S&P Capital IQ

CONTENTS

Selective Insurance Group, Inc. NasdaqGS:SIGI

FQ4 2009 Earnings Call Transcripts

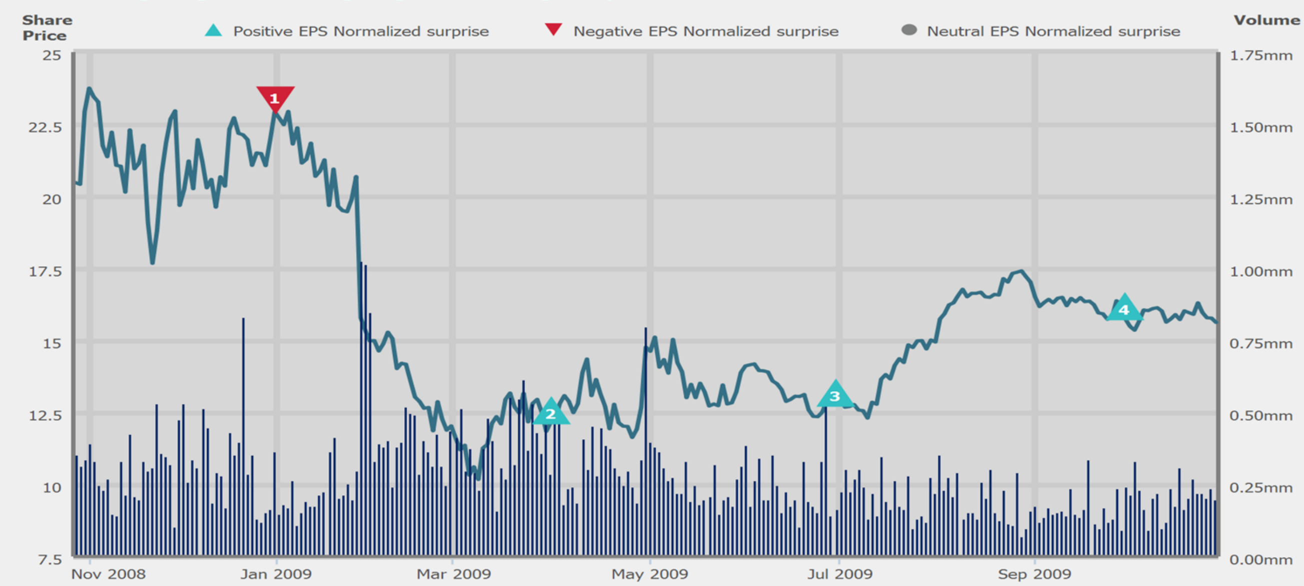
Thursday, February 04, 2010 1:30 PM GMT

S&P Capital IQ Estimates

	-FQ4 2009-			-FQ1 2010-	-FY 2009-	
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	ACTUAL
EPS Normalized	0.37	0.47	▲27.03	0.38	1.31	1.39
Revenue (mm)	392.46	389.80	▼(0.68 %)	391.18	1512.89	1514.02

Currency: USD
Consensus as of Feb-04-2010 11:42 AM GMT

Stock Price [USD] vs. Volume [mm] with earnings surprise annotations



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ4 2008	0.48	0.10	▼1 (79.17 %)
FQ1 2009	0.01	0.05	▲2 400.00 %
FQ2 2009	0.24	0.43	▲3 79.17 %
FQ3 2009	0.34	0.44	▲4 29.41 %

Call Participants

EXECUTIVES

Dale A. Thatcher
Former Chief Financial Officer, Executive Vice President and Treasurer

Gregory E. Murphy
Chairman and Chief Executive Officer

Jennifer DiBerardino

John J. Marchioni
President and Chief Operating Officer

ANALYSTS

Amit Kumar
Macquarie Research

Joe DeMarino
Piper Jaffray

Mark Alan Dwelle
RBC Capital Markets, LLC, Research Division

Peter Seuss
SuNOVA Capital

Presentation

Operator

Good day, everyone. Welcome to the Selective Insurance Group's Fourth Quarter and Year End 2009 Earnings Release Conference Call. At this time, for opening remarks and introduction, I would like to turn the call over to Vice President of investor Relations. Ms. Jennifer DiBerardino, you may begin.

Jennifer DiBerardino

Thank you. Good morning and welcome to Selective Insurance Group Fourth Quarter 2009 Conference Call. This call is being simulcast on our website and a replay will be available through March 5, 2009. 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 and operations. Operating income is net income, excluding the after-tax impact of net realized investment gains and 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 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 Executive Management Team: Greg Murphy, CEO; Dale Thatcher, CFO; John Marchioni Chief Underwriting and Field Operations Officer; Ron Zaleski, Chief Actuary; and Kerry Guthrie, Chief Investment Officer. Now I'll turn the call over to Dale to review the quarter results.

Dale A. Thatcher
Former Chief Financial Officer, Executive Vice President and Treasurer

Thanks, Jen. Good morning. 2009 was a challenging year, given the economy volatile financial markets and soft market conditions. In spite of those difficult headwinds, we are pleased with our fourth quarter and full-year results in all that we have accomplished. Surplus was up to $982 million, GAAP equity was back over $1 billion, Commercial pricing was a positive 2.7% for the quarter as it continues to move higher and investment income improved 78% in the fourth quarter from a year ago.

