S&P Capital IQ

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American Financial Group, Inc. NYSE:AFG

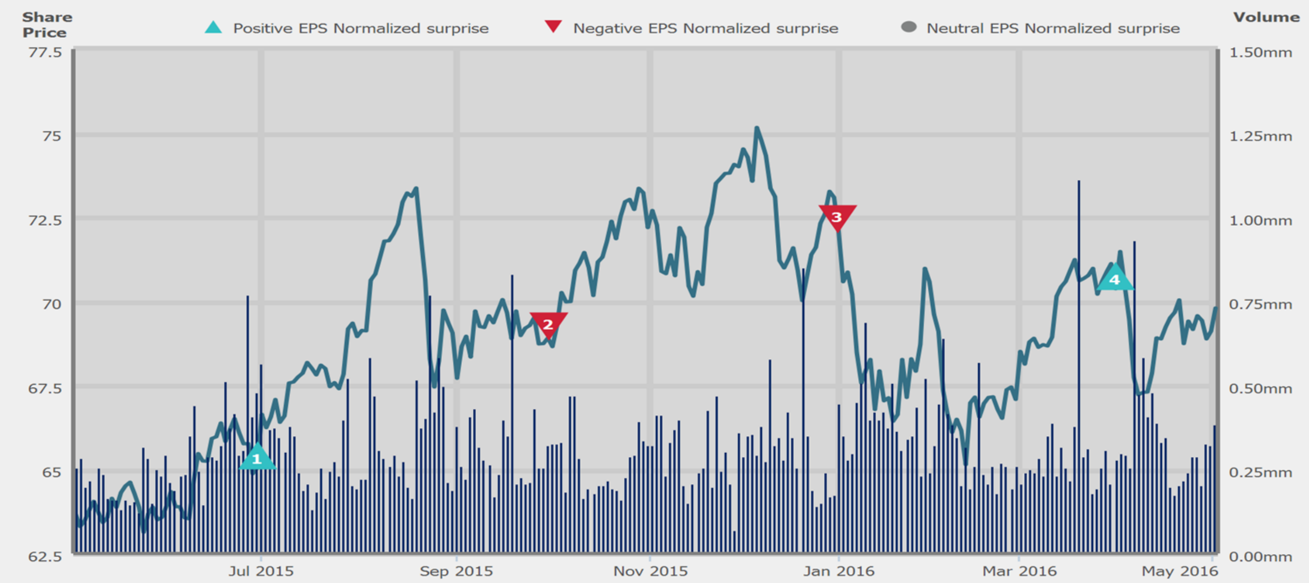
FQ2 2016 Earnings Call Transcripts

Wednesday, August 03, 2016 3:30 PM GMT

S&P Capital IQ Estimates

	-FQ2 2016-			-FQ3 2016-	-FY 2016-	-FY 2017-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	1.26	1.28	1.59	1.49	5.61	5.89
Revenue (mm)	1093.93	1027.00	(6.12 %)	1240.66	4513.65	4675.98

Currency: USD
Consensus as of Aug-03-2016 12:33 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ2 2015	1.19	1.28	1 7.56 %
FQ3 2015	1.50	1.38	2 (8.00 %)
FQ4 2015	1.60	1.52	3 (5.00 %)
FQ1 2016	1.18	1.25	4 5.93 %

Call Participants

EXECUTIVES

Carl H. Lindner
Co-Chief Executive Officer, Co-President and Director

Diane P. Weidner
Assistant Vice President of Investors Relations

Joseph E. Consolino
CFO, Executive VP, Director and Chairman of the Board of Neon Capital Ltd

S. Craig Lindner
Co-Chief Executive Officer, Co-President and Director

ANALYSTS

Amit Kumar
Macquarie Research

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Ryan J. Byrnes
Janney Montgomery Scott LLC, Research Division

Presentation

Operator

Good day, ladies and gentlemen, and welcome to the American Financial Group 2016 Second Quarter Results Conference Call. [Operator Instructions] As a reminder, this call is being recorded.

