S&P Capital IQ

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# Cincinnati Financial Corporation NasdaqGS:CINF

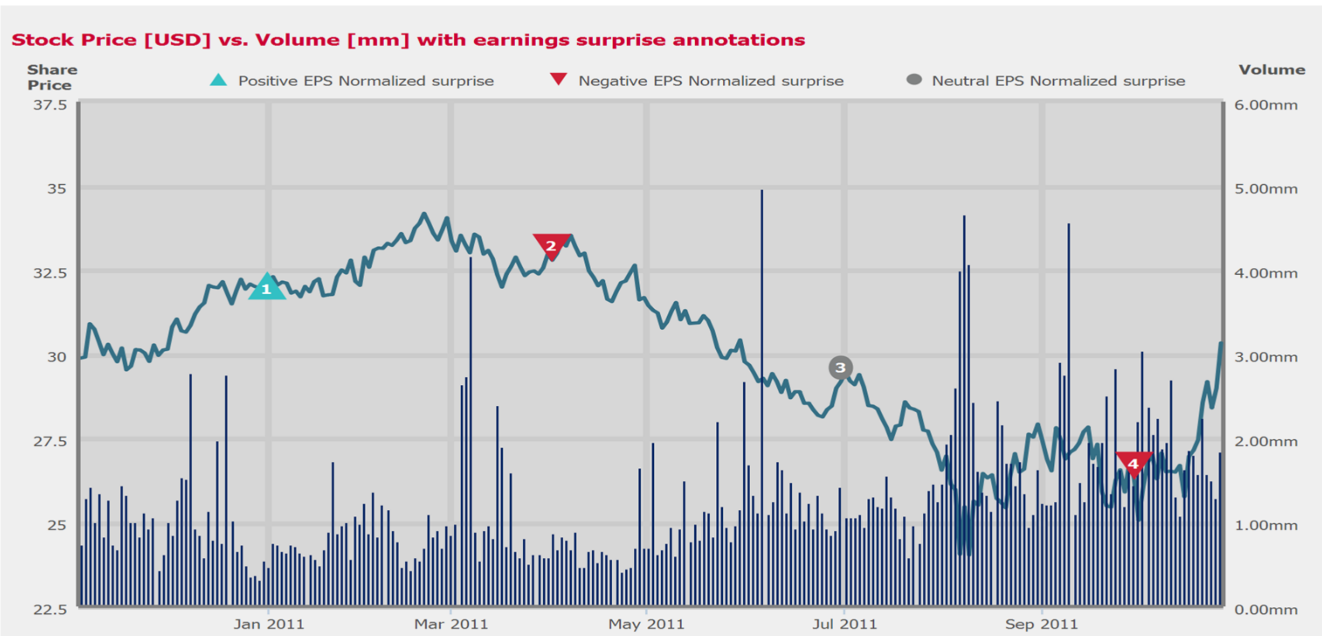
*FQ4 2011 Earnings Call Transcripts*

Thursday, February 09, 2012 4:00 PM GMT

## S&P Capital IQ Estimates

| | -FQ4 2011- | | | -FQ1 2012- | -FY 2011- | |
|---|---|---|---|---|---|---|
| | CONSENSUS | ACTUAL | SURPRISE | CONSENSUS | CONSENSUS | ACTUAL |
| **EPS Normalized** | 0.56 | 0.86 | ▲53.57 | 0.38 | 0.44 | 0.74 |
| **Revenue (mm)** | 950.75 | 955.00 | ▲0.45 | 975.84 | 3757.50 | 3803.00 |

Currency: USD
Consensus as of Feb-09-2012 2:06 AM GMT




- EPS NORMALIZED -

| | CONSENSUS | ACTUAL | SURPRISE |
|---|---|---|---|
| **FQ4 2010** | 0.37 | 0.70 | ▲1 89.19 % |
| **FQ1 2011** | 0.37 | 0.33 | ▼2 (10.81 %) |
| **FQ2 2011** | (0.59) | (0.57) | NM |
| **FQ3 2011** | 0.16 | 0.13 | ▼3 (18.75 %) |

# Call Participants

## EXECUTIVES

**Dennis E. McDaniel**
*Vice President, Investor Relations Officer and Vice President of the Cincinnati Insurance Company*

**Jacob F. Scherer**
*Former Chief Insurance Officer*

**Martin Francis Hollenbeck**
*Chief Investment Officer, SVP, Asst. Secretary, Asst. Treasurer and President of CFC Investment Co.*

**Michael J. Sewell**
*Chief Financial Officer, Senior Vice President and Treasurer*

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**Vincent M. DeAugustino**
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# Presentation

**Operator**

Good morning. My name is Steve, and I will be your conference operator today. At this time, I would like to welcome everyone to the Fourth Quarter 2011 Earnings Call for Cincinnati Financial. [Operator Instructions]

Thank you. I'll now turn the call over to Dennis McDaniel, Investor Relations Officer. Please go ahead.

**Dennis E. McDaniel**
*Vice President, Investor Relations Officer and Vice President of the Cincinnati Insurance Company*

Hello, this is Dennis McDaniel. Thank you for joining us for our fourth quarter and full year 2011 earnings conference call. Late yesterday, we issued a news release on our results, along with our supplemental financial package. To find copies of any of these documents, please visit our Investor website, www.cinfin.com/investors. The shortest route to all of the information is in the far right column via the Quarterly Results quick link.

