Selective Insurance Group, Inc. NasdaqGS:SIGI

FQ2 2009 Earnings Call Transcripts

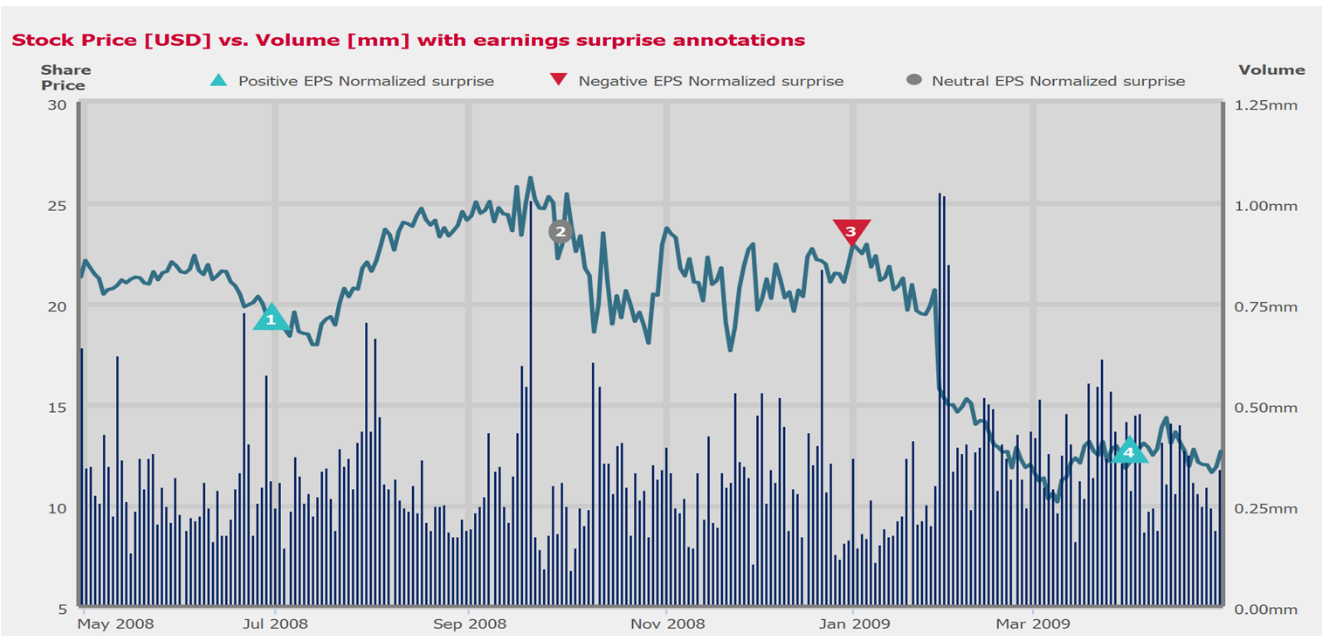
Thursday, July 30, 2009 12:30 PM GMT

S&P Capital IQ Estimates

	-FQ2 2009-			-FQ3 2009-	-FY 2009-	-FY 2010-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.24	0.43	79.17	0.28	0.94	1.32
Revenue (mm)	405.95	388.25	(4.36 %)	409.87	1626.96	1663.23

Currency: USD

Consensus as of Jul-30-2009 2:35 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ2 2008	0.51	0.52	1.96 %
FQ3 2008	0.45	0.45	0.00 %
FQ4 2008	0.48	0.10	(79.17 %)
FQ1 2009	0.01	0.05	400.00 %

Call Participants

EXECUTIVES

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

Gregory E. Murphy
Chairman and Chief Executive Officer

Jennifer DiBerardino

John J. Marchioni
President and Chief Operating Officer

Kerry A. Guthrie
Former Chief Investment Officer and Executive Vice President

ANALYSTS

Alison Marnie Jacobowitz
BofA Merrill Lynch, Research Division

Doug Mewhirter
FBW

Michael Fitzgerald Grasher
Piper Jaffray Companies, Research Division

Peter Seuss
SuNOVA Capital

Presentation

Operator

Good day, everyone. Welcome to the Selective Insurance Group Second Quarter 2009 Earnings Release Conference Call. At this time, for opening remarks and introductions, I would like to turn the call over to Vice President of Investor Relations, Ms. Jennifer DiBerardino.

