S&P Global
Market Intelligence

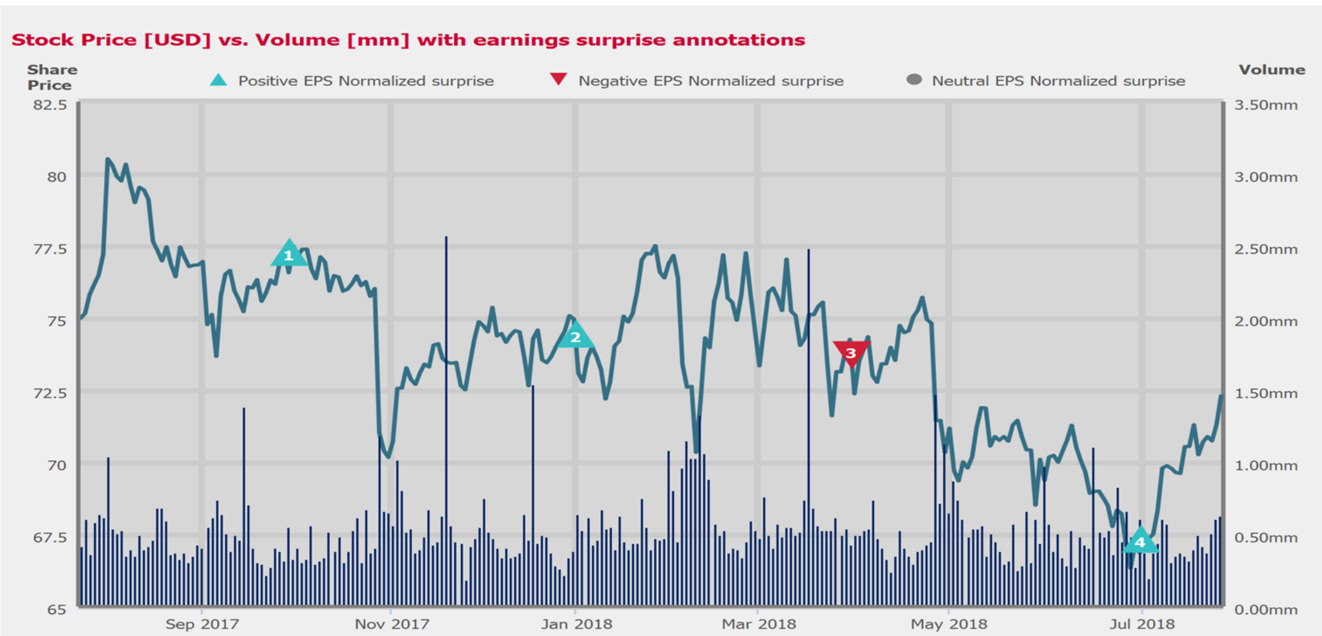
Cincinnati Financial Corporation NasdaqGS:CINF
FQ3 2018 Earnings Call Transcripts

Friday, October 26, 2018 3:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ3 2018-			-FQ4 2018-	-FY 2018-	-FY 2019-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.73	0.84	15.07	0.97	3.23	3.32
Revenue (mm)	1457.20	1915.00	31.42	1485.00	5733.00	6149.60

Currency: USD
Consensus as of Oct-26-2018 10:50 AM GMT



- EPS NORMALIZED -	CONSENSUS	ACTUAL	SURPRISE
FQ3 2017	0.51	0.58	13.73 %
FQ4 2017	0.85	0.93	9.41 %
FQ1 2018	0.80	0.72	(10.00 %)
FQ2 2018	0.55	0.81	47.27 %

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Call Participants

EXECUTIVES

Dennis E. McDaniel
VP & Investor Relations Officer

Jacob Ferdinand Scherer
Executive VP, Chief Insurance Officer & Director

Martin Joseph Mullen
Chief Claims Officer & Senior VP of The Cincinnati Insurance Company

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

Steven Justus Johnston
President, CEO & Director

ANALYSTS

Joshua David Shanker
Deutsche Bank AG, Research Division

Mark Alan Dwelle
RBC Capital Markets, LLC, Research Division

Meyer Shields
Keefe, Bruyette, & Woods, Inc., Research Division

Michael David Zaremski
Crédit Suisse AG, Research Division

Ronald David Bobman
Capital Returns Management, LLC

Presentation

Operator

Good morning. My name is Michelle, and I will be your conference operator today. At this time, I would like to welcome everyone to the third quarter 2018 earnings conference call. [Operator Instructions]

I would now like to turn the call over to Dennis McDaniel, Investor Relations Officer. Please go ahead.

