S&P Capital IQ

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The Progressive Corporation NYSE:PGR

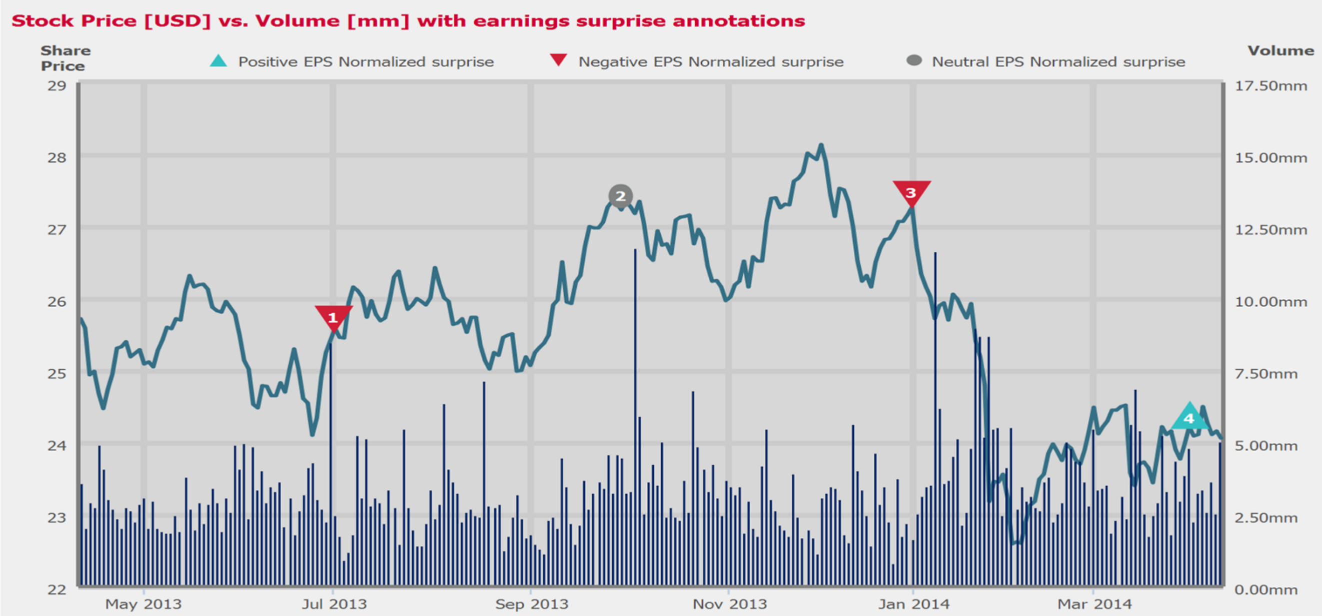
FQ2 2014 Earnings Call Transcripts

Thursday, July 31, 2014 2:00 PM GMT

S&P Capital IQ Estimates

	-FQ2 2014-			-FQ3 2014-	-FY 2014-	-FY 2015-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.48	0.45	(6.25 %)	0.36	1.61	1.70
Revenue (mm)	4643.07	4627.70	(0.33 %)	4680.53	18261.09	19203.75

Currency: USD
Consensus as of Jul-30-2014 4:28 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ2 2013	0.41	0.39	(4.88 %)
FQ3 2013	0.36	0.36	0.00 %
FQ4 2013	0.42	0.41	(2.38 %)
FQ1 2014	0.39	0.40	2.56 %

Call Participants

EXECUTIVES

Brian C. Domeck
Former Vice President

David Benson

Gary Traicoff

Glenn M. Renwick
Non-Executive Chairman

Matt Downing

ANALYSTS

Adam Klauber
William Blair & Company L.L.C., Research Division

Ian Gutterman
Balyasny Asset Management L.P.

Josh Stirling
Sanford C. Bernstein & Co., LLC., Research Division

Mark Alan Dwelle
RBC Capital Markets, LLC, Research Division

Meyer Shields
Keefe, Bruyette, & Woods, Inc., Research Division

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Robert Ray Glasspiegel
Janney Montgomery Scott LLC, Research Division

Vinay Gerard Misquith
Evercore ISI, Research Division

Presentation

Operator

Welcome to the Progressive Corporation's Investor Relations Conference Call. This conference call is also available via an audio webcast. [Operator Instructions] In addition, this conference is being recorded at the request of Progressive. If you have any objections, you may disconnect at this time.

The company will not make detailed comments in addition to those provided in its quarterly report on Form 10-Q, quarterly reports to shareholders and letter to shareholders, which have been posted to the company's website, and will use this conference call to respond to questions.

Our keynote moderator for the call will be Matt Downing. At this time, I will turn the call over to Mr. Downing.

Matt Downing

Thank you, Caroline. Good morning. Thank you for joining us on what I imagine is a busy morning for many of you.

Participating on today's call are Glenn Renwick, our CEO; and Brian Domeck, our CFO. Also on the line is Dave Benson, who will be sitting in for Bill Cody, our Chief Investment Officer. The call is scheduled to last about an hour.

As always, our discussions on this call may include forward-looking statements. These forward-looking statements are based on management's current expectations. They are subject to many risks and uncertainties that could cause actual events and results to differ materially from those discussed during this call.

Additional information concerning those risks and uncertainties is available on our 2013 annual report on Form 10-K, and our quarterly reports on Form 10-Q issued during 2014, where you will find discussions of the risk factors affecting our businesses, Safe Harbor statements relating to forward-looking statements and other discussions of the risks, uncertainties and other challenges we face.

Each of these documents can be found via the Investors page of our website, progressive.com. Caroline, we're now ready to take our first question.

Question and Answer

Operator

[Operator Instructions] And our first question comes from Mark Dwelle from RBC Capital Markets.

Mark Alan Dwelle
RBC Capital Markets, LLC, Research Division

I was kind of surprised to be first. Question that I had was we're seeing a lot of the aggregators kind of increase their ad spend. Are you seeing an increase in lead submission coming from that channel?

