S&P Capital IQ

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Selective Insurance Group, Inc. NasdaqGS:SIGI

FQ3 2016 Earnings Call Transcripts

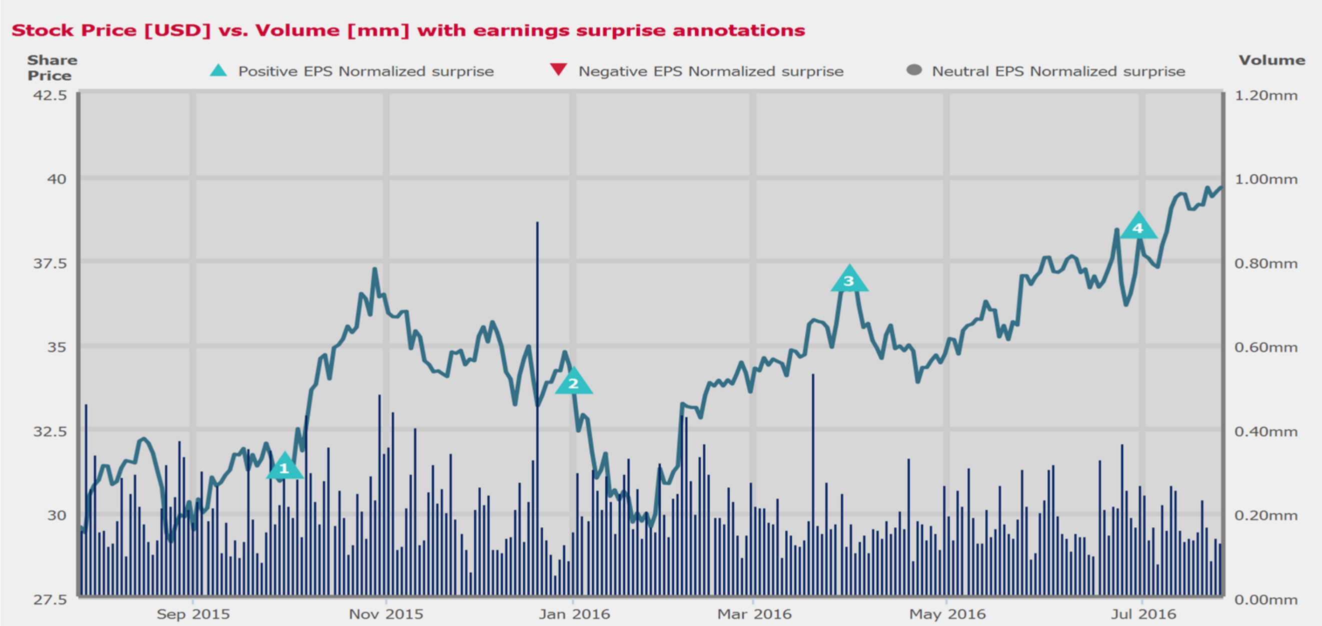
Thursday, October 27, 2016 12:30 PM GMT

S&P Capital IQ Estimates

	-FQ3 2016-			-FQ4 2016-	-FY 2016-	-FY 2017-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.71	0.62	(12.68 %)	0.72	2.74	2.67
Revenue (mm)	579.42	581.70	0.39	591.58	2293.64	2442.89

Currency: USD

Consensus as of Oct-27-2016 2:51 AM GMT



- EPS NORMALIZED -	CONSENSUS	ACTUAL	SURPRISE
FQ3 2015	0.68	0.81	19.12 %
FQ4 2015	0.68	0.81	17.39 %
FQ1 2016	0.58	0.66	13.79 %
FQ2 2016	0.61	0.72	18.03 %

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Call Participants

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Chairman and Chief Executive Officer

John J. Marchioni
President and Chief Operating Officer

Rohan Pai

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Presentation

Operator

Good day, everyone. Welcome to Selective Insurance Group's Third Quarter 2016 Earnings Call. At this time, for opening remarks and introduction, I would like to turn the call over to Senior Vice President, Investor Relations and Treasurer, Rohan Pai.

Rohan Pai

Good morning, and welcome to Selective Insurance Group's third quarter 2016 conference call. My name is Rohan Pai, Senior Vice President, Investor Relations and Treasury. This call is being simulcast on our website and the replay will be available through November 28, 2016. A supplemental investor package, which includes GAAP reconciliations of non-GAAP financial measures referred to on this call, is available on our Investors page of our website, www.selective.com.

Certain GAAP financial measures will be stated during the prepared remarks that will also be included in our quarterly report on Form 10-Q. To analyze trends in our operations, we use operating income, which is a non-GAAP measure. 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 businesses.