For the fourth quarter, we reported strong operating income per diluted share of $0.47, more than triple last year. Earnings were driven by a significant improvement in alternative investment income, good property results and favorable prior-year liability reserve development. The fourth quarter statutory combined ratio was 103.7%, a point higher than a year ago. I'll remind you that the normal seasonality of premium written is such that the fourth quarter is always lower than the other three putting pressure on the statutory expense ratio. By comparison, the GAAP combined ratio was 100.2% for the quarter, down slightly from a year ago.

For the year, the statutory combined ratio came in slightly better than our expectations at 100.5% and the GAAP combined ratio was 99.8%. Overall, prior-year statutory loss and LAE favorable reserve development on a pretax basis for the quarter was approximately $11 million or 3.2 points on a combined ratio, compared to $9 million or 2.3 points in the fourth quarter of 2008. For the year, favorable reserve development on a pretax basis was approximately $29 million or two points on a combined ratio.

Commercial lines premium growth continues to be a challenge, given the tough economic and competitive conditions. Commercial lines premium declined 4% in the quarter driven by the $17.5 million in return audit and endorsement premium compared with $13.2 million a year ago. We expect to begin seeing easier year-over-year comparisons for audit and endorsement return premium, and we did see slight improvement from the third quarter. If unemployment rates don't deteriorate from the current 10% levels, we anticipate the return premium trend will reverse in 2010.

New business declined 10% in the quarter while renewal premium increased 2%, and retention improved to 76%. We were one of the few carriers who have been successful getting positive commercial lines pure price since the second quarter of 2009 when pricing increased 0.6%. We achieved 1.5% in the third quarter and 2.7% in the fourth quarter, which reach us a level where we are covering our projected loss cost trends.

We reported a commercial lines statutory combined ratio of 103.3% in the fourth quarter and 99.8% for the year. Commercial property performed very well again in the fourth quarter with a 76.2% statutory combined ratio and 83.9% for the year. The fourth quarter workers' compensation statutory combined ratio of 130.1% has a lot of moving parts related to reserves, in audit and endorsement premium, which makes it difficult to draw any conclusions.

Workers' compensation policies are initially rated based on an estimated exposed payroll and are then audited three months after the policy expires to determine actual payroll. Given the poor economy, particularly for contractors, we had substantial return premium this year. The full-year combined ratio of 107.6% gives a much better view to the performance of this line. For the full year or the impacts of favorable development in excess audit and endorsement return premium generally offset each other.

Personal lines net premium written grew 11% in the quarter to $57 million. The Personal line's statutory combined ratio for the quarter was 107.1% compared to 105.6% a year ago and for the year was 104.4% versus 103.7%. Homeowner results were in line with expectations in the quarter. The Personal lines combined ratio was negatively impact in the quarter by 2.2 points due to $1.2 million of unfavorable development in Personal Auto.

On the reinsurance front, we successfully renewed our Property Catastrophe Treaty, our surety and fidelity excess of loss treaty and the National Workers Compensation Reinsurance Pool Quarter Share Treaty, all on January 1, 2010. The surety and fidelity treaty structure remained the same as 2009 and renewed with a moderate price decrease. Due to our effective catastrophe management strategy, we are able to reduce the rate online by 8% for our catastrophe program. We believe Selective's reinsurance programs continue to be well-diversified with the slight of financially strong reinsurers distributed between broker and direct markets.

Turning to investments. The fourth quarter net investment income improvement was primarily driven by after-tax alternative investment income, which increased $15 million from the fourth quarter 2008 to a $3.3 million gain. The improvement in the equity and credit markets in the latter half of the year drove the improvement for alternatives. As a result, six of the seven alternative strategies had positive investment income in the quarter.

The outlier continues to be commercial real estate, which we expect to be weak for the foreseeable future. In the third quarter, due to the one quarter reporting lag, alternative investments underperform the S&P 500 Index by 1,200 basis points. However since we initiated this strategy in 1997, alternative investments have returned 9.4% on an annualized basis compared to 1% for the S&P 500. Partially offsetting the positive impact alternative investments had on investment income was a decrease in fixed income due to lower yields and lower dividend income as a result of the pruning we did in the equity portfolio in 2009.

Our fixed income portfolio after-tax yield was 3.3% for the year. For 2009 our unrealized loss improved from $55 million to an unrealized gain of $37 million after tax, driven largely by our available-for-sale fixed maturity securities. Other-than-temporary impairments or OTTI in the quarter we recorded at $7.5 million after-tax, primarily reflecting the continuing credit crisis and the associated securitized problem loans. Invested assets were up 7% for the year to $3.8 billion, reflecting an unrealized gain during the period of $133 million pretax.

The financial market's recovery from its lows earlier in the year is the driver of this gain. Markets amortized cost on the whole fixed income portfolio remained strong, ending the year at 101.8%, up from 97.1% a year ago.

As the financial market volatility increased early in 2009, we took a number of steps to protect surplus and minimize risks while maintaining a well diversified portfolio. Our municipal portfolio total is $1.6 billion and has an average rating of AA+. We carefully minimize our exposure to states with challenged economies. Our fixed income portfolio overall maintains a very high credit quality of AA+ and a duration of 3.5 years.

We believe we are conservatively postured for any additional market volatility as the economic and political environments remain influx. We continue to watch for inflationary trends and feel we are well positioned to weather potential increases in inflation. Our cash position is higher than we have kept historically but believe that it's still appropriate.

