S&P Global
Market Intelligence

Selective Insurance Group, Inc. NasdaqGS:SIGI

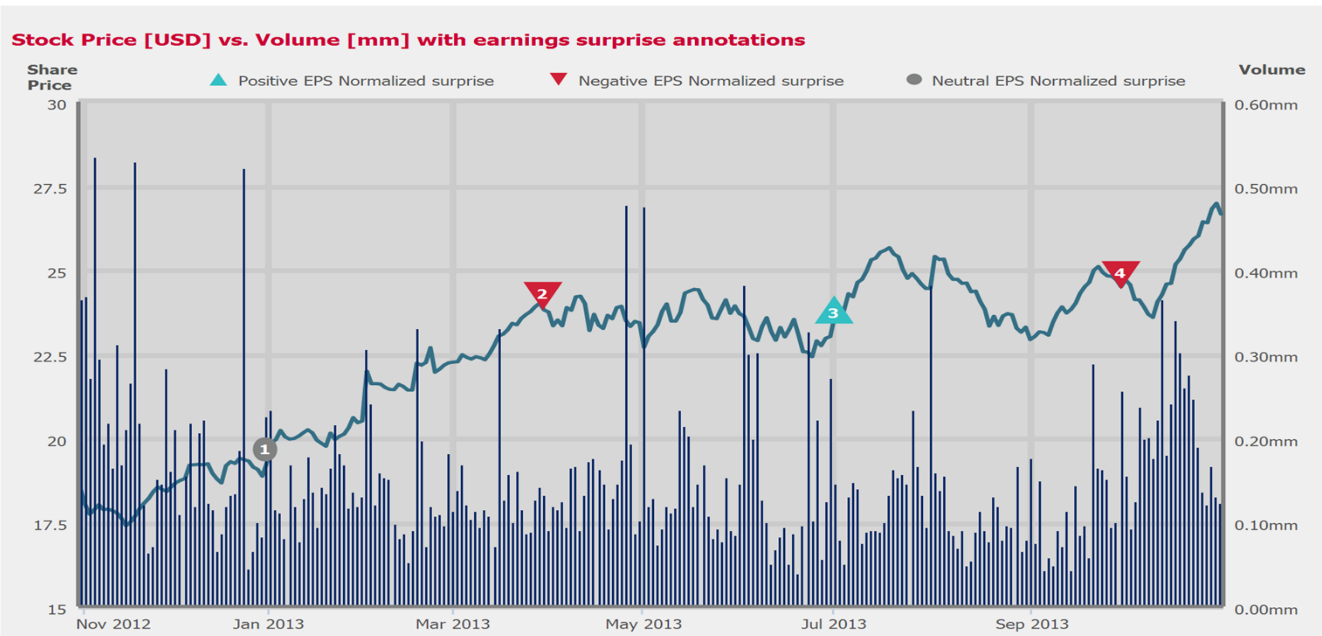
FQ4 2013 Earnings Call Transcripts

Friday, January 31, 2014 1:30 PM GMT

S&P Global Market Intelligence Estimates

	-FQ4 2013-			-FQ1 2014-	-FY 2013-	
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	ACTUAL
EPS Normalized	0.45	0.45	▲0.00	0.28	1.64	1.65
Revenue (mm)	480.83	488.03	▲1.50	489.99	1896.53	1903.74

Currency: USD
Consensus as of Jan-31-2014 5:21 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ4 2012	(0.17)	(0.04)	NM
FQ1 2013	0.38	0.36	▼1 (5.26 %)
FQ2 2013	0.35	0.42	▲2 20.00 %
FQ3 2013	0.44	0.42	▼3 (4.55 %)

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Call Participants

EXECUTIVES

Dale Allen Thatcher
Former Executive VP, Treasurer & CFO

Gregory Edward Murphy
Chairman & CEO

Jennifer Wilson DiBerardino
Former Sr. Vice President, Investor Relations & Treasurer

John Joseph Marchioni
President & COO

ANALYSTS

Mark Alan Dwelle
RBC Capital Markets, LLC, Research Division

Ronald David Bobman
Capital Returns Management, LLC

Vincent M. DeAugustino
Keefe, Bruyette, & Woods, Inc., Research Division

Presentation

Operator

Good day, everyone. Welcome to the Selective Insurance Group's fourth quarter 2013 earnings release conference call. [Operator Instructions] At this time, for opening remarks and introductions, I would now like to turn the call over to Senior Vice President, Investor Relations and Treasurer, Ms. Jennifer DiBerardino. You may begin.

