S&P Global
Market Intelligence

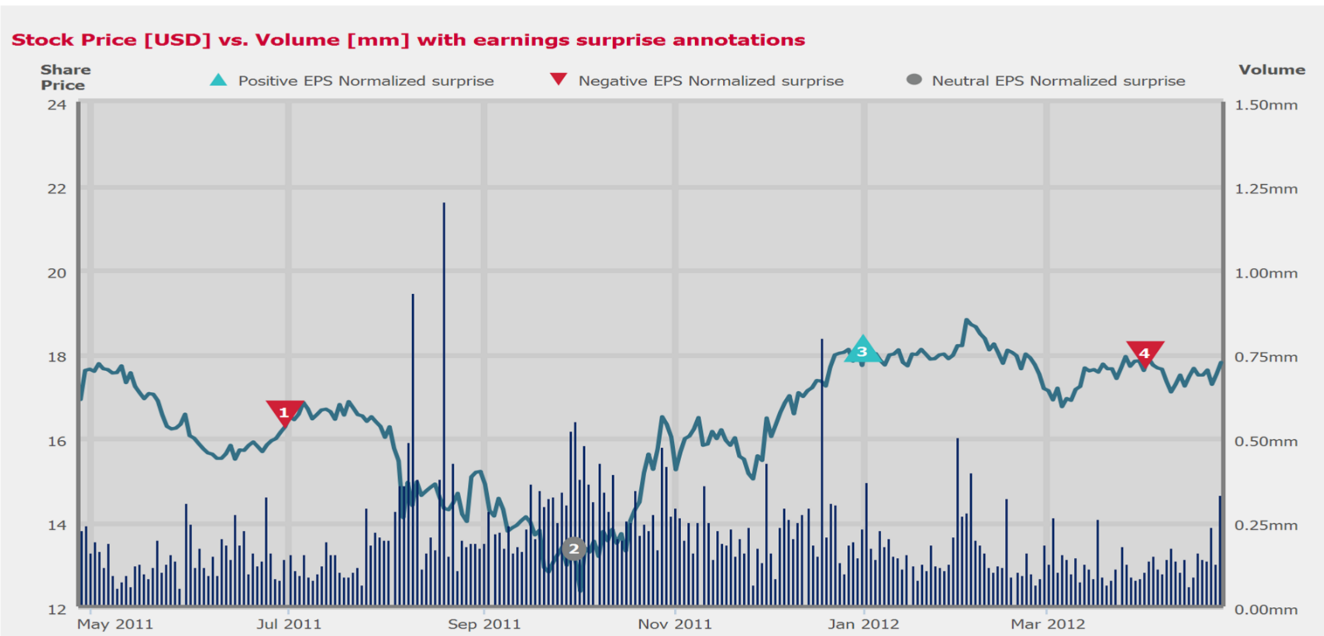
Selective Insurance Group, Inc.
NasdaqGS:SIGI
FQ2 2012 Earnings Call Transcripts

Thursday, July 26, 2012 12:30 PM GMT

S&P Global Market Intelligence Estimates

	-FQ2 2012-			-FQ3 2012-	-FY 2012-	-FY 2013-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.01	0.01	0.00	0.36	1.06	1.63
Revenue (mm)	434.03	428.91	(1.18 %)	441.11	1742.42	1887.88

Currency: USD
Consensus as of Jul-26-2012 1:28 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ2 2011	0.02	0.01	1 (50.00 %)
FQ3 2011	(0.45)	(0.34)	NM
FQ4 2011	0.31	0.33	2 6.45 %
FQ1 2012	0.37	0.28	3 (24.32 %)

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Call Participants

EXECUTIVES

Dale Allen Thatcher
Former Executive VP, Treasurer & CFO

Gregory Edward Murphy
Chairman & CEO

Jennifer Wilson DiBerardino
Former Sr. Vice President, Investor Relations & Treasurer

John Joseph Marchioni
President & COO

ANALYSTS

Alison Marnie Jacobowitz
BofA Merrill Lynch, Research Division

Drew Woodbury
Morningstar Inc., Research Division

Raymond Iardella
Macquarie Research

Robert Edward Farnam
Keefe, Bruyette, & Woods, Inc., Research Division

Robert Paun
Sidoti & Company, LLC

Ronald David Bobman
Capital Returns Management, LLC

Scott Gregory Heleniak
RBC Capital Markets, LLC, Research Division

Presentation

Operator

Good day everyone. Welcome to the Selective Insurance Group Second Quarter 2012 Earnings Release Conference 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, Ms. Jennifer DiBerardino. Ma'am you may begin.

Jennifer Wilson DiBerardino
Former Sr. Vice President, Investor Relations & Treasurer

Good morning, and welcome to Selective Insurance Group's Second Quarter 2012 Conference Call. This call is being simulcast on our website and a replay will be available through August 24, 2012. A supplemental investor package, which includes GAAP reconciliations of non-GAAP financial measures referred to on this call is available on the Investors Page of our website, at www.selective.com.

