S&P Global
Market Intelligence

Selective Insurance Group, Inc. NasdaqGS:SIGI

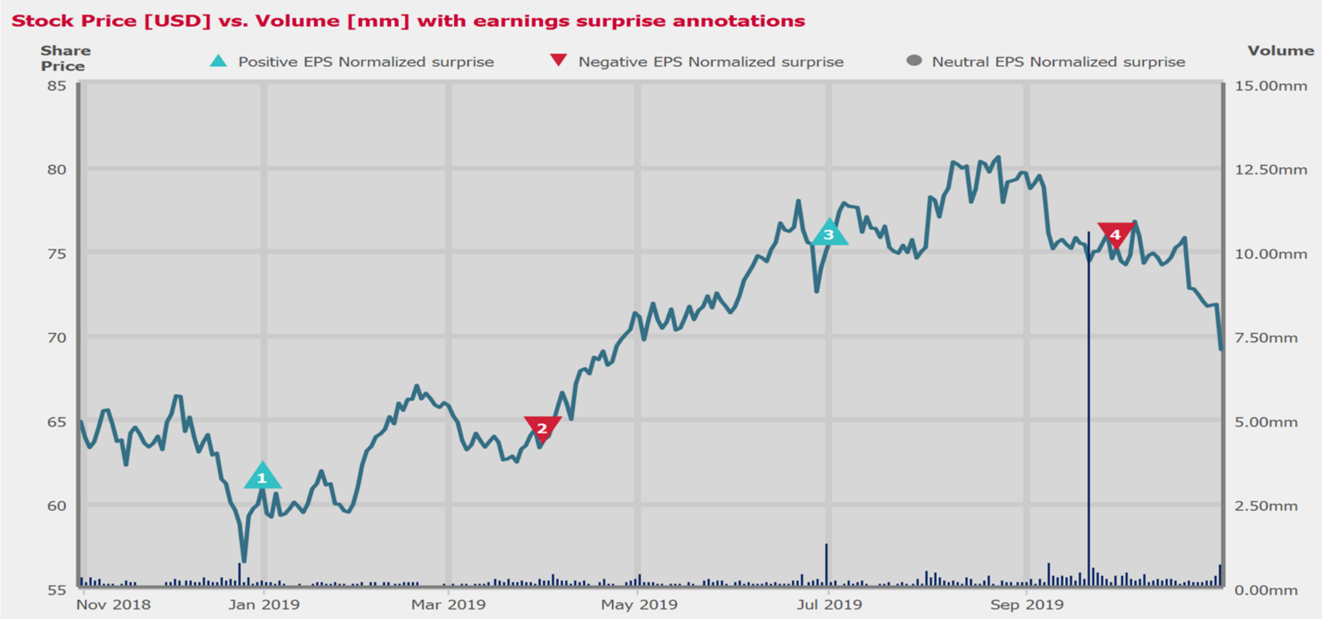
FQ3 2019 Earnings Call Transcripts

Thursday, October 31, 2019 1:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ3 2019-			-FQ4 2019-	-FY 2019-	-FY 2020-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	1.07	0.97	(9.35 %)	1.11	4.12	4.39
Revenue (mm)	718.14	710.40	(1.08 %)	722.70	2840.30	2976.60

Currency: USD
Consensus as of Oct-31-2019 12:18 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ4 2018	0.93	1.20	29.03 %
FQ1 2019	0.94	0.90	(4.26 %)
FQ2 2019	1.06	1.16	9.43 %
FQ3 2019	1.07	0.97	(9.35 %)

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Call Participants

EXECUTIVES

Gregory Edward Murphy
Chairman & CEO

John Joseph Marchioni
President, COO & Director

Mark Alexander Wilcox
Executive VP & CFO

Rohan Pai
Senior VP of Investor Relations & Treasurer

ANALYSTS

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Scott Gregory Heleniak
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Thomas Henry Shimp
Sandler O'Neill + Partners, L.P., Research Division

Presentation

Operator

Good day, everyone. Welcome to Selective Insurance Group's Third Quarter 2019 Earnings Call. At this time, for opening remarks and introductions, I would like to turn the call over to Senior Vice President, Investor Relations and Treasurer, Rohan Pai. You may now begin.

Rohan Pai
Senior VP of Investor Relations & Treasurer

Good morning, everyone, and welcome. This call is being simulcast on our website and the replay will be available through December 2, 2019. 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.

Certain GAAP financial measures will be stated in the call that also are included in our previously filed Annual Report on Form 10-K and Quarterly Form 10-Q reports. To analyze trends in our operations, we use non-GAAP operating income, which is net income excluding the after-tax impact of net realized gains or losses on investments, unrealized gains or losses on equity securities, and debt retirement costs related to our early redemption of debt securities in the first quarter. We believe that providing this non-GAAP measure makes it easier for investors to evaluate our insurance business.

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

Joining today on the call are the following members of Selective's executive management team; Greg Murphy, Chief Executive Officer; John Marchioni, President and Chief Operating Officer; and Mark Wilcox, Chief Financial Officer.

With that I'll open it to Greg.

Gregory Edward Murphy
Chairman & CEO

Thank you, Rohan, and good morning. After 20 years as Chief Executive Officer at the Best Super Regional Company in the Country, I am extremely pleased to announce the well-developed transition plan that appoints John Marchioni as Chief Executive Officer, effective February 1, 2020 when I become Executive Chair for a one-year period. John has been President and Chief Operating Officer since 2013 and is fully prepared and capable to assume the Chief Executive Officer role. I could not be more happy for him and the ongoing success of the company.

I'll make some introductory remarks and then focus on some high-level themes and initiatives that enhance our strategy and position us for continued outperformance. Mark will then discuss our financial results and John will review our insurance operations in more detail, providing additional color on key underwriting and strategic initiatives.

Our third quarter results were solid, reflecting continued strong execution across our underwriting and investment functions. For the quarter, our combined ratio was 95.2% and after-tax net investment income was up 6% to $45 million. We generated non-GAAP fully diluted operating earnings per share of $0.97 and an annualized operating ROE of 11.2%.

Our third quarter results were impacted by: One, higher than expected levels of non-cat property losses of $5 million after tax or $0.09 per diluted share and $3 million of employee severance-related costs, which were split between underwriting and corporate expenses that accounted for $0.05 per share. On a year-to-date basis, our non-cat property losses are within our expected range. In addition, we remain focused on generating renewable pure price increases that for the quarter were 3.7% in line with our expected claim trend as well as driving ongoing underwriting and claim improvements. We expect new and renewal pricing will continue their upward momentum that will produce additional underwriting margin improvement in 2020.

