THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

AFG - Q3 2016 American Financial Group Inc Earnings Call

EVENT DATE/TIME: NOVEMBER 02, 2016 / 3:30PM GMT

CORPORATE PARTICIPANTS

Diane Weidner *American Financial Group - Assistant VP of IR*

Carl Lindner *American Financial Group - Co-CEO*

Craig Lindner *American Financial Group - Co-CEO*

Jeff Consolino *American Financial Group - EVP & CFO*

Carl Lindner III *American Financial Group - Co-CEO*

CONFERENCE CALL PARTICIPANTS

Ryan Byrnes *Janney Montgomery Scott - Analyst*

Paul Newsome *Sandler O'Neill Asset Management - Analyst*

Jay Cohen *BofA Merrill Lynch - Analyst*

Mike Zaremski *Balyasny Asset Management Fund - Analyst*

PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the American Financial Group third-quarter 2016 earnings conference call.

(Operator Instructions)

As a remainder this conference call is being recorded.

I would now like to turn the conference call over to Diane Weidner, Assistant Vice President, Investor Relations. Please go ahead.

Diane Weidner - *American Financial Group - Assistant VP of IR*

Thank you, Abigail, good morning and welcome to American Financial Group's third-quarter 2016 earnings results conference call. I'm joined this morning by Carl Lindner III and Craig Lindner, Co-CEOs of American Financial Group and Jeff Consolino, AFG's Executive Vice President and Chief Financial Officer. Our press release, investor supplement and webcast presentation are posted on AFG's website; these materials will be referenced during portions of the call.

Before I turn the discussion over to Carl I'd 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 on 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 response to questions. Our 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 such that it may contain factual or transcription error that can materially alter the intent or meaning of our statement.

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

Carl Lindner - *American Financial Group - Co-CEO*

Good morning. We released our 2016 third quarter results yesterday afternoon. Please turn to slide 3 of the webcast slides for an overview. We were pleased to report core earnings per share of $1.51, a new third-quarter record for AFG. These results include record earnings in our annuity segment and strong profitability in our property and casualty operations.

Annualized core operating return on equity was 12.2% for the third quarter of 2016 compared to 11.6% in the third quarter of 2015. Net earnings per diluted share were $1.23 and include a $0.30 per share charge to strengthen our A&E reserves and $0.02 per share for realized gains on securities. We repurchased $26 million of AFG's common shares during the third quarter at an average price per share of $73.98.

We also announced the special cash dividend of $1 per share payable in December. The aggregate amount of this special dividend will be approximately $87 million. The special dividend is in addition to the company's regular quarterly cash dividend of $0.3125 per share which was increased in August 2016 for the 11th consecutive year.

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're also pleased to be making progress toward completing our merger with National Interstate. Jeff will be providing a more detailed update later in the call. We revised our 2016 core operating earnings guidance for AFG to be in the range of $5.55 to $5.75 per share.

Our revised 2016 core earnings guidance includes our most recent assessment of the impact of Hurricane Matthew. Based on the information we have to-date we expect the net impact of Hurricane Matthew to our property and casualty operations to be in the range of $10 million to $15 million before taxes. Craig and I will discuss our guidance for each segment of our business later in the call, but now let's take a closer look at AFG's results for the quarter.

Please turn to slides 4 and 5 of the webcast which include an overview of results in our specialty property and casualty operations. Beginning on slide 4, you'll see that gross and net written premiums declined 3% and 4% respectively in the 2016 third quarter compared to the same quarter a year earlier.

Third quarter underwriting profit was down approximately 7% year-over-year. Higher profitability in our property and transportation group was more than offset by lower underwriting profitability in our specialty casualty and specialty financial groups.

The third quarter 2016 combined ratio of 93.2%, increased slightly from the 2015 third quarter and included 1.1 points of favorable prior year reserve development and 1.2 points in catastrophe losses. Overall renewal pricing in our specialty property and casualty group was up approximately 1% during the third quarter, slightly higher than in the previous quarter.

