S&P Global
Market Intelligence

Selective Insurance Group, Inc. NasdaqGS:SIGI

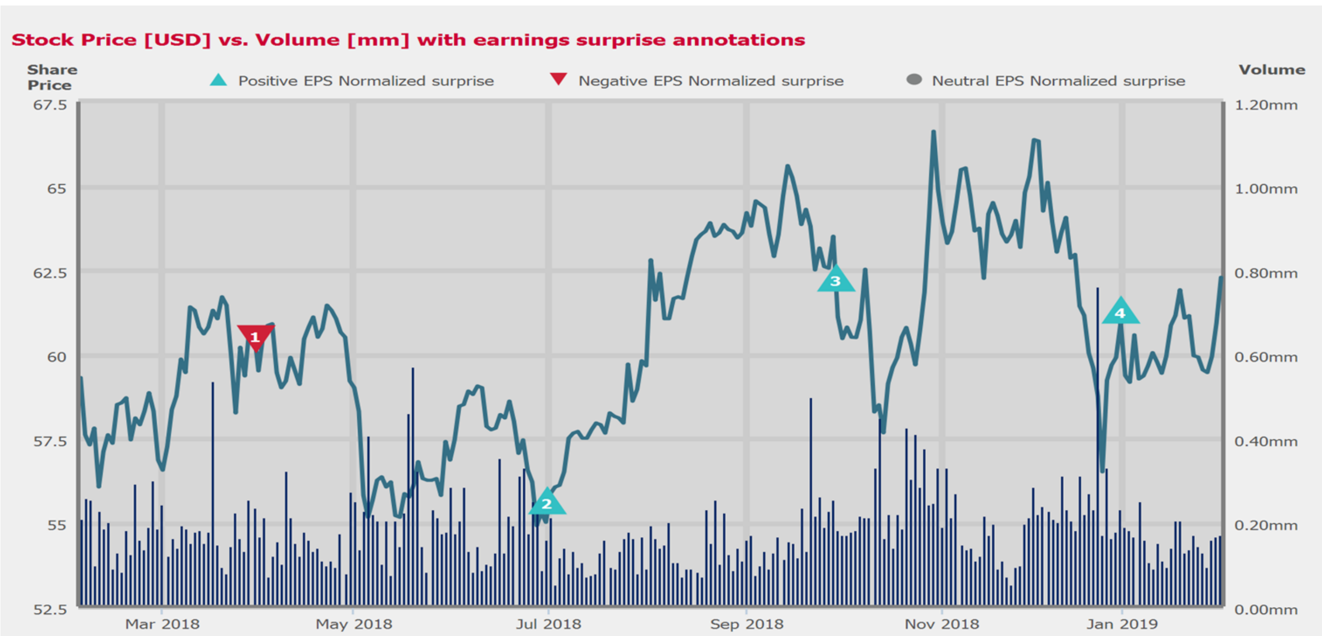
FQ4 2018 Earnings Call Transcripts

Friday, February 01, 2019 3:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ4 2018-			-FQ1 2019-	-FY 2018-	
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	ACTUAL
EPS Normalized	0.93	1.20	▲29.03	0.96	3.38	3.66
Revenue (mm)	674.04	643.00	▲(4.61 %)	692.58	2617.11	2586.10

Currency: USD
Consensus as of Feb-01-2019 12:10 PM GMT



- EPS NORMALIZED -	CONSENSUS	ACTUAL	SURPRISE
FQ1 2018	0.48	0.46	▼(4.17 %)
FQ2 2018	0.88	1.01	▲14.77 %
FQ3 2018	0.91	0.99	▲8.79 %
FQ4 2018	0.93	1.20	▲29.03 %

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Call Participants

EXECUTIVES

Gregory Edward Murphy
Chairman & CEO

John Joseph Marchioni
President & COO

Mark Alexander Wilcox
Executive VP & CFO

Rohan Pai
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Crédit Suisse AG, Research Division

Presentation

Operator

Good day, everyone. Welcome to Selective Insurance Group's Fourth Quarter 2018 Earnings Call. At this time, for opening remarks and introductions, I would like to turn the call over to Senior Vice President, Investor Relations and Treasurer, Rohan Pai.

Rohan Pai
Senior VP of Investor Relations & Treasurer

Thanks, and good morning, everyone. This call is being simulcast on our website and the replay will be available through March 1, 2019. A supplemental investor package, which includes GAAP reconciliations of non-GAAP financial measures referenced on this call, is available on the Investors page of our website, www.selective.com.

Certain GAAP financial measures stated in today's call also are included in our previously filed annual report on Form 10-K and quarterly Form 10-Q reports. All numbers are GAAP unless otherwise indicated.

To analyze trends in our operations, we use non-GAAP operating income, which is net income excluding the after-tax impact of net realized gains or losses on investments and unrealized gains or losses on equity security and in the fourth quarter of 2017, the impact of the write-down of our net deferred tax assets due to tax reform.

We believe that providing this non-GAAP measure makes it easier for investors to evaluate our insurance business. As a reminder, some of the statements and projections made during this call are forward-looking statements as defined by the Private Securities Litigation Reform Act of 1995. Forward-looking statements are not guarantees of future performance and are subject to risks and uncertainties. We refer you for Selective annual report on Form 10-K and any subsequent Form 10-Qs filed with the U.S. Securities and Exchange Commission for a detailed discussion of these risks and uncertainties. Please note that Selective undertakes no obligation to update or revise any forward-looking statement.

On today's call are the following members of Selective's executive management team: Greg Murphy, Chief Executive Officer; John Marchioni, President and Chief Operating Officer; and Mark Wilcox, Chief Financial Officer.

And with that, I'll turn the call over to Greg.

Gregory Edward Murphy
Chairman & CEO

Thank you, Rohan, and good morning. I'll first make some introductory remarks focusing on some high-level themes and discuss those that we'll continue to drive our performance and strategy. Mark will then discuss our financial results, and John will review our insurance operations in more detail, providing additional color on key underwriting initiatives.

We are extremely proud of our excellent 2018 fourth quarter and year results. For the quarter, non-GAAP operating income established a record $72 million or $1.20 per share and the annualized non-GAAP operating return on equity, or ROE, was superior at 16.3%. For the quarter, each of our underwriting segments contributed to the exceptional 92.7% combined ratio and produced an annualized ROE of 8.1 points. In addition, after-tax net investment income was up 42% to $44 million, contributing 10 points of annualized ROE.