Jennifer DiBerardino

Thank you. Good morning and welcome to Selective Insurance Group's Second Quarter 2009 Conference Call. This call is being simulcast on our website and a replay will be available through August 27, 2009. A supplemental investor package which includes GAAP reconciliations of non-GAAP financial measures referred to on this call is available on the investors page of our website at www.selective.com.

Selective uses operating income, a non-GAAP measure, to analyze trends and operations. Operating income is net income excluding the after tax impact of net realized investment gains or losses. We believe that providing this non-GAAP measure makes it easier for investors to evaluate our insurance business.

As a reminder, some of the statements and projections that will be made during this call are forward-looking statements, as defined by the Private Securities Litigation Reform Act of 1995. Forward-looking statements are not guarantees of future performance and are subject to risks and uncertainties.

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

Joining me today on the call are the following members of Selective's executive management team: Greg Murphy, CEO; Dale Thatcher, CFO; John Marchioni, Chief Underwriting and Field Operations Officer; Mary Porter, Chief Claims Officer; Ron Zaleski, Chief Actuary; and Kerry Guthrie, Chief Investment Officer. Now I'll turn the call over to Dale to review the quarter results.

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

Good morning. We're pleased to report solid insurance results in the second quarter with a statutory combined ratio of 98.8%. We had excellent commercial lines property results and some favorable casualty reserve development. The best news in the quarter was commercial lines, renewal pure pricing of +0.6%. This is the first reported positive renewal pricing since the first quarter of 2005.

A full quarter ahead of our expectations. We're very encouraged by the pricing trend and believe it reflects our dedicated field underwriting team leveraging excellent agency relationships and predictive modeling capabilities in a continued competitive marketplace.

For the second quarter, we reported strong operating income per diluted share of $0.43, down 17% from a year ago mainly due to lower investment income. Of note in the quarter is a net tax benefit of $3 million. Recall on the first quarter excess taxes of $4 million had to be booked due to the application of APB 28.

We indicated then that this accounting anomaly would reverse in future quarters, and we're seeing the majority of that here. You can see the full tax reconciliation on the 10-Q we filed later today. Alternative investments generated a loss of $5.8 million after-tax, compared to a $0.2 million after-tax gain in the same period in 2008.

Commercial real estate valuations continue to be challenged. Although only 14% of our alternative portfolio, real estate strategies generated a third of our overall alternative investment losses for the second consecutive quarter. We expect commercial real estate will continue to be challenged until global economic conditions improve.

We began investing in limited partnerships a decade ago as part of an overall equity strategy to diversify away from the public equity markets, while achieving higher risk adjusted returns. We have consistently achieved this objective even in recent quarters, as evidenced by the S&P 500 Index which decreased 11% in the first quarter, while the alternative portfolio declined only 6%.

Alternatives represent only 4% of invested assets. As the financial markets improve and stabilize, we would expect our alternative portfolio valuations to do the same. Investment assets were up 2% at June 30, 2009, compared to December 31, 2008, reflecting fair value increases on our available-for-sale portfolio.

Unrealized losses on our available-for-sale securities improved $23 million after-tax, largely driven by fixed maturity securities. The net impact of the improvement was $0.43 per outstanding share. Market-to-book values improved in the quarter to 99.5%. The valuation improvement, along with higher net income contributed to the 4% increase in book value from the previous quarter to $17.85 per share at June 30.

Other than temporary impairments or OTTI in the quarter, we recorded an $8.1 million after-tax, primarily reflecting our intent to sell several securities that are currently in an unrealized loss position. As required, we adopted the new FSP for recognition and presentation of other than temporary impairments.

The cumulative effect of the accounting change was not material. Amounting to $2.4 million net of deferred tax, which decreased accumulated other comprehensive income and increased retained earnings. Our insurance operations performed very well in the quarter. Our 98.8% overall statutory combined ratio was essentially flat with the year-ago quarter. Pretax catastrophe losses were $5.3 million or 1.5 points compared to catastrophes a year ago that were $13.4 million or 3.5 points.

Overall, casualty prior-year statutory laws and LAE favorable reserve development on a pre-tax basis for the quarter, was approximately $6 million or 1.5 points on the combined ratio, compared to immaterial development in the second quarter of 2008. This quarter's favorable development was primarily driven by workers' compensation for accident years 2004, through 2007. As we continue to maintain our focus on expenses, the GAAP expense ratio for the second quarter improved one point from last year to 31.4% and remained flat with the first quarter.

