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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the American Financial Group 2019 Fourth Quarter Results Conference Call. (Operator Instructions) Please be advised that today's conference is being recorded. (Operator Instructions)

I would now like to hand the conference over to your speaker today, Diane Weidner, Assistant Vice President, Investor Relations. Thank you. Please go ahead, ma'am.

Diane P. Weidner - *American Financial Group, Inc. - Assistant VP of IR*

Good morning, and welcome to American Financial Group's Fourth Quarter 2019 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 CFO. Our press release, investor supplement and webcast presentation are posted on AFG's website. These materials will be referenced during portions of today's call.

Before I turn the discussion over to Carl, I would like to draw your attention to the notes on Slide 2 of our webcast. Certain statements made during this call may be considered forward-looking statements as defined under the Private Securities Litigation Reform Act of 1995. These statements are not guarantees of future performance. Investors should consider the risks and uncertainties that could cause actual results and/or financial condition to differ materially from these statements. A detailed description of these risks and uncertainties can be found in AFG's filings with the Securities and Exchange Commission, which are also available on our website.

We may include references to core net operating earnings, a non-GAAP financial measure, in our remarks or in responses to questions. A reconciliation of net earnings attributable to shareholders to core net operating earnings is included in our earnings release.

If you are 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 am pleased to turn the call over to Carl Lindner III to discuss our results.

Carl Henry Lindner - *American Financial Group, Inc. - Co-President, Co-CEO & Director*

Good morning. We released our 2019 fourth quarter and full year results yesterday afternoon. If you would, please turn to Slides 3 and 4 of the webcast slides for an overview.

Craig and I were pleased to report AFG core operating earnings of $8.62 per share for the full year 2019, up 3% from last year, and generating a core return on equity of 14.9%. Returning capital to our shareholders is an important component of our capital management strategy, and reflects our strong financial position and our confidence in AFG's financial future. We paid $446 million in dividends during the year, representing $149 million in regular common stock dividends and $297 million in special dividends. Our quarterly dividend was increased by 12.5% to an annual rate of $1.80 per share, beginning in October of last year.

Growth in adjusted book value per share plus dividends was an impressive 17.8%. And AFG's 5-year total shareholder return, representing growth in share price plus dividends, was approximately 120%, exceeding the total return performance of the S&P 500, the S&P Property and Casualty Index and the S&P Life and Health Index over the same time period.

Turning to Slide 4, we're pleased to report fourth quarter core net operating earnings of $2.22 per share. The strong operating profitability and investment results in both our Specialty Property and Casualty and Annuity operations highlight the value of our diversified portfolio of insurance businesses, which has enabled us to produce consistently strong core earnings results over time.

Fourth quarter 2019 annualized core operating return on equity was 15%. And net earnings per diluted share were $2.31 and included $0.09 per share in net non-core items, including the costs associated with our plans to exit the Lloyd's of London insurance market in 2020.

Craig and I thank God, our talented management team and our great employees for their work in helping us to achieve these results and position our business for success. Looking forward, we've established initial 2020 core operating earnings guidance for AFG in the range of $8.75 to $9.25 per share. Craig and I will discuss our guidance for each segment of our business in more detail later in this call.

Now I'd like to turn our focus to Property & Casualty operations. If you turn to Slides 5 and 6 of the webcast, which includes an overview of the fourth quarter results. As you'll see, on Slide 5, gross and net written premiums in our Specialty Property and Casualty insurance operations grew by 8% and 9%, respectively. Pretax core operating earnings in the AFG's P&C Insurance segment were $199 million in the fourth quarter of 2019, compared to $214 million in the prior year period, a decrease of $15 million or 7%. I'm extremely pleased with the strong underwriting margins produced by our Specialty Property and Casualty Group during the quarter, particularly in the wake of a challenging crop year. Our Specialty Property and Casualty insurance operations generated an underwriting profit of $89 million in the 2019 fourth quarter, compared to $102 million in the fourth quarter of '18. Lower underwriting profitability in our Property and Transportation Group, again, primarily due to lower year-over-year earnings in our crop operations, was partially offset by higher year-over-year underwriting profits in our Specialty Casualty and Specialty Financial Groups.

Fourth quarter 2019 combined ratio of 93.5% increased 1.5 points year-over-year and includes 3.8 points of favorable prior year reserve development, compared to 4.7 points of favorable prior year reserve development in the 2018 fourth quarter.

We continue to see strong renewal pricing momentum. Average renewal pricing across our entire Property and Casualty Group was up about 5% for the quarter. And when you exclude workers' comp, renewal pricing was up approximately 7% in the fourth quarter, reflecting a continued improvement from renewal rate increases achieved during the first 9 months of 2019. Over one fourth of our Specialty Property and Casualty businesses achieved double-digit rate increases during the quarter, or said another way, nearly one third of our non-workers' compensation businesses achieved double-digit rate increases during the quarter.

Renewal pricing in our Specialty Property and Casualty Group overall, is the highest we've achieved in over 5 years, meeting or exceeding our expectations in each of our Specialty Property and Casualty subsegments. I'll discuss in more detail as we review the results of each.

Although loss cost trends across our Specialty Property and Casualty businesses remain stable overall, we continue to closely monitor loss activity and the impact of social inflation, along with general loss cost inflation and interest rates. As we've discussed for many years, we're in our eighth year of rate increases in our commercial auto liability business, dating back to when we first saw an uptick in commercial auto severity -- loss severity in 2012. We were able to address issues through underwriting and rate actions, and got this business back on track after several years of concerted effort. We're also taking measures in a few other areas within our Specialty Property and Casualty business, where loss costs are running higher, and where we see more aggressive trial bar activity and increased jury awards during severity -- driving severity.

