released reserves on those years in more straight-line fashion, but reserves are uncertain and we make our best estimate each quarter.

So even with the small step back that we had in workers’ comp and reserve in this quarter, we’re confident in our consistent process. It’s the result in 23 years of consecutive favorable reserve development. So, I think, more than something that has to do with the recession, I think it's just being prudently cautious with some of the really old claims and how we handle them this quarter.

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

Okay. That color is really helpful. One of the things that we heard more recently from some participants at our conference is about some things about the litigation environment. And one of those was that some more economically hard-hit jurisdictions have been yielding higher awards. I'm just curious if you've seen any of that in your own book or if that was maybe something we shouldn't extrapolate it?

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

This is Marty again. That’s actually an area that we track very closely concerning the areas that we are in and some of the counties that -- certainly our target is being the more volatile counties as it relates to jury verdicts and we are very prudent about watching our files as they progress through litigation environment in those particular counties. So I don’t think we have seen any change in that. We continue to monitor pretty closely. But I wouldn’t say overall there's been any change in our book in those counties.

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

Okay. Perfect. And J.F., one of the things that we've heard is that some competitors are making investments in small commercial agent portals with what seems to be like a concurrent increase in the appetite for small BOP accounts. And I'm just curious if you're seeing any more competition for small commercial accounts in light of the relative strength in pricing versus the larger and midsized accounts?

Jacob Ferdinand Scherer
Former EVP & Chief Insurance Officer, Cincinnati Insurance Company

Vincent, I don't -- no, I can't say that we’ve seen any change in that. Explain to me again when you're talking about investments, you're talking about -- in their companies for agent portals?

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

Sure. So most of it has been, I mean, Hartford's probably been the biggest proponent of that but there's been a number of other competitors that have made comments about agent facing technology and also looking to get, I think, more aggressive on BOP accounts, just as a way to take advantage of the pricing strength and then also to get, I guess, more mind share as far as just having more looks throughout any given period and that helping them to get increased traction on even the larger accounts just from that greater visibility.

Jacob Ferdinand Scherer
Former EVP & Chief Insurance Officer, Cincinnati Insurance Company

I expect we’ve seen that going on for the last 3 or 4 years. To say that it’s heated up or any different or they're getting feedback from our agents or whether it’s impacting our ability to compete in that area. I haven't seen a lot of change or difference right now, but it’s clearly a pretty hot area in the marketplace.

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

Okay. That’s good to hear. And then if I could sneak one more in. Mike, you've commented before quite recently on the FASB's insurance contract's draft. And the comments are due today and just since you're a little bit closer to it than many of us, I'm curious if you have any insight into how -- or how likely these proposals are to get implemented?

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

It's a great question. Thank you for it. I m not going to guess on what's the ultimate outcome. I m not -- I'll say -- I don't play in that arena. We stay on top of exposure drafts that do come out. We will have a comment letter that is, I believe, in process of being posted. I think there's about 31 letters that are currently out there. But we do support the FASB and their efforts and what they're trying to do.

And so the current exposure draft, however, we believe is really not an improvement under the current U.S GAAP. We think what is out there right now is really time tested. It's highly effective. It's preferred by the investors. And we think investors really do understand the current accounting process. What is being proposed would really fundamentally change the way that we -- we record things.

And I think it will be very difficult for investors to understand. It's -- as you know, recording premiums, recording losses, actuarial and so forth. It's a very complex industry that we work in. And I think the exposure draft really adds complexity on top of complexity. We'll have to look at all of our systems, potentially re-mapping, maybe getting new systems, like where the initial data comes in, we'll change.

And what we'll really then change is our managers. We'll be managing with different numbers. And so this potentially will fundamentally change the way that we operate our business versus just doing a change in accounting in the way that we report. So we encourage you to read the comments that will be out there.

I think they're due by the end of the day today. I got to mention there is 31 that's out there. We will have one. There's also one that we participate in with the U.S. property casualty coalitions. So we'll have to see, but I'm not going to make any predictions. But at the end of the day, we do support the FASB and their efforts.

Operator

Your next question comes from the line of Scott Heleniak from RBC Capital Markets.

