S&P Global
Market Intelligence

Selective Insurance Group, Inc. NasdaqGS:SIGI

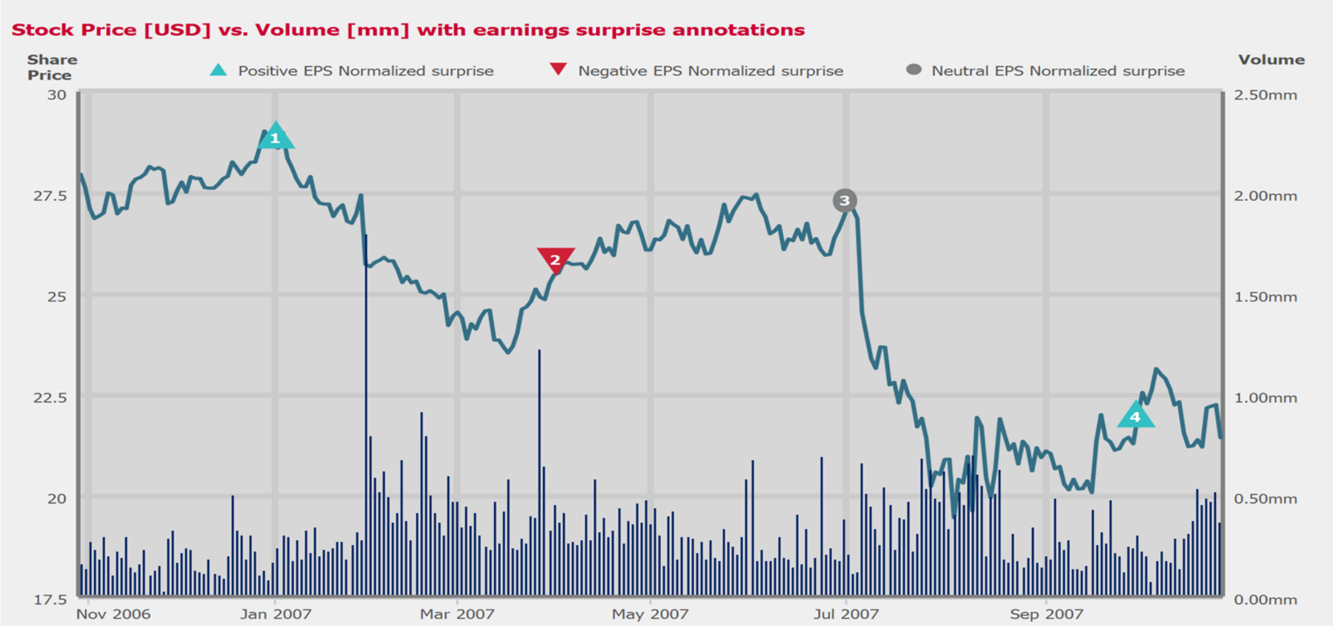
FQ4 2007 Earnings Call Transcripts

Tuesday, February 05, 2008 1:30 PM GMT

S&P Global Market Intelligence Estimates

	-FQ4 2007-			-FQ1 2008-	-FY 2007-		
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	ACTUAL	
EPS Normalized	0.56	0.60	7.14	0.52	2.16	2.21	
Revenue	-	-	1.76	-	-	-	
Revenue (mm)	458.52	466.61	-	463.24	1824.55	1846.23	

Currency: USD
Consensus as of Feb-05-2008 12:34 PM GMT



- EPS NORMALIZED -	CONSENSUS	ACTUAL	SURPRISE
FQ4 2006	0.60	0.62	3.33 %
FQ1 2007	0.55	0.50	(9.09 %)
FQ2 2007	0.49	0.49	0.00 %
FQ3 2007	0.54	0.63	16.67 %

Table of Contents

Call Participants

EXECUTIVES

Dale Allen Thatcher
Former Executive VP, Treasurer & CFO

Ed Pulkstenis

Greg Murphy

Jennifer DiBerardino

John Joseph Marchioni
President & COO

Ron Zaleski

ANALYSTS

Amit Kumar
Fox-Pitt Kelton

Charlie Gates
Credit Suisse

Michael Grasher
Piper Jaffray

Rohan Pai
Banc of America Securities

Scott Heleniak
Ferris, Baker Watts, Inc.

Presentation

Operator

Welcome to the Selected Insurance Group Fourth Quarter Earnings Release Conference Call. At this time, for opening remarks and introductions, I would like to turn the call over to the Vice President of Investor Relations, Mr. Jennifer C. DiBerardino.

Jennifer DiBerardino

Good morning and welcome to Selective Insurance Group Fourth Quarter 2007 Conference Call. This call is being simulcast on our webcast and a replay will be available through March 6, 2008. A supplemental investor packet 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 in non-GAAP measure to analyze trends and operations, operating income as net income excluding the after tax impact of net realized investment gains or losses. We believe that providing these non-GAAP measures 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 annual report on Form 10-K files with the US 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 us today on the call are the following members of Selective's Executive Management team; Frank Murphy CEO, Dale Thatcher Chief Financial Officer, Jim Ochiltree Head of Insurance Operations, Ed Pulkstenis Chief Underwriting Officer, John Marchioni Chief Field Operations Officer, Mary Porter Chief Claims Officer, Ron Zaleski Chief Actuary and Kerry Guthrie Chief Investment Officer. We would like to note that this is Jim Ochiltree's last earnings call before his retirement in March. Upon Jim's retirement, Ed, John and Mary will report directly to Greg each with new and expanded responsibilities as we have previously outlined in 2007.