I would now like to turn the call over to Diane Weidner. You may begin.

Diane P. Weidner
Assistant Vice President of Investors Relations

Good morning, and welcome to American Financial Group's Second Quarter 2016 Earnings Results Conference Call. I'm joined this morning by Carl Lindner III and Craig Lindner, co-CEOs of American Financial Group; and Jeff Consolino, AFG's EVP and Chief Financial Officer. If you are viewing the webcast from our website, you can follow along with the slide presentation if you'd like.

Certain statements made during this call are not historical facts and may be considered forward-looking statements and are based on estimates, assumptions and projections, which management believes are reasonable, but by their nature, subject to risks and uncertainties. The factors which could cause actual results and/or financial condition to differ materially from those suggested by such forward-looking statements include, but are not limited to, those discussed or identified from time to time in AFG's filings with the Securities and Exchange Commission, including the annual report on Form 10-K and quarterly reports on Form 10-Q. We do not promise to update such forward-looking statements to reflect actual results or changes in assumptions or other factors that could affect these statements.

Core net operating earnings is a non-GAAP financial measure which sets aside significant items that are generally not considered to be part of ongoing operations, such as realized gains and losses, discontinued operations as well as other significant items that are not able to be estimated with reasonable precision or that may not be indicative of ongoing operation. AFG believes this non-GAAP measure is a useful tool for analysts and investors in analyzing ongoing operating trends and will be discussed for various periods during this call.

A reconciliation of net earnings attributable to shareholders to core net operating earnings is included in our earnings release. If you're reading a transcript of this call, please note that it may not be authorized or reviewed for accuracy. Thus, it may contain factual or transcription errors that could materially alter the intent or meaning of our statements.

Now I'm pleased to turn the call over to Carl Lindner III to discuss our results.

Carl H. Lindner
Co-Chief Executive Officer, Co-President and Director

Good morning. We released our 2016 second quarter results yesterday afternoon. I'm assuming that our participants have reviewed our earnings release and the investor supplement posted on our website. I'm going to begin on Slide 3 of the webcast slides.

We're pleased to report core earnings per share of $1.28, equal to last year's second quarter core results. We believe the results in the quarter showcase the value and the diversity of our portfolio of Specialty Property and Casualty and Annuity businesses.

Annualized core operating return on equity was 10.5% for the second quarter compared to 10.9% in the second quarter of last year. Net earnings per diluted share were $0.62, and this includes a $0.73 per share charge related to the lines of business that our Lloyd's of London operation, Neon, has exited; and $0.11 per share for realized losses on securities. Those were partially offset by a gain of $0.17 per share related to the sale of an apartment property and a small adjustment to the loss on the sale of AFG's long-term care business.

Last Monday, we announced that AFG had entered into a merger agreement with National Interstate to acquire the remaining 49% of the outstanding shares of National Interstate it does not own for $32 per share plus a pre-closing dividend of $0.50 per share, valuing the transaction at about $320 million. We're pleased to have reached this agreement. We know National Interstate's business well and have confidence in its management team.

Today, it is one of the largest businesses within our Specialty Property and Casualty Group. By acquiring their remaining minority shares, we'll simplify our ownership structure and recognize also a non-core tax benefit of approximately $64 million upon the closing of the transaction, which we expect to be in the fourth quarter of this year.

Importantly, we're pleased that the National Interstate shareholders will have the opportunity to vote on and approve this transaction. We do have a commitment to vote in favor of the merger from a 10% shareholder, who's the larger shareholder other than AFG.

We repurchased $21 million of AFG's common shares during the second quarter at an average price per share of $68.31. Our repurchase activity was dampened by the National Interstate negotiations, which had us out of the market for a large part of the quarter.