Similarly, we are addressing elevated loss cost through underwriting and risk selection and securing rate increases to stay in front of loss ratio trends. I'm really encouraged by the pricing environment right now, and especially our ability to achieve strong renewal rate increases in many of our Specialty Casualty businesses. Concurrently, we're increasing initial loss picks in several of our longer-tailed liability lines, such as our Excess and Surplus lines, Public Sector and other businesses where we have more exposure to social inflation, and we are holding more IBNR. We continue to think we are prudently reserved and no less so than we were a year ago, based on the types of business we write and on the way we operate our business.

Now I'd like to turn to Slide 6 to review a few highlights from each of our Specialty Property and Casualty Groups. The Property and Transportation Group reported an underwriting loss of $2 million in the fourth quarter of 2019, compared to an underwriting profit of $64 million in the comparable prior year period. Record levels of prevented planting claims in our crop operations were the driver of lower year-over-year underwriting profit. Higher underwriting losses in our Aviation and disappointing results in our Singapore branch business also contributed to the fourth quarter underwriting loss. Both of these businesses achieved significant renewal rate increases throughout last year, and we continue to focus on improved risk selection, but we still got more work to do.

I'm particularly pleased with the excellent performance of our commercial auto operations in the fourth quarter and for the full year. These businesses also reported -- these businesses reported strong underwriting profitability, and also, the growth in gross written premiums of 9% year-over-year.

Catastrophe losses for the Property and Transportation Group were $7 million in the fourth quarter of '19, compared to a favorable impact of $2 million in the 2018 fourth quarter. Fourth quarter 2019 gross written premiums in this group were down by 4%, and net written premiums were flat year-over-year. Higher premiums in our Property and Inland Marine and Ocean Marine businesses were more than offset by lower premiums in our transportation businesses and crop operations. Lower premiums related to our winter wheat and rainfall index products were the driver of the lower crop premiums. The timing of the renewal of a large commercial auto account impacted 2019's fourth quarter transportation premiums. Excluding this large renewal, fourth quarter net written premiums for this group increased 3% year-over-year.

For the full year, gross and net written premiums in this group grew by 4% and 7%, respectively.

Overall renewal rates in this group increased 5% on average in the 2019 fourth quarter and 4% for the full year. Though our commercial auto liability renewal rates -- continue to increase substantially and by 10% in the quarter.

Specialty Casualty Group reported an underwriting profit of $69 million in the 2019 fourth quarter, compared to $22 million in the comparable '18 period. These results were largely due to a reduction in the core underwriting loss at Neon, resulting primarily from lower year-over-year cat losses.

Higher underwriting profitability in our workers' comp businesses, primarily as a result of higher favorable prior year reserve development, also contributed to these improved results. Each of our workers' compensation businesses continue to report very strong underwriting margins in the fourth quarter and for the full year.

Catastrophe losses for this group were $6 million and $28 million in the fourth quarters of 2019 and 2018, respectively, and were primarily attributed to Neon. As we complete our exit from Neon, we do expect a significant reduction in catastrophe exposures in 2020.

Gross and net written premiums increased 19% and 15%, respectively, for the fourth quarter of 2019 when compared to the same prior year period. Growth in our surplus lines and excess liability businesses, primarily the result of new business opportunities, rate increases and stronger renewal retention, were primary drivers of the higher premiums. In addition, higher premiums reported by Neon, premium growth in our executive liability business and the addition of ABA Insurance Services contributed to the higher year-over-year premiums.

Renewal pricing for this group was up 6% in the fourth quarter and up approximately 3% overall for the year.

Excluding our workers' compensation businesses, renewal rates in this group were up 11% in the fourth quarter and 8% for the year. Renewal rates in our Specialty Casualty Group overall are the highest we've seen since the first quarter of 2013. And when we exclude the impact of workers' compensation, these rates are the highest we've seen in more than 5 years.

Specialty Financial Group reported an underwriting profit of $32 million in the fourth quarter of 2019, compared to $20 million in the fourth quarter of '18. Higher year-over-year underwriting profits in our financial institutions, surety and trade credit businesses contributed to these results. Nearly all businesses in this group continued to achieve excellent underwriting margins. Catastrophe losses were $2 million in the fourth quarter of '19, compared to $10 million in the previous year's fourth quarter.

The average calendar year combined ratio of this group over the past 5 years has been just over 86%. I'm very pleased with these outstanding results.

Gross and net written premiums increased by 4% and 10%, respectively, in the 2019 fourth quarter when compared to the same 2018 period, due to solid growth across all businesses in the group and a higher portion of retained business in the 2019 fourth quarter. The renewal pricing in this group was up 2% during the fourth quarter and 1% for the full year of '19.

Now if you would turn to Slide 7 for a summary view of our 2020 outlook for the Specialty Property and Casualty operations. We expect a 2020 combined ratio for the Specialty Property and Casualty Group overall between 92% and 94%. Net written premiums are expected to be 1% to 5% lower than the $5.3 billion reported in 2019, primarily due to the runoff in Neon. Excluding the impact of Neon, we expect growth in net written premiums in the range of 3% to 7% this year.

Now looking at each segment, we estimate a combined ratio in the range of 92% to 96% in our Property and Transportation Group. Our guidance assumes no favorable reserve development for crop in the first quarter of 2020, and a normal level of crop earnings for the year.

