FINANCIAL HOLDINGS, INC.

Atlas Financial Holdings

(NASDAQ:AFH)

2018 Third Quarter Financial Results Conference Call Transcript

November 6, 2018

Operator

Greetings and welcome to Atlas Financial Holdings 2018 Third Quarter Earnings Results Conference Call

I would now like to turn the conference over to your host, Scott Wollney, Chief Executive Officer. Please go ahead, sir.

Scott Wollney

Thank you very much and good morning, everyone. With me today is Paul Romano, our Vice President and CFO. We are very pleased to report continued strong underwriting performance in the third quarter highlighted by a better than industry combined ratio, greater than 20% return on equity and book value appreciation. Tangible achievements resulting from our focus on analytics and fin-tech related initiatives were also notable in the quarter.

I'll now turn it over to Paul to provide details about our quarterly materials and review our policy regarding forward-looking statements.

Paul Romano

Thank you, Scott and good morning everyone. Yesterday, after market close, Atlas issued its third quarter 2018 financial results. Copy of this press release are available at our Investor Relations section at the company's website at www.atlas-fin.com.

On this call, Atlas may make forward-looking statements regarding the company, its subsidiaries and businesses. Such statements are based on the current expectations of the management of each entity. The words anticipate, expect, believe, may, should, estimate, project, outlook, forecast or similar words are used to identify such forward-looking information.

The forward-looking events and circumstances discussed on this call may not occur and could differ materially as a result of known and unknown risk factors and uncertainties affecting the companies, including risks regarding the insurance industry, economic factors in the equity markets generally and the risk factors discussed in the Risk Factors section of its Form 10-K for the year ended December 31, 2017.

No forward-looking statement can be guaranteed. Except as required by applicable securities laws, forward-looking statements speak only as of the date on which they are made, and the company and its subsidiaries undertake no obligation to publicly update or revise any forward-looking statement, whether as a result of new information, future events or otherwise.

When discussing our business operations, we may use certain terms of art which are not defined under US GAAP. In the event of unintentional difference between the presentation materials and our GAAP results, investors should rely on the financial information in our public filings. All amounts discussed on this call are in US dollars unless otherwise indicated.

We will be utilizing a slide show presentation in conjunction with this call. Though we may address a few slides specifically in general, we will use this as an accompaniment. Feel free to follow along as we will follow the basic structure of this document. This presentation is available on our website's Investor Relations section and then under the Earnings Release Info selection. It will also be shared with those of you on the live webcast version on this call. For those of you following along with our presentation, we will begin on slide 3.

With that, I will turn the call back over to Scott.

Scott Wollney

Thanks, Paul. Atlas reported a strong third quarter, which included positive net income, book value appreciation and an annualized return on equity of 22.6%. The commercial auto insurance segment continues to demonstrate relatively hard market conditions and our focus has been to best position the company to maximize return on deployed capital.

We're also excited about the incremental opportunities, especially in the transportation network company or TNC space coupled with our fin-tech related initiatives, including a new program launched with a leasing company in connection with the major TNC in the quarter. And finally, the data that we've been providing quarterly to investors in connection with our claim activities and reserves is coming in as anticipated to date. I will detail this information later in the call after Paul walks through our quarterly financial results.

Our continuing use of predictive analytics is helping to both select better than average risks and appropriately price our business to optimize underwriting results. We've been monitoring price elasticity closely and Paul and I will discuss the impact we expect it to have in the near and longer term. As highlighted on side 3, our gross premiums increased more than 15% due to both rate increases as well as continued market share expansion, most notably, in the livery segment, which includes primarily commercial drivers under dispatch through TNCs.

Current market conditions and the evolution of our target market are providing substantial growth opportunities for Atlas. That said, we remain focused on margin over top line growth as always. As I mentioned earlier, we think about growth in the context of return on deployed capital over the long term and believe that a patient approach to expansion with a bias towards risk selection and price optimization will drive value creation through return on equity and book value appreciation.

While market conditions remain hard, testing price elasticity and competitive response is critical to the execution of this strategy. Later in the call, I will expand on our current observations and the related impact we expect it to have on our results and strategic activities. Paul will also provide more detail on our financial results in a few minutes.

Our market continues to evolve, as you can see on slide 4. Taxi premium remains flat, primarily due to positive rate change, despite declining market size and in some jurisdictions market share. However, our taxi book, as a percentage of our total book, continues to decline based on growth in the other segments. As we've noted on prior calls, the taxi segment is the most price sensitive within our niche.

We've seen consistent growth in the paratransit segment, which is very favorable from a competitive market perspective. It is increasing in terms of addressable size and as an industry remains healthy with strong margins in general. Our livery business is growing most rapidly with the expansion related to TNC operations providing the greatest opportunity. We believe that this market still has not developed fully from a primary insurance perspective, but are seeing very positive traction.

To the extent that part time transportation network and other gig economy drivers increasingly purchase commercial insurance, the size of our addressable market could increase by as much as $500 million to $1 billion annually. It takes time to cultivate these relationships, but we're enthusiastic about our pipeline and are working to provide options to a variety of drivers and of course price it appropriately for long term underwriting profit.

