S&P Capital IQ

CONTENTS

Selective Insurance Group, Inc. NasdaqGS:SIGI

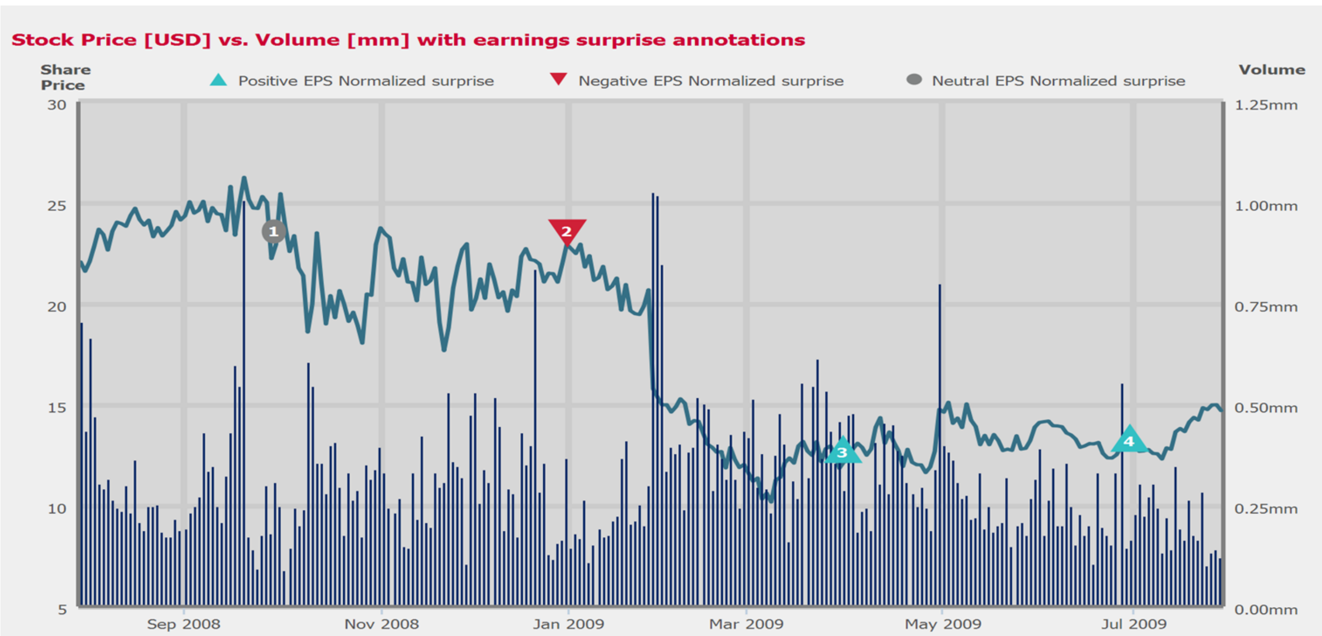
FQ3 2009 Earnings Call Transcripts

Thursday, October 29, 2009 12:30 PM GMT

S&P Capital IQ Estimates

	-FQ3 2009-			-FQ4 2009-	-FY 2009-	-FY 2010-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.34	0.44	29.41	0.36	1.24	1.42
Revenue (mm)	405.08	390.18	(3.68 %)	387.60	1547.22	1576.08

Currency: USD
Consensus as of Oct-29-2009 11:05 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ3 2008	0.45	0.45	0.00 %
FQ4 2008	0.48	0.10	(79.17 %)
FQ1 2009	0.01	0.05	400.00 %
FQ2 2009	0.24	0.43	79.17 %

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

Ronald J. Zaleski
Former Chief Actuary and Executive VP

ANALYSTS

Amit Kumar
Fox-Pitt Kelton Cochran Caronia Waller Limited, Research Division

Doug Mewhirter
FBW

Michael Fitzgerald Grasher
Piper Jaffray Companies, Research Division

Robert Farnam
FBW

Samuel Hoffman

Presentation

Operator

Good day, everyone, and welcome to the Selective Insurance Group's Third 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, Investor Relations, Ms. Jennifer DiBerardino.

Jennifer DiBerardino

Thank you. Good morning, and welcome to Selective Insurance Group's Third Quarter 2009 Conference Call. This call is being simulcast on our website and the replay will be available through November 30, 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 in operations. Operating income is net income, excluding the after-tax impact of net realized investment gains and losses, as well as the after-tax results of discontinued operations. We believe that providing this non-GAAP measure makes it easier for investors to evaluate our insurance business.

As a reminder, some of the statements and projections that will be made during this call are forward-looking statements as defined by the Private Securities Litigation Reform Act of 1995. Forward-looking statements are not guarantees of future performance and are subject to risks and uncertainties. We refer you to Selective's annual report on Form 10-K and subsequent Form 10-Qs, filed with the U.S. Securities and Exchange Commission, for a detailed discussion of these risks and uncertainties. Please note that Selective undertakes no obligation to update or revise any forward-looking statements.