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 risk and uncertainty. 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 statement.

Joining on today's call are the following members of Selective's executive management team: Greg Murphy, Chief Executive Officer; John Marchioni, President and Chief Operating Officer; Tony Harnett, Chief Accounting Officer; and Ron Zaleski, Chief Actuary.

With that, I'll turn the call over to Greg.

Gregory E. Murphy
Chairman and Chief Executive Officer

Thank you, Rohan, and good morning. Before getting into the quarter, I want to take the opportunity to welcome Rohan Pai, our new Senior Vice President of Investor Relations and Treasurer. Many of you already know Rohan from his prior experiences. We're delighted to have him on our team. I'd also like to thank Brad Wilson, who handles HR matters on an interim basis. He did an excellent job.

I will begin with introductory remarks and focus on some of the high level themes for the quarter. John will discuss our insurance operations and provide color on some of our underwriting initiatives. Tony Harnett, who is our Chief Accounting Officer, will then discuss our financial results in a little more detail.

In the third quarter, we continued the trend of strong profitability that we have reported in recent years. Our underwriting results were solid, with very profitable margins across our Standard Commercial Lines and Personal Lines segments as we continued to execute underwriting and claim actions to improve our E&S operating performance.

Year-to-date, our operating return on equity was 10.5%, which is in line with our long-term target of generating a return of 300 basis points above our 7.9% weighted average cost of capital. Our net premiums written were a solid 8% for the first 9 months and book value per share decreased 12%.

We're particularly pleased that, earlier this week, Standard & Poor's recognized our strong operating performance and capital position and upgraded our financial strength ratings to A from A-, which continues to demonstrate how we've successfully executed on our financial and strategic objectives. There are 4

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themes that I'd like to highlight this quarter. The first theme is that our overall top line growth remains robust, driven by solid 9% growth in our core Standard Commercial Lines operations. A big part of our top line expansion story has been our ability to consistently obtain Commercial Lines price increases that are above market levels recorded by Willis Towers Watson Commercial Lines or CLIPS service.

In Standard Commercial Lines, renewal pure price for the quarter was a very strong 2.5%. More importantly, for the past 27 consecutive quarters ending June 30, 2016, we have outperformed the CLIPS industry index by approximately 1,600 basis points on a compounded cumulative basis, while our retention held steady.

To successfully balance growth and profitable like this, is a tremendous accomplishment. Our ability to execute our pricing strategy has been underpinned by our strong underwriting-driven culture and our 3 competitive advantages: one, our true franchise value with ivy league distribution partners; two, sophisticated capabilities in underwriting and claims; and three, our superior customer service delivered by our best-in-class employees. The market is becoming more competitive for new Commercial Lines business, and companies are fighting hard to maintain their renewal books through price reductions.

Record low interest rates, coupled with A.M. Best estimates at the industry's operating at close to a breakeven margin, make it difficult for companies to drive renewal pricing down if they're seeking to generate adequate returns on capital. That said, we've demonstrated a strong track record of successfully navigating to all sorts of markets. We believe that our deep relationships with our distribution partners, sophisticated tools with talented employees position us well to continue to generate solid results.

The second theme is that we had strong profitability in the quarter with a 92.9% statutory combined ratio. This result benefits from our cumulative price increases in recent years as well as the various underwriting and claims initiatives that we've implemented across our book. Our Standard Commercial Lines segment generated extremely strong profitability. We experienced significant improvement in our workers' compensation results over the past 2 years, driven in part by price increases, underwriting initiatives, such as reducing our books hazard profile and enhanced claim process efficiencies. Commercial auto, on the other hand, is a class that we've been closely watching. After a number of years, with strong and stable trends, we've experienced higher-than-expected claim frequency to the 2015 and '16 accident years as well as higher severity for earlier accident years. Results in this class have deteriorated across the industry, and we've already taken steps to address this. John will provide additional details.

Profitability in Personal Lines was solid, benefiting from price increases in various underwriting initiatives, particularly to address margins in our homeowners' book. As the industry likely reacts to increased trends in the personal automobile book through pricing, we should see increased opportunities to grow this line. Flood claim handling fees related to our participation in a National Flood Insurance Program or NFIP totaled $2 million in the third quarter.

In E&S, we continue to address profitability through targeted price increases, underwriting changes and integration of our claims handling functions into our corporate operations. The decline at top line growth rate during the quarter is a direct result of the targeted actions we've taken to improve underwriting margins in this segment. Taking into account the various initiatives that we've implemented, we expect the combined ratio to improve next year.