Glenn M. Renwick
Non-Executive Chairman

Mark, we're -- we would agree with you there's a lot more activity in the aggregator space. I'm not going to comment directly on our leads there. In some cases, to be quite frank with you, we have reduced our leads from some aggregators. There's not a clear answer to one across the board. But in some cases, we have not had the results that we would find consistent with our price point for other independent agency distribution product. So we have taken a range of actions. In some cases, less production with some aggregators, and in some cases, we have a strong relationship with some aggregators. So the point I think that you're getting at is, is this becoming a bigger part of the landscape production? Yes, I think that's a very fair assessment. Recognize that for -- I would say, let me just go with, say, 2/3 -- 2/3 of all new business production. You can throw sort of 2 or 3 carriers that track that. So we're not talking necessarily about the largest production of new business. But it is a function for some who do not necessarily, in my -- this is my opinion, do not necessarily have quite the same brand strength to be able to promote themselves in the way that we do.

Operator

[Operator Instructions] Our next question or comment comes from Meyer Shields from KBW.

Meyer Shields
Keefe, Bruyette, & Woods, Inc., Research Division

This is sort of a nitpicky question. When I look at the Q, when you talk about severity trends -- I'm going to focus on BI -- it's 3% to 4% for the second quarter and the first 6 months. But the first 3 months were higher, like 6%. So I'm trying to understand how the math works for that.

Glenn M. Renwick
Non-Executive Chairman

Yes, let's -- we actually have our Chief Actuary here, so he'll try to give you as much insight to that as we have. Gary, would you like to take that a little bit?

Gary Traicoff

Sure. This is Gary Traicoff, Chief Actuary. So on the year-to-date basis, our overall BI severity is running around 4% or so. And on the quarterly basis, what we had talked about was more to the tune of a 2% to 3% range. So all we're really looking at are the overall severity in the first half of the year compared to the first half of last year. And what you can see in looking at that is that in the second quarter, our severity was upped a little bit more than what we experienced in the first quarter.

Meyer Shields
Keefe, Bruyette, & Woods, Inc., Research Division

You mean the other way around, right?

Gary Traicoff

Yes, I'm sorry, the other way around.

Meyer Shields
Keefe, Bruyette, & Woods, Inc., Research Division

Okay, that's helpful. Bigger picture, I guess, Glenn, you made reference to competitors' rate actions. On a month-to-month basis, is that getting better or worse?

Glenn M. Renwick
Non-Executive Chairman

I'm not sure quite what better or worse means there. Let me answer it in a different way. In the early part of the year, focusing on our own rate actions, we took in several states and rates that were probably, let's say, heading for a 3 to 4 kind of rate action for the year. And we see competitors, and it ranges of course, but we see 2% to 3% to 4%, sort of relatively consistent there as well. I'm not sure what the outlook will be for the rest of the year. That -- we obviously will react to how we see things. But it is reasonably possible, based on what I'm seeing now, netting aside sort of hail and all that sort of stuff, that we might be in for a period of several months of reasonably stable rate action. We are very comfortable with our current rates. And at least relative to our outlook and relative to the trends that -- some of which we just discussed, we feel that's consistent with the way we're priced for the future. We're always pricing to a point in the future. So we're not seeing anything that takes us off our pricing estimates. I can't comment on others. We've seen some rate action from others that are in about the same league as ours. And if I had to go out on a limb, I would say that probably there will be a relatively stable rate environment for the next quarter or 2. But that could change if we see trends changed. You just commented on the difference in trend, and if that changed, we'd have to react.

Operator

[Operator Instructions] Our next question or comment comes from Josh Stirling from Bernstein.

Josh Stirling
Sanford C. Bernstein & Co., LLC., Research Division

So, Glenn, I have a question -- I have to ask a question on Snapshot. At your investor day, I think you showed us the sort of the real-time image of your GPS-enabled devices floating around Northeast Ohio. And I was curious, it's been a couple of months since then, since you started shipping, and I'm wondering if you could give us a sense of how it's going. How many units have you shipped with the new chip? What are you finding about customer opt-in rates with this new feature and greater monitoring? And how -- and I think one of the most interesting questions related to this is how are you tweaking sort of the customer interface and customer-facing sort of product offering, whether it's pricing or sort of what data you share with them based on this new information you're collecting?

Glenn M. Renwick
Non-Executive Chairman

Yes, a lot in there, Josh. I think what we showed you was a look into the sort of the way we think and the way we expect to shape our product. Let me suggest to you that we will bring out changes more in a product design change as opposed to leaking them out sort of individually. That will happen in a timeframe that is to be determined. I'm not getting out in front of myself or from a competitive perspective here, but you can be sure that we will let you know when that happens. What have we done since then? The whole idea of sort of that big data analysis and what we showed there was not necessarily the types of things that will absolutely find their way into the product, but hopefully a good indication of the way we can apply things and match external data sets, along with our internal data sets and just totally enrich the whole environment. And that is continuing to go very well. Very well except for the fact that we seem to always need more servers to put into our cluster and so on and so forth. But I guess that's good news. One thing I did comment on -- and I want to be very careful not to suggest that these are the leading indicators of product change, but recognize that one of the things I've said with Snapshot is that we would very much like our agents to be able to create a level of penetration amongst consumers, much more consistent with what we think the consumers' willingness to accept would be. I will derive my proxy for the consumers' willingness to accept based on our penetration in direct. So as we had a chance, which is a very rare opportunity for us, to enter an agent distribution state where we had not been, Massachusetts in this case, we actually tried some things, and the product designers tried some things that are not -- again, not necessarily reflective of exactly what will come about. But they wanted to test different hypotheses. And what was interesting is that, as one of the problems with Snapshot is that the rate, and this sort of goes a little bit to the whole field of comparative rating, how things are changing in a way that the rate that is quoted may not necessarily be reflective of the rate that the customer actually realizes only a short time thereafter based on driving behaviors. So this pre- and post-rating variable issue is a very important one, I think, in our field. But we gave the agents the opportunity to be able to give some part of a discount. Let's just go with me here because I'm trying to give you information but not play our hand. Let's assume the expected value of a discount is known. We gave some portion of that expected value of the discount as an upfront discount. We all know statistics. That means some people are going to get that, some people are going to get more, some people are going to get less. So we actually tried that as a way to see if ultimately, the same end result might occur. But by shifting part of the discount to the shopping process where the agents' ability to match the penetration of Snapshot, consistent with direct, in fact, closed. And while we have early reads, and I reported on that in my letter, that's something we're very intrigued, because we would love to see our agents be able to offer this more consistently with what we think the consumer demand is for it. And those are the sorts of things that you can probably expect to see in future designs, in some way, shape or form, along with the other R&D-type efforts that we gave you a glimpse at -- glimpse into in our investor day. All the other elements that you can expect from Snapshot, our comfort with segmentation, our comfort with retention, those things -- there's nothing dramatic to report since investor day, but those things are still exactly where we would like to have them.