This exceptional quarter capped off an overall strong year of company financial performance. 2018 marks the fifth consecutive year that we reported double-digit non-GAAP operating ROEs, placing us at among extremely select group of insurance companies that have achieved this level of elite performance. This is particularly impressive track record in the context of: one, material industry catastrophe losses over the past 2-year period; two, a very competitive commercialized pricing environment; and three, a depressed interest rate environment. The strong track record is also a testament to our ability to execute our strategy of disciplined growth. For the year, non-GAAP operating ROE was 12.5% and ahead of our 12% financial target. In addition, our combined ratio of 95 generated 5.5 points of ROE while after-tax net investment income contributed 9.2 points. Verisk's Property Claims Services estimates U.S. industry catastrophe losses for 2018 at $46 billion or about 8 points on the industry's overall combined ratio. The year will likely go down as the third most costly for the U.S. industry -- insurance industry, excuse me, from a standpoint of catastrophe losses, serving as another painful reminder of the risk of severe events. The major catastrophic events that occurred during the year included Hurricanes Florence and Michael as well as California wildfire. In addition, noncatastrophe losses also placed pressure on commercial property as well as homeowner results.

The fact that the industry's had to grapple with severe weather-related losses in each of almost -- in each in the past 10 quarters suggests a new elevated norm that must be addressed through underwriting actions and strong underlying pricing rather than hoping for weather improvements.

Industry-wide commercial property results have been volatile and commercial auto has been a consistent poor performer, which when coupled with ongoing pricing pressure within the Worker's Compensation line, have led to an expected 2018 industry combined ratio of about 99 or an 8% ROE. This level of performance barely matches the industry's cost of capital. An improvement over 2017, however, nothing to write whole about. As I've often said before, hope is not a strategy that will drive improved underwriting results. And when you look into 2019 and '20 underwriting performance, the only thing that really matters is earned renewal pure rate that exceeds expected claim inflation or loss trend. We've established a strong track record of pricing discipline and we strive to mitigate the risk of severe losses through a high-quality underwriting, product risk appetite and prudent reinsurance purchases.

In addition to our outstanding financial performance during the year, we've also executed successfully at a number of strategic initiatives that will assist sustained outperformance. First, our Standard Commercial Lines renewal underwriters achieved overall renewal pure price increases of 3.5% for the year, in line with our expected claim inflation levels. Second, as we discussed last quarter, considerable improvement has been achieved in improving our overall customer experience strategy with goal toward adding value-added services to make our products superior. The development of a 360-degree review of the customer that allows us to engage customers in a manner of their choosing, our digital platform continues to gain traction across Personal and Commercial Lines, allowing for continued enhanced customer engagement.

In addition, we are making available our Selective Drive sensor and mobile technology to commercial fleet customers. In addition to fleet management, we expect the adoption of this technology to influence driving behaviors and improve loss experience over the longer term. Third, we've been taking active steps over the past 2-year period to address profitability in our E&S segments that include implementing meaningful targeted price increases, exiting challenged business segments and improving the claim processes. Fourthly, our geographic expansion remains well on track and added $26 million of new business for the year. Over the past 2 years, we've opened New Hampshire as well as the Southwest region presence in Arizona, Colorado, Utah and New Mexico. This brings our total Commercial Lines presence to 27 states.

Our expanded regional capability provides access to growth opportunities as well as improving diversification of our business. Finally, our investment team has done a superior job in repositioning the portfolio to take advantage of the rise in the short-term interest rates without increasing the overall risk profile.

The excellent 35% growth for the year in after-tax investment income reflects the benefit of a lower tax rate, higher alternative investment contributions and tactical moves within the portfolio taking advantage of the rising interest rates.

Our investment portfolio is conservatively positioned from a credit, duration and liquidity standpoint. With an investment assets to equity ratio of 3.33x and an after-tax yield of 2.8, investment performance was a strong contributor to our overall ROE for the year.

Initiatives for 2019. Looking forward to the next 2-year period, there remain in a number of areas that require a laser-like focus in order to maintain our financial position: one, achieving Standard and

Commercial Lines written renewal pure price increases that match or exceed expected loss inflation trends; two, delivering on our strategy for continued disciplined growth, driven by the addition of new agents, greater share of wallet and geographic expansion; three, continuing to enhance our customer-experience strategy, including value-added technologies of services such as Selective Drive and others that will improve retention and hit ratios creating a true differentiation in the marketplace; four, improving profitability in commercial auto and E&S via targeted underwriting act -- targeting underwriting and pricing actions; and five, actively managing the investment portfolio to enhance after-tax yields while managing credit risk and liquidity risk.

Turning to 2019 expectations. Our guidance for the year is based on our current view of the marketplace and incorporates the following: one, a GAAP combined ratio, excluding catastrophe losses of 92. This excludes no prior year development. Catastrophe losses of 3.5 points, after-tax investment income of $175 million, which includes $8 million of after-tax investment income from our alternative investments and overall effective tax rate of approximately 19%, which includes an effective tax rate of 18% for the investment income, reflecting the tax rate of 5.25% on tax advantage municipal products.

And a tax rate of 21% for all other items. Weighted average shares of $60 million on a diluted basis.

And now I'll turn the call over to Mark.

Mark Alexander Wilcox
Executive VP & CFO

Thank you, Greg, and good morning. For the quarter, we've reported fully diluted earnings per share of $0.76 and record non-GAAP operating earnings per share of $1.20. Net income included $26 million of after-tax net realized losses related to the sale of some investment securities to optimize our after-tax new money yields as well as unrealized losses from our public equities. For the fourth quarter, our annualized ROE was 10.4% and the annualized non-GAAP operating ROE was a very strong 16.3%. While the year began on a challenging note with the first quarter's higher-than-expected non-CAT property losses, results were extremely strong in the subsequent 3 quarters.

For the year, our non-GAAP operating ROE of 12.5% exceeded our long-term financial target of 12% for 2018. We ended the year with record levels of capital liquidity and feel extremely positive about our financial position.

For 2019, we have established a non-GAAP operating ROE target of 12%, which we believe is an appropriate return for our shareholders based on our current estimated weighted average cost of capital, the current interest rate environment and P&C insurance market conditions. Consolidated net premiums written increased 5% in the fourth quarter and were up 6% for the full year. Each of our segments contributed to the top line growth for 2018, including 6% growth in Standard Commercial Lines, 4% growth in Personal Lines and 7% growth in the E&S segment. Continued strong written renewal pure price increases and stable retention rates drove the growth in Standard Lines. We also enjoyed new business growth in Standard Commercial Lines in the quarter and for the year. The consolidated combined ratio was a solid 92.7% in the fourth quarter. On an underlying basis or adjusting for catastrophe losses and prior year casualty reserve development, our combined ratio was 93.1%. For the year, our consolidated combined ratio was 95%. Our x CAT combined ratio of 91.4% for the year was better than our most recent guidance of 92%, but above our original guidance of 91% going into 2018.

