S&P Global
Market Intelligence

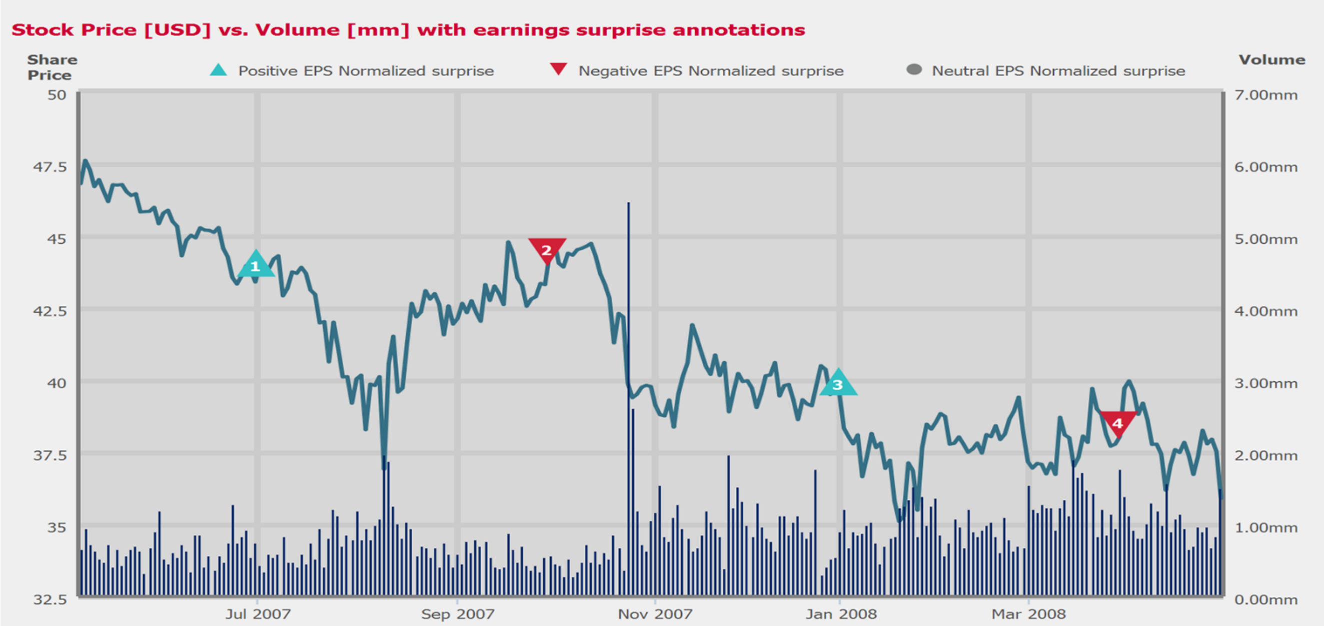
Cincinnati Financial Corporation
NasdaqGS:CINF
FQ2 2008 Earnings Call Transcripts

Wednesday, August 06, 2008 3:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ2 2008-			-FQ3 2008-	-FY 2008-	-FY 2009-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.28	0.42	▲50.00	0.53	2.17	2.34
Revenue	-	-	▲(1.13 %)	-	-	-
Revenue (mm)	927.44	917.00	-	920.80	3612.16	3625.84

Currency: USD
Consensus as of Aug-06-2008 3:21 PM GMT



	- EPS NORMALIZED -		
	CONSENSUS	ACTUAL	SURPRISE
FQ2 2007	0.85	0.94	▲10.59 %
FQ3 2007	0.78	0.66	▼(15.38 %)
FQ4 2007	0.73	1.07	▲46.58 %
FQ1 2008	0.71	0.66	▼(7.04 %)

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Call Participants

EXECUTIVES

Heather Wietzel

J. F. Scherer

Jack Schiff

Jim Benoski

Kenneth William Stecher
Non-Executive Chairman of the Board

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

Marty Mullen

Steven Justus Johnston
President, CEO & Director

ANALYSTS

Beth Malone
KeyBank

Dan Schlemmer
FPK

Michael Phillips
Stifel Nicolaus

Paul Newsome
Sandler O'Neill

Scott Heleniak
RBC Capital Markets

Presentation

Operator

Good morning. My name is April and I will be your conference operator today. At this time, I would like to welcome everyone to the Cincinnati Financial second quarter 2008 conference call. (Operator Instructions)

Thank you. Ms. Wietzel, you may begin your conference.

Heather Wietzel

Thank you, April. Hello, everyone. This is Heather Wietzel, Cincinnati Financial's Investor Relations Officer. Thank you for joining us today for our second quarter conference call. This morning we issued the news release on our results along with our 10-Q, supplemental financial package, and a listing of the securities we own. If you need copies of any of today's material, please visit www.cinfin.com where all of the information related to the quarter can be found on the Investors page under the Quarterly Results quick link. In particular, some of today's comments will refer to pages and the financial supplement.