Scott Gregory Heleniak
RBC Capital Markets, LLC, Research Division

Just a couple questions. The first is, you guys have made a pretty big push to hire the loss control specialist over the past few years. Just wondering how far along you are in that process and what kind of benefit you're getting? I would assume it's still ongoing, but if you can give a little detail on that.

Jacob Ferdinand Scherer
Former EVP & Chief Insurance Officer, Cincinnati Insurance Company

Yes. This is J.F. We've added 60% field -- to the field since 2009 in the loss control area. We'll be closing in on total of 100 field reps in that area. To that, we've also added some specialist in property, casually, auto, professional liability, construction. So as far as the results, I'd say part of the reason why our growth has been -- where we expected it, but healthy, is that the ability of the loss control reps to gain confidence for us to go into slightly larger more complex accounts.

We're in the midst now of a very extensive inspection protocol implementation, and the inspection protocol, literally over this next several years, hundreds of thousands of inspections on the peers line side and quite a few on the commercial line side that the loss control reps will continue to lead the way on. One of the areas that we've seen the most lift from loss controls has been in workers' comp.

We've seen those results over the last couple of years. We're now inspecting and interviewing every single account for us that has a $50,000 premium or more in workers' comp. We send loss control out and go through probably half a day questionnaire with the policy holder, then follow up with loss litigation activities there.

So I don’t think we’ve seen all the lift we’re going to get. In fact, I know we haven’t seen the lift we’re going to get on the property side from the loss control stand point. We’re really just now getting into the meat of what they’re doing there.

Scott Gregory Heleniak
RBC Capital Markets, LLC, Research Division

Using it kind of consistently even for their renewed accounts to consistently kind of follow up in addition to obviously what you described, the new business in some of the more larger complex accounts as well?

Jacob Ferdinand Scherer
Former EVP & Chief Insurance Officer, Cincinnati Insurance Company

Yes, for example, on the property side, we’ve profiled every single account that we have in the company and based on a protocol that's been established by our loss control department, we have determined how many of those locations need to be inspected, with, and with what frequency. So not only will we be out on new business or we might be out inspecting properties more in depth than we would have in the past but we are saving them up on a rotation wherein some cases depending on the complexity of the account, it might be 4 times a year, or it might be once every 3 years.

But where in the past, that type of thing was left to the judgment of the underwriter based on just the circumstances when the account came up for renewal. We've transferred that accountability to our loss control division based on their knowledge of complexity of accounts, TIVs, total insured values, things of that nature. And these things will automatically happen now rather than it being random.

Scott Gregory Heleniak
RBC Capital Markets, LLC, Research Division

Right. Okay. That’s good explanation. Just a question, too, on the personal lines side. You guys talked about some of the new initiatives to improve margins and how that was impacting some of your new business. Did you see any impact at all in your renewal book? It didn't really look like it because premiums were up, I think, 10% or 12%. Just curious how your renewal customers are responding to some of these actions?

Jacob Ferdinand Scherer
Former EVP & Chief Insurance Officer, Cincinnati Insurance Company

Well we're seeing a little bit of -- in other words, we’re inspecting as I mentioned, we will inspect 60,000 or 70,000 structures this year, a 100,000 next, most of which are going to be renewals. And we are seeing a decent percentage of those where we're non-renewing or canceling those policies based on what we’ve discovered.

We're also seeing that those policies may, in fact, not have been rated correctly. In other words, there are surcharges for things such as wood stoves, protection classes, where a house might be located. There might have been an error when the policy was first written. So we're actually charging more in many cases for the policy just to get the right rate.

So -- but having said that, our retention remains good. It’s still in the low 90s for personal lines which is a pretty strong retention rate. We’ll continue along with this inspection protocol. I think you’ve heard us talk about the rate increases that we’ve initiated over the last several years.

Once again, since 2009, we’ve increased rates countrywide cumulatively just under 50% in homeowners. So on the one side, as far as pricing is concerned, that’s been a real positive but I'm real confident that getting out, seeing these properties, reaffirming the condition of the properties, taking a look at the roofs, one of the big motivations for us is to verify the age of the roofs. In those cases where the roofs are older than 15 years, asphalt shingled roofs older than 15 years, we're going to an ACV endorsement in those cases. We're going towards higher deductibles, minimum $1,000 on new business for accounts less than $500,000 coverage A and $2,500 minimum deductible for accounts greater than that.