Dennis E. McDaniel
VP & Investor Relations Officer

Hello. This is Dennis McDaniel at Cincinnati Financial. Thank you for joining us for our Third Quarter 2018 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 made by others in the room with us, including Chief Investment Officer, Marty Hollenbeck; and Cincinnati Insurance's Chief Insurance Officer, J.F. Scherer; Chief Claims Officer, Marty Mullen; Senior Vice President of Commercial Line, Steve Spray; and Senior Vice President of Corporate Finance, Theresa Hoffer.

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. Now I'll turn the call over to Steve.

Steven Justus Johnston
President, CEO & Director

Good morning, and thank you for joining us today to hear more about our third quarter results. Net income for the third quarter of 2018 was more than 5x the same period a year ago, approximately 3 quarters of the growth in net income again reflected variability related to this year's new accounting requirement for changes in the fair value of equity securities. About 1/8 of the increase was from other nonrecurring items, generally related to taxes, and Mike will comment further on that in a moment. The remaining growth in net income largely reflects improved underwriting results despite higher catastrophe losses, and is reflected by our improving property casualty combined ratio and 41% growth in non-GAAP operating income. Our 96.8% combined ratio for the third quarter of this year was 2.5 points better than a year ago and is the result of several factors, including ongoing benefits of diversifying our business in recent years. Our commercial line segment experienced another good quarter, with a combined ratio of near 95%. Importantly, we're seeing signs of improvement in paid loss cost trends for our commercial casualty line of business. The paid ratio for the first 9 months of 2018 was almost 2 percentage points lower than the same period a year ago. While we're currently maintaining a prudent amount of IBNR reserve for that line, particularly for accident year 2018, we were comfortable with releasing some reserves for older accident years, largely accident years 2016 and prior. We continue to take a careful approach to growing our commercial lines business, and targeting underwriting actions slowed net written premium growth to 1% on a 9-month basis. Overall commercial lines estimated average price increases for the third quarter were slightly higher than the first half of 2018, including higher average pricing for our commercial casualty line of business. Our excess and surplus lines segment continues to perform very well, with third quarter and year-to-date combined ratios in the low 70s. It has reported 24 straight quarters of combined ratios below 100%. Excess and surplus lines premiums are also growing at a healthy rate, in the double-digit range for the third quarter and first 9 months of this year. Our personal line segment in Cincinnati Re were affected by significant levels of weather-related catastrophe losses, experiencing third quarter combined ratios a little over 100%. Cincinnati Re remains profitable for the full year and inception-to-date. Our personal lines segment continued to experience a rise in average rate increases. The third quarter 2018 average was a little higher than the second quarter, with personal auto again near the high end of the high single-digit range. Both of these areas of our business continue to grow at healthy rates, and we anticipate better underwriting results in future quarters. Throughout our property casualty operations, we continue to obtain relatively higher renewal pricing on policies where our models and judgment indicate it's needed, as we segment accounts through careful underwriting of various risks. That segmentation is not always reflected in the average renewal price increases we report. However, when the benefits of segmentation combine with rising reported average renewal price increases, as they did this quarter, it can significantly enhance our overall profitability. Our life insurance subsidiary also had an outstanding quarter, nearly doubling net income reported a year ago along with earned premiums growing at 9%. Our primary measure of long-term financial performance, the value-creation ratio, was 6.3% for the third quarter of 2018. The component of net income before investment gains or losses contributed 2.4 percentage points, an improvement of 1.1 points versus a year ago, including 0.7 points from other nonrecurring items. In addition, investment gains in our equity portfolio contributed 4.6 percentage points, offsetting a negative 0.7-point effect from the fixed maturity portfolio. Our results for the quarter were solid, and included several areas of ongoing improvements in our operations.