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

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

Good morning. We're pleased to report solid insurance results for the statutory combined ratio of 99.8% in the third quarter. Commercial Lines renewal pure pricing continues its positive trend, with a 1.5% increase in the quarter, up from a positive 0.6% in the second quarter. We're very encouraged by the positive pricing trend, and believe it reflects our dedicated field underwriting team, leveraging excellent agency relationships and predictive modeling capabilities, in the face of what's still can be characterized as a very competitive Commercial Lines marketplace and a difficult economy.

For the third quarter, we reported strong operating income per diluted share of $0.44, essentially flat with a year ago. Earnings were driven by better property results, lower catastrophe losses and improved investment income.

As announced in our press release yesterday, we've entered into an agreement to sell our HR Outsourcing business to AlphaStaff of Fort Lauderdale, Florida. The transaction is expected to close by year end. While we strongly believe in HR Outsourcing Services as a natural complement to our distribution force and business model, it made more sense to find a quality partner who could focus on those efforts, as we devote our full-time resources to profitable growth opportunities in our insurance operations.

We will continue to support AlphaStaff's business growth through our agency plant as part of the agreement. Note that Selective HR financial results have been moved into discontinued operations, including an after-tax $7.9 million goodwill impairment charge in the quarter.

Alternative investments generated a pretax gain in the quarter of $2.7 million, compared to a $3.2 million gain in the same period in 2008. Five of our seven strategies generated positive results in the quarter. Real estate continues to be a drag on the overall alternative investment performance, and we would expect this to continue until the commercial real estate market stabilizes. As our alternatives largely report on a one-quarter lag, the $11.5 million improvement in the third quarter from the previous quarter reflects second quarter market conditions. Invested assets were up 6% at September 30, 2009, compared to December 31, 2008, reflecting an unrealized gain during the period of $137 million pretax on our available-for-sale portfolio.

The financial market's recovery from its lows earlier this year is the driver of this gain. Market to amortize costs on the whole bond portfolio improved in the quarter to 102.3% from 99.5% at June 30. For the nine months, our available-for-sale unrealized loss improved from $57 million to an unrealized gain of $31 million after-tax, driven largely by fixed maturity securities. The net overall improvement increased book value per outstanding share by $1.67. The valuation improvement, along with higher net income, contributed to the increase in book value from $16.84 at December 31, 2008, to $18.58 at September 30, 2009. Other-than-temporary impairments or OTTI in the quarter were recorded at $2.8 million after-tax, primarily reflecting our intent to sell two securities that are currently in an unrealized loss position. This is a substantial improvement from the prior three quarters, and reflects the stabilizing financial markets.

Insurance operations performed well in the quarter. Our 99.8% overall statutory combined ratio was up from the 97.6% reported a year ago. Despite lower catastrophe losses and favorable reserve development, the combined ratio was negatively impacted by increased loss costs, and a reduction in earned premium, mainly due to audit and endorsement return premium. Pretax catastrophe losses for the quarter were $1.9 million or 0.5 points on the combined ratio, compared to catastrophes a year ago that were $12.8 million or 3.4 points.

Overall casualty prior-year statutory loss in LAE favorable reserve development, on a pretax basis for the quarter, was approximately $8 million or 2.2 points on a combined ratio, compared to $5 million or 1.3 points in the third quarter of 2008. Commercial Lines' premium growth continues to be a challenge, given the tough economic and competitive conditions. Commercial Lines premium declined 9% in the quarter, half of which was driven by the impact of audit and endorsement return premium of approximately $18 million, compared to about $1 million a year ago. This continues to hit the Workers' Compensation and General Liability lines of business the hardest. New Business declined 13% in the quarter. Renewal Premium declined 2%, while Retention ended the quarter at 75%.

Personal Lines' results improved 1.6 points in the quarter to a statutory combined ratio of 101.8%, from 103.4% a year ago. The improvement was driven by a decrease in total property losses and a decrease in loss costs in the casualty lines. Personal Lines' net premium written grew 11% in the quarter to $62 million. The price increases that we have achieved over the past two years and our expansion efforts outside New Jersey are reflected in the premium growth.

At September 30, the premiums-to-surplus ratio was 1.6:1, down from 1.7 at June 30. Surplus increased $30 million in the quarter to $903 million, while stockholders' equity increased $40 million to $986 million. Now I'll turn the call over to John Marchioni to review the insurance operations.