For the 9-month steadfast underwriting performance coupled with outstanding investment results generated top-performing annualized non-GAAP operating return on equity of 12.3%, which was above our full year target of 12%. The 12.3% operating return on equity was reduced by about 60 basis points due to the significant unrealized gains on the fixed income portfolio that increased the book value by almost $3 per share or 10%. These gains reflect the low interest rate environment and will reverse as securities near maturity. Overall net premiums written were up 6% led by one solid overall renewal pure price increases of 3.6%, strong retention, and 3 new businesses that was up 5% for the first 9 months.

Our combined ratio of 94.3% for the first 9 months was excellent with each of our segments contributing to the solid results. From a strategic standpoint, we're focused on our initiatives to generate profitable growth through increasing share wallet within our IV lead distribution partners, appointing new partners, as well as growing in our 5 recently opened states. For the first 9 months of the year our insurance operations generated an annualized operating return on equity of 5.9 points. Our investment results for the 9 months were brilliant, despite lower interest rate environment, reflecting some repositioning in the portfolio, coupled with strong cash flow as a percentage of net premiums written that were 22% for the quarter and 15% year-to-date.

After-tax net investment income increased 15% for the 9 months and generated 9.1 points of annualized operating return on equity. On a cash basis, our combined ratio was a healthy 88%. As we head into the closing months of 2019, there're a few topics that I would like to comment on. The first is, as I've always stated, arithmetic has no mercy and between lower interest rates and the growing expected industry-wide claim trends, the overall direction of the pricing environments for standard commercial lines must increase and it is moving higher, still under-performing commercial auto and property lines of business require more underwriting and pricing intention, in order to reach targeted profit levels.

In addition, we've been very careful in writing and pricing workers' compensation business, which I believe will become an industry hotspot by 2021. Finally, -- industry forecast of a 96.7 combined ratio for 2019 suggests an operating return on equity of about 7.5% which is just in line with the industry's cost of capital.

For selective commercial lines renewal pure pricing was up 3.5% in the quarter and 3.3% for the first 9 months in the year that continued our 10-year track record of achieving renewal pure price at or above expected loss trend levels. We are achieving price adequacy and our underwriting margins remain in line with our targets. We will continue to achieve price increases in areas where we're not being adequately compensated, but our strategy in this environment is to grow where we see attractive opportunities.

We see some signs of loss trend increasing in the marketplace. We feel our reserve position is strong for 2 reasons: one, prior accident year losses developing favorably; and two, observed current accident year reported casualty claim counts are below expected levels. The reported claim count is the leading indicator of pure premium. We maintain a highly disciplined product planning process that includes on leveling and trend in the past 4 accident years and averaging those 4 years with our current year to project the baseline loss ratios by line of business. Those loss ratios are then trended based upon future expectations to create forecasted loss ratios. In addition, our detailed quarterly reserving process includes the monitoring of claim counts severity trends that allow us to react quickly to emerging trends.

Second, while there were no headline-generating catastrophe losses during the quarter, we're still active from a standpoint of near misses as well as numerous severe convective storms that impacted for the most part of Midwest. The industry exposure to significant hurricanes, earthquakes, and wildfires is pronounced and how loss mitigation is implemented is critical to reducing the magnitude of these types of events. For selective, our cat losses are in line with our expectation for the year.

Third, as the industry assimilated some prolonged interest rate environment, there will be downward pressure on industry-wide portfolio returns that will necessitate better underwriting margins to make up any investment shortfalls. For companies that are still struggling with underwriting profitability issues, lower investment returns will result in a renewed sense of urgency to improve underwriting margins through higher pricing.

Our agile approach to pricing, underwriting risk, segmentation, and claims improvements positions us well for the current environment. With the commercial lines conditions turning into more of a tailwind, as well as our sophisticated pricing, we are very confident in our ability to maintain attractive ROEs.

For the 9 months of the year behind us, our full year 2019 expectations are as follows: A GAAP combined ratio excluding catastrophe losses of 91%, this excludes any fourth quarter prior year development, catastrophe losses of 3.5 points, after-tax net investment income of $180 million which includes $14 million of after-tax investment income from our alternative investments, and overall effective tax rate of approximately 19% which includes an effective tax rate of 18.5% for investment income reflecting the tax rate of 5.25% on tax advantage municipal products, and a tax rate of 21% for all other items, and weighted average shares of $60 million on a diluted basis.

Based on our excellent operating performance in 2020 outlook, the Board declared a 15% increase in the quarterly cash dividend on common stock to $0.23 per share.

Now I will turn the call to Mark to review the results for the quarter.

Mark Alexander Wilcox
Executive VP & CFO

Thank you, Greg, and good morning. For the quarter, we reported $0.93 of fully diluted earnings per share and $0.97 of non-GAAP operating earnings per share. We generated an annualized ROE of 10.7% and a non-GAAP operating ROE of 11.2%. Through the first 9 months, our annualized non-GAAP operating ROE of 12.3% is above our 2019 ROE target of 12%. Consolidated net premiums written increased 4% in the quarter with continued solid 6% growth in outstanding commercial lines segment, driven by strong new business growth and accelerating pure renewal rate increases, partially offset by premium declined in Personal Lines and E&S.

Underwriting profitability remained strong with a third quarter combined ratio of 95.2%, on an underlying basis or excluding catastrophe losses and prior year casualty reserve development, our combined ratio was 93.6% with a 1.6 percentage point comparative quarter increase, principally driven by higher non-cat property losses and an increase in the expense ratio, which I'll touch on shortly.

For the first 9 months of the year consolidated net premiums written increased 6% with strong contributions from outstanding commercial lines and E&S segment. Our reported combined ratio was a profitable 94.3% and our underlying combined ratio was 92.5%, which reflects 60 basis points of underlying margin improvement thus far in 2019.

For the quarter, catastrophe losses added 3.7 points of the combined ratio and included exposures through a series of smaller hailstorm storms and tornadoes as well as a $3.7 million estimate for Hurricane Dorian. Non-cat property losses of 16.7 percentage points for about a point higher than expected and put some pressure on our actual and underlying combined ratios compared to the comparative quarter. Year-to-date, our non-cat property losses accounted for 16.1 points on the combined ratio, down by just over a point from the same period in 2018 and a generally in line with our expectations.