Selective uses operating income, a non-GAAP measure, to analyze trends in operation. Operating income is net income excluding the after-tax impact of net realized investment gains or losses, as well as the after-tax results of discontinued operations. 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 that will be 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 to Selective's 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 statements.

Joining me today on the call are the following members of Selective's Executive management team: Greg Murphy, CEO; Dale Thatcher, CFO; John Marchioni, EVP of Insurance Operations; and Ron Zaleski, Chief Actuary.

Now, I'll turn the call over to Dale to review the quarter’s results.

Dale Allen Thatcher
Former Executive VP, Treasurer & CFO

Thanks, Jen. Good morning. Catastrophe events in the second quarter once again masked the continued improvement in our underlying results. Despite $30 million of catastrophe losses resulting from the latest storms, we continued to improve commercial lines pricing while maintaining very strong retention levels. For the quarter we reported operating income for diluted share of $0.01 versus $0.00 a year ago. As we stated in our pre-release, the biggest impact on earnings was catastrophe losses, but lower than anticipated net investment income also contributed.

The second quarter statutory combined ratio of 106.2% was a 3.3 point improvement from the year ago quarter. Catastrophe losses in the quarter were $30 million pre-tax or 7.7 points versus 10.7 points a year ago. Favorable prior year casualty development of $5 million or 1.3 points partially offset these results. As indicated last quarter, the expense ratio was slightly elevated due to additional underwriting expenses related to the E&S operations.

On acquisition, MUSIC's unearned premium was fully seeded back to Montpelier which results in the GAAP underwriting expense ratio being under some additional pressure until the premium that we write is earned and is able to support the ongoing expenses of these operations.

Total statutory net premium written was up 14% in the quarter with commercial lines up 15%. The increase was driven by our 6.5% standard commercial lines renewal price, strong retention and our E&S business which contributed $28 million.

Audit and endorsement additional premium continued to benefit the top line adding $6 million in the quarter. This is a positive indication as this marks the fifth consecutive quarter of additional audit and endorsement premium.

Standard Commercial Lines pure price was up 6.5% and retention improved to 82% from 80% a year ago. For the quarter, the Commercial Lines statutory combined ratio was 105.6% including 5.8 points of catastrophe losses. Commercial property ex-cat continued to perform well with the statutory combined ratio of 87.7%. Commercial auto also turned in another good quarter with a 96% combined ratio.

The BOP line ex-cat reported a second quarter statutory combined ratio of 85.7% including favorable prior year development of 14.5 points. Personal Lines net premium written grew 8% in the quarter to $77 million and we achieved 5.6% rate on the book. The statutory combined ratio however was 109.2% and included 16.5 points of catastrophe losses.

The homeowner's ex-cat combined ratio improved 4.5 points from a year ago to 82.3% as we have driven significant rate in this book of business. We successfully completed placement of our July 1, 2012 excess of lost treaties. The casualty excess of lost treaty was renewed with substantially the same terms as expiring and continues to provide $88 million in coverage in excess of our $2 million retention.

We expanded our property excess of lost treaty adding an additional $10 million and limit to the top layer. The treaty now covers $38 million in excess of $2 million retention. Pricing on the program was flat as reinsurers benefit from underlying primary price increases while maintaining their own expiring rates.

Turning to investments, second quarter after tax net investment income declined 13% from a year ago to $26 million. The decline was largely driven by alternative investments which produced after tax income of $2 million in the quarter versus $5 million last year. The older vintage character of the alternative investment portfolio leads to lumpiness in reported income from quarter-to-quarter. Market volatility and a slower merger and acquisition pace due to the economy negatively impacted the private equity portfolio as results are not highly correlated with the S&P 500.

In the second quarter, we added the alternative portfolio with 2 new investments in the mezzanine financing strategy. We invested capital in one fund over the course of the quarter and have committed capital to the second fund as seen in the exhibit on Page 18 of the investor packet.

Invested assets increased 4% from a year-ago to $4.2 billion. The after-tax yield on fixed maturity securities was 2.6% for the quarter, flat with last quarter and down about 20 basis points from the year ago period. We maintained an overall credit quality of AA minus in the fixed income portfolio, and increased duration slightly to 3.3 years including short term investments. We continue to invest in high-quality corporates and selectively in the municipal sector.

Our unrealized gain position improved to $172 million pre-tax as of June 30 from $102 million a year ago. Also of note is the quarter end unrecognized gain in the fixed income held to maturity portfolio of $44 million pre-tax or $0.53 per share after tax.

Surplus in stockholders' equity remained strong at $1.1 billion at June 30. Book value per share increased 2% to $19.75 from $19.31 at June 30, 2011, which has been restated to reflect the adoption of a deferred policy acquisition cost accounting change on January 1, 2012. Our premium in the surplus ratio was 1.5 to 1. We continually review capital management options to maximize shareholder return.

Now, I'll turn the call over to John Marchioni to review the insurance operations.

