S&P Global
Market Intelligence

Selective Insurance Group, Inc. NasdaqGS:SIGI

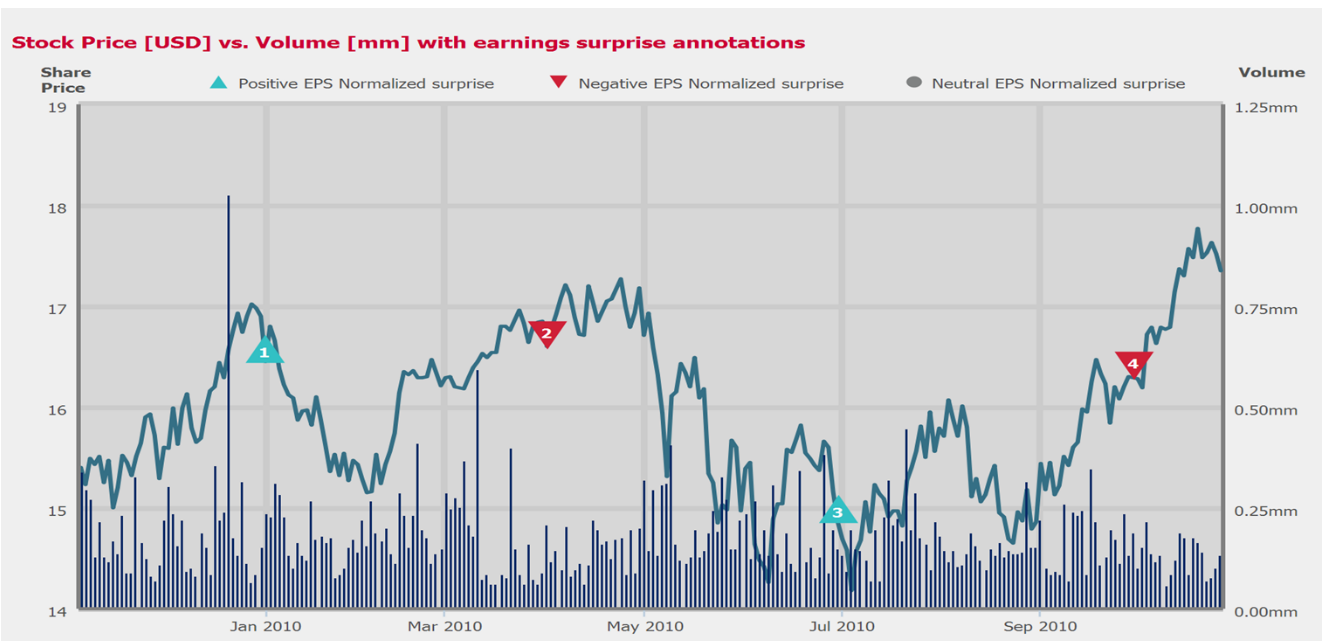
FQ4 2010 Earnings Call Transcripts

Thursday, February 03, 2011 1:30 PM GMT

S&P Global Market Intelligence Estimates

	-FQ4 2010-			-FQ1 2011-	-FY 2010-		
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	ACTUAL	
EPS Normalized	0.38	0.48	▲26.32	0.34	1.25	1.35	
Revenue (mm)	384.96	394.09	▲2.37	385.07	1555.37	1564.62	

Currency: USD
Consensus as of Feb-03-2011 6:06 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ4 2009	0.37	0.47	▲1 27.03 %
FQ1 2010	0.20	0.12	▼2 (40.00 %)
FQ2 2010	0.38	0.41	▲3 7.89 %
FQ3 2010	0.38	0.35	▼4 (7.89 %)

Table of Contents

Call Participants

EXECUTIVES

Dale Allen Thatcher
Former Executive VP, Treasurer & CFO

Greg Murphy

Gregory Edward Murphy
Chairman & CEO

Jennifer DiBerardino

John Joseph Marchioni
President & COO

Ron Zaleski

ANALYSTS

Alison Jacobowitz
Bank of America Merrill Lynch

Bob Farnam
KBW

Caroline Steers
Macquarie

Doug Mewhirter
RBC Capital Markets

John Grimstad
Piper Jaffray

Robert Paun
Sidoti & Company

Presentation

Operator

Good day, everyone and welcome to the Selective Insurance Group's Fourth Quarter Year End 2010 Earnings Release Conference Call. At this time, for opening remarks and introduction, I'd like to turn the call over to Senior Vice President, Investor Relations and Treasurer, Ms. Jennifer DiBerardino.

Jennifer DiBerardino

Good morning, thank you. Welcome to Selective Insurance Group's Fourth Quarter 2010 Conference Call. This call is being simulcast on our website and a replay will be available through March 4th, 2011. A supplemental investor package, which includes GAAP reconciliations of non-GAAP financial measures referred to on this call, is available on the Investor's page of our website at www.selective.com.

Selective uses operating income, a non-GAAP measure, to analyze trends and operations. Operating income is net income excluding the after-tax impact of net realized investment gains or losses, 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 Reports 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 statements.