John J. Marchioni
President and Chief Operating Officer

Thanks, Dale. Good morning. Insurance operations is focused on growing profitably. The decline in Commercial Lines premium this quarter reflects not only a tough economy, but more importantly, underwriting and pricing discipline. Pricing and retention are the two levers that underwriters monitor carefully. Our inside renewal underwriting teams are working hard to balance price increases with retention levels. With the success we've had in driving overall price, there was a two-point drop in Commercial Lines retention to 75% in the quarter.

On a point-of-renewal basis, overall retention in the quarter was 88%, essentially flat with a year ago. When we look further into our retention, it's clear that we are driving improvement in our overall mix. At September 30, retention at the point of renewal for the lower quality 1 & 2 Diamond business was 80%, while our best-performing 4 & 5 Diamond business retained at 90%. We believe this demonstrates that our underwriting expertise and predictive modeling tools are working as intended. Given current economic conditions and a continued presence of some undisciplined competition for new business, we believe that 75% total retention and 88% point-of-renewal retention are good results in today's markets.

Our field underwriters are writing the majority of new business in the highest-quality 4 & 5 Diamond range. The shift in quality of new business versus pre-modeling is noteworthy. 4 & 5 Diamond business now represents 67% of new business versus 53% pre-modeling. While the other end of the spectrum, 1 & 2 Diamond business, now represents only 7% of new business versus 17% pre-modeling. We believe our strong relationships with our 960 agents provides our AMSs with the best new business opportunities.

While the third quarter was the toughest so far this year for new business growth, we are confident that the business we are putting on the books has the best opportunity for profitability, given the underwriting information and granular pricing capabilities our underwriters have at their fingertips. New business pricing was down a modest 0.9% in the quarter, unchanged from the second quarter. In addition, we have seen submission activity from our agents remain very strong, while hit ratios were down from last year. Together, these factors demonstrate the discipline we've instilled in our operations.

Year-to-date, Commercial Lines' new business was up 3%. By segment, One & Done automated small business was up 8% to $56 million; middle market or AMS-generated business was up 1% to $133 million; Selective Risk Managers, our large account business, was down 1% to $16 million, as this segment of the market continues to experience the most competition. We continue to see the shift in our Commercial Lines book of business away from contractors to our other more profitable classes.

At September 30, our contractors' mix stands at 40% of Commercial Lines premium, down from 43% at year end 2008. Our new business success in these classes is demonstrated by the following statistics for the first nine months of 2009: New Manufacturer and Wholesaler business was up $8.5 million or 27%; New Specialty business, which includes social service, golf courses and public entities, was up $6.3 million or 27%; New Mercantile and Service business was up $1 million or 2%.

The non-contractor classes of business perform, on average, about six points better on the combined ratio than the contractors' classes. As we grow these classes faster than contractors, our profitability will improve. To that end, we have provided our agents with a variety of programs, such as sales developmental training and active leads for writing good business within our appetite, which support our Commercial Lines' diversification efforts. These leads have been pre-scored through our models, and target pricing is provided to best ensure profitability.

For Personal Lines, market pricing moved much sooner than for Commercial Lines. We began increasing rates in 2008. Through September of this year, we have implemented 21 rate increases of 3% or more. We are expecting to implement another six before the end of the year. Together, 2008 and 2009 increases equate to $26 million in additional premium opportunity at our enforced book of business.

Our MATRIX homeowner and automobile models, with their precision pricing capabilities, create organic growth opportunities. In Personal Lines, total new business increased 43% in the quarter from a year ago, while outside of New Jersey, new business increased 57%. This demonstrates our diversification efforts are working. We are also seeing significant improvement in the quality of both Homeowner and Automobile business into higher-scored sectors that have better claim experience. We believe that predictive modeling through MATRIX, along with $26 million of additional rate on this $216 million book of business, will allow us to achieve our goal of being profitable on a run rate basis in the third or fourth quarter of 2010. Now I'll turn the call over to Greg.

Gregory E. Murphy
Chairman and Chief Executive Officer

Thank you, John, and good morning. I'm pleased with our third quarter results. The recovery in the financial markets have moved our alternative investment portfolio back into positive territory for the third quarter. We are seeing fundamental improvement in Personal Lines as a result of the numerous rate increases we've implemented and the predictive modeling capabilities we have through our MATRIX system. In Commercial Lines, we have achieved renewal price increases ahead of our competitors. We are benefiting greatly from predictive modeling and our other knowledge management initiatives. We believe that if you cannot deliver granular price changes, you're going to get killed in this market.

Our knowledge management tools were key in our ability to deliver a positive pure pricing. For Commercial Lines, renewal pure pricing increased 1.5% for the quarter, up from 0.6% in the second quarter. For the third quarter, Commercial Lines' renewal pure pricing outside of New Jersey is even stronger at a positive 2.1%. Through November 23, total Commercial Lines renewal pure pricing was up a positive 2.6%, which was up 0.4 points over the month of September, and is now very close to covering our loss trends. Our Commercial Lines pricing strategy is very targeted. We focus most aggressively on increasing price in the least-profitable 1 & 2 Diamond sectors. While this does negatively impact retention rates, we are comfortable shrinking in the short term to preserve long-term profitability.