Jennifer Wilson DiBerardino
Former Sr. Vice President, Investor Relations & Treasurer

Thank you. Good morning. And welcome to the Selective Insurance Group's fourth quarter 2013 conference call. This call is being simulcast on our website and replay will be available through March 3, 2014. A supplemental investor package, which includes GAAP reconciliations of non-GAAP financial measures referred to on this call, is available on the Investors Page of our website www.selective.com.

Selective point out, this quarter based on analyst feedback, we have added 2 new exhibit to the investor package. One is a GAAP insurance operations resulted by major line of business on Page 9, and the second includes catastrophe loss and casualty reserve development by major lines of business on Page 13.

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, 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 any 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, President and Chief Operating Officer; and Ron Zaleski, Chief Actuary.

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

Dale Allen Thatcher
Former Executive VP, Treasurer & CFO

Thanks, Jen, and good morning. The fourth quarter marked the conclusion as a strong year for Selective, as we delivered on our 2013 goals. For the year, our statutory x cat combined ratio of 94.8% was more than 1 point better than our original guidance of 96%, as the impacts of our granular pricing strategy and underwriting and claims initiatives worked through results.

Catastrophe losses added 2.7 points to the combined ratio compared to our original expectation of 3 points. After-tax net investment income was stronger than expected, finishing the year at $101 million compared to our original guidance range of $90 million to $95 million.

For the quarter, operating income of $0.45 per diluted share was up from an operating loss of $0.04 per share in the fourth quarter of 2012, which was adversely impacted by Hurricane Sandy. In addition to lower catastrophe losses, better underwriting results drove the improvement.

The fourth quarter statutory combined ratio was 99.6% compared to 110.4% for the prior year period. Catastrophe losses in the quarter were $14 million pre-tax or 3.2 points compared to $52 million pre-tax or 12.8 points a year ago. Cat 29, a series of tornadoes, high wind and hail that impacted several Midwestern states in November were the primary source of the cap losses.

Also in the quarter, we had favorable prior year casualty reserve development of $8 million or 1.7 points compared to a favorable prior year casualty development of $2 million or 0.5 points in the prior year period. Overall, statutory net premiums written were up 10% in the quarter, driven by standard commercial lines, which were up 10% and excess and surplus lines, which increased 20%.

Standard commercial lines renewal pure price was up 7.5% in the quarter and 7.6% for the full year, right in line with our projection. Meanwhile, retention and standard commercial lines remained strong at 82%, but the statutory combined ratio of 100.2%, including 3.2 points of catastrophes.

For the quarter, commercial property generated 82.7% statutory combined ratio. Our largest line of business, general liability, produced the statutory combined ratio of 98.5%.

Workers compensation results continue to be challenged and produced the statutory combined ratio of 127.3% for the quarter, which included $9 million or 12.8 points of adverse reserve development. Workers compensation results clearly remain disappointing. We continue to modify underwriting and claims processes to improve results and we stay ahead of reserve trends through clearly ground up reserve analysis.

Personal lines statutory net premiums written grew 4% in the quarter to $71 million, with a statutory combined ratio of 94.9%, including 3.6 points of catastrophe losses and 2.7 points of favorable prior year casualty development. Personal lines renewal pure pricing for the quarter was 7.2%, while maintaining strong retention of 85%.

For the year, we are pleased with a 96.9% statutory combined ratio generated by personal lines, as rate increases of 7.8% and various underwriting initiatives benefited the results.