For the quarter, catastrophe losses added 2.4 percentage points to the combined ratio. Losses from Hurricane Michael accounted for $10 million on a pretax basis or 1.6 percentage points on the combined ratio, which was in line with our prior guidance for that event. We also incurred about $2.5 million of losses related to the California wildfires, which impacted our E&S operations in the quarter.

For the year, catastrophe losses accounted for 3.6 percentage points on the combined ratio, which was in line with our longer-term expectations of 3.5 points. We are pleased with this outcome given the relatively high level of insured catastrophe loss activity in the U.S., in 2018. Noncatastrophe property losses in the quarter equated to 13.3 points on the combined ratio, in line with our expectations. For the year, non-CAT property losses added 14.8 points to the combined ratio, which was 1.5 points higher than the comparative period in 2017 and elevated relative to expectations.

During the fourth quarter, we experienced $17.5 million of net favorable prior year casualty reserve development, which reduced the quarter's combined ratio by 2.8 percentage points. For the year, net favorable prior year casualty reserve development totaled $41.5 million and reduced the combined ratio by 1.7 percentage points. Partially offsetting this was an increase in our current accident year casualty loss picks compared to expectations, which impacted the overall combined ratio by 2.2 points in the fourth quarter of $17.5 million and 1.3 points for the year or $71 million, principally driven by commercial auto line of business.

Our expense ratio came in at 33.7% for the fourth quarter, which is up sequentially, but down a point compared with the year ago. For the year, the expense ratio was 33.2%, which is down 1.2 points from 2017, reflecting continued efforts to manage our expenses.

The profit base portion of our expense ratio, which includes supplementary commissions and performance-based compensations, was about 3.4 points in 2018, compared to 3.8 points in 2017, driven by a higher combined ratio in '18 compared to '17 and expected reversal of that benefit in 2019 will put some modest upward pressure on our expense ratio this year.

We remain focused on seeking areas of efficiency and cost savings while continuing to invest in our employees and in key initiatives around geographic expansion, enhancing our underwriting tools, technology and the customer experience. These ongoing investments position us well for the future as we build out our capabilities and strategic position in the marketplace.

Corporate expenses, which are principally comprised of holding company costs of long-term stock compensation, totaled $3.4 million in the fourth quarter, which is down $6.2 million relative to the comparative quarter. The primary reason for the reduction in the quarter was lower long-term stock compensation expense, resulting in part from the decline in our share price during the fourth quarter. Corporate expenses totaled $25.4 million for the year and are down $10.9 million relative to 2017, exceeding our $10 million long-term savings, which we highlighted in 2017.

As with the profit-base component of our expense ratio, there were some nonrecurring elements of corporate expense savings in 2018 that will put some modest upward pressure on corporate expenses in '19. That said, we expect the volatility in long-term compensation to decline modestly over time as a result of the structural changes we made to this program in early 2017.

Turning to investments. Fourth quarter net investment income after-tax was an excellent $44 million, up 42% from a year ago. Overall, the average after-tax yield of the fixed income portfolio was 2.9% during the fourth quarter compared to 2.2% a year ago. The average new money yield on the fixed-income portfolio during the fourth quarter was a very strong 3.3% after tax. The weighted average after-tax book yield on our fixed income portfolio of 3% at year-end positions us well going into 2019.

During 2018, we were able to increase our after-tax pretax book yield on our core fixed income portfolio by 47 basis points as we continued to tactically position investment portfolio to take advantage of rising rates without increasing credit risk or extending the duration of the portfolio. As an example, approximately 16% of the fixed-income portfolio is in floating rate securities, which reset principally on 90-day LIBOR. The book yield on these securities is benefited from the 111 basis point increase in 90-day LIBOR at 2018 and grossed 16 of the 47 basis points increase in our book yield in 2018.

In addition, we've also been actively managing our core fixed income portfolio on a sectoring and security level basis to increase the risk-adjusted yield. We were particularly aggressive in the fourth quarter given the market volatility that resulted in some good opportunities to raise our book yield, although it did result in a higher than normal level of realized losses, which we believe was a good trade-off.

Our average credit rating remains strong at AA- and the effective duration of our fixed income and short-term investment portfolio is relatively unchanged at 3.6 years.

Risk assets, which principally include high-yield fixed-income securities, public equities and our alternative investment portfolio, accounted for 7.2 percentage points of our -- of total invested assets as of the end of the year, down from 7.9 points a year ago. With the gradually diversifying our portfolio of risk assets and our longer-term target is up to a 10% allocation, although the timing will depend on market conditions and opportunities.

During 2018, we modestly de-risked the portfolio by trimming our allocations to public equities and high yield. Our other investment portfolio, which primarily consists of limited partnerships and private equity, private credit and real asset investments and reports on a 1 quarter lag, generated pretax income of $6.9 million for the quarter compared with $3.4 million in the year-ago period. For the year, this portfolio generated $17.8 million in pretax income compared to $12.9 million in 2017.

During the year, we entered into agreements to sell some of our pre-2008 vintage alternative investments for a pretax loss of $2.7 million to better manage potential downside volatility in this portfolio and create capacity for new commitments going forward.

Recall that our alternative asset performance is reported on a 1 quarter lag and that our first quarter 2019 results will reflect the asset outperformance for the full quarter of 2019, for which the total return on the S&P 500 Index was down about 14% and the Barclays High Yield Index was down 4.5%. An expectation of negative marks on the alternative portfolio for the fourth quarter is reflected in our 2019 after-tax net investment income forecast of $175 million.

As it relates to taxes. We had a very low 12.3% effective tax rate in the fourth quarter, which helped drive down our 2018 full year effective tax rate of 15.5%. This was driven by some capital loss carryback items to prior periods that carried the previous 35% statutory tax rate resulted in some permanent benefits in the tax line item in the fourth quarter. We consider this a one-off benefit. And as Greg mentioned, we are projecting a 19% effective tax rate in 2019. This benefit was excluded from non-GAAP operating income.