We believe there will be a change in industry behavior in 2010, and companies will raise prices to improve underwriting results for the following reasons: Loss trends continue to move higher, particularly for medical expenses; five years of Commercial Lines pure price reductions; interest rates remain low; and a recognition of more volatile financial markets, and as reserve releases start to diminish and calendar year loss ratios move higher.

The past year has been challenging on many fronts, but we've seen significant recovery in progress. Book values up 10% since December 2008, with a five-year compounded annual growth rate of 4.4%. We've made significant progress in our Personal Lines profit improvement plan, with 21 filed rate increases of 3% or more to date, and another six anticipated for the fourth quarter. Investment income has stabilized as alternative investment income turned positive this quarter.

Commercial Lines pure pricing turned positive and the run rate is getting close to covering loss trends. When we exceed loss trends and written policy increases start to make their way in to earn premiums, profitability should improve. The economic effect of audit and endorsement return premium comparisons should improve in the fourth quarter. As we move into 2010, we'll begin to show growth in Commercial Lines, unless the competition ignores technical underwriting requirements and remains reckless. We have a number of claims initiatives under way to even more vigorously manage loss and loss adjustment expenses, such as mitigation management; ongoing vendor management to get the best quality at the best price; more effective integrated outcomes in the resolution of claims and workers compensation and other casualty lines; and we have diligently managed our expenses, maintaining about a 31.5% year-to-date expense ratio, in spite of top-line premium declines.
We are positively revising our full year 2009 combined ratio guidance to approximately 101%, on both a GAAP and statutory basis. This change reflects the improved profitability we've seen year-to-date, and includes a fourth quarter assumption of one point of catastrophe losses. It does not assume any reserve development, favorable or unfavorable. Now I'll turn the call to the operator for your questions.

Question and Answer

Operator

[Operator Instructions] And your first question is from the line of Amit Kumar of Fox-Pitt, Kelton.

Amit Kumar
Fox-Pitt Kelton Cochran Caronia Waller Limited, Research Division

I guess just going back to your comments regarding the change in industry behavior in 2010, what do you sort of has at, I guess, as to -- do you -- are you in the Bill Berkley camp fair? You see this in the first half, or are you talking more so about maybe Q3 or Q4 of 2010?

Gregory E. Murphy
Chairman and Chief Executive Officer

I got to tell you, for us to be able to achieve -- I mean, I got to tell you, we've got a pretty clear plan laid out for 2010, and our ability to stand behind that plan is now based on our very granular pricing capabilities. Obviously, if the market moves, it needs to move in the first quarter of 2010 for us to exceed that plan. And we believe that because of investment returns, because of loss cost trends, because of five years of ongoing premium reductions, that, that price trend needs to move and needs to start in the first part of 2010.

Amit Kumar
Fox-Pitt Kelton Cochran Caronia Waller Limited, Research Division

I think as I look at your rate changes -- and I know you guys talked about CLIPS I think a day before yesterday, CIAB [Council of Insurance Agents & Brokers] numbers came out, which I think talked about a 6% rate decrease in Q3, and if you look at the comments from some of the brokers, essentially it's a buyer's market. Can you just sort of help me reconcile this delta where you are able to generate these price increases, while some of the peers and the brokers are still talking about it being very easy, simply based on the current economy?

Gregory E. Murphy
Chairman and Chief Executive Officer

Yes, I think there are -- yes, let's kind of take that in its pieces and I'll let John comment on this as well, but let's first understand that the market scout on CIAB are not really that scientific or actuarially sound methods, but they are an indication correctionally of what you can see in the marketplace. I think these are generally in the larger accounts sector where you could be seeing more reckless pricing. So that could be one reason. You got to understand that if you're talking to a large broker about segmentation and pricing changes, and then you come and look at our book for instance, our average account is more in the 10,000 range, so -- and the other element of that, I think, is when you start to look at our book, there's about maybe 30% that we're really focusing on price increases, so there's 70% of the book that really hasn't gotten much of any price increases as a result of our very, very granular, targeted rate increases. So I think part of it is you've got to look at it more in the account by account basis. You have to have to segment the sizes of the accounts. And that's why we believe that we track more closely to advising or CLIPS, and when you look at the CLIPS surveys, they have moved positive and it does kind of corroborate our position about what we're doing in the marketplace. John, what...