The third theme is catastrophe loss. After a number of years of benign catastrophe losses, we witnessed a large event, Hurricane Matthew, almost making landfall as a Category 4 storm. While the damages from the hurricane were certainly devastating for the communities that were affected, it could have been far worse as the hurricane actually stayed on its projected path and made landfall in Florida. Our initial estimate from losses from hurricane Matthew is in a range of $10 million to $14 million, partially offset by $1 million of fees servicing flood claims on behalf of the NFIP.

We take an extremely conservative approach to managing our catastrophe aggregations and risk. Our reinsurance program limits losses from a 1 in 250 probability of event set to approximately 3% of stockholders' equity.

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Finally, I wanted to point out that our other expenses, which include long-term stock-based compensation to employees, were up $2.7 million from the same quarter a year ago. This increase reflects our significant financial outperformance relative to our peer group coupled with strong stock performance this year. Tony will provide some additional color on our expenses and investments.

Where we remain conservatively positioned to deal with the prolonged low interest rate environment, we have slightly increased our allocations to high-yield private equity and public equities, which together represent a relatively small 7% of our overall portfolio.

As we look forward to 2017, we continue to target select growth opportunities by leveraging our strong relationships with our agency partners. We will remain disciplined and seek targeted price increases where warranted. We're working with our agents to generate superior customer experience delivered by our best-in-class employees. Customer experience has been and will continue to be critical to our success, and we're investing in technology and employee development to support the strategic focus.

With 3 quarters of the year behind us, and having achieved better-than-expected results, we provide the following expectations for the full year 2016: a statutory combined ratio excluding catastrophe losses of approximately 89.5%. As always, this assumes no fourth quarter prior year casualty reserve development. Catastrophe losses of 3 points, which is down slightly from our prior guidance of 3.5 points. After-tax investment income of approximately $95 million and weighted average shares outstanding of 58.5 million.

Our guidance for the statutory combined ratio of 98.5% is extremely strong in the context of an estimate -- generate an estimate, industry combined ratio of 99% to 100% range as per A.M. Best.

Lastly, our search for a new Chief Financial Officer to replace Dale is well on track, and we hope to introduce that person to you on our next quarterly call.

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

John J. Marchioni
President and Chief Operating Officer

Thanks, Greg. Good morning. We remain focused on delivering strong profitability while balancing this goal with our strategic objectives around retention and top line growth. For the first 9 months of the year, we achieved an overall statutory combined ratio of 91.2 and net premiums written growth of 8%. Our strategy for profitable growth remains on track, with plans to increase our geographic distribution and also our share of wallet with our existing distribution partners. While catastrophe losses were relatively benign, we experienced higher-than-expected noncatastrophe property losses, mainly from fire-related damage and a number of unique events.

For the third quarter, noncatastrophe property-related losses accounted for 14.5 points on the overall combined ratio, which was approximately 2 points above our expectation. On a year-to-date basis, noncatastrophe property losses accounted for 13.1 points on a combined ratio, which was only 60 basis points above our expectations. As we look across our portfolio, we cannot point to any unifying reason for the increase in non-catastrophe property loss in this quarter and believe these were largely idiosyncratic claims.

Our core Standard Commercial Lines results remain extremely strong. Year-to-date growth in Standard Commercial Lines through September 30 was a solid 9%, driven by stable retention of 83%, new business growth and renewal pure price increases, averaging 2.6%. Our Commercial Lines statutory combined ratio was 90.1%, a 0.7 point increase relative to the year ago. On an underlying basis, the year-to-date combined ratio, excluding catastrophes and prior period development, increased by 0.5 points compared to the prior year period.

For our renewal portfolio, we continue to use our dynamic portfolio manager underwriting tool to implement targeted underwriting and pricing initiatives while balancing retention and profitability objectives. For our highest quality Standard Commercial Lines accounts, which represent 50% of our premium, we achieved renewal pure rate of 1.5% and point of renewal retention of 91%. On our lower-

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quality accounts, which represent 10% of our premium, we achieved pure rate of 7.2% and point of renewal retention of 78%.

Drilling down to the byline results for Commercial Lines. Our largest line of business, general liability, reported a year-to-date statutory combined ratio of 83.9%, which included $33 million or 8.4 points of favorable prior year casualty reserve development. Favorable reserve development relates primarily to lower-than-anticipated claim severities for the 2008 through 2014 accident years.

Workers' Compensation profitability remains strong. Our focused underwriting initiatives to enhance the quality of the book, efforts to improve claim outcomes and compounded renewal pure price increases have resulted in solid underwriting margins. Year-to-date, we achieved an 82.8% statutory combined ratio, which includes $36 million or 15.7 points of favorable prior year casualty reserve development. This was driven primarily by lower severities an accident years 2014 and prior as results benefit from the significant changes in claims handling and outcome management as well as lower prevailing lost cost inflation.