As discussed earlier, during the second quarter of 2016, AFG's specialist Lloyd's market insurer completed a strategic review of its business under a new leadership team and relaunched as Neon Underwriting Ltd. on June 13, 2016. As part of its strategic review, Neon sold and/or exited certain historical lines of business, including its U.K. and international medical malpractice and general liability classes. As a result of Neon's claims review of its exited lines of business, AFG recorded a non-core charge of $65 million to increase loss reserves primarily related to its medical malpractice and general liability lines as well as to record charges in connection with the restructuring of the business.

We are maintaining our 2016 core operating earnings guidance for AFG in the range of $5.35 to $5.75 per share. Craig and I will discuss our guidance for each segment of our business later in the call.

Now let's take a closer look at AFG's results for this quarter.

Please turn to Slides 4 and 5 of the webcast, which include an overview of results in our Specialty Property and Casualty operations.

Beginning on Slide 4, you'll see that gross and net written premiums were up 6% and 3%, respectively, in the 2016 second quarter compared to the same quarter a year earlier. Second quarter underwriting profit was up 24% year-over-year. Higher profitability in our Property and Transportation Group was partially offset by lower underwriting profitability in our Specialty Casualty and Specialty Financial Groups.

Second quarter 2016 combined ratio of 93.9% improved 1 point when compared to the 2015 second quarter and included 2.9 points of favorable prior year reserve development and 2 points in catastrophe losses. Overall renewal pricing in our Specialty Property and Casualty Group was flat during the second quarter.

Now I'd like to turn to Slide 5 to review a few highlights from each of our Specialty Property and Casualty business groups. Our Property and Transportation Group reported second quarter underwriting profitability of $15 million compared to an underwriting loss of $13 million in the prior year period. Higher underwriting profits in our property and inland marine and transportation businesses, primarily due to favorable prior year reserve development, were the drivers of the improved results. Catastrophe losses were $12 million for this group during the second quarter, primarily the result of April storms in Texas. In the comparable prior year period, catastrophe losses were $7 million.

Growing conditions for corn and soybean crops remain favorable so far this year. The condition of these crops is reported to be in line or better with results at this time last year. Soybean pricing is up 7%, 8% from spring discovery pricing while corn is down about 13.5%. Fluctuations at these levels don't concern us.

Gross and net written premiums for the second quarter of 2016 were 8% and 6% higher, respectively, than the comparable 2015 period. New premium from our Singapore branch, which opened for business in June of last year, and higher year-over-year premiums in our agricultural businesses, primarily the result of timing differences in the recording of crop premiums, were the primary drivers of the increase. Now if you exclude crop, gross and net written premiums both increased 3% over the comparable prior year period. Overall renewal rates in this group increased 3% on average for the second quarter 2016, which included a 4% increase in National Interstate's renewal rates.

Second quarter 2016 underwriting profitability in our Specialty Casualty Group declined $14 million year-over-year. I'm especially pleased with the profitability within our Workers' Compensation and executive liability businesses during the second quarter. These results helped to offset current accident year losses in Neon's political risk and trade credit business and higher adverse prior year reserve development in our E&S businesses. The majority of the businesses in this group reported modest growth in the second quarter. Gross written premiums for the second quarter of 2016 increased 4% and net written premiums were flat when compared to the second quarter of 2015.

Higher premiums in our Workers' Comp and targeted markets businesses were partially offset by lower premiums in our E&S and General Liability businesses. Net written premiums were impacted by the cession of Neon's U.K. medical malpractice business. Renewal pricing for this group decreased 2% in the second quarter, including a decrease of approximately 4% in our Workers' Comp businesses. If you exclude comp, renewal pricing for the Specialty Casualty Group was flat on average for the quarter.

Underwriting profit in our Specialty Financial Group was slightly lower year-over-year. Nearly all the businesses in this group continued to achieve excellent underwriting margins during the quarter. Gross and net written premiums for the second quarter were up 10% and 6%, respectively, when compared to the same 2015 period, primarily as a result of higher premiums in our financial institutions business. Renewal pricing in the group was flat for the quarter.