Net written premiums in this group are estimated to be up 6% to 10% in 2020, and we expect our Specialty Casualty Group to produce a combined ratio in the range of 90% to 94% in 2020. Our guidance assumes continued strong renewal pricing in our E&S, excess liability and several of our longer-tail liability businesses.

Neon accounted for $401 million in net written premiums in 2019. As a result of this business being placed into runoff, we expect net written premiums in the Specialty Casualty Group to be down 10% to 14% in 2020. Excluding the impact of the Neon runoff, growth in this group is expected to be in the range of 1% to 5%. And our guidance for this group also includes the expectations that our net written premiums in our workers' compensation businesses will be flat to down slightly in 2020.

When you exclude the impact of both the Neon runoff in our workers' comp businesses, growth in the net written premium in this business, in this group is expected to be in the range of 6% to 10%.

Specialty Financial Group combined ratio is expected to be in the range of 86% to 90%. Our projection for growth in net written premiums is in the range of 4% to 8%. Net investment income is expected to be flat to up 4% year-over-year, and this guidance reflects an assumed annualized return of 10% on investments required to be marked to market through operating earnings, approximating the return earned in 2019.

And on the pricing front, we expect overall Property and Casualty renewal pricing in 2020 to be up 3% to 5%. And when you exclude workers' compensation, we expect renewal rate increases to be in the range of 5% to 7%. Thank you, and I'll now turn the discussion over to Craig to review the results in our Annuity segment and AFG's investment performance.

Stephen Craig Lindner - *American Financial Group, Inc. - Co-President, Co-CEO & Director*

Thank you, Carl. I'll start with a review of our Annuity results for the fourth quarter, beginning on Slide 8. Statutory annuity premiums were $1.14 billion in the fourth quarter of 2019, compared to $1.48 billion in the fourth quarter of 2018, a decrease of 23%. Higher sales of traditional fixed annuities in the financial institutions channel, and higher pension risk transfer premiums were more than offset by lower sales of fixed-indexed annuities in all channels. In response to the continued drop in market interest rates in 2019, AFG implemented numerous crediting rate decreases in order to maintain appropriate returns on our annuity sales, which impacted premium volume. Annuity sales of $5 billion for the full year in 2019 were the second highest level in our history, and contributed to growth in average annuity investments and reserves of approximately 11% for the year.

We believe we're well positioned to continue to profitably grow our business and capitalize on our consumer-centric model.

In the second quarter of 2019, we changed the way we define annuity core operating earnings to exclude the impact of items that are not necessarily indicative of operating trends, such as the impact of fair value accounting for fixed-indexed annuities, unlockings and other items related to changes in the stock market and interest rates.

Core operating earnings now include an expense for the amortization of fixed-indexed annuity option costs, which is a better measure of the cost of funds for fixed indexed annuities. We believe these changes provide investors with a better view of the fundamental performance of the business and a more comparable measure of the Annuity segment's business compared to its peers.

Turning to Slide 9, you'll see the components of pretax Annuity core operating earnings under this new definition. Results for periods prior to the second quarter of 2019 are shown in a comparable format to the new definition of Annuity core operating earnings and are reconciled to previously reported Annuity core operating earnings.

Growth in average invested assets and reserves in the fourth quarter of 2019 and higher earnings from investments marked to market through operating earnings, contributed to higher year-over-year annuity earnings. In addition, fourth quarter 2019 results include an unusually high amount of investment income that is not expected to recur. Earnings from investments marked to market vary from quarter-to-quarter based on the reported results of the underlying partnerships and investments.

I'm pleased that our Annuity segment earned an after-tax core operating return on equity in excess of 12% for the full year of 2019.

Turning to Slide 10, you'll see that AFG's quarterly average annuity investments and reserves grew approximately 9% and 10%, respectively, year-over-year. The benefit of this growth was partially offset by the runoff of higher-yielding investments.

As you can see on Slide 11, over the past 10 years, our Annuity segment's cumulative net earnings have exceeded its cumulative core operating earnings with net earnings at 105% of core operating earnings over this period of time.

Now please turn to Slide 12 for a summary of the 2020 outlook for the Annuity segment. We estimate 2020 pretax Annuity core operating earnings to be in the range of $395 million to $425 million, compared to $398 million reported in 2019. Incorporated in our guidance is an assumed annualized return of 10% on investments required to be marked to market through operating earnings, similar to the return earned in 2019.

Our guidance also reflects the impact of lower interest rates, in particular, the impact of lower short-term rates, which will have a negative impact on the Annuity segment's approximately $4 billion of net investment in cash and floating rate securities. We expect 2020 annuity premiums to be in the range of $4.5 billion to $5.2 billion as we continue to remain focused on disciplined pricing to help us achieve our targeted returns. We expect that this level of premiums will lead to growth in average annuity investments and reserves of 7% to 9% in 2020.

Now please turn to Slide 13 for a few highlights regarding our $55.3 billion investment portfolio. AFG's reported fourth quarter 2019 net realized gains on securities of $51 million after-tax and after deferred acquisition costs. This compares to net realized losses on securities of $188 million reported in the fourth quarter of 2018. Approximately $43 million of the realized gains recorded in the fourth quarter of 2019 pertained to securities that AFG continued to hold at December 31, 2019.

As of December 31, 2019, net unrealized gains on fixed maturities were $862 million, after-tax and after DAC.