This expense discipline in a declining premium environment reflects the many initiatives that we have implemented over the past year and a half to remain competitive. In 2009, we initiated a vendor consolidation project in which we will enjoy savings of approximately $1 million over the next year.

Earlier this year, we eliminated the retiree life insurance benefits for current employees for a one-time benefit of $4 million and we initiated control hiring practices that continue today.

Commercial lines reported a profitable 98.3% statutory combined ratio for the quarter, a half point improvement from a year ago. This improvement was driven by commercial property which reported a 78.6% statutory combined ratio, 15.8 points better than a year ago.

Commercial lines, statutory net premium written declined 8% in the quarter, driven by the economic downturn and its impact on audit and endorsement premium. We had approximately $20 million in net return premium in the quarter compared to $6 million a year ago. Return premium is being driven largely by higher levels of unemployment and its impact on workers' compensation and general liability. We expect this negative trend to continue until unemployment rates stabilize.

Commercial lines new business increased a strong 12% in the quarter, reflecting our appointment of 200 new agents over the past two years, proactively assisting agents to identify new business opportunities through our leads program and the broadening of our small business pipeline.

As we have said previously, there'll be some volatility in our personal lines results. The statutory combined ratio for the second quarter came in at 102.1% versus 98.1% a year ago. The change is largely attributable to unfavorable casualty development of approximately $1 million in private passenger auto or 1.9 points on the overall personal lines combined ratio, compared to immaterial development in the year-ago quarter and property results that were $1 million or 1.5 points worse than prior year.

We're committed to our stated goal to achieve a profitable personal lines combined ratio run rate in the latter half of 2010, and expect to achieve that goal with the pricing improvements we're seeing.

We successfully completed negotiations of our July 1, 2009, excess of loss treaties for property and casualty. The property treaty was renewed with the same terms and a rate increase of 2.8%. The casualty treaty renewed with a 6.1% rate increase and it continues to cover $88 million in excess of a $2 million retention.

However, we sought to reduce volatility from shock losses by decreasing our co-participation in the first layer of the treaty. 85% of the three excess of two, has been placed to July 1, compared to 65% in the prior year. The financial strength of the reinsurers on our treaties are strong, with a weighted average A.M. Best rating of A.

At June 30, the premium to surplus ratio was 1.7, down from 1.8 at March 31. We continue to take actions to improve profitability and reduce volatility in order to organically generate surplus.

We're encouraged by the strength of personal lines pricing in the positive turn in commercial lines pricing. We're mindful of the balance of capital to satisfy rating requirements and the ability to take full advantage of opportunities in a hardening commercial lines market. Now I'll turn the call over to Greg.

Gregory E. Murphy
Chairman and Chief Executive Officer

Thanks, Dale and good morning. I'm very pleased with the second quarter results and the start of commercial lines pricing power, a full quarter ahead of our expectations. Commercial lines renewal pure price rose 0.6 points for the quarter. However, the market place continues to be very competitive and the successes we are achieving are based on the following operational and corporate strategies for long term profitable growth.

One, the granularity of pricing achieved through predictive modeling for all lines of business. Facilitating risk selection and pricing for both new business and renewals. Two, commercial lines price increases which turned positive ahead of our expectations. Three, ongoing diversification of our commercial lines book of business into non-contracting segments that we have successfully written since mid-1990s, specialty, manufacturing and mercantile in service. Four, personal lines improvement plan, including rate increases and growth outside of New Jersey. Five, focus on the best-in-class claim practices to reduce loss costs. Six, leveraging our excellent agency relationships for profitable growth opportunities. And seven, focused expense management, as Dale just mentioned to you. Now I'm going to turn the call over to John Marchioni to walk you through our pricing and growth strategies in our insurance operations.

John J. Marchioni
President and Chief Operating Officer

Thanks, Greg. Good morning. Insurance operations is focused on profitability, first and foremost, but we're also taking full advantage of growth opportunities when appropriate, as evidenced by our strong second quarter commercial lines new business increase of 12% and personal lines new business increase of 14%.

We believe we can grow with confidence due to our strong agency relationships and field underwriting model, supported by our predictive modeling capabilities that drive discipline underwriting and pricing decisions. The diamond score distribution of modeled and new business, has improved as intended in 2009, with the best performing four and five Diamond business increasing from 58% in June of 2008, to 65% in June 2009, and the worst-performing one and two diamond business decreasing to 9%.