Now if you'd please turn to Slide 6 for a summary view of our 2016 outlook for the Specialty Property and Casualty operations. Although we continue to expect an overall combined ratio between 92% and 94%, we've adjusted our estimates for the combined ratios within each of our Specialty Property and Casualty Groups. We've also adjusted our estimate for overall growth in net written premiums to be in the range of 1% to 5%, down slightly from a growth of 2% to 6% estimated previously.

In the Property and Transportation Group, we now estimate a combined ratio in the range of 93% to 96%, which narrowed a bit from our previous estimate of 93% to 97%. We now expect growth in net written premiums in this group to be between 1% and 5%, a decrease from the previous range of 4% to 8%. Net written premiums year-to-date in this group have grown 5%, excluding our crop business, and we expect crop premiums to be about 5% lower this year versus 2015.

Our Specialty Casualty Group is now expected to produce a combined ratio in the range of 93% to 95%, slightly higher than the range of 92% to 94% estimated previously. Net written premiums are now expected to be flat to up 4%, a slight decline from the previous expectations of 1% to 5%. The combined ratio in our Specialty Financial Group is now estimated to be in the range of 83% to 86%, an improvement from the range of 84% to 88% shared last quarter. Growth in net written premiums in this group is estimated to be in the range of 5% to 9%, an increase from our initial range of 3% to 7%, primarily as a growth in our financial institutions business. Details for each of our Specialty Property and Casualty Groups can be found on the slide.

I'll now turn the discussion over to Craig to review the results in our Annuity segment and talk about AFG's investment performance.

S. Craig Lindner
Co-Chief Executive Officer, Co-President and Director

Thank you, Carl. I'll start with a review of our Annuity results for the second quarter, beginning on Slide 7.

The Annuity segment reported $76 million in pretax operating earnings in the 2016 second quarter compared to $88 million reported in the second quarter of 2015. Although the reported earnings are down about 14%, our business fundamentals remain strong. It's important to note that the decrease from last year's reported earnings is driven by the impact of fair value accounting.

Under fair value accounting, variances from expectations of certain items such as projected interest rates, hedge costs and surrenders as well as changes in the stock market, have an impact on the accounting for fixed-indexed annuities. Although these accounting adjustments have been recognized through AFG's reported core earnings, many of these adjustments are not economic in nature but rather impact the timing of reported results.

In the second quarter of 2016, medium- to long-term interest rates decreased approximately 30 to 40 basis points compared to our expectation that they would increase slightly. This contributed to a $26 million unfavorable impact on pretax earnings. Conversely, in the second quarter of 2015, interest rates rose significantly, resulting in a favorable impact on pretax earnings. This favorable result was partially offset by the impact of a stock market decrease during the quarter.

Annuity earnings before the impact of fair value accounting were $102 million during the second quarter of 2016, a 32% increase from the comparable 2015 period. AFG's second quarter 2016 earnings benefited from favorable investment results, including the positive impact of certain investments required to be marked to market through earnings as well as growth in annuity assets, as shown on Slide 8.

AFG's quarterly average annuity investments and reserves grew by 13% and 14% year-over-year, respectively. The benefit of this growth was partially offset by the runoff of higher-yielding investments.

We continue to achieve appropriate returns on new business and the interest spread on our in-force business continues to exceed our plan by several basis points. Furthermore, if interest rates continue to remain low for an extended period of time, AFG has the ability to reduce the average crediting rate on approximately $21 billion of traditional fixed and fixed-indexed annuities by approximately 75 basis points.

AFG's annuity premiums grew 22% year-over-year in the second quarter to $1.1 billion, due primarily to growth in fixed-indexed and traditional fixed annuity sales in the financial institutions channel. We believe AFG's growth in fixed-indexed and traditional fixed annuity sales is consistent with the overall growth in the annuity industry as sales of these annuities have increased while the sales of variable annuities have decreased. We believe AFG's increase in annuity premiums is also the result of new products, additional staffing and increased market share within existing financial institutions. Additionally, we've reduced the crediting rate on new annuity sales several times in 2016 due to the decline in interest rates. These reductions, once announced, often lead to a short-term spike in sales in advance of the effective date of the rate decreases. Additional information can also be found in AFG's Quarterly Investor Supplement posted on our website.