In the third quarter, we experienced $14 million of net favorable prior year casualty reserve development, driven by $13 million in the workers' compensation line, $3 million in the general liability line, and offset in part by $2 million of adverse development for personal auto. The impact of net favorable prior year casualty reserve development was 2.1 points on the combined ratio for the quarter and first 9 months.

Given the industry discussion of reserves and loss trends this quarter, I wanted to provide a quick reminder of our reserving processes. Our actual reserve indicating completely ground-up reserve review for all of our major lines of business quarterly. In addition to performing aggregate loss ratio projections on a multiple actuarial methods, we established specific expectations of frequency in severity by line of business, which provides us with a deeper insight into emerging trends, enabling us to respond quickly to elevated loss trends and assumptions that are not in line with expectation.

Our reserving processes include an independent mid-year and year-end reserve review completed by an independent Big Four Accounting Firm, which provides a second level of review as well as additional industry insight into the adequacy of our reserves. Finally, just as a reminder, we purchased a significant amount of reinsurance, including large casualty and property XOL programs where we see individual losses in excess of $2 million.

Moving to expenses. Our expense ratio came in at 34.1% for the quarter, which is up 160 basis points from the comparative quarter, the increase was principally driven by 60 basis points of higher profit-based compensation for our distribution partners and employees, driven by our strong year-to-date results, as well as the employee severance related costs that Greg mentioned, which negatively impacted our expense ratio by 30 basis points in the quarter. A 33.6% expense ratio for the first 9 months was 60 basis points above the prior year period.

A profit-based compensation for distribution partners and employees drove the majority of this increase due to the better than expected combined ratio. And if favorable underwriting trends continue through year-end, there'll likely be some continued upward pressure on the expense ratio. Corporate expenses, which are principally comprised of holding company costs on long-term stock compensation, totaled $6.4 million compared to $7.5 million in the comparative quarter. For the first 9 months, corporate expenses totaled $28 million compared to $22 million in the year ago period. The year-to-date increase was driven mainly by the 23% appreciation in our share price, in the first 9 months of 2019 versus 8% appreciation in the year ago period, which increased stock compensation expense related to the liability portion of our awards.

Turning to investments. For the quarter after-tax net investment income of $45 million was up 6% from the prior year. The overall after-tax yield on the fixed income portfolio, including high yield was 2.8% during the quarter, which is flat compared with the year ago. The average new money yield on the fixed income portfolio during the quarter was 2.5% after tax, approximately 12% of the fixed income portfolio is invested in floating-rate securities, which reset principally based on 90-day LIBOR. But we still find the all-in yield of these floating rate securities attractive compared to those of similarly rated fixed price securities. As interest rates have declined we've been tactically managing down our allocations from a peak of around 18% of the portfolio.

Our average fixed income credit rating remains strong at double-A minus, and the effective duration of the fixed income and short-term investment portfolio is down modestly to 3.3 years. On a sequential basis, the pre-tax book yield on our core fixed income portfolio decreased to 11 basis points in the third quarter and is down 9 basis points for the year. On a go-forward basis, we expect continued pressure on the book yield, given the significant reduction in rates since peaking early in the fourth quarter of last year.

Risk assets which principally include high yield fixed income securities, public equities, and alternative investment portfolio accounted for 7% of total invested assets as at the end of the third quarter, which is down modestly from year-end, mainly reflected a reduced allocation to common stocks.

Our alternative investment portfolio, which includes limited partnerships and private equity, private credit, and real asset investments and reports on a one-quarter lag, generated a pre-tax gain of $5 million for the quarter compared with $7 million in the year ago period.

Turning to capital. Our balance sheet remains strong with $2.1 billion of GAAP equity, an increase of 19% so far this year. Strong appreciation in the value of our fixed-income portfolio resulted in net unrealized after-tax gain totaling a $175 million on a year-to-date basis.

The strong growth in GAAP equity will put some downward pressure on our ROE as we look ahead to 2020. We continue to operate at the low end of our premiums to surplus target range at 1.4 times to 1.6 times. This flexibility at the operating level, when combined with our $267 million of holding company liquidity provides us with meaningful capacity to grow if market opportunities present themselves. At a 1.4 times operating leverage, each combined ratio point equates to about 1 point of ROE, which is about twice that of the industry.

In addition, 3.1 times investment leverage into each point of pre-tax book yield on our investment portfolio results in approximately 2.5 points of ROE.

With that, I will turn the call over to John to discuss our insurance operations.

John Joseph Marchioni
President, COO & Director

Thanks, Mark, and good morning. I want to start by thanking Greg and the Board for the opportunity to become the next CEO of this very special company. As has been the case throughout his tenure, Greg's primary focus has been to do what's in the best interest of our employees, our customers, and our shareholders, and his approach to this transition has been no different, and for that I'm truly grateful.

I'll begin with the 9-month results of our operations by segment and then provide an overview of some of our strategic initiatives. Our standard commercial line segment, which represents approximately 80% of premiums, generated net premiums written growth of 7% for the first 9 months, continuing a consistent track record of strong and profitable growth. The segment generated new business growth of 9%, stable retention of 83%, renewal pure price increases of 3.3%, and an excellent combined ratio of 93.9% or 93.3% on an underlying basis. Commercial lines renewal pure prices increased 3.5% in the third quarter, up sequentially from 3.1% in the second quarter as general liability and commercial auto contributed to the improvement.

While the direction of market pricing is certainly a positive, the level of increases has been so far more muted in the small and mid-market commercial lines space than it has been for large accounts or high hazard E&S, on our highest quality standard commercial lines accounts, which represented 49% of our commercial lines premiums, we achieve renewal pure rate of 1 9% and point of renewal retention of 91%. On the lower quality accounts, which represented 11% of premium, we achieved renewal pure rate of 7.9% while retaining 79% at point of renewal.

Our ability to analyze the risk and return characteristics of each piece of business at an extremely granular level allows us to achieve additional loss ratio improvement from mix of business changes, while maximizing overall retention.

Drilling down to the results for the first 9 months by commercial line of business, our largest line, general liability, achieved an 87.4% combined ratio, which included favorable reserve development, totaling $10 million or 2 points on a combined ratio. We achieved renewal pure price increases of 2.7% for this line including umbrella. While loss trends have remained generally benign in our portfolio of predominantly small and mid size accounts, we are monitoring frequency and severity trends, including litigation rates.

