

# Selective Insurance Group, Inc. NasdaqGS:SIGI

## FQ3 2015 Earnings Call Transcripts

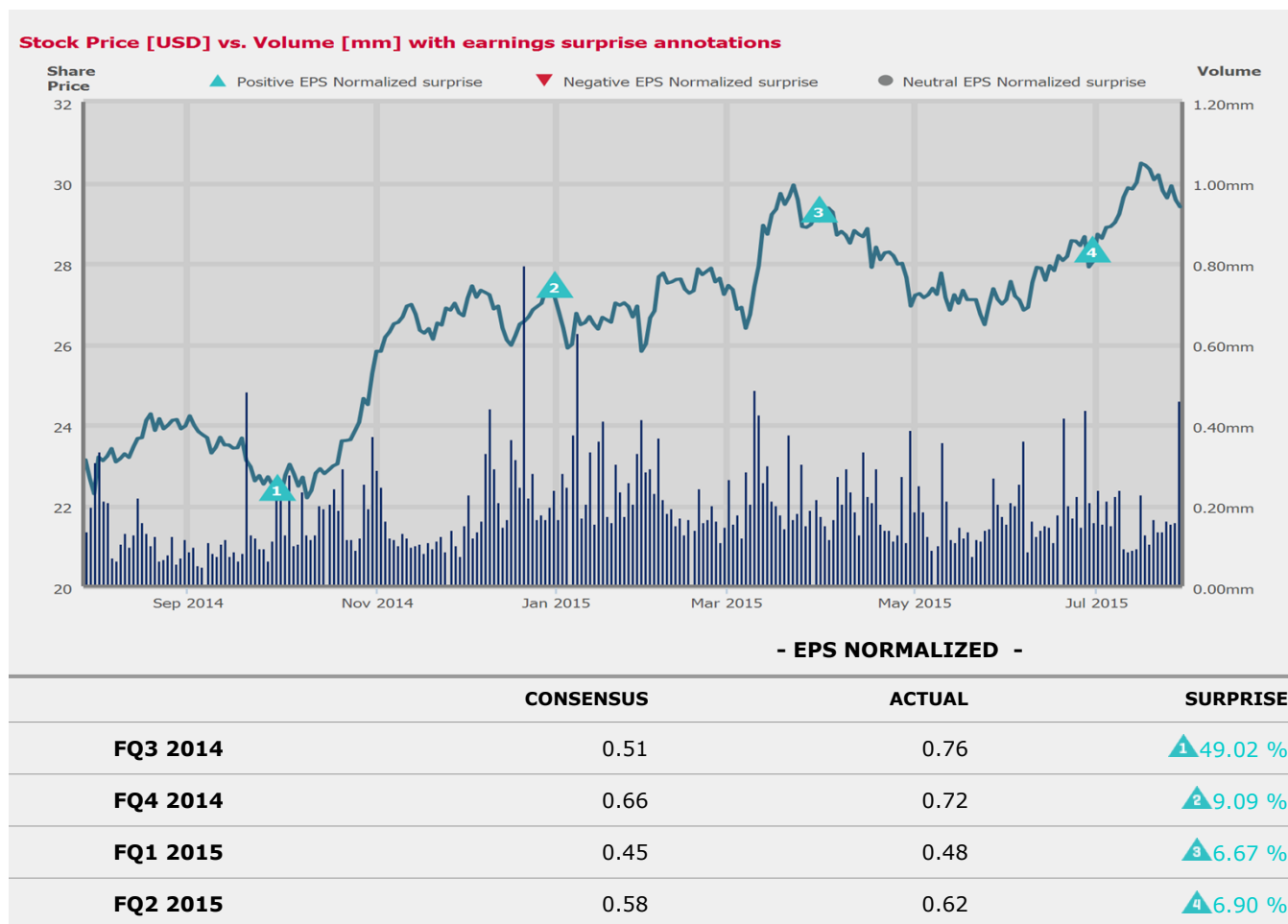
Thursday, October 29, 2015 12:30 PM GMT

### S&P Capital IQ Estimates

	-FQ3 2015-			-FQ4 2015-	-FY 2015-	-FY 2016-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
<b>EPS Normalized</b>	0.68	0.81	▲19.12	0.70	2.48	2.62
<b>Revenue (mm)</b>	536.69	540.50	▲0.71	547.02	2129.57	2250.52