Atlas's competitive advantages continue to resonate with our traditional customers and are equally relevant to the newer subsets of our target market. Our specialty focus and commitment coupled with customer centric claim handling deliver unique value that we expect better operators to both appreciate and for which they will pay marginally higher prices.

We have maintained our focus on owner operators in small fleets, which we believe have been the most profitable subsegment of commercial auto, but are also seeing opportunities to engage larger accounts through the use of in-vehicle technologies and other insured tech driven aspects of our business model, enabling us to underwrite them profitably and deliver sophisticated comparative advantages as well.

On slide 5, we show our geographic breakout. We had growth in 19 of our active states this period, up slightly from growth in 18 states for Q2. There are also states with shrinking premiums, primarily those where rate increases earlier in the year were largest. While we have not seen signs of any new entrants, local competitors in some jurisdictions can be slower to follow price leadership than in others.

Our overall market share is approximately 13%. We have long maintained that proportionate share would be 20% of the market, which provides significant runway for potential growth and is achievable given the current hard market for commercial auto. Overall, demand as measured by vehicles and policy counts has been up, but did moderate in the third quarter. Some of this was likely the result of a relatively small percentage of our agents reacting to the change in our A.M. Best rating with the balance likely a reaction to continued price increases.

Our competitive environment is currently populated, primarily by smaller local nonstandard companies. Atlas's comparative advantages, which I referenced earlier, are driven by niche expertise, customer centric service and claims handling and other differentiators that compare favorably to these more generalist companies. These are the things that our customers prioritize when they decide where to purchase their insurance and evaluate how much of a premium they may be willing to pay.

We expect that while competitors in certain areas have been slower to follow rate increases than in the past, they will do so given the overall market condition in commercial auto. Our team are confident that the rate changes we've made will result in optimized underwriting margin and are comfortable with moderated growth or even reduced volume in areas that are more price sensitive in the current environment.

Based on feedback from our distribution channel, our product is still considered best-in-class from a service and claims perspective and the Atlas companies remain their premium choice to present to insurers. We are further distinguishing our offerings through the fin-tech initiatives cultivated in recent periods.

We outline our pricing changes on slide 6. We've continued to be very proactive in pushing right into the marketplace well above the industry standard or ISO rate. From quarter-to-quarter, this will shift based on underlying industry rate changes in our observations regarding price elasticity. In addition to increasing base rates overall, Atlas is using predictive analytics in a way that distinguishes our business from competitors and we're committed to continue to innovate to sustain this competitive advantage. Our goal is to maximize hit ratios for favorable counts and reduce the relative amount of less profitable accounts.

As you can see from the data on the left hand side of slide 7, as price increases, business volume decreases in a relatively linear way. We believe this is an indication that we're on the edge of the supply and demand curve. While it's impossible to know exactly where this line will be on a prospective basis in the current hard market environment, we think it's appropriate to test the waters in a conservative way.

The persistency data shown in the lower right side of the slide confirms that we're retaining only 61% of the more lost challenged accounts in our book where rates are increased the most, while we retain 95% of the more favorable accounts. This approach effectively re-underwrites a portion of our book on a continual basis. Writing a larger number of better accounts at competitive rates, while writing fewer more challenged accounts that require much higher rates than many of our competitors offer is slowing growth in the near term, but will increase margin and return on equity over time.

Our ability to implement this strategy is the result of niche expertise coupled with the significant investment we've made, both financially and in terms of human resources in the area of analytics in recent years. While we're very confident in the impact this will have on our margins, because those accounts facing the largest rate increases are tending to leave for cheaper rates from competitors and those we are retaining are expected to be more profitable based on current pricing, we're taking a conservative approach to the current year loss ratio, which I'll discuss in more detail later in the call.

Slide 8 shows our in-force business, which remains at record levels. Paul will now discuss our financial results and I will then share details regarding the impact of the pricing dynamic as well as a more fulsome discussion regarding market conditions and strategic opportunities.

Paul Romano

Thanks, Scott and as always, I encourage each of you to review our filings, our slide presentation and to reach out to Scott or myself with any questions. Slide 10 provides some key financial highlights for the third quarter 2018. Gross premium written was $75.9 million, up about 15% from 65.9 million in the prior year period. As we shave discussed in the past, while we do anticipate growth based on current market conditions, we remain focused on underwriting profit and risk selection as our priorities.

In-force premiums were at their highest level at $286.7 million as of September 30, 2018. This is up from $270.9 million at June 30, 2018 and up from 268.5 million at December 31, 2017. Net income for the third quarter 2018 was $5.6 million or $0.47 per common share diluted. Year-to-date, we reported net income of 16.7 million or $1.39 per common share diluted.

Book value per share was $8.53 at September 30, 2018 and has increased by 15% since year end 2017. Annualized return on equity was 22.6% in the third quarter of 2018. Our operating leverage, as measured by written premium to combine statutory surplus was roughly 1.97 to 1 at 9/30, as indicated in the top chart of slide 11. Managing our operating leverage is important from both regulatory and rating agency perspectives.