Field underwriters are also focused on writing new business at the best possible price. Pricing on new commercial business in the second quarter was down only 0.9%, a significant achievement when considering the strong improvement in mix of business. Diversification of our commercial lines book of business away from contractors has been an ongoing focus and we are experiencing significant success.

Our contractors mix stands at 41% of commercial lines premium at June 30, down from 43% at year-end 2008. While we routinely evaluate our underwriting appetite and made changes accordingly, our success in writing a business in 2009, has been driven by a greater emphasis on growing classes of business and we have been successfully underwriting for 10 or more years.

Manufacturing representing 16% of our commercial lines book has a three-year direct accident year combined ratio of 91.7%. Specialty, which includes segment such as public entities, golf courses and social services, represents 20% of commercial lines with a 93.2% three-year direct accident year combined ratio. Mercantile and service represents 23% of our commercial lines premium with a 94.4% three-year direct accident and near combined ratio.

Our new business success in these classes are demonstrated by the following statistics for the first half of 2009. New Manufacturing Wholesaler business was up $9.8 million or 50%. New Specialty business was up $4.7 million or 40%. New Mercantile and Service business was up $1.6 million or 5%.

The 960 agents that make up our strong franchise work with us to drive price on renewals and write the best new business at responsible pricing levels despite the tough, competitive and economic environment. We have provided our agents with numerous programs such as sales, developmental training and active leads for writing good, new business within our appetite and support our commercial lines diversification efforts.

These leads have been pre-scored through our models and target pricing has provided the best insurer profitability. Overall, new business was as follows for the first six months. One & Done automated small business was up 11% to $38 million, middle-market or AMS-generated business was up 9% to $92 million. Selective Risk Managers, our large account business was up 55% to $11 million.

We continue to enjoy success in our small business production with the average premium written per work day increasing to nearly $320,000 in the quarter. We have a competitive product for artists and contractors and continue to write that business. However consistent with our diversification efforts to grow the non-contractors book, 55% of the new small business year-to-date is coming from the Manufacturing specialty and mercantile in service SBUs.

While the middle market continues to be competitive, our field underwriters have been successful in taking advantage of new business opportunities that meet our underwriting appetite and can be written at profitable rate levels. The knowledge management tools that we had put at the underwriters' fingertips, facilitate the new business process.

In spite of the competitive market, we are seeing more good opportunities to write large account new business and submissions are up considerably over last year. We are maintaining our underwriting discipline by turning away the business where we cannot achieve actuarily sound pricing.

The sales meetings we have held over past year have provided many of the new business opportunities that we are seeing. Consistent with our diversification efforts, non-contractors new business accounted for 66% of Selective Risk Managers production to date.

Our inside renewal underwriting teams are working hard to balance price increases with retention. Overall, we achieve commercial lines renewal pure price increases of 0.6% in the second quarter, while retention dipped slightly to 76%. The granular capability to obtain price on our renewal book is largely due to our predictive modeling capabilities.

These increases, which we believe to be ahead of the majority of the industry, do not yet outpace loss cost trends but will demonstrate a glide path to long-term profitability. We view the slight dip in retention as something to watch carefully, but believe that it demonstrates the discipline our underwriters are employing in a difficult market.

We are confident in our ability to match price to risk at the individual account level and are managing the balance between rate and retention accordingly. Our worst performing business is receiving the largest increases and retaining at much lower levels.

In personal lines, our MATRIX models for both homeowners and automobile create organic growth opportunities with precision pricing capabilities. We grew new business outside New Jersey by 35% in the quarter, demonstrating that our diversification efforts are working. We're also seeing significant improvement in the quality of both homeowner and automobile business into higher scored sectors that have better Claim experience.

As Dale said, we are committed to making personal lines profitable. We've implemented 14 of our anticipated 21 rate increases of 3% or more, in the first six months of 2009. These increases equate to $9 million in additional rate on top of the $15 million we achieved in 2008. The rate of success is demonstrated by the eighth consecutive quarter of personal lines, net premium written growth with a 4% increase in the second quarter compared to 2008.

We believe that predictive modeling through MATRIX along with the additional $24 million in rate on this $216 million book of business, will allow us to achieve our goal of being profitable on a run rate in the third or fourth quarter of 2010. Now I'll turn the call back to Greg.