So that’s had some effect. That’s depressed our new business but the new business is still at a decent level where I am not alarmed at all. I don’t think we're alarmed at all that the new business is down given the fact that we're getting a much better book of business right from the very beginning.

Scott Gregory Heleniak
RBC Capital Markets, LLC, Research Division

Okay. That makes sense. And then my last question was just about -- I don't know if you had an early read on what your new agency appointments might be for 2014? Compared to this year, I think you're on track for 80, which looks like you might even beat that but I don't know if you had any early expectations on that?

Jacob Ferdinand Scherer
Former EVP & Chief Insurance Officer, Cincinnati Insurance Company

Yes. We’ll probably be around a 100 next year. And I suspect we'll finish this year in the low 90s on it. And I would, in addition to the number of agencies we appoint, we’re also monitoring the critical mass of the agency. In other words, what’s the total property and casualty premium that each agency currently controls. And we're at about a $1.3 billion to $1.4 billion at this point of the year in terms of that amount of premium we have appointed this year. And next year I would suspect the target would be $1.5 billion to $1.8 billion.

Operator

Your next question comes from the line of Josh Shanker.

Joshua David Shanker
Deutsche Bank AG, Research Division

Yes. Can we talk about where you stand on E&S right now? If you look at the standalone expense ratio there, is it still being run as a start up or is it at full throttle?

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

Yes. Josh, this is Mike. Some of those expenses are still some of the ramp up as we're growing that business and expanding and adding folks to that group. What you're also going to see, you probably noticed in there also that commissions are up a little bit also and that’s primarily due to the profit sharing. So the numbers are relatively small when you're putting expenses on the premiums compared to the commercial lines or the personal lines, but that still is a -- that is still a growth mode there.

Joshua David Shanker
Deutsche Bank AG, Research Division

What size volume needs to be there to reach critical mass?

Steven Justus Johnston
President, CEO & Director

Josh, this is Steve. I think -- I think we’re approaching that. I think as these expenses that we have had as a start-up entity have been running on. I think we'll be close to finishing those and we should be in a position where we’re in a -- what you would consider an ongoing operation.

Joshua David Shanker
Deutsche Bank AG, Research Division

Okay. In that market, when I talk to some competitors who are dedicated to that market, they say the pricing isn't as strong as in -- is in the admitted marketplace. Do you find it's true? Do you find that's inhibiting your desire to grow as quickly in there as you might otherwise be able to?

Jacob Ferdinand Scherer
Former EVP & Chief Insurance Officer, Cincinnati Insurance Company

Josh, this is J.F. I guess, I'd answer that in 2 ways. We're continuing to see upper single digit renewal increases in the -- in the E&S company, very consistent, and so we haven't seen any let up in that.

Now having said that, and keeping in mind that our appetite is relatively conservative. We write a fair number of accounts that would probably fall into the category that could fall into the standard market and then back into the E&S market from time to time. And what we have seen is that on larger accounts that we have in the E&S market, they are finding their way back into the standard market. I don't know exactly.

Joshua David Shanker
Deutsche Bank AG, Research Division

With you?

Jacob Ferdinand Scherer
Former EVP & Chief Insurance Officer, Cincinnati Insurance Company

No. We have lost those accounts.

Joshua David Shanker
Deutsche Bank AG, Research Division

Okay.

Jacob Ferdinand Scherer
Former EVP & Chief Insurance Officer, Cincinnati Insurance Company

We would have preferred to keep them in the E&S market, the terms and pricing that we had already and then we lost them. And also if any standard market company will quote on that account, the agent can't place it with us. In other words, they have to get 3 declinations from the standard market or to be eligible to be put in the E&S market.

So that we are seeing that occur in terms of some larger accounts. I'll put it into context and we have mentioned this before, our agencies write close to -- now, based on all the appointments we have last few years, close to $3 billion in excess and surplus lines premiums.

We're not in markets for all of it, some of it is a very challenging business. However, we're in market for a good bit of it. So I don't think I would -- we don't view our opportunity to grow to be simply be consistent with the overall growth rate that you might see in the E&S industry.

We're continuing to take advantage of the fact that the model we have, how we tie the premiums into our agencies overall, profitability with our company, the -- our claims approach, all of the things we think make attractive to do business with us, continues to give us, I think, and will continue to give us a lot of opportunity to write our agencies E&S accounts. Notwithstanding what's going on in the larger accounts.