However, given the steep yield curve, we carefully monitor market opportunities to increase yield. We completed the divestiture of our HR Outsourcing business to AlphaStaff of Fort Lauderdale, Florida, effective January 1. As we said when we announced the sale, we have agreed to continue to support AlphaStaff's business growth through our agency plan.

Note that on the cash flow statement, a cash outflow of $12.5 million was recorded related to the sale of a subsidiary. This merely represents the cash on Selective HR's balance sheet at closing required to settle the outstanding payrolls they were processing at that date. Over the second half of the year, we experienced solid growth in surplus levels. Surplus rebounded $79 million in the fourth quarter, ending the year at $982 million.

In the fourth quarter, we implemented a Statutory Accounting Pronouncement SAP 10(R), which governs tax deferrals and their admissibility for surplus purposes. Instead of looking adjusted deferrals that would reverse in one year, SAP 10(R) allows a three-year view which provided an additional $34 million to be added to surplus in 2009.

Stockholders' equity also improved substantially to cross back over the billion-dollar market year end. Book value per share increased 12% from $16.84 in 2008 to $18.83 in 2009. The improvement in our capital position resulted in a year end premium to surplus ratio of 1.5 to 1.0, down from 1.7 to 1.0 in 2008.

Historically, we have been comfortable at a higher operating leverage. But given this still turbulent economy, we think it's prudent to run at these current level of operating ratio for the foreseeable future. With that in mind, we have no immediate plans to repurchase shares. We expect to maintain excess capital to be prepared for the inevitable market hardening and to be positioned to fully realize our growth capabilities, whether through organic means or acquisition.

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

John J. Marchioni
President and Chief Operating Officer

Thanks, Dale. Good morning. Our inside and field underwriters held their ground in 2009 despite a difficult market. Premium declined but policy counts grew and the quality of our book continues to improve, boding very well for long-term profitability.

Our superior agency force has worked with us to minimize the impact of the soft market, and write business with us in a very disciplined and targeted way. Despite a difficult year in which we tightened underwriting discipline and pushed a rate ahead of the market, our agency again rated us an 8.5 on a 10-point scale for overall satisfaction on our annual agency survey, which is conducted by an independent third party.

In fact, agency participation for the annual survey increased 7% over 2008 participation rate. Agents also ranked our field underwriters or AMSs very high for professionalism. This is validation that are hightouched business model and superior agency relationships matter. We aimed to be the partner of choice and we're succeeding.

Our inside renewal underwriting teams are working hard to balance price increases with retention levels. With the success we've had in driving price on a targeted portion of our book of business, we ended the year strong with commercial lines retention of 76%. On a point of renewal basis, overall retention for the year was 87%, essentially flat with a year ago.

When we look further into our retention, it is clear that we are driving improvement in overall mix. At year end, retention at the point of renewal for the lower quality one and two Diamond business was 78% as we achieve rate increases on this business of 6.5%. Indicating the progress we are making, we achieved 10% price increases on this portion of our book in the fourth quarter.

On the other end of the spectrum, our best performing 4 & 5 Diamond business retained at 90% and pricing remained essentially flat. We believe this demonstrates that our underwriting expertise and predictive modeling tools are working as intended. It also demonstrates a support of our agency force in selling these necessary price increases. Needless to say, we truly appreciate their efforts.

Our field underwriters are writing the majority of new business in the highest quality 4 & 5 Diamond range. The shifting quality of new business since we introduced modeling is noteworthy. 4 & 5 Diamond business, now represents 66% of new business versus 53% pre-modeling. One in two Diamond business now represents only 8% of new business compared to 17% pre-modeling.

We believe our strong relationships with our 960 agents provide our AMSs with the best new business opportunities. New business pricing was down 2.5%, a strong result when considering the improvement in mix by Diamond. In addition, submission activity from our agents remained strong while continues to be pressure on hit ratios. Together, these factors demonstrate the discipline we do still in our operations.

For 2009, commercialized new business was essentially flat. By segment, one and done automated small business was up 7% to $74 million. Middle-market or AMS-generated business was down 4% to $169 million. Selective Risk Managers, our large account business was up 4% to $23 million.

We provide our agents with a variety of programs that support our commercial lines diversification efforts such as sales, developmental training and active leads for writing good business within our appetite. The leads have been pre-scored through our models and target pricing is provided the best to ensure profitability.

We continue to see the shift in our commercial lines book of business away from contractors to our other more profitable classes. At year-end, contractors accounted for 39% of commercial lines premium down from 43% at year-end 2008. The non- contractors classes of business performed on average about seven points better on a combined ratio than the contractors class. The non-contractors classes are manufacturer and wholesaler business, specialty, which include social service, golf courses and public entities and mercantile in service. We grew policy counts in the Non-Contractors segment by 7% in 2009 while contractors counts declined 2%. As we grow these classes faster than our contractors, our profitability should improve.

Personal Lines results are clearly not what they're need to be but the Personal Lines team has worked tirelessly to implement pricing, product and technology changes to grow the book with granular pricing capabilities through our MATRIX modeling. We expect these capabilities to drive future profitability. Unlike commercial lines, the personalized market began to harden in 2008. Over the past two years, we filed rate increases that could generate over 20 million of premium on our enforced book of business with additional increases already effective in early 2010.