Before I turn the call over to Dale this morning to review 2007's Fourth Quarter and Full Year results, I want to bring to your attention that the investor packet has been revised due to a typographical error in the press release. Under the supporting assumptions for our 2008 guidance range, the second assumption for $14.4 million and after tax catastrophe loses was inadvertently equated to a per share amount of $0.18. That number is actually $0.27 per share. Now I will turn the call over to Dale.

Dale Allen Thatcher
Former Executive VP, Treasurer & CFO

Despite the continued highly competitive nature of the insurance industry and the unprecedented turmoil in the financial markets, we produced another year of solid underwriting profitability with a GAAP combined ratio of 98.9% or 97.5% on a statutory basis. Both ratios increased over 2006 reflecting a more difficult pricing environment and higher loss costs. Catastrophe losses for 2007 came in lighter than anticipated at 1.0 on the combined ratio or $14.9 million pretax. We experienced strong fourth quarter overall statutory net premium written growth of 5.5% including 5.4% in commercial lines and 5.7% in personal lines. For the full year, we grew statutory premium of 1.4%, about three points above 2007 industry expectations which calls for a decline of 1.2%.

Our 2007 premium growth was driven by a 13% increase in commercial lines and new business largely attributable to our high touched field model. Other initiatives that drove new business production in 2007 were the addition of 143 agents bringing the total to 876 or 1800 store fronts. Expanding into our 21st state Massachusetts for commercial line and deploying 20 new agency management specialists to support the state and agency expansion. We have also been proactively asking our agents for their best business through targeted agency sales meetings which create the opportunity to evaluate an additional $76 million in new premium potential in 2007.

Operating income exceeded our expectations for the quarter at $0.60 per diluted share or $32.2 million. For the year, operating income was $2.21 per share or $124.8 million, an overall return on equity with 13.6%, about 400-basis points higher than Selective's weighted average cost of capital.

The fourth quarter GAAP combined ratio came in at 99.7% compared to 97% in 2006. On a statutory basis, the combined ratio in the quarter increased 2.9 points to 101.9%. Primarily as a result of price decreases, coupled with higher non-catastrophe property losses. Overall, total property claim counts were down 7% from the fourth quarter 2006, but large loss counts increased. This losses appear to be part of a normal variability we have seen in 2007, however, they do represent an increase over the exceptional fourth quarter we experienced in 2006. Business owners or BOP returned to profitability in the quarter with a combined ratio of 90.3% compared to 125.8% last year. The BOP improvement reflects a decrease in claim severity in 2007. This is indicative of the variability we expect in this line.

With the implementation of the BOP predictive model, we will be able to grow this line of business more confidently to a level where large losses will not impact combined ratio as dramatically.

The improvement in our Workers Compensation book of business is a big success story for 2007. We implemented a multidisciplinary Workers Compensation improvement strategy at the beginning of 2006 targeting a two-year 7-point reduction in accident year combined ratio from its then 110.3% level. Not only did we achieve our goal, but we exceeded it by nearly a point and ended 2007 with an accident year combined of 102.5%. The success we had in Workers Compensation demonstrates our organizational strength to create the right tools and deploy the best talent to achieve our strategic goals.

For personal lines excluding flood, we reported a statutory combined ratio in the quarter of 122.6%. This includes the impact of adverse prior year reserve development in our homeowner's line of $5 million or 10 points which related to underground oil storage tank losses in New Jersey. Personal lines growth was positive for the second quarter in a row as net premiums written grew 5.7% in the fourth quarter to $49.8 million compared to last year. Growth was driven by the full implementation of our automated pricing system matrix for personal auto across all our personal line states.

Automobile net premiums written grew 15% in the quarter to $12 million for all personal lines states excluding New Jersey. In these states were almost half of our auto renewal book and our entire new automobile book has been rated through the model, new auto business was up 131% for the quarter, with matrix, we can now achieve better policy rating and pricing and grow our business with confidence to achieve profitability.

In January 2008, we began to roll out our new matrix for homeowners across all states. Expansion into additional states and the roll out of matrix for homeowners will provide us with opportunities to grow and to diversify our personal lines book of business.

Statutory loss in LAE reserves developed favorably by approximately $5 million in the fourth quarter and $16 million for the year. The 2007 favorable development was driven by continued favorable trends in commercial auto severity and lower than expected loss emergence in personal auto liability partially offset by adverse development for other lines of business.

For 2007, total direct incurred frequency was down 1.3%, however, total direct incurred severity was up 11.6% primarily impacted by large losses in excess of our re-insurance retention. Overall, direct loss costs were up 10% for the year. There is little question that the competitive markets we saw in 2007 will continue in 2008. Our goal as an organization is to grow profitably in any market conditions. As a result, we are taking proactive steps to improve efficiencies and optimize scale in our business. This effort has two components, first, we have made a difficult decision to reduce our workforce by 4% or approximately 80 positions including the immediate displacement of 60 employees. The remaining positions were open and will not be filled. We anticipate these changes and other operational adjustments will generate annualized pretax savings of approximately $8 million partially offset by a one time pretax charge of approximately $4 million in the first quarter of 2008.