Currency: USD

Consensus as of Oct-06-2015 8:48 AM GMT



# Call Participants

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## EXECUTIVES

**Dale A. Thatcher**

*Former Chief Financial Officer,  
Executive Vice President and  
Treasurer*

**Gregory E. Murphy**

*Chairman and Chief Executive  
Officer*

**Jennifer W. DiBerardino**

*Former Senior Vice President of  
Investor Relations*

**John J. Marchioni**

*President and Chief Operating  
Officer*

## ANALYSTS

**Jay Adam Cohen**

*BofA Merrill Lynch, Research  
Division*

**Scott Gregory Heleniak**

*RBC Capital Markets, LLC,  
Research Division*

# Presentation

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## Operator

Good day, everyone. Welcome to the Selective Insurance Group's Third Quarter 2015 Earnings Call. At this time all -- for opening remarks and introductions, I would like to turn the call over to Senior Vice President, Investor Relations and Treasurer, Ms. Jennifer DiBerardino. Ma'am, you may begin.

## Jennifer W. DiBerardino

*Former Senior Vice President of Investor Relations*

Thank you. Good morning, and welcome to Selective Insurance Group's third quarter 2015 conference call. This call is being simulcast on our website, and the replay will be available through December 1, 2015.

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, [www.selective.com](http://www.selective.com).

We use operating income, a non-GAAP measure, to analyze trends and operations. Operating income is net income excluding the after tax impact of both net realized investment gains or losses and 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 made during this call are forward-looking statements as defined by the Private Securities Litigation Reform Act of 1995. Forward-looking statements are not guarantees of future performance and are subject to risks and uncertainties.

We refer you to Selective's Annual Report on Form 10-K and any subsequent Form 10-Qs filed with the U.S. Securities and Exchange Commission for a detailed discussion of these risks and uncertainties. Please note that Selective undertakes no obligation to update or revise any forward-looking statements.

Joining me today on the call are the following members of Selective's Executive Management Team: Greg Murphy, CEO; John Marchioni, President and Chief Operating Officer; Dale Thatcher, CFO; and Ron Zaleski, Chief Actuary.

Now I'll turn the call over to Greg for introductory remarks.

## Gregory E. Murphy

*Chairman and Chief Executive Officer*

Thanks, Jen. Good morning. The strong third quarter and year-to-date results reflect the successful execution of our strategy. We achieved rate increases that outpaced the industry to improve underwriting mix and to enhance claim outcomes. We have a strong track record of achieving our goals, and this quarter was no exception.

Based on our strong results, I'm happy to announce that the board has approved a 7% increase in our quarterly dividend -- in our quarterly stockholders' dividend to \$0.15 per share. It will be paid December 1, 2015, to shareholders of record on November 13, 2015.

As I said before, we thrive in this macroeconomic environment of low interest rates and over capitalized industry with premiums to surplus leverage of 0.7 to 1 and a slowly recovering economy, as it forces the industry to focus on underwriting returns that make up for the declining investment portfolio yields.

The 3 key advantages we have in this environment include, underwriting leverage, investment leverage and superior underwriting and pricing tools we use to manage and monitor profitability at a very granular level.

Our underwriting leverage at 1.5x is twice the industry's premium to surplus and each 1 point of combined ratio generates 1 point of return on equity, versus the industry's 0.5 point of return on equity.

As a result, the industry must price its Commercial Lines product higher in order to generate the same ROE as Selective. We expect that interest rates will continue to remain low for the next several years and consequently, expect our leverage advantage to drive outperformance relative to the industry.

We believe that pressure to increase prices will remain for the next several years, because it will take many years to increase industry-wide book yield, given the 4-year average fixed income portfolio duration and the negative impact on combined ratios from the wind down of favorable reserve development.

In my first time in the 35 -- in my 35-year career at Selective, after-tax underwriting income exceeded after-tax investment income this quarter.

Looking into 2016 and beyond, the successful carriers will be the ones who have invested in sophisticated pricing and enhanced customer experience. We continue to invest on all fronts to extend our competitive advantages relative to the industry. Our pricing capability in conjunction with data analytics provide us a competitive advantage over those carriers, who are in early stages of implementing either. Focusing on customer experience will be a game changer for the carriers who get it right, providing our customers with the ability to do business with us when and how they want.

We have made investments in technology, such as customer self-service portal, a mobile app and upgrading our website, which should go live in November. We realize our functionality must meet the needs of an ever demanding customer, who is influenced by the technology they use in their daily lives.

In closing, I'm very pleased with the success we have achieved in delivering profitable growth and increasing shareholder value. I remain confident in our ability to continue to successfully execute on our strategies to achieve the aggressive goals we establish for Selective, as demonstrated by this quarter's increase in our quarterly dividend.

Now I'll turn the call over to Dale to review the third quarter results.