Personal Lines new business is up 27% for the year and the quality of the book has improved substantially since the implementation of MATRIX. When you're simultaneously fixing and growing a book of business as we are in Personal Lines, it takes longer for the improvements to shell-through to the bottom line results. This is particularly evidenced by the fact that the actuarial new business Penalty and Personal Auto drops by 12 points by the fourth year we write a policy. As mentioned, we have been very successful in getting rate filings approved as we grow this book with actuarial sound pricing through MATRIX.

We are successfully diversifying our Personal Lines book as evidenced by the new business increase of 41% outside New Jersey. We are also seeing significant improvements in the quality of both Homeowner and Automobile business into higher insurance scored and multi-line policy sectors that have better claim experience and retained at higher levels.

We believe that predictive modeling through MATRIX, together with the substantial rate increases already approved on this book will allow us to achieve our goal of being profitable in the third or fourth quarter of 2010 with the full-year expected Personal Lines combined ratio of 100%. Now I'll turn the call over to Greg.

Gregory E. Murphy
Chairman and Chief Executive Officer

Thank you, John, and good morning. I'm very proud of what our dedicated employees and agents accomplished in 2009 in a very difficult economy and competitive environment. 2010 will continue to present its share of challenges. But we have strategies in place that competitively position us to take advantage of a changing Commercial Lines marketplace.

Industry-wide, Commercial Lines pricing discipline continues to be elusive due to customer pushback and a weak economy. Some companies are using an undisciplined market share growth strategy because they believe that's what shareholders want, but they could ultimately be destroying shareholder value. Underpricing new business in this market, coupled with the unlimited ability for prices to move higher at renewal is, in our opinion, irresponsible.

Most Commercial Lines pricing surveys are showing pricey decreases while the industry CPI as reported by the iii is up approximately 4%. The exception is Telehouse [ph] (01:22:36) CLIPS, which we have repeatably said is the more accurate survey because it's based on Commercial Lines renewable pure price and not based on anecdotal information.

We in no way control the market share leadership position. However, we are successfully driving rate in a very difficult margin. Through targeted rate increases, on approximately 15% of our Commercial Lines business, we generated overall pure price increases as follows: October, 2.5%; November, 2.4%; and December, 3.1%. In the fourth quarter, we covered our projected loss trend with higher pricing.

In January 2010, our largest renewal month, pure price increased 3.5%. As we continue to drive higher prices and we see the benefits of our underwritings and claims initiatives, we believe underwriting results will improve. In addition, we are non-renewing underperforming business which other carriers write willingly below our expiring price. We find this most difficult to understand.

Industry fundamentals point to a need for higher Commercial Lines pricing in 2010. One, investment returns have declined by approximately 40 basis points over the past year. Two, at some point the well of favorable development will run dry. Three, the insurance aspect of CPI was approximately 4% in 2009. And four, on level accident loss ratios, projections in 2010 should trend higher. All of which lead to a need for higher Commercial Lines pricing.

I personally want to thank each and every agent for their assistance in helping us achieve our pricing strategy. In 2009, the top line continued to be under pressure due to the economy, high unemployment rates and a competitive Commercial Lines marketplace. We returned $73 million in audit an endorsement premium and generated $266 million in new Commercial Lines business, $55 million of new Personal Lines business and we successfully grew our overall policy count by 6%.

We leveraged our strong agency relationships with initiatives that will facilitate organic top-line premium growth. Over the past two years, we've added over 200 agents in unpenetrated territories providing extra capacity for growth. We have been very successful in 2008 entry into Massachusetts and Tennessee. In 2009, we wrote premium of $22 million in Massachusetts and $15 million in Tennessee. And we've introduced new products that continue to research additional product opportunities that will provide expanded premium potential.

We have the ability to grow with confidence due to our strong underwriting and claims personnel, great agency relationships and our predictive modeling capabilities. We have a series of initiatives to enhance our claim handling processes. These initiatives focused on improved workflow, litigation management, reduce cycle time and medical expense management. We can assess the equality of a piece of business and price it for profitability, including the ability to tell our agents the reason why scores and the pricing are what they are.

This is an important facet of the relationship approach to writing model business with our agency partners. We're not just using a black box approach and our agents truly appreciate that competitive difference. We believe we've taken the right steps to set the stage for Personal Lines growth and profitability. We have the right people, the right automation, the right leadership and the right strategies in place to return this book of business to profitability. With the changes that Dale outlined in our high-quality investment portfolio, we've been rebalancing and we have reduced the level of risk.

We continue to approach our investment strategy with an eye towards reducing investment earnings volatility. As price valuations continued to improve for certain asset classes, we will assess their impact on our portfolio and act accordingly. We ended 2009 in a strong surplus position of $982 million and all of our leverage ratios improved. As we continue to add organic surplus growth in 2010, we increase our capability for a more aggressive premium growth, including acquisition opportunities.

Before I provide 2010 guidance, I wanted to re-emphasize the process that we go through for budgeting. On an accident year basis, we bring the last four years of loss ratios up to the current rate level in order to project the 2010 loss ratio by liability line of business. This provides a longer-term view which we believe is appropriate and more conservative way to establish the 2010 loss ratios.