Gregory E. Murphy
Chairman and Chief Executive Officer

Thanks, John. As John described, we're focused on profitable growth to achieve long-term outperformance. Our predictive modeling and pricing strategies for both commercial lines and personal lines are demonstrating success in the tough market. We're willing to give up growth in the short run to drive higher levels of profitability.

The tools we're utilizing have been in development for over the past four years and as these strategies have become fully integrated into our underwriting process, we're seeing their power. Another area I want to discuss that will drive further improvements is our claim initiatives.

Our claim staff both in the field and in corporate, are improving claim strategies to further reduce loss cost making us even more competitive. Those initiatives are as follows: Litigation management, including the effective use of both staff and panel counsel; two, ongoing a vendor management and improved vendor panels under construction for all regions to ensure that we have the highest quality vendors at the best price and to add expertise to our claims adjustment process; three, more effective integrated outcomes in the resolution of claims in workers' compensation and other casualty lines.

In casualty, we're looking to reduce cycle time through timely and proactive claims adjustments, focused litigation management and file review initiatives. In workers' compensation, we believe we'll produce better outcomes through changes in case management utilization, centralized bill review and increased PPO penetration and return-to-work initiatives.

Fraud is garnering a lot of industry attention lately and as always, we're actively monitoring for any signs of increase. The biggest industry uptick has been in personal lines but that represents only 15% of our business. Given the state of the economy, there is a heightened fraud diligence throughout our corporation.

We have excellent agency relationships and those relationships are working for us in the current challenging environment. The average agency is $2.2 million in premium with 22% of our agency plant writing $3 million or more annually. We provide our premier agents with ease of doing business through an unmatched field model, leading technology and superior service standards.

We have been rewarded by garnering the first, second or third spot in 63% of our agency plant in agents that have been with us for at least five years. This degree of penetration provides us the best opportunities. We met with 75 agents at six Producer Council meetings during the month of June. We went through a series of analyses with each group of agents identifying Selective's and our peer companies' strengths and weaknesses.

Agents tell us across the board that our top three strengths are our field model, relationships at all levels of the organization and responsiveness across the board in underwriting, claims, safety management and technology. They also identified areas for improvement which for the most part, create new opportunities for us to grow market share.

Although we expect higher loss and expense ratios in the second half of the year due to increased loss costs and the impact of earning in the affects of negative rate, we are positively revising our full-year 2009, combined ratio of guidance to below 101.5, on both a GAAP and statutory basis.
This change reflects the improved profitability we've seen year-to-date and includes our assumptions for catastrophe losses of 1.4 points for the balance of the year. It does not assume any reserved development, either favorably or unfavorable. And now I'd like to turn the call over to the operator for your questions.

Question and Answer

Operator

[Operator Instructions] And your first question comes from the line of Francisco Secada [ph] (1:13:01) with Piper Jaffray.

Michael Fitzgerald Grasher
Piper Jaffray Companies, Research Division

It's Mike Grasher with Piper Jaffray. Greg, just to start, I guess, the change in your combined ratio guidance is more or less a result of the performance in the quarter and just getting to the numbers by year end, is that the case?

Gregory E. Murphy
Chairman and Chief Executive Officer

Yes, and I think basically, the fact that, that includes that as well as we're about a quarter ahead of our pricing on the commercial lines, and I think taken into all the underwriting things that we've achieved and where we are through six months, yes, that's what it reflects.

Michael Fitzgerald Grasher
Piper Jaffray Companies, Research Division

And then also, just a question around the frequency of claim, in case I missed it. Are you seeing less claim frequency? Is it about the same?

Gregory E. Murphy
Chairman and Chief Executive Officer

Yes, frequency actually has been down in the commercial lines in the liability sector. That's really what we're talking about, mainly liability. In personal lines, it actually took a little bit of an uptick but overall, when we look at liability in aggregate on a fiscal year basis, as we look at frequency it's down just under 5%. That's continued to track fairly well.

Michael Fitzgerald Grasher
Piper Jaffray Companies, Research Division

And then with regards to the new reinsurance pact at July 1, what kind of an impact might that have on the premium to surplus ratio? Or your amount of excess capital?

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

Well, the reinsurance program is similar to the reinsurance program that we've had in the past. So there's nothing new designed in the program to impact the premiums to surplus. There's no kind of additional quota share or anything like that in there. It's just the standard excess of loss treaties that we renewed.

Michael Fitzgerald Grasher
Piper Jaffray Companies, Research Division

Okay, but didn't you lower your exposure to some degree?