Now I'd like to turn to slide 5 to review a few highlights from each of our specialty property and casualty groups. Our property and transportation group reported third quarter underwriting profitability of $44 million, compared to $20 million in the prior year period. Higher underwriting profits in our crop, transportation and property and inland marine businesses were the drivers of the improved results.

Catastrophe losses for this group were $7 million in the third quarter of 2016, comparable to the third quarter last year. It's shaping up to be a good crop year. We're pleased that the October harvest price discovery period closed with soybean prices up 10% and corn harvest prices down 9.5%, well within policy deductibles. In addition, overall corn and soybean yields this year are projected to be higher than historical trend yields, with a potential for a record yield for soybeans.

I'm also pleased with the improvement in year-to-date accident year and calendar year combined ratios for specialty property and transportation group excluding our crop business. National Interstate reported their third-quarter 2016 earnings after the markets closed last night, but in light of the pending merger won't be conducting an earnings conference call. Given what we perceived to be a high level of interest in commercial auto results after commentary by several other property and casualty insurance companies and their quarterly calls, I thought we should provide some context for National Interstate's results.

I'm going to focus on underwriting metrics and trends, rather than after-tax earnings. For the quarter, National Interstate's accident year combined ratio improved 2.1 points to 96.5% compared to the third quarter of last year. Year to date through 9 months, National Interstate's accident year result is 96.9%, an improvement of 1.2 points over the 98.1% booked in the comparable period in 2015. There has been no reserve development favorable or unfavorable in National Interstate's 2016 figures.

So for 2016 accident year and calendar year are the same. National Interstate's accident year results are not at the level where we're happy with the returns yet. But we're very encouraged by the trend line.

Our gross and net written premiums for the property and transportation group during the third quarter were 7% and 4% lower respectively than the comparable 2015 period. The decrease was largely the result of lower year-over-year premiums in our crop business, primarily the result of lower spring commodity prices and timing differences in the recording of crop premiums. If you exclude crop, third quarter 2016 gross and net written premiums were virtually unchanged from the prior year period.

We continue to focus on adequate pricing in this group; overall renewal rates in this group increased 4% on average for the third quarter of 2016, which includes a 6% increase in National Interstate's renewal rates. Based on overall commercial auto industry experience and results reported recently by other companies, we believe that additional rate increases will be required as we move into 2017.

Third-quarter 2016 underwriting profitability in our specialty casualty group declined $18 million year-over-year. Our workers comp businesses continued to report strong profitability, which was more than offset by lower profitability in our excess and surplus lines and targeted market business, as well as continued underwriting losses in our Lloyd's business Neon.

Gross and net written premiums decreased 2% and 8% respectively for the third quarter of 2016 when compared to the same prior-year period. Higher premiums in our workers' compensation businesses were more than offset by Neon's exit of certain lines of business and tougher underwriting standards in this Lloyd's-based business. Net written premiums were also impacted by higher ceded premiums within Neon.

If you exclude Neon, third quarter net written premiums in this group were actually up 2.6%. Renewal pricing for this group decreased by 1% in the third quarter, including a decrease of approximately 4% in our workers' compensation businesses. Excluding comp renewal pricing in this group was up approximately 1% for the third quarter versus being flat last quarter.

Underwriting profit in our specialty financial group was $19 million in the third quarter of this year compared to 26 million in the third quarter of 2015. The decrease is primarily due to lower underwriting profit in our financial institutions business, primarily in this quarter, the result of August storms and flooding in Louisiana. Nearly all the businesses in this group continue to achieve excellent underwriting margins during the quarter.

Gross and net written premiums increased 13% and 9% respectively in the third quarter compared to the same 2015 period, primarily as a result of higher premiums in our financial institutions business. I am pleased that we've been able to act on the disruption in the market resulting from American Modern's exit from the Lender-Placed Insurance Business. Renewal pricing in this group was flat for the quarter.

Please turn to slide 6 for a summary view of our 2016 outlook for the specialty property and casualty operations. Although we continue to expect an overall combined ratio between 92% and 94% we've adjusted our estimates for the combined ratios within each of our specialty property and casualty groups. As noted earlier, our revised guidance reflects the estimated impact of losses from Hurricane Matthew. We've also adjusted our estimate for overall growth in net written premiums to be in the range of 0% to 2%, down from the previous range of 1% to 5%.