As you'll see on Slide 14, our portfolio continues to be high-quality, with 91% of our fixed maturity portfolio rated investment grade and 98% with an NAIC designation of 1 or 2, its highest two categories.

We have 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 fourth quarter 2019 results and share a few comments about capital and liquidity.

Joseph E. Consolino - *American Financial Group, Inc. - Executive VP, CFO & Director*

Thank you, Craig. Slide 15 summarizes AFG's fourth quarter consolidated core operating earnings results. AFG reported core EPS of $2.22 in Q4 2019. Core net operating earnings in the quarter were $203 million. The year-over-year increase in core earnings in the 2019 fourth quarter was primarily the result of significantly higher core operating earnings in our Annuity segment, offset somewhat by lower core earnings in the P&C insurance segment.

Interest and other corporate expenses were $21 million higher year-over-year. Parent company interest expense increased by $2 million from Q4 2018. During the course of 2019, we issued two hybrid 40-year subordinated debentures and retired one of our higher cost hybrids, which became callable in Q4 2019.

In March, we issued $125 million at 5 7/8%, and in December, we issued $200 million at 5 1/8%. A portion of the proceeds from the December offering was used to redeem $150 million of AFG's 6.25% hybrids, due in 2054. We like these hybrid securities due to their long maturities, the par call feature and the equity treatment afforded by many of the rating agencies.

Other expenses were $19 million higher year-over-year. Higher expenses related to employee benefit plans tied to stock market performance, were the primary driver of this increase. In addition, other expense in the 2018 fourth quarter was abnormally low. The fourth quarter of 2019 is closer to an ongoing run-rate.

Slide 16 reconciles core net operating earnings to net earnings. In the fourth quarter of 2019, AFG recognized $51 million or $0.56 per share in net after-tax realized gains on securities. Annuity non-core items increased net earnings attributable to shareholders by $19 million or $0.21 per share. We recorded a $58 million or $0.64 per share non-core after-tax charge during the fourth quarter for Neon reserve strengthening, and expenses related to exit costs associated with the runoff of this business. The exit from this business will allow AFG to reallocate capital to its other insurance businesses and to opportunities that have the potential to earn targeted returns on investment.

Neon and its predecessor, Marketform, had failed to achieve AFG's profitability objectives since AFG's purchase of Marketform in 2008. Beginning with the first quarter of 2020, Neon will be reported as non-core.

We also recorded a small loss on the early retirement of AFG's 6.25% hybrid subordinated debentures, which was $4 million after-tax or $0.04 per share during the 2019 fourth quarter.

Moving to Slide 17, AFG's adjusted book value per share was $59.70 as of December 31, 2019. We returned $204 million to our shareholders in the fourth quarter, with the payment of our regular quarterly dividend and the payment of a $1.80 per share special dividend. Parent cash was approximately $165 million at the end of the fourth quarter. We maintain solid levels of capital in our insurance businesses to meet our commitments to the rating agencies. Our excess capital stood at approximately $1.1 billion at December 31, 2019. We define excess capital as the sum of parent company cash, excess capital within our insurance subsidiaries and borrowing capacity up to a 22% debt, excluding hybrid subordinated debt to total adjusted capital ratio.

As we have said previously, when AFG's excess capital reaches $1 billion or more, in the absence of other alternatives for deployment, we will evaluate opportunities to return capital to shareholders. We plan to hold approximately $200 million to $300 million as dry powder to maintain flexibility for opportunities as they arise. Our management team reviews all opportunities for deployment of capital on a regular basis.

In closing, Slide 18 shows the single page presentation of our initial 2020 core earnings guidance.

Our guidance assumes an effective tax rate of approximately 20% on core pretax operating earnings. AFG's expected 2020 core operating results exclude non-core items such as realized gains and losses, annuity non-core earnings and losses and other significant items that may not be indicative of ongoing operations. We're now prepared to open the lines for any questions.(Operator Instructions) I show our first question comes from Amit Kumar from Buckingham Research.

QUESTIONS AND ANSWERS

Amit Kumar - *The Buckingham Research Group Incorporated - VP & Senior Analyst*

Thanks, and good morning guys. A few questions. Let's start with Neon. So just going back to the guidance, as well as Neon's exit, it moves to non-core. If you look at the quarters, is there going to be some, I guess, seasonality in earned premium pattern? I'm trying to figure out, when I look at the individual quarters, I should think about those numbers differently, ex-ing out Neon, which eventually would come to your eventual guidance for 2020?

Joseph E. Consolino - *American Financial Group, Inc. - Executive VP, CFO & Director*

Hi Amit, this is Jeff Consolino. First, just in terms of geography, with Neon moving to non-core, any impact of Neon in 2020 by quarter will be below the core operating earnings items, and so that would not affect our overall presented operating earnings by quarter.

In terms of the seasonality of Neon historically, Neon did have a reasonably sizable, for its business, property reinsurance book. As you know, there are important renewal dates that occurred during the course of the year for that. So Neon's premiums overall tended to be heavier in the first quarter and the second quarter, weaker in the third quarter. And so that kind of seasonality would need to be neutralized in anything you are doing to estimate it.

Overall though, I think if you focus on the subsegment premium guidance that we've given, that's probably a good indication of how things will roll out during the course of the year by quarter.

Amit Kumar - *The Buckingham Research Group Incorporated - VP & Senior Analyst*

Would there be any 8-K, which would provide historical Neon's, I guess, results and premiums?

Joseph E. Consolino - *American Financial Group, Inc. - Executive VP, CFO & Director*

Amit, we have no such plans to file an 8-K with that kind of disclosure.