Josh Stirling
Sanford C. Bernstein & Co., LLC., Research Division

That's really helpful, Glenn. And if I could, I'd ask you another question, not on Snapshot but maybe go behind the curtain a little bit. You took an opportunity in your letter to talk about your systems upgrade that you're 80% done. And I think you talked about this last time, really a couple of years ago maybe when you started. I'm wondering if you could remind us what exactly the systems upgrade was intending to accomplish, what sort of functionality or new data you could get or flexibility to manage the business. And I think taking it up to sort of our level, is this something that ultimately leads to greater capacity for growth? Or should we think about this as an initiative for you guys to reduce your processing or data costs and ultimately drive sort of a higher bottom line?

Glenn M. Renwick
Non-Executive Chairman

Good. Thanks. I threw it in there. I didn't really think people cared too much about the things that are sort of behind the scenes. So critical day-to-day activities for us, so expensive and so demanding of a lot of resources. So I'm happy to talk about it a little bit. Bottom line is we are -- we, like so many companies, had pretty good systems, but they were designed in an era where effectively batch processing was the design criteria. It doesn't mean that it was entirely batched. It's been changed and modified over years, and everybody has words for that. I'll stay away from them. But for the most part, we really wanted to take a look at what the future of Progressive would look like, from both a capacity perspective, real-time processing. And if you had to choose one major thing, this would be sort of a complete rewrite of everything into real-time processing as opposed to a combination of things that had been a little bit. The core was never designed that way, and all the art houses around it have been sort of changed to be modern but not necessarily totally consistent. This does provide us some functionality that we never had before. But I think for your purposes, that would be pretty boring in terms of date organization of endorsements and so on and so forth. It certainly also brought us into a mode where Progressive -- where we might have designed and did, in fact, design systems that said, most of what we see are relatively small family units, 2-, 3-car units. So things with more than 5 cars or more than 5 drivers were not necessarily a design criterion. And in fact, they were capped. Now we have no such need to cap them, and it's more reflective of our business environment. And I'm sure if I was actually on the processing of phones, there are a lot of other benefits that are presented in that system. But if I were you, I would tell you it is one of those things that allows Progressive not to be constrained in the types of things that we're talking about, whether it's mobile, Internet, total real-time consumer interactions, and allowing the consumer to be much more a user of our systems, where the systems that we designed well over 30 years ago were designed with a user that was an employee of mine. And a lot of that has been put into this, and I don't think I'm overstating it. We're really happy with the outcome. It took longer than we expected. It cost more than we expected. I guess that's not new news for systems. The point that I would emphasize is that the risks that are so inherent in a project that takes that long, costs that much, uses that many resources, at least those risks now seem to be largely behind us, and the benefits are starting to be accrued both by our customers, our own people and by the ability to design products that are able to take advantage of the features.

Operator

Our next question or comment comes from Adam Klauber from William Blair.

Adam Klauber
William Blair & Company L.L.C., Research Division

Noticed that you've got a greater level of short-term securities than usual. I think the number at 6/30 was over $3 billion. As we think about dividends and potential capital return, whether share buyback or dividends, for the end of the year, do -- will that have an impact on capital return?

Glenn M. Renwick
Non-Executive Chairman

Brian, why don't you take that and maybe have Dave comment on the...

Brian C. Domeck
Former Vice President

Sure. I wouldn't link up the -- our investment portfolio composition with our capital return and timing of those things. I think more the -- we always want to have our portfolios be liquid and diversified. And, obviously, being liquid helps facilitate things like debt repayments and share repurchases and dividends and the like. But in terms of keeping that much in terms of our short-term investment is more of an investment portfolio decision as opposed to keeping it for capital management activities. We still have lots of flexibility on the capital management activities. And we don't direct Bill and Dave necessarily to what their investment portfolios should -- composition should be to affect those changes. Dave, if you want to add any color as to what we are holding in short-term investments and why.

David Benson

Sure. We have increased in the short-term on the quarter primarily driven by 3 factors: our debt issuance that we executed in April; second, we modestly reduced the duration of the portfolio in the quarter, and to affect that, we sold treasuries, and most of those proceeds went into short-term; and then third, our cash from operations were not entirely invested in fixed income or equities. The residual flowed into short-term, and that's a function of our view on risk and risk premium. Risk premiums are awfully tight, and we're exercising patience, essentially waiting for a better set of risk return opportunities to develop.

Adam Klauber
William Blair & Company L.L.C., Research Division

Okay. And actually then, could you just, I guess, comment on how we should think about capital return for the end of the year? Obviously, did a lot of dividends at end of the year and beginning of this year, and had some level of buybacks. As we think about this year, is it reasonable to assume that you could be at the current level? Or how should we think about it?

Brian C. Domeck
Former Vice President

Here's what I'd say. One, capital position is strong. So we have continued to generate capital throughout the year, both from an underwriting perspective as well as investment returns. So capital position is strong, and we added to it by taking advantage of the interest rate environment, and issuing debt. So capital position is strong. We have sufficient capital to grow the business as much as we can. And that's our first order of investment in terms of returning and growing the business. What you can count on, at least for the end of the year, is one component of our capital management, and that's the variable dividend. But even that is subject to the constraints that comprehensive income has to -- after-tax underwriting profit has to be higher than comprehensive income. So -- but given our position today and positive return of the portfolio, we're well in position to that. Now that variable dividend, just as a reminder, is 1/3 of after-tax underwriting profit then multiplied by the gain share factor. Now if you were to actually calculate where we are through the end of June, that dividend through the end of June is about $0.31. And that's purely calculateable. But obviously, the second half of the year would factor in, both in terms of underwriting profit, as well as the final gain share score would influence that final dividend. That component piece, we've articulated as sort of set. What we do in terms of any other activities, whether it be share repurchases or in the past, on occasion, we have used special dividends, it's a function of both our aggregate capital position, needs in the business, our share repurchases would be our assessment of the market value of our stock versus our own internal assessment of intrinsic value. And if we think it is a good buy, we will make share repurchases. You'd see those. We don't forecast. We don't say, "Here's how much we're going to buy over the next year." Obviously, you can see it each month -- each and every month in our news release. And then if any of the vehicles of capital generation exceed variable dividend, share repurchases, and we still think we have more capital, then we could consider a special dividend again. But as of right now, we have not discussed that.