John J. Marchioni
President and Chief Operating Officer

The only other thing I would add is we certainly saw the market start to get more disciplined in the second quarter, and then things turn back to aggressive pricing, from a new business perspective, in the third quarter. And just to reiterate what Greg had said, when you look at how we're achieving our rate changes, the business that we're pushing out into the market, based on applying rate increases, tends to be the lower-quality business. And I think that's what a lot of the competition is really starting to see out there and starting to pursue, with rate levels that are quite honestly, are inadequate. So you combine that with the fact that many companies -- and we reported to you in our prepared comments and new business pure price number, many companies don't aggressively measure new business pure price, and I think, as they start to realize the pricing levels are putting this business on the books, that's going to force some discipline as well, as they start to earn that through that renewal inventory.

Gregory E. Murphy
Chairman and Chief Executive Officer

And the other part of the comment that I just -- the consumer, and I think that will be a critical part in maybe maintaining a softer market for a longer duration of time. Consumers are very, very -- price increases, the business is very difficult today, so in some cases, they can sit there and say -- they could tell their agent to move them at any cost to another carrier just to get a cheaper price. So those are legitimate headwinds out there. And I hope you get the message from us, with 2.6% price increases through October 23, we're very close to covering our loss trend at that point and we feel good about that, but we're also -- understand that we are out there ahead of the market. I read most of their commentary. No one else is really getting price increases, particularly in the regional space. So we understand that we are a little bit -- we are ahead of the market, but until the market gets those kind of price increases, their combined ratio is going to be under pressure for another six, or nine, or 12 months more than ours will be under pressure. And I just think that's part of the reality of loss trends and price changes, as we move forward.

Amit Kumar
Fox-Pitt Kelton Cochran Caronia Waller Limited, Research Division

I guess, just talking about your premium-to-surplus levels being at 1.6, obviously, you've talked about -- you've seen that slightly where you talked about the new business opportunities and how much you can expand. How far can you go on the premium-to-surplus level before you sort of hit some sort of a ceiling?

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

I'd say we're very comfortable at our current 1.6:1 premium surplus. Obviously, in this economy and with the pressures we're having, we're actually seeing some decline in premium, which moves that ratio downward. But I'd say that we're comfortable with these capital levels. The one thing we've said publicly is if you did have a very rapid hardening of the pricing out there, there may be some need to do something differently, but quite frankly, we just don't foresee that you're going to see that kind of a rapid hardening. So we've very comfortable where we are.

Amit Kumar
Fox-Pitt Kelton Cochran Caronia Waller Limited, Research Division

Final question, in terms of the reserve releases, I may have missed it. Can you give some more color as to what lines do they come from? Specific lines?

Ronald J. Zaleski
Former Chief Actuary and Executive VP

Actually, reserve releases came from all workers comps, general liability and commercial liability, all about the same amount.

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

That was Ron Zaleski, our Chief Actuary, by the way.

Operator

And your next question is from the line of Mike Grasher of Piper Jaffray.

Michael Fitzgerald Grasher

Piper Jaffray Companies, Research Division

Just more, I guess, question around that risk to capital and has improved dramatically here over the course of the first three quarters in '09, what level or what's it going to take from A.M. Best's perspective to remove that negative outlook that they have placed? And granted you still have A+ rating, but I'm just curious as to what they look at or what they're looking for?

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

Basically, what they're looking is improvements in the operating earnings, which basically, the pressure was on the investment side of things and obviously with the alternatives moving back in the positive territory, that's a very favorable thing. And then to see as begin to generate capital organically, which that's exactly what you're seeing here, so I think beyond that, it becomes -- that we've got to demonstrate a few quarters of that so that they feel comfortable that it's definitely the new current state.

Michael Fitzgerald Grasher
Piper Jaffray Companies, Research Division

Do they come back to you, sort of once a year? Or is that -- can occur at any time? Or how should I think about that?

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

Rating agencies reserve the right to do whatever they want at any time, but we do have a regularly scheduled annual meeting with them, which generally the meeting occurs in late February and they release their results in late April or early May. That's been the tradition, but they're not locked into that.

Michael Fitzgerald Grasher
Piper Jaffray Companies, Research Division

So they will get at least one more look before they come in in February?

Gregory E. Murphy
Chairman and Chief Executive Officer

And Mike, they have their own model. They have the BCAR [Best's Capital Adequacy Ratio] model and that's a measurement that we closely follow and we saw quite an improvement in those results in the third quarter, as our surplus topped over $903 million.

Michael Fitzgerald Grasher
Piper Jaffray Companies, Research Division

And then I want to ask the workers comp, just to confirm, it looks like the deterioration in the combined ratio, in the loss ratio was entirely related to the amount of premium? Or numerator, denominator effect more so than deterioration on that...