Next, our Chief Financial Officer, Mike Sewell, will highlight some important aspects of our financial performance and financial condition.

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

Thank you, Steve, and thanks to all of you for joining us today. Growth of pretax investment income, at 1% for both the third quarter and first 9 months of 2018, has slowed somewhat, reflecting the fact that in recent years, many of our higher-yielding bonds were called prior to maturity or redeemed upon reaching maturity dates. As a comparison, our pretax investment income grew at a 2% rate for full year 2017 and up 4% in 2016. On the other hand, after-tax investment income is 12% higher, so far, in 2018 compared with the first 9 months of 2017, continuing to contribute significantly to earnings and book value growth. Dividends from our equity portfolio continued growing nicely, up 5% during the third quarter of 2018, and 6% on a year-to-date basis. Our investment portfolio experienced overall gains for the third quarter of $381 million before tax effects. That included a $458 million increase in our equity portfolio, partially offset by a $76 million decrease from our bond portfolio. We ended the quarter with a net appreciated value of nearly $3.4 billion, including $7 million in our bond portfolio. Taking a closer look at interest income from our bond portfolio, which decreased 1% during the quarter, the pretax average yield was 4.19% for the third quarter of 2018, down 24 basis points from last year's third quarter. We continue to invest in bonds, including $324 million in net purchases during the first 9 months of this year. Taxable bonds purchased during the third quarter of 2018 had an average pretax yield of 4.53%, 72 basis points higher than we purchased for last year's third quarter. Tax-exempt bonds purchased averaged 3.87%, also up 72 basis points from a year ago. Cash flow from operating activities continue to provide funds for our investment portfolio. Funds generated from net operating cash flows for the first 9 months of 2018 totaled $826 million, up 11% from the same period a year ago, despite 2018 income tax payments that nearly doubled the 2017 amount.

Now I'll comment on the $56 million third quarter 2018 benefit from certain nonrecurring items, of which $50 million was a result of tax accounting method changes for which we received approval from the IRS during the quarter, as disclosed in the income tax footnote of our 10-Q filing. The largest of these tax accounting changes pertain to the valuation of our tax base for loss reserves, which had a $49 million favorable effect on our reported third quarter net income.

Turning to our underwriting expense ratio. We continue to carefully manage expenses, with an eye towards strategically investing in our business where we think it makes sense. Our 9-month 2018 property casualty underwriting expense ratio rose by only 1/10 of a percentage point compared with the same period of 2017. Regarding loss reserves, once again, our consistent approach to setting overall reserves resulted in property casualty net favorable development on prior accident years. Third quarter 2018 favorable reserve development benefited our combined ratio by 3.5 percentage points, and the 9-month 2018 benefit of 3.3 percentage points exceeded the same period last year by 0.6 percentage points.

Our commercial casualty lines of business experienced $21 million of favorable reserve development during the quarter. Most of our major lines of business have experienced favorable reserve development in the first 9 months of 2018. On an all-lines basis by accident year, it included 39% for accident year 2017, 20% for accident year 2016 and 41% for 2015 and prior accident years. Regarding capital management, both financial strength and financial flexibility remain in excellent shape. I'll conclude in typical fashion with a summary of third quarter contributions to book value per share. They represent the main drivers of our value-creation ratio. Property casualty underwriting increased book value by $0.20. Life insurance operations added $0.09. Investment income other than life insurance and reduced by noninsurance items contributed $0.92, including $0.34 from other nonrecurring items. Net investment gains and losses for the fixed income portfolio decreased book value per share by $0.36. Net investment gains and losses for the equity portfolio increased book value by $2.22. And we declared $0.53 per share in dividends to shareholders. The net effect was a book value increase of $2.54 during the third quarter, to a record high $51.22 per share. And now I'll turn the call back over to Steve.