On this call, you'll first hear from Steve Johnston, President and Chief Executive Officer; and then, Chief Financial Officer, Mike Sewell. After their prepared remarks, investors participating on the call may ask their questions. At that time, some responses may be made by others in the room here with us, including Executive Committee Chairman, Jack Schiff Jr.; Chairman of the Board, Ken Stecher; Executive Vice President, J. F. Scherer; Principal Accounting Officer, Eric Matthews; Chief Investment Officer, Marty Hollenbeck; and Chief Claims Officer, Marty Mullen.

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, please 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 the statuary accounting rules and therefore were not reconciled to GAAP.

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

**Steven J. Johnston**
*Chief Executive Officer, President, Director and President of Cincinnati Life Insurance Company*

Good morning. It's a pleasure to speak with you today from [indiscernible] Tennessee, where we will meet with agents this afternoon. This is the fourth state among 22 in total that we are visiting during the first and second quarters. Our agents with their optimism, their commitment to our partnership and shared goals really energize us. After three state quarters of heavy catastrophe losses, the fourth quarter was profitable, with commercial line, personal line, excess of surplus lines, life insurance and investments all contributing to strong operating earnings. Essentially, all our indicators of longer-term performance are moving in the right direction and that bodes well for creating shareholder value.

Various strategic initiatives are having a positive effect and I'll highlight several key areas.

As we discussed during our last quarterly conference call, better insurance pricings is a top priority. We are experiencing improvement through a combination of our diligence, plus somewhat more favorable conditions in several markets. Our pricing precision for each policy continues to improve as we gain more experience with our pricing models.

More thinly price risks are getting significantly higher prices. Fourth quarter increases in renewal pricing occurred for each property casualty segment and also, for each major line of business within segments.

As we pre-announced, commercial lines renewal pricing accelerated during the quarter with average increases in the low to mid-single digit range. Just over 80% of our commercial lines renewed at flat or higher prices. For our excess of surplus line segment, renewal prices continue to increase and are solidly in the mid-single digit range.

Pricing changes for that segment have been positive for the last 16 consecutive months. For personal lines, we believe our 10% increase in 2011 renewal premiums is roughly half from higher rates and half from higher policy accounts. Policy retention has remain fairly steady over the past 2 years with fourth quarter retention in the high upper 80% range for commercialized policies, and then our low to mid 90% range for personalized policies. Our agents are able to sell the value of our products and services. They continue to work with us to implement price increases where they are needed.

The market remains competitive, particularly for new business, while agencies appointed since the beginning of 2010, drove our 6% new business premium increase for 2011. New business written premiums for agents appointed prior to 2010 decreased approximately 2%.

We are seeing plenty of opportunities to grow profitably and are comfortable declining new business opportunities we believe are underpriced. We also continue to gain confidence that our pricing analytics are helping us to distinguish the more attractive new business offerings from the less attractive ones.

In 2011, we appointed 133 new agencies in areas we consider unreserved about a dozen more than we planned at the beginning of the year. During 2012, we planned to appoint around 130 agencies. It takes several years for our new agency to develop the double-digit market share we enjoyed with agencies appointed for 10 years or longer. The accelerated pace of appointments in recent years, plus our commitment to serving all our agencies and our clients put us on a path where we believe we can achieve $5 billion of direct written premium by 2015.

Above all, our emphasis on premium growth is to do so profitably, in order to raise the level of earnings and book value over the long-term.

Our life insurance business also grew in 2011 with earned premiums up 4%; term life, the largest product line rose 9%. Although, life insurance profits remain challenged by the low interest rate environment, our agencies value the ability to offer quality like products and services to their commercial and personal insurance clients.

The year 2011 will be remembered by many for its violent weather and other natural catastrophes. From a financial perspective, our unprecedented catastrophe losses in 2011 were an earnings event rather than a capital event, as we ended the year with higher shareholders equity than at the start of the year.

An important risk management element for keeping our capital strong is an effective reinsurance program, and we have renewed all our primary reinsurance treaties for 2012. For our [indiscernible] treaties property rates were up approximately 10% and casualty rates were down around 5%.

We chose to add $100 million more to our property catastrophe reinsurance coverage, rating it to $600 million per event and we now retain the first $75 million of loss. For our $500 million event, our net retention is $115 million compared with the $88 million in 2011 and $104 million in 2010.

Assuming stable levels of facultative reinsurance, we estimate that our total 2012 premiums [indiscernible] to reinsurers will be approximately $181 million down roughly 16% from 2011 and up about 8% from 2010.

Another important aspect of 2011 high-level catastrophe activity was that it allowed us to showcase our expertise in providing claims service. I can thoroughly stand up about how well our claims staff performed and about how our claims response and other elements of our service play an integral role in our ability to profitably grow the company.

We aim to give policyholders consistent value and service through all these storms and we believe shareholders deserve consistency too. The payment of our dividend to shareholders last October marked our 51st consecutive year of increasing dividends, and we are committed to efforts that will benefit shareholders and other stake holders for years to come.