Gregory E. Murphy
Chairman and Chief Executive Officer

Yes, there's a little bit of movement in the 2009 year, but most of that is, like you say, there's a lot of gyrations happening there in the audit and endorsement from an audit and endorsement standpoint and as Dale mentioned, we had about $18 million of negative audit endorsement premium in the third quarter. That's substantially lands in two lines. The biggest one is the workers' compensation line and the next one is the GL line, as those are exposure-based lines. So let's make sure we understand that that is less exposure on the books. That has pushed around both our underwriting expense ratio in that line, our loss adjustment expense ratio in that line, as well as a little bit on the loss ratio as a result of that huge fluctuation. And just to get this point out there, we only had $1 million of positive audit endorsement in third Q of '08. As we move into the fourth quarter of 2009, we'll be comparing it to a fourth quarter of

2008. That's got about $13.5 million of negative premium. So that's what we're starting to mean, that the comps will start to level out a lot more as we move into the fourth quarter of this year.

Michael Fitzgerald Grasher
Piper Jaffray Companies, Research Division

And then, the change in the premium and from workers comp, year-over-year, how much was related to the negative audit versus how much on the retention aspect?

Gregory E. Murphy
Chairman and Chief Executive Officer

Dale -- we'll look into that exact split right now. I only have it in total but I don't have it by line. But we'll get that for you in the second. Any other questions that you have while we extract that information?

Michael Fitzgerald Grasher
Piper Jaffray Companies, Research Division

No, I'll come to you a little bit later.

Operator

And your next question is from the line of Sam Hoffman of Lincoln Square.

Samuel Hoffman

I just wanted to follow up on that question because it seems that your loss ratio, excluding CATs [catastrophe] and excluding development increase to 69.7% for the quarter from 66.9% in the second quarter and it sounds like some of that was due to the workers compensation kind of one-time item, but I just want to clarify how much of that increase -- what do you attribute that increase to? And how much of that was a sort of one-time versus a run rate, going forward?

Gregory E. Murphy
Chairman and Chief Executive Officer

Well, there's a lot of moving parts in our loss ratio, so it's hard to just succinctly answer that question. But I mean, I'll just tell you the over-arching issue is that you're still earning in negative rate and you still have positive loss trend. So obviously, as you move forward, you're going to see the ramifications of the negative rate and the trend impact your loss ratio on a quarter-to-quarter basis. So last quarter was the first quarter we wrote at positive rate. This quarter, we wrote at even more positive rate level. So you're going to see that kind of affect the liability lines as you move out into the fourth and first and the second quarters of '10. And then the other thing is that kind of pop the number around a fair amount is your performance in the property lines. But, it's hard to sit there and disaggregate that number into its pieces. There were some reserves that were moved into the current year, but most of that was due to the audit and endorsement situation

Samuel Hoffman

It just seems that the 2.8% increase is quite significant one quarter to the next and so maybe we can follow-up off-line in terms of...

Gregory E. Murphy
Chairman and Chief Executive Officer

There's a lot of factors that push those numbers around.

Samuel Hoffman

But what do you see the run rate going forward as...

Gregory E. Murphy
Chairman and Chief Executive Officer

We don't prognosticate future run rates in terms of individual loss ratios. What we will tell you obviously, is you can expect the combined ratio for the year to be approximately 101. So you can back into that by -- you know what our expense ratio looks like in the fourth quarter. You know that always tracks higher because our premium, on a net premium written basis though, it's down in the fourth quarter and they you can kind of just work your model backwards and you can kind of play with that.

Samuel Hoffman

And the 101 excludes reserve releases?

Gregory E. Murphy
Chairman and Chief Executive Officer

There is no contemplation of either favorable or unfavorable development in that number, correct. And as one point of casualty loss is in there as well.

Samuel Hoffman

So I mean implicitly, what you're saying is that the 69.7% was unusually high for the quarter?

Gregory E. Murphy
Chairman and Chief Executive Officer

No, I didn't say that. I said that there are a number of factors that push that around and some of them could be the audit premium or other issues and it's very hard to just sit there and disaggregate that number any other way than that.

Samuel Hoffman

There were two other items, your yield on fixed income securities has dropped to 4.35% from 4.6%. Can you explain that? And is that one-time as well?

Gregory E. Murphy
Chairman and Chief Executive Officer

That's a reflection of the lowering yields that are available in the marketplace and some of the trades that we put on our portfolio that have de-risked it, it terms of some of the -- and you can also see at the same time, we shorten up duration a little bit as a result of that. But yes, the yields that we brought on versus the yields that came off, you are seeing a separation of that and that's one of the main thesis's for why price increases need to go up in the industry, because absolute yields are lower and there's a bad news of recognition of more volatility in the investment world. So as you deal with both of those issues on the investment side, your underwriting results need to improve to offset that, which means that your price increases need to move higher because loss trends are loss trends.

Samuel Hoffman

Third thing is your other operating income line and other operating expense line decreased dramatically in the quarter and I guess the spread got worse for you guys. Can you just talk about the implications of the divestiture or any other factors for that line because that sort of adversely impacted you guys in the quarter?