#### **Dale A. Thatcher**

*Former Chief Financial Officer, Executive Vice President and Treasurer*

Thanks, Greg, and good morning. For the quarter, we reported operating income per diluted share of \$0.81, up from \$0.76 a year ago. Our statutory combined ratio in the quarter was 90.5%, improving a point from a year ago.

The underlying combined ratio, excluding catastrophes and prior year casualty development, was 92.2%. CAT losses for the quarter were 1.3 points, lower than our third quarter expectations and in line with the 1.2 points we reported a year ago. Non-CAT property losses were in line with expectations and essentially flat with third quarter 2014.

Favorable prior year casualty reserve development in the quarter was \$15 million or 3 statutory combined ratio points, compared to \$8 million or 1.7 points a year ago. The favorable development is related to the benefits we've realized from our underwriting and claims initiatives over the past several years. Our overall reserve position remains very strong.

For the quarter, overall statutory net premiums written grew by 10%, driven by improving retention levels, higher new business written and renewal pure price increases.

Standard Commercial Lines premiums were up 10%, benefiting from improved retention of 84%, an 18% increase in new business and renewal pure price of 2.8%.

For the quarter, this segment generated a statutory combined ratio of 88.4%, compared to 90.9% a year ago. The improvement was driven by earned rate exceeding expected loss inflation and favorable reserve development.

Including 18.8 points of favorable development, workers' compensation reported an 84% statutory combined ratio in the quarter, improving approximately 27 points from a year ago.

The favorable development is largely attributable to continued lower-than-expected frequencies. We also continue to see a decrease in severity, resulting from the claims initiatives we have instituted to address workers' comp results. The accident year combined ratio for workers' comp is closer to breakeven.

General liability also reported strong profitability with an 89.1% statutory combined ratio. This line benefited from 4.1 points of reserve releases, which were driven by favorable claim frequency and severity. Earned renewal pure price increases in excess of expected loss inflation also contributed to the improvement.

We are seeing some severity-driven pressure on commercial auto in the 2015 accident year, which contributed to the 104.5% combined ratio in the quarter.

Standard Personal Lines statutory premiums declined 3% in the quarter, as targeted nonrenewals and lower new business impacted production. Retention improved 2 points to 83%, while renewal pure price continued to be strong at 5.4%. The Personal Lines statutory combined ratio was 95% for the quarter, including 8 points of catastrophe losses. In the prior year period, the statutory combined ratio was 88.9%, including 2.2 points of CAT losses.

Homeowners reported a combined ratio of 96.8% in the quarter, compared to 86.8% a year ago due to higher CAT activity. On an ex-CAT basis, the combined ratio at 81% was in line with the 81.8% reported in the third quarter of 2014. Renewal pure price in this line remains strong at 6.4%.

The personal auto combined ratio in the quarter was 103.4%, up from 100.3% a year ago. We had no development this quarter, compared to 5.3 points of favorable prior year casualty development in the third quarter of 2014. Renewal pure price for the quarter was 4.4%.

Excess and Surplus Lines continue to generate strong growth with a 36% increase in statutory net premiums written in the third quarter. The increase is reflective of strong new business growth of 26% and also the impact of a change in our reinsurance structure, which effective July 1 incorporated E&S business into our main property and casualty excess of loss treaties. Given this change, it's better to look at growth this quarter on a direct basis, which indicates an increase of 27% from a year ago.

The E&S statutory combined ratio in the quarter was 101.1%, an improvement of 1.8 points from the 102.9% reported in the third quarter of last year. Adverse prior year casualty reserve development of \$4 million added 8.7 points to the combined ratio this quarter. The overall expense ratio was under some pressure this year, mainly due to the level of profitability we are experiencing and the corresponding impact on incentive compensation.

Incentive compensation programs include the profit sharing compensation paid to agents and our employee incentive plan. Additionally, pension expense increased from service cost accruals and the negative impact of declining interest rates this past year.

Expenses at the holding company have also increased, reflecting the stock price appreciation in the market-to-market on our employee long-term incentive plan.

Moving to investments. After-tax net investment income declined to \$24.6 million for the quarter from \$25.8 million in the third quarter of 2014. The decline was largely driven by lower returns from the alternative portfolio, which continues to be impacted by the portfolio's exposure to energy related limited partnerships.

As a result of lower alternative investment income and the continued low interest rate environment, our annualized after-tax portfolio yields in the third quarter declined to approximately 2% from 2.2% a year ago. Year-to-date, after-tax new money yields have averaged 1.6%, as we continue to invest in high-quality fixed income products.