On the call, Chairman Jack Schiff, Jr. will introduce President and Chief Executive Officer, Ken Stecher and Chief Financial Officer, Steve Johnston. Ken and Steve will give prepared remarks after which we will open the call for questions. However, first, please note that some of the matters we discuss 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, reconciliation of non-GAAP information as required by Regulation G was provided with the release and is available on the Investors page of our website under Financials and Analysis. Statutory data prepared in accordance with statutory accounting rules is permitted by the State of Ohio and Delaware, including the National Association of Insurance Commissioners' accounting practices and procedures manual, and therefore is not reconciled to GAAP.

So with that, let me turn the call over to Jack.

Jack Schiff

Thank you, Heather, and good morning to all of you and thank you for joining us again today. In June, we announced a series of management transitions that will assure the continuity of our company's values, commitments and operations. These significant changes to the Cincinnati executive team and to the department leadership and reporting put us in good shape now and they also help prepare our next generation of leaders.

Cincinnati has a new president and chief executive officer, a new chief financial officer and several new department heads. However, please do not let all of this newness concern you. Your current relationships with the Cincinnati people you know will serve you well.

Jim and I continue to serve as vice chairman and chairman respectively. We remain actively involved particularly with agency relationships. Ken Stecher, our new President and Chief Executive Officer is a 40-year associate and seasoned leader who many of our industries know well. He is a person of integrity, high energy, excellent in his communication and very much a believer in continuing our tradition of being an agent centered company.

Other leaders with new or expanded responsibilities may be less familiar to you as Jim, Ken and me but they are longtime associates. We are blessed that we can make transitions in a normal course that give us opportunities to place proven leaders where we believe their individual talents may produce the most benefit.

We do have one new face today at the table; Steve Johnston is Chief Financial Officer and started his career with Cincinnati Financial about five weeks ago following extensive experience in actuarial and investment matters serving as Chief Financial Officer of his former company before joining Cincinnati.

Going forward, Ken and Steve will be doing the major share in our investor conference call. I am comfortable knowing they will be able to provide you with the right information either from their own resources or with the able support of our Vice Chairman, Jim Benoski; our new Chief Claims Officer, Marty Mullen; our promoted Executive Vice President, J. F. Scherer; and Investments Senior Vice President, Marty Hollenbeck who also are all here in the room to handle your questions.

Let me turn things over to Ken to get the real business for today's call, our second quarter results.

Kenneth William Stecher
Non-Executive Chairman of the Board

Thank you, Jack, and thanks to all of you for joining us today. I want to begin my comments today by acknowledging you have seen a pretty steady flow of information from us over the past month or so. Today's detailed release almost seems anti-climatic with all the information that is already out there. However, we have some topics we want to revisit today to give you some additional insight. We also want to stress that as we anticipated, we returned to profitability in the second quarter.

The first quarter net loss largely reflected non-cash other than temporary impairment charges, which continued, but at a lower level in the second quarter. In the second quarter, we saw a slower rate of decline in premiums but higher catastrophe losses. Final investment results were right on with previous comments.

I am going to briefly comment on the news we have announced in recent weeks on our view of our investment strategy as well as our financial strength ratings. I will also talk about the property casualty markets always a topic of interest. After my remarks, I will turn the call over to Steve to cover details of the insurance results and our up-to-date perspective on our full-year outlook.

Jack mentioned how pleased we are to be able to make executive transitions in the normal course. We also have in process some updates to our retirement and health plan benefits that have been in the works for quite some time. We are working to assure that Cincinnati has the next generation of leaders and associates ready to move into place. Good people have always been and will continue to be the source of our strength. We planned and are making an orderly implementation of those changes.

At the same time, events that were not fully under our control caused other less orderly changes. The property casualty industry saw record catastrophe losses during the second quarter while economic and credit concerns caused continued disruptions in the stock market at large and in our portfolio. We reacted to these two different sets of events in proven fashion even though the extent of these specific events was not predicted.

Reacting to the catastrophes as we have for more than 50 years, we supplemented the work of local claims representatives with volunteers from around the country to respond to policyholders affected by weather. We received about 3500 claims through July 31 from second quarter catastrophes. We have already closed approximately 70% of those claims. Agents tell us that this prompt and personal claims service is a source of new business referrals.

Reacting to the financial markets, we continued to lower our exposure to companies that reduced or eliminated their dividend. This also served to continue to address our concentration in the hard hit financial services sector. We are acting to help protect our capital and future investment income. We carefully studied our options after Fifth Third's announcement of its dividend reduction and at our first opportunity we chose to sell more than half of our position.

Earlier in the quarter, we had completed our sale at our Wachovia and Huntington holdings and taken some gains from our excellent position along with other smaller changes in the portfolio. Our intent is to systematically reinvest the $360 million net proceeds of the Fifth Third sale and other cash flow to achieve our long-standing portfolio objectives of balancing near-term income generation and the potential for long-term book value growth. As we balance those objectives, it will likely take a few quarters to return to our track record of raising investment income every year.

You saw in today's release the impact of dividend reductions on investment income in the first half of 2008 and we have adjusted our full year expectations accordingly. We believe the actions we have taken are consistent with our view of prudent enterprise risk management. As we have indicated, our Board and investment department are working to enhance our investment parameters so that we more closely align our investment strategy with specific risk tolerances. The objective is to improve our ability to identify and respond to changing conditions.