Please turn to Slide 9 for a summary of the 2016 outlook for the Annuity segment. We continue to be committed to disciplined pricing of our products, consumer-friendly product design, careful expense management and growing our business when we can achieve desired long-term returns.

Due to the strong results in the first 6 months of 2016, AFG is increasing its expectations for earnings before fair value accounting for fixed-indexed annuities to a range of $370 million to $385 million. This is up from AFG's original expectation of $350 million to $370 million. Due to the higher-than-expected negative impact of fair value accounting, offset in large part by our strong pre-fair value accounting results through the first 6 months of 2016, we now believe that full year 2016 pretax Annuity operating earnings will be in the range of $305 million to $340 million, a slight decrease from the previous guidance. Based on premiums recorded through the first half of the year and our recent level of sales, we now expect that premiums for the full year of 2016 will be in line with the $4.1 billion sold in 2015.

Significant changes in interest rates and/or the stock market, as compared to our expectations, could lead to additional positive or negative impacts on the Annuity segment's results.

In April, the Department of Labor issued the final version of its fiduciary rule that will impose additional requirements on the sale of certain annuities, including indexed annuities to retirement accounts, including IRAs. It is expected that all carriers will experience some impact when the rule takes effect in 2017, including temporary sales disruption during a transition period.

Based on our analysis of the rule and discussions with our distribution partners, we're planning for certain changes to our business model, including new products and compensation arrangements. We believe these changes should allow most of our current distribution partners to continue to sell our traditional fixed and fixed-indexed annuities. About half of our annuity sales are qualified and therefore subject to the new rules. We believe the biggest impact to AFG will be on sales of fixed-indexed annuities by nonregistered representatives in our retail channel. Sales by nonregistered reps through this channel represented about 10% of our annuity sales in the second quarter of 2016. We continue to believe that our business model makes us less vulnerable to the rule than many of our competitors for several reasons. Our sales of variable annuity products are minimal. Furthermore, these products are sold in the 403(b) market, which is excluded from the Department of Labor regulation. Our insurance companies have higher financial strength ratings than many of our competitors. Many of our fixed-indexed annuity products have a simpler product design with shorter surrender charge periods, lower commissions and trail commission options. And finally, our distribution channels include banks, broker dealers, registered investment advisers and large national marketing organizations that will be best positioned to comply with the more rigorous compliance standards. Based on our analysis, we do not believe the implementation of the final DOL rule will have a material impact on the company's results of operations.

Please turn to Slide 10 for a few highlights regarding our $41 billion investment portfolio. AFG recorded second quarter 2016 net realized losses on securities of $10 million after tax and after deferred acquisition costs compared to net realized losses of less than $1 million in the comparable prior year period.

As of June 30, 2016, unrealized gains on fixed maturities were $639 million after tax, after DAC, and unrealized gains on equities were $46 million after tax.

In April of 2016, AFG sold an apartment property in Pittsburgh that was owned and managed by a subsidiary of Great American Insurance Company. As a result of this sale, we recognized a non-core after-tax gain on the sale of $15 million.

As you'll see on Slide 7, our portfolio continues to be high quality, with 89% of our fixed maturity portfolio rated investment grade and 97% with an NAIC designation of 1 or 2, its highest 2 categories. We've provided additional detailed information on the various segments of our investment portfolio in the Quarterly Investor Supplement on our website.

I will now turn the discussion over to Jeff, who will wrap up our comments with an overview of our consolidated second quarter 2016 results and share a few comments about capital and liquidity.

Joseph E. Consolino
CFO, Executive VP, Director and Chairman of the Board of Neon Capital Ltd

Thank you, Craig. Slide 13 recaps AFG's second quarter consolidated results by segment. Core net operating earnings per share in the quarter were $1.28, in line with 2015's second quarter core results and also within the range of core earnings guidance of $1.25 to $1.30 announced on July 25. That $1.28 is based on core net operating earnings in the quarter of $113 million. You'll be able to see a more detailed view of these components on Page 4 of our Quarterly Investor Supplement.