Operator

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

Ian Gutterman
Adage Capital Management, L.P.

I guess, Steve, my first question is, I was hoping you could give a little more color on your pricing comments on commercial lines. I guess I was a little surprised that casualty is starting to slip, just other carriers just talk more about casualty and comp hanging in there and property showing the most pressure due to the lack of losses. So I'm just curious why you're seeing something a little different.

Steven Justus Johnston
President, CEO & Director

Yes. Good question. I think the overwriting theme has been pretty consistent overall. As we look at it by line, though, I would have to say that the property is where we are continuing to get more, particularly on the small property and just a bit less on the casualty. I think, just we want to point that out in terms of just being totally open and a fair disclosure to give you a little color by line. But overall, I think the pricing has been pretty darn consistent.

Ian Gutterman
Adage Capital Management, L.P.

Okay. Great. And let's see, my next one was on the reserves. I guess, on the comp -- can you explain sort of why this is limited to '09 and prior, I guess, is what I'm trying to get at. Is there a risk that this bleeds into '09 to '12 and is it as simple as that the loss control initiatives will prevent that or could there be potential for this to leak?

Steven Justus Johnston
President, CEO & Director

Yes. That's another good question. I don't think so, I mean, there is always potential for anything, when something is uncertain as reserves. But we feel very confident and we tend to historically, by accident year, be more prudent, I would say, with the newer accident years and more recent accident years because there is more uncertainty given the limited age of development we have there.

I do think and what we saw this time as when you get into some of the older accident years, it's a well known reserving axiom that your simpler claims, settled more quickly and the tougher ones require more work on the older claims. And so I think it's limited to those older claims at this point.

Ian Gutterman
Adage Capital Management, L.P.

Okay. And do the loss control specialists just work with recent years vintage or they have worked on older claims as well, pre-existing claims?

Steven Justus Johnston
President, CEO & Director

I think it's going to be more with the newer claims, in terms of…

Ian Gutterman
Adage Capital Management, L.P.

Okay. Right.

Steven Justus Johnston
President, CEO & Director

Really preventing newer claims, yes.

Ian Gutterman
Adage Capital Management, L.P.

Okay. Okay. And then there was also a little bit of adverse in specialty package, anything unusual there?

Steven Justus Johnston
President, CEO & Director

I don't think so, that's a relatively small line and as we roll out our CinciPak product, it's going to become smaller yet, so I don't think that there was anything there of note.

Ian Gutterman
Adage Capital Management, L.P.

Got it. And then my last one is on auto and I guess before I ask the question, make sure I'm thinking about it right? Can you remind me how much of your auto book or personal lines book is sort of written through commercial agencies as sort of in combination to the business owner versus true personal lines in all agencies?

Steven Justus Johnston
President, CEO & Director

Most of our agents are appointed for both personal and commercial. We really have had good success on rounding all the accounts where we had a business owner. We're also able to write the personal lines account and life insurance and so forth. But I think if you look in totality, you will find most of the personal lines is for non-business owners that we write the business insurance for. This is just that size.

Jacob Ferdinand Scherer
Former EVP & Chief Insurance Officer, Cincinnati Insurance Company

Yes. Ian, there's only be a handful of agencies in the country that are personal lines only agents for us.

Ian Gutterman
Adage Capital Management, L.P.

Okay. That’s what I thought. But this question may not be as appropriate but maybe it still is. I was just wondering if you're seeing increased competition in auto. I mean travelers, I'm sure you've seen has been very public about cutting rates, cutting commissions. Progressive has talked a lot about pressure from these rater vehicles. Are you seeing any of that or because of your profile not being so much personal lines only agents, are you not seeing that as much?

Kenneth William Stecher
Non-Executive Chairman of the Board

Well, it’s hard to imagine, it would get tougher particularly with the advertising that the Geicos and the Progressives do. I can’t say that we've seen anything unique to Travelers so far. The only thing we will write on occasion on monoline private passenger auto policy, but typically what we write are packages.

So and in fact on homeowners, we’ve just almost gotten to the point where we’re not writing any monoline homeowners at all, we require the full package. And so the buying decision of the public would tend to be more of what’s the total package cost. There's a lot more agent involvement in it. And we’re trying to focus more on the more affluent buyer.