Early communication with claimants remains a key area of focus across our claims organization. Our workers' comp line generated an 81.7% combined ratio aided by favorable reserve development totaling $33 million and accounted for 14.2 points on a combined ratio. This favorable development related primarily to lower than expected severities for accident years 2017 and prior. Renewal pure pricing was down 2.8% and we continue to take a cautious approach to underwriting this line, which on a current accident year basis is generating a combined ratio closer to 96%. Workers' compensation pricing for the industry has come under sustained pressure and loss cost filings by NCCI and other individual state bureaus continue to be negative.

Commercial auto has been an area of focus for us and the industry as the results have been significantly worse than target levels for a number of years. The combined ratio for this line was 107.1% and there was no prior year development and liability claim trends remain in line with expectations for the current year. To improve profitability, we achieved price increases averaging 7.4% this year on top of similar price increases in each of the past 2 years.

We've been actively managing new and renewal portfolios in target business segments and improving rating and classification. As adoption of our selective drive product increases over time, our customers will gain greater insight into driving habits of their employees and have the potential to improved loss experience.

Our commercial property book generated a 98.9% combined ratio, while results have been profitable, they have not met target levels driven by adverse, weather, and large fire losses. While market pricing has improved, frequency - it's a very trends remain elevated and support the need for additional pricing.

Our renewal pure price increases average 4% excluding inland marine and we are taking steps to address the drivers of higher loss experience through business mix shifts and safety management efforts.

Our personal lines segment, which represented a 11% of 9-month premiums reported a 1% decline in net premiums written, mostly reflecting the more competitive market conditions, especially for personal auto. Renewal pure price increases average 5.3% retention remained solid at 83% but new business was down 24%.

Market competition in personal lines and for personal auto in particular has become far more pronounced this year, the segment produced a combined ratio of 96.9% or 88.2% on an underlying basis.

In personal auto, net premiums written declined 1% for the first 9 months and the combined ratio was 103%. Results included $2 million of strengthening for prior accident year casualty reserves, which added 1.5 points of the combined ratio.

Renewal pure price increases averaged 9.3% for personal auto liability and 4.5% for physical damage. While the benefit to improve profitability, these price increases are clearly putting pressure on new business. The homeowners line reported a 2% premium decline relative to a year ago and a combined ratio of 99.5% including 78.7 points of catastrophe losses.

As the majority of our premium is written on an account basis, our competitive position in the auto line has hurt our homeowners' growth, despite some expected volatility and quarterly results this has tended to be profitable in recent years and renewal pure price increases averaged 2.9% for the first 9 months.

Our E&S segment which represented a 9% of total premiums, generated 7% net screens written growth for the 9-month, primarily reflecting the on boarding of new distribution relationships.

The premium decline in the Q3 related primarily to unfavorable comparisons following the addition of a single large distribution relationship in the year ago period. The segment generated a 94.7% combined ratio for the 9 months, a meaningful improvement relative to the 103% combined ratio a year ago.

Renewal pure price increases average 4.4%, over the past few years, we undertook a number of deliberate steps to achieve price adequacy, improve the business mix, and centralize our claim processes, which are contributing to the improved combined ratio performance in this segment.

We are pleased with the performance of this business, and expect to generate consistent profitability going forward. We will continue to see pressure on growth in the Q4 as our decision to exit a snow removal program that was heavily weighted to the end of the year, will impact year-over-year comparisons.

However, with our profitability levels improves, we are well positioned to generate stronger growth in our core binding authority segment.

I'll switch now to some of our strategic initiatives, which continue to drive our best-in-class operating and financial performance.

Some of the major initiatives we've been highlighting have included; one, Managing new and renewal pricing in alignment with expected loss trend, enabling us to respond quickly to any changes in market conditions; second, continuing to execute on our strategy of profitable growth in our current markets and through geographic expansion; third, leveraging sophisticated tools and technologies that enable better underwriting, pricing, and claims decisions; fourth, delivering excellent customer service solutions and value-added services to increase hit ratios and retention. First, with respect to our pricing stance in the marketplace, we are far more focused on price adequacy that we are in the trajectory of increases. We feel very good with the embedded profitability, which is essentially in line with our target margins. We will continue to manage renewal pricing on a granular basis, targeting accounts that we feel are not price commensurate with future profitability expectations.

Our strong distribution relationships, sophisticated pricing tools, and culture of underwriting discipline, enables us to successfully execute our pricing strategy, effectively managing our goals around profitability and retention rates.

Second, we continue to leverage our superior distribution relationships as we execute on our objective of generating strong and profitable growth. Our stated long-term objective of obtaining 3% commercial lines market share is built around appointing partner relationships that control approximately 25% of their markets and seeking an average share of wallet of 12% across those relationships.

We have an additional commercial lines premium opportunity in excess of $2.7 billion over time if we hit our long-term targets and can do so without having to stretch our underwriting appetite or shift our risk profile.

Our geographic expansion strategy has been tracking well since we opened 5 new markets over the past 3 years, consisting of New Hampshire and a Southwest Hub incorporating the State of Arizona, Colorado, Utah, and New Mexico. Current in-force premiums totaled approximately $59 million from these new states.

Third, we continue to invest in deploying sophisticated underwriting tools and technologies that enhance our decision management capabilities and operating efficiencies.

For example, we deployed our underwriting insights tool to new business underwriters in 2017, which provides model-driven guidance and real-time insights into how each piece of new business compares with similar accounts already in the portfolio.

We recently rolled out our underwriting workstation which along with automated data retrieval and data prefilled improves underwriting efficiency and exposure analysis.

We recently opened our new Innovation Lab at our headquarters in Branchville, New Jersey, a facility that will enable our efforts, to identify and deploy improvements to our product, agency and customer experience, and operational efficiency. Continuing to invest in the build-out of these tools is core to our strategy and has been a key factor in driving our outperformance.

Finally, as we have often discussed on these calls, one of our major strategic initiatives has been enhancing the overall customer experience. Our objective is to create a differentiated value proposition for our distribution partners and customers. And position selective as a leader in this area.

Our self-service and digital service offerings, allow our customers to engage with us in a 24/7 environment. We now have 360 degree view of our customers, allowing us to build out a more proactive communication program as we seek to create more value for them.

Strong customer adoption of these offerings validates the investments and allows us to continue differentiating selective in a crowded marketplace.