As Greg mentioned, commercial auto is a line that we are very focused on to improve profitability. Year-to-date, commercial auto reported a statutory combined ratio of 108.9%. That includes $20 million or 6.8 points of unfavorable prior year casualty reserve development. The increase in our commercial auto liability reserves related mainly to higher severities in accident years 2013 and '14 as well as higher frequencies in the 2015 accident year.

To address profitability in commercial auto, we continue to achieve rate increases and are taking targeted underwriting actions. For example, we began last year to limit our participation in challenge classes such as power transit and wholesale durables and nondurables. Year-to-date, through September 30, renewal pure price in commercial auto liability was 4.6% and auto physical damage was 5.8%. We are targeting more aggressive pricing per power unit in higher hazard classes of commercial auto.

Switching to Personal Lines, the overall results continue to demonstrate the aggressive underwriting actions we have been taking to improve the profitability of the homeowners' book. The overall statutory combined ratio was a solid 90.7% through September 30. On an underlying basis, the statutory combined ratio improved 4.8 points from the prior year.

Net premiums written were down 1% for the third quarter and are down 2% on a year-to-date basis. We have focused our distribution efforts around targeting the consultative buyer who values the advising counsel or professional agent and places both their auto and home policies with us.

Within homeowners, underwriting results benefited from the generally benign weather. The statutory combined ratio was a profitable 85.4% for the first 9 months. We continue to target a 90% combined ratio in a normal catastrophe year, which we assume includes 14 points of catastrophe losses, and we are very close to achieving that goal.

In personal auto, the statutory combined ratio was higher at 106.4% on a year-to-date basis. The industry continues to grapple with increased frequency and severity trends in this class. While we have not seen an uptick in our own loss trends up to this point that would lead us to change our assumptions, it is something that we are closely monitoring. The industry's quest for rate adequacy should provide us with opportunities to grow the book while improving margins.

Moving on to Excess and Surplus Lines. For the first 9 months of 2016, the statutory combined ratio for this segment was 100.9% with an underlying statutory combined ratio excluding catastrophe losses and reserve development of 95.7%. We are beginning to see the benefits of recent underwriting actions and price increases implemented in our E&S business. Overall price increases average 4.8% on a year-to-date basis. In specific classes, such as California contractors, we are targeting significantly higher price increases. We're targeting substantial margin improvement in E&S through a shift in business mix, claims improvements and targeted price increases and are willing to walk away from business that does not meet our profit hurdles.

As we look to the future, we remain focused on executing our strategy of disciplined growth in our current markets and gradual expansion into new markets. We've talked to you in the past about our long-term target for Commercial Lines of getting to a 12% share within our agencies and agency representation of

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25% within the states in which we operate. If we successfully execute on our growth objectives within our existing markets, that would translate into a 3% market share for Commercial Lines. We've appointed 78 agents so far in 2016 and are planning for an additional 85 more in agency appointments in 2017. In terms of expansion states, we are targeting Arizona and New Hampshire for Commercial Lines in the latter half of 2017.

I'm highly confident that we have the right people and the right tools to continue to outperform. Our relationship with our distribution partners are among the strongest in the industry and underpin our successful results.

Now I will turn the call over to Tony to review the financial results.

Anthony D. Harnett
Senior Vice President and Corporate Controller

Thanks, John. For the quarter, we reported net income per diluted share of $0.66 and operating income per diluted share of $0.62 compared with $0.81 per diluted share of operating and net income a year ago. The results were driven by strong profitability across our Standard Commercial and Personal Lines operations. With 9 months behind us, we are well on track to significantly outperform the industry on a combined ratio basis. The drivers of our financial results include ongoing renewal to our price increases, strong premium growth, favorable net prior year casualty reserve development and generally benign CAT losses. Our statutory combined ratio in the quarter was 92.9%, a 2.4 point increase relative to the same period last year. Catastrophe losses added 1.9 points to the combined ratio for the quarter and 2.1 points on a year-to-date basis. This is better than our full year guidance of 3 points. Noncatastrophe property losses added 14.5 points to the combined ratio for the quarter.

Our reserve position is strong, and we recorded favorable prior year casualty reserve development in the quarter of $19 million, equating to 3.5 points on the combined ratio. This compared to $15 million or 3.0 points a year ago.

In the quarter, reserve releases were driven by favorable claims trends in the general liability line of business, which reported $11 million of favorable prior year casualty development and the Workers' Compensation line of business, which reported $15 million of favorable prior year casualty development. Partially offsetting this was $7 million of unfavorable prior year casualty development in commercial auto. Also in the quarter, we increased our current year loss reserve estimates for commercial auto by $7 million to reflect higher-than-expected claim frequencies.