Amit Kumar - *The Buckingham Research Group Incorporated - VP & Senior Analyst*

Okay. Moving on to the Specialty P&C segment overall. If you ex-out the impact from crop, would you say that underlying margins in '19 improved or were they flat versus 2018, making adjustments for any unusual items? I'm trying to understand more from a 40,000 foot level, how the underlying book has improved versus 2018?

Joseph E. Consolino - *American Financial Group, Inc. - Executive VP, CFO & Director*

Amit, this is Jeff. I'll cover that one, and I'm sure others might want to elaborate. So if you start with the investor financial supplement for our Specialty Group on Page 7, we do show, for the full year, a 96.2% combined ratio, excluding catastrophes and prior year development for full year '19 versus a 95.7% for the full year '18. So on its face, one might assume that margins are not improving and are stagnating, but you are very good to indicate that crop will have an impact on that. And we've made no secret to the fact that the 2019 crop reinsurance year is not a very satisfactory one relative to several of the good years we've had in the past. That alone would move that by more than 1 point, possibly more than 1.5 points. As an offset, Neon did improve during the course of 2019 versus '18, but what you're seeing there is underlying margin improvement across all of our businesses, somewhat offset by the impact of crop.

Amit Kumar - *The Buckingham Research Group Incorporated - VP & Senior Analyst*

Got it. That's helpful. And just one last one on comp. In terms of the reserve releases, I think, let me see, I was trying to look at the reserve release pattern for 2019 versus 2018 for the quarters. And any sort of movement in the AYs in terms of where the reserve releases came from?

Joseph E. Consolino - *American Financial Group, Inc. - Executive VP, CFO & Director*

Amit, would you mind repeating the last part of that question? It came through a little garbled.

Amit Kumar - *The Buckingham Research Group Incorporated - VP & Senior Analyst*

So I guess what I was trying to understand is that the reserve releases, if you look at them on an accident year basis, and before we get the Schedule P's, how did they evolve over 2019, when you look at the historic AY reserve buckets for comp?

Joseph E. Consolino - *American Financial Group, Inc. - Executive VP, CFO & Director*

I'm not sure you'd be able to get that out of the supplement. So it's presented within the Specialty Casualty segment. You can see the pattern of development during the course of the year, but more than just workers' comp is going to affect that. Also, we have the other specialty liability lines in there, as well as Neon.

I think as a blanket statement, our goal with the business is to be prudently reserved and appropriately reserved at every quarter end. We have in-depth actuarial reviews of every business unit, every quarter, and adjustments are made to make sure that we're adhering to our standards of being prudently reserved. So I don't know that one can note any kind of a pattern as to how things would result. It really is a factor of what our business people, our claims people and our actuaries are seeing at each quarter's actuarial review.

Amit Kumar - *The Buckingham Research Group Incorporated - VP & Senior Analyst*

I was more focused on, if you look at the comment in the press release, where you talked about higher favorable prior period development, and I was just trying to sort of forecast as we move to 2020 and look at the historic patterns. So I was just trying to understand, on an AY basis, is workers' comp business profitable? And how are we thinking about comp business for 2020?

Carl Henry Lindner - *American Financial Group, Inc. - Co-President, Co-CEO & Director*

Yes. Amit, I'm happy to add some color about workers' comp. Obviously, our '19 overall workers' comp results are very good. Healthy accident year combined ratio and a very healthy calendar year combined ratio. 2020 underwriting margins will be somewhat lower. Though, we still feel that, overall, on an accident year basis, we'll make a small underwriting profit overall in our comp business, and we'll make a healthy calendar year underwriting profit. Premiums were kind of flattish last year. I think we -- I said earlier, premiums would probably be down low single digits this year. We expect pricing to be down mid-single digits overall in our workers' comp business in 2020. As Jeff mentioned, I mean, we feel like we have a strong reserve position on our overall business. Loss ratio trends continue to be in check. Our loss ratio trend, actually, which is loss costs offset by changes in exposure, we still feel we're kind of flat to maybe down 1% on our overall workers' comp business. So we feel very good about prospects for profitability and for good returns in our workers' comp business this year.

Amit Kumar - *The Buckingham Research Group Incorporated - VP & Senior Analyst*

Got it. Okay I will stop here. Thanks for the answers, and I will re-queue.

Operator

Our next question comes from Jay Cohen from Bank of America.

Jay Adam Cohen - *BofA Merrill Lynch, Research Division - Research Analyst*

Thank you. Good morning, no good afternoon, at least in New York. I want to ask about Neon. Really 2 questions. The first is, if you could talk more about the decision to put it into runoff? Because arguably, that business is getting better now, pricing is going up, you could make a case, hey, this could be -- the profitability should improve quite a bit over the next several years, but you, obviously, didn't take that path. So that's question one. Second question is, how much capital gets freed up by running off this business and over what time?

Joseph E. Consolino - *American Financial Group, Inc. - Executive VP, CFO & Director*

Hi Jay, this is Jeff, and it's afternoon here in Cincinnati as well. With respect to the Neon decision, we did put out that pre-release on January 6, I believe. We quoted it during our comments here, Marketform and Neon have failed to meet its -- their return targets during the tenure of AFG's ownership. And even though the business was clearly improving, and we've made some comments here that speak to its improving contribution to our overall results, we were not convinced that it would reach the level of targeted returns that would justify remaining invested. And furthermore, when we look at the opportunities we have elsewhere in our businesses, we felt like that capital could be better deployed elsewhere. I mean, overall, we are maintaining funds at Lloyd's to support the business and that will get released as the business runs off. In round numbers, I would say, we have about $300 million of capital allocated to the business and that will be freed up in proportion to the runoff as it occurs.