Overall, we continue to make excellent progress on our various strategic objectives. Looking out beyond 2019 we are in a extremely strong financial and strategic position, we have the technology, tools and people that will position us for future long-term success and are confident in our ability to generate superior financial results for our shareholders on a consistent basis.
With that, we will open the call up for questions, operator?

Question and Answer

Operator

[Operator Instructions] Our first question on queue, it will be coming in from Mike Zaremski of Credit Suisse.

Charles W. Lederer
Crédit Suisse AG, Research Division

Congrats to Greg and John. This is actually Charlie on for Mike. I know you touched on it briefly, but it was notable that you guys were released reserves in the GL line this quarter and have done so consistently this year, given that some other carriers have been talking about a rising loss trend. Can you talk about what you're seeing in that line and other casualty lines?

John Joseph Marchioni
President, COO & Director

Got it. So this is John, I'll start. And I guess what I would do, at the outset is bring you back to the comments that both Greg and Mark had in the prepared remarks, relative to the discipline, not just around our planning process that leads to our loss ratio selections, but also the reserving process that we have as an organization and based on those inputs we feel very good about where we are relative to general liability in particular and all lines on an overall basis, but I would also again point to the fact that has been reiterated here this morning and over the last several years, which is if you look at our history over the last 10 years and just assume a loss trend of about 3%. We've generated pure price increases, net of exposure change, at or above that level over that 10 year period and that's also embedded in each of those accident years, when you think about trends that might be developing going forward. So you combine that with our position to execute our pricing strategy and manage retentions on a very granular basis and you put that all together, that to explain why we feel solid based on where we are today.

Gregory Edward Murphy
Chairman & CEO

And Mike (sic) [Charlie], this is Greg. Let me just add a little couple of point. First of all, again one size does not fit all, okay? So when we start thinking trend and we start thinking price. I'd like you to start to contemplate the fact that type of business that we write, we are, our average account size of 12,000 and the fact that 87% of our casualty policies are written at $1 million below, the fact that we have a reinsurance program on attached to $2 million. So a lot of the inflationary aspects of that get pushed into the reinsurance market.

I think put a different profile on it. And then I think when you really just even go back over the last 5-year period and you look at where our rate level is and just look at our rate level relative to clips. We were at like 3.2% renewal pure rate and in CLIPS for all in, everything small, medium, and large accounts is not even at 2%.

So that consistent outperformance and like John mentioned were in account underwriter, so where are those increases going? They're going NGL, they're going in other lines of business to build up what we feel we need is the right price for that exposure. So there is a lot in all of that answer, but I think it's important when people start applying those one rule or it's like if you find one rule to rate increases, your head is going to pop off because you got companies now talking about rate with exposure or no. Let me put take exposure out, let me take comp out, let me put comp in and let me -- so when you think about it like that, our rate that we disclose is renewal pure price, no exposure rated and if we were to amp it up for exposure, if we take our rate level for the first 9 months of the year, almost up 6 points to give you a sense of the difference between what we report and what you may hear in the market relative to what rate is. So again, I know that, there is a lot in all of that, but I think it's important to understand all that when you look at the performance of the company like Selective.

Charles W. Lederer

Crédit Suisse AG, Research Division

Got it. That's very helpful. And then on the personal auto side, can you provide more color on what you're seeing there as far as the most pronounced competition?

John Joseph Marchioni
President, COO & Director

Yes. Charlie, this is John. I guess, what we continue to see is, our hit ratios remain under pressure, which is the best way to measure where the competitive environment is. And we understand our price increases, based on our view of profitability in that line has been higher than the market, broadly and that continues to hurt our competitive positions. Now we are starting to see an increase in commentary from some of the bigger players that maybe there is some change in loss trends relative to personal auto, which may start to change that pricing environment, we haven't seen that yet. But that's really how we've seen the impact on our new business and as we said earlier, that new business impact in our competitive positioning for auto also impacts the whole line because we do write a lot of continued business with the Auto and Home.

Operator

Our next question will be coming in from the line of Scott Heleniak of RBC Capital Markets.

Scott Gregory Heleniak
RBC Capital Markets, Research Division

Congratulations to John and congratulations to Greg. Very, very exciting. Wanted to ask about the first, I wanted to ask where was just the E&S premiums they down a little bit. They have been growing at a nice clip for quite a while now and the margins have really turned around and improved there. So I know you mentioned for Q4 the discontinuing of program but wondering if you could talk a little bit more about kind of what you're seeing there, in terms of rates and terms and conditions? Obviously, the commentary hear from other people in E&S is constructive. So just wondering, kind of what your, what you guys are seeing across your book of business there?

John Joseph Marchioni
President, COO & Director

Yes. Scott, I appreciate the question. This is John. I'll start and then anybody else to follow on. We continue to see pressure. When you look at the year-over-year comparisons, as I mentioned previously, relative to the on-boarding of a significantly large relationship in the Q3 of last year, which impacts the year-over-year comparisons in this quarter and then, I mentioned also that we expect a little bit of pressure in the Q4 because of exiting -- a small but volatile book of business around snow removal. I would say what you hear in the broad market relative to E&S pricing movement, you really have to break it down into different segments and again recognize that which way is in the small-end of the market. Our average premium size is about $3,000 are predominant business is considered small binding authority business in your general run of the mill segments. I think where the pricing has really moved and moved somewhat aggressively in E&S is going to be on the higher hazard business, larger accounts, and property in particular, we're not a significant property player. It's about 25% of our book. But it's not a coastal and wind-exposed property book and that's what I would say is more of a driver that you are hearing about in the marketplace. I would say our -- the business that we write, you probably think about from a pricing trend perspective, more of what we see in our standard market, in the small and middle-market space in terms of how prices moving for GL in particular.

Gregory Edward Murphy
Chairman & CEO

And Scott, here Greg, I just think that, again, this gets into the different profile business, when we sure it's good for everybody. We write a mostly contract binding authority business. John mentioned it's smaller, it's smaller Style accounts. We're not big coastal writer on property and where we are seeing some rate movement is in the habitation risk, particularly in the high levels and the hotel area. We see a lot of that business. Exiting the primary market, coming back to us and we're writing that at fairly healthy levels.

We've also seen a lot of improvement in our pricing, particularly in the contracting segmentation and I think with all the changes that that team is made on under Johns' direction, we feel good about where we are price wise and now want to see it a little bit more into a growth mode. But as we've always said to you we want to start with, where are the right levels is for pricing and we'll always the topline grow or shrink based on how the market is accepting that.