Top line growth was solid and overall statutory net premiums written increased 6% in the quarter. This was driven by renewal to our price increases, stable retention levels and higher new business in Commercial Lines. Premium volume in Personal Lines was relatively flat compared to last year's third quarter. Pricing actions in our E&S segment led to a 2% decrease in premiums relative to a year ago.

Standard Commercial Lines premiums were up 9% for the third quarter, led by strong retention at 84% and renewal pure price increases averaging 2.5%. For the quarter, Standard Commercial Lines generated a statutory combined ratio of 92%.

In Personal Lines, premiums were down 1% for the third quarter. Retention held steady at 83% and renewal pure price increased its average 4.7%. We've been pushing for additional renewal price increases in Personal Lines, which averaged 3.6% in personal auto and 5.8% in homeowners during the third quarter. For the quarter, Personal Lines generated a statutory combined ratio of 92%.

In our E&S segment, premiums declined 2% for the third quarter. This is a sharp slowdown relative to recent quarters and primarily reflects aggressive and targeted pricing actions that we have taken in certain segments of the market to address margins. Overall, price increases averaged 5.8% in the quarter while retention held relatively flat. New business volume declined sharply. For the quarter, our E&S segment generated a statutory combined ratio of 101.4%.

Our overall expense ratio has been under some pressure this year due to supplemental commission expense to our agents, resulting from the level of profitability that we are experiencing. The other expense

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line item is also up relative to a year ago, primarily reflecting higher long-term stock compensation to our employees. We continually review our major processes and expenditures for operating efficiencies to work towards our long-term goal of reducing our expense ratio.

Turning to investments. After-tax net investment income increased 1% relative to the prior year period to $24.9 million. The investment income contribution to our ROE was 6.4% for the third quarter. Fixed income, which represents 92% of our portfolio, experienced a 6% increase in pretax net investment income as a higher asset base and modestly increased allocation in high yield more offset lower reinvestment rates with investment grade holdings.

Alternative investments, which report on a 1 quarter lag, reported a pretax gain of $1.6 million slightly up from the $1.3 million in the third quarter of 2015. As we have highlighted on recent calls, we see some opportunity to diversify further and modestly increase our risk allocation going forward. Our approach to adding risk assets to our portfolio will be measured and in line with our conservative approach to enterprise-wide risk management. In the quarter, after-tax new money yields on our core fixed income portfolio averaged 1.4%. Our fixed income portfolio was highly rated with an average credit quality of AA- and a 3.7-year duration, including short-term investments.

Given the increase in treasury yields during the quarter, the pretax unrealized gain position on our fixed income portfolio decreased to $150 million at September 30th. The pretax unrecognized gain position in the fixed income held to majority portfolio was $6 million or $0.06 per share on an after-tax basis.

Surplus and stockholders' equity were $1.6 billion each at the end of the third quarter. Book value per share increased 12% to $27.22 from year-end 2015, as our balance sheet benefited from strong year-to-date profitability and the decline in interest rates.

Now I'll turn the call back to Greg.

Gregory E. Murphy
Chairman and Chief Executive Officer
Thank you. Operator, would you please open the line for questions?

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Question and Answer

Operator

[Operator Instructions] The first question on the line is from Arash Soleimani with KBW.

Arash Soleimani
Keefe, Bruyette, & Woods, Inc., Research Division

Starting with Excess and Surplus, can you talk a little bit about the -- I know you mentioned some of the growth and loss ratio metrics there, but how should we think of the growth there over the next few quarters? Should we expect this to be more in line with 3Q or more in line with the quarters before that? And then, I don't know if you already mentioned this, on the core loss ratio for E&S, it looked like that has gone up quite a bit excluding CATs or prior period development. Just wanted to dig into that a bit more.

Gregory E. Murphy
Chairman and Chief Executive Officer

All right. So let me start this. So some of the E&S movement in the core non-CAT loss ratio year-on-year is we did establish for 2016 a little bit higher expectation in terms of where our loss ratio is. The biggest issue we have relative to this is there is enormous amount of claim and underwriting improvements that are working their way into the book. Our actuarial books and our claim people are working hard together to try to better understand and how to measure those improvements to be able to establish a better loss cost expectation for 2017. But I can tell you it's going down and it's going down on a number of fronts. It's going down from a loss adjustment expense as we move the handling of that inventory from panel firms to our staff counsel, a re-architecture of our panel firms, particularly in California and other metrics, and then a way more aggressive handling of the larger inventory through our existing complex claim unit that handles these types of claims all the time. So it's a matter of how much actuarial benefit you put into a number based on what we're actually seeing. So that will be -- it's hard to specifically target a number on that yet, but I certainly have a number in my head.