For example, these new parameters address security and sector concentrations and could lead to actions such as rebalancing the portfolio by trimming or selling off positions. In the wake of our announcement of catastrophes and reduced dividend income but before the sale of our Fifth Third shares, the four agencies that rate our financial strength placed our ratings under some type of watch or review.

Fitch and Standard & Poor's followed up by removing their watches and lowering the ratings moving our insurance operating subsidiaries down one notch for insured financial strength. Both agencies chose to move the holding company's credit rating down two notches giving us a more standard notching profile than we had previously enjoyed.

In my view, we have taken steps to stabilize our capital and surplus and we will continue to meet the quantitative or financial measurement-based criteria for our current ratings or possibly ratings one notch above our current level. I am less certain about the qualitative or subjective criteria that rating agencies apply as part of their formula for determining ratings. Like all of us, they see what is going on in the economy and the stock market. They also draw their own conclusions about each rated company, assessing the full spectrum of operations and financial strength.

Even if our quantitative measures are within their range for the rating we want, they can see trends or movements that make them nervous. We continue to be highly responsive to rating agency information requests and to put policyholder safety first maintaining reserves ahead of claims and covering our liabilities with a large, highly-rated and diversified bond portfolio.

On that note, let me turn briefly to today's highly competitive insurance market and how it is affecting our results. The slower rate of decline in the quarters' net written premiums reflected healthy new business activity as well as the benefits of our strong agency relationships and policyholder retention. We feel our current pace for new and renewal business is consistent with our agents' practice of selecting and retaining accounts with manageable risk characteristics that support the lower prevailing prices.

A number of factors contributed to the 22.8% new business growth, including new agency appointments and our excess and surplus lines activities. We continue to make case-by-case decisions not to write or renew certain business. In this environment, we have been careful to stay within our underwriting guidelines. J.F. will be available to respond to questions with more specifics on pricing.

We remain committed to our local independent agents and to maximizing their advantages. We are working on specific ways to reach new geographies, to provide agents with products to meet the changing needs of their customers, and then put in place systems that will increase the efficiency and ease with which they do business with Cincinnati.

As you may have seen, we have announced plans to enter Texas, our 35th state of operation, by the end of this year. Texas is home to four of the 10 fastest growing metro markets in the country. We will enter with an eye to managing risk, but see the state offering exciting growth potential. We absolutely have the capital to support those efforts and we have the capital to write the business our agencies bring to us which bodes well for our ability to come out of the soft market prepared to grow profitably.

I will add that our excess and surplus lines business continues to meet our expectations with the rollout to our agency's proceeding. Not only are we writing non-standard business for our agents' customers, we are getting additional at-bats for accounts that require both standard and non-standard coverage. Our agency value in presenting their customers with a solution that offers them the complete package including coverages backed by our company's records of financial strength and superior claims service.

Turning to personal lines, we think some recent initiatives will continue to make a contribution in the second half and our new pricing structure in many states will further improve our competitive posture. For example, we are making new agency appointments and expanding geographically by adding personal lines in areas where our agents previously represented Cincinnati for commercial lines only.

As we expand, we are sending underwriters to the field to train agencies and give them a quick start on our products and systems. As we take our personal lines policy processing system into these new areas, we have opportunities to gain benefits of scale and spread our risk assuring our ability to offer our agents a competitive, stable personal lines market. We believe we are on the right path. In the second quarter, recently appointed agencies were a big source of personal lines new business.

During the third quarter, we were implementing more pricing points, fine-tuning our rates for each risk to produce very competitive premiums for our agents' higher quality accounts. All of these actions move us closer to achieving the benefits of scale that will help us assure our agents access to a competitive, stable personal lines market.

For both commercial lines and personal lines, the biggest effect on the quarter's profitability was the catastrophe losses but pricing and reserve changes were also factors. Steve is going to talk about how the pieces fit together in the first half of this year and how they may play out for the remainder of 2008.

I will turn the call over with the aside that Steve has been in Cincinnati for about five weeks. I am pretty sure I speak for the rest of us when I say that he has fit in as if he has been a part of our team for years. Steve?

Steven Justus Johnston
President, CEO & Director

Thank you, Ken, and thanks to all of you for joining us today. I am looking forward to becoming reacquainted with many of you in the investing community. As Ken said, I am going to cover the details of the insurance results and review our thinking on the full year outlook. Before I dive into the numbers, I want to briefly share how fortunate I feel to be with Cincinnati. This is a quality company that I have studied from afar for a number of years.

Being on board with this team, my goal is to continue the work Ken has done to make our results and financial condition transparent to you and to manage the company's financial and accounting decisions with the same high integrity.

Turning to the property casualty results, I am going to refer to some data that you can find in our financial supplement which is available to all on our website www.cinfin.com in the Investor section. Second quarter net written premiums declined by 2.5% narrowing the six-month decline to 5.4%. Although we continue to experience a competitive market, we are maintaining our focus on underwriting discipline.