Since overall pure price for 2009 was 0.9%, our early 2010 earned premium is still below our projected loss ratio trends. With this in mind, we'll provide the following 2010 guidance. Full-year combined ratios of approximately 101.5% on a GAAP and statutory basis. Combined ratios do not include any assumptions for reserve development, either favorable or unfavorable. Catastrophe loss expectations of approximately 1.6%, which is our historical average, and weighted average shares at year end of approximately $54 million.
In building your earnings models, you should consider the following: One point of GAAP combined ratio equals approximately $0.17 or one point of ROE; and two, if you refer to the investment exhibits on Page 9 of the supplemental investor package (sic) [packet], you'll see investment income by component for the fourth quarter and full-year 2009 with related yields and tax rates. We believe this information will allow you to create your 2010 models building in your own assumptions for interest rate and financial market movements. Now I'll turn the call back to the operator for your questions.

Question and Answer

Operator

[Operator Instructions] And our first question comes from Joe DeMarino. [Piper Jaffray]

Joe DeMarino
Piper Jaffray

Can you explain how the return of audit premiums impacts incurred losses?

Dale A. Thatcher
Former Chief Financial Officer, Executive Vice President and Treasurer

Sure, what happens is the way we do our loss projections by year, what happens is this return premium is really a diminishment of exposure that we thought you wrote in this year and the prior year. So what happens in the current year, we're putting up the losses for this year but this premium reduction is actually going back in the Scheduled P development into the 2008 year. So it does have an impact on Scheduled P development.

Joe DeMarino
Piper Jaffray

And my other question is based on your comment that, I think, you said you expect easier comps soon in terms of premium audits. If you could maybe just share some of the details of your assumptions regarding that statement.

Dale A. Thatcher
Former Chief Financial Officer, Executive Vice President and Treasurer

Yes, when you look at our auto premium adjustments and how -- and you've got to understand, as we recalibrate the audit premium we're also fixing the endorsement and getting the current term of the policy down to the right exposure level. So when you look at how that has ramped up over quarter-by-quarter, it's not until you get to really the fourth quarter of 2008 that you saw that number get into the double digit level. So we hit about $13 million, $13.5 million in the fourth quarter of 2008. And then pretty much every quarter of 2009 has bounced around between $17 million and almost 19 million per quarter, and we actually averaged out to about $18 million a quarter. So what happens is you have your recalibration of your business down to this new, let's call it, 10% unemployment rate. That doesn't mean we're not going to have any audit and endorsement premium in 2011. But as you've recalibrated your exposure down to your new work force level or new sales levels, when you get into 2010 and you compare it to 2009, just as long as we don't see any real deterioration in our level of unemployment, we'll be comparing our 2010 numbers up against the 2009 number that have an audit premium adjustment really for the 2008 year in it. So I don't mean to get overly complicated, but that's the improvement. When we say the comps will get better, we're going to be comparing a 2010 premium level on the exposure book that's already been recalibrated to approximately a 10% unemployment rate and we're going to be comparing that premium level up against first quarter, second quarter, third quarter, fourth quarter of '09 that has an audit premium adjustment for the prior year in it. So it's got 2008 adjustments and 2009, and that's what we mean by that.

Operator

Our next question comes from Mark Dwelle. [RBC Capital Markets]

Mark Alan Dwelle
RBC Capital Markets, LLC, Research Division

How many points of cap loss did you have in your results this year?

Dale A. Thatcher

Former Chief Financial Officer, Executive Vice President and Treasurer

It's by 0.6. I'm testing my memory, Mark, but I want to say 0.6 points...

Gregory E. Murphy
Chairman and Chief Executive Officer

It's 0.6 points for the full year that compares to 2.1 points in 2008.

Mark Alan Dwelle
RBC Capital Markets, LLC, Research Division

So to maybe put this year's actual results in the context of your guidance, if you had a couple of points of reserve releases this year and you were basically one point better this year versus the baseline assumption for cap losses, that's three points in total. So if I add that back to your actual GAAP combined ratio of 100.2, I like guidance basis. This year you'd have done about 103 give or take and your guidance then is 101.5, is that the right way to do the math?

Dale A. Thatcher
Former Chief Financial Officer, Executive Vice President and Treasurer

That's the absolute correct analysis that you should do, Mark, yes. So what we're saying in that is embedded in that improvement is what's happened is irrelative to price. And then underwriting and other activities, the change in the mix of business and a whole heathrow of other underwriting initiatives that are embedded in that, including a change in mix of business.

John J. Marchioni
President and Chief Operating Officer

You've hit the major points, this is John Marchioni. It's the various underwriting improvements that we talked about in terms of our improving mix of business by Diamond, by SBU, with those mixes improving. And then also the improvement we're seeing come through on the personal line side, which will also help in the year-over-year comparison.

Mark Alan Dwelle
RBC Capital Markets, LLC, Research Division

And then, I guess, as you talk through the various lines and initiative, I guess one of the things that kind of came through loud and clear to me was the potential for improvements in the personal line segment. I presume most of that must be on kind of the auto side, that was, obviously, the area that had the rougher go this year.

Gregory E. Murphy
Chairman and Chief Executive Officer

I would say it's on both sides. When you look at our roll out of MATRIX, auto came first. And you're seeing that fully-earned it's way through the book now. And MATRIX for homeowners came out about a year and a half after that. But when you look at the price we're taking, it's pretty consistent. In fact, probably little bit higher on the homeowner side. So you would expect -- we would expect to see improving mix in terms of distribution, as we said on insurance score, which helps us both on the frequency side but also on the retention side. And the better retention is, obviously, going to drive a long term profitability. But then in addition to the mix, you're seeing overall rate levels continue to go up industry wide but also on our book of business. So the combination of those two factors is what we expect to drive the improvement of our personal lines.