Turning to capital. Our balance sheet remains very strong with $1.8 billion of GAAP equity at year-end. Despite rising interest rates that put pressure on the market value of our fixed income portfolio, our book value per share was driven by strong earnings and was up 6.4% for the year adjusted for dividends. We continue to adopt a conservative stance with respect to managing our underwriting risk appetite, investment portfolio, reserving processes, reinsurance buying, catastrophe risk management. Our debt-to-capital ratio of 19.7% at the end of the year is trending below our longer-term target of approximately 25%, providing us with the flexibility to increase financial leverage if opportunities arise.

We generated adequate capital to -- through our operating earnings to sustain the top line growth rate of approximately 9% while maintaining our current leverage ratios. Our 1.4x premium to surplus ratio means that each point of underwriting margin equates to approximately 111 points of ROE. In addition, our 3.33x investment leverage implies that every 100 basis points of pretax yield from our investment portfolio results in 273 basis points of ROE. As it relates to our reinsurance program, we enjoyed a successful renewal of our catastrophe reinsurance program on January 1. We maintained our existing structure that keeps a 1 in 100 net PML from a major catastrophe risk, U.S. hurricane at a very manageable 2% of GAAP equity and a 1 in 250 net PML at 5% of GAAP equity. We modestly increased participation on the program to make room for new markets. And our renewal pricing reflected the loss-free status of our program and our continued efforts to generate strong renewal pricing in our property portfolio and continued efforts to diversify our exposure.

With that, I'll turn the call over to John to discuss our insurance operations.

John Joseph Marchioni
President & COO

Thanks, Mark, and good morning. I'll begin with an overview of the results of our insurance operations by segment and then review our key strategic initiatives to position us for continued success.

Our Standard Commercial Lines segment, which represented 79% of premiums in 2018, generated 6% net premiums written growth for the quarter and for the year. Net premiums written growth for the year was driven by stable retention of 83% and overall renewal pure price increases of 3.5%. This segment generated a combined ratio of 92.9 for the fourth quarter and 94.3 for the year. For the fourth quarter, renewal pure price increases remained strong at 3.4%, with retentions remaining stable at 83%. For the highest-quality Standard Commercial Lines accounts based on future profitability expectations, we achieved renewal pure price increases of 2.2% for the year and point of renewal retention of 91%. This cohort represented 49% of our Commercial Lines premium. On the lower-quality accounts, which represented 11% of premium for the year, we achieved renewal rate of 7.9%, while retaining 77% at point of renewal.

This granular approach to administering our renewal pricing strategy allows us to achieve additional loss ratio improvement through mix of business changes while continuing to deliver rate increases that equal or exceed expected claims inflations.

Going down to the results by line for Commercial Lines, our largest line of business, general liability, generated a combined ratio of 89.8 in the quarter and 88.6 for the year. Excluding umbrella, we achieved renewal pure price increases of 1.6% for General Liability during the fourth quarter and 1.7% for the year. Reserve releases were modest at $1.5 million in the fourth quarter. The workers' comp -- compensation combined ratio was 59% in the fourth quarter and 70.3% for the year. This line experienced $30 million of favorable prior year reserve development for the quarter as a result of lower-than-expected severities for accident years 2017 and prior.

Workers Compensation renewal pure prices declined 1.3% in the fourth quarter and were down 0.2% for the year. While reported profitability remained strong due to favorable emergence on prior year reserves, our current accident year results and those of the industry do not support the significant reductions in pricing that we were seeing across the country. While pleased with our performance in this line, we are maintaining underwriting and pricing discipline in the face of an extremely competitive marketplace. Commercial auto results were disappointing and remain a challenge for us and the industry. Loss frequencies have remained elevated for recent years, resulting in upward adjustments to our estimates for the prior and current accident year casualty results. The commercial auto combined ratio was 123.8 in the fourth quarter and 115.7 for the year. Results for the quarter included $12.5 million of unfavorable prior year casualty reserve development due to higher claim severities as well as elevated frequencies in accident years 2015 through 2017.

In addition, we increased the current year loss estimate during the quarter by $13.5 million to take into account the elevated loss experienced. We've been taking a number of active steps to address profitability to commercial auto, including renewal pure price increases that averaged 7% in the fourth quarter, which was in line with the level for the year. This is on top of renewal price increases averaging 6.7% in 2017 and 4.9% in 2016.

Most of the benefit of these changes has been offset by continued increase in loss frequencies and severities. As such, the elevated loss trend should support additional rate in 2019. We'd also continue to take a more conservative underwriting and pricing expense on higher hazard classes, resulting in a shift of mix towards lower and medium hazard accounts. Longer-term, we expect the introduction of Selective Drive to improve the performance of active accounts in that program.

Our commercial property book generated a 92.8 combined ratio for the fourth quarter and a 101 combined ratio for the year. Results in this line were negatively impacted by catastrophe and noncatastrophe weather losses incurred earlier during the year as well as a heightened frequency of large fire losses. While industry pricing for this line appears to be picking up, we believe it remains inadequate on a risk-adjusted basis, especially in the context of elevated losses over the past 2 years.

Renewal pure price increases for our commercial property business, excluding Inland Marine, averaged 4.6% in the fourth quarter and 4.1% for the year, having trended up throughout 2018. We expect industry-wide pressure in the line to result an additional pricing heading into 2019.

Our Personal Line segment, which represented 12% of premiums for the year, reported flat premium volume in the fourth quarter and 4% growth for the year. The Personal Lines segment produced profitable combined ratios of 91.8 in the fourth quarter and 95.8 for the year. We are pleased with the overall performance of this segment, which generated solid underwriting results despite generally elevated in weather-related losses from the year. We've made significant progress in lowering the expense ratio for this segment, which was 31.8 for 2018, excluding the benefit of the flood operation, compared with 34.9 for the prior year. The homeowners' line generated a combined ratio of 74.2 during the fourth quarter, benefiting from generally benign weather in our footprint.

Results for the fourth quarter included $1.5 million of prior year unfavorable casualty reserve development, which added 4.7 points to the combined ratio. For the year, the homeowners' line generated a 95.5% combined ratio. For the quarter and year, net premiums written were approximately flat compared with the prior year period due to a competitive pricing environment and efforts we've been taking to limit catastrophe exposure.

In Personal Auto, net premiums written increased 1% for the fourth quarter and 8% for the year. Top line growth rates have been declining as market competition has again picked up. Renewal pure price increases in our book averaged approximately 6.2% for the year. Our combined ratio of Personal Auto was 116.1% in the fourth quarter and 106.3% for the year. Prior year adverse casualty reserve development totaling $3 million added 6.9 points to the combined ratio for the quarter and 1.8 points for the year. On an accident year basis, our combined ratio was approximately 105. We continue to focus on our plan to improve the performance through price increases, mix change and expense ratio improvements. As these actions work their way through the book, we expect to see further margin improvement and our 2019 combined ratio expectation for this line is approximately 102.