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

I mean that is the major impact in the quarter, is the fact that we sold SHRS [Selective HR Solutions]. So that's now moved to a discontinued operations line. So their income and their expenses are pulled out of those other categories on the face of the income statement and moved to the discontinued operations line. I know that several other analysts have asked the question about that. We're going to try and put together a little bit of a schedule and post it out on the web later today within our investor packet.

Samuel Hoffman

Would you expect anything to be less than that line after the divestiture?

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

Yes. Right. Basically, yes, both of those will permanently be lower now because they won't contain the SHRS activity.

Samuel Hoffman

It's similar to the third quarter?

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

We're not making any prognostications with regards to the individual components that remain there.

Samuel Hoffman

And finally on the tax rate, maybe you could just briefly discuss that.

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

Sure. Basically, it's the tradition, it's been there since APB 28 came out, that you have to prognosticate what your expected tax rate will be for the full year and book your taxes on an individual quarter basis to that rate. So the difference between looking at the quarter on a cut-off basis and what your expectation for the full year gets booked as an effective tax rate adjustment within the quarter. So you can see -- you can particularly tell, I guess, when you go to the year-to-date number that the effective tax rate adjustment is pretty small at this point and therefore -- which is exactly what you would expect it by the fourth quarter, you get to your full year run rate.

Gregory E. Murphy
Chairman and Chief Executive Officer

What all that means is obviously the taxes that will occur in the fourth quarter will be pretty true to the taxable at 35% and tax exempt at the tax exempt rates.

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

The other thing, I got some information to Mike Grasher's previous question. Basically, on the audit side of things is about two-thirds of the audit premium comes from the workers' comp line of business, so out of the $18 million, it's a little over $11 million.

Operator

And your next question is from the line of Doug Mewhirter of RBC Capital Market.

Doug Mewhirter
FBW

I just had one market-related question, I guess John or Greg, maybe could answer it. It's more of a I guess, it's more of a hypothetical. So you've been talking actually for the last couple of quarters about how a lot of times a competitor will come in and take away a long-time account at maybe 20% off of expiring. Would you describe that typical competitor as more in the category of a national carrier or more in the category of a regional carrier, without getting too specific, of course?

John J. Marchioni
President and Chief Operating Officer

The answer is yes. It's regional, national and in certain cases, the combination of the two.

Doug Mewhirter
FBW

And I would assume that the -- would it be large versus small? I guess it would be more regional in the smaller and national on the larger, or is that not--

John J. Marchioni
President and Chief Operating Officer

Not necessarily. We compete against both national and regional players in our small markets and the middle market business all the way up the line in terms of size of business, so you do see them. It varies more geographically and more by segment. So

Your contractors, competitor set, in certain cases, is slightly different than the competitors, say you'll see in manufacturing or specialty.

Gregory E. Murphy
Chairman and Chief Executive Officer

And I got to tell you, Doug, that has a big impact on our ability to move pricing and I would tell you, that really curtails your ability to move more and get a larger basket of policies in the price increase area. And that's where our struggle is in terms of how we look at 2010 and how hard we want to push and how big we want that inventory to include and how much we want those rate increases to be. And that's where we have spent, as a management team, a fair amount of time on it. We'll continue to, as we set our pricing strategy for 2010, which theoretically will be done in the next few weeks. You got January pricing that will be -- that are going to be put out on the street in another few weeks. So you need to be way ahead of this curve, if you miss January, you miss the whole month. Now that needs to be decided pretty soon.

Operator

And you do have a follow-up question from the line of Mike Grasher of Piper Jaffray.

Michael Fitzgerald Grasher
Piper Jaffray Companies, Research Division

Just a quick question on the change in goodwill. I think the discontinued operation impairment charge is $7.9 million after tax. Just trying to figure out, I think we ended last quarter at $29 million in goodwill and $29.6 and now it's dropped to $7.8. Can you reconcile the change? It's $7.9 million, I'm assuming 35% tax rate would be $12 million.

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

I'm sorry. I'm trying to figure out where you're trying to go exactly. What's that, Mike?

Michael Fitzgerald Grasher
Piper Jaffray Companies, Research Division

So the $12 million plus of what's being reported now at $7.8 million gets to $19 million and the $19 million compared to $29 million, where did the--

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

So to take the $8 million, you use a 35% tax rate, that grosses it up to the $12 million or the number that you need there, I think, is what you're looking for, right?

Michael Fitzgerald Grasher
Piper Jaffray Companies, Research Division

I'm still $10 million short.

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

Well, the overall goodwill that gets eliminated there is about $21 million. Obviously, there's -- the difference in the loss relates to the fact that we did sell it for $13 million.

Operator

And you do have a follow-up question from the line of Amit Kumar of Fox-Pitt Kelton.