Steven Justus Johnston
President, CEO & Director
Thanks, Mike. It was a good quarter, and we feel optimistic about the future. That optimism includes anticipation of meaningful contributions over time from leaders at Beaufort Underwriting Agency, the Lloyd's managing agency subsidiary of our pending acquisition of MSP Underwriting Limited that we announced earlier this month. Collectively, we aim to focus on profitable growth and providing superior service to our appointed agencies. History tells us that doing so will benefit all stakeholders of Cincinnati Financial and its affiliated companies, creating shareholder value over time. As a reminder, with Mike and me today are J.F. Scherer, Steve Spray, Marty Mullen, Marty Hollenbeck and Theresa Hoffer. Michelle, please open the call for questions.

Question and Answer

Operator

[Operator Instructions] Your first question comes from Mike Zaremski from Crédit Suisse.

Michael David Zaremski
Crédit Suisse AG, Research Division

Maybe I'll start on the E&S segment. I know it's not the largest segment, but results continue to be phenomenal. And, just curious, I -- maybe you could talk more about what this book is weighted towards? Because just -- I always thought that, over time, the combined ratio here would kind of gravitate toward a -- better than the total commercial, but it seems to just continue to be phenomenal. So maybe you can give some more color on what's going on there?

Jacob Ferdinand Scherer
Executive VP, Chief Insurance Officer & Director

Mike, this is J.F. Scherer. The book is obviously heavily weighted casualty versus property. We don't write coastal property in the E&S company. The appetite range runs everything from special events policies -- small special events policies -- to fairly sizable products liability coverages. I think part of the reason why we're doing so well is that what we write tends to be associated with the property and casualty, the standard side of an account, so 45%, roughly, of the E&S policies we write are accompanying a Cincinnati Insurance company package. The E&S premiums and losses are included in our agent's profit sharing, so they are very careful about what they place with us. And we also have the benefit that our claims folks that handle the standard business also handle the E&S policies. So I think, all in all, when you add it all together, I think we're getting a more carefully selected business. We are patient about growing CSU in that we -- our agencies write about $3 billion in E&S business in their agencies. We'll finish the year around $250 million in CSU. So we view it that we have a lot of opportunity, and we don't need to try to explode on the scene or stretch to write the business that we're writing. So we're very comfortable writing the casualty side. We don't see ourselves expanding into coastal property here. And so we're taking a -- and probably, obviously, the management of CSU, Don Doyle and the rest of his staff, they are just doing an exemplary job in terms of how they review things and how carefully they promote things.

Michael David Zaremski
Crédit Suisse AG, Research Division

Okay. Great. If we can switch gears to personal lines. Maybe we can -- you can touch on both home and auto. Auto feels kind of like a -- it feels like the auto-centric or the personal-line-centric insurers are feeling a lot better and pricing is kind of coming down in auto, whereas maybe some of the commericial-centric personal lines writers are continuing to try to improve their mix and whatnot. And then in homeowners, some carriers have talked about some negative trends in terms of underlying. So maybe you could touch on those 2 lines of business, please?

Jacob Ferdinand Scherer
Executive VP, Chief Insurance Officer & Director

Well, we're feeling pretty good about private passenger auto, that we think the rate increases, the analytics that we're applying are setting things in a good direction there. And we have been taking some fairly significant rate increases, as we've disclosed, in the upper single-digit range. On homeowner, notwithstanding the fact that the results don't look as good, we're pretty optimistic about the direction that we're heading there. High net worth continues to grow at a nice clip. Historically, high net worth has been more profitable than middle market. And we think that the team that Will Van Den Heuvel has assembled in that area -- a great number of professionals with many years' experience in the high net worth space, will produce results that will be very favorable. We are seeing the negative trends that many other carriers have talked about. Our rate increases in homeowners are mid-single digits, and we see that strengthening over the next couple of years. And also, in addition to rate increases, we'll continue to do what we have been doing relative to inspections and loss control associated with our homeowner book of business. We are seeing and have seen larger claims in the homeowner area. Those tend to be pretty volatile. Right now, based on what we've seen, we're maintaining in a fair amount of -- a prudent level of reserving, which you would expect out of us, on that homeowner line. We have confidence that we think things will level out, and that those results will get much better.