Now we now estimate a combined ratio in the range of 90% to 92% in our property and transportation group, an improvement from the previous estimate of 93% to 96%, primarily as a result of anticipated strong crop probability. We now expect growth in net written premiums for this group to be between 0% and 3%, a decrease from the previous range of 1% to 5%.

Our specialty casualty group is now expected to produce a combined ratio in the range of 95% to 97% slightly higher than the range of 93% to 95% estimated previously. Net written premiums are now expected to be down 3% to flat, a decrease from the previous expectations of flat to up 4%.

Now per my prior comments, if you exclude Neon, the growth in net written premium in this group would be more like flat to up to 2%. We now estimate a combined ratio in our specialty financial group in the range of 84% to 86%, slightly higher than 83% to 86% estimated previously. Growth in net written premiums in this group is estimated to be in the range of 5% to 8%, a slight decrease from our previous range of 5% to 9%.

We continue to expect overall property and casualty renewal pricing to be flat to up 1%. Additionally, we now expect our property and casualty investment income to grow by 9% an increase from growth of 6% estimated previously. Details for each of our specialty property and casualty groups can be found on the slide.

Now it's my pleasure to turn the discussion over to Craig to review the results in our annuity segment and AFG's investment performance.

Craig Lindner - *American Financial Group - Co-CEO*

Thank you, Carl.

I'll start with a review of our annuity results for the third quarter beginning on slide 7. The annuity segment reported a record $107 million in pretax operating earnings in the 2016 third quarter, compared to $67 million reported in the third quarter of 2015, an increase of 60% year-over-year.

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

In the third quarter of 2016, the impact from changes in the stock market and interest rates was moderate. Conversely in the third quarter of 2015, the significant stock market decline resulted in a large unfavorable impact on annuity earnings. In addition, interest rates decreased during 2015 third quarter compared to the expectation that they would rise which also had a negative impact on annuity earnings in the prior-year period.

Annuity earnings before the impact of fair value accounting were $106 million in the third quarter of 2016 compared to $89 million in the third quarter of 2015, an increase of 19%. AFG's third quarter 2016 earnings benefited from favorable investment results, including the positive impact of certain investments required to be marked-to-market through earnings.

In addition, AFG's quarterly average annuity investments and reserves grew approximately 11% and 13% year-over-year respectively as noted on slide 8. However, the benefit of this growth was partially offset by the runoff of higher yielding investments.

Furthermore, AFG's third quarter 2016 earnings were favorably impacted by better stock market performance during the quarter compared to a negative impact from a significant drop in the stock market in the third quarter of 2015. We continue to achieve appropriate returns on new business and the interest spread on our inforce business continues to exceed our plan by several basis points. We remain focused on disciplined pricing of our product, consumer friendly product design, careful expense management and growing our business only when we can achieve desired long-term results.

We believe this business model, which we adopted many years ago positions us well in a changing regulatory environment. As expected AFG's annuity premiums decreased significantly in the third quarter of 2016 as compared to the third quarter of 2015. Annuity sales of $941 million in the third quarter of 2016 were down 29% from last year. Medium to longer term market interest rates dropped by 80 to 90 basis points in the first 9 months of 2016.

Accordingly, we reduced our crediting rates on our annuities several times during 2016 in order to maintain appropriate returns on new business. We believe these rate decreases had a negative impact on sales, particularly in the retail channel. Additional information can also be found in a AFG's quarterly investor supplement posted on our website.

Please turn to slide 9 for a summary of the 2016 outlook for the annuity segment. We are increasing our expectations for earnings before fair value accounting for fixed indexed annuities to a range of $377 million to $387 million. This is up from our previous expectation of $370 million to 385 million, and includes a more normalized run rate of investment income going forward as compared to the unusually high amount achieved in the second and third quarters of this year.