For 2011, our value creation ratio was 6.0%, but that’s below our target range for the annual average and any 5-year period. We are encouraged that our book value per share increased despite a catastrophe loss ratio that was three times higher than the annual average for the prior 10 years. Further, we remain confident that various initiatives to improve profitability and grow premiums will continue to bear fruit, driving stronger value creation over the coming year.

Now, our Chief Financial Officer, Mike Sewell will further comment on results during the quarter and several points regarding our balance sheet.

**Michael J. Sewell**
*Chief Financial Officer, Senior Vice President and Treasurer*

Thank you, Steve. And thanks all of you for joining us today. I'll start by highlighting important trends in our property, casualty, underwriting performance. While our full-year 2011-combined ratio of 109.2% was disappointing compared to our history and targets, we see several reasons to be optimistic.

On a calendar year basis, the combined ratio before catastrophes improved by $0.07 of a percentage point. Factor out the effect of additional 2011 ceded premiums from reinstating our property catastrophe reinsurance treaty and that improvement was 2.0 percentage points.

On an accident year basis before catastrophes, the combined ratio for accident year 2011 improved by 2.7 percentage points over accident year 2010 after factoring out the effect of reinstatement premiums.

We remain confident about the strength of our loss reserves and development patterns. Our approach is consistent. We aim to remain solidly in the upper half of the actuarially estimated range knowing that it is important for long-term financial performance. Reserve development on prior accident years recognized during 2011 was fairly consistent with 2010 down $0.09 of a point to a ratio of 9.4%.

For favorable reserve development recognized during 2011, 63% was for accident year 2010 in line with 62% for accident year 2009 that was recognized during 2010. For both periods, the balance of favorable development was concentrated in the 2 next most recent accident years.

Our updated loss and loss expense reserve estimates as of December 31, 2011 show accident year 2010 develop favorably by about 6 points on a ratio basis, while accident years 2009 and 2008 developed favorably by approximately 8 points over the years.

For both 2011 and 2010, our commercial, casualty lines of business was the majority beneficiary of the favorable development. There is no absolute assurance that accident year 2011 will develop in a similar pattern, but we do aim to be consistent in our reserving practices.

During the fourth quarter, we refined our allocation to line of business, segment and accident year for loss expense payments and reserves knowing adjusting other expense or AOE. For the refinement had a 0 effect by consolidated property, casualty loss expense reserves in total some lines of business experienced higher incurred loss expenses in some lower. This was a 1x refinement of reserves among the lines of businesses.

The full-year 2011 ratio affect raised on a personal a line segment ratios by approximately 3 percentage points then lower the commercial line segment ratios by about 1 point. Some lines of business had larger effects.

Turning to expense management. Our insurance operations reflecting focus on improving service and efficiency. The total number of associates and contractors is down 4%, since the end of 2009 and includes a 4% increase in field associate's offsets by a 5% decrease in headquarters staff and a 30% decrease in contractors.

Our 2011 property, casualty underwriting expense ratio at 32.2% was 60 basis points lower than last year. We anticipate the expense ratio continuing to benefit from future premium growth and more efficiency in our processes. Investment income is an area where we trend -- our trend continues to run counter to what the industry is experiencing.

[indiscernible] rose 1% for the year 2011 on a pre-tax basis. A pre-tax yield or above portfolio for year 2011 was 18 basis points lower than the prior year, so interest income continues to face a headwind.

The portfolio had an effective duration of 4.4 years at year-end down from 5.0 years at the end of 2010. Due to an income was the source of our investment income growth during the 2011. Dividends from our equity portfolio were up 4% for the fourth quarter and up 5% for the year.

Our equity portfolio also had a nice rebound in valuation during the fourth quarter. The portfolios fair value ended the quarter up 13% reversing the 12% decline during the third quarter.

Pre-tax net unrealized gains for the total investment portfolio reached nearly $1.5 billion at the end of 2011, an increase of 19% from a year earlier. Our investment approach remains consistent and we think the long-term capital appreciation potential is important.

Our capital remains strong and we ended the year with over $1 billion and holding company cash and marketable securities. We are well positioned for capital management purposes and for growing our insurance business.

I’ll conclude my prepared comments by summarizing the contributions during the fourth quarter to book value per share. Property, casualty-underwriting profit increased book value by $0.39. Life insurance operations added $0.04. Investment income other than life insurance and reduced by non-insurance items contributed $0.41.

Shareholders equity changes related to our pension fund, lower book value per share by $0.11, primarily due to the low interest rate environment. It changed an unrealized gain at December 31 for the fixed income portfolio, net of realized capital gains and losses increased book value per share by $0.07. So change in unrealized gains at December 31 for the equity portfolio, net of realized capital gains and losses increased book value by $1.22, and we paid $40 and $0.25 per share in dividends to shareholders. The net affect was a book value increase of $1.62 during the fourth quarter to $31.16 per share. Adding the dividend, our value creation ratio for the quarter was 6.8%.

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

**Steven J. Johnston**
*Chief Executive Officer, President, Director and President of Cincinnati Life Insurance Company*

Thanks Mike. We have in place a strong foundation both financially and strategically, and we will see better days ahead in terms of company performance. In addition to having the most dedicated associates in the business, we work with the most professional independent agencies in the business. We look forward to strengthening our partnership as we meet with agents at sales meetings across the country over the next 4 months. We also look forward to meet in person with many investors and shareholders throughout this year and we appreciate your interest in Cincinnati financial Corporation.
With me today to further discuss our results and outlook are Jack Schiff Jr., Ken Stecher, J.F. Scherer, Eric Mathews, Marty Mullen and Martin Hollenbeck, and we all are available to respond. Steve, we're ready to open the call for questions.