Joining me today on the call are the following members of Selective's Executive Management. Greg Murphy, CEO, Dale Thatcher, CFO, John Marchioni, EVP of Insurance Operations, and Ron Zaleski, Chief Actuary.

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

Dale Allen Thatcher
Former Executive VP, Treasurer & CFO

Thanks, Jen, good morning. Our results for the fourth quarter and 2010 were on target with our overall expectations. There were number of moving parts during the year, but overall we are pleased with how well we held our ground.

Soft market conditions persisted in the commercial lines space and catastrophe losses were higher than average while we continued to push positive rate in both and personal and commercial lines.

We experienced our most significant catastrophe year through a series of microcaps and over $56 million in pretax losses or four points on the combined ratio more than twice what we normally budget. In spite of the difficult industry environment, we successfully achieved our seventh consecutive quarter of Commercial Lines price increases.

For the quarter, we reported operating income per diluted share of $0.48 as compared to $0.47 a year ago. Higher net investment income and favorable prior year reserve development due to ongoing net positive claims trends drove our results.

The fourth quarter statutory combined ratio was 102.8%, an improvement of almost a point from a year ago. Catastrophe losses in the quarter were a more normal 1.2 points offset by prior year favorable casualty reserve development of $7 million pretax or 1.8 points.

Total statutory net premiums written were down 1% in the fourth quarter and 2% for the full year. Due to normal seasonality, our fourth quarter premium is lower than the other quarters putting pressure on the statutory expense ratio.

Multiple years of declining premium has impacted industry expense ratios across the board. However, we've been diligent in our efforts to remain expense conscious. Despite of 2% decline in 2010 premium, our expense ratio has remained relatively constant from a year ago. For the year both the statutory and GAAP combined ratio coming in at 101.6% in line with our guidance of 101.5%.

Commercial Lines growth continues to be a challenge given economic and competitive conditions. Commercial Lines statutory net premium written declined 4% in the quarter, largely driven by audit and endorsement return premium and a decline in new business as we continue to maintain underwriting discipline.

The $5.5 million in return audit and endorsement premium in the quarter was a significant improvement from the over $10.8 million we saw in the third quarter. For the full year, we experienced approximately $48 million in return premium versus $62 million in 2009.

You'll note that the historical numbers are revised as a result of a refinement to our definition of audit premium. For the fourth quarter and going forward, workers' comp policies that are cancelled mid-term are now included in cancellations not in audit premium.

Commercial Lines new business declined 29% in the quarter. This decline illustrates the challenge for middle-market and large accounts. We continue to grow small business, which makes up a much larger percentage of our book on a policy count basis versus the middle and large account business.

Commercial Lines renewal pure price was up 2.8% in the fourth quarter and up 3.1% for 2010. Point of renewal policy retention held firm at 87% for the quarter and year as we continue to push for positive pure price. Retention is strongest for small business while middle-market and large accounts are seeing the most pressure.

We reported a Commercial Lines statutory combined ratio of 101.9% in the fourth quarter and 100.8% for the year. Catastrophe losses contributed 3.3 points to the combined ratio in 2010. Commercial Property performed very well throughout the year with a 93.7% statutory combined ratio including 16 points of cat losses.

Commercial Auto also had a good year reporting a statutory combined ratio of 90.2%. Commercial Auto results were positively impacted by favorable prior-year development of 9.6 points of lower than anticipated severity, primarily in the 2004 through 2009 accident years.

Similar to the rest of the industry, workers' compensation results continued to show the negative impact of a soft economy. The fourth quarter statutory combined ratio for this line of business was 123.8%. This includes about 6 points of adverse prior year reserve development related to severity in the 2008 and 2009 accident years. And although, workers' comp net premium written was up slightly in the quarter, it was entirely due to less audit return premium.

Personal Lines net premium written grew 13% in the quarter to $64 million and the statutory combined ratio was 108.1%, which included 2.3 points of cat losses. The quarter results also included three large home owners property claims totally approximately $4 million and adding 7 points to the Personal Lines combined ratio in the fourth quarter. While we continue to grow personal lines given the current relative size of the book, large losses create volatility from quarter-to-quarter.

Turning to the reinsurance renewals, we successfully renewed the property catastrophe program in January. The program structure changed to $360 million in excess of $40 million, compared to the $310 million in excess of $40 million we have in place in 2009.

The diversification of the program remain strong and it's comprised of a group of financially solid reinsurers with an average A rating from AM Best.

Fourth quarter and after tax net investment income increased 2% to a $31 million from a year ago. Alternative investment income of $6 million after tax drove the increase, partially offset by declining fixed income yields. The after tax yield on fixed maturities was 2.8% flat with the third quarter but down about 50 basis points from 2009.

Investment assets increased 4% from a year ago to $4 billion. Our overall fixed income portfolio maintains a very high credit quality of double AA and duration of 3.5 years including short-term investments and 3.7 years excluding short-term.

We continue to increase our investment in corporate bonds while reducing our exposure to municipal securities. Equity exposure was 1.8% of invested assets up slightly from last year and down from 2.1% in December of 2009.