And as the last caveat to that, we have executed two reinsurance to close transactions in respect of Neon's liabilities in recent years, one related to the 2007 and prior open years of account, and then a second one relating to the 2015 and prior years. That is a vibrant market with many participants. So we will evaluate those types of opportunities as they come to us, making sure that we are compensated appropriately for the reserve position we believe we have for the business. And at that time, we -- if we did successfully implement such a transaction, that would accelerate the release of capital from that business.

Jay Adam Cohen - *BofA Merrill Lynch, Research Division - Research Analyst*

Got it. That's very helpful. And I guess, it does demonstrate the kind of discipline you've shown over the years, both entering and exiting businesses when they're not working out. So it certainly fits into the longer-term narrative of the company.

Operator

Thank you. Our next question comes from Paul Newsome from Piper Sandler.

Jon Paul Newsome - *Piper Sandler & Co., Research Division - MD & Senior Research Analyst*

Good afternoon. Congratulations on the quarter. I was hoping you could talk a little bit more about your view on sort of claim cost trends on an underlying basis. I know you said that you have, in your view, stable loss trends, and I assume that it means that the rate of increase is not changing. But then you also mentioned that you are taking higher loss picks in certain casualty lines and increasing more IBNR, which, I think, suggests to me maybe an incremental increase in that, at least, the forward view on loss trends. Could you maybe reconcile those thoughts? And maybe just expand a little bit more on your view on loss trends?

Carl Henry Lindner - *American Financial Group, Inc. - Co-President, Co-CEO & Director*

I'd be happy to take a crack at that. This is Carl. Our overall loss ratio trend is about 1.5%, when you look at loss costs plus the offsetting factor of payroll or that type of thing. And for the year, our average renewal rate increase is a little over 3%. When you look at excluding comp, our overall loss ratio trend is a little under 3% versus about 6% rate for the year.

I mean, overall, our loss cost, loss ratio trends are stable and pretty benign across most of our businesses. But as I mentioned before, we do have a few areas that we've seen some of the same trends as others, more aggressive trial bar activity and increased jury awards, and we've been taking the actions that we feel that we need to there. Commercial auto, as we mentioned, we've been at that a long time. But frankly, with the continuing severity trends in commercial auto liability, even though our overall commercial auto business, we're satisfied with, the commercial auto liability portion of that business still has got a ways to go. So we're continuing to take -- we took double-digit rate, 10% in the quarter. So that's an area we've talked about a lot. The habitational business, as it relates to -- within our E&S business, we've mentioned that before, and that's a business that we've taken quite a bit of corrective action and that we've tried to have more conservative picks on.

Also, the Public Sector business, which is municipalities that we write. And in that area, in our business there, we tend to be in excess of higher retentions and annual aggregate deductibles that are retained by our pool clients. So we are -- do have a little bit of protection there, and our reinsurance policy soften our risk too. But we're seeing some of the same social inflation type of topics as others in that -- within that business.

So we've been more conservative, I think, in how we're approaching that in our picks. That said, our Public Sector business has been very profitable. But we have seen more impact from social inflation, and we're reacting accordingly with pricing, with terms and in the way that -- from an actuarial standpoint. We've talked about public D&O and some of the trends there. Now we're not a large writer of public D&O, but in that business, clearly, there's been trends in that. But along with that, as others, we're seeing rates, retentions changing dramatically and that. So I hope that gives you a little more color.

Jon Paul Newsome - *Piper Sandler & Co., Research Division - MD & Senior Research Analyst*

Absolutely. That gets me where I need to go. Second question, I want to ask about the investment expectations next year. You've got a couple of peers that have been talking about essentially ratcheting down expectations for alternative investments prospectively by a couple of points. It sounds like you were thinking that those are relatively stable expectations. If that's the case, what gives you comfort that those alternatives will return about what they've done historically?

Stephen Craig Lindner - *American Financial Group, Inc. - Co-President, Co-CEO & Director*

Hi Paul, this is Craig. When we put the plan together, we went through all of our investments, kind of individually, and did our best estimate of what we expect in terms of returns, reported income out of each of those investments. Our mix is probably a little different than many others. Over the last couple of years, we have invested a fair amount of money in apartment buildings and those have performed extremely well, both from the standpoint of increasing cash flows, and in terms of the valuation, cap rates, obviously, have come down. So that probably puts us in a little different position than others in terms of the mix of investments that are marked to market.

Jon Paul Newsome - *Piper Sandler & Co., Research Division - MD & Senior Research Analyst*

Thank you.

Operator

Our next question comes from Larry Greenberg from Janney Montgomery.

Lawrence David Greenberg - *Janney Montgomery Scott LLC, Research Division - MD of Insurance*

Thank you very much. I'm wondering if you might be able to provide us a little bit more color on what we should expect for crop in the first quarter of '20? I know you've said in the past that we shouldn't expect any profits. And I think, this morning, you said no PYD from crop. But is there any way to maybe compare what the expectation is, relative to what we saw overall in the fourth quarter, recognizing that the earnings impacts probably emerge in slightly different buckets, first quarter versus fourth quarter?