Also, we are implementing extremely targeted changes in our agency commission structure that will remain competitive for agents who produce the strongest results for us while reducing commissions where our historically higher payments have not generated what we believe to be an appropriate level of profitable growth. The changes will bring our program more in line with the competition. Commissions on 87% of total direct written premium will not be affected by these changes.

Our supplemental commission program designed to reward our most profitable growth agencies remains intact. The new commission structure is expected to generate annualized pretax savings of approximately $8 million. The changes are targeted for rollout in most states in July 2008.

On January 1, 2008, we renewed our property catastrophe insurity and fidelity excess of loss re-insurance treaties. Additionally, a third treaty was placed with the National Workers Compensation Reinsurance pool which covers our participation in the involuntary MCCI pool, a residual Workers Compensation market. We saw 16.5% rate reduction for our property catastrophe reinsurance treaty and limits were lowered by $25 million t $310 million with retention remaining unchanged at $40 million. At these limits, using RMS risk link model version 7.0, Selective has covered to 1 in 159-year event in the short term view in a 1 in 209-year event in the historic view. Our expected catastrophe treaty cost for 2008 are approximately $16.5 million, a 15% decrease from 2007 levels. We achieved excellent diversification with 28 quality re-insurers participating in the catastrophe program.

Diversified insurance services revenue was up 5% in 2007 and generated a 10.7% return on revenue. The fee-based flood insurance operation grew 20% bringing total flood business service to $143 million. Our flood program continues to receive the endorsement of the Independent Insurance Agents and Brokers of America and we are the seventh largest flood writer in the country based on 2006 market share information. We continue to monitor the current legislation being discussed in Washington to determine any potential impact on our flood operations.

Selective HR Solutions ended the year at 25,111 work site employees down 7% from 2006. The weakening economy particularly in Florida led to the lack of growth in work site lives. This in turn led to some organizational efficiency measures being taken in the fourth quarter to maintain margins.

After tax investment income rose 9% to $37.3 million for the quarter mainly due to an 8% pretax increase in six maturity income as the portfolio grew 4% to $3.1 billion over the course of 2007. In addition, our alternative investment returns increased 138% for the quarter to $6.4 million. The total investment portfolio increased 4% to $3.7 billion during the year. The overall annualized after tax portfolio yield was 3.6%, unchanged from 2006. Duration including short term assets was approximately four years. Invested assets per dollar of stock or its equity increased 4% to $3.47 compared to 2006.

In our fixed income portfolio, the fall in interest rates during the fourth quarter increased unrealized gains by $11.4 million to a total of $23.6 million at yearend. This resulted in a $0.14 after tax positive impact on book value per share which was up 5% to $19.81 from yearend 2006.

Our book value at yearend included only $29.1 million or $0.54 per share and after tax goodwill and no discounting of loss reserves. Book value has grown at a compounded rate of 10.1% over the past five years and is the solid representation of the value we continue to generate for shareholders.

We continue to maintain a high quality fixed income portfolio and have no significant sub prime mortgage exposure. We have included several schedules as a supplement to our investor packet available on the website to help investors understand our mortgage related investments. As a result of strong pre-purchased do-diligence guidelines, none of our structure securities which include residential and commercial mortgage back and asset back securities experienced any downturns in 2007.

We continue to actively manage our excess capital. In 2007, we repurchased $5.7 million shares or 10% of total outstanding shares in an average price of $25.13. In lieu of additional share repurchase of these in the fourth quarter, we net share settled a total of $46 million of our senior convertible notes due 2032 after calling the securities for redemption in November and December. The resulting impact on our diluted share count was that we essentially retired two million shares at an average price of approximately $23.00 ending 2007 with $54 million shares outstanding. Through the payment of dividends and share repurchase activity, Selective returned 116% of 2007 earnings for shareholders demonstrating our ongoing proactive capital management approach.

Now I will turn the call over to Greg.

Greg Murphy

2007 was a year of challenges in our industry and in the financial markets. While we were not immune from the challenges, we were able to execute on our strategies to achieve profitable growth. Our dedicated employees have worked tirelessly over the past few years with Selective in a strong competitive position so that we can deliver lasting results and value for our shareholders. Due to our unique field-based model and strong relationships with our agents, we experienced solid 2007 commercial lines new business growth of 13% to $313 million.

Pricing on new business was down about 6% in 2007 as compared with 2006 levels. By market sector, new business growth for 2007 breaks down as follows. One & Done automated small business, $62 million up 44%, middle market or AMS generated business $215 million up 6%, Selective Risk Managers or SRM, our large account business $36 million up 19%. In 2007, SRM rode an all time high of $36 million in new business despite the difficult market place in which total renewal pricing was down about 5% for the year. Results were favorably impacted by the strong partnership between SRM and Safety Management resulting in 89% of SRM accounts now on safety management service plans.

Our current SRM book of business is up 2% to $162 million on a direct basis and produced 2007 accident year combined ratio of about 98. The growth in the One & Done new business reflects the increase in the number of new business classes eligible for seamless processing to the automated small business system as well as the introduction of the Workers Compensation and BOP predictive models. The new classes accounted for 23% of the record setting new business written per work day of $251,000.00. In addition, One & Done new business premium increased 56% in 2007 for accounts with modeled lines of business versus 31% for non-model. This substantial growth clearly reflects our more granular pricing capabilities which target the best business.

It is all about ease of doing business and I am confident in telling you that Selective is one of the easiest companies to do business with in a commercial lines marketplace today.

We attribute this to our very successful combination of high tech and high touch.