Including the impact of fair value accounting for FIAs, we now believe that full-year 2016 pretax annuity operating earnings will be in the range of $310 million to $345 million both up $5 million from our previous guidance. Based on premiums recorded in the first nine months of the year and our recent level of sales, we now expect that premiums for the full-year of 2016 will be in line with, or slightly higher than, the $4.1 billion sold in 2015. Significant changes in interest rates and/or the stock market as compared to our expectations could lead to additional positive or negative impacts on the annuity segments results.

We continue to make product and process changes needed to comply with the Department of Labor fiduciary rule adopted earlier this year. Our goal is to minimize disruption resulting from the implementation of the rule in April of 2017. We're proceeding under the premise that the DOL rule will not be impacted by the pending litigation.

Most of our largest independent marketing organizations are making adjustments to their operations to provide a long-term solution to their need to have a financial institution sign, the best interest agreements and a number of these entities have made application to the DOL to serve as a financial institution.

AFG believes the biggest impact of the new rule will be on insurance-only licensed agents whose sales represented less than 10% of our third quarter premiums. While we continue to believe the adjustments required of us and our distribution partners to comply with the new DOL rule will have a negative impact on premiums next year, we do not believe the implementation of the DOL rule will have a material impact on AFG's business.

Please turn to slide 11 for a few highlights regarding our $42 billion investment portfolio. AFG recorded third-quarter 2016 net realized gains on securities of $1 million after tax and after deferred acquisition costs compared to net realized losses of $6 million in the comparable prior year period. As of September 30, 2016, unrealized gains on fixed maturities were $669 million after tax, after DAC and unrealized gains on equities were $103 million after tax.

As you'll see on slide 12, our portfolio continues to be high quality with 89% of our fixed maturity portfolio rated investment grade and 97% within an NAIC rating of one or two, 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 third-quarter 2016 results and share a few comments about capital and liquidity.

Jeff Consolino - *American Financial Group - EVP & CFO*

Thank you, Craig.

Slide 13 recaps AFG's third quarter consolidated results by segment. Core net operating earnings per share in the quarter were $1.51. The $1.51 is based on core net operating earnings in the quarter of $134 million. You'll be able to see a more detailed view of these components on page 4 of our quarterly investor supplement.

The reconciliation of AFG's core net operating earnings, to net earnings is detailed on slide 14. As Carl noted earlier, net earnings attributable to shareholders were $109 million, or $1.23 per share in the quarter. Net earnings for the quarter include $1 million, or $0.02 per share in after-tax realized gains as well as after-tax charges of $26 million, or $0.30 per share to strengthen our A&E reserves.

The components of our special A&E charge are further outlined at the bottom of the slide. The adjusted three-year A&E survival ratio for AFG's P&C insurance subsidiaries now stands at 10.8 times paid losses. This compares to an industry three-year adjusted A&E survival ratio of 7.3 times paid losses as of year-end 2015 according to data compiled by SNL.

As indicated on slide 15, AFG's adjusted book value per share was $51.73 as of September 30, 2016. Adjusted tangible book value per share was $48.94 as of September 30, 2016. Our capital adequacy, financial condition and liquidity remain strong. We maintain sufficient capital in our insurance businesses to meet our commitments to the rating agencies.

Our excess capital stood at approximately $1.1 billion at September 30, 2016. We returned $50 million to our shareholders through dividends and share repurchases during the quarter. Approximately 4.2 million shares remain under our repurchase authorization as of November 1, 2016.

As Carl noted earlier, we're making progress towards our merger with National Interstate. Holders of National Interstate common shares will vote on the merger at a special meeting next Thursday, November 10. The merger will become effective upon an affirmative vote of at least a majority of the shares owned by shareholders other than AFG and its affiliates. Between the pending National Interstate merger and the $1 special dividend announced last night, we have committed approximately $400 million of this excess capital.

Adjusting for the payment of the $87 million special dividend and the approximately $320 million of merger consideration for the National Interstate transaction, excess capital would stand at $665 million as of September 30, 2016. As a reminder we plan to hold approximately $200 million to $300 million as dry powder to maintain flexibility, especially in light of opportunities that may arise from industry disruption. We plan to continue returning excess capital to our shareholders through the course of 2016 and review all opportunities for the deployment of capital on a regular basis.