Our E&S segment, which represented 9% of total net premiums written for the full year, generated 7% growth in the fourth quarter and for the year. We sacrificed growth during 2017 and the first half of 2018 as we addressed underwriting profitability and exited some unprofitable classes. We've begun to see improvement in profitability from these actions and plan to maintain our focus on this front as we've started to see a return to reasonable growth rates.

The combined ratio was 92.9% for the fourth quarter and 100.3 for the year. Renewal pure price increases in E&S averaged 2.9% during the fourth quarter and 4.7% for the year, with substantially higher price increases in targeting classes. While the relatively small size of the book could lead to some quarterly volatility, improved underwriting, pricing and claim outcomes have us on track to achieve our risk-adjusted profitability target for the segment by the end of next year.

I'll now switch to discuss some of our major strategic initiatives. We are always striving to make Selective a market leader, a truly unique company in our industry that can generate sustained operating and financial outperformance. To position us for the future, we continue to invest in and strengthen our sustainable competitive advantages, which are: one, our franchise distribution model with Ivy League agents; two, sophisticated tools and processes that allow our underwriters and claims adjusters to make better decisions faster; and three, an excellent customer experience delivered through top-notch employees and technological advances.

First, our extremely strong relationships with our distribution partners is a core competitive strength for us. Our longer-term Commercial Lines target is to attain a 3% market share in this region, in which we operate by appointing partner relationships approximating 25% of their markets and seeking an average share of wallet of 12% across those relationships. This call represents an additional premium opportunity in excess of $2 billion in our existing footprint.

During 2018, we've appointed 110 new distribution partners, including our newly opened geographic expansion states, bringing the total to over 1,320 partners and approximately 22 storefronts. Over the past 2-year period, a regional hub in the Southwest was established. Our franchise distribution model was a key element of our strategy in these new markets, allowing us to gain access to substantial business through a limited number of partner appointments. By limiting our appointments to approximately 40 across these 4 states, we are positioned to grow profitably with a small group of top-notch agencies. We are extremely pleased with the new business opportunities we are seeing at this early stage. Our focus in the coming years will be on building our operations in the Southwest and our thoughtful and deliberate manner.

Second, we continue to deploy sophisticated underwriting and claims tools that enable our personnel to make better decisions faster, creating greater efficiencies and improving outcomes. Our underwriters received real-time model driven underwriting and pricing guidance on every account, along with the tool to measure the impact of each decision on our overall portfolio. We have a process of deploying an underwriting workstation that will improve the efficiency of our underwriting staff, allowing them to handle larger portfolios without sacrificing our underwriting or pricing discipline. Our ability to clearly understand the risk-return characteristics of the business, on a granular basis and obtaining the appropriate price is a differentiator in the market. Our success is best demonstrated by our 10-year track record of obtaining market-leading renewal pure price increases while simultaneously maintaining and even improving retention rates.

On the claims side, we continue to utilize modeling and advanced analytics to segment our incoming claims inventory, resulting in improved outcomes and a better claims experience. We continue to invest in technologies that help us enhance overall customer experience and position us to increase retention rates and new business hit ratios over time. Our digital platform allows customers to interact with us in a 24/7 environment in a manner of their choosing. We've developed a 360-degree view of our customers, enhancing our ability to provide value-added services, such as proactive messaging, in relation to product recalls, potential loss activity or policy changes. We seek the partner with our agents on this customer-experience journey so that our customers will have a seamless experience regardless of how they choose to interact with us. Our Selective Drive program was introduced to policyholders in the fourth quarter. Leveraging connected Telematic centers, this platform helps commercial fleet owners with logistics management and improved safety by tracking and scoring individual drivers based on driving attributes, including phone usage while the vehicle is in motion. This program is provided to customers free of charge. We continue to invest in leveraging sophisticated technologies to provide our agents and customers, which should over time improve our retention rates and new business hit ratios.

Overall, we remain extremely pleased with our financial and strategic position heading into 2019, which we believe is the strongest in our history. We'll maintain a steadfast focus on underwriting discipline as we execute on our various strategies to generate profitable growth. The investments we are making today in our franchise distribution model, sophisticated underwriting claims tools and technology and enhancing the overall customer experience in omnichannel environment will position us as a leader in the coming years. With that, we'll open the call up for questions. Operator?

Question and Answer

Operator

[Operator Instructions] Our first question is coming from the line of Mr. Mike Zaremski with Crédit Suisse.

Michael David Zaremski
Crédit Suisse AG, Research Division

I -- Mark, you mentioned, I believe, in the prepared remarks about some, looking at my notes, pressure on the expense ratio, if I heard -- upward pressure on the expense ratio, if I heard correctly, if you could elaborate?

Mark Alexander Wilcox
Executive VP & CFO

Yes. Mike, that's exactly right. When you look at our expense ratio, we've made some what I would consider some durable benefit in reducing the expense ratio over time. We sort of peaked at 30.55% in 2016 and brought that down to a 33.2%, 230 basis points of expense ratio improvement over the last 2 years. What I was referring to was, there's an element of profit-based expense within the expense ratio and with a slightly high combined ratio than expected in 2018. As we would hope to normalize that going into 2019, there'll be a modest upward pressure. But we're talking sort of 0.2 here, it's not a material number. And then, of course, the ultimate expense ratio and the profit component will be a function of the loss ratio and our results in 2019. That's what I was referring to.

Gregory Edward Murphy
Chairman & CEO

Mike, and -- this is Greg. So -- there -- we're obviously making major investments for future growth opportunities. John touched a little bit of some of the things that we're doing in advanced analytics, decision management, the workstation that we're rolling out. I mean, when you think about what we're doing in CX and compare that to the competition or the fact that we are building more runway in our geo, geo expansion, what we're doing in the areas of safety, safety management, whether it's the drive product or other sensor technologies we continue to roll out on the system side, we've got a lot going on, on that front that it continue to refresh and make sure we have the best-in-class systems. But there's a lot that we do as an organization. And obviously, that's an enumerator and then on top of that is things -- profit-based things that Mark mentioned. But I want you know, are we focused on expenses? Yes. Are we going to expense our way to success? No. And so we are very strategic and mindful about how we manage and invest for the future. I think we strike that tuning fork to the best efforts.