Our first to market agency integration technology xSELerate, won awards in 2007 from selling an IT consultancy group and from the two most widely used agency management systems groups AMS and Applied. We believe xSELerate provides a significant future premium growth opportunity, in fact, new commercial lines business process through xSELerate in 2007 was up 270% and $93 million. Additionally, through the increased usage of straight through processing for small business, we can now more aggressively leverage our AMS to focus on accounts above $50,000.00. Our unmatched field model creates strong relationships with agents. With our enhanced technology, sales meetings and agency workshops, we expect to drive the average premium volume per AMS fro $2.3 million to $3.5 million over time.

Now that all commercial lines predictive models are in use, our underwriters have the best possible information at their finger tips to facilitate more granular underwriting decisions that should generate profitable business. We believe the ease of doing business is the primary reason that for the second year in a row, our agents rated us a very high 8.9 out of 10 for overall satisfaction.

Throughout 2008, we will continue to drive profitable growth by maximizing the tools and strategies put in place over the past few years and by deploying the best talent in the organization to distinguish ourselves from the competition. Our 2008 profit growth opportunities include expectations to write $70 million in new business from the 200 new agents appointed in 2006 and 2007, the appointment of 75 new agents in 2008. New business opportunities from the 65 new producers we helped our agents hire and train in 2006 and 2007 plus an additional 55 plan for 2008 generating new business growth in our 21st footprint state Massachusetts as well as opening our 22nd state Tennessee for commercial lines by the fourth quarter of

2008 and for personal lines in January 2009, and leveraging our ease of doing business with the award winning technology xSELerate to capture new business.

We have spent years implementing initiatives that improve underwriting and claims performance such as predictive modeling, analytical tools from knowledge management, improvements in safety management, matrix for personal lines, the Workers Compensation improvement plan and other initiatives. We have factored the expected improvement from these initiatives into our combined ratio assumptions for 2008. We also anticipate an estimated 0.8 point reduction in our combined ratio for the expense initiatives that Dale outlined net of the restructuring charge.

We are setting our 2008 diluted earnings per share guidance to a range of $2.20 to $2.40 including the first quarter $0.05 restructuring charge. This range includes the following major assumptions, a statutory combined ratio of approximately 98, a GAAP combined ratio of approximately 100, after tax catastrophe losses of $14.4 million or $0.27 per share, after tax investment income growth of 3% including 10% pretax yield on alternative investments. Diversified insurance services revenue growth of 5% and return on revenue of 10%. Diluted weighted average shares of $52.5 million which includes the expectation of repurchasing $3.5 million shares over the course of the year.
Now I will turn the call back to the operator for your questions.

Question and Answer

Operator

(Operator Instructions)

Your first question comes from the line of Amit Kumar with Fox-Pitt Kelton.

Amit Kumar
Fox-Pitt Kelton

Just three quick questions, first of all, these 80 jobs that are being eliminated, what part of the company are they coming from?

Greg Murphy

They are coming from basically all areas of the organization, but just to give you a sense here in the corporate facility is about 32 of those jobs overall are coming out of the corporate facility. The remainder of 60 are throughout the organization.

Amit Kumar
Fox-Pitt Kelton

Just moving on to the commissions revamp and I think you mentioned an 87% premium number, what is the actual agent count who are going to be impacted by these changes?

Greg Murphy

Well, let us take them piece by piece because it is hard to really answer that question because certain changes like BOP for instance, changing BOP renewal commissions theoretically reflects everyone of our agents that writes a BOP account, but I think to really kind of focus in on the message which is that premium on 87% of our commissions are unaffected, the biggest one is our New York general liability where that represents approximately $3 million of the overall $8 million annualized commission savings and that is focused principally on our group of agents in New York and that is the most targeted part of that overall change, and then obviously the Pennsylvania and New Jersey homeowners affects all of our agents in those two states that write homeowners, but they are so isolated that to kind of break it down in totality of the $8 million, $3 million of the annualized commission savings are in New York, about $2 million of them are BOP overall and then the other $1.4 million are on municipalities, but that does not include the state of Pennsylvania.

So, they are very targeted in terms of the change in the effect on agents.

Amit Kumar
Fox-Pitt Kelton

Just moving on in terms of the reserve addition, can you perhaps give some more color because you must have finished your exhaustive reserve review in terms of what trends you saw on the historical accident years and what trends do you foresee in your current book of business.

Greg Murphy

Let me just start with that, I mean just to let you know, we do a very detailed review systematically in our organization and that is every quarter, so we are doing a tremendous amount of work on our reserves as we move through. I am going to let Ron Zaleski talk to you about some of the trends that he has seen in the overall loss development area.

Ron Zaleski

In 2007, we have seen of course a total of $60 million in favorable development. Most of which is coming from the commercial auto line which has been very favorable to us over the last three years. The trends we are seeing now is that commercial auto is going pretty flat going into 2008 and we do not really have any expectations for further improvements there. As far as our other lines of business are concerned, we see for 2008 that our reserve levels are very strong and stable.

Amit Kumar
Fox-Pitt Kelton

In your Investor Day presentations, I know you put that slide which shows the market opportunity by different segments and I was just looking at that, I am looking at what you have outlined for ’08, can you just sort of update us as to what your thoughts are and perhaps also touch upon M&A opportunities going forward?