On slide16, you'll find a single page summary of our 2016 core earnings guidance. As a reminder, AFG's expected 2016 core operating results exclude non-core items, such as realized investment gains and losses and other significant items that may not be indicative of ongoing operations.

Now, we'd like to open the lines for any questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

And our first question comes from Ryan Byrnes with Janney. Your line is open.

Ryan Byrnes - *Janney Montgomery Scott - Analyst*

Great. Thanks. Good morning, everybody. I had a question on, I guess, your comp book. It looks like the underlying loss ratio is ticking up there a little bit due to rate, I'm assuming in some of the legal environment in Florida. I just want to get your thoughts there on where that's going and also I guess the potential rate increases heading into 2017.

Carl Lindner III - *American Financial Group - Co-CEO*

Well, Jeff's looking up the actual numbers for you. Our outlook for our workers comp book is very good, very positive overall. Almost all of our businesses are performing very well this year. We even grew a little bit in the third quarter and in Summit with the resolution of the 14.6% rate increase that was drastically needed in Florida, on a going forward basis; Summit will do just fine.

Our strategic comp business has outstanding results. And as I mentioned before, Summit in California, very pleased about the accident year and calendar year underwriting profitability. And looking forward, yes, there's been some rate declines in different states and that. But a lot of the industry profitability estimates have improved over the past year.

If you just take California, the estimates have improved. So I think everyone's results have been a little better than what they would have expected. And Republic, our subsidiary is no different in that. So we're very positive about the results this year and very positive that despite even some of the rate decreases that have happened, I think we have a positive outlook as we go forward. Jeff, do you have any specific on the?

Jeff Consolino - *American Financial Group - EVP & CFO*

Ryan, I'm looking at slide 9 or page 9 of our investor supplement. That's our specialty casualty subsegment. The workers' compensation business is contained within that subsegment, but there are other businesses there, including our E&S businesses and other businesses, but Neon is within that. So when I look at the underlying combined ratio, excluding cats and prior year development, the upward move to 97.4 from 92.9 is primarily attributable to Neon's result in the quarter. The same would be true for the underlying loss ratio, which moved from 63.3 to 66.5. So I wouldn't draw any conclusions from that data about comp business, because Neon is really the driver of the upward movement in those ratios.

Carl Lindner III - *American Financial Group - Co-CEO*

I think overall, we feel very good about the adequacy of our reserves on workers' compensation also.

Ryan Byrnes - *Janney Montgomery Scott - Analyst*

Great. That's helpful. And then Jeff, maybe just since you're the chair of Neon, I guess when did the re-underwriting actions really get going? I'm just trying to figure out when that should end, when top line may perk up a little bit and I guess some of that loss ratio pressure start dissipating?

Jeff Consolino - *American Financial Group - EVP & CFO*

Well, in terms of top line, I don't think we have any preconceived notions about that. What we want the management there to do like any of the other business units, within our specialty P&C group, is we want them to focus on the bottom line, not the top line. What you're seeing in terms of premiums this year is the exit of several lines of business, where Neon's management, upon a strategic review, determined there was an adequate profit potential. And then in this quarter, we've had, as Carl kind of indicated, [on] specialty casualty subsegment we've had some reduction in net premium related to the company, Neon's review of its reinsurance purchasing and purchasing its program in the third quarter, which will cover 12 and 18 months going forward.

I think in our last quarterly call in the second quarter, Ryan, we said that we are very pleased with the management team at Neon and they're turning over every stone and they're trying to improve the balance sheet. They're trying to improve the profit position of the business. There's a lot of hard work being done this year. We would hope that next year that the year of account results and the equivalent accident year results would show improvement, but we think really, this is a multi-year process to get to profitability to a reasonable level.

Carl Lindner III - *American Financial Group - Co-CEO*

Ryan, the positive thing is, when you look over eight or nine years, if Neon would have been breakeven, that would've improved the overall combined ratio by 1.3 points. So as we move towards better results in Neon, particularly in their next year and going forward, it has the potential to move our overall combined.