Operating cash flow has increased this year by 64% compared to last year, driving an increase in invested assets to \$5 billion. Our fixed income portfolio continues to be highly rated with an average credit quality of AA-minus and a 3.6-year duration including short-term investments.

For the entire portfolio, the pretax unrealized gain position increased to \$79 million from \$71 million at the end of the second quarter. The pretax unrecognized gain position in the fixed income held-to-maturity portfolio was \$10.5 million or \$0.12 per share on an after-tax basis.

Surplus and shareholders' equity were each \$1.4 billion at the end of the quarter, while book value per share increased 5% from the year-end 2014 to \$23.77. Annualized operating ROE was 14% in the quarter, well above our weighted average cost of capital of 8%.

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

**John J. Marchioni**

*President and Chief Operating Officer*

Thanks, Dale. Our insurance operations continue to perform extremely well. For the first 9 months, we had an overall statutory combined ratio of 92.3%, an x-catastrophe combined ratio of 88.5%, and net premiums written growth of 10%. We continue to leverage our strong marketplace position to profitably grow our business.

Standard Commercial Lines and E&S growth is strong, and we are confident that the business we are renewing and putting on the books new has significant profitability potential, due to our granular pricing and superior underwriting tools. Our strong Commercial Lines new business growth of 28% to \$262 million this year is the product of our talented field underwriting staff working alongside the best distribution partners in the industry.

We are pleased with the success of our efforts to build additional capacity by increasing a number of our Agency Management Specialists, or AMSs, to 103. These efforts have provided increased growth capacity, as AMSs continue to work with our agents to grow our share of wallet and win new business.

On the renewal portfolio, we continue to balance rate and retention by providing our underwriters the tools they need to make informed decisions. Year-to-date, Standard Commercial Lines retention remains strong at 83% and renewal pure price was 3.1% on a written basis.

For our highest quality Standard Commercial Lines accounts, which represent 55% of our premium, we achieved renewal pure rate of 2% and point-of-renewal retention of 91%. On our lower quality accounts, which represent 9% of our premium, we achieved pure rate of 7.9% and point-of-renewal retention of 80%, allowing us the opportunity to push further for additional rate, even if retention levels decline. This level of pricing sophistication is critical to our success in a competitive market.

Overall, renewal pure price increases year-to-date were at 3.5%, which was above our expected loss inflation of 3%. Use of our dynamic portfolio manager tool to balance rate and retention on an account level resulted in Commercial Lines renewal pure price increases of 3.1% year-to-date.

Personal Lines pure rate was strong at 6.3% year-to-date with homeowners achieving an 8.3% rate increase. For E&S, new business pricing is in line with our target pricing levels, while renewal price increases remain lower than target at 1.4% year-to-date. On an overall basis, our expectation for 2015 renewal pure price increases is to achieve between 3% and 3.5%.

In workers' comp, we are starting to experience the benefits in this line, as we refine our book and increase our mix of lower hazard great business. While this line has challenged others in the industry, we are experiencing significant improvement in claim outcomes from our strategic case management unit, workers' compensation escalation model and fraud detection and recovery. The 87.7% statutory combined ratio achieved in workers' comp for the first 9 months includes 12.6 points of favorable reserve development.

As a result of our performance, we are revising our workers' comp combined ratio guidance for the full year 2015 down to 91%, assuming no additional reserve development from our original guidance of below 103%.

Growth in our Excess and Surplus Lines business has been very robust. Direct premiums written are up 24% year-to-date, which is largely attributable to new business growth of 34%. The contractors,

mercantile and services sectors continue to drive growth. A key factor in driving the business this year is the implementation of a new policy rater.

We are comfortable with new business pricing levels, but we would like to drive more renewal rate in targeted classes. We continue to implement the pricing analytic capabilities for E&S that we have successfully implemented in our Standard Lines. As we do this, we expect E&S profitability to be more in line with Standard Commercial Lines.

Personal Lines net premiums in year-to-date has been negatively impacted by the ongoing strategic nonrenewal of underperforming business and the decrease in new business. However, retention has improved from 2014. We are optimistic about improving the take-up rate in the Selective Edge products. We believe that this business will ultimately perform and retain better than the non-Edge business. In the third quarter, the Edge product accounted for 17% of our automobile new business and 23% of our homeowners new business.

We are very pleased with our overall insurance operations performance and believe we have the momentum for further improvement.