In the fourth quarter, we had an opportunity to reduce our exposure to alternative investments and sold five funds for a net realized loss of $3.4 million after tax. By reducing this exposure, we were able to lower our outstanding commitments by $22 million to $64 million and carry back an $18 million tax loss to take advantage of expiring capital gains offsets.

While we are still committed to maintaining a private equity strategy in our portfolio, the reduction allows us to reallocate risk in the equity and equity like investment assets to achieve better risk adjustment returns.

There has been considerable press lately about stress on state and local governments from declining revenues, large unfunded liabilities and entrenched cost structures. This has spurred speculation about potential fallout on the municipal bond market. With our investment outsourcing arrangement we have broad access to municipal bond experts who are constantly monitoring the portfolio in light of the changing landscape for municipalities.

Our $1.4 billion municipal bond portfolio is very high quality with an average double AA rating. 33% of the portfolio matures within three years with another 32% maturing between three and five years. The portfolio has a 63% rating to high quality revenue bonds and an additional 9% to state general obligation bonds.

At 13%, our largest state exposure is the Texas. However the local Texas general obligation bond that tend to be at a higher risk represent only $53 million or 3.7% of the $1.4 billion portfolio, well diversified and closely monitored by our outside investment managers.

The reminder of our Texas exposure is the highly rated revenue bonds, Texas permanent school fund bonds and pre-refunded bonds that all have dedicated revenue streams. Our exposure to New York, California, New Jersey, and Illinois represents only $34 million or 2.3% of the portfolio.

Overall, we are comfortable with the quality, composition, and diversification of our mini-exposure and continue to monitor the environment. Compared to a year ago, the unrealized gain position improved to $83 million pretax at December 31st 2010 from $45 million December 31st 2009. Also noteworthy is the quarter end unrecognized gain position in the fixed income held-to-maturity portfolio of $42 million pretax or $0.51 per share after tax.

Other than temporary impairments or OTTI in the quarter were minimal at $278,000 after tax versus $7.5 million in the fourth quarter of 2009. Surplus remained strong at the $1.1 billion at December 31st and stockholders' equity increased 7% to $1.1 billion from year-end 2009. Our book value per share, which includes minimal intangibles increased to $19.95 from $18.83 at year-end 2009.

Our capital position as measured by the premium-to-surplus ratio improved to 1.3 to 1, down from 1.5 to 1 a year ago. The dividend yield is currently 2.9% providing a competitive return while the stock trades at 90% of book value. We continue to monitor our capital levels and review options to maximize shareholder returns.

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

John Joseph Marchioni

President & COO

Thanks, Dale, good morning. Our agents and employees held their ground to another challenging year in the commercial lines market. I'm proud of the discipline our underwriters continue to exercise. We achieved our seventh consecutive quarter of positive Commercial Lines renewal price, a substantial achievement considering the market we continue to face.

Our 980 agents play an integral part in achieving that success and we continue to value our strong relationship with them. We closely monitor retention as we execute our pricing strategy.

On a point-of-renewal basis, Commercial Lines policy retention for the quarter was 87%, relatively flat with 2009. Full year policy retention was also 87%. Pressure on retention levels remains greatest on the large accounts as competitors are still most aggressive for this business. We remain focused on the long-term profitability of our commercial lines book of business.

By using our underwriting tools and leveraging a relationship between our agents and underwriters both inside and in the field, we've improved our overall mix of business. The policy retention at the point of renewal is strongest on our highest quality accounts.

In 2010, this business comprising about 58% of our model book retained at two points better than average as we achieved renewal price increases of 1.7%. Our worst performing business comprising about 15% of our book, showed retention levels seven points below the average as we achieved 9% renewal price increase.

These statistics demonstrate the success of our strategy to get rate on a granular basis when market conditions do not permit more broad-based renewal price increases. If companies don't have the capability to target rate through this level of detailed segmentation, we believe they will find it difficult to achieve renewal price increases when the market starts to firm.

We're writing the majority of our new model business in the highest quality 4 and 5 Diamond range only work to achieve profitability in our worst performing business through discipline underwriting and more aggressive pricing.

Our agency partners are supporting these efforts as submission activity from our agents remained strong, although pressure remains on hit ratios. As a result of the pressure on hit ratios, Commercial Lines new business was down 21% for the year compared to 2009.

By segment, one-and-done automated small business was flat at $74 million. Middle-market or AMS generated business was down 26% to $125 million. Selective risk managers, our large account business was down 50% to $12 million.

We've made progress in diversifying our Commercial Lines book of business. In 2010, non-contractor new business comprised 68% of Commercial Lines new business four points better than a year ago.

The line of business showing the greatest strain is workers' compensation. While frequencies have declined 26.9% over the three years, since we deployed predictive modeling, medical and indemnity severity is up substantially, driven by medical costs inflation, and the soft economy.

This is an industry wide issue. We are addressing the situation by increasing rates where we can and by diversifying our Commercial Lines book away from contractors, the segment most impacted by economic conditions. On the claim side, we have a number of initiatives underway to improve case management, better assign claims in a more specialized model, and increase penetration with our provider networks.