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

We did place a little bit more of three x of two first casualty excess of loss treaty. It went from a 65% placement to an 85% placement, but that really doesn't have a material impact on any premiums to surplus kind of issue.

Gregory E. Murphy

Chairman and Chief Executive Officer

But what it will do, Mike, though it does take a little bit more of the volatility out on that layer. We felt given the trade that we had in front of us that, that was advantageous to us to put to increase that trade and I think what you're seeing overall, and I tell you, the folks that negotiated those treaties of seven, one contracts did a great job in terms of we we're -- personally I was expecting much higher rate increases but we were very encouraged about what we got.

Michael Fitzgerald Grasher
Piper Jaffray Companies, Research Division

Question I did have around the Alt-A exposures, any sense of the subordination levels on those Alt-As?

Gregory E. Murphy
Chairman and Chief Executive Officer

Yes. I'll that over to Kerry. Obviously we look at the Alt-As, we're pretty much -- and I'm very comfortable with how we've sized our exposure down and where we stand in all three areas that we look at, which as to manage a team, we're kind of very focused into the private-labeled RMBS, the private-labeled CMBS and the Alt-A. And the Alt-A is basically in the 2006, year both what we're kind of very much focused into on the 30, year and the hybrids in that. But I'll let Kerry kind of provide a little more color on that.

Kerry A. Guthrie
Former Chief Investment Officer and Executive Vice President

All of the Alt-A exposure on the portfolio that remains, was originally all AAA rated. So it's not subordinated Alt-A exposure.

Michael Fitzgerald Grasher
Piper Jaffray Companies, Research Division

Then with regard to issuer or the originator on those transactions?

Kerry A. Guthrie
Former Chief Investment Officer and Executive Vice President

What do you mean by issuer or originator?

Michael Fitzgerald Grasher
Piper Jaffray Companies, Research Division

I mean, who actually originated the loans? Do you have that granularity or is that available to us?

Kerry A. Guthrie
Former Chief Investment Officer and Executive Vice President

I have that but I don't have it with me.

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

It's not something that we publicly disclose before. I didn't get into that kind of level of detail.

Gregory E. Murphy
Chairman and Chief Executive Officer

Okay, well Mike, just to let you know, what we do, the folks in the investment department utilizing Intex and other things, they look inside everyone. They can see every mortgage, they know where it is. They have delinquency rates, they have LTVs, they have -- so that's really how, when we look inside the tranche, we can tell where's the geo locations of the properties? How delinquent are they? And then when we run our stress test, we're looking at a whole host of factors when we go through that process. We do look at, we could see every mortgage inside the portfolio and we know how that mortgage performs and we know where it is.

Operator

And you're next question comes from the line of Alison Jacobowitz with Bank of America, Merrill Lynch.

Alison Marnie Jacobowitz
BofA Merrill Lynch, Research Division

But the reserve development, for the total Company it was 6 million, right? I was just wondering if you could quickly give the breakout again, and what that was? The line sort of ticked out.

Gregory E. Murphy
Chairman and Chief Executive Officer

Sure, Dale is pulling that through. Most of it was in workers' compensation in the older years, and then the rest was kind of sprinkled around, but Dale is pulling it out right now.

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

All right, so for the first quarter we had $7 million of -- or excuse me, for the second quarter, we have $4 million of a favorable development in workers' comp, and about a $1.4 million in general liability. And there was a $1.5 million in commercial auto liability, but then we had $1 million unfavorable in personal auto.

Alison Marnie Jacobowitz
BofA Merrill Lynch, Research Division

And then, I just wondering also, in your other income and other expenses, could you just talk a little bit about that? I know it bounces around and there's a lot of stuff in there, but just how we should be thinking about that going forward a little bit?

Gregory E. Murphy
Chairman and Chief Executive Officer

Yes, I'll let Dale comment on that. One of the biggest movers that's in that other line is the tax adjustment regarding how -- the requirements to record income tax. And I'll let Dale talk about how much that impacted the numbers in the quarter.

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

Right, so that's the major impact that you have in there that makes it bounce around. The other thing that you find in there is the compensation with regards to restricted stock compensation also is in there. So as the underlying stock price moves, that will change the mark-to-market on the compensation expense that we have there. So those are the things that make it jump around a bit. I'm not sure which other you are looking at, too -- that's the other thing that we always struggle with, if it's the other on the face of the full income statement? Or if it's the other within our investor packet. Kind of depends. Different analysts concentrate on different pieces there but the effect of tax rate adjustment in the quarter was a $2.1 million favorable within the other.