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

**Gregory E. Murphy**

*Chairman and Chief Executive Officer*

Thanks, John. While weather was not a factor in the quarter, Hurricane Joaquin caused losses in the South early in the fourth quarter. Our thoughts go out to the families and businesses devastated by the flooding that occurred. While claims continue to be reported, our total loss estimate for personnel and commercial lines appears to be very manageable at approximately \$5 million.

As Dale and John outlined, results for 2015 year-to-date are strong. With that in mind, I provide the following refinements to our 2015 full year guidance. The statutory combined ratio, excluding catastrophes and any further prior year casualty reserve development of an 89, an improvement from our original guidance of 91. Catastrophe losses of 4 points. Overall, renewal pure pricing between 3% and 3.5%. After-tax investment income of approximately \$95 million at the lower end of the range provided in July. And weighted average shares of 58 million. Now I'll turn the call over to the operator for your questions.



## Question and Answer

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### Operator

[Operator Instructions] Our first question is from Scott Heleniak from RBC Capital Markets.

### Scott Gregory Heleniak

*RBC Capital Markets, LLC, Research Division*

Just wondering if you could talk a little about the excellent results in workers' comp, and I know you went over a little bit of detail. But just wondering if you can talk a little bit more about the turnaround there? I know you guys had some initiatives you laid out about 3 or 4 years ago. And what are the areas where you're -- where it's really developing a lot more favorably than you expected? I know you've talked about controlling medical costs and fraud and claims management. If you can touch on that, just how you're seeing that significant improvement?

### John J. Marchioni

*President and Chief Operating Officer*

Scott, great question. This is John. Let me just take you through our view on how we've made some of that improvement and why we feel good about where we stand in that line of business. And really divide it into 2 pieces. The first is a focus on improving our underwriting mix of business. And I would say really 2 drivers behind that. One is we had to attack certain pieces of our renewal inventory that were driving our higher frequency in severities in terms of both price and in certain cases targeted nonrenewals. And then the other big move for us, which impacted both the renewal inventory, but more so in new, was a shift towards smaller, lower hazard mix of business. So when you think about the hazard grades, which are A through G on the workers' comp side, A through G are really the lower hazard class of the business, that's been our focus. And we started to really see an uptick in new business in those areas, which is driving our in-force book towards a lower frequency and lower severity book. So that's the underwriting focus that we've really started to realize some benefits from. The second part of this, and we think we're now starting to realize some of the benefits and see a lot more opportunity for us going forward, is what we've done on the claims side. So we've consolidated our claims operations, which allows us to be much more specialized now and better position ourselves from a management perspective. But then have also introduced workers' comp escalation modeling, which allows us very early in the life cycle of a claim and then reviewing multiple times during that life cycle, identify those claims that have the potential to develop into much more severe or harder to manage claims. And we get ahold of those early, and then we move them to our newly formed strategic case management unit, which is a group of experts who are well positioned to manage those claims more aggressively out of the gate and improve work -- return to work outcomes on that side of the business. We've also done a lot more in terms of modeling on the fraud and recovery sides, but we think all of those will continue to contribute to results on a go-forward basis. So as you said, we laid this strategy out. I think we've really focused on execution on both the underwriting and the claims side over the last couple years, and we're seeing the results.

### Gregory E. Murphy

*Chairman and Chief Executive Officer*

And, Scott, if I could add to it. And then obviously the third leg, I mean, which is obvious, is the rate element, rate in excess of trend. But I want -- I guess, I want to use this as an opportunity to say, whether we're talking about a line of business like comp or commercial auto or speaking about an unprofitable or less than desirable profitable agent or a segmentation in our book that we're looking at. What John just articulated is the same process that we use for every element of analyzing our performance. So we can go in exactly what we just -- John just went through with you for an agent of ours, we can go through and analyze their book, segment it in exactly in the same kind of format, which allows us to very granularly go in and make adjustments. And that's why, I think, you see our retention be much higher than the industry. And that's why you see our renewal pricing much higher than the industry. It's because of the very surgically managed process that we go through, no matter what it is we're analyzing.



**Scott Gregory Heleniak***RBC Capital Markets, LLC, Research Division*

Okay. Great. That's very comprehensive. And then, just wondering if you could touch on just the loss cost trends in general? I think you said those are running kind of around 3%. So is that kind of stable with the last few quarters? Is there any change there as far as frequency or severity?