Greg Murphy

Let me address just that, obviously we are continuing to round out our footprint. As you can see, we are adding Tennessee. I mean that will not add much premium volume to the ’08 numbers, but it is part of our durable growth message, but a bigger part of the message obviously is the expansion of our franchise. We have been very protective of the franchise and part of our initiatives was to make sure we had the operation running with absolutely peak opportunities to grow the organization, that included the amount of knowledge we had, our underwriting capability and I think we have reached that and that is why we continue to expand the number of agents that we have. Adding 75 more agents in 2008 will clearly get us close to the thousand benchmark that we have established, and I think that then starts to develop what you talked about in terms of our premium opportunities, we write about a four share of the commercial lines marketplace in New Jersey. We write in many other states anywhere from a one to possibly upward to a three share and that is our opportunity to really grow and take a bigger market share in those states that is going to be our focus and the reason why we are going to be able to do it is because of the ease of doing business and because of our field base model and our AMS is out there helping our agents write business and our first in market technology. That is quite incredible that our technological competition is Travelers, Hartford and Zurich, but yet we were first in the market with that and Selective was the one that won the awards from every major group out there for our ease of doing business in terms of the capability for us to move premium from agent seamlessly to us.

Those are all the things that we are going to really focus on in 2008. Now to kind of touch on your M&A opportunities, we are out looking to seize opportunities in the marketplace, but our focus right now is mainly executing on our Greenfield growth initiatives that we feel will generate a tremendous value for us and our shareholders into the future. We are still looking at the capability of a right fit for us in the marketplace though.

Operator

Your next question comes from the line of Michael Grasher with Piper Jaffray.

Michael Grasher
Piper Jaffray

You were talking about driving AMS production higher from $2.3 million to $3.5 million and I think you said over time, can you define or give us a little bit more in terms of what your expectations are from timing?

Greg Murphy

We are looking at that as kind of like a three to four year time horizon on that.

Michael Grasher
Piper Jaffray

So we should not expect that all in 2008 alone?

Greg Murphy

No, you should not. That is a systematic process of getting our agents and I will let John Marchioni and others comment as well, but that is a systematic process of improving our underlying capability to get more business process seamlessly through our One & Done system and then to move our AMS market as we move through the next 2008 and 2009.

John Joseph Marchioni
President & COO

I would add to that in Greg's comments, he talked about our expectations or actually our performance with regards to the three ways in which we measure our commercial lines production being One & Done, AMS, Middle market and selective risk managers. We are constantly evaluating each of those three areas to determine how the best way to onboard those businesses and the ability to move more business through that One & Done pipeline allows us to free up AMS's from that smaller low touch business and allows them to generate more premium per AMS, so that is how we developed that. That is how we focus our efforts and that is why the multiple year time horizon is what Greg cited because it is related to our ability to expand that pipeline and yet not sacrifice the underwriting capabilities that we have in that One & Done system.

Michael Grasher
Piper Jaffray

Just thinking about the cap losses, just curious if, is there any way or have you attributed any of the reduction in cap losses to some of the accounts that perhaps you have called over the past couple of years?

Greg Murphy

For the most part, where we get hit cap losses, obviously the Northeasters affect us probably more so than obviously than the wind that you get and some of the tornado activity that now is part of our mid western exposure, so they come from multiple fronts, so that is nothing particular with respect to our overall underwriting profitability initiatives. We are a little more focused right now what individual accounts add to our annual average loss and to make sure we are getting proper pricing for those accounts in the marketplace so we have a more targeted effort in the management of that risk inventory and we are doing that on a much more targeted basis as we move into 2008 and 2009 as well.

Michael Grasher
Piper Jaffray

I wanted to switch over to the investment portfolio. A great amount of detail obviously in this quarter's press release is much appreciated. Question regarding the Hillocks and the CDO exposures within the RMBS portion, can you share with us the vintages related to those holdings?

Greg Murphy

Sure, between Kerry and Dale, I know we have vintages identified in some of our portfolios overall, I am not sure if we have any detailed level.

Dale Allen Thatcher
Former Executive VP, Treasurer & CFO

There is a detailed schedule that is included within the packet that will give you the vintages on the mortgage portfolio.

Michael Grasher
Piper Jaffray

I did see it on the CMBS, is it there for the RMBS as well?

Dale Allen Thatcher
Former Executive VP, Treasurer & CFO

No.

Greg Murphy

I do not have those vintages on the RMBS handy, but I think they cover a wide variety of vintage years.

Michael Grasher
Piper Jaffray

Okay, so there is no heavy concentration in say ’05 through ’07?

Greg Murphy

That is correct.

Michael Grasher
Piper Jaffray

The CDO’s themselves, are they multi sector or are they specifically RMBS?

John Joseph Marchioni
President & COO

They are both commercial real estate. There is an old A CDO and I believe there is only four of them in total, a very small number.

Michael Grasher
Piper Jaffray

And I guess the final two questions, one would be who has the rapper on those Hillocks and CDO’s?

John Joseph Marchioni
President & COO

That I believe MDIA has about $9 million, CIFG has about $9 million, Ambac has about $10 million. It is kind of diversified and spread out. There is no concentration on the ABS wraps.

Michael Grasher
Piper Jaffray

Any FIDIC?

John Joseph Marchioni
President & COO

I believe there is one loan that has FIDIC insurance.

Michael Grasher
Piper Jaffray

And that gets to my last question, the triple B rated holdings in the mini portfolio, are any of those wrapped by FIDIC?

John Joseph Marchioni
President & COO

FIDIC has about $7.5 million market value. There is actually three ABS wrapped. I am sorry your last question.