Gregory E. Murphy
Chairman and Chief Executive Officer

And Mark, when you really look at that, you're really seeing the benefits of three years of rate level working their way into that book. This rate level changes started in '08 in earnest, so you saw a good hefty rate level in '08 as well as '09. And now, what we're prognosticating in terms of '10. So it's everything we talked about. It's everything that we do on a regular basis in terms of underwriting, pricing, getting our right market share in terms of on an agency-by-agency basis. And now you'll see in 2010 and into '11 an improving overall person alliance book of business.

Mark Alan Dwelle
RBC Capital Markets, LLC, Research Division

Dale, you commented in terms of the impact of the payroll audits and similar adjustments had on the workers comp line. It seems like the BOP business was also pretty negatively impacted, are the same sort of effects rolling through there as well?

Dale A. Thatcher
Former Chief Financial Officer, Executive Vice President and Treasurer

No, the BOP line isn't auditable. So you don't have the same kind of audit premium adjustments that are impacting there. And we routinely have discussions. One of the problems with the BOP line, is just that it's so much smaller. It doesn't take but a few larger losses to put a lot of fluctuation through that particular line. And Johnny, you've got anything else you want to add?

John J. Marchioni
President and Chief Operating Officer

And in addition to audit and endorsement premium, obviously, as your book renews and you retain business, the impact in the economy is felt in other places. As sales receipts go down in your retail sectors, number of power units begin to drop and you're renewing business. And as business continues, it does decline. So that's going to impact your overall exposure level even in those non-auditable lines of business.

Dale A. Thatcher
Former Chief Financial Officer, Executive Vice President and Treasurer

I guess I would add that although it's not going to come through in the auto endorsement way that does in workers comp, the BOP line, obviously, those are small businesses and right now small businesses are hurting pretty badly. So you definitely see decline in business there and there's going to be some effects of the economy showing through there.

Mark Alan Dwelle
RBC Capital Markets, LLC, Research Division

Were fourth quarter results particularly affected by the fairly large winter storm late in December? And similarly, have you seen any early effects from the storm's already under discussed [ph] this year?

Gregory E. Murphy
Chairman and Chief Executive Officer

Well, we really don't, at this point, comment about 2010 results. But what we did see is in 2009 in terms of the fourth Q property results, they pretty much perform in line with our overall expectation. And that in the line kind of gets pushed around with a certain amount of severity. You've seen that severity evidenced itself sometimes in the first quarter or in other quarters. But when you look at that performance of that line overall, it performed really better than our expectations. And fourth quarter catastrophe losses were zero.

Dale A. Thatcher
Former Chief Financial Officer, Executive Vice President and Treasurer

Yes, but just so you understand, there a lot of losses that you can get in a deep freeze, just so you understand that, that don't evidence itself in a PCS [ph] event or it can create problematic situations in areas that aren't sensitive of a lot of frozen pipes, a lot of unusual snowstorms down in areas can create with the snow problems. But generally speaking, our property books performed very, very well.

Operator

Next question comes from Amit Kumar. [Macquarie Research]

Amit Kumar
Macquarie Research

Just going back on your comments regarding the buyback, I think you've said that you don't plan to buyback stock. I'm just wondering, what sort of premium to surplus level do you feel like that you need to get to sort of revisit this decision?

Gregory E. Murphy
Chairman and Chief Executive Officer

Well, we're not making any prognostications on that, but I would say that we're very comfortable at a 1.5 to one premiums in surplus, which would indicate that we have an appropriate level of capital for doing what we want to do in terms of our strategic plan and how we want to grow. We'll obviously continue to assess that over time.

Amit Kumar
Macquarie Research

In your operating comments, you mentioned that some companies are still being undisciplined. Not taking any names, is it more so in the regional space, the large public companies or large non-public names?

Gregory E. Murphy
Chairman and Chief Executive Officer

Yes.

Amit Kumar
Macquarie Research

So it's all of the above.

Gregory E. Murphy
Chairman and Chief Executive Officer

What I would say is that -- I'm going to be careful on this one. I would say it's a few carriers. It's not as broad-based as you might, I don't want you to misinterpret that comment. It's coming in certain directions but it's more focused than it is just holistically across the board. And you just see that in the marketplace. And it just makes it more difficult for our people to do what they need to do on their renewal book. When agents are constantly concerned about who, what other company may come in on the other side of the trade and just way underpriced a piece of business. And it makes everything that we're doing that much more difficult in this kind of market.

Dale A. Thatcher
Former Chief Financial Officer, Executive Vice President and Treasurer

I think it's is also important to note that -- I mean, I think where we have see it, most particularly is on new business pricing that's may be a tad more disciplined on the renewal. But if you think about that, it's very difficult for a company to really evaluate the quality of their new business pricing. And we put a lot of time and effort into doing that ourselves so that we can maintain that discipline and have a pricing strategy on the new business side that matches the renewal. I think other companies aren't as far along on their capabilities there as we are.

Amit Kumar
Macquarie Research

And then when you talk about these pricing decreases, are they meaningfully below you or is it maybe instead of a 5% to 10% range?