Carl Henry Lindner - *American Financial Group, Inc. - Co-President, Co-CEO & Director*

Hi Larry, this is Carl. I mean, generally, in a normal crop year cycle, the first couple of quarters, if there is favorable development from the prior year, those would be the quarters that, that would go into, and primarily the first quarter. Most of the profit is booked for our crop year in the fourth quarter and some in the third quarter, if we feel good about the quarter. So I think we're fairly conservative as we -- we want to be pretty far along in a given crop year, probably into August or September before we're comfortable booking any kind of profit or making any kind of call.

We're just not that smart to be able to forecast something like that as there's a lot of variability. I think we've been very clear that in 2020, in the first quarter, number one, again, going back, we don't book any current crop year expectations generally in the first couple of quarters. And I think we've been clear that there is no favorable development, at least to our knowledge now, based off of last year's crop year. Last year was a poor crop year. There's no way around that. Does that help?

Lawrence David Greenberg - *Janney Montgomery Scott LLC, Research Division - MD of Insurance*

It does. But I was just trying to make some relative comparison first quarter versus fourth quarter, overall impacts.

Joseph E. Consolino - *American Financial Group, Inc. - Executive VP, CFO & Director*

Larry, this is Jeff. And I know we kind of talked about this for the first quarter with the way that positive impact from crop comes through in the subsequent calendar year, both as development but also as a ceding commission or negative commission expense for profit commissions.

The replay of what Carl said, is we try to recognize the profit from the crop reinsurance year primarily in the fourth quarter of that calendar year with a little bit, if we're confident, in the preceding third quarter, we do want to be conservative and not unwind anything. So oftentimes, in a profitable crop year, there would be some positive impact in Q1 and Q2 of the subsequent calendar year. How that relates to the overall profit from the crop year really depends on how accurate we are in gauging what profit should have been released in Q4 and Q3.

Carl Henry Lindner - *American Financial Group, Inc. - Co-President, Co-CEO & Director*

Larry, there aren't a lot of companies that give guidance like we do. And we try the best we can in our Property and Transportation segment guidance to look -- put crop in there in a normal year, and with the range of result there and volatility within crop, to give room for either a weaker year or a stronger year in that. I mean, that's how we -- so best guidance I can give you is, we do our best to bake in the crop results into the segment guidance that we give everybody. And I think we've been -- I think if you go back and check us, we've been pretty good over a lot of years.

Lawrence David Greenberg - *Janney Montgomery Scott LLC, Research Division - MD of Insurance*

Yes. No, I appreciate that and thanks for the color. My only other quickie is just on the available for sale, fixed NII line in annuities. And you referenced that you don't expect that to reoccur. Was that just driven by calls and tenders? Or was there anything else in there?

Stephen Craig Lindner - *American Financial Group, Inc. - Co-President, Co-CEO & Director*

This is Craig. Primarily, prepayment fees and there was another item, the acceleration of the discount amortization due to actual and expected principal prepayments on certain structured securities that we had invested in. To kind of size those for you, in the quarter, we had around $11 million of income from the items that I just talked about. In a normal quarter, we'd expect $2 million to $3 million. So it did help us in the fourth quarter.

Lawrence David Greenberg - *Janney Montgomery Scott LLC, Research Division - MD of Insurance*

Great. Thanks very much.

Operator

Our next question comes from Greg Peters from Raymond James.

Charles Gregory Peters - *Raymond James & Associates, Inc., Research Division - Equity Analyst*

Good afternoon. Most of my questions have been asked. I think either it was in your prepared remarks or in one of the answers to someone's question, you referenced that your catastrophe exposures or risk for catastrophe losses would be down this year as a result of your exit from Neon, I believe. And I'm just curious, as we think about 2020, with the changing portfolio mix, is there any implications on your reinsurance costs?

Joseph E. Consolino - *American Financial Group, Inc. - Executive VP, CFO & Director*

Hey Greg, it's Jeff. We will be running Neon off. We had exited the property treaty reinsurance business in Neon ahead of January 1, and put the business into runoff. There will be certain property and related exposures that will be live through the course of 2020, but those will be decreasing.

As it relates to our catastrophe reinsurance costs, a couple of things. The first is that we maintain the $15 million retention for our U.S. group, a separate $15 million retention for Neon. Obviously, Neon has delivered some pretty significant catastrophe losses to us in '17 and '18. I would expect that, that would grade down to 0 during the course of the year or something that approximates to 0, although we'll still have exposure during the wind season. Already, though, with the exit from property treaty, we'll be buying less reinsurance for Neon because we won't have those treaty exposures from 1/1 and forward in 2020. Similarly, we have a catastrophe bond that sits on top of both traditional towers, and that catastrophe bond is priced as a multiple of expected loss, and it covers both Neon and our U.S. group. With a diminishment in the Neon exposures, I would expect our expected loss, upon reset, will go down, and our cost of the catastrophe bond will go down and the coverage will improve. So I think that 2020 will be a transition year, mainly because the exposure to catastrophes from Neon will still be possible, although diminishing. And you'll see the real benefit of that in 2021, when we'll be largely clean of those types of exposures. But just -- as our Specialty Casualty Segment a year ago had $28 million of cat losses and $23 million of those were related to Neon. So taking those exposures out will reduce our cat volatility, once we have the runoff completed.

Charles Gregory Peters - *Raymond James & Associates, Inc., Research Division - Equity Analyst*

Thanks for the color. So pivoting, I just thought I'd ask Craig one question. In your guidance for 2020 around your annuity premium, it suggests there's a risk, it could be a down year this year. And I know you've provided some color around what's going on in the marketplace. Just to give you another bite at the apple and give us a sense of by distribution channel, where is there more competition? Where is there less competition? Where do you think the growth is going to come from? And where do you think the pressure is going to come from?