The reconciliation of AFG's core net operating earnings to net earnings is detailed on Slide 14. As Carl noted earlier, net earnings attributable to shareholders were $54 million or $0.62 per share in the quarter.

As indicated on Slide 15, AFG's adjusted book value per share was $50.22 at June 30, 2016. Adjusted tangible book value per share was $47.41, also at June 30, 2016. Our capital adequacy, financial condition and liquidity remain strong. We maintain sufficient capital in our insurance businesses to meet our commitments to the rating agencies. Our excess capital stood at approximately $950 million at June 30, 2016. The National Interstate transaction provides the opportunity to deploy approximately $320 million of our excess capital later this year. As a reminder, we plan to hold approximately $200 million to $300 million as dry powder to maintain [ph] flexibility, especially in light of opportunities that may arise from industry disruption.

During the quarter, we returned $45 million to our shareholders through dividends and share repurchases. Approximately 4.6 million shares remain under our repurchase authorization as of August 2, 2016. We will plan to continue returning excess capital to our shareholders through the course of 2016 and review all opportunities for deployment of capital on a regular basis.

On Slide 16, you can find a single-page summary of our 2016 core earnings guidance. As a reminder, AFG's 2016 core operating results exclude non-core items such as realized investment gains and losses and other significant items that may not be indicative of ongoing operations.
Now we'd like to open the lines for any questions.

Question and Answer

Operator

[Operator Instructions] Our first question comes from Amit Kumar of Macquarie.

Amit Kumar
Macquarie Research

Congrats on the quarter and getting the deal done. Just a few quick questions. The first question I have is on Workers' Compensation. Earlier today, AIG in its results took an adjustment, just based on the NCCI discussion on rate filings and some of the recent cases which have been decided. I did not hear you talk about the impact of those decisions on your book. Can you just talk about how you foresee that impacting your book? And would you have -- would there be a need to take any result adjustments?

Carl H. Lindner
Co-Chief Executive Officer, Co-President and Director

Thank you, Amit. This is Carl. Our folks at Summit are specialists, and they have a leading position in the Florida market. We think they are a pretty bright management group. One thing that they were very bright in doing was reserving conservatively over the last few years, in the eventuality that the Castellanos and/or the Westphal cases would be decided against the industry. When we take a look at our reserve position, we feel that our reserves are adequate in Florida and for Summit. And that our reserve position reflects the potential increased loss costs stemming from both Castellanos and Westphal. So from a reserve standpoint, we feel comfortable with our current reserve position. As far as the adequacy of Florida rates, it's really important for the stability of the Florida Workers' Comp market that the insurance commissioner approve the biggest part of the 19.6% rate increase that's been filed by the NCCI, because we feel on a prospective going-forward basis that, that level of rate is needed for adequacy in the Florida Workers' Comp market in that. So from a pricing and from a future profitability standpoint, it's important to get the biggest part of that 19.6% rate increase that's filed by the NCCI.

Amit Kumar
Macquarie Research

Got it. That's very helpful and it does seem that at least this issue has sort of snuck up on us very quickly, so that color is very helpful. The second question I had was on Neon. In terms of talking about the $65 million charge, you said that part of it was increased loss reserves and then the other was -- and there's a part for other stuff. Can you just talk a bit more about how we should think about -- has this issue been -- is it ring-fenced now with this charge? And what exactly would happen going forward with this book?