Michael Grasher
Piper Jaffray

Looking over the mini portfolio, the triple B exposures that you have there, I guess the specific holdings and then if any of those were wrapped by FIDIC as well?

John Joseph Marchioni
President & COO

Well, just to be clear on that. A lot of that schedule that appears, a lot of those bonds that have wrapped insurance are not triple B rated. What we did on the non-rated because as you know, a lot of these insured bonds of issuance are coming with ratings that the issuer is not paying for that. We do look at the underlying ratings on those and what we did for the purposes of coming up with an underlying rating, we assigned a triple B minus weight just to be conservative. It is our belief that the average underlying ratings because some of those do have public issues outstanding with ratings attached is much higher, it is probably an A.

Your specific question, we have on a market value basis, less than $3 million of a triple B rated issue and we have $5 million non-rated by FIDIC. The FIDIC exposure less than three is triple B and about $5 million is non-rated.

Greg Murphy

And I think the important part obviously is we did not buy any of the product in the marketplace based on the fact that it came with an enhancement. These guys have systematically done all of the heavy lifting on every purchase that we have done and that is why you do not see a big down drift in our overall underlying credit quality and that is why if you just look at the credit enhanced portfolio in the mini, it is a double A minus, the underlying credit of just the enhanced portion, so it demonstrates the kind of work that our investment folks do.

Operator

Your next question comes from the line of Charlie Gates with Credit Suisse.

Charlie Gates
Credit Suisse

I only have one question. Greg, I think in your prepared remarks you indicated the magnitude of erosion in commercial lines pricing during the period. I missed it. Could you elaborate basically on what you are saying about commercial lines pricing including that commentary?

Greg Murphy

Sure. For the year, our commercial lines pricing on a pure price basis was down about 4% and that is on a renewal basis and the new business comment that I made year-on-year is new business with the price down about 6%. If you recall at the end of the third quarter, that price on our new business was actually down around 7%, so we see some improvements in the pricing trends as we move on and when you look at that, whether you are looking at it by region, it is really not a lot of outliers except for maybe one of the Midwestern areas where pricing is off that, so pretty much all of our pricing is pretty in locked step and our goal is to try to reel in as we move in to 2008 is to pride our underwriters with the information on a renewal basis, where do we need to be on the price, which accounts are strong for us and that we need to retain our position in those accounts and I think in terms of the amount of knowledge in information we were provided not only to our renewal inside underwriters, but also on a new basis is in my mind best in class to be able to make sure, a) we are going after only profitable business on a new basis, and b) we are trying to protect our beach head position with respect to our renewals.

Charlie Gates
Credit Suisse

You commented that you though that it was more competitive in the Midwest, could you elaborate on that?

Greg Murphy

That is only in one of the three regions where it was slightly, just to give you an idea regionally, our pricing in almost every territory was pretty much right on the mark with the exception of one territory, one, three state territory where pricing was off about 7%, but in the other two Midwestern territories, pricing was off 4.8% and 4.9% and that is relative to the average that I mentioned to you before of 3.9, so those six states, only three of them were a little bit more of an outlier.

Charlie Gates
Credit Suisse

What are the three states where the competition is greater?

Greg Murphy

We are not going to really go into that level of depth in terms of which states are that, but of the nine states, only three of the nine are slightly more competitive than the rest, and there is not a tremendous amount of premium volume in those states anyway.

Charlie Gates
Credit Suisse

What do you think it reflect from a general standpoint if you were explaining why it is more competitive in those three states than others?

Greg Murphy

Since we run into the same competitors, nine of those states, holistically, not much.

Operator

Your next question comes from the line of Rohan Pai with Banc of America Securities.

Rohan Pai
Banc of America Securities

I was trying to get a sense of the personal lines strategy, even excluding the adverse development in homeowners, what is the strategy behind growing this business with combined ratios above 110 in auto and home?

Greg Murphy

John Marchioni will talk to you about that.

John Joseph Marchioni
President & COO

There are a couple of pieces and we have talked a little bit about this in prior quarters, but let me just sort of restate where we are on our strategy because clearly, our desire to grow this business is on the basis of our belief and our strong conviction that the business we are writing new, using our matrix predictive modeling tool on the auto side and soon to be on the homeowners side is putting business on the books at a much more profitable level than our legacy books.

Now, unlike commercial lines, it takes you a lot longer to address your legacy books from a profitability standpoint because you are running up against the regulatory restrictions in a number of states. So what you will see is on the legacy books, where you cannot move that business through the pricing models, we are taking some pretty aggressive base rate action, base rating increases in a number of those states and that started to earn this way through the book. You will some of that in ’07, but you are really going to start to see the benefits of that in ’08 and ’09 and then we measure a mix of business from a new business standpoint to make sure that in fact, our model is working as indicated. So as we look at favorable trend in terms of mix of business, whether it is average credit scores or full coverage versus liability only or multi car versus single car, we start to see improvements in our mix of business which is another indicator of future profitability and then a final piece on the auto side is with regards to New Jersey, which continues to be our largest state is we have a requirement as every other carrier to maintain a portion of your book of urban business that matches your roll of state market share in that business because of regulatory requirements is under prices as it is with everybody.

Our ability to manage the size of that book in proportion to the overall book is another indicator of future profitability. The size of that has reduced relative to the rest of the book in the last two years and we will start to see the benefits of that going forward.