We continue to manage to an approximate 2 to 1 relationship between net written premium and statutory surplus. Our current operating leverage is at these expected levels as a result of accessing the terms of our existing quota share arrangement for the ASI pool companies. During the third quarter of 2018, our quota share session rates were 30% and 25% of subject written premium for the ASI pool companies and for Global Liberty respectively. We are not making any changes to our quota share session rates for the fourth quarter of this year.

Slide 12 breaks out the key components of our combined ratio after accounting for the effects of reinsurance. Atlas's combined ratio was 88.5% for the three month period ended September 30, 2018 as compared to 87.9% in the prior year period. The primary year-over-year differences relate to the carried loss ratio for the current accident year. As Scott touched on earlier and as we've noted on our previous quarterly calls this year, we have elected to establish our current year loss ratio for 2018 a few percentage points higher than the post reserve strengthening loss ratio indicated for 2017.

The current calendar year loss ratio relating to claims incurred for the three month period ended September 30, 2018 was 61.6% compared to 59.5% for the three month period ended September 30, 2017. On a year-over-year basis -- on a year-to-date basis, the company has carried a loss ratio in the 61 to 62 percentage point range. While we have increased rates significantly in most jurisdictions as seen on slide 6 of the deck, both our new business hit ratio and our renewal persistency have been reduced dramatically in areas that experienced the largest rate increases.

As shown on slide 7, retention for the third of our business with the worst expected loss ratios was 61%, while retention for the best third was 95%. Overall, this shift to better than expected loss ratio accounts should enter positive benefits for the company's overall loss ratio. However, this shift does extend the period of time over which these benefits will be recognized as compared to absolute rate changes.

We believe that the current carried loss ratio for 2018 is appropriately conservative based on price change and elasticity seen thus far during 2018. On a positive note, we continue to see reported claims per car year remain below business growth rates. We attribute this fact to favorable risk selection. Scott will discuss this in more detail later in the presentation.

As has been the case in the past, our current year expected loss ratio will be evaluated in the scope of the company's full year actuarial review based on the data as of December 31, 2018. The underwriting expense ratio for the three month period ended September 30, 2018 was 26.9% compared to 28.4% for the prior year period. As always, we encourage you to look at the full year expense ratio, as there are seasonality and timing impacts on this ratio in any given quarter. Year-to-date, our expense ratio was 27.1% versus 27% at the same period in 2017.

Slide 13 provides quarterly and annual combined ratio trend information, including its components. As with our expense ratio, we encourage users to look at our combined ratio and its components on an annualized basis rather than focus on changes from quarter-to-quarter as there are a number of factors which could impact the shorter term view.

Slides 14 and 15 provide an overview of our overall balance sheet strength and our cash and invested assets. We have always maintained the view that a conservative investment philosophy is important. A primary investment objective is to protect capital to support underwriting operations. As shown on slide 15, cash and invested assets declined year-over-year as a result of funding related to increased quota share session, initiated earlier in this year and claim settlement activities.

This was expected and consistent with the nature of this type of reinsurance arrangement and the changes implemented in the claims processes. As seen on slide 15, the majority of our 218 million of cash and invested assets are publicly traded high quality fixed income securities. Earlier in the year, we indicated that our investment committee made a decision to reduce exposure to other than fixed income investments or OTFI. Our OTFI investments are audited annually and qualify as admitted assets from an insurance regulatory standpoint.

We do not have concerns about the value of any of these investments, however, based on the current book value, we have made a decision to reduce the percentage of OTFI investments during the year. In the second quarter, OTFI investments were reduced by $1.4 million. These investments are generally less liquid than our publicly traded securities and we are not forcing accelerated liquidation, if we would negatively impact returns.

Actions taken to date should reduce OTFI investments by approximately $10 million before year end 2018. Based on the current valuations, we do not expect any deterioration of the current recorded value of these investments during Q4 of 2018. Book value per common share was $8.53 at September 30, 2018 as compared to $7.42 at December 31, 2017. The elements of the $0.11 change in book value per common share relative to December 31, 2017 are outlined on page 16. Please note that the change to unrealized losses on our fixed income portfolio had a non-cash decrease to book value per share of $0.25 during the first nine months of 2018.

With that, let me turn the call back to Scott for his concluding remarks.

Scott Wollney

Thank you, Paul. Let me now turn to an update on our reserves and claims data. We have worked throughout 2018 to provide investors with transparent information about clams and reserve activities using similarly formatted data from quarter-to-quarter. On slide 18, we define the key buckets into which our reserves are allocated. Each of these is expected to behave differently and I'll address them specifically.

Collectively, they highlight key changes during the year in connection with the ASI pool companies, which represent the largest portion of our reserves and have been affected most by the implementation of analytics. In particular, you can see that overall inventories have declined in more challenging areas like Michigan and pre-modeled liability claims and continue to represent a lesser amount of our exposure.

Slide 19 provides additional information about overall trends. Since year end 2017, accident year 2017 and prior reserves have decreased by 41.1%, while claim counts have been reduced by 66%. Case reserves set by our predictive analytics tools continue to represent an increasing percentage of overall reserve inventories and true IBNR allocated for claims not yet reported for accident year 2017 and prior is growing relative to expected incremental claims.