The $14 million rise in new business for the first half included just under $4 million in premiums from our new excess and surplus lines company in just its first six months of operation. In addition, the 36 agencies appointed this year already contributed $2 million in new commercial lines business and agencies that initiated or expanded their use of Cincinnati's personal lines in the past 18 months were big contributors to new personal lines business.

Moving from growth to profitability, in the second quarter the consolidated property and casualty combined ratio increased 14.9 percentage points from the 2007 second quarter, largely because of the 13.5 point rise and the contribution from the atypical level of catastrophe losses.

Let's look at commercial lines and personal lines separately to give some insight into our analysis. For commercial lines, premiums declined due to market competition. We saw a 14.7-point rise in the second quarter of 2008 combined ratio, primarily because of the higher catastrophe losses. The property intensive business lines bore the brunt of the catastrophe losses, as one would expect.

Briefly, we had some non-cat weather losses also. We saw a handful of losses from events that did not cause enough industry-wide damage to be classified as catastrophes. For example, we had a $4 million loss when the tornado hit a distributor's facilities in North Carolina. There is just been a lot of bad weather across the United States this year.

Moving to the favorable development and reserves, the commercial casualty business line contributed the bulk of the favorable development in the quarter. That business line's loss and loss expense ratio was 39.8% compared with 54.6% in the second quarter of '07. Savings of $60 million reduced that ratio 31 points for the quarter, compared with $27 million or 12.9 points in last year's second quarter. The commercial casualty line continued to benefit from an initiative begun in 2001 to use a claims mediation process that promotes earlier liability settlement resolution. The line also benefited from revised expectations for loss expense inflation.

For personal lines, we are reporting a 15.4 point rise in the second quarter 2008 combined ratio, also driven by higher catastrophe losses. Those losses were partially offset by improvements in the loss and loss expense ratio, excluding catastrophe losses and by lower commissions and other underwriting expenses. The 4.8 percentage points of improvement in the second quarter 2008 loss and loss expense ratio excluding catastrophe losses were primarily due to fluctuations in prior period reserve development on a year-over-year basis.

Savings from favorable development of prior period reserves reduced the loss and loss expense ratio by 7.2 points in the second quarter compared with just 0.3 points in the same 2007 period. That largely reflects savings from the other personal line of business, which includes our personal umbrella coverage.

Before I comment on the outlook, I have a few observations on other aspects of the business. First, the Cincinnati Life Insurance Company contributed $0.06 to second quarter operating income, compared with $0.05 last year. This steady flow of dollars to the bottom-line helps offset the ups and downs of the property casualty market.

Second, we repurchased just over 800,000 shares in the second quarter bringing the year-to-date repurchase total to approximately 3.8 million shares making 2008 already our third-highest year since we began the program in 1996. The investment department generally makes repurchases when we believe the open market stock price is favorable. However, our activity may be limited in the second half as we balance repurchases with capital preservation.

Finally, to summarize the outlook as Ken mentioned, our investment team has adjusted its outlook for income growth. For full year 2008, they believe investment income could be 90% or more of the $608 million we reported for 2007. For 2009, they expect the first quarter comparison will be negative but believe that we will start to see year-over-year growth in the second or third quarter.

On the insurance side, we continue to believe our full year net written premiums could decline as much as 5% if current commercial lines pricing trends continue. We believe that is a satisfactory comparison in light of industry reports. It shows that we are using prudent underwriting but continuing to look for appropriate growth opportunities such as new agencies, new geographies and our new excess and surplus lines operation.

We believe our GAAP combined ratio may be above 100% for the full year. As we have noted, our target relies on three assumptions. First, that savings from favorable reserve development reduces the ratio by approximately 4 percentage points. Second, we expect the current accident year loss ratio to be under further pressure. Finally and here is the change we announced in June, our target now assumes that the catastrophe loss ratio could add as much as 9 percentage point to the ratio.

Our case-by-case underwriting approach supported by field underwriters, loss control associates and our claims team helps us retain quality accounts and places us in a position to benefit when the market changes. We have been successful in recent soft market cycles outperforming the industry with lower combined ratios. With adequate revenues and a strong capital position, we believe we are prepared for the future. Ken?

Kenneth William Stecher
Non-Executive Chairman of the Board

Thank you, Steve, for those details. Before we open for questions, let me reiterate that I welcome the opportunity to lead a company with many distinct advantages in the marketplace. I welcome the challenge to continually demonstrate the value of those advantages. Cincinnati's unique agent-centered mission, philosophies, and proven strategies have benefited many people from policyholders and claimants to agents, associates, and shareholders. They will never go out of style. We will be applying those strategies as external conditions evolve whether that means competition or weather or economic and insurance cycles.

We are moving ahead with a variety of initiatives that range from our entry into Texas to our entry into excess and surplus lines. They include our emphasis on expanding personal lines products and technology into more of our commercial lines agencies and states to achieve the economics and the diversification needed for long-term success.

With the support of our local independent agents, our focus will be on achieving two goals. On the financial side, we will be working to establish policies to preserve our capital stability. On the insurance side, our priority will be to increase ease of doing business for our agencies, both by advancing our technology and by leveraging our local presence and decision-making in the agents' communities.