Michael David Zaremski
Crédit Suisse AG, Research Division

Okay. No, I understood you guys have done a great job improving that ratio over time. My next question was, Greg, in the prepared remarks, you talked about an elevated -- the industry is experiencing elevated levels of frequency of, I think, property losses, but you can correct me if I'm wrong. Does that raise your expectation of the noncatastrophe property loss ratio?

Gregory Edward Murphy
Chairman & CEO

Yes, I would tell you that, we've seen -- obviously, you can see our separated CAT, non-CAT property, which is exactly the question. For us, that's why we've always disclosed our combined ratio x CAT so you could put in your estimate. We're very disciplined. We follow PCS. So if it's not a PCS event, it doesn't get included in our numbers. So our number is pretty pure relative to what a PCS loss would be and how it affects our results. But you're absolutely right, Mike. It's the -- it is the weather related and also severe property-fire-related pressure that we're seeing both on commercial property and home that have driven up the need for ongoing improved underwriting, whether it's hail, cosmetic damage, deductibles, whatever you do in terms of cost-sharing roofs when it comes down to the home side. And where you replace the roof where you repair and what is the co-participation between us and the insured on some of that. These are all issues that seem like -- again, and now we are in the middle of another polar vortex, which will be another issue possibly for the industry for the quarter. But it just doesn't seem that there is really any kind of significant diminishment of the weather-related activity other than knuckling down and doing the hard work.

Mark Alexander Wilcox
Executive VP & CFO

And if I just might add. The elevated level of noncatastrophe property losses that Greg mentioned has been factored into our expectations for the 92% underlying combined ratio for 2019. So there's a little bit of elevated loss cost trends going into '19 versus expectations going into 2018 that's factored into the forecast for the year.

Michael David Zaremski
Crédit Suisse AG, Research Division

Okay. Got it. And then my last question is on commercial auto. Thank you for the color again this quarter. Roughly for the full year 2018, what was the impact to the underlying commercial loss ratio? And how are you guys -- are you guys thinking things get a little bit in 2019 within your forecast?

Mark Alexander Wilcox
Executive VP & CFO

Mike, this is Mark again. Just very quickly on the numbers. When you look at the -- I think your reference was to the fourth quarter commercial auto results. We had both current and prior year pressure on the loss ratio. It was about 10 points related to the prior year and about -- just about 10.5 points related to the current year. So in total, call it, $26 million of pressure on the commercial loss cost line in the quarter adding, call it, just about 20.5 points on the overall combined ratio in the current period.

Michael David Zaremski
Crédit Suisse AG, Research Division

Yes. for the -- yes, for the current year. How about for the full year '18? I know it was -- it hurt the underlying by a couple -- 2.5% this quarter, just curious about the full year.

Mark Alexander Wilcox
Executive VP & CFO

Yes. So the full year, from a prior year development perspective, it was $37.5 million or about 7.6 points. For the current year, it was -- we actually took some pretty significant action and more so than we did in the prior year, so it was $29.5 million in terms of dollars and about 6 points on the combined ratio. So you include it in the underwriting loss for the full year is $67 million of prior and current year action of about 13.6 points on the full year. And that compares to the full year last year of $48.5 million or about 10.9 points in terms of current and prior year action.

Gregory Edward Murphy
Chairman & CEO

So Mike, let me try to make sure we got a couple of things. So let's just go by accident year. I think it's a lot easier to take some all the quarter ins, outs. And right now, roughly speaking, our '17 accident year for commercial auto is about 113, our '18 accident year is about 108 and we would expect some trend downward improvement -- because really that's your question: What's going to happen in '19? And we expect that to trend down. Is it going to be, as John mentioned, a huge step-down? No. But we are seeing, as John mentioned, some of the -- we are seeing some leveling out of frequency. We still have severity at very elevated levels in the '17 and '18 years on the commercial BI portion of that line. And John touched on it a little bit, hey, if we could get our drive product in more of our fleets, the more wheels on the ground, the better you are in terms of fleet management. And just do the Hawthorne effect of people getting game scoring on their driving, know where they are, distracted driving. It's a huge issue on the road. And between what we're doing on that front, ongoing rate, underwriting actions that we're doing relative to radius checks and there's a whole -- we're talking over like everything that we're doing in auto, but I will tell you there is numerous activities. And this isn't just -- this is not a hope strategy, I'll tell you that, Mike.

Operator

The next question is coming from the line of Christopher Campbell with KBW.

Christopher Campbell
Keefe, Bruyette, & Woods, Inc., Research Division

I guess my first question, just the overall x-CAT combined ratio guidance, it's basically like flat year-over-year with the updated guidance. I guess just -- I mean, how are -- how should we think about that just in terms of the pure rate that you guys are taking versus the loss cost trends? Are those kind of in balance and then that's why we would expect that to be flat. I guess just how should we think about that?

Mark Alexander Wilcox
Executive VP & CFO

Chris, this is Mark. Let me start. You're absolutely right. And I what I would say is, a cyclical rhythm is we have some investor conferences coming up in the next few weeks and we'll lay out in a bit more detail on a waterfall chart, walk you through the, call it, the underlying combined ratio in '18 which was 93.1 versus the expectations for '19, which is the 92 flat and give you a little bit more color. But we do have a little bit more loss trend factored into the trends for 2019, call it, close to a 3.8 loss trend in total. And that's largely offset by earn rate. A little bit of upward pressure on the expense ratios that I mentioned, but that's, call it, 0.2 point. And then the remaining that drive the margin improvement, call it, 110 basis points of margin improvement year-on-year is really underwriting mix that John spoke about, then claims improvement outcomes as well.

John Joseph Marchioni
President & COO

And this -- Chris, this is John. The only thing I'd add because I think, Mark hit it exactly right, at the risk of stating the obvious, that upward pressure we've built in a little bit in terms of our trend expectations is driven by the property and the commercial auto lines on the Commercial Lines side. As we've seen past trends move, that's reflected in how we think about future trend and as far, we've built a little bit more conservatism into our expected claim inflation going forward.

Christopher Campbell
Keefe, Bruyette, & Woods, Inc., Research Division

Okay. Got it. And then just kind of another -- I mean, a little bit deeper on that since you mentioned the commercial property. I guess -- and I think in the opening script, you mentioned like 10 consecutive quarters of higher core loss ratios in the property book. So I guess just -- I mean, how are you thinking about rates? And are you seeing competitors kind of starting to take this a little bit more seriously? Because it feels like if it's hitting your core losses for 10 consecutive quarters it is basically telling you you're underpriced in my opinion.