Operator

Your next question or comment comes from Bob Glasspiegel from Janney Capital.

Brian C. Domeck
Former Vice President

Before we go to that next question, I want to -- I should correct something I've said. It's comprehensive income has to be higher than after-tax underwriting income. I think I inadvertently reversed the order, so I want to correct that before we leave the call.

Robert Ray Glasspiegel
Janney Montgomery Scott LLC, Research Division

Glenn, you're talking in terms of stable pricing over the near-term environment and stable results. But the personal lines auto cycle has just been a lot more stable than I've seen in my 30-plus-year career where you and GEICO and Allstate are earning attractive returns and attractive margins in sort of an orderly competitive environment where market share swings aren't that dramatic. And your direct business is growing, your agent business is struggling, and you're, in total, growing slower than you have over your history. Why is that -- what -- why is this going to change? Do you agree with my sort of characterization of the environment that this is just a lot more stable business than it's been? Or are we possibly in a environment where what we see over the next couple of months is what we're going to see over the next couple of years?

Glenn M. Renwick
Non-Executive Chairman

I think I would largely agree with the characterization except for the last part. I just -- not that I disagree with it. I just don't know. You've seen this business as long as I have, and there are times where, frankly, you think you're in a stable environment. We've gone everything from very rapid trend increases to deflation periods or slight deflation in periods. So I don't know. I think what you have to do is step back a little bit and ask sort of 2 things: what are sort of happening environmentally to the industry that's outside of our control, and what are things that we would do ourselves relative to things that are inside of our control from a growth perspective? So I can take your -- so I generally agree with your premise and then do that. External, I think we addressed that, at least some of the things that have to be on everybody's minds, and they're appropriate to be on everybody's minds. The whole vehicle technology cycle. I mean, do I expect frequency to come down? Yes, I do. But I also expect that we will see opportunities to ensure things and act differently than probably we can even predict today. So I think there is a strong vector of change that would suggest certain aspects of vehicle technology are going to produce lower accidents. Fine. That doesn't scare me as much as I think it scares some other people. I think that will have some consolidating effect on the industry, but that's to be determined. What we have to do is think about our strategy. And I think our IR meeting was at least a significant portion of that. So our strategy, we want to find ways to almost be disruptive in the rating stability, and not necessarily the aggregate rate, but ultimately lower levels of segmentation. And the best address of that, and I think the reason that Josh has asked the question each time, is that by taking data from the vehicle, which is directly related to my first comment, the vehicle technology, we think we see Progressive being a leader. We think we're geared up for it. We think it's in our DNA to find ways to segment driving behavior very differently than we have done before, and ultimately in a way that is smaller segmentation, more accurate segmentation and quite possibly disruptive. And that we fully will play to our advantage. The second major thing that we do that is for growth, we really outlined in our third era comments. And a lot of what we're doing now and some of it is at very different stages. So we are far from mature on these types of things. But as we have grown, and you've seen our growth through certain segments of the market, we have attained some pretty healthy market shares. Now to grow, we want to grow in other parts of the marketplace where we weren't historically strong. And we're starting now to say to be strong, we need to complement our product offerings. And you know what we're doing there. But that's not a little -- once in a while, we'll do it for 1 year or 2. This is a major repositioning of the company without leaving behind the things that we're already strong on. But there, the growth will no doubt get slower. But when we enter a part of the marketplace that we haven't been strong, we've very -- been very clear to say, "We don't have strong market share, don't even have low market share in some cases." We think we will be a very credible offering when we come and are starting to come to market with strong PHA partners. There are opportunities for us to get even stronger in that bundling. We announced the renters product, which is not -- certainly not a premium play. That is a play to primarily get consumers and start to get that attachment point that we believe will be right for a group of customers that will be coming, the sort of customer who can stay around for 20,25 years. So those are our 2 biggest parts. We could go into more detail. But we see our growth opportunities by continuing not to float along as it was yesterday but to challenge the opportunity to segment much more aggressively and, at the same time, be able to provide the products that allow us to go deeper into that insurance journey of our customers, that are more likely to go into that insurance journey and ultimately become a significant part of the market for the customers that we call the Robinsons.

Robert Ray Glasspiegel
Janney Montgomery Scott LLC, Research Division

Well, very thoughtful answer, Glenn. If you -- and Progressive's competitive position is strong, and the returns are great. The one sort of missing piece when you roll it all up is the growth angle. And you're growing where you want it and stable where you want it. But when you roll it all up, Progressive's going to be generating growth numbers that are way below what historically the company has given. Does Progressive have the DNA to sort of continue to execute the strategy like you execute -- like you suggest and report mid-single-digit top line growth if the environment just stays in a stable scenario?

Glenn M. Renwick
Non-Executive Chairman

I'm going to set out to answer your question a little bit differently. At least as long as I'm in this role, we have the DNA to keep thinking about what the hell it is that's going to drive us to higher growth in the future. I don't panic when the situation is the way it is. But I sure need answers as to why we will proactively be able to drive and be a catalyst for different numbers in the future. And I think we've -- I think we've outlined that. The fact is we're going to grow in -- we don't have to extract more out of the sectors that we're already strong in. We, of course, want to keep that at the current or better pace. But I feel terrific that we're really being a -- almost a new entry into a 40% part of the marketplace, with a strong brand, strong product and starting to associate with the right kind of products that we'll need to really be able to play in there.