I consider those as my personal commitments. I firmly believe that we can serve Cincinnati's strength and change what needs to be changed to create value for shareholders over the long-term. We are confident in the continued contribution of our solid insurance operations to our earnings and our ability to sustain a strong capital position and on our Board's intention to reward shareholders with cash dividends that rise year after year.

From my perspective, our capital position and cash flow continue to support our current cash dividend payout and should provide our Board the flexibility to consider future dividend increases for our shareholders.
With that, we are about ready to open for questions. Let me remind everyone that we have quite a group here to field your questions. Jack, Steve and I are joined by J. F. Scherer, Marty Hollenbeck, Steve Johnston, and Jim Benoski as well as Marty Mullen, a 30-year Cincinnati veteran who was recently named our Chief Claims Officer. So, April, let's go ahead with questions.

Question and Answer

Operator

Your first question comes from the line of Paul Newsome with Sandler O'Neill.

Paul Newsome
Sandler O'Neill

Good morning. Thanks for the call. I was hoping you could give us just a little bit more color on the Fifth Third sale in particular. You mentioned it was sort of the first available opportunity. Could you talk about why the sale happened immediately versus say a thought of holding on until better times come for the financial markets? And how you were thinking about that?

Kenneth William Stecher
Non-Executive Chairman of the Board

Well, Paul, I will start and then I will let Marty follow up. Since we were a 10% shareholder, when they were in blackout we were also in blackout. So which meant that once they decreased their dividend, the blackout existed until the point in time where they released earnings. So that was the timing there. I think the standpoint of the sale instead of waiting for a recovery, when you look at the enterprise risk management process and when you look at the size of that position to our overall portfolio, which everyone knows how large a position that was relative to our capital base and the real uncertainties in the market, I felt that preservation of capital was a very key thing that we had to address at that point in time.

We had saw other bank stocks and you have seen those also that they did one dividend cut; some of them subsequently followed with a second dividend cut, you know, were uncertain as to where their dividends might go. Hopefully, it's not going to be changed from the current level until it starts to reverse and rise again. But I felt from the capital preservation point of view, I didn't want to take the risk of going down into the single digits.

We still have a large position that we still retain so we will enjoy quite a bit of the upside. So that is my perspective. I will let Marty add any color to that that he would like.

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

I think, Paul, Ken pretty much covered it all right there. I mean it was a risk assessment analysis on our part; the credit crunch if you will is still far from over. It is still playing out so we were just analyzing the further downside risk and determined that the 32 plus million shares that we were going to hang onto were adequate to participate in that upside, that recovery that we hope ensued.

Paul Newsome
Sandler O'Neill

Did the rating agencies have much of a role if any?

Kenneth William Stecher
Non-Executive Chairman of the Board

It really was driven by enterprise risk management. We have to say that in any time when they are going through their analysis, concentrations of investments is always one of the things they taken to a count. But this was mainly driven by our enterprise risk management process.

Paul Newsome
Sandler O'Neill

Great, thank you. And I will let some other folks get their questions in.

Operator

Your next question comes from the line of Michael Phillips with Stifel Nicolaus.

Michael Phillips
Stifel Nicolaus

I guess first off, welcome back Steve. It's good to hear your voice again.

Steven Justus Johnston
President, CEO & Director

It's good to be back, Michael.

Michael Phillips
Stifel Nicolaus

A couple of questions. One, you mentioned in the press release your new business growth, a lot of which comes from the agency appointments, but you also mentioned the book rolls initiatives in that regard. Can you talk about how big that is for your new business in terms of numbers maybe? And then, I guess how much of a priority do you place on that versus just kind of individual account by account business?

J. F. Scherer

Michael, this is J.F. Just to give you a little idea, right now we will be even with book rollovers underwriting on a risk-by-risk basis. We discuss with our agencies the advantages they might have in reducing the number of carriers they have. Obviously we try to convince them that for the long-term what we can do for them measures up.

We have about $38 million in books of business, if you will, of about 150 separate books that we are analyzing right now. We won't roll all of that to the Cincinnati Insurance Company but our agencies have indicated in all those cases that we can take a look at it and that those would be eligible in their agencies for phasing out a carrier.

So, I think we've really never talked a lot about book rollovers as a company because we don't take the approach that we want to take everything in a book. We think that is dangerous. We think we can step up on the very good accounts. Our excess and surplus lines company gives us much more flexibility on those accounts that we don't think qualify for Cincinnati Insurance Company but that has played a nice part this year in some of the increase in new business.

Michael Phillips
Stifel Nicolaus

I guess a follow-up on that, with the current market conditions and agents under pressure to increase their revenue, are they looking to do more book rolls to help their expenses or are they looking to appoint more and more companies to help possibly grow the top-line that way? Which of those wins out for agency do you think?

J. F. Scherer

Well, in very good agencies that granted everyone is under pressure from a revenue standpoint, but having to split up the pie in an agency among ever more increasing carriers is not something even in a tough time that an agency wants to do. They want a lineup of carriers that are reliable year in and year out and do reflect the strengths of the agency. We do see in certain states obviously, just as we are going to go into Texas, we see certain carriers coming into states where we are already active and they because they will be drawn to the better agencies will be going into the agencies that represent our company. It's always a balance.