Predictive modeled base case reserves, which are set using the methodology we introduced in early 2016 and expect to represent the bulk of our reserves as older claims are adjudicated are addressed on slide 20. In total, claims in this category continue to close with redundancy relative to case, returning reserves into IBNR as illustrated by the chart on the right side of this slide. Aggregate case reserves of 70.6 million were set by the model since inception and the amount paid on closure, including closures without payment totaled 62.4 million.

Predictive model based case reserves represent the majority of pending third party liability claims for accident years 2017 and prior at this point. Our expectation is that overall claims in this category will close at or slightly below the case reserve predicted by our models over time. These models were built to predict ultimate loss in aggregate across all modeled claims and are refreshed to refine predictive ability as well as to capture underlying trend information.

We're encouraged that the collective paid amounts and closed claims are beginning to flatten out as older aged claims are closing. A continuation of this trend would provide incremental support that the models are working as anticipated. As we've discussed before, claims that were too old to be modeled when our current protocol was introduced carry a factor case reserve, which was established based on average incurred amounts when the current model based approach was implemented.

Additional IBNRs allocated to these claims. An update related to this bucket is provided on slide 21. As part of our year end 2017 work, experienced members of our claims team conducted a detailed review of these well-developed claim files and created a database to benchmark expectations, regarding ultimate loss cost. The grade bucket represents a combination of factor based case reserves and an allocation of IBNR equal to the expected ultimate loss costs related to these claims.

Year-to-date 2018, 486 older claims, which were not scored by the predictive model were closed with an aggregate paid amount of $14.3 million compared to an expected benchmark range of $9.2 million to $20.7 million. The remaining count of non-scored claims is 495 with average allocated case and IBNR per feature of approximately $35400. We're encouraged by closures in the middle of the anticipated range and are continuing to monitor the balance of this inventory, which represents approximately 17.5 million of our carried reserves very closely.

Slide 22 outlines activity related to Michigan. This has been a challenging state for Atlas as well as other commercial auto insurers in recent years. Our overall exposure to Michigan was significantly reduced since it was identified as trending in the wrong direction and it represents less than 1% of our business. Open claim inventories have been reduced to 310, which is 73.5% -- or of which 73.5% have been scored.

There are 110 open Michigan claims, which were file reviewed with a reserve allocation of $8.2 million, which results in an average reserve per claim of $65,700 apiece. The remaining newer 200 Michigan claims, which were modeled, but not file reviewed at year end 2017 are included in the light blue bucket described earlier.

On slide 23, the remaining IBNR for accident years 2017 and prior claims that have not yet been reported to us are less than a month old, so have not yet been scored is shown at 43.4 million, which grew slightly from the prior quarter. Based on historical frequency trends, we should pay approximately 580 of these going forward. We will continue to update this information quarterly to provide clarity regarding progress.

The average IBNR per expected claim in this category is $74700. While there's a significant focus on reserves, we also think it's important to share information about actual claim closure and severity trends. Slide 24 confirms that we continue to close claims faster than in the past and for lower calendar year paid severity amounts. Ultimately, the goal of introducing analytics in our claims process was to accelerate the triage and review of potentially large clams to facilitate faster resolution for more effective investigation and defense as appropriate.

We're pleased to see data supporting this expectation. With that, let me discuss market conditions and the impact of innovations on which Atlas has been working. On slide 25, we share the pricing data for commercial auto overall as of Q2 2018 from the Council of Insurance Agents and Brokers. We expect the Q3 data to be published later this week and anticipate a continuing trend of high single digit and low double digit price increases in our niche market.

Pricing levels are higher than they've been in more than a decade at this point and appear to continue to strengthen. This is expected to create buoyancy in our niche. Research continues to confirm that more P&C companies in the commercial auto space intend to reduce exposure, which suggests that we will not see new entrants in the near future.

On slide 26, you can see how our sector compares to the P&C industry at large. Commercial auto generally continued to be implementing the highest rate increases of any large segment with P&C. As shown on slide 27, our insured vehicles in-force increased during the period. Although in the short run, rate increases have slowed growth in certain areas, we've continued to file increases to the extent supported by data and loss experience. Our expectation is that this approach will create the most shareholder value in a favorable market environment.

We also expect hit ratios to return to levels similar to prior years, provided our competitors once again follow Atlas's price leadership. As I noted earlier, the competitive response following our price changes this year has been slower than in the past and we're keeping a close eye on price elasticity. While this informs our decision regarding pace of loss ratio improvement as Paul described earlier, it does not change our view that the combination of rate change and better than industry risk selection will improve loss ratio over time.

Slide 28 shows that our risk selection appears to be working with claims presented remaining consistent to down, while our number of vehicles in force is growing. This is an important leading indicator, which has been very steady in recent years as you can see. On slide 29, we highlight our newly launched digital usage based product, designed for part time transportation network drivers branded as OptOn. This is a mobile app that provides short term primary commercial automobile insurance coverage for Ride Share drivers across all ride share driving periods with premium price per mile based on numerous factors including how, when and where insurance drive. The OptOn mobile application, which supports coverage and pricing as well as claim detection and reporting is now available in the Apple App Store and the Google Play store.