And then the last piece on the homeowner's side is we are just now rolling our predictive model for homeowners which really put us a lot closer to the competitive frontier. Unlike auto, the use of predictive modeling on the homeowners side is really not that well developed, there are a few carriers in the marketplace using it. That is starting to roll out in January. It has rolled out in January for a couple of our expansions and they should roll off through the course of the year, so clearly, yes, we are planning to grow this line, but we believe that the strategies we have in place are going to put that business on the books at much more profitable levels than our legacy book would indicate.

Rohan Pai
Banc of America Securities

I guess, John, could you maybe tell us what the combined ratio is for New Jersey in auto versus the other states?

John Joseph Marchioni
President & COO

New Jersey personal auto for the year was 1063.

Rohan Pai
Banc of America Securities

I think you suggested at one point that by 2008 you would want to bring the personal lines book to profitability, is that still a target or are we looking at '09?

John Joseph Marchioni
President & COO

Actually, in the last quarter, we stated by the end of 2009 that we would expect to achiever profitability in this.

Rohan Pai
Banc of America Securities

Just one more question on the thing on the press release, you had cited the contract as being more competitive, if you can just kind of give us an update on one, the competitive trends there, and two, if you see anything on the loss trend side?

Greg Murphy

Well the comments really about the construction area is just the fact that it represents 45% of our aggregated commercial lines business and the fact that we are expecting a more difficult economy as we move through with the housing slow down and housing starts slow down, and all that Ed kind of talked a little bit more about. But from a standpoint, it has really been the hallmark of our relations with a lot of our agents in the sense that 45% of our business is in the construction area. We have a very strong position there, only about 15% of that business overall is either in residential or commercial GCs, so we do not have a big exposure from that front. We write a lot of artisans, we have a very well diversified book, and I am going to let Ed comment a little more about just the construction area.

Ed Pulkstenis

We do see some impact obviously with the difficulties in the economy in our audit and endorsement premium, but just to give you a sense of the book. We track our commercial lines book over 80 business segments, 26 of those are contractors. Of the 26, ten of them had more than $25 million of premium for 2007 and those ten make up about 70% of the book, so again as Greg said, there is primarily trade contractors. They are certainly not the larger or even medium sized homebuilders that you read about frequently in the press, so with that level of diversification, we are able to continue to manage this book. It has been profitable historically and we really do not see any trends on the profitability side that materially would change that going forward.

Operator

Your next question comes from the line of Scott Heleniak with Ferris, Baker Watts.

Scott Heleniak
Ferris, Baker Watts, Inc.

Just a couple of quick questions, can you touch on the higher not cap property losses a little bit, is that more of a severity versus reconciliation and did you kind of see those trends in the past few quarters or is this kind of a new occurrence?

Greg Murphy

There were more of a severity issue and Ed has done a lot of work on that.

Ed Pulkstenis

We have tracked the property losses throughout the year. We did have as Greg mentioned in the prepared comments or Dale an exceptional year for property in 2006. as we look at the property losses, we look at a number of different metrics, a number of different elements to understand where those losses are coming from that we see, as was mentioned, really no systematic trends that would lead to any adverse trends in profitability going forward. I think that there are other areas of our property book as well that we look at. Our in book which is property based is stable. Our commercial, auto, physical damages are stable, our BOP book for the quarter actually showed the combined ratio was down to a 90, which was an absence of large losses, so I think what you are really seeing is kind of the normal volatility that happens on this business. The presence or absence of a few large losses really does swing the results and I think that is what we are seeing.

Scott Heleniak
Ferris, Baker Watts, Inc.

The Workers Comp I guess is a little bit higher than it had been tracking in the past few quarters, any change in loss trends there and is there any kind of target that you guys are going?

Greg Murphy

I think that the fact that there in the quarter was, we had changed and Ron can comment that on the tail factor and the line overall, just due to a combination of medical inflation and just general developmental trends that added around $3 million of lost development into the quarter that is about 3.5 points of that combined ratio in the quarters due to that one event, so we do see an ongoing systematic improvement in that book and I think that is a reflection of the six initiatives that we articulated and have shared with you on many occasions.

Scott Heleniak
Ferris, Baker Watts, Inc.

Finally, do you have a policy cap for New Jersey auto at the end of the year?

Greg Murphy

We have a car count that I can give you and that is around 71,000 to be exact, 70,957 if you want the exact number of cars. Around that 71,000 if that is okay.

Scott Heleniak
Ferris, Baker Watts, Inc.

That is about exact you can get I guess.

Operator

Your next question comes from the line of Amit Kumar with Fox-Pitt Kelton.

Amit Kumar
Fox-Pitt Kelton

Just going back to the matrix modeling, if I had to sort of compare the new business and the old business which did not run through it, what is a good ball park number in terms of the combined ratio swing in this business?

John Joseph Marchioni
President & COO

First of all, we are just about a year into this, so our ability to have credibility in the new business numbers from a combined ratio standpoint is still a little bit early, but we certainly have measures in place to make sure that what we are seeing from a lost development standpoint in our new business versus our renewal book is where we expect it to be as we roll this out. So it is early in terms of looking at a credible combined ratio in the new book, but we do have a lot of measures that compare the mix of new business to the fixed of renewal business.

Amit Kumar
Fox-Pitt Kelton

You were talking about competition and you were saying that you run into the same competitors, maybe can you just expand on that in terms of where do you see the competition coming from in terms of what do you see out there? What are they exactly doing; is it terms and conditions, is it pricing or is it coding without even having lost run?