# Question and Answer

**Operator**

[Operator Instructions] And your first question comes from the line of Matt Rohrmann from KBW.

**Matthew Rohrmann**

Two questions, first, on the development side, obviously your details on the pre-announcement about their role development in the property side, I mean then the quarter came in with some excellent results on the casualty side. Just curious what were the primary drivers of the favorable experience on the casualty side? Was there anything in there in terms of special settlements or is that just sort of overall trends?

**Steven J. Johnston**
*Chief Executive Officer, President, Director and President of Cincinnati Life Insurance Company*

Matt, I think it was overall trend. We tend to look at the full year and you know it's going to have variation, but we think we have a very consistent practice. We think it's been consistent over time. We've got reasonable consistency if you look at full years across time, and we think the benefits come from a lot of the hard work, our associates and agents are putting in terms of getting ready, knowing more about our risk, all sorts of underwriting initiatives, front line underwriting by our agents. So we think that's been the primary driver.

**Matthew Rohrmann**

It feels like workers' comp is heading the way you wanted to write, Steve?

**Steven J. Johnston**
*Chief Executive Officer, President, Director and President of Cincinnati Life Insurance Company*

Sure. That's one that we're feeling particularly pleased about. I'll let J.F. -- would want to add any more comments, because that's been the real team effort there.

**Jacob F. Scherer**
*Former Chief Insurance Officer*

Yes. We've talked a lot about the workers' comp in the last couple of years between a lot of help from predicting modeling and analytics on the pricing side, much more in the way of specialized lost control activity and most especially some of specialized activity we've had in the claims handling area. And we're frankly pretty proud of the improvement we made this year. It appears that the industry is going to go in the opposite direction this year, and we're confident that we can improve it even beyond what we've done already.

**Matthew Rohrmann**

Okay, great. And then last question, as you guys travel around the country doing your meetings, I just want to get a sense of how balanced the strength and pricing is. I mean, is it heavy in the Midwest post the storms, property obviously, but I'm just wondering how broad based that is, as you guys meet with different folks across the board?

**Steven J. Johnston**
*Chief Executive Officer, President, Director and President of Cincinnati Life Insurance Company*

Matt, we feel to be fairly broad based. There's a lot of enthusiasm, a lot of optimism, I think most of the agency folks, as we talk to them. Obviously, every policy is different, every situation is different, we do think it on a risk-by-risk basis, but term and I think it has been pretty uniformly positive in terms of the performance.

**Jacob F. Scherer**
*Former Chief Insurance Officer*

Yes. And I guess I would add a little bit to that. We've only been in Charlotte, Atlanta and Birmingham so far on our trip. So we haven't been out west during the Midwest that we travel a lot. Talk to agencies, many agencies, visit Cincinnati as well, and as Steve said, I think there is an acknowledgment universally that price increases are deliverable. Having said that and you all of it now is that many of your reports that new business can still be pretty competitive. So that if you will, the finesse that’s being used to raise rates appropriately, kick it on, and when you're feeling it a very good account only do want to retain, you do want to go to extremes, because if they gets to the marketplace, it will draw attention. But we're not giving at all from any agent you talk to, any sense of a lack of confidence on their parts to be talking about rate increases with their policyholders.

**Steven J. Johnston**
*Chief Executive Officer, President, Director and President of Cincinnati Life Insurance Company*

Hey Matt, before we let you go, I want to give just some a little bit of refinement on the workers’ comp and so just a clarification and we talked about it in the press release in terms, and Mike in his opening comments about the all other expense reserve. And for the year, again while the calendar year was the same unaffected in terms of allocating to line, the workers’ comp did benefit by about 11 points on the calendar year, by that refinement.

**Operator**

Your next question comes from the line of Vincent DeAugustino from Stifel, Nicolaus.

**Vincent M. DeAugustino**
*Stifel, Nicolaus & Company, Incorporated, Research Division*

In the press release commentary, you mentioned the possibility of writing as much as $5 billion in premiums by 2015. So just a few questions on that with the first thing, how much of that growth do you think could be driven by accepting business that Cincinnati is already quoting on, but just not meeting your profitability hurdles versus how much of that do you think would need to come from new agents or geographies and accounts? And then second what net written premium to surplus ratio would you anticipate running at, if you could reach that $5 billion target, I'm assuming that you could up the leverage a little bit, but just curious if you would have something in mind?

**Steven J. Johnston**
*Chief Executive Officer, President, Director and President of Cincinnati Life Insurance Company*

Let me just touch briefly on the elements of it. I think the key point is that we want to grow profitably, that’s key. We want to get as much of that growth is from our same agents we can. But we also recognize that we're under served in certain areas where we’re appointing new agents. In terms of the capitalization, we could grow up a bit, we’re running about 0.8 to 1 in terms of our premium surplus ratio. Now we feel confident that as we grow the book profitably, especially when you consider the capital as the whole income, we’ve got plenty of capital to support all the profitable business our agents can send us.