We recently launched this product after a successful beta testing phase and to date the adoption validates our extensive research based belief that there is a meaningful interest in primary insurance, among part time TNC drivers, provided an appropriate product is available. We received support from our domestic concerns regulator, which reinforces our view that innovative and sure tech products such as OptOn are critical to meet the needs of our clients, industry and the insurance risks related there too.

Combining Atlas's unique heritage and specialty team with bricks-and-mortar insurance infrastructure and sophisticated fin-tech innovations will deliver sustainable and potentially disruptive value over time. Our innovation and commitment to the specialty commercial auto niche has also led to other potentially large opportunities related to our traditional product offerings as well.

Moving to slide 30 and expectations, we've always put a priority on margin, underwriting profit and return on equity over top line growth. We continue to identify significant opportunities in the TNC space with these priorities in mind. We expect to further leverage Atlas's core competencies and heritage in connection with the evolving and expanding TNC segment. Last year, we highlighted some of our successes in this area.

This quarter, we're excited that Atlas influx drive in connection with lift work together to launch an insurance program initially geared towards commercial use drivers in New York City. We will be monitoring driver adoption and evaluating additional opportunities in connection with this program. We're excited to further leverage Atlas's core competencies and heritage in connection with the evolving and expanding TNC segment.

We intend to report updates on this program over time to develop, while also keeping competitive implications in mind. From an operating margin perspective, we'll continue to focus on increasing rate versus exposure, while maintaining operating efficiency. We will leverage the value of our core assets through partnerships with reinsurers, analytics and technology companies and other strategic resources. Innovation is a critical aspect of our strategy and we will continue to expand utilization of in-vehicle technologies and our ongoing commitment to analytics across the enterprise.

The effective development and implementation of fin-tech will undoubtedly change the insurance industry and we're committed to positioning Atlas as a leader in this evolution. We reiterate our expectation of achieving return on equity of at least 20% for the year. Earlier in the year, we guided to a full year EPS of at least $2 on the basis that our loss ratio for 2018 would be at or below last year's and we continue to manage to that expectation. We want to emphasize key elements of our results that will impact the final result for the year.

First, as discussed earlier in this call and on prior quarterly calls, we've made a decision to conservatively carry a loss ratio above the prior years, despite putting a significant amount of rate into the market. Based on persistency and hit ratios year-to-date, more of our 2018 premium relates to renewal retention and new business consisting of accounts expected to generate a better loss ratio rather than more challenged accounts, as they are less likely to accept appropriately higher rates. We believe this will result in a lower loss ratio than what we've carried in the past and is consistent with our earlier expectations for this year's result.

Second, while claims statistics and persistency data are encouraging, we're continuing to record a current year loss ratio in the 61% to 62% range as at September 30, 2018. Consistent with my comments on last quarter's earnings call, it's important to note that meeting or exceeding our earnings guidance will be subject to the final ultimate loss ratio developed at year end 2018.

And third, we are remaining appropriately conservative and plan to wait for year-end actuarial work to reinforce our positive view on 2018 before any reduction to our loss ratio will be made. As always, our current year expected loss ratio will be evaluated in the scope of the company's full year actuarial review based on data as of December 31, 2018. Any change to the full year 2018 loss ratio would be applied to earned premiums for all four quarters of the year, but be recognized in the fourth quarter results. Our focus remains on bottom line execution with both the near and long-term priority on pricing, risk selection and claims management to optimize underwriting profit.

Now, let's open it up for questions.

Question-and-Answer Session

Operator

Our first question today comes from Paul Newsome of Sandler O'Neill.

Paul Newsome

I was wondering if you could talk a little bit more about the increase in policy in-force or cars in-force, it looked like it's bumped up there in August?

Scott Wollney

So, a lot of those related to the TNC opportunity that I mentioned, which was put in force towards the end of the quarter. Obviously, the premium for those we'll earn over the upcoming months and we do expect to need to expand that program between now and the end of the year. In terms of our traditional business, the overall in-force vehicles were relatively consistent with last year. So that would be consistent with the green dash line that you see on slide 27.

Paul Newsome

Could you talk a little bit about cash usage over the course of the year? And how that will flow into the fourth quarter and perhaps next year?

Scott Wollney

So, I think the biggest shift as Paul referenced is the funding of the increased quota share reinsurance session. We increased the session for the ASI pool companies to 30% on April 1. And as you know, the way that those programs work, you fund them upfront and then cash is returned back through seeding commissions, so that will flatten out to a run rate probably in the first quarter of 2019.

In terms of the underlying duration and liquidity into the business, we expect it to be consistent with about a 3.5 year duration in our fixed income portfolio. We're a little bit higher than that right now, but I think about 3.8 years' duration, Paul.

Paul Romano

Yeah.

Scott Wollney

But we have already made, taken steps to shorten that duration slightly based on investing the new dollars coming in.