**Gregory E. Murphy***Chairman and Chief Executive Officer*

Before we -- we call it claim inflation is running 3. So our expected claim inflation -- we always sit down and talk to you, we always talk about expected claim inflation and that. So that's different than trend in my mind, just so we get that clear. So we always kind of prognosticate about the 3 points of expected claim inflation that's due to higher medical, the impacts of higher medical on liability suits. And then there's loss trend, which actually happens. Trend is generated by the frequency times severity. We've seen frequency and severity overall be pretty manageable in total. And I would say that just to give you a sense -- and again, I wouldn't put overly high focus on this, because these numbers get pushed around all the time. So on the liability side for instance, on a fiscal year basis for the 9 months, we're seeing a downtick in overall liability, frequency of 3%. We're seeing a decrease in overall liability and severity of 1%, loss cost down around 4%. On the other hand, on personal liability, we see a decrease of frequency of around 5%. We see an increase of severity around at 11.5% for an overall of 6%, 5.9%. But I have to say those numbers get pushed around all the time, and I don't know -- I mean, directionally, they do tell you something, but I wouldn't get so dialed into that. Those are numbers that won't get -- until we actually see a longer period of time, our actuaries anticipate a number of claim volume that we expect for every year, and then they look at that claim volume to actually what's reported. And that happens over a longer duration. And just -- they're not just pushing buttons every quarter in terms of how they manage that number.

**Scott Gregory Heleniak***RBC Capital Markets, LLC, Research Division*

Yes, okay. That's helpful. That's some good context, some good examples there. And then just wondering on E&S if -- you've had very strong growth for a long time there. Just wondering if you could touch on just briefly the reserve strengthening? I think you've seen a couple quarters of that. And just some of the actions you're taking. I know you've talked about nonrenewals and price actions. But just wondering if you could touch more on what you're seeing there? And then specifically, the strengthening at all, where that is coming from, which specific year? And if there's any more detail you can provide on that.

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

One of the things to keep in mind there, Scott, would be the E&S operations obviously are very young for us and they're very young in general. Both operations were begun in the 2007 time frame. And then obviously, we purchased them at the end of 2011. So the data that we have available for examining loss trends and loss history is really not statistically credible. Obviously, we collect the data and we analyze it to the extent that we're able to, but we end up basing a lot of our loss picks and our loss development off of industry data and industry expectations. So we do take a little bit more conservative view over our reserve development on the E&S side, just because of that lack of data. So that's always something to kind of keep in mind there. Clearly, that operation is about 75% general liability. And obviously, that's where we're seeing it. I'd say it's -- since we've only held it since the end of '11, you're basically talking about the '12, '13, '14 kind of years where you're seeing some development. But again that is based on projecting industry trends upon our reported pattern. So it's tough to tell, but we feel it's conservatively stated.

**John J. Marchioni***President and Chief Operating Officer*

And then, this is John, I'll just add to that too. Keep in mind a couple of things. Number one, the retention on that book of business runs in the 50 to 60 range. So at a much lower level than our standard

operations on Commercial Lines that run in the low 80s. Which the key point there is it allows us to take more significant action to change the in-force book of business. And I think that's what we've done. And if you look at the accident year numbers that when you strip out the impact of prior year development, you see performance that's a lot closer to our expected performance on a run rate basis. In addition to that, when we look at the amount of new business that we're writing relative to the pricing levels we're writing at, we're very comfortable that we're acquiring business at pricing levels that are at or above our targeted level of adequacy, and now taking very targeted actions on the renewal inventory. So you just want to make sure that when you project forward from your current accident year performance, that you understand the differences between your in-force book, what it is today and what it is in the prior periods, and whether or not it was different in those prior periods. And we look at the actions that have been taken and see a positive movement in that in-force book of business.

**Scott Gregory Heleniak**

*RBC Capital Markets, LLC, Research Division*

Got it. And then, just one last one. You touched on a little bit about the South Carolina flooding. Is that -- the \$5 million number that you gave, does that include -- is that a net number? Does that include any benefit from flood claims that you might get? Or that's just the loss number?

**Dale A. Thatcher**

*Former Chief Financial Officer, Executive Vice President and Treasurer*

There's no -- that's just the loss number. There's no current expectation in that estimate for flood claim, processing fees. Obviously, a #5 flood rider [ph] will have some of that, but we haven't projected that at all. And I'd say the \$5 million, as Greg indicated, is not a big number for fourth quarter.

**Operator**

Our next question is from Jay Cohen from Bank of America Merrill Lynch.

**Jay Adam Cohen**

*BofA Merrill Lynch, Research Division*

A couple questions. First is, I guess, in the Standard Commercial business, in the quarter, it looks like the pure price was up about 2.8%, which is a number, which has been trending lower. One might expect that continues to go lower, assuming that the claims trend is in fact a 3% number. Does it get tougher as you get into next year to improve the margins in that business? Or are there other actions that you can take that will offset that potential pressure between cost and pricing?