**Vincent M. DeAugustino**
*Stifel, Nicolaus & Company, Incorporated, Research Division*

Okay. And I know you just mentioned the impact from work comp on the refinement and the adjusting salaries, but I was curious if you could maybe call that out for personal auto, just because I think that the core underwriting results there looked a little abnormal?

**Michael J. Sewell**
*Chief Financial Officer, Senior Vice President and Treasurer*

Yes. This is Mike Sewell, for the personal auto, the effect was that is increased 8.5 points for the quarter -- for the year, I am sorry, that’s for the year. So the workers’ comp was down benefited 11.5 for the year. Personal auto was up 8.5. Now I do comment that the personal lines, it was up 2.8, but commercial lines was down 1.0. But overall when you look at the AOE reserve in total, the net reserve from year-to-year, it’s within $2 million between the 2 years. So it really had a 0 effect on total reserves and it’s really just between the lines.

**Operator**

Your next question comes from the line of Ray Lardella from Macquarie.

**Raymond Lardella**

Quick question, I guess on the number of agents you guys appointed during the fourth quarter, 32. I mean how much of premium do those agents write? I think you had put out a number for the first three quarters, just curious if those were larger, smaller and relatively similar?

**Steven J. Johnston**
*Chief Executive Officer, President, Director and President of Cincinnati Life Insurance Company*

Well just in the fourth quarter, the agencies would have not contributed a lot to the new business. They're just up and running, agencies appointed in 2011 were $14.9 million. So it ramps up 2, 3, 4 months after they get on board with us, and so there is a contribution there.

**Raymond Lardella**

Okay. Maybe I'm asking the question a little incorrectly. But I think in your presentation, it's above $1.6 billion in the agents you'd had appointed during 2011, up in the first 3 quarters. I'm just curious is that another $400 million of upside potential in premiums you guys could write from those new agencies or have you not released that number yet?

**Steven J. Johnston**
*Chief Executive Officer, President, Director and President of Cincinnati Life Insurance Company*

We do track not only the number of agencies we acquired, but the total standard, commercial lines and personal lines premium in those agencies, like we average right now about 22% of the personal lines premiums that our agencies write. So when we make those appointments, we would think over a period of, let's say 10 years, they're just from those agencies, we could hit that type of mark, same would be on the commercial line side after 10 years, we write about 10% of the agencies volume. And so we would expect that the lift will get for making those appointments would be in that range. Nothing just happened over the last, let's say 5 years, wouldn't discourage us from believing we couldn't have the same kind of penetration in agencies we've got to appointing recently.

**Raymond Lardella**

Okay, that's helpful. and then I guess, just talking, I think on the conference call, you guys have talked about the delta between pricing for a 1year policies and 3 year policies and how it had expanded a little bit. I'm just curious when does the commentary about pricing of low-to-mid single-digits, does that encompass both 1 year and three year policies and then 2, could you guys comment on maybe where the delta is between the 1 and 3 year policies right now or in the fourth quarter?

**Steven J. Johnston**
*Chief Executive Officer, President, Director and President of Cincinnati Life Insurance Company*

Yes it does include the 1 and 3 year policies in terms of our averages. We would typically charge somewhere in the range of 5 percentage points difference between a 1-year and a 3-year policy. and so something would be typical right now for a 1-year policy would be in the mid-single digits, 4% or 5%. So we would go up precise 8% or 9% maybe 10% on a 3-year policy. The marketplace atmosphere right now is such that there is a lot of -- our 3-year policy has always been a strength and most especially the time like this. So we're being careful to make sure we're getting a premium for the 3-year policy and our agencies are finding that sellable and very attractive to be able to offer that.

**Raymond Lardella**

Okay, that's helpful. And then I guess lastly, just thinking about capital. I mean obviously 0.8 number [ph] surplus a lot of capital at the holding company and I know overtime, you guys have been able to grow book value given the size of the equity allocation. One, I guess, are you guys comfortable about 25%

of equities for your total portfolio and then 2, I mean do you guys continue to believe you create more shareholder value by holding that extra capital in equities?

**Steven J. Johnston**
*Chief Executive Officer, President, Director and President of Cincinnati Life Insurance Company*

Yes, make sure by the end of this, I've answered your question. So I do believe that we feel comfortable with the 25% in equity. I think as we have growth patterns as the -- what is the excess capital? The definition may have changed a little bit as we went through the '08, '09 period as we've seen weather, we've seen. We think for a growing company, it's good to have strong capital, and that's been a great thing about the Cincinnati over the 60-year history. We've never been constrained by capital to grow. and so we want to make sure that we have plenty of capital to grow. We want to balance that with returning capital to our shareholders and we do that we think with the dividend, with increase about for 51 consecutive years now. We repurchased shares each in the last three quarters. So we're just going to balance it over that period of time, and make sure, we've got plenty of capital to grow, but also make sure that we're returning capital to our shareholders.

**Raymond Lardella**

And then last question I guess and I know you guys have talked about the loss adjustment expenses in that the change in allocation there, but I guess for the fourth quarter, it look like the accident year loss ratio excluding catastrophes was quite a bit lower just for the business overall versus the first 3 quarters of the year, sort of 9.30 year-to-date number. I'm just curious was there a true up with the 2011 accident year going on during the fourth quarter or maybe can you talk about some of the thought process in the lower accident year loss ratio.