John Joseph Marchioni
President & COO

Thanks, Dale. Good morning. Through our commercial lines underwriting and pricing sophistication, we achieved our 13th consecutive quarter of price increases, with 6.5% in the second quarter, ahead of the 5.1% we achieved in the first quarter. This is a good result, given the still competitive commercial lines market and continued weak economic environment. Our ability to push price while maintaining strong retention levels is a testament to both our granular pricing strategy and superior agency relationships.

We provide our underwriters with the business intelligence they require to price by line and by class of business to actuarially sound rates. We have been successful with commercial lines pricing by targeting rate where we need it the most. By line, we are getting high single digit price increases in workers' compensation, general liability and BOP while averaging 6.5% on the overall commercial book in the second quarter.

In fact, as we track pricing of retention by quality of account, we achieved 14% pure rate on our lowest accounts with a retention of 68%, while our highest quality accounts retained at 89% with a pure rate increase of 5%. This differentiation will lead to mixed improvement as we continue to achieve overall rate increases in excess of loss trend. Having this data allows us to take a granular approach to pricing and refine our strategy.

The dynamics in the commercial lines market place are such that some carriers were pushing rate across the board at levels not supported by the current market. Many of these carriers are now backing off pricing somewhat to avoid large drops in retentions levels. This has caused some changes in that market where we believe we have an advantage over carriers as the sophisticated tools and agency relationships we have in place make it easier to react to a change in marketplace.

Market pricing for new business remains inconsistent, creating less adequately priced new business opportunities this quarter. As a result, new business in the second quarter totaled $59 million, which was down sequentially from $70 million in the first quarter. By market size, new business versus a year ago was as follows:

Small business was flat at $19 million and middle market and large account business was up 9% to $40 million.

Personalized net premium grew 8% in the quarter, while new business was flat with the year-ago period. The second quarter catastrophes that occurred in our footprint had a significant impact on personalized profitability, adding 16.5 points to the combined ratio, including 37.4 points in the homeowner's line. However, our homeowner's ex-cat combined ratio improved 4.5 points from a year-ago period to 82.3 as we have not only driven rate across the book, but it made underwriting changes including significant changes to deductibles in order to achieve profitability in this line.

Weather-related losses are always a factor in homeowners and drive the need for not only price increases but a meaningful shift in cost sharing and other underwriting changes to get this line to an acceptable profitability level.

We are pleased with the improvement in our underlining results and we'll continue to push rate and refine our underwriting initiatives to generate further profitability improvement in this line to a target range of high 80s combined ratio in a normalized catastrophe year.

Overall filed personalized rate increases that were affected for the quarter averaged 5.6% while retention held steady at 87%.

Earlier this month, the President signed a law extending a National Flood Insurance Program until September 30, 2017. As the sixth largest writer of flood premium, we view this as a positive development. This is the first time since 2004 that an NFIP long-term re-authorization has taken place.

In addition to the 5-year extension, the bill increases the annual limitation on premium increases from 10% to 20% as well as other changes to move the program towards charging adequate rates.

As a Write Your Own carrier, our flood premium is 100% seated to the federal government and we receive revenue through servicing fees, without any loss exposure.

Our E&S operations are fully integrated and contributed $28 million in net premiums written in the quarter. This business is now written on MUSIC paper. Pricing is beginning to build as the market improvement we are seeing in the standard lines business is making its way into the E&S space.

In the short term, results will be negatively impacted by the fact that earned premium will take some time to catch up with expenses while we are pleased with the progress we are seeing to-date in the E&S.

Lastly, I'd like to mention that the change in our A.M. Best's rating to "A Stable" appears to have had no impact on our operations. Our agents tell us that it has not encumbered their ability to write the best quality business with Selective, as the majority of our competitors operate at or below an A rating. Agents are selling Selective superior products and service. Our 80-plus-year history of being rated A or better from A.M. Best is a testament to our longstanding financial strength.

Now, I'll turn the call over to Greg.

Gregory Edward Murphy
Chairman & CEO

Thanks, John, and good morning. We do not view the current commercial lines market conditions as hard by any measure. In fact, the conditions are constantly changing. As the commercial lines marketplace began to firm last year, some of our competitors attempted to quickly raise prices on an across-the-board basis. As these companies strive to decipher what level of price the market will support, their rate increases appeared to be moderating. Our strategy has been to work in partnership with our excellent agency force to achieve the rate necessary to improve profitability while still focused on retention. We are still very comfortable with the commercial lines marketplace given the still very competitive commercial lines market place and the weak economic environment we are comfortable with our three year target of 5% to 8% rate increases.

What's not changing in the industry is the low interest rate environment and the elevated level of catastrophe losses. Both of these factors continue to weigh on the industry results and should be the impetus for driving significant commercial lines pricing power. However, the market continues to limp along with very inconsistent industry-wide new business pricing. Due to our sophisticated underwriting tools we are better positioned to deal with the fluctuations in the marketplace. Our AMSs have the ability to evaluate new business opportunities and price them appropriately with the aid of our new models which are going through their third generation roll out, with the dynamic portfolio manager our inside underwriters have the tool they need to evaluate their entire book of business and the impact that their underwriting decisions have on profitability.