John J. Marchioni
President and Chief Operating Officer

And then I'll just -- this is John. Let me just add some additional commentary relative to your question around new business or growth in the E&S segment going forward. The first thing I'd say is we don't prognosticate about top line growth in any one of our segments or overall, but let me just provide with some additional color relative to the E&S. So as we noted in the prepared remarks, and I've talked about it in prior quarters, we have taken some very aggressive action relative to our pricing on both our new and renewal inventory, targeting specific segments. I would say, in the quarter, our renewal inventory held up fairly well with those increases and there were pockets of new business that dropped off significantly because of the pricing actions we've taken. We view this as a segment that we know what our target rate levels are, and we're going to acquire new business at those rate levels. And in segments that we cannot do that, we're going to let that business drop. And I think you saw some of that in the quarter. That said, we look at that as the importunity in front of us and look at our pricing by segment. There are plenty of segments across the country that we think our pricing will allow us to grow new business opportunities. We focused our marketing and underwriting resources on those segments and fully expect to see new business rebound as we go forward.

Arash Soleimani
Keefe, Bruyette, & Woods, Inc., Research Division

In terms of fee income from flood, where -- what line item does that show up in?

Gregory E. Murphy
Chairman and Chief Executive Officer

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It shows up in Personal Lines and other, principally as a loss adjustment expense reduction. So that's where you'll find it. So what we're looking at this year is about $2 million in the third quarter from Louisiana event and then $1 million coming through in the fourth quarter relative to the flooding that we had in North, South Carolina, parts of Georgia and Florida.

Arash Soleimani
Keefe, Bruyette, & Woods, Inc., Research Division

Okay, perfect. And in terms of some of your -- like the new states like Arizona that you're mentioning, can you talk about the strategy there in terms of getting or forming agent relationships? I know in your existing states you have -- you focus on the 1,100 agents and the $1.7 million per agent. How do you -- if the new agents, I guess, fit into that same type of mold?.

John J. Marchioni
President and Chief Operating Officer

Yes, great, great question. So first comment I would make is that we're opening up our new states with the same exact operating model that we have in our existing states. So based on our regional office, we've delegated underwriting authority and also using a franchise value approach to our agency appointment. So if you think about the 1,100 we have across our footprint, existing footprint and the target of getting representation that has access into at least 25% of the market, we intend to take the same approach over the first couple of years in those existing states. We are, in fact, leveraging some of our national and regional broker relationships that we already have in place in our existing footprint who happen to have offices in our expansion states because we're a known quantity to them, we've got a great relationship and a significant premium volume with them, and that gives us a great entrée into those states. The other point I'd add, and this applies not just to new appointments and new states, but new appointments in existing states. We are very clear in the prospecting discussions about our expectations coming in. We expect to very quickly move into one of the top couple of spots in terms of their Commercial Lines relationships overall. We secure that commitment from that agent to do so, and then we hold each other accountable over the course of the first few years to make sure we are both delivering on our end of the promise. So that philosophy will be the same for every one of our new expansion states.

Arash Soleimani
Keefe, Bruyette, & Woods, Inc., Research Division

And lastly, was there anything unusual with the Personal Lines expense ratio? That looks like it was up a bit year-over-year. So I just wanted to ask about that.

Gregory E. Murphy
Chairman and Chief Executive Officer

Nothing specific that's really that unusual in there. I would just tell you that part of our creeping expense ratio when you disaggregate our combined ratio between loss and loss adjustment expense and underlying expense ratio, our expense ratio has creeped up a little bit, mainly because of the volumetric drop in the top line. And I will tell you that we fully expect to get that Personal Lines back into growth. You've always heard me describe our Personal Lines division as a tale of 2 cities. One is very aggressive home rate increases, as John mentioned. We are within 1 or 2 points of achieving our target ex CAT combined ratio, which when you boil all the debt math down is 76 is where we want to get to. And we are not that far from there, and we've been aggressively implementing rate increases. And then as a result of doing that, obviously, we lost a little bit of auto business along the edges. It's very, very competitive pricing in the marketplace. So -- but that started to come back to us now. You've seen the automobile results reported industry-wide. You hear of the frequency severity challenges that they had. Our book overall has maintained a very stable structure in terms of our performance in total in terms of loss trend. I think it's because it's a mature book and it doesn't face a lot of acquisition cost in the book overall, and that's what you're seeing. So I think as the market starts to come back to us, we can grow that, make some expense and efficiency -- structural improvements and knock a fair amount of combined ratio points off that number.