Paul Newsome

So the cash value should continue to fall, as you fund the quota share in to the fourth quarter and maybe the first and then flatten out there after on an absolute basis?

Paul Romano

Yeah. We should expect that. Also, part of the cash decrease specifically over the last year has really been related to -- part of it has been related to the fact that we have been closing and settling claims at a faster pace than we had in the past. So we are seeing some increase in the cash flow outward as a result of these claim settlements. However, that should level out over time here in the next couple of quarters as well.

Operator

The next question is from Bill Dezellem of Tieton Capital Management.

Bill Dezellem

A group of questions. First of all, your acquisition cost dropped off quite meaningfully from the third quarter a year ago, would you please discuss that?

Scott Wollney

Sure. It's a couple of components, Bill. The first component obviously is the increase in the session rates for the quota share reinsurance. We actually in our benefit to the acquisition cost line as a result of receiving seeding commissions on that line and as premiums are earn in, we're going to earn in a bigger portion of that seeding commission, so it's going to be a benefit to the acquisition cost line.

Also in the quarter, we did true up some of the contingent commission -- agent commissions that we had and those are related to profitability and premium growth within our cornerstone agents. So we did make an adjustment there as well in the quarter.

Bill Dezellem

And then if I may, how has the conversation with your actuaries different now at this point in the year compared to where it was last year or two years ago?

Scott Wollney

So I think the key difference is we've been focusing much more on the underlying data and the changes in the business to make sure that as we go into the year-end actuarial review, we avoid surprises or misinterpretations of what's been going on in the business. We felt like that was an issue at year end ‘17 and we want to make sure that we do not have any surprises related to misinterpretation this year.

So we've been talking with and working with a number of resources to make sure that we've got a very good handle and that our actuaries have a very good handle on the impact of the underlying changes in the business and of course it's also helpful that we now have an additional year’s worth of data.

And in particular, I think if you look at the slides that we shared, specifically slide 20 where we're showing the development pattern of the predictive model based claims versus what the model expected, you do start to see a flattening out, which becomes more pronounced with every quarter of data and that's going to help demonstrate what we've always anticipated, which was that those predictive model base case reserves will be sufficient in aggregate.

So that's been a key focus and then of course tracking those older non-model claims against our file review and the benchmark there is going to help provide good support that that analysis is reflective of the expected ultimate on those claims. So, a lot of work focusing on the underlying data and looking at the different buckets of reserves separately, because they are truly behaving separately, given the impact that we believe the model has had in terms of claims outcomes.

Bill Dezellem

And then lastly I believe it was in the press release that there was a reference to the fact that you expected that the loss ratio would begin trending in the right direction as a result of several of your initiatives over time. I was hoping that you could put a timeline on when you anticipated that change in direction?

Scott Wollney

Well, I think the key for 2018 is that we have increased rates, we also are seeing affective re-underwriting in the sense that we are retaining, as we touched on a very high percentage, 95% of our best third accounts from a profitability standpoint, persistency on the more challenged that counts is down in 61% and those accounts we are retaining in that lower band are accepting significant rate increases. So all of those things suggest that this year's full year loss ratio should be lower than last year's, last year's fully developed after reserve strengthening at year end ‘17 was about 60%.

And so, if all of the things that we are tracking continue to hold, we would expect that the full year review we do at the end of the quarter is going to support that conclusion, but as we commented on, we think it's appropriately conservative not to take credit for any reduction until we actually see it show up in that analysis. But to the extent there is a conclusion that there's a better full year result and we've been carrying that adjustment would be made to the full year’s earned premium, which is the point that we wanted to clarify at the end. So hopefully that's helpful to give people a perspective on where we're going with that.

From a longer term perspective, we aren’t looking at this as a single year initiative. We are in a hard market environment and while we would like to see competitors follow price leadership faster, we always like that to be the case. We are not seeing signs of new entrants, commercial auto generally continues to take rate and so we do believe that we are going to continue positive pricing momentum going into 2019 as well. So we’d hope that that positive trend that we expect to see 2018 versus 2017 will continue to move in the right direction into 2019 as well.

Bill Dezellem

And I am going to squeeze in one more here if I may. The accounts where you have only 61% retention kind of at the lower, the left hand side of the losses. Is that – are those retained – the 61% that you’re retaining, is that coming with some additional technology to help those customers improve their loss behavior different say from a year ago or talk to us about that idea. So clearly you’re raising price on them to improve your ratio with them, but really trying to understand if there are some other activities to help them actually decrease loss per vehicle?

Scott Wollney

Yeah, absolutely. So in some cases, for a particularly challenged account, especially if it's a mid-size or larger fleet where we've observed that there are certain types of accidents that we believe can be significantly impacted through the use of in-vehicle technology, such as some of the technology partners we featured in our Investor Day. We will use a targeted solution in addition to rate increases to help to effect positive change with those accounts. Obviously, the account has to be willing to invest in that technology or co-invest with us, depending on what we proposed and they also have to be willing to focus on change management, in other words, using that technology to better manage drivers, better train drivers, et cetera.