**Steven J. Johnston**
*Chief Executive Officer, President, Director and President of Cincinnati Life Insurance Company*

We think we're getting good improvement in the accident year loss ratio. We do feel we were benefited by a little bit by our true up, during the true up of the AOE, during the final calendar quarter, we think probably benefited the accident quarter by about 6 loss ratio points.

**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 of questions, you gave the $5 billion premium target and I'm just wondering what you foresee E&S per unit as being as part of that $5 billion and also personal lines roughly, do you say and expect next to be somewhere the same personal lines versus commercial and where do you see the E&S being fitting in there?

**Jacob F. Scherer**
*Former Chief Insurance Officer*

Scott, this is J.F., I'll give you a rundown on what we're projecting in the commercial lines area, we're looking at about $3.4 billion in personal lines about $1.2 billion, CSU, our excess surplus line subsidiary we're targeting about $160 million and in life insurance, $290 million. Was it helpful?

**Scott Gregory Heleniak**
*RBC Capital Markets, LLC, Research Division*

Great. That's helpful. And the next question I have was just on you guys have talked a lot this year, the past several quarters about predictive modeling. And I know you put a lot of effort into that. Just wondering is that completely rolled out to fully the most of the lines that you won or is there a more room for that in 2012 and the next couple of years.

**Steven J. Johnston**

*Chief Executive Officer, President, Director and President of Cincinnati Life Insurance Company*

On the Workers' comp side, it's fully rolled out and we have been using now for almost 2 years. On the commercial line side, it's in the process and in other words, our entire book of business has been modeled. But we're coming up on renewals for all of that. And so we still have ways to go, for all of our renewals to have received the contribution of the insight that the model is going to give us. So it's in process right now, it's going, we think, very well. One indicator that we'd like to see is that -- there was a question earlier about whether or not we can grow to these levels profitably, writing new business, the new business that it will be required. The model is showing that the new business that we're writing has drastically improved by virtue of having the model and running the perspective new business through the model, we're seeing the projected loss ratios on new business are actually very good. And so in addition to agencies being particularly careful with us, when they've first put business with us after recent employment. We have the benefit as a model helping us in that particular area. So in all areas both renewal and in new business, we're seeing a tremendous benefit from the model, it will continue to be refined, will come out with the next generation of our Workers' comp model. As you all know, it's a process, the model it's not a stationary target, but it's worked out very well for us.

**Martin Francis Hollenbeck**
*Chief Investment Officer, SVP, Asst. Secretary, Asst. Treasurer and President of CFC Investment Co.*

Scott, I might just add a little more about the personal lines as well and that it's gone through 3 rate revisions, three annual rate revisions now. It's really gaining traction and we've got plans for fourth. And so in addition to getting more rate, we feel we're getting on the personal line side as well as commercial to rate were shifts needed and we feel pretty positive about the rate increase and really the shift in the mix of our book towards what we feel that the better risk characteristics.

**Scott Gregory Heleniak**
*RBC Capital Markets, LLC, Research Division*

Okay. And then along those lines, but the -- as far as new business, what's the differential between the price increases, you're seeing on renewal versus new, and is there anywhere -- any class, geography in particular you're pulling back more, because the pricing is a lot more competitive. I know you kind of alluded to workers' comp a little bit, but is that where most of that is coming from?

**Steven J. Johnston**
*Chief Executive Officer, President, Director and President of Cincinnati Life Insurance Company*

Scott, I'll address the question on the differential between new and renewal. We think as J.F. mentioned, we're getting rate adequacy in both areas, but we don't have a lease with -- let's say split between how much more adequate or inadequate new versus renewal might be, so from that part of the question.

**Michael J. Sewell**
*Chief Financial Officer, Senior Vice President and Treasurer*

Yes. I would say in terms of where we're getting the new business, as was mentioned in the release, we are getting a lift from the new appointments that we've made. That's the reason why we're growing in new business. agencies that were appointed 2009 and previous, they were actually down a bit, I think that's a commentary on the fact of new business still remains fairly competitive. Just by way of description of the fourth quarter on a direct basis, our casualty premiums were up 3.7%, our property premiums were up 4.3%, commercial auto was up 2.5%, and this is all new business, workers' comp was down nearly 30%. We don't view that as an alarming amount, but it does -- it is a reflection on the conservatism that we're approaching comps. So I'd say as much as anything, we're pretty satisfied with the flow of new business, they add that's we're getting, it's still competitive, but we're confident that how we're pricing, what we end up writing is, we're in a better position right now than we would have been a year ago.

**Operator**

[Operator Instructions] And your next question comes from the line of Paul Newsome [ph] with Sandler O'Neill.

**Unknown Analyst**

I was hoping you might be able to help us get a better sense of the effective tax rate going forward. It's been jumping around a little bit and maybe you can do help us there?

**Steven J. Johnston**
*Chief Executive Officer, President, Director and President of Cincinnati Life Insurance Company*

Yes. I think I might add my comment a bit, but I think the main thing is just the mix between our underwriting profit and our investment income and we've got a variety of tax rates, underwriting tax that a 35% or gains or tax of 35% or with our dividends received deduction in the municipal bonds, we've got varying tax rates there and Mike might have a little more color on that, but I think it's the variation and where the earnings are coming from and what the tax rate is for that particular bucket.