Net premiums written for our E&S operations grew to $35 million in the quarter, up 20% from a year ago. While results in E&S improved from the prior year, this newest segment produced a combined ratio of 105.6% in the quarter.

We successfully renewed our 2014 property catastrophe treaty, increasing the limit of our top layer from $150 million to $250 million. This expands the program to $685 million in excess of $40 million in retention, and exhaust at approximately 1-in-250 year event.

As we increase our catastrophe reinsurance program, we look for ways to minimize the credit risk inherent in a reinsurance transaction, by dealing with highly rated reinsurance partners and by purchasing collateralized reinsurance products, particularly for extreme tail events.

The current program provides $197 million in collateralized limit. The entire program was placed essentially in line with 2013 seemed [ph] premium, in spite of the additional limit that was purchased. Pricing on the program decreased similarly to the pricing reported broadly in the market for January 1 renewals.

Turning to investments. Fourth quarter after-tax investment income was $26 million, essentially flat with the year ago. However, investment income beat our expectations for the full year at $101 million, driven mainly by returns on the alternative investment portfolio.

Investment assets increased 6% from a year ago to $4.6 billion, primarily due to increased operating cash flows and $78 million of net proceeds from our junior subordinated note refinancing in February. In fact, operating cash flows as a percent of net premiums written improved to 19% for the year, which compares to 14% in 2012 and 8% in 2011.

After-tax new money rates were 1.8% in the quarter and 1.4% for the year. As these rates are lower than our current portfolio yield, investment income continues to be negatively impacted.

As we look forward to 2014, we're using an estimated after-tax new money rate of 2.25% in our investment income projections. After-tax yields on the fixed income portfolio were down 22 basis points from a year ago to 2.3%, resulting in a 10 basis point decline in overall portfolio yield.

The overall portfolio unrealized gain position decline from $188 million pre-tax a year ago to $79 million, largely due to rising interest rates. Also the quarter end unrecognized gain position and the fixed income held-to-maturity portfolio was $24 million pre-tax or $0.28 per share after-tax. Our fixed income portfolio maintains a high credit quality of AA- in a duration of 3.5 years, including short-term investments.

Surplus and stockholders' equity ended the year at $1.3 billion and $1.2 billion, respectively. Book value per share at December 31, 2013, was $20.63, up 4% from 2012, as the impact of rising interest rates on our portfolios' unrealized gains has been more than offset by positive net income and the retention with revaluation.

Our premium surplus ratio for 2013 decreased to 1.4 to 1 from 1.6 to 1 a year ago. We achieved operating return on equity or ROE of 9.2% in the quarter and 8.4% for the year. Total ROE for these periods was 8.9% and 9.5% respectively compared to our current weighted average cost of capital of 9.2%.

As a result of the extreme winter weather, there has been headline news since the New Year began. We're providing a preliminary estimate for severe weather losses, including catastrophes for January 2014 of between $28 million and $32 million or roughly 6 points in the first quarter combined ratio.

The losses are due to the weather experienced throughout our 22-state footprint related to freezing temperatures and snowstorms. Early industry estimates on the broader impact of cat 31 and cat 32 are not yet clear.

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

John Joseph Marchioni
President & COO

Thanks, Dale, and good morning. 2013 was a strong year for Selective on many fronts as we met or exceeded our primary operational and financial targets. Standard commercial lines, which represent 76% of our premium, performed at a 97.1% statutory combined ratio for the year.

Personal lines, which is 70% of our premium written performed at a 96.9% statutory combined ratio. Representing 7% of our premium base, as the newest line of business, the excess and surplus operation improved their statutory combined ratio to 102.9% in 2013. The positive results were driven by the improvement in rate and retention augmented by our success last year in writing more quality new business.

We often speak of the competitive advantage by our strong agency relationships combined with a high-degree of pricing and underwriting certification. This is evidenced not only by the 19 consecutive quarters our standard commercial lines pure price increases that we have achieved, but also about a granularity of the pricing strategy that we continue to execute.