John Joseph Marchioni
President & COO

Chris, this is John. I think it's important to talk about our performance versus the industry performance. You have seen elevated losses on both industry performance and ours. Ours has been more driven by non-CAT property whereas the industry, I think, is seeing a little bit of movement on both the non-CAT and the CAT property sides. We've started to see -- and you see it in our prepared comments, we give you some rate detail by major line of business and over the last few Quarters, you've seen commercial property rates for us start to tick up a little bit and are running just over 4%. The industry movement that we've seen based on the industry's pricing surveys that we rely on has also been in the right direction. But it's still the low hour rate level and just a couple of points, but it's moving in the right direction. So I would say, when you look at the actual performance for the industry and then overlay a risk-adjusted combined ratio target because that's what we really have to focus on. We would view property as a line that you need to run at a much lower than average combined ratio over the long term because you're going to have this volatility that we're about and because of the short-tail nature of the line, you have to make sure it's your underwriting margins that are generated in the ROE because you're not going to get a whole lot of lift out of your investment returns on that line. So we've got a low-targeted combined ratio for that line that we're striving for. We continue to be a package underwriter so we can't just take a single view of that individual line. But we would see overall for us and for the industry, there is more rate needs than we're seeing in the marketplace right now.

Christopher Campbell
Keefe, Bruyette, & Woods, Inc., Research Division

Okay. Got it. And then I guess one final one for Mark. I guess, what's driving the larger net investment income guidance? I mean because how much of this is just the premium growth versus your interest rate assumptions? And then I guess how are you guys assuming interest rates move in '19?

Mark Alexander Wilcox
Executive VP & CFO

Yes, it's a good question, Chris. So the guidance for next year is $175 million of after-tax net investment income. And as Greg mentioned, that includes $8 million after-tax related to the alternative portfolio, which is down significantly from the $14 million of after-tax net investment income we generated from all -- in 2018. And that principally reflects what we would expect to be a choppy to down first quarter result and all it's based on what we show from the fourth quarter equity and credit markets given the lag in reporting. I did mention in my comments and we have it in the press release, it's sort of not necessarily a new metric, but say what we talked about the weighted average after-tax book yield in the portfolio as of the end of the year and that's right at 3%, call it, 2.97% and that's the core portfolio plus high yield. And that gives us a very good run rate and insight into expectations for net investment income going into 2019. We have a pretty stable set of cash flows now that we can anticipate. We do have investment rates. There's quite a bit of runoff in terms of principal repayment and coupon interest that we reinvest. So we have some reinvestments rates. We did talk a little bit about the big jump in LIBOR in 2018. We were not expecting to see a similar trend going into 2019. It's always difficult to forecast where interest rates are going to go. And things are different today, very different today than they were just 45 days ago. But our expectation is for a relatively flat interest rate environment going into 2019. A lot of that investment income related to that book yield that we have increased 47 basis points. Worked hard over the last year to increase that. And then really the wildcard is the alternative investment income. It's a very strong year in '18. We're projecting it to be down significantly in '19. But there's quite a bit, like CAT, obviously, there's quite a bit of volatility around projecting alternative investment income.

Gregory Edward Murphy
Chairman & CEO

So Chris, Greg, when you think about 2019, which in our opinion, it's already done from an underwriting standpoint with the exception of whether activity and property losses. I mean, your ability to effectuate improvement in your results, it's too late. Companies are now working on '20 because any -- unless you already have your written rate, your unearned premium, you're not moving it. So to tie together all the comments that Mark touched on, so when you think about our unearned premium level at like 3.5 rated at just for Commercial Lines, higher than that in E&S, similar to kind of that in the Personal Lines area and then when you think about a relatively -- we love this interest rate environment. We'd like to keep it stay like this for extended periods of time because it forces underwriting and when it -- we believe we're an excellent underwriting company. And for every 1 point of combined ratio, we get 1 point of return on equity. That's more than 2x the industry. So our ability to outperform on a combined ratio basis is significant. But Mark touched on it, no different than -- I just kind of walked you through the renewal inventory and where we are. What market's telling you, based on the product, the investment product that we've got on the books on the core and high-yield fixed-income side, we're looking at an embedded yield already of 3 after-tax. And it's not fair but 3 times 3.33x gives you an idea of the ROE that's already in there. And then what's going to push that one way or another is what happens to rates moving out in the rest of the year, which we don't believe we're going to see a lot of movement. They are -- we've pruned some of our alternatives to reduce our volatility, to improve profitability. Again, we're coming into the year with a solid reserve position as something that we've always kind of managed to prior ourselves on as an organization. So when you think about what's happening, cash flow at 18% of premium is an exceptional number. So our cash underwriting combined ratio is extremely strong. And those are the things that are going to drive performance in '19. But '19's pretty much already -- I don't want to say it's over because it hasn't really started yet because we just turned to February 1, but the -- our 2,300 employees will work very hard, they're best-in-class, our 1,300 Ivy League agents are focused around how we grow the organization this year in terms of new business and business opportunities because pretty much all of the core work and to set improvement and profitability one way or another -- and there's always tuning around the edges, but it's more of a '20 event than it is a '19 event.

Operator

The next question is from Mr. Paul Newsome of Sandler O'Neill.

Jon Paul Newsome
Sandler O'Neill + Partners, L.P., Research Division

The -- I was hoping I could sort of beat the dead horse of the Commercial Lines just one more time. And I just really kind of -- I want your thoughts on what you think is truly happening underneath the hood in terms of more beyond trend. And I guess some of the concerns the folks have had, not necessarily just for Selective, but broadly speaking as to why some of the things like higher attorney usage wouldn't necessarily spread to other lines of insurance, like general liability or workers' comp, general liability?