The Personal Lines book is growing, much of the growth reflects rate increases we've been able to achieve a new business as we diversify the book outside of New Jersey. New business increased 12% in 2010, as policy counts outside New Jersey were up 15%. Unlike, Commercial Lines, the Personal Lines markets has been more receptive to price increases as we achieved pure renewal rate increases of 6.4% in the fourth quarter and 5.4% for the year.

For the full year, our pure rate [ph] on automobile was 6.1% while homeowner's was 4.9%. We implemented rate increases in 2010 that will generate $14.8 million in additional premium on our in force book and we expect to implement another 39 rate increases in 2011 that will generate $50 million on our in force book.

Not only have we had success increasing price, but retention remains strong. The quality of our Personal Lines book continues to improve. The mix of business is changing as we write a greater distribution of low frequency high retention business. The overall insurance score is also improving.

We did not achieve our Personal Lines goals of a sub 100 combined ratio run rate in the latter half of 2010. Results were negatively impacted by elevated catastrophe losses, large buyer losses in the fourth quarter, and the cost of new business.

Personal auto profitability is directly related to the age of a book of business. The immaturity of our book will produce results that are below industry performance, but we expect that as our book ages this penalty will drip downward.

We fully expect to be profitable in Personal Lines for the full year 2011 despite this new business penalty. Personal Lines is an important component of Selective's business model as it has historically help smooth industry cycles and reduce earnings volatility.

It is also important to our agents that we offer Personal Lines products as the majority of independent agents write both Commercial and Personal Lines. Earning and rate increases and maturing the book will allow for more consistent profitability over the long haul.

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

Gregory Edward Murphy
Chairman & CEO

Thank you, John and good morning. Reflecting on 2010, I'm pleased with the progress Selective has made on a number of fronts that have set the stage for us to outperform our Commercial Lines competitors. We are at the trove [ph] of a multiyear highly competitive Commercial Line cycle coupled with a still struggling economy.

We met our expectations in 2010 despite a significant and unusual number of microcaps and higher than expected Commercial Lines audit and endorsement return premiums. Back in 2009, we took a leadership position in to drive Commercial Line's renewal price rate increases and ended 2010 with our seventh consecutive quarter of positive rate.

Our inside underwriters and agents fought an uphill battle to achieve the pricing success while artfully balancing retention. It's not an easy accomplishment in a continued undisciplined market place.

We made significant investments in our insurance operations for long term efficiency and profitability. We completed and implemented the second generation of predictive models after bringing them in-house. The use of models is one of many underwriting tools that allow us to improve our underwriting quality.

Over the past two years, we continue to increase our underwriting appetite as well as added 11 new Commercial Lines products to provide greater opportunity for our agency force to place more business with Selective.

In addition, we expanded our one-and-done pipeline to drive more small business through the seamless underwriting system, an area where we experienced ongoing new business growth.

In our Personal Lines operation, we achieved significant rate success in 2010 and will continue to drive rate into 2011, particularly in the homeowners' line. As John stated we're on track to achieve overall profitability in Personal Lines in 2011.

In 2010, we embarked on initiatives in our claim organization which are expected to reduce claim cost by three points over the next three year period that include litigation management through more effective use of staff and panel counsel, ongoing vendor management to ensure we have the highest quality vendors at the best price that add expertise to our underwriting adjustment - our claim adjustment process, and more effective integrated outcomes in the resolution of claims in workers compensation and other casualty lines of business.

In April, we announced the outsourcing of our investment portfolio to outside managers to take advantage of the broad sector and security expertise offered by dedicated investment managers. We completed several reviews of our portfolio that focus on the municipal sector.

We are able to take advantage of an opportunity in the alternative investment space to reduce our exposure and reallocate risk to achieve better long-term risk adjusted returns. The hard work of our employees and agents over the past several years will not go unrewarded. We expect to participate more fully in a market turn than those carriers without similar granular pricing and underwriting capabilities.

As we move through 2011, we will control the things within our power and continue to drive long-term profitability and growth. It's difficult to follow them and we are looking at another year where pricing discipline may still be elusive for the broad Commercial Lines industry.

Despite being subject to the same industry fundamentals, principally lower investment returns and rising loss costs, the talk at the top of most companies about the need for rate still isn't being deployed at the street level. In addition, the well of reserved releases will soon run dry making the need for increased pricing and underwriting discipline even more critical.

Our 2011 plan anticipates an ongoing difficult Commercial Lines marketplace without broad based price increases. We are able to incorporate into our plan three points of positive Commercial Lines price increase and five points of Personal Lines price increases that we achieved in 2010, as well as our expectations to drive positive rate in both segments in 2011.

Most of the premium increases will offset higher loss trends we have anticipated due to increasing medical and other claim costs. As a result, we provide the following 2011 guidance, a statutory and GAAP combined ratio of between a 101 and a 102, which includes an elevated catastrophe loss assumption of two points and no assumptions for reserved development favorable or unfavorable, and weighted average share outstanding of approximately $55 million.