Michael David Zaremski
Crédit Suisse AG, Research Division

Okay, that's helpful. And lastly, if we can focus on commercial liability. It looks like commercial auto has been improving, but maybe you could talk more broadly about loss costs on the commercial liability side? Some carriers are saying that they are seeing kind of an uptick in liability inflation along with just broader inflation, although it does seem like maybe commercial auto is getting a lot better in offsetting that. So just trying to get a sense for margins, because pricing, it seems like it's still steady low single digits. And I'm kind of wondering how you're seeing loss cost inflation?

Steven Justus Johnston
President, CEO & Director

Good insights, Mike. This is Steve. And I think we have seen some of those trends. I would like to think we got out a bit early on it and have been addressing it here over a period of time. And you'll recall that we have had periods where we've shown some adverse development on that line as we've reacted to seeing some of the trends. I think we have moved to take action in terms of both rate and prudent underwriting, and now we're showing a couple of quarters in a row where we've had some favorable development on that. I think it's still prudent that we treat the current accident quarter with due caution as we've seen this trend, but I do think we're on top of it, addressing it appropriately with both rate and prudent underwriting action.

Michael David Zaremski
Crédit Suisse AG, Research Division

Okay. And what about other than commercial auto, is there any lines that should be -- general liability and whatnot?

Steven Justus Johnston
President, CEO & Director

No, we feel pretty good about the book in total. And again, in the commercial auto, I think we're making progress there, with the accident year ex cat starting to move in the correct direction.

Operator

The next question comes from Meyer Shields from KBW.

Meyer Shields
Keefe, Bruyette, & Woods, Inc., Research Division

I really want to follow up on Mike's question. Steve, can you talk a little bit about the internal analytical capabilities that you have to anticipate, maybe, macroeconomic changes that would impact commercial claim frequency?

Steven Justus Johnston
President, CEO & Director

Yes, I think it's the whole team. It starts with claims. We have local claims representatives, led by Marty Mullen here, that are out working from their homes in the communities with the agents, and so I think we get some pretty early intelligence of what's going on at the street level from our claims people. That's brought here in the home office where we have a robust process called an oversight committee that has every department in the company represented. We do have the predictive model on the analytics side that very much segment the book. And in fact, we can look at every single policy in terms of how we feel it is priced relative to where we think it should be priced. We take action at a very granular rate in terms of encouraging keeping those that have the highest profit potential and working with those that don't, in terms of what we can do on the underwriting side, the loss control side, pricing, also working with the agents. So it's a very holistic approach that we use. And we do have, I think, specific to your question, the analytics in place and the predictive models in place that allow us to do this at a very granular level.

Meyer Shields
Keefe, Bruyette, & Woods, Inc., Research Division

Okay, that's helpful, and I think we're clearly seeing it in results. This is maybe a more specific question. We're hearing some chatter about better-funded law firms maybe impacting overall casualty claim frequency, severity, or both. Is that something that you are seeing?

Steven Justus Johnston
President, CEO & Director

You know, we're keeping an eye on that, and I'd let Marty Mullen comment on that.

Martin Joseph Mullen
Chief Claims Officer & Senior VP of The Cincinnati Insurance Company

Yes. Thanks, Steve. Meyer, we haven't really experienced that phenomena or trend across our casualty book, other than the past history has been pretty stable on that event.

Operator

[Operator Instructions] Your next question comes from Mark Dwelle from RBC.

Mark Alan Dwelle
RBC Capital Markets, LLC, Research Division

Just a couple of questions. Some prior people have covered a few of them. I just wanted to drill down on the loss cost a little bit. One of your competitors commented fairly extensively this morning about worker's comp and some of the pressure that they were seeing there with the high employment and a lot of new workers in the workforce. Just wondering what your experience has been so far, and how that compares with their commentary?