**Michael J. Sewell**
*Chief Financial Officer, Senior Vice President and Treasurer*

You're exactly right, Steve. And Paul is unlike when you think about the effective tax rate, when we take our pretax GAAP book income, 35% with that being a little bit lower this year than the prior year, which was about $500 million versus $176 million this year. By the time you take the tax-exempt interest in your dividends received deduction out. It ends up bringing you down to a pretty low number. And so then when you calculate that we're at 5.61 effective tax rate in the current year compared to 24.7 in the prior year. So if we had our earnings from operations been higher, we would have ended up with a more consistent effective tax rate.

**Unknown Analyst**

So should we be bringing about tax rate in the 24 to 25, 26 range that you historically have had?

**Michael J. Sewell**
*Chief Financial Officer, Senior Vice President and Treasurer*

If we're at the normal levels for our operating earnings, yes. Really when you look at Paul the 2 drivers, that's going to drive that down is the tax-exempt interest and the dividend received deduction. And so then it's your operating earnings that really going to be driving at the 35% rate.

**Operator**

Your next question comes from the line of Ian Gutterman from Adage Capital.

**Ian Gutterman**
*Adage Capital Management, L.P.*

I guess first can I get a clarification on the AOE. I think [indiscernible] I'm not quite sure, so for example, the 11 and point improvement on workers' comp was that a 1x catch-up and 2012 won't include that or will 2012 have a workers' comp combined ratio that is equal 11 points better than were thought a quarter ago?

**Steven J. Johnston**
*Chief Executive Officer, President, Director and President of Cincinnati Life Insurance Company*

Yes, that was really a refinement that just occurred that's not going to be recurring each and every year. So that 11.5% was really just 1x. And then on the go forward basis, the things will look normal. The other -- if I look at this commercial -- some of the other ones were a little smaller fluctuations, commercial property was posted a benefit of a 3.5, commercial casualty was up 2% because of it. On the personal line side, homeowners got a benefit of 1.6%.

**Ian Gutterman**
*Adage Capital Management, L.P.*

Also the reinsurance, I want to clarify on that. You said your ceded premium will be less in 2012 than 2011? Was that because of the reinstatement paid in 2011 or was that apples-to-apples?

**Steven J. Johnston**
*Chief Executive Officer, President, Director and President of Cincinnati Life Insurance Company*

That's correct. And that's because of the reinstatement premium and that's why we want to get 2 years, we're about 8% from where we were 2 years ago. But I think we did a good job. We look at having had the largest two catastrophe losses in the history of the company. The new RMS '11 model has higher estimates for us. So we thought it prudent and conservative to add another $100 million to the top of our layer. We also raised our retention as to $75 million. And I think one of the positive is, if you look at it and I think, and I know you want to talk about it, that if you would have a $600 million event, we estimate that with only be about 3% of our surplus with this new program would have been 4% of our surplus before. So we think we've strengthened our balance sheet, our risk profile by adding that extra $100 million. And I think we'll pay about $10 million more for the expanded program.

**Ian Gutterman**
*Adage Capital Management, L.P.*

Okay, great. So it sounds like if I take out the extra limit you bought sort of rate online basis, your prices actually didn't really move too much. It sounds like the 10% increase is essentially is for the extra limit?

**Steven J. Johnston**
*Chief Executive Officer, President, Director and President of Cincinnati Life Insurance Company*

That we didn't touch that layer of 100 [indiscernible] of 100 and we got some rate increase there. It's a layer we hadn't touched before and we hit it last year with both events and in 2008 with Hurricane Ike, so we did have rate increase on apples-to-apples on some of the existing limits.

**Ian Gutterman**
*Adage Capital Management, L.P.*

Okay. And were there any changes in terms any restrictions on what's covered?

**Steven J. Johnston**
*Chief Executive Officer, President, Director and President of Cincinnati Life Insurance Company*

No, I think we're very stable there.

**Ian Gutterman**
*Adage Capital Management, L.P.*

Okay, great. And then just my last one, I guess there were questions as much of the question, but you mentioned obviously trying to get the $5 billion and obviously get there in the right way and maybe in the future calls, you can give us a combined ratio target to go with that?

**Steven J. Johnston**
*Chief Executive Officer, President, Director and President of Cincinnati Life Insurance Company*

We tend to not be real granular in guidance, but we think that we need to be in the 95% to 100% combined ratio in terms of where we are going to be as we grow.

**Operator**

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

**Joshua David Shanker**
*Deutsche Bank AG, Research Division*

I wanted to know little bit about individual lines and reserving policies. So there is a lot of movements going on the reserve depending on what segment I'm looking at. And maybe you can go into -- is there a chief expert directing it, are there various independent actuaries in this segment? How are we getting so much movement in various directions going on?