We're not providing investment income projections but our investor packet includes an exhibit that shows investment income by component for the fourth quarter of full year 2010 with related yields and tax rates. We believe this information will allow you to create your own 2011 models using your own assumptions on interest rates and financial market movements.
Now I'll turn the call back to the operator for your questions.

Question and Answer

Operator

Thank you. (Operator Instructions) and one moment for the first question.

Gregory Edward Murphy
Chairman & CEO

Thank you operator.

Operator

Thank you. Our first question is from Doug Mewhirter with RBC Capital Markets. Your line is now open.

Gregory Edward Murphy
Chairman & CEO

Good morning Doug.

Doug Mewhirter
RBC Capital Markets

Good morning. Actually I have two questions. The first, I know that considering the winter storm activity up in the northeast in the fourth quarter, your catalogues have seen unusually low to be quite frank. Where there - or could you give me some close to quantifying what maybe the non cat winter related losses were from that those snow storms like either in the auto or the homeowners, there - aren't there even were any at all.

Gregory Edward Murphy
Chairman & CEO

Well, just going to frame it in terms of, when you look at snow falls like that you always have to look at the weight in the snow and you have to look at when it came and I think that this storm was a little bit different than some of the storms that maybe we had in the early part of 2009 and if you kind of reflect on the storms that we had in early 2009, they were like 25, 30 inches in places that normally don't get high snow falls i.e. Maryland, Virginia, and even further down south and that's where a lot of that claim activity came from fairly heavy weight of snow claims.

But when you look at this storm that happened recently, more of it was here in the north, the snow was lighter, it was coupled with higher winds, didn't create big snow loads on roofs and therefore did not create an unusual number of losses, although the snow is rather large it didn't create lot of losses for us. John, do you have anything else to add in terms of -

John Joseph Marchioni
President & COO

I think, as far as, fourth quarter of last year that it looks the storms came in late December, but we didn't see really any impact on (inaudible) losses and as far as the storms in the first quarter of this year, we haven't seen a significant increase so.

Doug Mewhirter
RBC Capital Markets

Okay, thanks, that's very helpful. My second and final question, I guess to Dale. So it sounds like you're pretty conscious on municipal bonds even though the spreads have widened considerably. I assume that you wouldn't see this as a buying opportunity, seeing that, you're still reducing your exposure of this asset class?

Dale Allen Thatcher

Former Executive VP, Treasurer & CFO

Well, I mean that's obviously the challenge, is that the there is a steeper muni yield curves that makes it somewhat tempting in that regard particularly in this lower yield environment, but the other thing we have to balance our muni purchases where it is not only a concern about the financial health of various municipalities, which obviously is definitely a concern but also with our AMP position.

And given the fact that our guidance indicates between a 101 and 102 combined ratio without those underwriting profits then you start breaking into the AMT area which removes some of the benefit of the municipals and the interest free loan to the Federal Government that you have to contemplate the overall returns that you're ultimately achieving. So the combination of that is what makes us less inclined to delve into the muni area in any big way.

Doug Mewhirter
RBC Capital Markets

Okay, great. That's helpful. That's all my questions.

Operator

Thank you. Your next question is from Bob Farnam with KBW. Your line is now open.

Gregory Edward Murphy
Chairman & CEO

Good morning Bob.

Bob Farnam
KBW

An overall question on the pricing model, I know you've talked several times about the Diamond pricing, the pricing for the different Diamonds. I'm wondering how you avoid adverse selection with those one Diamond account that you're jacking up the raise force, some are walking and some are taking the raise but I'm just wondering how you avoid adverse selection there?

John Joseph Marchioni
President & COO

This is John Marchioni, I'll answer that. A couple of things, I mean we do obviously look at retention very closely as well as the pure rate that we're earning on that business. But I think the most important thing to keep in mind there is the numbers we give you relative to rate in retention by those segments are at a line of business level and we continue to write an account level. So in many cases those lines will be associated on the same policy with other lines that score differently and in certain cases score better.

So, when you look at our retentions there, we manage it from that perspective, we certainly look at things on an account level, we have been getting a fair amount of price in our retention, in that segment rather the retention has been fairly low. And then the other thing we do is manage very closely our new business with the same measure.

So we understand where that business is coming in, the percentage of business we write those categories relative to our existing inventory is significantly lower and again generally the business we will see there is associated with higher quality of lines and because we built and deployed models of the line of business level, you need to manage it that way but also look at it in the context of the overall account.

Bob Farnam
KBW

All right, okay.

Greg Murphy

Bob I would add to that, I mean we have underwriting tools that allow us to flag a whole number of things. Diamond score is only one element and so we can look at the profitability of the agent, we can look at holistic areas where we have concerns from segmentation, from a corporate underwriting standpoint that might maybe drive down through a sector of a book.

So when we are looking at renewal inventory on a month-by-month basis our inside underwriters aren't just looking at diamond score, they are looking at a multitude of issues and through some of the tools that our folks have on their desktop, they are allowed to quickly sip through all of that and focus on the accounts that they need to really drive.