Anthony D. Harnett

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Senior Vice President and Corporate Controller

I would also just add that each year, in the fall, we do expense allocation studies and during last -- within last year's 10-Q as well as it will be in this year's 10-Q that we file later today, we did -- in that expense study, we shifted some expenses between personal and Commercial Lines, and that altered the expense ratio probably by about a 2 to 3 point variance when you compare year to year..

Arash Soleimani
Keefe, Bruyette, & Woods, Inc., Research Division

That makes sense. And how much of the business in Personal Lines does that Selective edge account for?

John J. Marchioni
President and Chief Operating Officer

It's between 25% and 1/3 of our new business.

Arash Soleimani
Keefe, Bruyette, & Woods, Inc., Research Division

Okay. And should we expect that to grow just with some of the, I guess, new initiatives you have in place?

John J. Marchioni
President and Chief Operating Officer

We certainly expect that to be the case. As we mentioned earlier, our philosophy, our strategies around targeting around the consultative buyer and the buyer who's going to package up their auto and their home, we would expect would lead to a higher percentage of edge for new business and for the overall inventory over time.

Operator

[Operator Instructions] The next question is from Scott Heleniak with RBC Capital Markets.

Scott Gregory Heleniak
RBC Capital Markets, LLC, Research Division

Just -- first question I have was just on the non-CAT property losses from fire. I know you touched on it a little bit. So you're saying that you really haven't seen that all year and you saw that -- that was more of a -- just a Q3 thing. And were those pretty much -- were those a few large losses or just -- or higher frequency or both?

Gregory E. Murphy
Chairman and Chief Executive Officer

It was a few large losses. And if I were to give you the number, we've always reported to you our non-CAT property as a percentage of total premium, and this clearly identifies it for you, Scott. So in the corner, our non-CAT property was 14.5 points on our overall combined ratio. And for the year, it was 13.1. So when you think about where we were relative to our budget, quarter was over by 2.1 points and the year was over by 0.7. So that virtually tells you that we were -- everything that we -- we were perfectly on track through the first 6 months of the year. All of the overage came in the quarter and it was principally severity-based.

John J. Marchioni
President and Chief Operating Officer

And Scott, just -- this is John. Just a couple of additional comments. Number one, with any large loss, we do a full underwriting review of those accounts by our corporate underwriting group and you do a lessons learned on that. And I would tell you that, generally speaking, these were quality accounts when you look at the underwriting in hindsight. And then the second piece is we've done an overall review of the property book to make sure there's no underlying change in hazard or exposure type and are comfortable that

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there's not been a significant shift in that inventory that would lead to more volatility or more large loss activity going forward.

Scott Gregory Heleniak
RBC Capital Markets, LLC, Research Division

Okay. And the -- I just want to touch on Workers' Comp and casualty, too. Obviously, really good combined ratios for the quarter. I know some of that was helped by favorable development. But what are you seeing on the claims side there, frequency and severity? Any kind of major changes relative to the last couple of quarters?

Gregory E. Murphy
Chairman and Chief Executive Officer

Not really. I mean, obviously, what we've seen is a decrease in frequency at a pretty big clip. And I think part of that is due to the underwriting. You heard me mention what we've changed in terms of the reduction in some of the higher hazard business. That's where a lot of the frequency. So we've seen, when you look at it on a calendar year basis, our frequency is down around 10% or 11%, which is a lot to be down. Our severity is not up on an unusual basis, more in line with our medical and medical trends and expectations. And I would say, generally, our severity is running lower than our long term -- what you would on a long-term bake in for hospital, physician services. RX is running actually below that. So it's been a good improvement in terms of what we do, but I think it reflects everything that we've done on the claims side in terms of the re-architecture of the claim department, consolidating, as we've mentioned, in prior calls, all of that now down in our Charlotte operation, and I think we're getting much better outcomes, particularly on the more severe claims. And I think it's just holistically all those things coming together is why you're seeing the results.

John J. Marchioni
President and Chief Operating Officer

And I would -- just one additional point I would make to that is we continue to see a shift in our mix of business on both the new business side and the overall inventory towards lower hazard classes. And as we measure them, NCCI hazard grades A through D and less on the hazard rates E through G, and that also, we believe, contributes to lower average severities and that mix shift will continue going forward.

Scott Gregory Heleniak
RBC Capital Markets, LLC, Research Division

Okay. And then just finally on -- speaking of mix shift, the E&S unit, I know you touched on it a little bit, but can you talk a little bit more about some of the mix changes, more specifically, kind of areas that you're sort of backing away from, or you expected to back away from? And I don't know if you can give anything on retention ratios. I know you've mentioned that in the past -- kind of what that was this quarter versus the last couple. It seems like, obviously, you must have now renewed more business this quarter. So just anything you can give would be helpful on that.