We actually see a little bit more business flowing into us. We've opened up some new relationships as well that we feel very good about, and would like to see the core contracting business start to pick up as we move into next year. But as John mentioned, we want to clearly foreshadow that snow book coming off in the fourth quarter.

Scott Gregory Heleniak
RBC Capital Markets, Research Division

All right. Okay, that's fair and definitely makes sense, sounds like it's more of a mix issue compared to what everyone else is seeing and talking about. I wanted to ask you about, most of your calls you guys thought you had bucket out your risks into highest rated versus the lowest-rated and it's -- it was 49%. I think it's been that level kind of the high -- the highest performance for a while now versus 11% lowest performing. Do you expect that to change as the market firms and loss trends changes in terms of where the rate disparity is between the lowest performing versus the highest performing, I think it's about 8% versus 2%. Do you expect that to widen and the definition of change of what's highest versus the lowest?

John Joseph Marchioni
President, COO & Director

Yes, this is John. That's a segmentation that happens on a regular basis and over time, you're essentially fitting your entire book of business into those buckets. So when you would expect to see is the combined ratio differential between your best and worst will start to tighten over time. Because you're managing, your pricing fairly aggressively on that worst 10% and you're getting a little bit less pricing on the best 50%. So when you think about that pricing curve, you anticipated flattening over time, but there is also a bit of a force distribution there. So there is always going to be a worst 10% that we're going to be targeting and targeting aggressively, but over time, and this does happen over time, you will see that combined ratio curve flattened out a little bit and then ideally your pricing will follow with that.

Gregory Edward Murphy
Chairman & CEO

And again, this is just -- this is a byproduct of the fact that we compete in the market that has a whole consortium of different players with different levels of sophistication and this is where, if everything was price to the perfect information curve, all the combined ratios of that segmentation would be the exact same, that they're not because of the miss and because of the lack of knowledge out in the marketplace and what you need to compete with. And as John mentioned, somehow we want to make sure that we're writing the right account for the right agent, and we're balancing our book overall but yet this is a -- an ongoing issue that your question to be answered would be, we would need a really hard, hard market to fix that slope of that curve significantly. I would say we take efforts, our best efforts, every year to improve that and try to reduce the slope of the line. But that would need a hard like back in a --when I first started in the '80s in this business, we would need like an '80s style hard market to really fix a lot of that in the marketplace but we are working on it every year.

Scott Gregory Heleniak
RBC Capital Markets, Research Division

Yes, got it. And just the last one is on the investment side, some of the, it look like there is some repositioning going on in the fixed income side, a $1 billion shift or so into 1-year to 5-year securities fixed income maturities from the 5 years to 10 years, was that the floating rate securities that you're referencing before? Is that most of the shift out of that or is there something else going on?

Mark Alexander Wilcox
Executive VP & CFO

This is Mark here. Thanks for the question, Scott, I'd say when you think about the investment portfolio, it remained very consistent from Q2 to Q3. The biggest repositioning we did was really on the rest of the asset side, where we felt public equities where we're getting into a very healthy valuation. So we really dialed back the public equity allocation and so you saw, as I mentioned, the risk asset allocation went down to one of the lowest levels we've had in some time, just below 7% or 6.9% compared to closer to 8% where we've been the floating rate securities bucket has been that one year or less for the most part of one year less category, but no real intentional shift between the 1-year to 5-year or the 5-year to 10-year category that was just normal transfer of, between no major changes as it relates to the maturities out there.

John Joseph Marchioni
President, COO & Director

Another way to think about it is if you look at the duration, the duration is down a little bit in the 3.3 years. That's probably the lowest duration with patent quite some time. And the other statistic we look at to think about the maturity of the book is really outweighed average life and that was pretty consistent for the quarter, at just on the 5 years.

Operator

Our next question will be coming in from the line of Jamie Inglis of Philo Smith & Company.

Jamie Inglis;Philo Smith & Co.;Managing Director and Partner

Greg, I want to say appreciate your great work building this company over this time, really do. And John, I look forward to your success, really do.

John Joseph Marchioni
President, COO & Director

Thank you.

Jamie Inglis;Philo Smith & Co.;Managing Director and Partner

I've got a question about the -- 2 questions. One about the E&S segment, if you think about it -- so I'll ask me going on in this business for you guys. But do you think is sort of same-store or same distribution or same territory sort of segmentation, if you can. Is this business going where you want it to be. I mean you're getting the rates that you want to be and you're growing as fast as you'd like to be growing.

John Joseph Marchioni
President, COO & Director

Yes, this is John. I think it's a great question. I would say the answer is yes. On an overall basis, our core business is that core binding authority, small binding authority business, predominantly contractors, habitation all other [indiscernible] service business and if you strip out all of the sub-segmentation noise in the quarter. We got a little bit of growth relative to our core binding authority business. As we cited last year as part of our profitability improvement initiatives, we had a couple of small-- more volatile, small premium more volatile segments, like snow removal and like liquor liability that was attached to restaurants, bars, and taverns that we've exited over the course of this year and we'll continue to exit into the fourth quarter. So that is causing some of the noise in terms of the topline. What do we think is generally or has definitely contributed so the bottom line improvement. So there has been some repositioning of the portfolio, but within that repositioning, the focus on the core binding authority space continues to be where our focus is. And we think we're well positioned to grow on that front.

Gregory Edward Murphy
Chairman & CEO

And this is Greg. Yes, and obviously the brokerage side, which I want to make sure, when we say the brokerage side, we're not talking large brokerage accounts. These are accounts that we generally rise in the market, day in and day out. It's just that they don't meet our standards from a primary standpoint, but yes, they do from an E&S standpoint. And I think -- this is a track that we could run a lot faster on as a growth opportunity in addition to the CBA business that John referred to earlier. So we'd like to see, and we're getting more aggressive in some staff, and we've got some nice system improvements coming online, that is going to improve our capability moving forward, and so we feel that there is where I think we've got an opportunity to capture -- the average contract binding authority account is like $3,000 and so --. And the other part of it's amazing, the amount of price sensitivity there is then a $3,000 account but that -- in some cases, there is. So we feel on the brokerage side, the average account is much higher than that, it's a multiple of that. And we've got an opportunity to expand that business.