Carriers without this level of sophistication will not be able to adapt to the market that's ever changing. We've demonstrated our ability to manage the market cycle by reducing premium growth when the markets are highly competitive and achieving commercial lines renewal price increases well ahead of the competition.

At 6.5% and an 82% retention for the quarter, our commercial lines price increases are comfortably in the 5% to 8% band that we projected. For the full year 2012 filed home rate is expected to top 10% while auto should be around 6%. Ongoing personal and commercial lines pricing efforts coupled with other underwriting and claims initiatives should enable us to achieve a 95% combined ratio by 2014.
Our claims initiatives have already delivered 1 point of loss cost savings and are progressing nicely towards our 3 point goal. Underwriting improvements, although masked by catastrophe losses, are having the positive impact we expected while we continue to actively manage expenses. While I'm pleased with the underlying improvements in our business through the first half of the year as a result of catastrophe losses and continued pressure on investment income from alternatives and the low interest rate environment, full year 2012 guidance is being revised to, one, a statutory and gap combined ratio between 102 and 103, which does not include any reserve development assumptions either favorably or unfavorably, catastrophe loss estimates of 3.5 for the full year, investment income between $100 million and $105 million after tax, weighted average shares outstanding of $55.6 million. Now I will turn the call over to the operator for your questions.

Question and Answer

Operator

[Operator Instructions] Your first question comes from Ray Iardella, Macquarie.

Raymond Iardella
Macquarie Research

A quick question I guess on pricing in July. I know - I think I asked the question last time about April. Any early indications in terms of commercial enterprising for July?

John Joseph Marchioni
President & COO

Ray, this is John. We are not going to give out pricing for July at this point but I think as you heard during the prepared comments from both myself and Greg, you are seeing a change in the environment. We feel like clearly the reported numbers are well within that 5 to 8 range that we felt the market needed to bear over the next couple of years, and I would say as we sit here today we feel good about maintaining those sorts of levels as we look forward into the coming quarters.

Raymond Iardella
Macquarie Research

And maybe touching on commentary around the audit premium, I know Dale had mentioned some tailwind in terms of premium from audits. But, John, I think you had mentioned the weak economy is still sort of inhibiting some of the growth in the business. I'm just curious - I mean, kind of what are your expectations going forward in terms of the economy and particularly I guess how it relates to the contractor’s book.

John Joseph Marchioni
President & COO

I would say the reference was to a continued weak economy, and clearly with that continued economic environment we saw stability relative to audit premium changes both up and down, and I would say as long as you continue to see the key economic indicators hover around the levels that they are at, you wouldn’t expect to see a big movement in either direction on audit premiums, and certainly contractors will be a bit of a leading indicator going forward depending on what starts to happen in the housing market, which has been a little bit up and down in terms of prognostications in the last month or 2.

Dale Allen Thatcher
Former Executive VP, Treasurer & CFO

One thing I would like to clarify Ray is that the audit premium for the last 5 quarters has turned over to an additional premium. So it’s actually a favorable for the last 5 quarters. Prior to that in the ’08, ’09 and ’10 timeframe is when we had the return premium that was causing a headwind. So now we definitely are having a small positive anyway from the audit premiums as we see stability. Still a weak economy but as John indicates it’s at least stabilized.

Raymond Iardella
Macquarie Research

Okay, that’s helpful. Then a last question, a quick numbers question for you Dale and then I will re-queue. Any development on the personal line side of the business or reserve development?

Dale Allen Thatcher
Former Executive VP, Treasurer & CFO

Yes, we did have small development there where we had basically adverse development in personal auto of $1 million and favorable development in home owners of $2 million.

Raymond Iardella
Macquarie Research

Okay and then the personal auto side is that DI severity I'm assuming.

Dale Allen Thatcher
Former Executive VP, Treasurer & CFO

Yes basically it's…

John Joseph Marchioni
President & COO

It's a constant drag between PIP [ph] and DI [ph].

Raymond Iardella
Macquarie Research

Okay, fair enough. I will re-queue.

Operator

Your next question comes from Alison Jacobowitz, Bank of America Merrill Lynch.

Alison Marnie Jacobowitz
BofA Merrill Lynch, Research Division

If I could just confirm one question, just the number upfront, the $5 million of reserve development, that's net of everything, correct?

John Joseph Marchioni
President & COO

That's correct.

Alison Marnie Jacobowitz
BofA Merrill Lynch, Research Division

Okay. And so then the real questions, I was wondering if you could talk about the expense ratio and how that - the timing of the earned premium, I think if I calculated correctly it was 35.5 in the quarter. How that plays out over the next several quarters if you could just help out with the timing maybe for the model and then as far as the guidance, your own outlook is concerned, last quarter I think it was 102.5 combined ratio with 2.5 points of Cats. And then the change this quarter is basically - you gave a range but you gave a Cat number that could go a couple of points higher. It feels like you improved your underlying underwriting outlook for the accident year ex-reserves for the second half of the year, this quarter versus last, and that you expect some improvement there. I'm just wondering if I'm getting that right.

John Joseph Marchioni
President & COO

Well lots of questions embedded in that long question but I will try and handle all of them and we'll figure out what I missed.