Importantly, we have maintained higher retention percentages, as we continue to track pricing. The tools utilized by our underwriters allow them to efficiently evaluate the impacts of pricing and non-renewal actions on their book of business, along with the impact of policy level decisions and in agents' portfolio.

This precision from better communications between our underwriters and agents and also allows specific targeting of the highest rate increases on our worse performing accounts and protecting retention on our best accounts. We are confident in our ability to maintain discipline regardless of how the market cycle develops.

In 2013 for standard commercial lines, our lowest quality account were low in variable buckets, which represent 9% of our standard commercial lines premium, we achieved 15% pure rate and 74% retention at point of renewal. Our highest quality accounts were above average, which are 53% of our standard commercial lines premium, we obtained 6% pure rate with plan of renewal retention at 90%.

Better commercial renewal pure price achieved our full year projection of 7.6%. Retention in 2013 also remained strong at 82%, which is in line with our retention in 2012. In addition of price increases, we separately measured the impact of underwriting improvements for our combined ratio.

Currently, underwriting improvements are on track with our expectations. The 9% growth in standard commercial lines reflects the 70.6% rate increase and a 2% increase in policy counts.

In 2013 we took advantage of improving market conditions and grew new business by 18% to $277 million. As we have grown, we have successfully diversified premium within our 22-state footprint by growing faster in our newer than in our historic core states.

In 2001 we set a goal to have, no one state represent more than 30% of our premium. We have achieved this goal in 2008, when New Jersey premium represented only 29%. We've continued to further diversify with New Jersey currently representing only 23% of our total premium. We accomplished the concentration shift, while actively managing our overall growth.

Selective doubled in size from 1998 to 2006, and pulled back on growth when it made sense during the soft market. The acquisition of MUSIC has further expanded our premium base across all 50 states and will continue to diversify selective assets operation gross.

We have ample opportunity to increase penetration in our current footprint, as we utilize sophisticated underwriting tools to write business with the best agents. Our strategy to focus our field underwriters or AMS' on middle market accounts, while pushing small accounts to a more efficient small business model, resulted in an uptick in 2013 hit ratios for small middle market and large accounts. Diversification across industry segments is improving as well.

Currently, our workers comp results are not where they need to be, with a 114% accident year combined ratio. We continue to carefully manage growth in workers comp with full year premiums of 5% compared to 9% at our standard commercial lines book.

Our approach to improve profitability in workers comp is 3-pronged. First, renewal pure price of 7.5% in 2013 compared to 4% loss cost trend for the line. Second, claims improvement initiatives including a claim escalation model due rollout in the first quarter of 2014 and creation of a strategic case unit. And third, underwriting initiatives, which include an analysis of the more challenged segment of business.

E&S profitability improved over 2012 levels, while new business was up 19%, as we continue to see business migrate back from a standard market. Momentum in driving business from our retail agency partners through our wholesale agency partners is increasing, and we expect this to accelerate going forward.

E&S renewal pure price is at 7.5% in the fourth quarter and 6.5% for 2013, which when combined with our aggressive underwriting actions on targeted segments, leaves us well-positioned to produce consistent profitability in line with standard commercial lines in the E&S operations going forward.

For personal lines, the statutory combined ratio for the year was a profitable 96.9% compared to 100.7% in 2012. We continue to drive profitability in the homeowners line, as we increased rate across the book and made underwriting changes, including raising deductibles to increase cost sharing.

Additionally, in 2013, we tightened our underwriting appetite for monoline homeowners. For the year, our homeowners line achieved a statutory combined ratio of 95%, which includes 13.9 points of catastrophe losses and renewal pure price increases of 10.3%.

Personal auto results, while still below expectations, improved by nearly 3 points compared to 2012, as we have consistently achieved price increases that exceed loss trends. For the year, renewal pure price increased 5.6% in auto. We improved the geographic distribution of our book with about 65% of in-force premium outside of New Jersey in 2013 compared to 57% in 2010.