Amit Kumar
Fox-Pitt Kelton Cochran Caronia Waller Limited, Research Division

Amit Kumar from Fox-Pitt. Two quick follow-up, in terms of the discussion on competition, can you sort of isolate how much of that impacted your top line decline in commercial line space? Maybe an approximate number?

Gregory E. Murphy
Chairman and Chief Executive Officer

It's hard to define that. As John articulated in his comments, we're getting as many at-bats from our agents in terms of being able to put pricing out on the street and our hit ratio is down and...

John J. Marchioni
President and Chief Operating Officer

And in terms of the split-out and the overall 9% decline, it's roughly 2, 2.5 points of the 9% are driven by new business. That's not all competition-related, but you look at that as the subset of the 9% and then as we said, managing new pure price and managing mix the way we have has resulted in a lower hit ratio on the similar number of opportunities versus prior year.

Amit Kumar
Fox-Pitt Kelton Cochran Caronia Waller Limited, Research Division

And I guess the only other question is in terms of your rate change of 2.6%, can we just briefly maybe touched upon some of the lines where you're seeing the greatest traction? And...

Gregory E. Murphy
Chairman and Chief Executive Officer

Yes, I don't have the line breakout on the 2.6%. I can just tell you geographically, we now have two of our regions that are over 4% in price increases. So I've got the quarterly numbers by line, but the 2.6%, if you're trying to get your arms behind the 2.6%, I will tell you that it's pretty spread throughout many of our geo locations. We have 2 over 4, one at 2.9% and the other region at 2.6% and we still have one region that's having -- struggling getting any price increases at all. And I'll tell you, that clearly falls into the super competitive market that they're in right now in terms of our business, but that kind of gives you the best sense that I have because that's a quick draw-off of our mid-term pricing increases as we roll through the month of October, then we'll have everything by line and then all the other aspects of it.

Amit Kumar
Fox-Pitt Kelton Cochran Caronia Waller Limited, Research Division

And then what region is that which is super competitive?

Gregory E. Murphy
Chairman and Chief Executive Officer

Right now, the most difficult margin right now is New Jersey.

Operator

And your next question is from the line of Bob Farnam of KBW.

Robert Farnam
FBW

Going back to the reserve, the favorable reserve development, can you give us an idea which accident year is, like in workers' comp and general liability, those were coming from?

Gregory E. Murphy
Chairman and Chief Executive Officer

Sure. Ron will answer that for you.

Ronald J. Zaleski
Former Chief Actuary and Executive VP

Yes. For the most part, it's 2007 prior for all lines.

Robert Farnam
FBW

And you sounded like you were raising your estimates for the current accident year. is that -- can you quantify that?

Gregory E. Murphy
Chairman and Chief Executive Officer

Well, when we said that we're raising our -- I mean, that's two part. One, it's the audit premium impact and the fact that that was extraordinary at the level of audit premium that kind of pushed the numbers around. And then what I mentioned earlier is the natural progression throughout the quarter where we're still earning in minus rate and we still have positive loss trends and that does move your loss ratios higher on a quarter-to-quarter basis.

Robert Farnam
FBW

And I think you've indicated before you thought the rates needed to get to 3% or so to start off-setting loss costs?

Gregory E. Murphy
Chairman and Chief Executive Officer

That's a close number, yes.

Operator

And you do have a follow-up question from the line of Sam Hoffman of Lincoln Square.

Samuel Hoffman

You had commented that your real estate alternative investments would be a continued headwind on results, but yet that portfolio, I believe, was only $21 million at the beginning of the year and I think you took significant write-downs on it in the first quarter. And so how much of that is actually left? And how significant can that be, going forward?

Gregory E. Murphy
Chairman and Chief Executive Officer

Sure, there are three different investments in the real estate sector. It represents approximately 13% of our overall alternative investment portfolio. In terms of dollars, that's approximately $19 million, and as you can see in the package that we disseminated, the loss in the quarter was $1.2 million in that sector.

Operator

And that show no further questions at this time.

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

I do have, before Greg closes up, just I kind of figured out what Mike Grasher's question was here, actually Tony Harnett figured it out. It's that -- where that extra piece of goodwill is, is that it's been relocated into the assets of discontinued operations line. So the goodwill was not written-off entirely, it was just written down to reflect the selling price. So that remaining chunk of goodwill, about $9.5 million resides in the assets of discontinued operation line on the balance sheet. With that, I'll pop it over to Greg to close it out.

Gregory E. Murphy
Chairman and Chief Executive Officer

Well, thank you, then. Well, underwriting and reserve discipline, coupled with a conservative well-positioned investment portfolio will be the foundation for our long-term performance. If you've got any other follow-up questions, please contact Jennifer and Dale. Thank you very much.

Operator
And this does conclude today's conference call. You may now disconnect.