Everyone's got a definition of that, but what we don’t want to do and of course everyone is talking about the comparative raters and what happens. When that auction begins, we’re in a lot of these comparative raters. We don’t like it but we are truly focusing more and trying to direct our marketing and our discussions towards the more value conscious buyer. The person who appreciates the agent appreciates the kind of claim service that we give and are willing to pay up for it.

Ian Gutterman
Adage Capital Management, L.P.

Got it. And to the extent J.F. said Travelers is successful in being able to get some market share out of cutting commissions, meaning the price gain is enough to offset that and that sticks and maybe say I'm going to make it up. Say Liberty sees that and says, "Well, Progressive and Travelers are cheaper, we'll cut commissions too and then some other people follow."

If commissions are going down in the personal line space over time, would that be something you suspect you would follow? Or just given your business model, do you think you kind of stay where you are and market that as a differentiator that we take better care of our agents and people are just going to try to squeeze your commission?

Jacob Ferdinand Scherer
Former EVP & Chief Insurance Officer, Cincinnati Insurance Company

Well, we study and we recently studied the commission levels that our competitors pay between the base commission that we pay our agents, add to that the profit sharing component, we're at the top of the heap. And we intend on staying there.

Ian Gutterman
Adage Capital Management, L.P.

Got it.

Jacob Ferdinand Scherer
Former EVP & Chief Insurance Officer, Cincinnati Insurance Company

I don’t have -- as a company, we don’t have much interest in trying to win the commodity gain in personal lines. We're more valued approach than that and so that will be the focus of our marketing.

Operator

Your next question comes from line of Paul Newsome [ph].

Unknown Analyst

Just 2 questions and actually really just 2. The first one, when we think about your book and you can even comment on the industry as a whole and the re-underwriting process that's coming through, as I understand it, you've described it as being mostly focused on the lower tiers and less in the higher tiers. Does that -- are we at the point where the math is going to mean that the overall average rate of price increases will decelerate because you've gotten to those lower quality tiers already?

Steven Justus Johnston
President, CEO & Director

That’s a good question. I don’t know that, that’s necessarily the case. This is Steve. It is clear that we're looking at each policy, its unique characteristics. We're taking the appropriate rate increase based on those characteristics, but I think it will be too simple to say that, that’s going to result in more or less increase overall. It could go, I think, in either direction when you focus on such granular pricing.

Unknown Analyst

My second question is have you looked at the sensitivity between just your overall profitability and the commission rate given the contingent commission has some -- I assume there is some relationship between basically your combined ratio overall and your contingent commission?

But have you ever looked at sort of big picture sensitivity on what that means? I assume that we should be sort of thinking along those lines but I've never really been able to figure out exactly what it means, even though there is a maximum band.

Steven Justus Johnston
President, CEO & Director

Yes. Paul, I guess we’ve never tested it, if I understand your question, right. Could we pay -- are you saying could we pay less in profit...

Unknown Analyst

Well, no, I just think your combined ratio -- as your combined ratio goes down, your contingent commission is going to go up. And I'm wondering what sort of sensitivity there is? If you've ever looked at how much that contingent commission could go up if you reached really an extraordinary level of underwriting profitability?

No, I just think it your combined ratio as your combined ratio goes down your contingent commissions going to up, and I am wondering what sort of sensitivity there is, if you ever look at just how much that contingent commission could go up if you reached, really, an extraordinary level of underwriting profitability.

Steven Justus Johnston
President, CEO & Director

Yes, this is Steve. We have actually done simulations on that in the past. I think that we're in partnership with our agents, obviously. We really rely on them as front line underwriters and so we see those 2 going hand in hand.

Unknown Analyst

Is there any rule of thumb that we could as outsiders use?

Steven Justus Johnston
President, CEO & Director

I don't think so. I think if you look at the past history, particularly in the last couple of years, I don't know that I would necessary have a rule of thumb for you.

Operator

There are no further questions at this time. I'll turn the call back over to Steve Johnston for closing remarks.

Steven Justus Johnston
President, CEO & Director

Well, thank you very much. Thanks to all of you for joining us today. We appreciate your questions, we appreciate your interest and we look forward to talking to you soon. Thank you.

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