Now, I'll turn the call over to Greg.

Gregory Edward Murphy

Chairman & CEO

Thank you, John. Our 2014 expected x catastrophe statutory combined ratio of 92% is built around a fundamental three-year plan laid out in early 2012 to achieve overall annual renewal pure price increases of 5% to 8%. The result speak for themselves, as we achieved overall renewal pure price increases of 6.3% in 2012, 7.6% in 2013, and we expect to achieve 6% to 7% in 2014.

As we look out into 2014, we are confident in our ability to achieve expected renewal pure price increases in personal lines of 6.25% and E&S of 8.5%. Commercial lines could face more pressures, give the declaration in the industry that commercial lines pricing power is over.

We don't agree for the following reasons: one, for 2013, the industry has closed to an accident year combined ratio of 100%; two, expectations that the industry returns to a more normal level of catastrophe losses; and three, ongoing pressure on investment yields.

[indiscernible] Company has estimated in 2014, commercial lines industry ROE of 7%, which underperforms the industry cost of capital by about a 120 basis points. To give some perspective, we calculate that in 2014 the commercial lines industry would need to increase pricing, assuming a 3% loss trend, about 20% in order to lower statutory combined ratio by 10 points and generate 12% ROE.

Our 2014 commercial lines renewal pure price target is 6% to 7%. Based on recorded premium to date, the commercial lines renewal pure price increase for January 2014 is expected to be up 6.2%. Although, January renewals can be competitive, as carriers gear up for the new year, let this January renewals typically represent about 10% of our commercial lines annual premium buying.

We remain encouraged by our growth opportunities, as market conditions continue to modestly improve. In addition to the benefit of pure price increases, we are gaining traction in our E&S business, expanding our agency force and implementing new products.

Our success for profitable growth lies in our ability as a super regional carrier to work side-by-side with the best agents in the business. Why is this important? Because our agents have very effective sales management cultures and provide their customers with a highest level of service, they generate strong retention. Partnering with the best agents and providing Selective franchise value proposition helps us create mutual success.

We offer the following 2014 estimates as guidance. The x statutory combined ratio of 92% for x catastrophe losses; no prior year casualty development; more points of catastrophe losses for the year; after-tax investment income of $100 million; and weighted average shares of $57.4 million.
Now, I'll turn the call over to the operator for your questions.

Question and Answer

Operator

[Operator Instructions] Our first question comes from Vincent DeAugustino of KBW.

Vincent M. DeAugustino
Keefe, Bruyette, & Woods, Inc., Research Division

First question, you guys have kind of already hit on it, but with personal auto and workers comp. So those remain kind of through the last need to work states. And kind of just back me on with math, if you hit a 100% combined ratio on both of those that would imply something in the neighborhood of about a 3 point ROE improvements. And so you guys listed some of the workers comp rate and non-rate actions that you haven't planned. I'm just curious, if those in combination over the next 24 months might get us closer to a 100% combined ratio? And then just how significant are the non-rate versus rate actions for both of those?

John Joseph Marchioni
President & COO

This is John, I'll start, and then certainly Greg or Dale could jump in. We don't put out guidance relative to the actual combined ratios by workers comp. And certainly, internally we have a very good sense in terms of what those 3 areas of improvement will generate for us, and we highlighted them in the prepared comments. The rate over trend and we know what it's been in the past and we have our forecast based on the final rate increases that we know for this place. So rate over trends is one part of that. The mix improvements and we mentioned challenged segments. Based on our analytics capabilities and our modeling capabilities, we understand which segments of business and which hazard grades of business are really driving the negative performance. We have aggressive plans to address those and expect those to generate real improvement. And then finally on the claim side, as we mentioned by having an escalation model, which essentially gives us an very early indication that which claims are likely to really cause us issues in the future. And getting them into the hands of topnotch claims professionals, that's where the real dollars are in the claims and recoveries. So those are very meaningful in our eyes. We don't disclose the actual impact of those. But I would say internally, we're very comfortable in terms of what those will do for us over the next couple of years. On the personal auto side, you cited that as the other line that we really need to address, we agree. We talked about the rate over trend. We also have some underwriting mix improvements that we look at there as well, that we continue to see an improvement in mix in a number of key variables that we use for rating purposes that we know lead us to lower-frequency, higher-retention business. And as we've also said in the past, because of our expansion outside of our state of New Jersey, where our book is less mature in terms of average age of years enforced in the industry as that book continues to age, which it has and it will, and we expect to see that improvement come down as well. And then finally I would say, a number of the claims initiatives that we talk about, generally speaking on a liability side as well the property side as we implemented, will impact personal auto as well as homeowners.