Certainly if an agency has a group of already very viable carriers, the last thing they want to do is dilute the relationships with those good carriers. So it's a balance. And just as we balance the numbers of agencies we appoint in a certain state, so too will agencies balance the number of carriers they are going to have.

Michael Phillips
Stifel Nicolaus

Okay, thanks. And last question. Steve, I think you mentioned on the reserve development a good chunk of that in commercial lines came from commercial casualty. I think you said you haven't revised expectation for loss inflation. That kind of got choppy that when you were saying at least on my end. Can you explain what you were talking about there?

Steven Justus Johnston
President, CEO & Director

Is it just, Michael, when we look at the reserves, the various assumptions that we put into our actuarial analysis, one of them is the inflation assumption. As we look back at how the actual numbers have been developing relative to what we had built in as an inflation assumption, we just think this is the time to revise them down a little bit.

Michael Phillips
Stifel Nicolaus

No kind of numbers around what the numbers are that you are looking at there with inflation?

Steven Justus Johnston
President, CEO & Director

I don't have those with me. They are kind of blended in with a number of other assumptions.

Michael Phillips
Stifel Nicolaus

Okay, thanks very much.

Operator

Your next question comes from the line of Beth Malone with KeyBank.

Beth Malone
KeyBank

Thank you, good afternoon. I just have a couple of questions here. One is on the risk management that you apply to make a decision to sell the Fifth Third. Is that a different or does that constantly get recalibrated or is it a different? Did you change the way you look at that?

Kenneth William Stecher
Non-Executive Chairman of the Board

Beth, this is Ken. Basically enterprise risk management process is something that has been developing for the last few years. And so I think it's something that all carriers and all companies are looking at just looking at the broad risks that they have across their organization. And when we started to look at that and we started to look at the size of that investment in our portfolio along with the other financial stocks, it started to point out that it was just a little bit of an oversized position. So, it really has been something that has been developing from the last few years.

As we mentioned in some of our other comments, we are also in the process too of just revising our investment policy and that is going to put some parameters in place that would help us manage these investments as we go forward. If we have a stock that is a winner like Fifth Third in the future, which bring us to looking at that at an earlier point in time as to the size and the outlook and things like that. So it's something that's been evolving for a few years.

Beth Malone

KeyBank

Okay. And on the E&S book, the new E&S book, is that developing or what is your experience on that so far? Is it developing as you would have anticipated? Do you have more than you expected demand for it?

Kenneth William Stecher
Non-Executive Chairman of the Board

From my perspective, I think it's going along very well. And I know J.F. can add color to that. I think any time you start up a new organization like that, and many of her agencies write the excess and surplus lines, but we want to make sure that we have adequate underwriting in place; we want to make sure our technology is in place; and we want to make sure that we understand the risks that are in that market. So, I think it's going along very well, but I would like J.F. to add some comment to that.

J. F. Scherer

Beth, we started out slow in January where we actually only had a few agencies to make sure our systems were in place to write the business that we wanted to. We start off with five states, then another five states in Phase II that were live by the end of May. So we're not trying to explode on the scene with excess and surplus lines, but I think it is fair to say that our agencies have embraced it.

Our hit ratio right now is around 40% of the submissions that we are getting. I guess we've written through six months. We wrote $3.7 million in business in our excess and surplus lines, but the attractive consequence as well is that we calculate we wrote about $2.5 million in new business in Cincinnati Insurance Company on the non-E&S lines within those accounts.

So, we are very happy with the progress we are making. We're rolling out property in addition to the casualty as the year goes on in these states. We will be active in 33 of the 34 states, with Delaware being our state of domicile. So, therefore, we are an admitted company there. We will be active in the 33 states by the end of the year, and our agencies once again are giving us a lot of opportunity. So it is very positive from our viewpoint.

Beth Malone
KeyBank

Okay. And then, one last question. On your communications with your agents, I know that is one of your strengths, your agency force. A number of those agents also own Cincinnati Financial stock because they've been with you for a while now. I just wonder, have you changed your communications with the agents or are you just doing just the same thing you always have done? And what kind of feedback have you gotten from the agents to date on the market conditions in Cincinnati stock?

Kenneth William Stecher
Non-Executive Chairman of the Board

I think they understand that we are under more pressure because of the financial sector in general. And they understand that the investment policy that we have followed for many years has resulted in a little bit of a drop in our book value. I think one of the things that we did here just recently with my announcement was we sent out a letter to all the agents, just reinforcing the fact like I had in my comments what our main focuses are. The agents are going to remain our customers. We are going to stay much focused on providing service to them. The relationships are key and we are not going to change any of the key metrics that have gotten us to where we are today.

If anything, we want to continue on that same path and improve in areas where we can. I think getting back to stock prices briefly; they understand the volatility of the markets. They understand the solid balance sheet that we have, and I think they are like all the other investors. They are looking long-term, and we believe we are in fine shape to go forward.

Beth Malone
KeyBank

Okay. And just one last question on that on the rating changes from the rating agencies. Do you see that as having any impact on your ability to write the business you normally write?