And so in some cases, accounts are very willing to do that, especially if it moderates their price change. In some cases, they're not in which case typically those accounts will go to a competitor. And so the use of technology and especially using it to prevent losses is always our preference. And we've talked a lot about how strongly we believe in terms of the benefit of that, particularly when engaged by uninsured who wants to effect positive change and is willing to do what's necessary, so we can be a great resource, we know that technology can be a great tool, but it really has to be a partnership with the insurer, where they're willing to utilize all of that information as well. So in some cases, they will.

In other cases, it may not solve the problem, but again to a great extent, those are the accounts that are going to competitors. The ones we're retaining are very likely to have gotten both an increase of rate and especially for fleets are committing to using some kind of an in-vehicle technology tool that we validated and believe can help reduce the number of accidents and help us better adjudicate claims when there are accidents.

Over time, we'd love to see all of our insured fleet have some kind of in-vehicle technology, whether it's camera, traditional telematics, cell phone based analytics, that's not going to happen overnight, but when we think about our vision for the future, that is absolutely central to what we think is the model that's going to be most effective, both for our customers and also for our bottom line.

Operator

Our next question comes from Bob Farnam of Boenning & Scattergood.

Bob Farnam

I have a few questions on the OptOn product. So what do you see is the market opportunity for that? Do you see competitors with a similar price per mile product and probably more importantly, this is a new thing for you in terms of pricing and underwriting this type of product, how do you get confident with your ability to price on a per mile basis?

Scott Wollney

So based on our research to kind of take the three parts separately, if a meaningful amount of part time transportation network drivers in the US purchase primary insurance using that product, the addressable market could be anywhere from $500 million to $1 billion and obviously that segment's growing. So for, given our niche market size, there's a meaningful incremental market opportunity, but we also recognize that in the near term, not all part time drivers recognize the need to buy primary insurance or would be willing to pay for it. So we have already seen and expect to see that continue to evolve.

In terms of competitors, there are no other commercial auto carriers who are providing a mobile app based usage driven product the way that we are. There are some price per mile products in the personal auto space those tend to have more of a static rate per mile for a particular insured, which I think is more consistent with the more sort of traditional risk related to personal auto. Within public auto, one of the key elements we have in our historical data is a significant knowledge of the exposure and the volatility and exposure related to people who move people around and so all of that was factored into our building the underlying predictive analytics based algorithms that drive the pricing for the OptOn product. So we feel very confident that our pricing model, which is very dynamic and can vary based on how a driver drives is monitored by the app where they're driving, how much they're driving the time of day, even the weather.

So all of these things factor in, but to the third question, because of this new initiative, we are limiting our initial rollout of the product to a single state, Illinois and we also intend to build the premium base relatively modestly, so we've commented in prior calls we'd anticipate in the first 12 months, generating a run rate of $3 million to potentially $20 million of premium. We think 3 million will be enough to provide data to support the credibility of all the underlying analytics and algorithms.

We would not want to write more than 20, at least without significant support from either a reinsurer or some other form of capital, because it is a new product and from the beginning, we took the position that, while we've built this product as really a sort of a company within a company to ensure optimal innovation, we have also committed to the idea that the expense related to developing the product as well as exposure to loss would all be contained within an amount that would be consistent with our accretion expectations, which will be positive.

In other words, we don't want to do anything with the launch of the product that would be non-accretive to our bottom line. So we do anticipate it is a relatively modest rollout, although we are, as I said on the call, really excited to see the adoption levels in terms of the number of people downloading the app and it really does validate the fact that there is a significant amount of interest among part time drivers to obtain primary insurance, provided it is something that's appropriate for them and makes sense in terms of the amount that they drive.

Bob Farnam

Are you able to -- how do you – again, you had an issue with maybe some of the drivers not knowing about the product or caring about the product, how do you -- what kind of outreach do you have to be able to get some of these customers to say, hey, this is a -- this could work for you.

Scott Wollney

So our initial launch was through industry or segment influencers. So, there's a number of resources, a couple of whom we referenced specifically in our OptOn press release who provide information blogs, other resources for part time transportation network drivers to help them understand the environment that they're in and understand how to optimize their revenue, especially for drivers who intend to drive over the longer term.

And so one of the things that's been highlighted by those resources is the fact that there is risk that can be appropriately addressed with insurance and I think they along with candidly some of the big TNC companies have been somewhat critical that the insurance industry has not really provided an elegant or appropriate solution. So we believe that the product we've launched is that solution. So, the first step really is to make sure that that influencers the people who are part time transportation network drivers are looking to as experts, understand the product offering and are in a position to endorse it and communicate that.

The second really is digital marketing strategy. So one of the real advantages of a mobile app based product is the fact that we can use digital marketing to target individual drivers using a number of techniques that we won't go into for competitive reasons, but much like any other digital product, there are sophisticated ways to get to consumers who demonstrate certain behaviors or interests based on how they use social media, how they, what they Google, et cetera. And so, we are testing that digital strategy to figure out how to optimize the number of downloads and conversions for every dollar we spend and again given our intent to have this be a gradual launch, we're doing it solely, we're doing it in a staged way.