Alison Marnie Jacobowitz
BofA Merrill Lynch, Research Division

Sorry.

John Joseph Marchioni

President & COO

Basically we revised our guidance to be between 102 and 103. Previously the statutory combined ratio was expected to be at 101.5. So the 3.5 points of catastrophe losses basically says we are taking the actual Cat losses for the first 6 months and we are keeping our original estimate of 2.5 points of Cat losses in the remaining 6 months. So if you take the actual 6 plus 2.5 for the remaining 6, you end up with about a 3.5 point Cat load for the full year. So hopefully that makes sense. As far as expense ratio, when I look at the statutory underwriting expense ratio is at 32.5%. The GAAP expense ratio is going to be the one that's higher because of the fact that the E&S premium is not yet earned in fully but you've got full running operations there. So basically that's going to come back down a little bit over the course of time. I guess the best way to look at that is I kind of use the stat expense ratio as a way to project the future GAAP expense ratio. Because you are using the stat, you are using it on a written basis, so you will end up seeing that benefit ultimately come through on the GAAP once you have the written premium coming through at a fully earned basis.

Gregory Edward Murphy
Chairman & CEO

Alison, this is Greg. The only thing I would add, if you look at relative to the performance, and John touched on this before, what we're pleased about is the 650 rate in the commercial lines which is ahead of our plan and not only that but strong retention at 82, which is probably slightly better than what we expected to get that kind of rate level. So, that kind of improvement really doesn't affect the current year that much. It will have some very mild impact. I mean more of that gets pushed out into the '13 year and that - so that's the thing that we look at relative to performance. I don't think that our loss trends have changed at really much from what we prognosticated during the year. So I don't think you're really seeing anything specific in the guidance directing you one way or another other than what we've already achieved.

Operator

Your next question comes from Drew Woodbury, Morningstar.

Drew Woodbury
Morningstar Inc., Research Division

I was wondering if you could give me some more specific commentary on the pricing market. The difference between national and regional players where you're seeing competition there, specialty versus primary, where are the most aggressive nature? Basically it seems that your rate increases are accelerating like you're not very bullish in the pricing market in general and hardening. So I'm just trying to reconcile those things.

Gregory Edward Murphy
Chairman & CEO

Yes, this is Greg and I'll let John comment too. I mean some of the things that we're looking on, obviously when you look at the amount of new business we wrote sequentially that was down, that tells us that companies are now trying to hunker down on their renewal inventory and protect that better. And you've got to really think about it from the standpoint that we operate in. Most company's new business opportunities are other company's renewal inventory. So as that protection starts, that starts to slow down the capability to drive rate and I think when - you got to really look at it as - as we look at driving rate across our book, for us to get elevated rates in totality, we need to go deeper into the inventory, to go deeper into the inventory that could cause more accounts to be pushed out into the marketplace as competition on the other side is very aggressively trying to market your business. This is what creates that cyclical side of trying to push rate and we feel that if any company out there, we've demonstrated the ability when no one was getting price increases, we were able to get lost trend, we feel very positive about that, we think it's reflective of our capability. But now that we've gotten rate level at 6.5 and 82% retention, we feel that we're at a point that we're comfortable in. As we told you in our Investor Day, we thought rate level of 5% to 8% over the next 3-year period is what we needed to have. And if you take the mid-point of that, that's 6.5 and that's exactly where we are. We're not saying we're stopping there, but certainly we're running into a resistance point out there because some companies now have gotten pretty aggressive in writing new business. John?

John Joseph Marchioni
President & COO

Yes, and just to add a little bit to that, I think we've clearly hit our stride in terms of managing rate retention, we've been at this for 13 quarters. We've built it in a very measured way over that time period, we looked at our retentions in a very granular fashion to understand what's happening. But the reason I think we're not bullish over the market continuing to move directionally is, what you saw is as companies who are later to the game and starting to drive price jumped in with an aggressive first step, and really went across the board with some pretty high single digit numbers, and then they sat back at the end of the quarter, looked at their retentions, saw a pretty significant dip and made a correction in the second quarter. I think what we're seeing now is other companies who just jumped into this trying to find their way a little bit and that will cause that quarter-to-quarter volatility relative to new business and our expectations relative to price on our own book of business. So we think it's sustainable, but we think you're going to have some choppiness because other companies are starting to feel their way through this to renew retention balance.

Operator

Your next question comes from Scott Heleniak, RBC Capital Markets.

Scott Gregory Heleniak
RBC Capital Markets, LLC, Research Division

The first question I have was on the investment side, you mentioned the - your increasing investments in the alternative investment portfolio, that's the first time you've done that in a long while. I'm just wondering how you came to that decision and whether you can expect to see more of that in the future?