Kenneth William Stecher
Non-Executive Chairman of the Board

I think, Beth, from my point of view and J.F. may have some additional comments, but right now we are in the top 2% with our A.M. Best rating. And the A+ if they would review us at a later date that would still be in the top 10% of the companies with those ratings. So I think that would put us in a very strong position to continue to operate the same way we do currently with our agents.

J. F. Scherer

Beth, this is J.F. No question we like the A++ rating. So do our agents. In the short-term, obviously there has been a little conversation out in the field other carriers commenting on Cincinnati. But we recently had our agents' meeting where about 380 couples attended and we talked with them. We see no dilution in their enthusiasm or confidence in the Cincinnati Insurance Company. We've seen evidence since the announcements in late June of very substantial prestigious marquee accounts that could be very sensitive to financial ratings placed with the Cincinnati Insurance Company, additional book rolls.

So, these agencies have done business with us in many cases for years. They have tremendous confidence in us. I guess to comment on the communication, we view the marketplace obviously as a competitive one. We have 108 territories. We think we communicate very well to all of our field associates with our agencies. Our agents are kept up to speed and know exactly what is going on with our company. And we are trying to leverage the 18 years experience as insurance professionals that our field underwriters have to navigate through a very competitive marketplace.

So it's tough out there for everyone. We are in the same boat as everyone else from that standpoint, but we are very pleased with our results.

Steven Justus Johnston
President, CEO & Director

Beth, this is Steve. I might just add that in our current position if you look at it on a statutory basis that the insurance companies, our premium surplus ratio still less than 0.9 to 1, I think annualized around 0.85 to 1. We have a very strong and diversified high-quality bond portfolio that is sufficient to cover our liabilities. I guess a third point, probably all of us were with a large number of our agents at the Presidents Club and I think it was comforting to hear from them a commitment. They did not seem to be concerned about the rating agency talk at the time. So I don't think it is an issue.

Beth Malone
KeyBank

Okay, thank you.

Operator

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

Scott Heleniak
RBC Capital Markets

Just want to start off with a question on the three-year policies. You guys still marketing these policies as actively as you had been the past couple of quarters? And what is your plan to market those as the soft market gets a little bit deeper? How are you thinking about that?

J. F. Scherer

Scott, I guess I would answer that by saying we are marketing it as we have since 1951. About 90% of our accounts have a three-year policy feature to them. We don't time our use of the three-year policy. Year in and year out, that three year policy creates I think a consistency and persistency in our book of business that our agencies and policy holders are drawn to. So we have neither increased nor decreased our approach in that area.

Scott Heleniak
RBC Capital Markets

Okay. You talked in your comments about marketing more successfully to personal lines agencies. Just wondering if you could talk about how you think you have had that success? Is it technology or pricing or how you think you've been able to penetrate more personal lines within the agencies?

J. F. Scherer

First and foremost would be technology, the introduction of our Diamond System throughout all states has been the key to our ability to open up some new states and to add agencies. So I think our agencies are getting more and more comfortable with the system. Agencies that up to this point had chosen not to do business with us because of the absence of technology or direct billing are embracing it as well.

Further, on the pricing side, we fine-tuned our pricing in a variety of areas. We've talked previously on calls where when we increased rates over the past several years in some areas we overshot the mark and that depressed our new business writings. We fine-tuned those. We are in the process right now of introducing nine additional tiering levels in our pricing schemes. I think we will be in a much better position to more accurately target business for our agencies.

So, we are actively recruiting more and more agencies. We anticipated that we would add 90 new personal lines agencies this year, the lions share of which was in commercial lines agencies for us historically that now we will be writing personal lines. We will meet that goal and we've got another 40 or 50 that we think we can add to that shortly after the first two year as well.

Scott Heleniak
RBC Capital Markets

Okay. And then, one last question. You mentioned in the press release some of the higher loss trends in workers' comp, executive risk. It sounds like a severity issue. I wonder if you could talk about that a little more detail about some of the claims that are coming in.

Kenneth William Stecher
Non-Executive Chairman of the Board

Sure, our analysis indicated that there were about $38 million increase in large commercial lines losses. Case reserves reflected normal fluctuations in loss patterns, had normal variability in our large loss case reserves for our workers' comp claims. We did have several unusual large losses related to the non-catastrophe weather, as I mentioned in the set comments.

We did have a higher number of executive risk losses between $250,000 and $1 million. I don't think from what I saw that it was anything that would be the start of a trend. It seemed to be a one-off thing. We did have as I had mentioned some larger claims with some adverse development, but if you look at in total including IBNR, including everything, we had quite favorable development.

So, you are right to point those out and I think we take it seriously as we look at our underwriting. We are a good underwriting company and good underwriting companies are always thoroughly looking at their books, their trends and their losses and we are going to continue to do that. I think its part of being on a good team around here. Our company knows Marty Mullen. I think over his 30 years here at Cincinnati he's probably remembers more than I know about the claims around here, so I might ask Marty, do you have any insight on that?