So we provide a lot of knowledge for them to know the accounts that they need to be driving a highest rate on. They are not just doing it across the board for that particular segment, so even within that segment they have certain things that they are trying to accomplish and which I think helps even more so avoid being left with the worse for the worst.

Bob Farnam
KBW

Very good, thanks for that.

Operator

Thank you, our next question is from Alison Jacobowitz with Bank of America Merrill Lynch. Your line is now open.

Greg Murphy

Good morning Alison.</TAG>

Alison Jacobowitz
Bank of America Merrill Lynch

Good morning, good, good, good. Just a number of clarifications. Can you, I just want to make sure I am getting it, did the net with prior year reserve change in the quarter?

Dale Allen Thatcher
Former Executive VP, Treasurer & CFO

It's $6.5 million, $7 million rounded.

Alison Jacobowitz
Bank of America Merrill Lynch

And that was favorable?

Greg Murphy

Favorable, correct, yes.

Alison Jacobowitz
Bank of America Merrill Lynch

And were there any current year interrupts in the quarter?

Dale Allen Thatcher
Former Executive VP, Treasurer & CFO

Not that were of any substance, not like what we had at the end of third quarter where we, in the third quarter we added to our comp line to bring to year-to-date up to a run rate, nothing unusual in the fourth quarter happened.

Alison Jacobowitz
Bank of America Merrill Lynch

Okay, great. Thank you.

Operator

Thank you, the next question is from John Grimstad with Piper Jaffray, your line is now open.

John Grimstad
Piper Jaffray

Hi, good morning.

Greg Murphy

Good morning.

John Grimstad
Piper Jaffray

Just a question, little follow up on the $7 million of favorable development, could break down the origination of that in terms of year in line?

Greg Murphy

Sure, point out there.

Dale Allen Thatcher
Former Executive VP, Treasurer & CFO

Sure it’s, so the, we’ve got $3.7 million of unfavorable development or adverse development in the workers comp. You’ve got $5.7 million of favorable development in general liability. You’ve got $1.1 million of favorable and commercial auto, $2.5 million in personal auto liability and a mixed bag beyond that.

John Grimstad
Piper Jaffray

Great and in terms of the years, the years that that would come from.

Dale Allen Thatcher
Former Executive VP, Treasurer & CFO

Basically it’s, you are seeing the ’08 and ’09 year develop a little bit on the unfavorable side and prior years are the ones that are developing favorably. So the ’07, ’06.

John Grimstad
Piper Jaffray

Great, great thank you and then, you talked a little bit about the immaturity of personal auto book and just was wondering if you could maybe give us a little bit more color in terms of simply when do you think it will become more mature?

Greg Murphy

Let me just kind of, I think it’s helpful if you kind of look at the personalized book under the following, on a year-to-date basis kind of framed it on a high level, I think this will give you a little bit more clarity. If you looked at the personalized book overall for the year it came in at 106.4. In the 106.4 there is about 7.5 points of catastrophe losses and just a small amount of development in there that was favorable about a point.

So when you look at that line ex-cat’s, it’s running at about a 100 and for us I would say a more normalized cat year because by all records this year past 2010 was clearly an extreme, extreme event. And we would probably normalize about 3 points of cat in the line, so we are kind of looking at a core book somewhat normal because we can’t sit here and play take out with cat. So we know normalized cat’s

3 points were running a 103 and then when we look at our book of our business, we are paying a new business penalty in our book that we feel adds approximately 8 points to the overall book.

And so when you look at - and that's on the auto side, on the home side it's a lot less than that, it's probably in the maybe say half of that on the home side. So when you look at what John talked about in terms of rolling that forward into 2011, there is a lot of rate, I mean we earned, we wrote, almost five points of positive rate in 2010, that's going to earn into '11, our loss trend in home is that, I mean in Personal Line activity little bit lower than it is in Commercial Lines and then we expect to drive a lot more rate in there.

So you are going to have just a lot of rate that will improve that book and then on a more gradual basis this penalty for new business growth will subside over time. So the 8 points will slowly diminish and that will take a number of years and a lot of that is really predicated on how much new business you continue to write relative to your total inventory.

But the new business penalty as the book matures will continue to lessen and then our pricing which is really the major factor when we look at the migration of the book in '11 over '10 is the fact that we are expecting a more normalized cat year earning in a lot more rate and then small amount of normalization on the new business loads.

John Grimstad
Piper Jaffray

That's very helpful, thank you.</TAG>

John Joseph Marchioni
President & COO

Let's put a little bit more clarity around how we, how do you take a 106 book and say you are going to be profitable in 2011, that's how that's - in our process that's what we are looking at relative to the Personal Line segmentation.

John Grimstad
Piper Jaffray

Great, thank you and one more quick one if I could. The three large homeowners' claims that, like you said added 7 points to Personal Lines ratio this year, those claims are related at all or those are just distinct separate?

John Joseph Marchioni
President & COO

They are completely unrelated and I think the key point there is, what the size of our home book as we continue to build scale, you are going to have that quarter-to-quarter volatility from large losses, but those are unrelated losses.