John Joseph Marchioni
President & COO

We're moving into that in a very measured way and the investments that we have added are mezzanine financing style. So they're not quite the same kind of J curve profile that you see in the other private equity space. So it's a little bit more consistent reserve, not nearly as much volatility, performs a lot more debt like, but it's certainly an opportunity to achieve better yield. It was since 2007 was the last time that we made new alternative investments although obviously we provided additional commitments to some of the previously committed alternatives before that. Again it's just - we feel it's an appropriate investment class, always have felt that way but we've also felt that it was one that we needed to commit just the right amount of dollars to - and not something that we wanted to have as too strong a portion of the overall portfolio. So we feel very good, basically right about where we are, there may be some additional small things as older investments provide some additional - as they have events that sell out some of their underlying investments and return capital to us, We'll have an opportunity to invest additional in that space, but don't anticipate it to be substantially larger as a percentage of our portfolio than it is currently.

Scott Gregory Heleniak
RBC Capital Markets, LLC, Research Division

And any change really in the credit quality of some of the new corporate investments you're making?

John Joseph Marchioni
President & COO

No, the average quality of the overall portfolio is still at a AA minus and we're not stretching for yield. I think that's how you get in trouble in this kind of an investment environment. Clearly everyone is troubled by the low rates that are available out there but it would be a mistake we feel to try and move away from what has served us well over the years.

Scott Gregory Heleniak

RBC Capital Markets, LLC, Research Division

Okay. And then on the personal line side, the growth for the past couple of quarters has mostly come from homeowners, and I understand probably most of that is price. But could you kind of break out how much of that is price versus actually new [indiscernible]. I mean, you don't have to give exact numbers.

Gregory Edward Murphy
Chairman & CEO

Yes. A lot of it's…

John Joseph Marchioni
President & COO

And I - just as Dale's pulling the price number versus the PIP count, that's a number that we constantly look at the ratio of new home to new auto. I think we're a little bit ahead of where we would have expected it to be in terms of mix of business. But part of that too is where is the pricing environment relative to auto and how comfortable are we getting more aggressive on auto pricing which to this point we have not been, so it's certainly an important balance. But at the same time, while we're building in a bigger cat load, from a profitability perspective we feel like we've gotten a home book close to where it needs to be on a run rate basis ex-cat coming in at that 82 kind of number, probably need a little bit more cushion built in for cat losses, but your question about mix is one that we will look at very closely.

Scott Gregory Heleniak
RBC Capital Markets, LLC, Research Division

And then just wondering on the agency side, how many new agency deployments you've had this year as part of your growth, does that really changed much versus what you typically do in a given year?

John Joseph Marchioni
President & COO

We're still around 1,000 agency relationship number, slightly above that, probably pushing about 1,050. We're focusing on adding some store fronts in some locations that we don't have complete geographic coverage of, but there is no dramatic change in the number of agencies that we have. But you'll see the number of store fronts pick up and especially in areas where we think we're missing opportunity relative to personalize lines of small commercial, but I would still define our strategy as one of franchise value. We are not - we don't have segments of agents, we have agency contracts from top to bottom that we think are going to be top performers and we're going to occupy one of those top spots. So a little upward movement, but no real change in strategy relative to agency count.

Dale Allen Thatcher
Former Executive VP, Treasurer & CFO

And with regard to the home, basically 6 points of the growth is related to pure price.

Operator

[Operator Instructions] The next question comes from Ron Bobman, Capital Returns.

Ronald David Bobman
Capital Returns Management, LLC

I had a few questions, I think John mentioned the E&S IP program detention till 2017, could you remind us about your - again, I know it's a fee-for-service business not risk bearing for Selective. You will see that you collect for servicing those policies and I guess writing those policies. Is it unit based or as the premium dollars charged increase there is some degree of increase in your fee that you receive. Are you in any way benefitting from the higher rates?

John Joseph Marchioni
President & COO

Yes, we get paid a commission rate on the premium base, so obviously to the extent that the price per unit of exposure increases, in its current construct of the program that would increase our revenue.

Ronald David Bobman
Capital Returns Management, LLC

Okay.

Dale Allen Thatcher
Former Executive VP, Treasurer & CFO

Your 2 revenue streams are that the premium based fee that you are paid for servicing the accounts from an underwriting perspective, and then you also get paid for servicing the claim activity. So those are 2 primary revenue streams on the claim side.

Ronald David Bobman
Capital Returns Management, LLC

Whether it's like year-to-date 2012 or 2011, how much revenue did you receive and what was the split claim based and production based, roughly?

Dale Allen Thatcher
Former Executive VP, Treasurer & CFO

The majority, in a normal year the majority is going to be underwriting servicing based, but obviously last year it would have been a little bit more elevated because of the high degree of flood activity, it's a ballpark - give us a second.

Gregory Edward Murphy
Chairman & CEO

I got it right here, so the commission revenue side on the side that comes from handling the production of the business from an underwriting standpoint, was the 6-month period was like $34 million and it looks like from what I could see here that the claim revenue fees were around $1 million, just to give you an idea what that looked like.

Ronald David Bobman
Capital Returns Management, LLC

Great, okay. Another question I had was, a question on retention, I'm sorry if I missed it. It sounds like from the rate numbers you mentioned, that the combined personal lines rate increase were somewhere like 5%, but it sounds like the planned rate increases are going to take, will hopefully take it up a little further. But I was curious where retention is and where it was.