Steven Justus Johnston
President, CEO & Director

Okay. I didn't hear the commentary or anything really about that. But I would comment on what we're seeing is still worker's comp to be very favorable. It is, in terms of the loss cost trends -- it is coming -- is being recognized, I think, with increased competition on the premium side, where there is very healthy competition for worker's comp, given its profitability. I think if -- we would comment to where we might see the impact of full employment in looking for -- making sure to get workers would be on the commercial auto side, where we pay very close attention to the age and qualification of the drivers that we see in commercial automobile. And not that we don't pay close attention to it in the worker's comp, but we have not seen it as much in the worker's comp trend as we have in the auto trends.

Jacob Ferdinand Scherer
Executive VP, Chief Insurance Officer & Director

Mark, this is J.F. I guess, the only thing I would add to that would be that the things that we notice most and monitor most and seems to be affecting our book of business most is just simple rate -- base rate loss cost decreases by NCCI. That's been pretty aggressive. We have -- historically, we've been a little concerned that that's -- those declines, for example, are a bit behind the times, and that -- so we, to a degree, try to neutralize those. And I would also agree with Steve that if there is one thing that we hear from policy -- -- agents from their policyholders is the frustration they have in finding qualified workers. And so we -- there's a pretty aggressive marketplace out there writing workers' comp, a lot of carriers that are offering agencies commission bonuses. We're pleased with our workers' comp book of business. I would say, compared to many other carriers, we still approach it more cautiously -- not pessimistically, but cautiously -- than others would.

Mark Alan Dwelle
RBC Capital Markets, LLC, Research Division

That's helpful. And then as you look at your, I guess, probably written premium growth, more so than earned, because that's going to naturally lag, I mean, you commented on kind of the rate environment and -- the pricing environment, rather. What proportion of your premium growth would you say is really being derived from just a better economy and more exposure unit growth and more, as you say, workers, et cetera?

Steven Justus Johnston
President, CEO & Director

Mark, this is Steve, again. I think it's really kind of split, generally what we see, about 50-50 there. We have -- because we are getting rate in the low single-digit range and premium growth in that same range and also seeing a pickup in activity in the economy as well. So I think it's -- the last I checked, it was pretty much a 50-50 split.

Mark Alan Dwelle
RBC Capital Markets, LLC, Research Division

Okay. That's helpful. And one other question, just kind of related to the tax rate in the quarter. There are a few moving pieces between the realized gains and the special items and so forth. Would you have sort of the effective tax rate on operating income for the quarter or an approximation, at any rate?

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

This is Mike. For the effective tax rate for -- I want to say traditional operating income, you could think of that almost as 21%, but also included in operating income is investment income. The effective tax rate on that is about 16%. So when you kind of think about operating income, what's the mix? Do you have more underwriting income that would drive you towards 21%? If you have less underwriting income, it will probably push it towards the 16%. The operating income effective tax rate for this quarter might look a little bit lower than normal. We filed our tax return right at the beginning of the fourth quarter. We had it prepared right at the end of the third quarter, waiting for a couple of items to kind of wrap up. So you have, sometimes, some book-to-tax adjustments, and so some of those adjustments from what we recorded at the end of 2017, we were making those adjustments and we made them right there towards the end of the third quarter. In this case, it had a positive effect, and so it actually brought our effective tax rate down for operating income. But I would say, absent nonrecurring items, investment gains and losses, book-tax adjustment, you probably are going to look at a normal run rate that might be in the 17% with a normal, maybe, mixture of underwriting income to investment income. And as we keep improving, it will start to go closer to a 21% as the combined ratio comes down and gets better.

Operator

Your next question comes from Ron Bobman from Capital Returns.

Ronald David Bobman
Capital Returns Management, LLC

I had 2 topics I was interested in. And this management team has garnered, and well-deserved, a great amount of respect, and the personal lines initiative on the high-end homeowners as well as the E&S business are both doing wonderful at their current stages. And I'm curious to know to sort of putting that as a backdrop, the Lloyd's Syndicate -- and I know it's still well away as far as closing, but what are the synergies behind it? Can you talk about that? And I'm sorry, I don't recall if you had a call immediately following the announcement and you spent too much time on that call, but would you talk about the synergies on the Lloyd's Syndicate, please?