Ryan Byrnes - *Janney Montgomery Scott - Analyst*

Okay, great. Thanks for that. And then just quickly, my last one, just the commercial auto market. It seems like that's continuing to be a pressure industry wide. Then looking over at National Interstate, it does seem like they're kind of working their way through it, kind of generating low double digit ROEs right now. And I just wanted to get your thoughts there as to, I guess, how much more pain there is in the industry and maybe just going over, could that be a growth area for you going forward?

Carl Lindner III - *American Financial Group - Co-CEO*

I'm really happy that we have a specialty within American Financial Group that's focused on commercial auto right now. We've been at National Interstate, we've been in a mode of taking quite a bit of rate over the last three years or so. I think because of the change in severity that many have reported and that we need to continue to take rate going into 2017 in order to get our new and -- our new investment of $300 million, we need to be at a 95 combined or better to earn a double digit return on that incremental investment in National Interstate. So that's -- our focus is continued improvement there.

I'm pleased to say, in the Great American commercial auto business, which is more physical damage oriented and some specialty coverages in that, that last year and this year, we've had excellent results and excellent returns. So I do think, there's a little more pain, maybe a little more culling on the National Interstate side, but at some point, as others are playing catch up to National Interstate and they begin to focus on re-underwriting and improvement, I agree with you, we should be in a great position, being a specialist, to be able to take advantage of that.

Operator

Thank you. Our next question comes from Paul Newsome with Sandler O'Neill. Your line is open.

Paul Newsome - *Sandler O'Neill Asset Management - Analyst*

Good morning. Thanks for the call. I was wondering if you could talk broadly, maybe by segment, about what we should expect for sort of underlying -- underwriting margin compression, given that it looks like rate increases are positive, but looked like to me lower than the underlying claims inflation.

Carl Lindner III - *American Financial Group - Co-CEO*

I think we'll probably give you -- as we release guidance for next year, sometime probably late in the year or early next year, I'll be able to give you our best answer to that, but I think the unique position we're in, a lot of our businesses don't necessarily correlate to pricing in that, I mean our crop business doesn't really correlate to the normal kind of approach to things. And that and in fact as we just talked about with National Interstate, which is a pretty major piece of our property and transportation segment, if anything, we will be continuing to take rate and pushing towards improved combined ratios. With a 6% rate increase this past quarter there, it gives us continued good momentum to do that.

And I think also, in our specialty casually, again some of the comments related to Neon, Neon's been kind of a pretty major drag overall and also if it's been a one point drag overall on our combined ratio, it's been much larger on the specialty casualty side. So to the extent that we can move towards better accident year results moving forward there, I think that gives us a little -- some positive momentum in that.

Specialty financial, the quarter's aberration in results is more due to the Louisiana event and some of those things. That business continues to do very well and there may be a few in the lender-placed property business. There have been some rate reductions, but overall, pricing has been pretty flat for the whole year. And I'm not sure that when you look at the inflation kind of offsetting, no rate, the loss ratio trends there certainly continue to be just fine.

Paul Newsome - *Sandler O'Neill Asset Management - Analyst*

Great. Second question somewhat unrelated. Are you considering a change in the segment reporting when you consolidate -- after you consolidate National Interstate?

Jeff Consolino - *American Financial Group - EVP & CFO*

No, we would not. Right now, National Interstate is resident within the property and transportation subsegment of our specialty P&C Group. As a reminder to those that aren't as familiar with our reporting, National Interstate is already fully consolidated in our financial results, because we have a controlling interest of 51%. That means their premiums and their expenses are all in our financial statements. And then the minority interest comes out as a one liner. The effect of the transaction and the merger will be to eliminate that minority interest expense, but other than that, the character of our financials would not be changed. We would not see the need to re-characterize or recast our subsegment reporting.

Operator

Thank you. Our next question comes from Jay Cohen with Bank of America Merrill Lynch. Your line is open.

Jay Cohen - *BofA Merrill Lynch - Analyst*

Yes. Thank you. I just wanted to ask about the reduction in your outlook for premium growth for the property and transportation segment and the specialty casualty segment. I guess the question is, a lot of the issues that you would think would be putting pressure on premiums, I assume you would have known about a quarter ago. I'm wondering, did something change during the quarter that caused you to reduce your expectations in both segments?