Joseph E. Consolino
CFO, Executive VP, Director and Chairman of the Board of Neon Capital Ltd

Amit, this is Jeff Consolino. Neon is going through a transformational process led by a new management team. And in June, they rebranded from Marketform to Neon under the new leadership team. We did take a restructuring charge in the quarter. That number you refer to is split between an increase in loss reserves and also a component contained in expenses for restructuring costs. You can see that in the release and the supplement, but it's $57 million and $8 million, respectively. The lines of business that constitute the Neon exited lines charge are lines of business that the new management team has exited. They have been shut down and in many cases, sold on a renewal rights basis to other Lloyd's syndicates in the market. The result of our claims study for those exited lines led us to take the $57 million charge. In terms of whether things are ring-fenced, I don't know exactly what that term means. It's certainly not a legal term or anything else. We have put up what we think are prudent reserves for those classes of business, but one can never say with any certainty what any reserve level is going to prove out to be. So we feel like we did the right thing there, and we'll continue to monitor the situation.

Amit Kumar
Macquarie Research

I didn't phrase -- the choice of words was poor when I asked that question. That reserve number, is that sort of the full limit to those -- some of those outstanding claims? Or what exactly is that number? Or was there like an actuarial study and it's the midpoint of the range or the higher end of the range? I'm just trying to understand what sort of noise could there be going forward. That's what I was trying to get to.

Joseph E. Consolino
CFO, Executive VP, Director and Chairman of the Board of Neon Capital Ltd

Sure. At Neon, we have quarterly actuarial reviews by our actuarial staff and annually, we have outside reviews, as do all of the syndicates at Lloyd's. In particular, this charge stems from a claims review, and the $57 million is in U.K. medical malpractice, international medical malpractice and also the general liability classes, which have been exited and in many cases, sold. Now to take an example for one portfolio of medical malpractice business, there was a ground-up claims review, that jurisdiction and looking at what the ground-up experience was relative to our attachment points and our development patterns that we were seeing and that led to the reserve increase. This is the result of the new management team going in and looking very carefully at the exposures they have, and so that's the basis for the charge.

Amit Kumar
Macquarie Research

Got it. And that's actually very helpful. The final question and I will re-queue after this, is obviously, you're closer to crossing the finish line with NATL. Can you sort of help us understand, when we think about that going forward, what exactly will change? I mean, obviously, the book has had issues and you've talked about that in the past. But how should outside investors think about that going forward? And how should we in fact even think about the time line of improvements? The time line of benefit to the ROE, et cetera, in terms of numbers down the road. That actually would be very helpful. That's all I have for now, and I will re-queue.

Carl H. Lindner
Co-Chief Executive Officer, Co-President and Director

Amit, it's our intention to run the business at double-digit returns over time. To get to that, generally, the combined ratio has got to be 95 or under. So we're working very hard currently and we will be working very hard going forward at moving the -- improving the profitability to the point where long term, we'll have double-digit returns. It may not happen over [indiscernible] take us a little bit [indiscernible] longer to [indiscernible] than what we would have thought a couple of years ago, but that's what our long-term intention is. We look at it as a one of the larger key parts of our Specialty Group, so. Did I cut out there? Amit?

Operator

Our next question comes from Ryan Byrnes of Janney.

Ryan J. Byrnes
Janney Montgomery Scott LLC, Research Division

Yes, you were cut out a little bit, but we could still hear you. But I want to shift a little bit over to the annuity side. Obviously, it was a pretty strong quarter, excluding the fair value adjustments. Just looking at the guidance for sales in the back half of the year, it implies a pretty significant slowdown. Is that simply due to the tough year-over-year comps? Or again, is it any changes to maybe the pricing or the crediting rates that you guys are offering going forward?

S. Craig Lindner
Co-Chief Executive Officer, Co-President and Director

Ryan, this is Craig. The biggest part of our forecast for the back half of the year is just that we've been very disciplined in pricing our product to get the right rate of return. And with the significant decline that we've experienced in interest rates since the end of the year, we've had multiple decreases in our credited rates. The competition -- some of the competition hasn't been quite as quick to make adjustments to their credited rates as we have, and that was our best guess at what the back half of the year is going to look like after we implemented the latest round of decreases in rates and have a look at the current level of applications that are coming in.