John J. Marchioni
President and Chief Operating Officer

It's all over the board. Generally speaking, with our relationships and our service model and our product capabilities, we don't generally lose accounts for small percentages. You're seeing, in certain cases, lesser quality accounts that we thought were maybe thinly priced that we tried to get some rate on, going for 15%, 20% below our aspiring, sometimes. But it varies.

Amit Kumar
Macquarie Research

In terms of your discussion, if I'd go back and look at your Q3 commentary, you had said that you expect there'll be a change in industry behavior in 2010. Now that we are in 2010, if you were to sort of compare your thought process between Q3 and now, would you say that you're relatively sort of pessimistic on that or is it unchanged?

Gregory E. Murphy
Chairman and Chief Executive Officer

I would say that we are not pessimistic on it, but I would say that when you look at the weight of evidence and you look at the fact that insurance CPI is up 4% and you look at some of core fundamentals in terms of where investment rates are and the pressure is on the other aspects of the fact that the industry will be -- possibly in 2010, the fourth year in a row that it's not going to grow. And that's the first time we've seen in a top line in the industry decline since, I think, 1943. So four years in a row of premium reduction, I think when you add up all of the factors that point to a much higher need for rate level, particularly when you start to back out of these companies, the amount of payroll development they're releasing in their combined ratio. So when you look at these -- as I'm not a fan at all of knocking weather out, weather is what weather is, you price for it and you get the benefits when it doesn't blow just like you get deductions of it when it does happen. But when you start to add back in the development, it's pretty significant. And you readjust some of these combined ratios, they're pretty stratospheric. And the only way that you can improve those over the long term is through higher price. So we feel that the market should be moving. We see it, but it's not happening holistically, but I would say that I feel about the same or maybe a little bit better than I did before.

Amit Kumar
Macquarie Research

But at the same time, if you sort of compare the premium leverage pre-'09, '11 to now, the industry does have a meaningful level of excess capital, right? So that...

Gregory E. Murphy
Chairman and Chief Executive Officer

You did point our case, so let's talk about excess capital. I mean, you're talking in a world now with the goalposts are being moved in between -- and sometimes right when the plays going on in the field. Forget about between quarters. So even as you're playing the game the goalpost are being pushed around in terms of, I think, there's a whole different recognition of volatility in your investment portfolio. There's a whole different concern about risk-adjusted filings and inflation and how that may affect your numbers and where you need to position yourself and your product in terms of how you price your product, relative to these inflationary measures. So that may evidence themselves. And we already talked about the fact that we're talking about an industry where everyone's saying inflation overall is not there. But you had the core insurance inflation is running about 4%, when you look at the underlying medical trends, when you look at car repair and other aspects of it. So these are the things that kind of point you to the fact that things are most volatile than they were before. Rating agencies are constantly retooling their models for the higher volatility and potential worsening results and price diminishment. So all of those things kind of get baked into an overall cake and understand where we are at $3.77 of invested assets per dollar and a 1.5 premium to surplus ratio. We feel we are probably tuned to take advantage of both sides of the equation.

Operator

[Operator Instructions] Our next question comes from Peter Seuss. [Lincoln Square Capital]

Peter Seuss
SuNOVA Capital

I just wanted to -- not to beat a dead horse, but just to fully understand the impact of the audit endorsement premiums. So if you had $73 million of adjustments in 2009, does that mean your earned premium was $73 million less than it otherwise would have been?

Gregory E. Murphy
Chairman and Chief Executive Officer

If you want to hear, I'm going to break out the pieces for you. With respects to the audit premium, yes. With respect to endorsement premium, it's not a one for one -- I don't have the separation of those per item. So extent that it's audit premium, yes. The audit premium on its book, and the [indiscernible] earned premium, I got some papers shifting around there, Peter. And then with respects to endorsement premium, since that you're adjusting the term of the policy, the current term, it just depends on when you're making that adjustment and what's the expired versus unexpired term of the policy with respects to what came through earned.

Dale A. Thatcher
Former Chief Financial Officer, Executive Vice President and Treasurer

And of that $73 million, about $50 million of it is audit premium.

John J. Marchioni
President and Chief Operating Officer

$50 million came right through your EP [ph], right through your own premium.

Peter Seuss
SuNOVA Capital

So basically, your earned premium was reduced by $50 million but your losses, the dollar losses are not affected at all?

Gregory E. Murphy
Chairman and Chief Executive Officer

Well, the $50 million of adjustment is theoretically in the earned premium -- I just want to be sure, it's the 2009 calendar year, be it losses that you're adjusting for that, for the most part, are in the 2008 year.

Peter Seuss
SuNOVA Capital

Okay, so results in a little bit of favorable development. So for this year, I guess you had, if you do $50 million, if you add the earned premium, the $50 million to your earned premium and then you take your losses from this year, it kind of implies you had a 3.4% negative impact to the loss ratio from the audit, from just the audit premium adjustments.

Gregory E. Murphy
Chairman and Chief Executive Officer

Right, if you just do the math on the current calendar year, it has a negative impact on the combined ratio.

Peter Seuss
SuNOVA Capital

And so you're saying that this will reverse next year? Meaning, it basically won't have any impact or it will have a positive impact?