John J. Marchioni
President and Chief Operating Officer

Yes, Scott. Actually, retentions were relatively stable on a year-over-year basis. So that wasn't the driver. The driver of the top line drop was almost entirely based on new business. The one segment I would highlight in terms of drop-off would be California contractors. And California contractors, which has been a long-term segment for us, is one that we felt needed some significant pricing action. And we've taken that on both the new and the renewal inventory, and that really drove the drop-off in new business. Restaurants, bars and taverns are -- I would say, are also a class that we've really started to drive up our new business pricing expectations, and we saw a little bit of a drop-off there as well. So again, I would just -- I would reiterate the earlier point, which is we view this as a segment that we determine our adequate pricing levels, and we either acquire business at those pricing levels or we don't. But those are the 2 segments that I would highlight. But don't want to give the sense that that's going to drive the overall new business performance going forward. That's -- those are 2 targeted areas and there's plenty

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of opportunity within that business that is in our appetite and that we think we can get adequate new business pricing levels on.

Gregory E. Murphy
Chairman and Chief Executive Officer

Yes. The only other area that you could add to that possibly would be Texas property, where we also took a much firmer stance on that. But like John mentioned, it's not shotgun approach. It's very specific where we really need to get the right rate level to support where our long targets for this operation, which -- we told you, we expect this operation over the long term to perform 4 to 6 points better than our Commercial Lines operation. We're working hard to do that.

Operator

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

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Rohan, nice to hear your voice at a new shop. A couple of questions. I guess, first, on the Workers' Comp side, obviously, the improvement here is pretty dramatic and that frequency number you started is also pretty significant. One would assume, though, if you're moving towards lower hazard classes, the premium per unit of risk should come down. Will that at least, on the surface, make it look like premium growth is slowing simply because you're writing different kind of business?

John J. Marchioni
President and Chief Operating Officer

Yes, Jay, this is John. You will certainly see our average policy size for new business, and ultimately to work us into the renewal inventory drop, and that will drive your new business writing on a premium basis overall. But the frequency severity trends that Greg gave you still roll up to a loss cost change that's well below our drop in average premium. So when we look at the gap between average earned premium and frequency times severity or loss cost, you want to see a favorable gap there, and we continue to see that. So I think that points to a positive result.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Yes, most definitely. That clearly is kind of what you're aiming for. Just for modeling purposes I wanted to make sure I understood it. And then on the commercial auto side, that business -- you're not alone. Obviously, it's been struggling for a lot of companies. The combined ratio did pop up this quarter relative to the past couple of quarters. Are you seeing an incremental worsening of the claims environment that you had to deal with from a loss ratio standpoint?

Gregory E. Murphy
Chairman and Chief Executive Officer

Jay, that's a great question. Nothing that I would say that is out of line. I would tell you that what we experienced is pretty systematic of what you see overall, which is more miles driven -- which is more miles driven is due to higher employment, lower gas prices, so on and so forth that put more power units and more miles on the road. But nothing -- I would say the biggest issue that, I would say, we face as an industry is distracted driving. And you don't have to do much, but drive down Route 80 on a busy day and see this level of distracted driving is unbelievable, in some cases. And that's what -- in my mind, that's the overarching risk management that needs to be dealt with. In my opinion, it's no different than any other hazardous driving that you see on the road, whether it's drunk driving or anything else. But when you're not minding the road properly, you have a very heavy piece of metal traveling at a very high rate of speed overall. But let me also just touch, Jay, relative to -- our performance relative to the industry, and I think this is where when you go back over time and look at the consistent 27 quarters and the 1,600 basis points over CLIPS, and you look at the fact that, that rate level that we've gotten consistently over that time frame is sitting in principal lines like general liability and commercial auto. And because of that

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tremendous outperformance, at least we've gotten our premium per policy or premium per power unit, as we like to refer to it internally, at much higher levels than the industry. They still need to go higher when we look at the specificity of our price decrease relative to the type of unit, relative to how it scores in Diamond scores and there's more work that we need to do, and we're pressing our folks very hard to make sure we do that. But at least we have some core premium in the margin to cover some of this higher-than-anticipated claim activity.

Operator

[Operator Instructions] As of this time, we have no questions on queue. I will turn the call...

Gregory E. Murphy
Chairman and Chief Executive Officer

Well, thank you very much for participating in the call today. If you have follow-up questions, please contact Rohan or Tony, and we look forward to a great fourth quarter. So thank you very much.

Operator
And that concludes today's call. Thank you for your participation. You may now disconnect.

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