Gregory Edward Murphy
Chairman & CEO

And I would say that, what John just went through, to me in the personal line area it's with a long-term story we communicated consistently. One is that we're going to have a very aggressive home strategy to bring the home combined ratio down on a normal cat year into that upper-80s band.

And then the other that we mentioned to auto was going to be a longer developing story, as we continue to factor in underwriting improvements and laid that down. So in terms of the expectation I think that story has always been, as I'd like to refer to it as the tale of 2 cities relative to first lines improvements. And on the comp side, I would say that John articulated the 3-ways to this tool. We're very aggressively managing each one of those, because bringing that cost number down is very important to us. You see those improvements embedded in the different parts of the workflow chart that we produce relative to rate and trend and then also relative to the underwriting and claim improvements. The bigger claim improvements, obviously impact the comp numbers overall, but that's something that actuaries have to respond to in a diligent manner. So that's only that commentary that we'll make on that.

Vincent M. DeAugustino
Keefe, Bruyette, & Woods, Inc., Research Division

And Greg, going to some of your rate commentary, I know rates not the only lever in it, probably too much focused on right now, it's just that your preface about it, I completely agree with your assessment that rate increases should continue. But we've seldom seen the industry earn its cost of capital and we're kind of nearing a cat normalized ROE, where we historically started to see competition start to ramp up a little bit. So I'm just kind of curious if you think maybe things are a little bit different at this time around and whether or not we're seeing enhanced discipline because of some of the factors that you kind of run through?

Gregory Edward Murphy
Chairman & CEO

It's interesting. I mean to me the biggest thing that's out there that I think that change the dynamics and I think that's true for several years now. Most companies, not all, more publicly report their renewal price increases, and I think that gives you a lens into what's happening in their premium base relative to rate and then you're comparing that with lost trend. So I think to the extent that, when you look at the numbers, when you look at our prepared comments, we're looking at an industry commercial lines that's close to a 100 combined ratio on an acting year basis. And Dale went through the cash free activity that we experienced in January. But my guess is we're not immune from that, so that's an industry-wide event that's going to be fairly significant. Investment yields that we talked about on the call, our new money rates of 2.25% still put pressure on trying to consistently raise rate, improve your underwriting in the sector. And I think the ongoing public disclosure of rate is very helpful and maybe it will keep a little bit more discipline in the marketplace.

John Joseph Marchioni
President & COO

And then if I could just add to that as well. That's more of the external aspect that what we're talking about here in terms of market pricing. At the same time, as we also reiterated in the prepared comments, we've learned a lot over the last 19 quarters in terms of how to really manage pricing retention throughout our markets cycle. And when you look back in the beginning of this pricing cycle, where the market forecast were so negative and we were starting to get positive rate, I think our underwriters, and our agents have really learned how to work together to manage pricing on a very responsible basis, regardless of where the market is. I bet it wouldn't get harder, if the markets started to move, but we feel like we've got the tools and the relationships in place to manage throughout the cycle.