Marty Mullen

No, thank you, Steve, that pretty much covers the synopsis of the losses during the second quarter. And your particular question concerning more comp losses, we did see one particular area between $500,000 to $1 million in new claims, a little unusual number in that second quarter than usual which contributed somewhat to that increase. But other than that, it was a normal trend.

Scott Heleniak
RBC Capital Markets

Okay. All right, thanks.

Operator

Your next question comes from the line of Dan Schlemmer with FPK.

Dan Schlemmer
FPK

Guess a lot of changes this quarter. So start off with congratulations to Jim and the other various promotions and also welcome, Steve. Glad to have you with us.

Steven Justus Johnston
President, CEO & Director

Glad to be here.

Dan Schlemmer
FPK

Ken, following up on Beth asking about the ratings, specifically on the A.M. Best, I think Cincinnati is still under review. Is there a specific timing on that or is that open-ended? I don't know if there is any other info you can give us just as far as what to expect in terms of timing? Is an A+ pretty much a worst-case scenario, or do you even have any info from them on that?

Kenneth William Stecher
Non-Executive Chairman of the Board

Dan, we really don't have any info. I think right now the timing is open-ended. We continue to have discussions with them. We believe when we do go through their analysis from a quantitative point of view, we believe that the A++ rating would still be warranted. I think there is still an open-ended timeframe there.

I do believe that if there was some kind of action taken, I think the A+ would be the worst-case scenario. I can't see with our BCAR rating that it would be any lower than that. I also believe that we do have the criteria that they look for to maintain the current rating that we have. I think it is the strong financial strength, the good reserving philosophy that we have. We do have a good niche in the marketplace and we are a very strong company in the space that we write in. So those are the things I believe they look for. So I think we are in a good position but obviously there still is some uncertainty because we still are under review.

Dan Schlemmer
FPK

Great, thank you. Separately, we talked last quarter I think it was J.F. commented on just specifically looking at the construction business. I think the comment is that was ballpark 40% or 50% of the premiums in GL and workers' comp.

Can you give us an update on that market and just what you are seeing first of all in terms of business? Obviously with the current state of the housing market etcetera that has got to be tough? Specifically, I'm assuming that business is just disappearing, right? There is less work being done. But is that increasing the pricing pressure within that segment within that niche?

J. F. Scherer

I think disappearing is a little strong. The percentages we talked about is 41% of our GL liability premiums would have a ISO general liability code related to construction and then 48% on workers' comp. So that is the balance in our book of business. No question it is down substantially and as far as pricing is concerned, our payrolls in the sales and the residential construction, it is still under a lot of pressure, modestly on the commercial construction side.

However, we still insure some good contractors and good contractors still continue to work. It is under pressure for us. Some of the states in which we would have a pretty high level of construction business, New York comes to mind, we've seen some declines in overall premiums that are around 10%, so falling off the table, nothing like that so strong but it is having its effect.

Dan Schlemmer
FPK

And last question on the

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losses, I think the comment was 70% of the claims have been resolved at this point. So I guess what level of uncertainty is still associated with the last 30% of claims? I don't know if you have a dollar value associated with those reserves and if you can make any comments on a range for just the

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specific reserves?

Steven Justus Johnston
President, CEO & Director

Dan, are you asking how much IBNR we might have left on those events, is that what you are asking?

Dan Schlemmer
FPK

Well, I guess, yes. How much IBNR, and then what is the level of uncertainty just with 70% of the claims resolved? What about the other 30%?

Marty Mullen

Dan, this is Marty Mullen. Thanks for the question. Fortunately, we were able to implement our storm team for those affected areas and I think it is safe to say they've done an excellent job in closing and resolving the majority of those cases to the point that all of those teams have been recalled. So the remaining claims are being handled by the local claim representative to finish off the final payments on those claims.

So I believe that is really indicative of the severity issue related to those storms is pretty much intact. As far as the total amount incurred for those storms it's approximately $77 million incurred for all 10 of those storms. So I feel like we have a good handle on the average claim and reserve per file and the exposure related to such and that the open pending files are well in hand.

Dan Schlemmer
FPK

I guess would it be fair to say then that given that your comments there that those claims are no more uncertain or no more risky of blowing up or anything like that than just the normal claims? That you are in a normal claims paying mode on those losses?

Marty Mullen

That would be correct. At this point in time, the majority of those cases although they are open have probably been inspected and evaluated to some degree.

Jim Benoski

Let me add something to that, Dan. This is Jim Benoski. The incurred that Marty mentioned of $77 million plus is actually paid loss and case reserve. In addition to that, we've got $44 million in IBNR. So, we think we have adequate reserves on case, but we still have $44 million in IBNR out there in case something does happen that we've got a fallback.

Dan Schlemmer
FPK

Very helpful. Thank you.

Operator

At this time, there are no further questions. I would now like to turn the conference over to Mr. Stecher. Please go ahead.

Kenneth William Stecher
Non-Executive Chairman of the Board

April, thank you and thanks everyone for joining us today. We appreciate your interest in Cincinnati Financial and look forward to tracking our progress for you throughout the remainder of 2008. Thanks and have a great day.

Operator
This concludes today's conference call.