John Joseph Marchioni
President & COO

Paul, this is John. I think it's a great question. Social inflation generally is something we're very mindful of and keep track of. I will tell you that we are at this point yet to see a significant movement in any of our major lines, liability lines of business relative to litigation rates. And to a lesser extent, and it's a little bit harder to track as specifically, just pure attorney involvement regardless of whether the file is in litigation or isn't litigation yet. Do we believe that, that's a trend that might shift going forward? We do think there is a risk of that, but we have not seen that to this point. Now remember, for us, we do tend to write a lower and medium hazard style of business across all of our lines. Do we write some higher hazard classes, do we write some heavier in-class vehicles and heavier in-class exposures on the liability side? We do. But we're predominantly a low- and medium-hazard writers. So as a result of that, the types of losses that make up the majority of our liability inventory across all lines tends to be of a less-hazardous exposure base. So it doesn't mean that we would be immune for it by any stretch, but that's a consideration. The other thing I'll say and it's been a big focus of our claims operation because we don't just focus on lowering outcomes from a loss and loss adjustment expenses perspective; we also focus on the claimant experience side of things. And a big part of that focus is early communication with claimants. And I will tell you, there's nothing better to getting a claim resolved in a fair outcome for everybody involved by early and clear communication on a claim and in many cases, litigation can be avoided which is everybody's benefit when you have good, solid communication up front. And that's been a great focus of our claims team and, I think, helps us on that front.

Jon Paul Newsome
Sandler O'Neill + Partners, L.P., Research Division

Do you expect some of these efforts on the technology side that you discussed to impact the frequency more than the severity or is it evenly -- I mean, I'm just kind of wondering how we might see the impact of some of this technology that's been put in these trucks and such to improve the claim process?

John Joseph Marchioni
President & COO

Yes. So I mean, we're speaking more specifically around Selective Drive?

Jon Paul Newsome
Sandler O'Neill + Partners, L.P., Research Division

Yes.

John Joseph Marchioni
President & COO

Yes, so our view is that, that should impact both frequency and severity. Frequency on the basis that drivers with the sensors in their vehicles knowing that their management is scoring drivers, that should certainly improve frequency as people start to exhibit better driving behavior and are less likely to be working their phone when they're driving. But it will also impact severity. If you believe that, in fact, accidents caused by distracted driving are going to have -- probably going to average high severity to that because you're going to have more head-on collision type accidents in a lot of cases because of distracted driving. But again, that's a technology that is in the very early stages. We've rolled that out in the fourth quarter. We're in the process of seeing increased take-up rates. But that is going to take some time before a significant portion of our book has that technology deployed. But we do think as customers start to see the benefit of that, it will improve performance. But we also can't lose sight of the fact that -- you heard a little bit of this earlier in our response to the earlier question relative to frequency and severity trends in commercial auto, and I think this applies to personal auto as well -- even if all of this focus around distracted driving and better driving habits starts to favorably impact frequencies, you do still have pressure on the severity side, partly on the liability front because of the social inflation aspect. But also because there is some impact on the liability lines because of the cost of repairing vehicles being higher. It certainly affects your physical damage more so, but it also leads its way into PD liability as well. So that could continue to put a little bit of above-normal inflation pressure on severity going forward.

Gregory Edward Murphy
Chairman & CEO

And so let me just -- and I believe that the drive in the organization is really a trifecta in here and you kind of touched on one of them, is obviously lowering and improving your loss cost, but also there's an element of hit ratio. We expect to our hit ratio to go higher at point of sale offering this product versus a company that doesn't have this product. And then as you build it in the inventory and customers get a better handle on how it's helping them better manage their fleet, better manage fuel costs, in some cases, some of our insurers are paying for this service to another third party. And we're offering it free as part of the Selective offering, I think it will improve retention as well. So there is a -- it's most likely the trifecta when you start to look at how this will drive improvement. But are we worried about driving, driving behavior, roads, poor road condition and then say it on top of that, the ongoing increase of legalization of marijuana state to state in some cases and what that does to add another element of problem on the road, does that concern us? Yes. So we have to combine all of those factors as we move forward when we think about pricing and we think about what we do to manage our exposure. But we're in the business. What we write it -- all of our products principally are written on an account basis. So whether it's Comp or Auto or General Liability, we are -- we try to be to our best efforts a full account underwriter.

Operator

[Operator Instructions] The next question is coming from the line of Mr. Mark Dwelle of the RBC Capital Markets.

Mark Alan Dwelle
RBC Capital Markets, LLC, Research Division

Just a couple left here that haven't already been thoroughly ploughed fields. The one -- first question I had and then you've already covered a lot on the investment portfolio. But for the alternatives in the first quarter, is it right and appropriate to assume that's probably going to be a negative number in the first quarter?

Gregory Edward Murphy
Chairman & CEO

Yes.

Mark Alexander Wilcox
Executive VP & CFO

Yes. Mark, that's right. It's a difficult one to estimate but our expectation is that there'll be a negative mark. There's not a lot of data out there. We have a diversified portfolio of about 60 funds across private equity, private credit, real assets, which include energy, infrastructure and real estate. Clearly, public equities was down significantly in Q4. Energy was a very, very tough fourth quarter and with a lag in reporting those trends to be reflected in Q1. Just from a -- there's not a lot of data points, but Apollo and Blackstone released earnings last night. They provide a little bit insight into how their portfolio did from a fee perspective and for both of them. Both the private equity portfolio and credit strategies were down in the fourth quarter. So as Greg said, yes, we would expect negative marks in Q1 related to the old.

Gregory Edward Murphy
Chairman & CEO

And obviously, that, Mark, that shrink wraps into the $8 million after-tax number. So we properly sized our expectation for the year, expecting a little bit lumpiness. But a lot of the energy prices have snapped back. It was a good number. Good print on Exxon this morning. And so things are -- there is some gas shortages throughout the country and some of our suppliers, our midstream on the gas side and others. So those all -- again, one quarter doesn't make a year.

Mark Alan Dwelle
RBC Capital Markets, LLC, Research Division

Sure thing, yes. Yes, maybe second quarter will be a snapback. The second question I had, Mark, somewhere in your comments and I kind of lost track of where, you referred to your flood business, was that -- there were a number of floods around the country in the fourth quarter, was that a meaningful impact to the expense ratio in the quarter?

Mark Alexander Wilcox
Executive VP & CFO

Look, it's Mark. The reference I think related to the benefit on the Personal Lines expense ratio, which is more the kind of the durable benefit, which has commissions that we generate, the fees we generate from flood. We do generate claims-handling fees from flood. There weren't any material floods in Q4. The majority of the benefit now that we -- both for the full year was in Q3 related to Florence and that was about $1 million. But there wasn't anything significant in the fourth quarter that drove the results.

Operator, are there any more other questions on the line.

Operator

Speakers, at this time, there are no further questions.

Gregory Edward Murphy
Chairman & CEO

Great. I appreciate the level of dialogue. If you have any follow-ups, Rohan is available. Mark's available. And thank you very much for your participation this morning.

Operator
Thank you. This concludes Selective Insurance Group's Fourth Quarter 2018 Earnings Call. Thank you for participating. You may now disconnect.