John Grimstad
Piper Jaffray

Thank you, understood, thanks a lot.

Operator

(Operator Instructions). Our next question is from Caroline Steers with Macquarie, your line is now open.

Caroline Steers
Macquarie

Hi, good morning.

Gregory Edward Murphy
Chairman & CEO

Good morning.

Caroline Steers
Macquarie

Just when you talked about the pricing declines of your competitors in Commercial Lines, I was just wondering how much farther below are their rates than yours and are their rates starting to get closer to yours over the past few quarters?

Gregory Edward Murphy
Chairman & CEO

Yes, I would just tell you, at some cases, we are losing accounts that we can't even get there in our pricing structure on certain cases that's not all the time. But, we find that when a competitor wants to get very aggressive to write one of our accounts, we find them going extremely low in many, in some cases below what we'll call our technical premium or pure premium which lost cost or in some cases we are losing an account for what we perceive to be, what we are paying out in losses, forget about expenses.

John Joseph Marchioni
President & COO

Yes, this is John. The only thing I had today, is just keep in mind, unlike Personal Lines, Commercial Lines pricing at a policy level is very much driven by discretionary credits they are applied to your base rates. If you are to look at base rate structures for competitors they are going to be all over the place and you may see some outliers, but generally speaking that's not where the difference is.

It's the decisions that an underwriter makes when determining price per unit of exposure and how much schedule credit they apply to an individual account, which is where you see what Greg talks about technical pricing levels manifested.

So, many states you can deviate on an individual account as much as 40 or 50 points off of your file base rates, when we talk about discipline in our operations it's our underwriters looking at an account, doing an exposure analysis using the various tools we have and then determining their comfort level deviating from the file base rates.

I think that's where you see from the discipline Greg's talking about is the level of individual schedule modifications that are put out on an individual policy account level, I suppose they are just pure base rate structures that are far lower.

Gregory Edward Murphy
Chairman & CEO

And Caroline, well some of the things that we look at to make sure -it's obvious that you only know your pricing, year-on-year in terms of your same store sales relative to your existing inventory. But some of the things that we look at relative to new business, we have our diamond scores, so we look at the credit, we look at the quality of the business, we are not only looking at diamond score, but we are also looking at the safety management report, there is a whole host of things that we look at relative to that.

But then we also look at how we are writing that business relative to manual premium and that is just a parameter that we use, it's not a perfect parameter, but it is a parameter and when we look at our business in terms of what we write year-to-year relative to manual both are holding stable or actually slightly improving year-on-year.

If you were company constantly cutting rate that what, it would evidence itself and the deterioration in your premium as a percentage of manual. Again it's not a perfect measure, it doesn't tell you what the competitor wrote to that, but it is an indication in terms of, if you want to look at eight benchmark, it's probably one of the only benchmarks out there that's probably most universal.

Caroline Steers
Macquarie

Okay, thanks and then just going back on exposure units. Some of your larger competitors have sort of indicated some modest improvement there and I don't know if that's just a function of size of the business that they are writing or if you guys are seeing that too in some of your small, middle market size.

Ron Zaleski

Well the best thing I can point there too is our audit premium and our audit premium as you saw, Dale mentioned that our total audit premium for the fourth quarter was $6.2 million and that compares to a third quarter that was $9.2 million, the second quarter that was $13 million return. These are all return premium, there are all RP's, first quarter that $11 million and a full year 2009, it ran $39 million.

So you are seeing a slowdown in audit premium which is telling you haven't seen the total stabilization, but you are clearly seeing a reversal of some of the heavy, heavy RP's that you are experiencing before and a better leveling of that.

Greg Murphy

The other point just to point back to something that was in the prepared comments and the reason we did focus on diversification. When you look at the contractors' book and the exposure impact the contractors as the economy really, went down a couple of years ago that was the segment hit the hardest and has been the slowest to come back from an exposure perspective. So when you look at our book there is an impact of that as well.

Dale Allen Thatcher
Former Executive VP, Treasurer & CFO

And then the other side of it is endorsement premium. Our endorsement premium, where you are starting to see endorsement that people are adding power units, they are adding other things to their schedules, we had positive endorsement premium in the fourth quarter, fine it was only 700, it's a little less than a million but that compares to some numbers that were running a lot more negative than that, that our endorsement premium for all of 2009 was a return of $23 million in the first quarter, my glass on here, in the first quarter, it was at $5 million, second quarter was $3 million, third quarter was $2 million, now the fourth quarter is positive million.

So again that's an exposure indication and you got to remember, when you look at our top line premium, about 3.5 points of the premium reduction is generated by return, if you just said the return on in endorsement premium for 2010 was zero, that would, that's where we are losing 3.5 points in the top line relative to that exposure diminishment. And it is starting kind of drop [ph] out and pick up.

Caroline Steers
Macquarie

Okay, that's all really helpful. Thank you all.

Operator

Thank you. (Operator Instructions). Our next question is from Robert Paun with Sidoti & Company, your line is now open.