Operator

Our next question or comment comes from Michael Nannizzi from Goldman Sachs.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

So one question I had if I could, and we've talked a little bit about growth broadly, maybe drilling down into the agency business. If I recall, you guys took some rate in maybe early part of '13 to make some adjustments. And we saw new applications fall commensurately, which makes sense. And I think you've talked about that rate activity moderating recently. But we haven't really seen the new apps reverse or kind of an inflection in PIF. And I was just wondering, am I reading that right? And maybe I'm not. But am I -- if I'm not, then maybe you could help me sort of triangulate what I'm missing.

Glenn M. Renwick
Non-Executive Chairman

Yes, I think I can help there. And if I don't and if I walk along too long, you can redirect. But to Bob's previous discussion, that was more of a longer term, so let me flip a little bit to a different timeframe. We even took some rate earlier this year in agency channel and selected states. So we're always taking rate, so it's very hard to characterize Progressive nationwide versus specific states. But we'll try to do it in a meaningful way. Here's my assessment. I'll do current sort of environment. I'll do some very short-term responses. I'll do some -- what I think are slightly longer-term responses and then sort of overall positioning, if I can think about it that way. My assessment, I wish -- one of the things I wish I had all through my career is the real ability to know what same-store sales were like. I don't know with any real precision exactly what shopping behavior is going on. We have seen, I think, extraordinarily well-intending proxies and different groups coming out, whether it's credit reports or Internet traffic or whatever it might be. Sometimes they're even conflicting, but they're all well intending, but there is no perfect proxy for shopping behavior. My assessment right now is it's relatively flat in the agency channel. I get there based on the quotes that we're seeing, which are relatively flat. I get there based on comments that we and others have made that they are seeing reasonably favorable retention in their book. So if they're seeing reasonably favorable retention, then you could assume that there's not an increase in shopping behavior. Our sales are down. There's no secret about that. And that is, if you have to sort of say tactically, sort of what are you worried about right this second? Agency growth. No question about it. It's on your mind. It's on our mind. Why is that? We are the largest player in that channel. It's well known, and 2 or so of the other large players in that channel are clearly confident and want to increase their growth. So they have come with a new product, new compositions to agents. And that's not the first nor the last time that we will see it or they will see it from us. So that's the spirit of competition, and we know there are things out there. I'm not going to comment on others. But yes, it's very clear that we are getting the same number of quotes, and we're not getting the same number of sales. So it's not hard to do that math. Short term, we've got some responses. There are some product responses that we'll do. I'm not going to go into the little nitty-gritty detail. But there are sorts of things that probably will have some effect. I don't think I will be the -- you'll see a dramatic change. But shopping discounts relative to the timing of when someone shops with us, a few situations with age of vehicle, there are things that we can do in a very short period of time. There are also some build plan restrictions that we've put on when we saw the market conditions in a couple of states a little bit differently in the early part of the year than what we're seeing now, so we can adjust those. John Sauerland has probably more at the prior IR meeting by giving you some insight into the fact that we are doing some degree of underwriting filtering. And that -- I bring that up because Progressive is much more of a -- we find a rate for everybody. But unfortunately, not everybody is buying insurance for the purpose of insurance, and we want to make sure that we can filter out those. So we've got underwriting filters in, and we would say we are relatively pleased with the use of those underwriting filters. But also be assured, like everything else, they have a sense of evolution. We have to fine-tune them, and there's some fine-tuning that we can do. Those are some of the short-term actions that we are likely to be able to do -- not likely, we will do. And on top of that, we will do the one that never seems to fail to work either against us and sometimes even for us: we will provide agents with some degree of incentive to reconsider their positioning with Progressive. So we'll do some agent incentives where it makes sense to do so.

Michael Steven Nannizzi

Goldman Sachs Group Inc., Research Division

And I guess with the competitive landscape, you mentioned a couple of other competitors, I mean, are you seeing the impact of competitors sort of reformulating products at a lower price point? Have you seen the impact of that manifest in your -- in that sort of quote to bind? Is that what you -- I guess you don't know for sure, but I mean, is that a supposition at least here recently?

Glenn M. Renwick
Non-Executive Chairman

No, we do know for sure. We can track at least -- well, if not for sure, awfully close. So we will take -- and let me be very clear here. I like to talk about Progressive, not other companies. We will take a sampling of our distribution of agents with a certain competitor and without a certain competitor. And we'll see the growth rates with and without. So -- and we will look at their results, and we will see what their new business production is and recognize what's the -- at least the size of ourselves and a couple other players in that channel. If the aggregate is not going up, then there's a little bit of shifting. So I think I was trying to be very clear there to say that yes, we think we're losing some that we were previously getting through actions being taken by others. Again, not the first time or the last time we'll see that. Don't expect us not to fight back. Just gave you some short-term stuff, some long-term stuff. And we always talk about this, but we're not as -- perhaps, we don't name them as much as some other companies. Our R&D efforts are always ongoing. We are currently doing things that will have a new product release as we continually have product releases that are addressing more of the preferred customer or the Robinsons, as we're calling them. We're also doing some things in our customer service environment to make sure that we have customer service that relates well to the, let's say, Robinson customers. And I already touched on these before, but the renters product, that is not something that you can sort of sit and say, "You'll see the results next week." We've rolled it out in Ohio. We will -- we're happy. We'll roll it out in Pennsylvania. Our PHA will double our agents. So these are -- so there's a series of both short-term and long-term actions that we'll take. And not to be too Pollyanna-ish about it, but we tried to show you at the IR meeting that we have effectively, in that channel, the lowest expense ratio, we believe the lowest loss adjustment expense, we believe segmentation -- and when I say lowest segmentation, I said that before, I mean more detailed segmentation, more granular. We, in our own assessment, don't feel like we give up anything to anybody there. So it's an awfully hard combination to beat, with the one caveat on top of all of that, that we have an expected margin for ourselves and for our shareholders that we don't compromise. But we think we're extraordinarily well positioned on those macro factors for a long time, and with a combination of the adjustments, product design, I feel pretty good about the future, but there's no question we're losing something in the last quarter. And we'll have to see how those sort of things go, and we'll quote very openly and honestly in the third quarter. But don't assume we're not conscious of it and trying to do something about it.

