S&P Capital IQ

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The Progressive Corporation NYSE:PGR

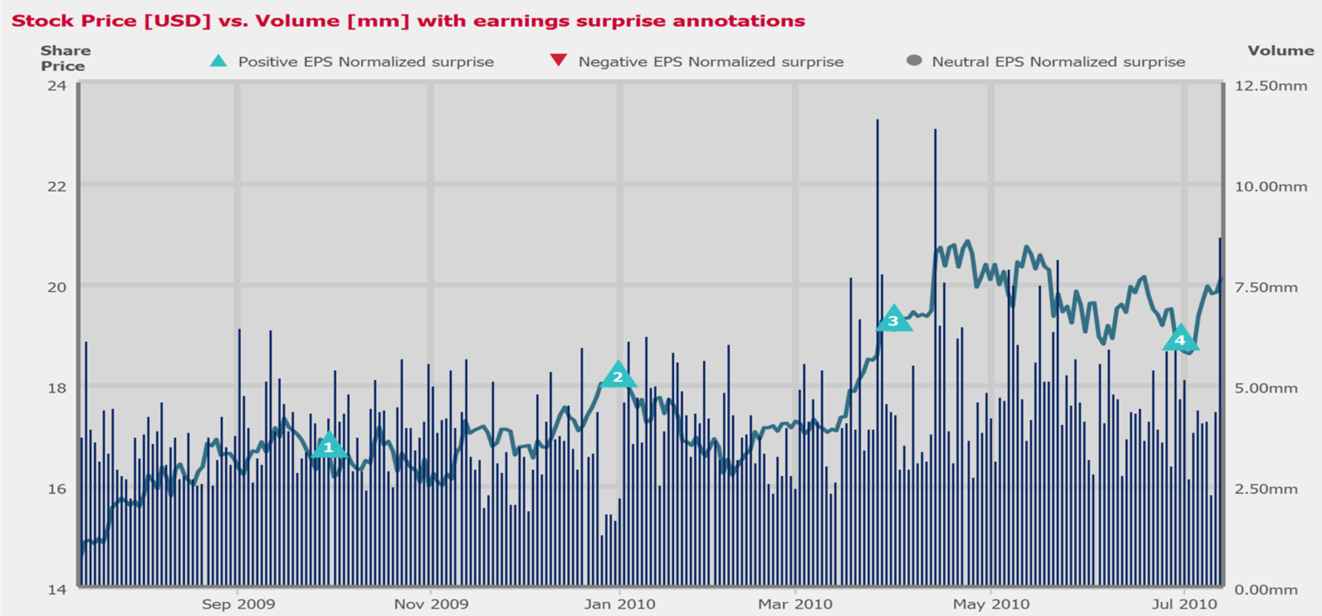
FQ3 2010 Earnings Call Transcripts

Tuesday, November 09, 2010 2:00 PM GMT

S&P Capital IQ Estimates

	-FQ3 2010-			-FQ4 2010-	-FY 2010-	-FY 2011-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.37	0.40	8.11	0.37	1.50	1.54
Revenue (mm)	3720.83	3715.40	(0.15 %)	3603.78	14779.78	15584.19

Currency: USD
Consensus as of Oct-22-2010 8:51 PM GMT



	- EPS NORMALIZED -		
	CONSENSUS	ACTUAL	SURPRISE
FQ3 2009	0.33	0.36	9.09 %
FQ4 2009	0.37	0.41	10.81 %
FQ1 2010	0.38	0.41	7.89 %
FQ2 2010	0.35	0.38	8.57 %

Call Participants

EXECUTIVES

Brian C. Domeck
Former Vice President

Clark Khayat

Glenn M. Renwick
Non-Executive Chairman

ANALYSTS

Brian Robert Meredith
UBS Investment Bank, Research Division

Doug Mewhirter
FBW

Ian Gutterman
Adage Capital

James Engle
John W. Bristol & Co.

Joshua David Shanker
Deutsche Bank AG, Research Division

Keith F. Walsh
Citigroup Inc, Research Division

Raymond Iardella
Oppenheimer & Co. Inc., Research Division

Vinay Gerard Misquith
Crédit Suisse AG, Research Division

Vincent D'Agostino
Stifel Nicolaus

Presentation

Operator

Welcome to the Progressive Corporation's Investor Relations Conference Call. [Operator Instructions] The company will not make detailed comments in addition to those provided on its quarterly report on Form 10-Q, shareholders report and letter to shareholders, which have been posted to the company's website, and will use this conference call to respond to questions. Acting as moderator for the call will be Clark Khayat. At this time, I will turn the call over to Mr. Khayat.

Clark Khayat

Thank you, and good morning. Welcome to Progressive's Third Quarter Conference Call. Participating on today's call are Glenn Renwick, our CEO; Brian Domeck, our CFO; and also on the line is Bill Cody, our Chief Investment Officer. The call is scheduled to last about an hour.

Statements in this conference call that are not historical fact are forward-looking statements that are subject to certain risks and uncertainties that could cause actual events and results to differ materially from those discussed herein.

These risks and uncertainties include, without limitation, uncertainties related to estimates, assumptions and projections, generally; inflation and changes in interest rates and security prices; the financial condition of and others issues relating to the strength of and liquidity available to issuers of securities held in our investment portfolios and other companies with which we have ongoing business relationships, including counterparties to certain financial transactions; the accuracy and adequacy of our pricing and loss reserving methodologies; the competitiveness of our pricing and the effectiveness of our initiatives to retain more customers; initiatives by competitors and the effectiveness of our response; our ability to obtain regulatory approval for requested rate changes and the timing thereof; the effectiveness of our brand strategy and advertising campaigns relative to those of competitors; legislative and regulatory developments, including but not limited to, healthcare reform and tax law changes; disputes relating to intellectual property rights; the outcome of litigation pending or that may be filed against us; weather conditions; changes in driving patterns and loss trends; acts of war and terrorist activities; our ability to maintain the uninterrupted operation of our facilities, systems and business functions; court decisions and trends in litigation and health care and auto repair costs; and other matters described from time to time by us in other releases and publications.