Gregory Edward Murphy
Chairman & CEO

You're talking personal lines now.

Ronald David Bobman
Capital Returns Management, LLC

Correct.

Gregory Edward Murphy
Chairman & CEO

They will stay stable…

John Joseph Marchioni
President & COO

At 87, so retention on personal lines was at 87 and that's been very stable over the last several quarters. I mean actually probably slightly ahead of our plan, but not materially.

Ronald David Bobman
Capital Returns Management, LLC

Okay. And then my last question related to the cats. In a scenario - I guess Greg or John, if this run of [indiscernible] and hail storm, and tornado and locusts, famine, continues and if you were of the firm belief that you were going to have this level of cat activity for the next let's say 3 years, what would you need to do? I mean, are you changing the terms and conditions of the homeowner's policies of respective deductible requirements or roof grade to even write a risk? Would it be activities along those lines that you are doing or would be doing, is it steeper rate increases? Would it be exiting personal lines all together? Would it be a different reinsurance program? What are your thoughts?

John Joseph Marchioni
President & COO

Great question. So, in terms of terms and conditions you are definitely seeing movement there market-wide, and we have certainly moved all payroll deductibles up to $1,000 and $1,500 based on roof age in particular, and also gotten a lot more aggressive in terms of underwritings to roof age. So you are seeing that movement market-wide. Greg has talked over the last several quarters about the need for a different risk-sharing structure there relative to both hail claims and wind claims. So that is certainly happening.

Ronald David Bobman
Capital Returns Management, LLC

But were you 3 years ago? What were the - what was your average deductable 3 years ago and where would you hope it is 12 months from now? I mean, can you - is it material?

John Joseph Marchioni
President & COO

Well, it is. So you used to see your deductibles in the range of 250 to 500 3 to 5 years ago, and now with the changes we're putting in place, once you go through a full renewal cycle, you are going to have your book at a $1,000 to $1,500 depending on the mix of business relative to roof age. So, in my mind, when you look at average severity of cat claims in the personal lines area that additional $500 deductible is in fact material. On the risk-sharing part, that's what I would say you're seeing. In terms of rate, that market has run pretty aggressively and retentions have stayed pretty high, market-wide. So, I would say that as companies now recognize that we probably are in a different weather pattern for an extended period of time, we bumped up our expected cat loads, that needs to come through in pricing. So what may be used to be in the 80 to 85 sort of combined ratio ex-cat for the homeowner as a target needs to drop lower than that. And I think as a result of those things you are seeing companies get a lot more aggressive on pricing. I would say the same thing applies on the commercial property side. There is no question that for us and a lot of competitors the underlying commercial property book has been very, very strong over the years. But now you have to build in a higher expected cat load and perform extremely well, 70s to low 80 kind of combined ratios, when you don't have excess cats. This way, when it does happen from to time to time you've got that built into your overall profitability model.

Gregory Edward Murphy
Chairman & CEO

I would also just to talk a little bit too about some of the things John mentioned. The difference fundamentally between personal lines and commercial lines, in commercial lines we're selling the entire account. So, when we are driving rate in commercial lines, our folks are working hard. You guys haven't asked a lot of questions, but comps running close to 9% rate, GLs at the about the 7, 7.2 level, and not only include primary but it's also the excess GL, and then we are also pushing to a lesser degree rate in the auto side on the commercial line side. But yet we look at that, we look at the account, we write the package, that's how we view that line of business. So I would say, there is a maybe a little bit more spongeability on that side between prop and liability, but we're pushing rate on the most significant areas on the liability side. It's a slightly different story in home and auto where we want to make sure we're writing the account, we want to make sure our home policies are priced up properly and where the proper account discount start to work in, so if somebody wants to bifurcate their home from their auto, we're just trying to look at the account credits relative to that style of business and we are hitting, as I mentioned, we expect the home rates to top 10% that we're filing this year. The other thing is when you look at the core book and even given the amount of weather through the first kind of 6 months of the year, our ex-cats have really improved. Now, as Dale mentioned there is a little bit of favorable development in there, but I believe it was possibly a little bit last year. But we're running at about an 82 ex-cats and a 106 for the year with cats. Now, we don't take cats out of our compensation. They are in there. So, we just report to you those number so you can see underlying improvement. But we're going to keep doing the things that need to do in home to improve that performance - it's rate, it's cost sharing and it's other changes relative to the underwriting criteria.

Ronald David Bobman
Capital Returns Management, LLC

Definitely. If you would oblige to me, the 10% rate filing increase for home, if we fast-forward 12 months and thereafter, the effective date of that filing, do you expect that this have to gotten an average of 10 on your book of business or is this just the case where the rate filing is 10, the credits et cetera, mix of business is going to be a good bit below that.