Brian C. Domeck
Former Vice President

The only other thing I'd add, just to give some context, the time period you referenced, we raised rates a fair amount in the second half of 2012. And that was in-agency channel. We also did it, and some indirectly in-agency. And that was more on the magnitude of 6% to 7% in terms of aggregate rate change. And that obviously slowed growth in the last half of 2012. We started to rebound particularly in the agency channel, at least on a year-over-year basis in terms of new business growth towards the last half of this year -- last half of last year. This year we've raised rates in agency between 2% and 3%. So there's not nearly the magnitude that we did in 2012. And it's keeping up with lost trends, severity trends, et cetera. But in 2012, when we raised that much, we also not only saw a decrease in the new business, but we also absolutely hurt our retention. And the 2% to 3% is much more manageable in terms of effect on retention. And while PLEs are growing more so in the direct channel than the agency channel, the 2% to 3%, we want to keep rates much more stable as opposed to the large swings -- or larger swings that happened in 2012. And I think we can accomplish that.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Yes. I just thought, I guess -- yes, sorry.

Brian C. Domeck
Former Vice President

No, go ahead.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

No. I was just thinking just the new eff being you kind of flipped negative again in the second quarter despite what would look like kind of easy comps in the second quarter of '13. So that's sort of the piece I was just trying to turn because it sounds like all of that makes us. But it just sounds like what -- you didn't see that the -- maybe the response that you might have expected from kind of more moderate rate activity in the quarter.

Brian C. Domeck
Former Vice President

But I think what we did see is we saw a drop in our conversion. But I think we also saw a drop in conversion more than we might expect just due to other competitor rate activities in the marketplace. So it's not only what we did but some things that other competitors have done. And as Glenn mentioned, it's a competitive marketplace. But long term, we can compete in that the marketplace very, very well.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

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Got it. Great. And then -- yes, I'm sorry, Glenn.

Glenn M. Renwick
Non-Executive Chairman

I was just going to throw in something since you're talking about the agency channel. Not to forget our commercial presence there, which really is a big help in a lot of different ways, even if it's not the biggest chunk of the premium. And there -- and I think I tried to comment in my letter that we really have had to take some pricing action, specifically in the -- for a higher-segment specialty and so on and so forth. We really have a good outlook on our current price levels. We may have even overreacted in a couple of places relative to some part, more of a smaller business order. In contractor segments, we think we've got those all adjusted now. So that's also an opportunity to make sure agents are feeling more comfortable with another product from us that has a good rate level. And we're looking towards seeing a little bit more growth come in, in the commercial sector, having gone through a fairly significant adjustment period there.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

All right, that actually dovetails -- the only last question I wanted to ask was on the commercial market. So it sounds like you've taken rate action there. How are you feeling about kind of the action you've taken and whether it -- and whether competitively, others are following suit? And are you liking that market in terms of positioning for further growth at this point? Or are you a bit more cautious just kind of given the trends that you've seen sort of recently?

Glenn M. Renwick
Non-Executive Chairman

Actually, I'd give you -- the answer is I'm liking it a lot more. And if I told you the answer at the end of last year or even into the first quarter, I would have been more hedged on it. We were seeing a fair amount of volatility. We took fairly significant rate action over a reasonable period of time. Anytime you take that much rate, you have affected mix, you have affected all sorts of things. We've gotten into, in the second quarter, a little bit more of a stable sort of mix. We know what's coming in. We realized, as I've said, we possibly overreacted a little bit in some of the sectors we've been historically very strong in. We've actually taken small decreases there and feeling actually very good, as does the general manager and the product managers of the commercial group. And they're intent on getting back to where we just historically have been, as always a nice profitable grower in that sector. To -- with regard to competitors, there have been a good number of comments made, always hard to sort of totally reconcile them. I think we're maybe a little ahead of the pricing actions that others are starting to think about taking or have recently taken.

Brian C. Domeck
Former Vice President

The other thing I'd mention sort of relative to the commercial lines, reserving has been a challenge, but I think we feel much better about our reserve adequacy and levels now. In the last -- prior to 2014, in the last couple of years, we have had unfavorable lost reserve development in commercial lines. So far this year, we've had a small amount of favorable development, which is fine. And given that business limits profile, et cetera, there is much more volatility in it. But from a reserving standpoint, we feel good about that. And that helps the product, management folks, product managers, general managers, help in terms of setting the right rate levels. So I think we feel good about that.

Operator

Our next question or comment is from Vinay Misquith from Evercore.

Vinay Gerard Misquith
Evercore ISI, Research Division

I have 2 questions. The first is a 2-part question. Thinking philosophically about the agency channel and PIF growth there, looking at your expense ratio of 20% and versus peer as I think roughly around the 23%, 24% mark, trying to figure out why Progressive would not be winning more business in an environment of competitive raters because I believe all the business then gets more evenly shopped. So are we missing something? But -- so that's the first part. And the second part is we've seen a preferred auto company just report with a 2% growth. And just -- so they're getting 2% growth. Curious as to why Progressive can't move the dial on the agency side a little bit more. Wondering if you're having a harder time in the preferred segment.