Ryan J. Byrnes
Janney Montgomery Scott LLC, Research Division

Great. And then how proactively do you guys manage down, I guess, the current in-force block? Again, if I look at -- you mentioned you could lower it by -- the whole block by 75 basis points. It seems to be kind of stable in that area. Just wanted to figure out how actively you guys can and how actively you guys do manage it?

S. Craig Lindner
Co-Chief Executive Officer, Co-President and Director

We are starting to manage it very actively, with rates having declined as significantly as they have. I mean, I will say we've tried to go very slow in reducing renewal rates. We've tried to be very fair with our customers. But with the big, big decline that we've seen in interest rates, we think it is prudent and fair to start making some adjustments to credited rates. I think we've been slower than many companies out there and that's why the spread between our current credited rate and average GMIR is wider than most companies, but we are starting to take a look at that and we are starting to make some adjustments.

Ryan J. Byrnes
Janney Montgomery Scott LLC, Research Division

Okay. Great. And then just quickly for my last one, switching back to property casualty side of the house. Specialty Financial growth was -- I think you increased your guidance there and it's probably kind of the lowest combined ratio segment there. Just wanted to get a little more color as to where that growth is coming from. It's been pretty consistent in really, the last kind of 6 quarters or so. So any color there will be great.

Carl H. Lindner
Co-Chief Executive Officer, Co-President and Director

Yes, I think with some of the regulatory noise in that space and American Modern's exit from that market, I think we've had some opportunities to grow our business a little more than usual.

Operator

[Operator Instructions] Our next question comes from Jay Cohen of Bank of America.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Just some follow-up questions. In the Property and Transportation Group, you had a decent amount of favorable reserve development. I'm wondering what drove that in the quarter.

Joseph E. Consolino
CFO, Executive VP, Director and Chairman of the Board of Neon Capital Ltd

Jay, this is Jeff. The prior period development mainly emanated from our Property & Inland Marine division and also our Transportation division within Property and Transportation.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Okay. And I guess as I look at the sort of the accident year loss ratio, excluding catastrophes, would you expect, given potential improvement on the transportation side, specifically in National Interstate, and hopefully a reasonably stable crop business, taking out any weather, would you expect that to trend lower from here?

Joseph E. Consolino
CFO, Executive VP, Director and Chairman of the Board of Neon Capital Ltd

Jay, this is Jeff. A year ago in the second quarter of 2015, our underlying combined ratio, i.e. the combined ratio excluding cats and prior year development, was 100.2%, and that's clearly not in the range that we hope to operate. So we have had an improvement in the underlying combined year-over-year, we're 4.4 points better at this point, and that's been driven by National Interstate, Property & Inland Marine, our Transportation business as well as some of our other agricultural businesses. And so we've had some pretty good movement in a number of our segments there within Property and Transportation. As Carl said, we're still not entirely satisfied with where National Interstate is, and some of our other units, but certainly, we're trending in the right direction. And you're right to focus on Property and Transportation among our subsegments because that really drove the improvement in our quarterly underlying combined ratio relative to the other subsegments.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Yes, although one other segment, just to switch gears for a second, the Specialty Financial segment has just been fantastic from a profitability standpoint and really quite consistent. I was wondering, you talked about growth being driven by the financial institutions business. Are there any factors behind that growth, what is driving your -- or particular products that's driving that growth?

Carl H. Lindner
Co-Chief Executive Officer, Co-President and Director

Well, I think I kind of mentioned that some of the regulatory disruptions among some competitors as well as American Modern's exit. American Modern is located right here in Cincinnati, so their exit from that space clearly has provided us some opportunities.

Operator

[Operator Instructions] There are no further questions. I'd like to turn the call back over to Diane Weidner for any closing remarks.

Diane P. Weidner
Assistant Vice President of Investors Relations

Thank you, Michelle, and thank you all for joining us this morning for our overview of our second quarter results. This will conclude our remarks for this morning.

Operator
Ladies and gentlemen, thank you for participating in today's conference. This does conclude the program, and you may all disconnect. Everyone, have a great day.