Stephen Craig Lindner - *American Financial Group, Inc. - Co-President, Co-CEO & Director*

Yes. Greg, what I would say is, it is a competitive environment. I don't know that it's any different than what we generally experience. There are always a couple of companies that are -- we think, price too aggressively. There are some new entrants into the indexed annuity business, larger companies that traditionally were not in the indexed annuity business that have now entered the market. Our a little more cautious guidance, I think, really is just a result of the very low level of interest rates and, frankly, lack of opportunities on the investment side. So we're going to price in a prudent way to achieve our targeted returns, and time will tell. Hopefully, we're going to end up having some growth this year, but given the current interest rate environment and, frankly, very tight spreads and kind of lack of opportunities on the investment side currently, we were a little more cautious with our guidance on premium growth.

Charles Gregory Peters - *Raymond James & Associates, Inc., Research Division - Equity Analyst*

Okay. Thank you for fitting me in at the end of your call.

Operator

Our last question comes from Amit Kumar from Buckingham Research.

Amit Kumar - *The Buckingham Research Group Incorporated - VP & Senior Analyst*

Your last questions. A few questions for you. Just going back, I guess, switching gears. As a P&C analyst, let me switch to the Annuity segment. I noticed on Page 23 of the supplement, the allowable dividends for the annuity book, that number has gone down to 287 versus 768. And I was curious what would be the driver of that reduction?

Joseph E. Consolino - *American Financial Group, Inc. - Executive VP, CFO & Director*

One driver, Amit, will be that we've paid a greater amount of dividends. You've got a basket over a 12-month period of what you can pay and we had taken a conservative stance on dividends from Annuity up to the parent, which has been relaxed somewhat. So that would be one major contributor right there.

Amit Kumar - *The Buckingham Research Group Incorporated - VP & Senior Analyst*

Okay. The second question I have is, on Page 17 of the supplement, where it has the GMIR analysis. I was noticing that the 2% to 3%, the 3% to 4% bucket, those have declined over the past few quarters, and what would be the driver of that decline?

Stephen Craig Lindner - *American Financial Group, Inc. - Co-President, Co-CEO & Director*

Amit, that high GMIR business has been a lot stickier than we would have expected when we issued the policies. I mean, it is declining as a percent of the total over time. But I think as the policyholders look at alternatives for their money, hard for them to find low-risk or no-risk alternatives that provide a better yield. So that business has stuck around quite -- been a lot stickier than we would have expected.

Joseph E. Consolino - *American Financial Group, Inc. - Executive VP, CFO & Director*

Amit, one factor is just that most new policies are issued with a very low GMIR, given the interest rate environment. So as -- in the 1% area. So as we have growth in account value with lower GMIR in that band of 1% to 1.99%, that's going to dilute everything else. And so one reason the percentages are going down is just because our percentage of lower GMIR business is increasing.

Amit Kumar - *The Buckingham Research Group Incorporated - VP & Senior Analyst*

Got it. So would that mean where it gives the ability to lower, when you mention the [1.19%] (corrected by the company after the call). So going forward, does that mean it comes out from this 9% bucket in the 4% and above?

Joseph E. Consolino - *American Financial Group, Inc. - Executive VP, CFO & Director*

I think what Craig was observing is you had a guaranteed interest rate of 4% or higher, it's going to be pretty attractive to hold that. So surrenders of that type of business are less than we would have anticipated when those contracts were issued. If that 9% was going to come down over time, another major contributor would be the overall growth of the business, and the dilution of that block of 4% or higher from $5 billion a year in new sales at a much lower GMIR.

Stephen Craig Lindner - *American Financial Group, Inc. - Co-President, Co-CEO & Director*

It's certainly going to continue to come down as a percent of the total. The policies we're issuing today, as Jeff indicated, have a 1% GMIR. So all new sales are going to be at a -- at that 1%, but substantially, all the new sales are going to be at 1%. So even though the persistency on the 4% and greater policies is up in the high 90s, it's still going to shrink as we go forward as a percent of the total.

Amit Kumar - *The Buckingham Research Group Incorporated - VP & Senior Analyst*

Got it. Last question. Switching to P&C. On the discussion on Singapore operations, I think in the opening remarks, there was some comment on additional or remedial steps, something like that, I'm sort of paraphrasing. Can you just talk about how we should think about that business over 2020? And even talk about some additional steps which you intend to take versus, I guess, putting that in run-off or something like that?

Carl Henry Lindner - *American Financial Group, Inc. - Co-President, Co-CEO & Director*

On Singapore, not a big business at this point. We're not happy with the performance of our Singapore business. We've been taking double-digit rate increase, we've been reunderwriting the business, refocusing it, and we're hoping that this year is a year that we see -- we move the business more towards the returns that we want. So that's where we're at in Singapore.

Amit Kumar - *The Buckingham Research Group Incorporated - VP & Senior Analyst*

Okay. That's all I have for now. Thanks for all the answers and good luck for the future.

Operator

Ladies and gentlemen, this concludes the Q&A session. At this time, I'd like to turn the call over to Diane Weidner, Assistant Vice President of Investor Relations, for closing remarks. Please go ahead.

Diane P. Weidner - *American Financial Group, Inc. - Assistant VP of IR*

Thank you all for your time this morning, and we look forward to speaking with you all again as we share our results for the first quarter of 2020. Hope you all have a great day.

Operator

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