Vincent M. DeAugustino
Keefe, Bruyette, & Woods, Inc., Research Division

And then one more if I could, to sneak it in for Dale. Dale you had mentioned that the new reinsurance program basically covers up to 1-in-250 year event. I think if memory serves me correctly, you guys were probably at 1-in-228 year before, so is the increase just purely on just the enhanced reinsurance cover or are there any underlying modeling changes that actually increase kind of the expected gross loss at a 250 event type thing?

Dale Allen Thatcher
Former Executive VP, Treasurer & CFO

It's actually a combination of those 2 things. The answer is that, obviously, adding the additional cover to top moves it out, but also with RMS coming out with their latest model this past year. Remember in 2012, new RMS model increased everything by excess of 80% for everybody, while their 2013 version actually decreased the curve for everybody by a little bit. So they gave a little bit of that back. So a combination of those 2 things are pushing the cover out to a 1-in-250-year event.

Operator

Our next question comes from Mark Dwelle with RBC Capital Markets.

Mark Alan Dwelle
RBC Capital Markets, LLC, Research Division

I'm going to start first with the guidance on the catastrophes. You're probably just beginning to get claims, I'm sure there is not a lot of rich data. But is it going to be biased more towards the personal lines or is it a reasonable mix of commercial and personal exposures that you're seeing?

Gregory Edward Murphy
Chairman & CEO

Some of our markets tending to match our mix of business, which runs around that 75% to 25%, our commercial lines are predominant.

Mark Alan Dwelle
RBC Capital Markets, LLC, Research Division

And I assume, all geographies are reasonably impacted and John [ph] commented at last, saying it's mostly burst pipes and cold weather related more so than snow and accident related?

Gregory Edward Murphy
Chairman & CEO

Cat 31 and cat 32, the combination of those 2 hit in 16 of our 22 states. And you also have on cat 32, actually the storm itself hit all of our 22 states, just that some of the states didn't get designated as cat zones by PCS. So, yes, it's very wide spread.

John Joseph Marchioni
President & COO

The benefit of the cold weather in a sense increased more burst pipes, but the snow blows [ph] were wider, so you have a tendency to have less roof collapses. But it's been mostly a very, very prolonged severe temperatures coupled with very high wind. So any weak spots in any structure really were exposed to the result of this event.

Mark Alan Dwelle
RBC Capital Markets, LLC, Research Division

Second question, I wanted to go into a little bit it was the guidance, and more particularly, the combined ratio guidance. I'm really just trying to probe there a little bit more about are you thinking about that. You generally had a pretty good track record on delivering your guidance targets. The combined ratio improvement represents 3 points to 4 points of accident year improvement. So you are thinking about that improvement kind of evenly across all the 3 segments of your business or do you see more potential in one segment versus another, maybe we can start there?

Gregory Edward Murphy
Chairman & CEO

I want to say that its improvement to a largest degree in, and I would say, commercial lines and E&S then followed by personal lines after that, and for the comments that I've made earlier relative to the home versus auto situation. But when you look at it, when just kind of thinking about it, when you look at earned rate, our earned rate next year is just based on the fact that we growth rate this year is 7.60%, we're going to be earning rate right around at 7% next year. So when you look at earned rate versus trend that's a big part of the lay-down of the improvement year-on-year, it's coming from rate over trend in totality. But when you look at the earned rate, it's fairly balanced among all 3 segments relative to how we got in the 7.6% overall rate.

Mark Alan Dwelle

RBC Capital Markets, LLC, Research Division

And then I guess parallel with that is as much of the improvement or is any of the improvement going to come from additional leveraging of the expense ratios? Certainly, it's been the case in the E&S segment. I was curious how much of that might have been factored in as well?

Gregory Edward Murphy
Chairman & CEO

Our expense ratio as we've showed you in the multi-year waterfall model, actually starts to elevate as improvements in our core operations are more than offset by profit-based elements of our compensation. So that's something you always have to be mindful of. As we continue to drop and improve our combined ratio in profit-based elements, which for the largest element of us would be the incentive to agents through the supplemental commission program that we institute, is why we see expense ratios actually go higher because of that profit base. I don't want you to read in there, that we're becoming less efficient, as Dale and his folks are always showing you the premium volume that we've generated for our employees that's an efficiency measure that we look at. And as we've shown you our expense ratios are trending to go higher out next year and even into '15 and '16, mainly as a result of a much higher supplemental commission agent payout.