Glenn M. Renwick
Non-Executive Chairman

Okay. I almost have the same question as you do sometimes. It's why with the lowest -- lower expense ratio, why aren't we winning? Let me just suggest to you without overplaying things that I can't possibly know, we do business with many, many thousands of agents. I'm sure they all have different issues, but there are commission issues that sometimes help with the placement of business. There are other products that sometimes are influential. So while they have access to the comparative raters, I'm not necessarily saying that they are always going to -- and certainly, they would tell me, they don't always place at the lowest possible price. What we've got to make sure is that we're not only the lowest possible price, which we're not all the time, so let's not assume that even though the expense ratio at the macro level gives us that opportunity, and over a long time, I'd bet on that. But certainly, when you take segmentation and you take individual price, you're going to see a wide range of prices from carriers in the marketplaces. And then again, we are very clear about our margin requirement, and I can't speak to others. So the comparative rater is certainly an issue, and those with ultimately long-term low prices will work. I don't know that necessarily means necessarily that we or anyone else has to be the lowest. We have to provide product that sells. And we believe -- and we talked about this to some degree. We believe that now we have a commission level that is highly reflective of what we see as the macro cost of acquisition regardless of channel. So we have tried to keep our acquisition cost at least at the macro channel level roughly equal between direct and agency. And we think that, that's actually, long term, the best possible thing we could do to allow the agency channel to continually be not only relevant but competitive with any other channel, and allow it to be the consumer's choice of how they shop. With regard to preferred, with that, just, do we think we can move the needle? Absolutely. I mean, I said it before in the answer to Bob's question, this is an area where it may be harder for many of you to think, but this was not a space that we really, really played in with any great intensity. We've taken stock over the last several years -- it's not like a 1-day thing -- of what do we need to really play? We kind of got many of the things right. We started into the -- specifically the agency channel with a homeowner's offering that didn't -- it wasn't the right match. And that doesn't necessarily mean anything bad. It just wasn't the right match. So we regrouped on that, and now we feel, after some significant period of evaluation, not only do we have the right match, we may have just the best possible match that we could find. So our outlook for the preferred in the agency channel, a, there's a lot there; b, it's hard to get; c, we didn't really have all the tools, now we think we have. And just because we have all the tools doesn't mean we're going to displace others overnight. But I think we're going to give agents a really viable alternative. And one of the things you may or may not have heard me talk about is I don't want to go with just the same product that others have. I want to feel like the product is designed to -- almost as if the consumer was thinking about how our product might be designed. So things like single deductible for property claims that involve the auto, things like that. If we can make a better product and give that to the agent, the idea of the fact that it comes from 2 different distributors but working very closely together, I don't think will be our -- be an Achilles' heel at all.

Vinay Gerard Misquith
Evercore ISI, Research Division

That's helpful. Just a second question. Was wondering if you could comment on recent share sales advice by top management.

Glenn M. Renwick
Non-Executive Chairman

I think that involved me, but I didn't quite catch the question.

Vinay Gerard Misquith
Evercore ISI, Research Division

Yes. So there was a significant amount of share sales. I'm just wondering if it is...

Glenn M. Renwick
Non-Executive Chairman

Oh, okay. Well, I didn't -- I seriously didn't catch it, so I wasn't trying to avoid it. Happy to do that, never fun to sort of talk about yourself. So let me try and give you what I think is the operative issues. We had a situation here midyear, and someone else can give you the specifics, where we had what I'll call 3 tranches of performance-based stock coming due. There was actually 2, but 1 had a multiplier on it, and that multiplier was at the max. So here, I have an event that actually all happened essentially at exactly the same time. I'm not going to be defensive here. I'm just giving you the facts. If you may, if you go back and look at proxies, you'll see I haven't changed my cash compensation in well over 10 or 12 years, don't intend to. I take everything on a performance basis, so I'm paid in equity. Here, I got a situation that, frankly, precipitated with a short note that told me how much I had to pay in taxes. And I have consistently kept an extraordinarily high amount of Progressive equity, in fact, to the point that most people think I am making a big mistake just because it's so concentrated. I am extraordinarily happy with that. I bought all of my options that ever came due over a long period of time. So I had x amount of shares. I was forced, to meet tax obligations, to sell something. That was the precipitating event. What I decided to do with a little bit more discussion than I had planned was to keep my holdings in Progressive, which are over 4 million shares and another 1 million outside -- or in a unvested situation, about level. I mean, I think you'll find what happened with this transaction, pre-imposed, my holdings in Progressive are about the same. I want to make one other point just from the issue that this would come up with regard to confidence. By far, the majority of that, over 3 million shares, 3.2 million, I think, are in a deferred account. So that is my commitment, that Progressive is going to go strong for a long time after I'm not here. And that's paid out over a 10-year period and is not changeable for any other investment instrument. So I would tell you not to read too much into that. Frankly, I had to sell something to do something. I sold a little more than necessary, I decided, just to stay stable. I have a requirement from the board to be at about 5x my salary -- I'm looking around to see if that's the right number, haven't looked at it a long time -- in equity. I hold somewhere between 100% and 200% of my salary in stock. Hopefully, that's all I need to say about that.

Vinay Gerard Misquith
Evercore ISI, Research Division

Yes. I mean, I didn't mean to be disrespectful, but this is...

Glenn M. Renwick
Non-Executive Chairman

No, no, no.

Vinay Gerard Misquith
Evercore ISI, Research Division

I mean, this is really great color.

Operator

Our next question comes from Ian Gutterman from Balyasny.

Ian Gutterman
Balyasny Asset Management L.P.

I guess first, Glenn, I guess, a couple of follow-ups. The earlier question on BI severity, I was just -- since Allstate reported today comparing your comments about 3% to 4% versus theirs, and they're about 1% for the first half. And certainly not to ask you to explain their results, but just curious if you feel that your BI severity is running either higher than maybe you would have anticipated or higher than industry? Or is there anything that makes you feel that, that should be coming down going forward or that you're struggling with anything?

Glenn M. Renwick
Non-Executive Chairman

No. Actually, I would actually be happy that someone else is seeing something a little lower. It might be a foretelling of the future. Our mix and our profile of limits are always going to be a little bit of a factor there. That's a moderately significant difference. Gary, do you have any insight to why the...?

Gary Traicoff

Yes. I mean, we see on industry data, we see BI severity in the 2.5% to 3% range. So we feel that we're fairly consistent with what we're seeing with respect to the industry.

Ian Gutterman
Balyasny Asset Management L.P.

Got it, got it. Just on the...

Glenn M. Renwick
Non-Executive Chairman

The one thing I didn't comment on in my letter was PIP. And PIP can be obviously very important. It's obviously not BI, but it's the same range or same medically driven issue. And in PIP, we're seeing, with eliminating sort of comparisons, a 4% to 5% kind of trend in PIP. And probably for those who are close followers, Florida is always a very interesting PIP state, and we're starting to see in Florida some of the actions that John Sauerland had outlined with regard to underwriting. We're starting to see the frequency of PIP claims that are submitted within the first 60 days actually come to a level that we would think is more normal. So we may have actually filtered out the sort of things that are driving PIP -- overall PIP costs. It's not a severity issue but a frequency issue. So we're able to keep the price right for everybody who intends to keep the coverage. So generally, we're seeing good things in our PIP. And as -- Gary, nothing extraordinary as we look at our claims ordering process. We're not seeing anything in BI that is overly concerning.