Jamie Inglis;Philo Smith & Co.;Managing Director and Partner

Okay, great. And then to shift over. If you think about your new stage, new territories, is this a good time to be growing those given sort of the general market seems to be tightening and it's different lines have been place. But as a general rule, the market appears to be tightening. Is this a good time to be growing in this -- in those new areas? Is there potential for adverse selection against you guys in this market? What are your thoughts about timing in this expansion?

Gregory Edward Murphy
Chairman & CEO

So I would say that we didn't really think about market timing in terms of the pricing environment. We made a decision to open up these new markets, which started over about 4 years ago, when you think about the initial launch of that effort. And part of it is because we think we've built an underwriting operation that will perform throughout market cycles. And if you look over the last 10 years in terms of our ability to generate margin improvement and consistent profitability and manage pricing, we've demonstrated an ability to manage profitability throughout the pricing cycles. So I think that's a consideration one, we enter those states with the same underwriting tools that we've had in existence for our entire portfolio. We talk a lot about the renewal inventory management but those same pricing and risk selection tools are used on a real-time basis by our new business underwriters. So we knew going into these markets that we had those tools available which was going to prevent us from being in an any potential adverse selection situation, so that's point number one. Point number two is we went ahead with the same field underwriting philosophy, the same underwriting appetite, and the same agency management philosophy, so we spent about a year prospecting agents and to put it in perspective, our average agency count by state is in the low teens, we opened up Arizona with about 15 and the other states with about 10 agency partnerships, which was a fairly diligence selection process. So I would say the flow of new business, which has been strong and within our underwriting appetite is coming from agents that knew us in many cases they had regional or national relationships with us and understood what our appetite was coming in. So I think we feel really good about the disciplined, approach that we use to answer those states, and while the market shifts, I think broadly across our existing footprint and our new states will provide more opportunity for us as pricing starts to move. We don't necessarily think differently about the new states versus our legacy states.

John Joseph Marchioni
President, COO & Director

And Jamie, I would just add to that. The part of the strategy is obviously doing a greenfield versus an acquisition for us, Greenfield was the right way to go because of everything John mentioned people, agency, technology, and culture that we wanted to establish all foods that. Well, you pick up the geo-diversification, which I think is a critical part for us to help balance some of our East Coast exposure. So again, you are in some cases trading different types of exposures in terms of catastrophic activity, but it does better level load that and less than some of our catastrophe reinsurance costs Countrywide, but also then it starts as John mentioned, opens up opportunity as we expand to get bigger, we would expect that our share of wallet expectations will go higher because there are a number of accounts that our agents write, that have properties outside of our footprint, that now we will have access to write, because our ultimate goal is 50 state capable, that's is going to take a while, but we're not going to be the full boots on the ground in every state. But we will, we do want to ultimate will become more capable throughout the country to write accounts.

Operator

Our next question will be coming in from the line of Chris Campbell of KBW.

Christopher Campbell
Keefe, Bruyette, & Woods, Inc., Research Division

I guess my first question is on workers' comp. And I apologize I joined the call late in case this was already covered. But the loss ratio was up about 800 bips year-over-year. But then you still had reserve releases. I guess just where are you guys booking your core loss ratios is in that line versus where you were at a year ago?

Mark Alexander Wilcox
Executive VP & CFO

I mean we're -- right now we have a very healthy process and when we establish and how we record our expectation for 2019, in terms of free expectations around frequency severity and the reserve release of you're asking what accident years it came from, it was prior to accidents -- it's 2017 and prior in terms of where it -- where that came from. It's principally severity focused and more so on the medical side than on the indemnity side.

John Joseph Marchioni
President, COO & Director

And just to add to that, Chris, just from a reserve development perspective this year in this -- in Q3 if you're referring to the quarter-over-quarter change versus the year-over-year change, although they are -- the percentages are pretty similar, we had $13 million of favorable development go through that line item. So that was a 17.2% benefit on the workers' comp line. A year ago we had $20 million of favorable development. So it's 45.4 percentage point benefit. That's really, I think the difference you're referring to. So a year ago, we had a little bit more favorable claims emergence in the quarter. And then we reflected in Q3 of 2019.

Mark Alexander Wilcox
Executive VP & CFO

But the accident years are pretty similar, when you look at the '19 accident year versus the '18 accident year, maybe a slight improvement, but not much though.

Christopher Campbell
Keefe, Bruyette, & Woods, Inc., Research Division

Okay, got it. That makes sense because I think the favorable development explains most of it. Okay and then just a question on commercial auto like the big drop in the loss ratio there. What's the dynamic happening there because I would expect that to be a little bit higher given all like to high severity trends, but just trying to understand that a little bit more of the crosswalk between the 2 year-over-year loss ratio in commercial auto?

Mark Alexander Wilcox
Executive VP & CFO

Let me get started and Greg and John can jump in as well. But suffice to say commercial auto is not meeting expectations coming into a 108 combined for the quarter is not where we want to be from a target combined ratio perspective.

The good news, though, is that we are having a little bit more stability in the claims trends when you think about frequency and severity in commercial auto. So last year we saw some pretty significant pressure on both the prior accident years as well as the current accident year in the commercial auto line of business and in Q3 2018, we booked $10 million of adverse development, which was about 8 points on the loss ratio for commercial auto. We were $25 million year-to-date through 9.30 which was about 6.8 points on the loss ratio.

The other piece to the puzzle there is last year, we're also starting to feel, particularly when we went into the third quarter, an elevated level of claim counts to put pressure on frequency and we increase the current accident year, pretty significantly, that was $16 million year-to-date through 9.30 but most of that happened in the third quarter of 2018. So we had a $13 million increase in the current accident year about 7 points on the loss ratio in Q3, so those are the moving parts. It's still not where we want to be, but I think have settled down and in commercial auto. John talked about the rate increases year-to-date is that -- got some 0.4 percentage points. So things are starting to stabilize and hopefully we'll start to see to margin improvement and that line of business going into 2020.

John Joseph Marchioni
President, COO & Director

So Chris, I think the easiest way to look at this and to take all the noise out is just look at our underlying combined ratio. And if you looked at -- your question was what are you seeing, but let's focus on the underlying for a second. So our underlying combined ratio for the 9 months of '18 is what's called above 550 for the 9 months of '19, it's about 650. So we're up 100 basis points. So to answer your question, we're seeing an increase in the underlying combined ratio of 100 basis points, in spite of increasing rate 7.5% this year, 7.5% last year. And I think what you -- so you are seeing an element of year-on-year, a modest increase in that. I would just call that mostly noise and some of that is the fact that this line of business has the highest loss trend in than any other of our lines of business and that was true in the expectation, in the 2019 year as well as that we'll carry somewhat into 2020 as we sweat through all of those projections as we move forward, but we are starting to see a little bit of the apex of what we view as claim frequency relative to either -- if you want to look at relative to power units or look at it relative to on-level premium. We are starting to see that level out and kind of flatten out and not continue the upward trend that we saw up to 2018, call it.