**John J. Marchioni**

*President and Chief Operating Officer*

Yes, Jay, this is John. I'll start and then Greg or Dale can certainly follow on. You're certainly seeing a trend. And without pure price coming through, it does get more difficult to improve an underlying loss ratio, which is why we feel comfortable that we're very close to our run rate target. And need to -- we're moving into a phase where we can, in fact, make efforts between pricing and underwriting and claims improvements to match loss trend and continue to perform at our current level. So yes, it gets harder, but then it becomes more important to be able to deliver at a kind of underwriting mix and claims improvements that we've delivered over the last couple years. And that never stops. You're always focused on making sure you're attacking this small portion of your renewal inventory that's driving your performance. And that's where you get a continued underwriting mix improvement, making sure that the quality of the new business that you're acquiring and the pricing levels at which you're acquiring it bodes well for future performance. And then continuing to drive improvement throughout our claims operation. As Greg said earlier, we talked a lot about comp and the changes we've made in comp on the claims perspective, but those efforts are holistic across every line of business. And we think that underwriting and claims improvements will contribute to loss ratio improvement in excess of rate over the next couple years.

**Gregory E. Murphy**

*Chairman and Chief Executive Officer*

And, Jay, this is Greg. You know we've been working hard on rate relative to the industry, even raised [ph] the price since 2009. I mean it's hard to find a carrier out there in the marketplace that has been as disciplined as we have. And we just don't want to lose that at this particular point in the market. So the advantage that we have, I think, is really important as John pointed out. I mean, we've worked hard to get our rate. We have 3 legs on the stool that we're always managing, and those are the 3 legs that we articulate relative to comp and articulated how we attack any problem in the organization. But most importantly, we've gotten our profitability right now where we need to run at. Now the question is how do we maintain it at that level? We're working very closely with our agents. The advantage that we have now going into the market, and we hope that you see this for other competitors and continue the pressure on reporting renewal price increases, because that's the leading indicator of performance in the future. Many of our competitors still have combined ratio issues. They are going to have to work to lower their combined ratios through rate. You've heard us talk about this before. If you want to lower your combined ratio by like, say, call it like 4 points, you've got to increase rate by 10 when you look at the improvement of -- at the margin relative to what it does on the combined ratio. So we've got a number of competitors that are still tracking way higher than we are. And given our leverage and all the other things we talked about, we feel we're positioned well. And the thing about this market is there is nothing that I believe that will change in the longer -- in the relatively longer-term time period of time that will take the focus off underwriting. So underwriting is going to be king relative to performance overall.

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

And, Jay, I'll jump in with kind of a mathematical view of the equation, is that generally speaking our loss trends have tended to run in the, call it the 2.6%, 2.7% to 3% range for the last 5 or 6 years, and that's loss inflation. We always round that to 3%, and just call it a 3% loss inflation trend. So 2.8% is right in that range also. So we feel pretty good about that. We still have embedded claims and underwriting improvements that we expect to pay dividends in the future. So we still feel very good about the position that we're in, in terms of our ability to deliver results.

**Jay Adam Cohen***BofA Merrill Lynch, Research Division*

Good answer from all 3 of you. I got the trifecta. Second question, in the personal auto side, not a big line of business for you, but we've been hearing different stories from different companies about the frequency of personal auto claims. What are you seeing in that business?

**Gregory E. Murphy***Chairman and Chief Executive Officer*

Yes. I would say that we've read a lot, follow a lot on this. And you'd see that our book since it's so Jersey centric, that frequency hasn't really been a big deal in Jersey. And we're seeing it in our numbers. I mean, we write outside of Jersey, but just on the liability side, our frequency on a fiscal year basis is down 4.5%. Our severity is up in that line, but that gets again pushed around by this, it's not a lot of numbers, not a lot of dollars in that area. But we haven't seen this. And I think the study that I read not that long ago indicated that California was seeing an explosion in their frequency numbers. And I think it could be more geographic in nature, and the fact that so much of our business is in the State of New Jersey is why we're not seeing that specific trend.

**John J. Marchioni***President and Chief Operating Officer*

And just to add to that, the fact that our growth is coming outside of New Jersey. So, therefore, our mix is becoming less Jersey centric is part of what we think is contributing to the lower frequency. So we're not seeing the frequency trend, because our mix is changing a little bit more towards lower frequency states than we bid. Our core book in New Jersey is big.

**Jay Adam Cohen**

*BofA Merrill Lynch, Research Division*

Very helpful answer. I guess, with the traffic in New Jersey, you can't go more than 20 miles an hour anyway so...