Ian Gutterman
Balyasny Asset Management L.P.

Got it, helpful color. On the question on the investment changes, can you tell us what your new money rates are right now? And answer to the climate that part of the high cash is -- essentially sounded like waiting for rates to go up. Sort of what you would need to see in the environment to make the deploy? Is it just the Feds starting to raise rates? Or is it a couple hundred bps away from you guys wanting to deploy that? Just some sort of sense of what might make that come down over time other than, like you said, the debt proceeds that are kind of a temporary factor?

Glenn M. Renwick
Non-Executive Chairman

David, why don't you take a shot at that?

David Benson

Sure. New money investments on the quarter, this would include treasuries and non-treasuries. We're in the 2.30 [ph] range, pretty wide dispersion around that. But that's on a fully taxable equivalent basis. And on kind of getting more aggressive in divestments, we're absolute- and relative-value investors. I don't want to prejudge the ultimate destination for rates. But it feels good to take less rate risk here. Economic data on balance has been strong since the first quarter as we get closer to the end of the Fed taper, and beginning of the rate normalization process, the market will begin to discount that reality fairly aggressively, I think. And risk premiums on non-treasuries are awfully tight. And so we're just being patient waiting for a better set of opportunities.

Ian Gutterman
Balyasny Asset Management L.P.

That makes perfect sense. And then, Glenn, if I could throw one more in about marketing ad campaign. I'm just curious with any new thoughts on direction. Does Flo feel tired at all to you or -- I know you've obviously experimented with a couple of things over the past 2 to -- 2, 3 years that haven't necessarily taken off. When I think of sort of one of the large competitors, they seem to sort of -- yes, they get something really popular. They push it hard for a few years, and they get off and then come up with a new thing. You guys haven't really taken that strategy. I'm just sort of wondering if there's any thoughts about that.

Glenn M. Renwick
Non-Executive Chairman

Yes.

Ian Gutterman
Balyasny Asset Management L.P.

Whether it be changing Flo or adding something new as a -- sort of a second program, either way.

Glenn M. Renwick
Non-Executive Chairman

Somewhat both. Flo, we measure -- you can reasonably imagine, and we've shown you some statistics from time to time. But we measure a lot of them. We show you a few. We have no reason statistically to think that Flo is wearing, or wearing in a way that is negative, so expect to see Flo for some time to come. That doesn't mean that you should also expect to see some ads that don't involve Flo, and you may see them that are in the same general setting as the Superstore. Think of that as the white-background store, which sometimes we take a great deal of liberty on, and it might show up as a changing airport or a living room. So there's a leverage of brand equity in the Superstore. There's clearly brand equity in the character of Flo. You'll see both of them developed individually and together, and you will see some things that are quite different. We did show at the Investor Relations meeting what I'll call is more of a -- much more of an overlay. It's not a scream out and say, "Come buy our product right away." And that's what we call the thread campaign. The feature is the apron. And again, keep seeing all the brand linkage between Superstore Flo, the apron as an icon. We tried to do what we called rate suckers, which was really a way of demonstrating that in Snapshot, it -- you may very well be paying for other drivers and that unless you try Snapshot, you don't know that. That campaign was actually okay. Wasn't necessarily breakout, but it was okay. And it gives us greater confidence as to the type of things we want to move to. The bottom line is Flo and Superstore work really well. We do not want to make it so one-trick pony that we don't have a balance, and you will see a balance in our commercials. You'll also see us take Flo in different directions. But when you've got something that absolutely is working -- because I could certainly give you another company that's used something for quite some time and continue to get benefit from it. So there's a great deal to be said for a brand that has instant recognition. And in this day and age -- I'm probably answering your question longer than you want me to, but with so many -- so much of TV other than live sports being watched on a delayed basis, you've got to be really conscious of sort of fastforwards. And when you've got sort of iconography, color, those sorts of things absolutely matter. And we want to make sure that people know that we're out there advertising and wanting their business. So we're actually quite happy. Expect to see Flo, expect to see other things as well as we will never want to get to a point where we are not well prepared should something show some different consumer reactions. If Flo and Superstore were not to resonate as well, we clearly will not be waiting for that time to develop new ideas.

Ian Gutterman
Balyasny Asset Management L.P.

Got it. And this may be a suggestion, Glenn, as much as a question. But I guess, what I was kind of pondering was as you're trying to move from sort of the Dianes to the Robinsons, Flo maybe is more of a Diane-type campaign, I wonder if there needed to be something new, whether it be new characters or if I can be cheeky, Flo gets married and becomes a Robinson or whatever it might be. But something to sort of signal that second track of the company you're trying to launch.

Glenn M. Renwick
Non-Executive Chairman

We'll take all ideas. We're just not going to pay for them for them per se, if that's okay.

Operator

And our last question comes from Meyer Shields from KBW.

Meyer Shields
Keefe, Bruyette, & Woods, Inc., Research Division

I just wanted to follow up to get a sense of the really, really strong underwriting profits in commercial lines over the past few months and how that's likely to play out near term.

Glenn M. Renwick
Non-Executive Chairman

Yes, they have. In fact, I think the easiest statement there is the rate increases that we took really did stick. So -- and what I mean by that is you can take rate, but if it doesn't ultimately flow through to your average earned premium, then it hasn't really stuck, and you've driven away customers and so and so forth. So we've been lucky enough to actually see those rate changes flow through to average earned premium. And losses have come -- those that are not with us and those that we didn't think we had the right price for, they're not with us. And the losses are much more in line with what we expected. And as I said earlier, we may be at the top end of what price we need for that sector. And this -- we expect good profits from commercial, let's not be bashful about that. We're probably seeing something right now that's on -- certainly on the good side of norm.

Operator
That concludes the Progressive Corporation's Investor Relations Conference Call. An instant replay of the call will be available through Friday, August 15, by calling 1 (866) 403-8766 or can be accessed via the Investor Relations section of Progressive websites for the next year.