Gregory E. Murphy
Chairman and Chief Executive Officer

And understand that those were taxes that we did not take the full benefit for in the first quarter that are now kind of semi-reversing in the second quarter.

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

Exactly.

Operator

And your next question comes from the line of Doug Mewhirter with RBC Capital Markets.

Doug Mewhirter
FBW

Just follow up on the tax rate issue. Do you think that there is any, I guess, residual benefit that may flow into the third quarter, or I guess the reversal of the non-benefit? However you want to characterize that.

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

Well, we had about $4 million worth of additional expense recorded in the first quarter, and then we had about a $2.1 million benefit recorded in the second quarter. So you do have about 1.8 million of remaining benefit. And again, the way that works is at the beginning of the year, you have to make an estimation for the overall tax rate, and that's what you have to book your taxes to over the course of the year. Obviously, given the volatility that we have seen in our alternative investments, that kind of causes that overall rate to jump around a bit, and that's why you're seeing a bit more volatility there than you've maybe seen in the past. But that's something that's been out there. As you can tell from the fact that it's due to APB 28, that's been out there for a very long time.

Doug Mewhirter
FBW

The second question is, I understand your alternative investment funds have report on a one quarter lag. Have you gotten any indications of how their performance is? Or do you basically just wait until the end of the quarter and collect them all?

Gregory E. Murphy
Chairman and Chief Executive Officer

Well, that -- obviously, we're in constant contact with the various partners that we do business with. But what we're saying obviously, is in terms of the economy has stabilized, and we expect to see some of these stabilize as we move forward -- and I would tell you that, that obviously the real estate sector is probably going to be under still a little bit of ongoing pressure. But we do not put out any prognostication on that.

Doug Mewhirter
FBW

Okay, and I guess, Dale or Greg, you said that the investment funds were a third of the losses, if I'm not mistaken. What's the percentage of investment funds or investment-related funds as part of your overall alternatives portfolio? I'm sorry...

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

Real estate represents about 14% of the alternative portfolio, and it's been accounting for roughly a third of the losses from that -- the overall alternatives.

Doug Mewhirter
FBW

And my last question -- I guess more of a conceptual question. Looked like your new business really picked up on the large accounts. Do you think that -- and also your submissions have gone way up. Do you think the troubles with AIG, or whatever it's called now, Chartis, and maybe even Hartford, have you seen any tangible affects from that? Or is it just the large account business is just sort of swinging around in more of a macro way across the board?

Gregory E. Murphy
Chairman and Chief Executive Officer

John will answer that question.

John J. Marchioni
President and Chief Operating Officer

This is John Marchioni. I would say that those two companies in particular aren't really having an impact on the business that we're seeing. Keep in mind, for us our Large Accounts business is generally in the $250 to a $1 million on a guaranteed premium basis -- guaranteed cost basis. Which is not really where AIG in particular played. I just think for us, it's as a matter of continuing to get us a similar or slightly stronger number of opportunities. That business is almost all rated up on the casualty lines through an actuarial rating model, and in situations where we can get our price, we're going to take those opportunities. In situations where we can't, we're going to walk. And in the quarter, we just had more cases where whoever else was competing on that account wasn't forcing the pricing down below technical pricing levels, and I think we had a higher success rate as a result ofit.

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

The other thing I'll point out is that, remember last year, you had new business declining over the course of the year in the large accounts. So you're increasing on a smaller base than we've had previously, so that makes the percentages look a bit larger.

Operator

[Operator Instructions] And your next question comes from the line of Peter Seuss with Lincoln Square Capital.

Peter Seuss
SuNOVA Capital

The first, I was hoping you could provide a little bit more color on the paid loss improvement. I think it was $198 million this quarter, while it's been kind of in the $200 million to $235 million range for the past five quarters. So was that related to the improvement in frequency that you mentioned? Or if you could just give us a little bit more.

Gregory E. Murphy
Chairman and Chief Executive Officer

Yes, I would say when you start to look at paid claim volume, there's a lot of things that push that around. Some of it is a result of the claims that are -- that we're looking at in terms of trying to reduce cycle time. So it's very hard to peg that number on a quarter-to-quarter basis or look at any kind of sequential growth or a downtick in that number because that gets moved around by a whole host of initiatives, which include more proactive settlement day, conferences with both panel and staff counsel firms. And so there is just a lot of movement that happens within the paid to sit there and make any holistic comments about it.