Gregory E. Murphy
Chairman and Chief Executive Officer

Every year, you have some level of audit and endorsement premium. If you go back to 2008, we had about a $22 million number for the full year of '08. Obviously, the $73 million this year is pretty high. And I would say that the $22 million for 2008 was a bit on the high side. There are years, if you go back when the economy is growing robustly, where the audit premium number is actually a positive in a given year. So what were saying is that, once you stabilize the economy, you don't see as much negative audit premium activity because basically, the businesses that we underwrite stay roughly at the same size over the course of the year, as opposed to overestimating payroll at the beginning and then having a return premium at the end of the period.

Peter Seuss
SuNOVA Capital

So that's also really one of the main reasons why, to the earlier question, I guess they combined this year as one of three on an apples-to-apples basis with guidance. But you have a 3.5 point improvement essentially just from the audit adjustments going away. So that kind of gets you back to 100 on an apples-to-apples basis. And then, I guess you have your underwriting initiatives, et cetera, in place, which then could further improve it. Is that the right way of looking at it?

Gregory E. Murphy
Chairman and Chief Executive Officer

Well, I mean, the one thing to keep in mind is, obviously, when you have an audit that is indicating that you have less exposure than you thought you're going to have, you got less exposure on the other side, too. So I mean, it's not as simple as just doing the math the way you've done it there.

Peter Seuss
SuNOVA Capital

Sure, but I mean the reserve releases were 2 points for the year and they were kind of 1.3 points for the prior year. But I understand what you're saying. It just seems to provide a little bit of cushion. But okay, I think I understand it. Next question, just a couple of clean up questions. Just the other expense line was $3.7 million in the quarter and I guess it was $6.1 million in the prior quarter. Can you just give some color on what the run rate is there?

Gregory E. Murphy
Chairman and Chief Executive Officer

Actually, there isn't a run rate for that just because you've got a volatile piece coming through there, which is any long-term equity awards to our employees get mark to market. So it all depends on what's going on with our stock price and that impacts the other line, the other expense line for the particular quarters.

Peter Seuss
SuNOVA Capital

So that's really -- the main change is the equity expenses.

Gregory E. Murphy
Chairman and Chief Executive Officer

That's the big one that causes that number to float around.

Peter Seuss
SuNOVA Capital

And then lastly on your tax rate. I guess, for the quarter, the effective overall tax rate was 17%. Looking at your guidance, what do you think that number should be for 2010?

Gregory E. Murphy
Chairman and Chief Executive Officer

The best way that we can tell you to do that is you need to decompose the overall operating earnings. And if you apply a 35% rate to everything, but investments, and then calculate your investment earnings expectations and apply the respective rates to that, then you'll be able to come up with a run rate for the 2010 year.

Peter Seuss
SuNOVA Capital

And what is your tax rate on investments right now?

Gregory E. Murphy
Chairman and Chief Executive Officer

If you go to Page 9 of the supplemental information, you'll see the tax rate by category and basically...

Peter Seuss
SuNOVA Capital

Yes, I guess it's 28% or 27%.

Gregory E. Murphy
Chairman and Chief Executive Officer

Well, you'll need to make your calculation based on how you think each of the respective investment categories will perform. Obviously, the muni's [municipal] perform at a lower tax rate.

Peter Seuss
SuNOVA Capital

And actually, just kind of an overall question, probably for Greg. When you look at growth potential in 2010, I mean, what are some realistic expectations in terms of -- I guess you're getting some rate. Do you expect to grow your PIF?

Gregory E. Murphy
Chairman and Chief Executive Officer

Well, you know, Peter, we did put in there. We grew our PIF by 6% overall. So we did grow. And when you listen to everything that Dale was saying, we lost $73 million of audited endorsement premium off the top line or approximately 5 points, 4.5 points of our last year's premium. And we didn't lose a policy. Theoretically, it gets interesting now, one policy walked out the door, but we lost all of those premium on exposure. So in theory, as the economy picks up, you've got that opportunity to grab some of that $73 million back to increased exposure. That's one issue. We didn't put out growth guidance,, so I'm just kind of helping you understand the pieces. That rate level changes that John articulated, it's with respect to the personal lines, we've got rate change in the commercial lines that we're working on. You heard what we did in the first quarter, the month of January, since the first quarter is not over yet, it's hard to do that. Although I'm trying to get clairvoyant. I'm working on that skill, but that's a pretty good price level for 3.5 points on Commercial Lines business. And then you've heard what we've done in terms of our Greenfield efforts, in terms of how successful we've been in Massachusetts and Tennessee. We've added a lot of agents, we've done a lot in terms of what John's talked to you about in terms of various lead programs and trying to target best performing business. We look at the quality of the business we write. We don't want to write it on underpriced levels. So we look at the market conditions ultimately starts to improve and that depends on how you much you look at the overall economic growth, we just feel we positioned ourselves well to take advantage of that.

Operator

[Operator Instructions] And at this time, I'm showing no further question.

Gregory E. Murphy
Chairman and Chief Executive Officer

Thank you, operator. I want to sincerely thank our dedicated employees and professional agency partners for what be accomplished in 2009 in helping us implement our strategies designed to deliver our long-term performance. I also want to thank the shareholders for your investment and you making in our dynamic organization. We continue to implement our strategies and maintain underwriting discipline, while at the same time, improving our competitive position for the inevitable market hardening. If you have any further questions, please contact Jennifer and Dale. Thank you very much.

Operator

Thank you, and this does conclude today's conference. We thank you for your participation. At this time, you may disconnect your lines.