Steven Justus Johnston
President, CEO & Director

Sure, and we did have a call, and so we can make that transcript available to you, but we see it as a bolt-on, really, nontransformative acquisition. We see them in a standalone basis. So in terms of cost synergies, we don't see a tremendous amount there. We do see as we've picked up, in terms of Cincinnati Re, synergies in terms of expertise, in terms of being able to handle larger, more complex risks. And so we are also looking for ways that our agents can participate in that, and we can be more deeply involved with our agents in terms of providing them with all the products and services that they require.

Ronald David Bobman
Capital Returns Management, LLC

I'm sorry, I didn't follow you about -- so there are complex risks out there, I guess, reinsurance opportunities, that Cincinnati Re hasn't been able to pursue, candidly, for lack of expertise, and that this Lloyd's Syndicate may be able to underwrite. Is that the point you're making?

Steven Justus Johnston
President, CEO & Director

No, no. No, that wasn't the point I was trying to make. So let me try it again. I was probably not clear enough. As we grow as a company overall, in terms of expertise, we have added to that throughout the company, as you mentioned, whether it be in excess and surplus lines, whether it be in high net worth, we have done so in what we're calling target markets, which are niche opportunities, we've done so in what we're calling key accounts, which is larger properties -- all of this on the direct Cincinnati paper. Then we have Cincinnati Re that writes reinsurance, and it has brought a lot of talent to the table in terms of the modeling of catastrophe risks, the handling of different types of complex risks, that they can share the expertise of their underwriters with the underwriters that we have on the direct side. Similarly, with Beaufort, Beaufort doesn't do reinsurance. They write larger properties in the D&F market, about 60%, probably another 30% or so in the binder and some aviation, and we see the opportunity for that type of knowledge and expertise to be also helpful to our underwriters, as well as potential opportunities that our agents can submit business to a Lloyd's Syndicate with those type of skills.

Ronald David Bobman
Capital Returns Management, LLC

Okay. That helps a lot. Unrelated, switching gears, and again, early days in the commercial auto, but you've described, I think you said, a couple of quarters of even favorable development in that line, if I heard you right. Obviously, correct me if not. But I'm wondering whether you are seeing an actual reduction or stabilization in the incidence of claims or whether you're just seeing rate, the cumulative increase of rate upon rate upon rate getting ahead of what loss costs have been trending to? I'm trying to sort of differentiate rate from just the sheer incidence of occurrences that would result in a claim being submitted?

Steven Justus Johnston
President, CEO & Director

Okay. I think the first thing, the comment about a couple of quarters of favorable development had to do with commercial casualty and not commercial automobile. As we switch to commercial automobile -- and jump in if I'm not hearing the question right -- but as I heard it, you're asking about rate in terms of how it's doing relative to loss cost trends?

Ronald David Bobman
Capital Returns Management, LLC

Yes.

Steven Justus Johnston
President, CEO & Director

I'm kind of paraphrasing, but we do we feel that as we look at loss cost trends, we look very much into the future in the ratemaking process in terms of a trend being prospective and where we think the loss costs will be in the prospective rate and policy period that we're making the rates for. And so all the activity that we do in terms of claims, underwriting, loss control and so forth, we think has been helping to dampen the loss cost trends, and then what we do with the analytics side and the pricing side has helped to get us rate that we feel that is moving ahead of the loss cost trend. And that is why we are seeing the ex cat loss ratios moving down a bit from where they had been, both quarter-over-quarter and on a year-to-date basis, for the commercial auto.

Ronald David Bobman
Capital Returns Management, LLC

Okay. So is -- do you attribute all the improvement to rate getting ahead of loss cost trend. It's not a reduction in claims frequency, maybe it's a stabilization. Would you talk about sort of claims frequency and severity trends inside of loss costs?

Steven Justus Johnston
President, CEO & Director

Right, yes. So I tried to do it in 2 pieces. So when we talk about loss cost trend being prospective, what will the loss cost be in the prospective period that the rates are being made? That's where all the -- what you would consider traditional underwriting comes into play. Whether it be loss control, better classification, better claims handling, looking at the MVRs, just everything that you would do in the art of underwriting, we think has a dampening effect on the loss cost trend that will be experienced in the prospective policy period. Then we set the rates to be gaining ground on that loss cost trend, using predictive models and all the technology that we have. And so those are the 2 levers, and so we see the traditional art of underwriting being impactful to the loss cost trends.