Peter Seuss
SuNOVA Capital

And then I think this might have been asked a different way earlier, but I kind of missed it. On the alternative portfolio, you kind of made a comment in the opening remarks that it should stabilize and improve with the markets. Was that comment based on what you've seen so far out of the second quarter performance?

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

It's based on the fact that if you just look at the sequential quarter here, that we had a $20 million loss that we reported in the first quarter, and we're down to an $8.9 million loss in the second quarter that we recorded within the financial statements. We don't have any reports from our alternative investments for the third quarter, so that's not based on any information that we've received. It's just kind of a general commentary on the marketplace and what we've seen in terms of what we've reported.

Peter Seuss
SuNOVA Capital

And then lastly, just in the commercial lines' top line, do you anticipate kind of a sequential improvement if the economy rebounds, as consensus seems to think it will in the second half of the year?

Gregory E. Murphy
Chairman and Chief Executive Officer

Yes, Kind of how I would look at that is our commercial lines NPW is down about 8%, and half of that is coming from lower audit and endorsement, approximately half of that is coming from lower audit and endorsement premium. I still think that when we go back and look at the amount of premium track -- and I mean, we track it a whole host of ways. But my sense is that you will still see a little bit more of a headwind in the third quarter relative to that. It's not until I think you get the fourth quarter where the comps start to level out -- where when we get to the audit and endorsement premium in the fourth quarter of '08, is where you start to see a real pick up of that, and we track it and audit it and endorse it. We track premium that's booked more than three months behind the current month activity and when you look at a lot of those indications, a lot of it shows that it's not going to be the third quarter, it will be more in line with the fourth quarter when headwind will start to diminish. And then I think holistically overall, our numbers -- I think the economic effect of our numbers won't really stabilize until we see something in unemployment stabilize. So whether we're going to settle in at 10 or settle in at 11, once we get to that steady state, then you'll see a lot more top line growth as we move forward, because we will not have that headwind, we'll be moving from minus rate to positive rate. And at some point when you get some stabilization in there, you'll see some positive growth in exposures. But I still think you're going to see the drag in the headwind in the third Q. I think it's more in the fourth quarter – remember, the fourth quarter, we don't book an enormous amount of commercial lines premium anyway; but that's probably when it starts to turn from that standpoint.

Peter Seuss
SuNOVA Capital

Got it. And then lastly, the other operating expenses were down $3.3 million sequentially to $16.4 million. But it was down significantly year-over-year. And I guess you mentioned you had a $2 million tax benefit within that number, so should we kind of view the normalized number as like $18.4 million?

Gregory E. Murphy
Chairman and Chief Executive Officer

Dale is kind of pulling through that right now.

Peter Seuss
SuNOVA Capital

Yes, I mean, I know it's volatile from quarter to quarter, but just kind of on average over time.

Gregory E. Murphy
Chairman and Chief Executive Officer

And it's tough to peg that, as Dale articulated before. You've got stock price movements that affect anything that's compensation that's based on stock. So that moves around a bit, but...

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

I can't say that we really provide any prognostication, other than what we can tell you is just that, that the two major components that introduced volatility into it are the APB 28 tax adjustment, and then also the compensation expense component that moves based on how our stock price moves.

Peter Seuss
SuNOVA Capital

What was the stock comp -- sorry, what was the stock comp in the quarter?

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

In the quarter, the employee compensation expense -- let's see, I got a year to date number here. Let me track down the -- year to date, it's $4.6 million. I don't have the quarterly number right here.

Gregory E. Murphy
Chairman and Chief Executive Officer

We can get back to you later on.

Operator

[Operator Instructions] And there are no further questions at this time.

Gregory E. Murphy
Chairman and Chief Executive Officer

Okay. Well, thank you very much. We're very encouraged by the pricing trends in the commercial lines market. We've been successful in getting rate increases in personal lines. We're pleased with how the quality of both our commercial lines and personal lines book is improving and believe that our strategies will provide us with long-term industry outperformance. Thank you for participating on the call this morning. Please give Dale or Jennifer a call for any follow-up questions that you might have. Thank you very much.

Operator
Thank you, everyone. This does conclude today's conference call. You may now disconnect.