**Gregory E. Murphy**

*Chairman and Chief Executive Officer*

Have you ever driven on the parkway? Bumper to bumper, 90 miles an hour.

**Jay Adam Cohen**

*BofA Merrill Lynch, Research Division*

And if I squeeze in one more question. Your alternative investments, those are reported on a 1 quarter lag. Do you have any view into the performance in the fourth -- in the third quarter, which will show up in your fourth quarter, just given a lot of the noise around the financial markets in the third quarter?

**Dale A. Thatcher**

*Former Chief Financial Officer, Executive Vice President and Treasurer*

You're right that most of them report on a 1 quarter lag. The drag that we've seen so far this year has really been the oil centric or the energy centric alternatives. I can't say that we've got good insight into what you're going to end up seeing in the fourth quarter for our results. Out of those, clearly oil is still somewhat depressed, but I guess, stabilized at more depressed levels. So remains to be seen how that plays out. Obviously, the M&A environment is a lot more active these days. That tends to be a benefit to alternative investments. So it's -- there's a lot of moving parts there. Thankfully, it's a small number at the end of day. It's only about \$75 million in NAV. So it does move the investment income around a little bit, but at the end of the day, it's more of a mark-to-market issue.

**Operator**

[Operator Instructions] We have a question again for Mr. Jay Cohen from Bank of America Merrill Lynch.

**Jay Adam Cohen**

*BofA Merrill Lynch, Research Division*

I didn't want to dominate the call, but if no one else is asking questions, I've got one other question. And that is relative to the M&A environment in the assurance business. Are you -- I guess, how do I phrase this? Are you seeing more interest, are you getting called more often, whether it's as a buyer or a seller, to be involved with some sort of transaction?

**John J. Marchioni**

*President and Chief Operating Officer*

I would say that we have deployed all power to the cloaking device. So nobody can find Branchville, New Jersey. So clearly, there's a lot of discussion just in general with bankers about what's available out in the world. But at these kind of prices, we're not exactly going to be a buyer generally speaking, unless it's for something small. Obviously, we recognize that we have performed fantastically well. And therefore, we've identified ourselves as a great company. But what we tell our employers all the time is that we earn our independence by performing to plan and cranking the stock price up as high it'll go.

**Gregory E. Murphy**

*Chairman and Chief Executive Officer*

And, Jay, what I would add to that though too, is I think the M&A environment provides opportunity for Selective. We find the opportunity really in 2 key areas. One, people, obviously, as companies merge, employees get a little unsettled, I think, that creates a great opportunity to look at additional talent. I mean, we have a growing operation. We have a great reputation. People want to come work for Selective. And I think that's a positive. And then the second is, obviously, depending on who's merging with whom, it creates a business opportunity as our agents -- you've heard John and several of us talk about share of wallet, talk about where we are in concentration in different states. We have huge opportunities in

most all of our states with the exception of maybe 3 or 4 states where you would say that we're at our target market share. And as companies merge, there are agents that can get very uncomfortable with high concentrations and exposure to certain carriers, particularly when they're not as believing in what that carrier or what the new carrier's strategy is with respects to the long-term viability of independent agents. And I will tell you our success is on independent agents. We focus on them. You've been to some of our programs before. You can see first hand how we educate our agents, how we push our agents in multiple fronts to be better salespeople, to think about perpetuation, how do you sit there and look at customer experience, how do you look at a changing customer environment down the road. That's what we're preparing our agents for. And the fact that we have 1,140 agents, it's a heck of a lot easier for a carrier like Selective to manage 1,140 agents in 22 states than it is for most of our other carriers in the marketplace, who have thousands and thousands of agencies. You've always heard us say we've got the Ivy League of independent agents. They want to stay in the Ivy League, and they know that they need to do more to do that.

**Dale A. Thatcher**

*Former Chief Financial Officer, Executive Vice President and Treasurer*

Lastly, I'd just throw in there, Jay, is that we believe an independent path is the best way for us to generate long-term shareholder value. But obviously, if there were ever a credible offer that was in excess of what we could generate, the board would do their fiduciary duty. We just want to make that a really hard equation for anybody.

**John J. Marchioni**

*President and Chief Operating Officer*

All right, operator, are there any more people on the line?

**Operator**

Sir, we don't have any other questions in queue.

**Gregory E. Murphy**

*Chairman and Chief Executive Officer*

All right. Well, thank you for participating on the call today. If you have any follow-up questions, please contact Jennifer and Dale. Thank you.

**Operator**

Thank you, speakers. And that concludes today's conference. Thank you all for joining. You may now disconnect.

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