**Steven J. Johnston**

*Chief Executive Officer, President, Director and President of Cincinnati Life Insurance Company*

This is Steve, and we are consistent. We do, this is our actuarial best estimate recommendations. We think that there is a consistency across time in terms of the methodology and the way we go about our reserving. We have a reserve committee and definitely consistent overtime. We have outside actuaries that also look at our reserves. I think what added the volatility here in the fourth quarter is the -- this all other expense refinement that we made in this quarter. And I think basically what drove it is as we solve some of the catastrophe losses, where we would have a big reserve go up. And as we look at the way it was being allocated and we talk to our claims people in terms of where they were actually spending the time. It was indicating that we needed to refine how we allocated the all other expense. And so our actuaries came up with the methodology that lead a little bit more in claim counts also in terms of interviewing the claims people. And so that's the change, but in total for the calendar year, it was not an impact at all and again we think we've got very consistent procedures and controls from our actuarial department.

**Joshua David Shanker**
*Deutsche Bank AG, Research Division*

So please interrupt me if I'm saying some incorrectly here. So, on property because of all you -- was there very heavily for the significant claims. And you found our claims counter, claim severity with not as aggressive as you initially intended. So there was a significant reserve release based on claims offset slightly by allocating more AOE to those property lines? And then, AOE was taken away from the cash. I'm trying to figure out exactly how all the moving pieces are working there?

**Unknown Executive**

Yes, and we understand. It's a little bit noisy here in this quarter. But you are right; we did have favorable development on the actual estimates of these catastrophe losses. And that is also consistent with our history. As we said here international, I remember the first estimate on the national is getting close to 2 years ago now. I think we estimated about $35 million for that and it came in to 20 when that was finally settled. So we are seeing a favorable development. I think it's the strength attribute to our claims people and that we settled over 31,000 claims with our own people. And I think by getting boots on the ground, getting them out there and getting settled quickly we're able to bring them in there. So that's kind of a separate issue. And we benefited the quarter by about 3 loss ratio points there. Totally separate issue had to do is just how we allocate the -- all other expense and that was a refinement as Mike described here in the fourth quarter.

**Joshua David Shanker**
*Deutsche Bank AG, Research Division*

In a catastrophe of a year, why would the AOE rise in the casualty lines?

**Unknown Executive**

Well, I don't think that the AOE necessarily did rise in the casualty lines. In other words, workers comp had actually went with down so I think you got it,

**Steven J. Johnston**
*Chief Executive Officer, President, Director and President of Cincinnati Life Insurance Company*

Josh, when you look at the NOE the incurred for the calendar year ratio, there was no change between the 2 years. It was 6.3% for each year. So again, it's just the allocation between the individual lines.

**Joshua David Shanker**
*Deutsche Bank AG, Research Division*

Understood. And completely unrelated in a rising stock market we've been having for the last 8 to 15 weeks, does this give you an opportunity to take some profits on certain high dividend yielding stocks we are allocating to some that in meets the threshold, what's going on an allocation among equities?

**Martin Francis Hollenbeck**
*Chief Investment Officer, SVP, Asst. Secretary, Asst. Treasurer and President of CFC Investment Co.*

Josh, Martin Hollenbeck. We haven't dramatically changed a few only. The big run-up in equities last few months really largely just offset the decline in the third quarter of last year. In our type of stocks, the high quality dividend growers generally underperform certainly in 2009. It's a lesser degree in 2010. So, we think there is little more room to run. We like as Steve mentioned earlier, the allocation equities and what -- and the type of stock you buy, not just for the long-term growth potentials at the income vehicles, low interest rate environment had we not had the allocation we have 2 types of stocks we buy. We would show a decline in investment income both for the quarter and a year. So certainly a dividend increases have carried the day for us on the income front in the investment income front.

**Joshua David Shanker**
*Deutsche Bank AG, Research Division*

Okay. Thank you and congratulation on the quarter. If I can suggest in the 10-Q or 10-K, please try and hold our hand through all these reserving changes you [indiscernible] those great information and I expect you to do so again.

**Unknown Executive**

We will have that.

**Operator**

Your next question comes from the line of Fred Nelson [ph] from Crowell, Weedon.

**Unknown Analyst**

The question is I keep having coming to me in my little business world is, if you are an insurance company and premiums are sold for checks and money comes in and in an interest rate environment is basically 0, what do you do with that money to protect so, but you don't have a disaster with the money market fund or a bank failure. Where does the money go in the short-term and it doesn't bring one iota of income back.

**Michael J. Sewell**
*Chief Financial Officer, Senior Vice President and Treasurer*

Fred, lot of folks in fall 2008 took notice of what happened with the money markets, we're very cautious to spread that around and not have big concentrations. Back to cash yields nothing is literally unavoidable these days, so we have to be careful, and we don't -- we have not increased our risk profile, in any attempt to chase yield or return. So we're very cautious out there. We just spread it around.

**Unknown Analyst**

And you can increase your allocation to equities say 4%, 5% and do we have fix your parameters, you kind of meeting that parameter right now and the maximum.

**Michael J. Sewell**
*Chief Financial Officer, Senior Vice President and Treasurer*

I wouldn't term it [ph] that way Fred, now we got some room.

**Operator**

There are no further questions at this time; I'll turn it back over to Steve Johnston.

**Steven J. Johnston**
*Chief Executive Officer, President, Director and President of Cincinnati Life Insurance Company*

Thank you Steve, [ph] and thanks to all of you for joining us today and we'll look forward to speaking to you again in the first quarter call.

**Operator**

Ladies and gentlemen, this concludes today's conference call. You may now disconnect.