Carl Lindner III - *American Financial Group - Co-CEO*

Number one, Jay, five-sevenths of our crop premiums get booked in the quarter. So you can estimate exactly what your premiums are going to be. But particularly in the third quarter, small percentage differences from what you're estimating can lead to pretty major changes in that particular quarter for that reason. I think the more important thing is, I think I mentioned that, when you exclude crop, basically our premiums are pretty flat for the rest of the business in that.

I think the other thing I also mentioned is because of higher ceded premiums, Neon and timing of reinsurance purchase and the exit lines there, that can give you a different conclusion than what's reality also. If you exclude Neon in the third quarter written premiums in that group, we're up 2.6%. So we tried to again help discuss that and kind of help everyone understand in those two segments, the impacts of those two things. So the impact of Neon probably will not be similar going forward into future quarters.

Jay Cohen - *BofA Merrill Lynch - Analyst*

Got it. That's helpful. And the last thing, on the crop business, you did mention that part of the issue there was some timing differences. Will those timing differences help in the future and were they meaningful at all?

Jeff Consolino - *American Financial Group - EVP & CFO*

Jay, if you go back to the second quarter earnings release and conference call transcript, the timing differences actually boosted the second quarter of 2016. So the flip has already happened. So there wouldn't be an impact going forward of the timing differences from this quarter.

Operator

(Operator Instructions)

Our next question comes from Mike Zaremski with BAM Fund. Your line is open.

Mike Zaremski - *Balyasny Asset Management Fund - Analyst*

Thanks. I have two follow-ups regarding the annuity segment and the Department of Labor rule. First, are changes to commission levels paid to distributors likely as a result of the rule? And two, last week, the DOL put out a frequently asked questions letter. I was curious if you felt the letter lent any clarity as to whether your independent marketing organization partners will be able to successfully operate under the rules next year? And I do appreciate that sales channel represents less than 10% of your sales. Thanks.

Craig Lindner - *American Financial Group - Co-CEO*

Yes. We happen to have a meeting with our large IMOs last week and got their opinions as to the impact and how they're dealing with things. And I will say the tone was quite a bit more positive. We deal with principally the very large IMOs, but they generally think that they are going to have a solution to the rules that are going to be implemented.

I'm sure you know many of the large IMOs are filing to become financial institutions. The stipulations and the requirements aren't exactly clear. The Department of Labor needs to be more clear on exactly what is going to be required, but they were really very optimistic about their ability to deal with the new rules. Having said that, there is still quite a bit of uncertainty as to exactly what the rules are going to mean. They need a lot more clarification. And what was your first question?

Mike Zaremski - *Balyasny Asset Management Fund - Analyst*

That's helpful. And my first question was just broadly, do you expect the industry and yourself to implement changes to commission levels paid to your distributors as a result of the rule?

Craig Lindner - *American Financial Group - Co-CEO*

Yes. I think the result of the rule will be lower commissions without a doubt. We're kind of looking to our distribution partners to guide us, as to what kind of commission levels it will be acceptable and what they think they need to do to comply with the new rules. So we're going to, at this stage, receiving a lot of input from our distribution partners and trying to respond to that. I do believe that the net result will be a meaningful reduction in commissions.

Mike Zaremski - *Balyasny Asset Management Fund - Analyst*

Okay. And so I guess a reduction to commissions could, on the one hand, boost your margins, but then I guess there's maybe no free lunch and it could impact sales too, I'm just trying to think how to think about that.

Craig Lindner - *American Financial Group - Co-CEO*

Frankly, we've always been a low commission company, different than many that we compete with. Our model fits actually very well with the new rules. I think if you pay a lower commissions, everything else being equal, what you can do is pass on more value to the customer and I think that's going to be the net result of the rule.

Operator

Thank you. I'm showing no further questions. I'd like to turn the call back to Diane Weidner for closing comments.

Diane Weidner - *American Financial Group - Assistant VP of IR*

Thank you all for joining us this morning and we look forward to talking to you again next quarter when we share our fourth quarter results. This will conclude our call for today.

Operator

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