Greg Murphy

Well, it can be all of the above, but I would say that the two principal areas are coming from in some cases less sophisticated companies that do not have the underwriting tools that are trying to bid a renewal business down. You see that coming across from everywhere and then I just think you see the companies out there just trying to struggle to make premium targets and in particular, in some of the areas going after some larger accounts and that is where we saw that really hit us in the first quarter of 2007 where we talked to a whole group of agents and you find that they lost fifty or seventy or hundred thousand dollar account and in some cases, they lost it at 20% to 30% below expiring and they had no idea where this even came out of the blue and so, part of those efforts with our agents is the fact that that was a wake up call in January of '07. They are very proactively marketing their renewal inventory. They are out there in front of the customer demonstrating the value and services we bring particularly in a larger account with our claim handling, our safety management services and that is where they are trying to make sure that they are driving the value that we bring, but in some cases, the competition is just across the board, it is hard to pick any one competitor. It depends on the state in some cases. It depends on who is trying on to write the piece of business and that is the competitions across the board.

I mean, there is some level of sanity to it, but I would tell you that the carriers that do not have the sophisticated underwriting capability that take a one or two time piece of business from us or that we are trying to non-renew in some cases are in for a real wake up call as they move through and get the loss experience on that.

But just kind to answer your question before when you asked John about the matrix, new and renewal, and as we started to get a little more sophisticated, these numbers are still really pretty raw. But when we look at the new and renewal ROE relativities on new and renewal in the commercial lines, I mean, renewal inventory runs about 400 basis points better than new. There are always new business penalties put in the book even when it is modeled, there are new business penalties because your information ratio goes higher as the longer you retain that piece of business, so there is always a certain amount even in a modeled environment, there is always a penalty for new business, but I will tell you that penalty is way less severe when you, relative to a company that is not using sophisticated models, if you were looking at new renewals, those penalties would be tremendous or they should be tremendous. Maybe they are not, but they should be tremendous. In a modeled world, you lessen that separation, but there is clearly a separation there and it is something that we are really focusing on as we move into 2008 and 2009, a better understanding of our inventory, what is it in terms of ROE points? How do you look at new renewal? How do you segment that business and that is really the focus that we have as we move forward.

Amit Kumar
Fox-Pitt Kelton

And I guess, related to that, as you look forward towards ’09 and 2010 and perhaps even going forward, how do you expect this cycle to play out compared to the previous cycles?

Greg Murphy

I think that this cycle will be the difference between the haves and the have nots. I think the have nots are going to wake up in another nine to 18 months from now and realize what they have got and it is going to be devastating.

So the companies that have the sophistication, that have the ease of doing business, that have the technology, that have the business model, I mean in terms of field based business model, agents, the company walk with our agents, everyday and they say, ‘why are you growing with Selective? And why are you not growing with us?’ and the reason why we have the ease of doing business model. Not only do we have the people, but we have the technology and we have the authority and really organizational structure to allow our people to operate in a field model which other companies can talk to you about, but they cannot really execute that strategy because they do not even have the technology to the other people, or they do not have the culture, or they do not have all three of those things to execute that kind of strategy.

And then you have to couple that with best in class technology and we clearly spent a lot of time and effort on getting us to the point that we are in the marketplace. Are we satisfied with that? No we are not. We are now pushing into more end-customer self service. We are focusing our agents around how do you be open 24 hours a day. These are the things that we are pushing, how do we push good quality accounts to our agents so they run at the accounts that they know we are going to really want to write and that we are going to be able to write profitably and at the best price.

Those are the things that we are doing as an organization that will drive future value. I think we are the only carrier out there helping agents hire new producers in the marketplace. And then as we bring on more agents, this gets to the point before, we are not saturated at a thousand agents, think about it. That capability is just tremendous, but we want to maintain our franchise. We want to maintain the Ivy League structure of independent agents that we have, now we want to make sure that they commit back to us, the growth commitment and the dedication that we share with them.

Operator

(Operator Instructions)

Your next question comes from the line of Michael Gasher with Piper Jaffray.

Michael Grasher
Piper Jaffray

Just a follow up on I guess all of these, with all the success that you have had with the investment in the back office, the knowledge management system in the multi variant modeling, do you have internally expectations for improvement in your eventual combined ratio on a longer run basis for the blended lines of business?

Greg Murphy

Yes.

Michael Grasher

Piper Jaffray

And are you willing to share that with us?

Greg Murphy

No. Might I just add to that. It is something that we clearly focus on. I mean, I do not know how many companies you talked to that analyzed their business in 80 different product segment codes. We can sit there and articulate to you what our market share is, how profitable that business is, how many of them are profitable, how many of them are not profitable, what are we doing about those segments that are profitable? I mean, that is just a level of richness that you do not see. We track our business by line. We track it by state. We track it by agent and then we do a whole host of other initiatives really to better understand the make up of our business and what drives profitability long term.

Michael Grasher
Piper Jaffray

Understood, I am just waiting for the revision for the higher ROE.

Greg Murphy

So am I.

Operator

At this time, I do show that there are no further audio questions in queue.

Greg Murphy

If you have any follow up, please reach out to Dale or Jennifer. Thank you very much for your participation in the call today.

Operator
Thank you. This concludes today's Selective Insurance Group Fourth Quarter Earnings Release Conference Call. You may now disconnect.