Operator

Our next question comes from Ron Bobman with Capital Insurance.

Ronald David Bobman
Capital Returns Management, LLC

I had a question about workers comp, and not so much on the claim side and the loss side, but on premium rates. I assume you've got sort of different cohorts of workers comp, some that you regret the first day you look the account, others that are just under price and some that are satisfactory, and something you're making margin on. And I'm just wondering if you could sort of comment about the rate action I assume across these sort of different cohorts and what the competitive environment is as far as -- are you easily able to renew all at whatever rate you're sort of asking for or so you need or other certain pockets that have a degree of competition? I'd appreciate some color on that?

John Joseph Marchioni
President & COO

This is John. I'll start. I'll take a crack at this, and then others can certainly jump in. The one thing I would say is based on the tools that we have and the quality of our underwriters and our agents, we don't believe we acquire a lot of new business that we regret on day one. It could occasionally happen, but I would say generally speaking, we feel good about the controls we have and the mix of the things we have been writing. In terms of how we manage the renewal inventory, we talked even in prepared comments generally about the way we look at our renewal inventory by bucket, above average, all the way down to low and very low retention buckets. The same would apply. We give you overall numbers in terms of rate retention, but the same certainly applies when we look at our workers comp inventory. And because of the relative performance of comp to our other lines, our targets are generally a little bit more aggressive on the lower-end of our distribution of the policy inventory. So we feel like we're hitting the right areas by segment and not hazard rate. And I think that's an important consideration. With regard to the competitive environment, I would say that the comps remains surprisingly competitive. And I think in particular in the smaller lower-hazard segment of business, we continue to see a fair amount of competitive pressures there on some of the higher hazard and some of the more challenged segments maybe a little bit less. But we are focused on really hitting our rate targets across all of those segments. And on the low and very low buckets, our underwriters take the position that, if they can't get their rate level target on those accounts, they're going opt for letting it walk. And in many cases there are homes that are willing to take those accounts. So I hope I answered all pieces of your question there.

Gregory Edward Murphy
Chairman & CEO

We know we need to get as aggressive as we can on the comp line. And that's the area where a lot of our underwriting focus and claims focus is earmarked to. And again, it's a constant refinement of what we do, how we do it, we probably lay out the most complete and comprehensive plan in terms of what we're doing to improve the operations. And we're just aggressively trying to glitter [ph] on all fronts of that.

Ronald David Bobman
Capital Returns Management, LLC

Just to give a little bit of sort of reference, the most attractive cohort, I forgot whether you've called it Tier 1 or not or Tier 5, I think Tier 1, if I remember correctly. Would you give us a little bit of ballpark or figure for the average rate you're getting for that most attractive cohort and the retention? And then how I assume sort of diametrically oppose the Tier 5, most needy of improvement cohort you're pushing for rate or you're getting rate there with the retention for sort of the book ends of your results on rate and retention?

Gregory Edward Murphy
Chairman & CEO

So just to give you a sense, you got the overall rate level and retention by bucket, at least for the above average and the low and very low in the prepared comments. For comparison purposes on the comp side, in particular, the above average bucket is about 5.5% in terms of rate and retention of about 87%. And on the very low and low buckets, we don't have them together, but let's say the rate is in between the 50% to 90%. And the retentions are in the mid-to-high 60% range. So you'll actually see the balance there a little bit more aggressive on the low and very low buckets and the retention is lower than we see overall.

Operator

I am showing no further questions from the phone lines at this time.

Gregory Edward Murphy
Chairman & CEO

Well, thank you for participating in the call this morning. If you have any follow-up items, please contact Jennifer. Thank you.

Operator
That does conclude today's conference. Thank you for participating. You may disconnect at this time.