Christopher Campbell
Keefe, Bruyette, & Woods, Inc., Research Division

Okay. And then you're saying, 0.4% rate increases in commercial auto, so can we assume and you're expecting margin expansion. So are you guys assuming like 6% or less loss cost inflation going forward?

Gregory Edward Murphy
Chairman & CEO

We're not going to get into the specificity by line. I'd like to keep our loss trend overall because it does bounce around line by line, but I would say that when you think about the lines that will be weighted higher, it would be the half. So the margin improvement will come from our rate level relative to our expected loss trend. And we expect that to have an improvement as well as all the things we're doing from an underwriting standpoint, you would, John answered earlier, John a question about, above-average low medium long, that's why we're doing a lot of our heavy lifting to improve profitability and some of that comes squarely into the commercial auto segmentation.

Christopher Campbell
Keefe, Bruyette, & Woods, Inc., Research Division

And then just one last one on the net investment income. How should we be thinking about modeling that going into 2020? Given the recent interest rate declines?

Mark Alexander Wilcox
Executive VP & CFO

Yes, good question, Chris.

Gregory Edward Murphy
Chairman & CEO

Wait 1 quarter, Chris, you'll have it. I will make your life easier. How about this? One more quarter, you will actually have the number.

Mark Alexander Wilcox
Executive VP & CFO

The countdown is on. In 90 days' time, we'll give you the -- our best estimate for 2020. This year, we're expecting outgrowth in net investment income after-tax a $180 million despite the much lower interest rate environment where we are today versus where we started the year, where we're able to maintain the guidance and in fact to increase it by $5 million earlier in the year given the strong performance in the alternative portfolio. I'd say going into 2020, clearly there's going to be some pressure on the book yield in our core fixed income portfolio, offsetting that is going to be continued strong cash flow. Greg referenced the 22% cash flow from operations as a percentage of NPW in the quarter and 15% year-to-date. Our investment portfolio has experienced about 10% growth in invested assets thus far in 2019. So I think we could -- we're not going to -- we're not ready quite yet so to put out the number for 2020. But we feel pretty good overall about generating good continued strong net investment income for the portfolio going into 2020 despite the low interest rate environment. One thing, just to state the obvious, I sort of alluded to it earlier. Given the lower interest and rate environment strategy around managing the investment portfolio, we'll remain the same, which will be to stay up in quality at this point, say on the low end of duration from an interest rate perspective and with risk assets being a fairly frothy valuation. If you look at high-yield credit spreads or public equity valuations will probably continue to remain underway from a risk asset perspective. So staying in the course and being -- maintaining that conservative investment philosophy going into next year, we're not going to stretch of reach of the yield at this point.

Operator

[Operator Instructions] Our next question will be coming in from the line of Tom Shimp of Sandler O'Neill.

Thomas Henry Shimp
Sandler O'Neill + Partners, L.P., Research Division

Just a quick question, can you walk through the drivers of the reserve increase in the personal auto line?

Gregory Edward Murphy
Chairman & CEO

Like we said here, it's not a big increase overall. It's just a minor movement. I think from an actuarial standpoint, it just reflects where we are and a little bit of a upward movement, but a $2 million in a reserve inventory like that, it's hard to sit there and talk about that with great specificity. It's general -- I would characterize to be frankly, it sounds as a general noise and on the quarter-to-quarter basis.

Thomas Henry Shimp
Sandler O'Neill + Partners, L.P., Research Division

Okay. And then just one more question, you had a large insurer last week talking about the worsening tort environment. I was wondering if you guys could add any commentary regarding that.

John Joseph Marchioni
President, COO & Director

Yes, Tom, this is John. And I guess I would also call back to the prepared commentary that we have, which is our disciplined process around planning and reserving and how we look at frequency as in varying trends and changes in frequency and severity trends, has as well positioned to see any changes in the environment and from a pricing perspective react quickly to them, our disciplined history around pricing relative to a consistent loss trend, future loss trends expectations over the last 10 years has us feeling good about our current position. We haven't really seen in our own portfolio, any significant change from a severity perspective that has us alarmed, but we're also mindful of the commentary in the industry. I will also say and we've talked about a couple of different topics on this front. But it's -- and not that lower limit business is completely immune from a changing tort environment. I think some of that, it will certainly be in the mega awards focused on the bigger insurers. But there will be some potential bleed over into smaller accounts. And just to remind you, our casualty book of business is about 87% limits of $1 million and under. And then another 7% or so of limits between $1 million to $2 million, so about 95% of our business has limits of $2 million and less. And then we have our casualty excess of loss treaty that kicks in at $2 million. So you also want to keep in mind the limits profile and the hazard profile, which is also more heavily tilted towards low and medium hazard classifications on the casualty side.

Gregory Edward Murphy
Chairman & CEO

And I think the other thing you can look at, to kind of to still all that from what's really happening in the marketplace. As you look at some of these carriers and you look at the rhetoric relative to trend, but then look at where their price increases are by segment and then that really tells you something because when you look at it that way, you'll see that there is much higher price movement on the larger end of their account structure but yet when you go into some of their smaller end segments, there is still balancing in the 1%, 2% range, which then stacks up to our 320, 330, 350 and that because -- and that's -- so that kind of does -- it ties together with generally the type of business that we write and also when you start to disaggregate their performance and what they're doing rate wise, it allows you to get a little bit of a lens into what they're trying to fix and it seems like the fix is more on where a lot of attorneys are going reptile on different insureds but that has a tendency to be larger style insureds more not trophy, but I would say higher exposure type accounts, where you're starting to see that. And as John mentioned, you got to expect a little bit of that to come down into our -- throughout the entire portfolio, but we're well prepared for that and well schooled for it.

Operator

At this time speakers, we do not have questions on queue. Please proceed.

Gregory Edward Murphy
Chairman & CEO

Well, thank you very much for participating in today's call. If you have any follow-up, Mark and Rohan are clearly available for any additional questions that you have. And I must say these were great questions today. So we truly appreciate it. Thank you.

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