Operator

Your next question comes from Josh Shanker from Deutsche Bank.

Joshua David Shanker
Deutsche Bank AG, Research Division

Can we talk a little bit about the geography of new appointments? And where you're seeing the most growth in agencies? And also, when you think about the cohorts of agents that you've appointed over the last 5 years, I know that, long term, you have a goal of trying to get to maybe as much as 30% or 40% of the volume within an agency. Is the take-up rate on new appointments -- -- are they sending proportions of their business to you at the same pace of growth that you've seen in past appointment years?

Jacob Ferdinand Scherer
Executive VP, Chief Insurance Officer & Director

Josh, this is J.F. As far as the geography of the appointments would be concerned, we have appointed a lot of agencies for high net worth in California, New Jersey and Massachusetts, where we're not active in commercial lines. Now at some point, we will be active there, and many of those appointments will be converted to commercial lines agencies as well, but there have been a fair number of appointments there. As far as other appointments throughout the country, we are active now in Downstate New York, Long Island. So we're making a few more agency appointments there for commercial lines, but typically what we really are seeing is a fairly broad cross-section around the country where we have agencies, I guess, that would fall into 2 categories. Sometimes, when the M&A activity produces sales of agencies in a certain area, that can create a little bit of a disruptive effect. Sometimes producers leave. Sometimes we appoint the producers that leave, so we maintain a longer-term relationship that we've had. And then we also supplement, by appointments, agencies that have -- are not as productive as they used to be. So I wouldn't say that there's any particular state right now or any particular geography in the country that is outpacing any other. We still make new appointments in Ohio, for example. So we're -- we take a look at every single territory, and if we're not getting the activity level we need, we go back to the existing agents and hope that we can write more business with them, but if that's not the case, we appoint more agencies. As far as the productivity we're getting out of new agencies, it continues to be very good. Hoping to write 30% or 40% of an agent's book of business might be a little on the aggressive side, but, particularly in some of the newer agencies that we're appointing are very, very large agencies. The consolidation, the M&A activity have produced a lot of very large agencies. And so while we may not necessarily aspire to 30% to 40%, we continue to aspire to be the most significant contributor. I think that's the best way I would describe that: the most significant contributor to that agency's success over the long term.

Steven Justus Johnston
President, CEO & Director

And Josh, this is Steve. Just to throw some stats in there, agencies that we've appointed since the beginning of 2017 have contributed $16 million, or about 10% of the total new business written premiums over that period of time. And then just in terms of new appointments, there have been 120 new agency appointments here in the first 9 months of 2018, including 54 that market only our personal lines products that would be targeted towards the high net worth.

Joshua David Shanker
Deutsche Bank AG, Research Division

And when you think about one of those high-net-worth-only agencies, I imagine the same doesn't apply, that you're hoping to be the most important contributor. What is the goal of successful high net worth agency?

Steven Justus Johnston
President, CEO & Director

That's the same. It may take some time. We're certainly younger at it than some of the other folks that are out there, but the agencies that we're doing business with are agencies that have done business with Will Van Den Heuvel for 25 years. And we think we're bringing a good product to the market. We're seeing some tremendous receptivity on the part of some of those agencies. So I guess, just as I mentioned on the commercial lines side or my overall comments, we have no interest whatsoever in being a fringe player or a bit player in any agency we do business with. We will make a meaningful contribution to their success or we don't think that the relationship is worth pursuing.

Operator

I have no further questions in queue. I'll turn the call back over to Mr. Johnston for closing remarks.

Steven Justus Johnston
President, CEO & Director

Thank you all for joining us. Thank you, Michelle, for moderating the call. We look forward to seeing you again soon on our next year-end call. Thank you very much, have a great day.

Operator
Thank you, everyone. This will conclude today's conference call. You may now disconnect.