John Joseph Marchioni
President & COO

There is no impact of discretionary credit applied in home, so that won't have any impact. The one thing you may see is a little bit of downward pressure based on a mix change. So if the account with the characteristics that have the biggest rate increase attached to them, whatever you are looking at, building age or insurance or whatever it may be, they may retain at a slightly lower level than the accounts getting a little bit of a less increase would, but I would say that based on where the market is and where how price is hitting the home line, it is clearly more of an across the board style rate increase that's coming through the entire market, not just us, so that will actually mitigate any mix impact on the overall rate number.

Operator

Your next question comes from Robert Paun, Sidoti & Company.

Robert Paun
Sidoti & Company, LLC

Most of my questions have been asked. But I had a question generally on rates in the economy. You guys are pushing rate increases through with pretty good retention. Can you just talk about the impact a weakening economy would have on your ability to push further rate increases? And if the economy does continue to weaken, is this something that could also impact your expectations for the 5% to 8% increases.

Gregory Edward Murphy
Chairman & CEO

Yes, let me take a shot at this. I honestly feel the bigger drag is the competitive factor over the economy. So I would say that the bigger element in limiting our ability to drive rate higher is more competitive forces in our market necessarily than economic forces. As we tell our distributors, our great agents, we're the one industry that has delivered price reductions to customer year after year after year, and pricing now ultimately has gotten to the point where it's too thin. Our folks have been delivering price increases to customers, but they've been pretty moderated on an overall basis. So when you compare this to other, I won't even call this a hard market, as I said before by any measure, whether you look at growth in the industry relative to the GDP, you look at renewal pricing increases, you look at new business, you look at migration of business out of the primary into the E&S, you look at E&S pricing, all of those things, there isn't any sign there that demonstrates a really firm market overall, but I would say that it's more of the competitive factors than that. And what happens in a soft economy, and customers are trying to do, they will shop their business if they feel that hey, I have to reduce my cost structure somehow and what I'll do is I'll take my renewal account and turn it into a new business account, put it out to market and see who is willing to bid on that account to bid it down cheaper. That's where I think more of the drag comes in the marketplace overall.

John Joseph Marchioni
President & COO

Just to add to that, I think Greg is right, the competitive forces are keeping that in check, but I would also say inherent in our 5% to 8% ban that we talk about going forward, there is - the impact of the economy on the customer and their ability to absorb rate increases is inherent in that assessment as well. So if we look at rate need for the market overall based on expected elevated cat activity as well as expected continuation of depressed investment returns, that number is higher, it should be higher in terms of a traditional firming market, but inherent in the 5% to 8% assessment that we out there, is the customer under pressure from the economy as well as Greg said, driven also by the economic - the competitive conditions in the market.

Operator

Your next question comes from Alison Jacobowitz, Bank of America Merrill Lynch.

Alison Marnie Jacobowitz
BofA Merrill Lynch, Research Division

I don't think I heard it, I'm sorry if you said it, but can you tell us the difference between the new money yield and the fixed income portfolio yield?

Dale Allen Thatcher
Former Executive VP, Treasurer & CFO

Yes, the new money yield pre-tax is running around 2.4% right now, the stuff is rolling off pre-tax is running at about 3.4%.

Gregory Edward Murphy
Chairman & CEO

I mean that's something that we closely monitor where our investment portfolio is, what our after tax ROE is on our - what our ROE and investment portfolio generates, how that's declining through time and what it means from an underwriting improvement standpoint. So we closely monitor all of those elements as well as the potential threat of cost shifting as a result of what may happen out of ObamaCare.

Operator

[Operator Instructions] Your next question comes from Bob Farnam, KBW.

Robert Edward Farnam
Keefe, Bruyette, & Woods, Inc., Research Division

Quick question, pardon me if I missed it. How much are the commercial lines rate increases in excess of lost trends?

John Joseph Marchioni
President & COO

I would say right now our trend continues to be around 3% and right now our overall written price is at about 6.5%.

Robert Edward Farnam
Keefe, Bruyette, & Woods, Inc., Research Division

Great.

John Joseph Marchioni
President & COO

We’re good on the math on this because I’ve read a lot of calls over the last 24-hour period, the difference between those 2 numbers does not reduce your combined ratio on 100 cents on a dollar. So I think you guys need to understand that if you’re writing at 6.5% rate and your trend is 3, that doesn’t mean your combined ratio is going to come down 3.5 points because you guys got to remember that the expense ratio element that gets taken out, there is an element that gets paid to agencies for commissions, there is that element that gets paid for premium taxes and other expense levels. So it’s only - the impact on the combined ratio is only its effect on the loss ratio element. You need to understand that. Because I’ve seen a lot of misinterpretations over that and I think you guys just need to understand how that works through.

Robert Paun
Sidoti & Company, LLC

Got it. And the fact that it’s earned over 12 months.

John Joseph Marchioni
President & COO

And that's clearly the other element of this, which my actuary reminds me of every day is that it earns in over time.

Operator

[Operator Instructions] At this time there are no further questions. I will now turn it back to you for closing comment.

Gregory Edward Murphy
Chairman & CEO

Thank you operator. And if you have any follow-up matters please contact Jennifer or Dale. Thank you very much for participating in the call.

Operator
This does conclude today’s conference. Thank you for attending. You may disconnect at this time.