And so part of that strategy is reaching out and contacting drivers digitally and a second part of that strategy is on working with influencers and directly helping to educate them in terms of what this product does and why it's valuable to them. And over time, we also think that there is an opportunity to partner potentially with TNC companies or other strategically positioned businesses that are in or support the TNC space, because what we're doing is really symbiotic.

It solves a problem for personal auto insurers in the sense that most personal auto insurers are trying not to pick up claims from transportation network drivers where there are passengers which they don't intend to cover, but I think are receiving nonetheless. It will also move indirect liability away from the transportation network companies themselves who are absorbing a significant amount of risk under their access policies and so the product we're offering is providing the appropriate primary coverage at the appropriate price and provides a benefit really to everybody in the ecosystem.

So, our goal over time is to first have proof of concept, validate that it works the way we expect it to and then start to leverage some of those potential partnerships or relationships to think about how to expand the product outside of this initial pilot, but the first step is really validate proof of concept and that all the underwriting -- all the underlying algorithms, et cetera, are working as expected.

Operator

Our next question comes from Frederick Shepard of Capital Returns Management.

Frederick Shepard

Could you just talk a little bit more about your plans on shrinking the OTFI assets in the fourth quarter and maybe into 2019? And then I guess, do you have any visibility into the size of any of the sales realizations.

Scott Wollney

So, as Paul commented, we took steps earlier in the year to reduce OTFI by about 30% from where they were in the first quarter. Some of that has already been liquidated. The steps that were taken earlier in the year will result in, as Paul mentioned, approximately an additional $10 million of liquidation. We expect that all of those will either be liquidated at a gain or neutral to carried value. So, at that point, we will have met the initial expectation that the investment committee established. We always evaluate investment allocation and capital allocation in general at the board level and so to the extent the investment committee determines that an additional change in to 2019 is appropriate, we'll communicate that, but at this point, we can certainly confirm that the steps were taken earlier in the year to achieve the stated objective of at least a 30 percent reduction by year end this year, the actual reduction will probably be slightly more than 30% in total.

Frederick Shepard

And then maybe if you just talk a little bit more about the program with the TNC partner that you guys mentioned Atlas entered into in the quarter and maybe any other growth engines in the pipeline that can help drive continued top line growth going forward?

Scott Wollney

So at this point, we don't intend to provide much more information about the existing program that was launched, other than to confirm that it was launched in the third quarter, some premium related to that was recognized, but we expect incremental premium to be recognized in the fourth quarter and believe that there is incremental opportunity. Ultimately, what that opportunity is is going to be driven by driver adoption and so until we have more information, we aren't going to provide specific forecasts.

Also from a competitive perspective, we don't think it would be in our interest to do so, but it is an exciting opportunity and it's the first time that we've launched something directly in conjunction with a major TNC. So that's really the first step we think in terms of establishing a more significant position in that space.

In terms of other opportunities in the pipeline, there are a number of companies in many markets who are providing vehicles to TNC drivers. Some are affiliated directly with major TNC companies, some are not. We do have a pipeline through our independent network channel and also in some direct discussions with a number of those, but as we commented on last year, when we secured a large relationship with one of those types of companies, these are sophisticated relationships. We are often coming in with a price point that's higher than the cheapest price in the market.

Generally, we are requiring that some in-vehicle technology be a component of those programs for a number of reasons and so it's a dialog that takes time to develop and so we don't want to create an expectation that we're going to see these type of accounts be secured every single quarter, but we do feel good about the fact that there are a number of opportunities out there and that we are very well positioned to secure them with those entities that have a long term view, want to incorporate in-vehicle technology to everybody's mutual benefit and are willing to pay an appropriate price for the kind of service and kind of claims handling that they can expect if with their partner.

Operator

We have a follow-up question from Bill Dezellem of Tieton Capital Management.

Bill Dezellem

Relative to the OptOn product, what is the timeline that you're currently thinking for this test before you feel as you are ready to go for commercial legit?

Scott Wollney

So, our expectation is that we would run it for about 12 months to validate. Obviously, it is a brand new product. It's first of its kind, so adoption rates are going to help us understand whether that 12 months is too long or too short. I think the key is, we want to make sure we can validate the underlying assumptions, both in terms of acquisition cost and especially pricing and loss development and so that's really the key. For now, I would assume that that 12 months will continue to hold off. We are seeing kind of adoption rates and download rates consistent with what we might have expected, but it's still pretty early on.

So I don't want to be too specific, not because we're unwilling to, but because it is a new innovative product and we are really going to have to see how the data accumulates before we can be more precise on that. We are already starting the process of engaging with other regulators in states that we believe will be sort of phase 2 states because that regulatory approval process takes a considerable amount of time. We do now have a great template in terms of what the domestic regulator here in Illinois approved, which we think will help to facilitate those discussions. So, we're in the process of laying the groundwork for further expansion, but we aren't going to actually do it until we feel absolutely confident in the underwriting result.

Operator

There are no further questions at this time. I'll now turn the call back over to management for closing remarks.

Scott Wollney

All right. Thank you, everyone. We look forward to talking with you again in the future.

Operator

This concludes today's conference. You may now disconnect your lines. Thank you for your participation.