Robert Paun
Sidoti & Company

Can you talk a little bit more on the comp business and what actions you are talking to reduce the losses in that book. I know you still talked about raising rates. Do you have the number on increased rates on renewals in the quarter?

Greg Murphy

Yes, we do. I'll give you, so for the quarter, it was comp 2% was the quarter and the year on comp still running two-two and that line has a tendency to be under little bit more pressure because you do have sub administered stakes that due to rate increases and, we're starting to see some pickup on that side.

So it's an area that we are driving more rate, but I think it's an area for us as an organization that we're going to be much more focused on managing our costs of goods sold then, we have a number of initiatives focused around, our PPO network, in terms of the size of the network and then much better focus on triaging, getting claimants into network as fast as fast possible, it's the right triage more aggressive utilization on that front, doctor-to-doctor involvement, it runs a multitude of items that we just need to get more, much more aggressive at the management of that claim inventory.

John Joseph Marchioni
President & COO

You know, as Greg's points are right on, as we said again in the prepared comments, if you look at frequency in the comp line over the last few years, it's been down and down quite a bit, was driving a performance there for us and we anticipate the industry as severity.

So there are certainly things you could do on the underwriting side, on the pricing side as Greg indicated, you've got bureau of established rates in many cases, you're starting to see some hard wire rate increases filed state-by-state within our footprint.

But it's about managing the severity some of which is class driven, class of business driven that's where the underwriting comes into play, but the rest of it is what do you in terms of medical management and indemnity management early in those claims and that's why a lot of it is on the cost of good of sold side and claims initiatives.

Robert Paun
Sidoti & Company

Okay, thanks. That's helpful. And just last question on the investment portfolio. Greg, in the press release, you said there has been some renewed interests in the alternative investments. So why reduce the exposure at this time. Can you just walk us through your thoughts on some of the sales that you made in the quarter?

Dale Allen Thatcher
Former Executive VP, Treasurer & CFO

Basically - this is Dale. We look at the alternatives as a whole. I mean one of the issues obviously that we ran into in the '08-'09 timeframe was that we were predominantly invested in private equity space, so they have very limited liquidity capability.

So, although the alternatives are performing a bit better that also gave us a liquidity opportunity, so in the interest of balancing the overall risk, it made sense to us to lighten that up to eliminate some of that liquidity risk and put us in a better position on an overall basis. So that was kind of the thinking there, we have that opportunity.

We also had a tax position where we had capital gains in the 2007 tax year and those were in effect that tax year were closing at the end of 2010. So by generating capital losses in 2010 that we could carry back to '07 that provided us with really a yield opportunity in effect because those alternatives had to perform at substantially higher rates of return in the future to make up for that tax play that we were able to take advantage of.

Greg Murphy

So I think about it good sales set, it's about flexibility, we're not backing off that risk asset class, we are, but we just want to have more fundability with our money to be able to move in and out. So we thought that again signing down the liquid part of it and increasing the liquid part, but you're still staying in that risk class is something that we're trying to do. So it's just a movement within the fundable group.

Robert Paun
Sidoti & Company

Okay, got it. Thank you. That's all I have.

Greg Murphy

Okay, thanks.

Operator

Thank you. I have a follow up question from Bob Farnam with KBW, your line is now open.

Bob Farnam
KBW

Just one quick follow up on the workers' comp line frequency. Obviously, it has been down pretty good amount over the last few years. What is it looking like more recently though I'm curious whether that's bottoming you now?

Greg Murphy

Give me a second, I'll look it out.

Dale Allen Thatcher
Former Executive VP, Treasurer & CFO

The frequency is still for the action - it's still down 4.5%, so we're still in 2010 on an earn payroll basis down towards the frequency but has still been declining and let me, I think you bring up a great point about frequency and even some severities because I heard a lot of these comments mentioned around the edges.

We do our - just little clear, when we do our 2011 budget and expectations, we have zero change in frequency, we are not budgeting an ongoing declination in our frequency count, I mean we can do that, we budgeted zero. Now on the severity aspect, how we build our severity in, we do a four year look back, we bring everything on level and then we build into our severity a higher cost of goods sold increase and that is reflective of the fact that medical aspect which is the largest part, it's about 52% of the comp losses are medical, about 47% of that is in position services, 47% in hospitals.

When you look at those elements, they're up substantially in terms of inflationary aspects and the remainder of them (inaudible) that are still up in the 3.5% range. So when you go through and look at that element and the fact that liability claims for the most part trade-off of medical, so your medical is going higher and liability claims tradeoff medical and the other aspects on the property side are more around repair, and repair still go higher that's how we do our planning process for 2011.

So we have a higher loss costs trend in and I'm kind of not hearing that that same kind of methodology employed and I'm not sure exactly how that doesn't hold together for everybody.

Bob Farnam
KBW

Okay, thanks for that. Thanks again.

Operator

Thank you, and currently no further questions. I'd like to turn the call back over to presenters for closing comments.

Gregory Edward Murphy
Chairman & CEO

All right, thank you very much operator. And then obviously, if anybody has the follow up please reach out to Dale and Jennifer. So thank you very much operator.

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