In addition, investors should be aware that Generally Accepted Accounting Principles prescribe when a company may reserve for particular risks, including litigation exposures. Accordingly, results for a given reporting period could be significantly affected if and when a reserve is established for one or more contingencies. Also our regular reserve reviews may result in adjustments of varying magnitude as additional information regarding claims activity becomes known. Reported results therefore may be volatile in certain accounting periods.
We are now ready to take our first question.

Question and Answer

Operator

[Operator Instructions] Our first question is from Josh Shanker with Deutsche Bank.

Joshua David Shanker
Deutsche Bank AG, Research Division

I'm interested to know the schedule and what the plans are for potentially a new marketing campaign beginning in 2011 in terms of whether you're introducing a new ad spot or ad mix or whatnot, the plan's mostly television oriented.

Glenn M. Renwick
Non-Executive Chairman

Yes, I'm happy to talk about that. I don't think we've said anything too publicly about this. But as we go into next year, we will complement or augment, which we might choose our current Superstore campaign with another campaign that we now have developed, and are quite excited about it. We will do just very little bit of consumer testing in the fourth quarter. But you'll see that more as a companion piece to our current Superstore campaign. We're very happy with the Superstore campaign, and we have several new ads that have yet to be shown as well. Some of those will start to appear in the fourth quarter, but we have a couple of rounds that mostly new materials. So as we look forward to the first quarter of next year, which as most of you know is a very important quarter or time of the year for buying, we really have a nice inventory of the Superstore campaign and something additional to add to that. Along with that, we actually expect, probably later in the first quarter, maybe around the cusp of the first and second quarter, to be going more national with our Snapshot advertising. So we have some Snapshot advertising designed already and available for local market testing, but we'll wait until we have a slightly increased number of states with our Snapshot. We've got 24 there in direct today. We've put that in the 10-Q. And we'll have at least 75% of the country covered by that offering and we'll nationally advertise it around the end of that quarter.

Joshua David Shanker
Deutsche Bank AG, Research Division

Are any of the local ads available for online perusing at this moment?

Glenn M. Renwick
Non-Executive Chairman

I'll tell you what. During the time of this conference call, I'll get an answer to that. I would've said yes, but I'm not sure. So maybe we can get that answer during the call, and I'll get back to you.

Joshua David Shanker
Deutsche Bank AG, Research Division

And the other question was, I was interested in knowing what's going on in the newer states, I suppose Massachusetts and New Jersey in terms of growth, profitability of that growth and whatnot.

Glenn M. Renwick
Non-Executive Chairman

Do you want to comment on that, Brian?

Brian C. Domeck
Former Vice President

Relative to Massachusetts, I think we have previously mentioned that our first entry, we had a little bit of concern in terms of our rate level and rate adequacy and have, since entry, raised rates more than a few times. We now feel we are closer to rate adequacy, but we continue to still monitor that. It has been a challenging state, but as I've mentioned, we think we're closer. As a result, obviously, as we have raised rates, new application counts are much lower than our first point of entry, but we feel much more comfortable about our current rate level and ongoing profitability in terms of that. In terms of New Jersey, New Jersey is also one of the states with Personal Injury Protection where we had a few issues in terms of profitability and, over the course of the last year, have also raised rates a fair amount. And again, we feel closer to profitability and rate adequacy and certainly a little bit more in the direct channel than the agency channel in terms of that. And it's one that we closely continue to monitor as we closely monitor all the states that have Personal Injury Protection, which we have mentioned, particularly earlier in the year, had a fair amount of increase in frequency, which actually in the third quarter actually moderated a little bit, with frequency being down on a year-over-year basis for aggregate PIP states. But all of those states, and they tend to be some of our larger states, we have a vast amount of due diligence we continue to monitor. But net-net for both of those states, Massachusetts and New Jersey, the emphasis is ensuring rate adequacy and profitability. And then from there, we will then worry about growing those things.

Operator

Our next question is from Vinay Misquith with Credit Suisse.

Vinay Gerard Misquith
Crédit Suisse AG, Research Division

The first question is in marketing spend. We've seen the new application growth start to slow to plus 4%. Just curious about what your expectations are next year for marketing spend, whether you plan to keep it flat, down or up.

Glenn M. Renwick
Non-Executive Chairman

Our expectations for spend, Vinay, are always the same, that we will modify that based on our expected yields and our observed yields. So while cost of sale may change, we will modify our spend as best we can to reflect the yields we expect. So in terms of outlook for next year, we have no reason to expect that we're going to do any dramatic change in our advertising spend. We're very comfortable. I just outlined that we have some new material both in the current Superstore campaign and a campaign that is linked to Superstore, but has a very different perspective. So we're actually excited about our creative, and as long as we get the results that we're expecting, we will continue to reflect that in our advertising spend. So I'm not going to sort of suggest it's up or down; it will be reflective of the conditions. This year, you mentioned the 4%. There's no question that last year was a very aggressive year across the board, and I think many companies saw that in terms of new quotes or prospects coming to get a quote. This year, certainly towards the third quarter for us, quotes are more of a flat relative to last year. So we are comparing a 2010 year to a very strong 2009 year. So quotes were somewhat flat. So we're not getting quite the lift on year-over-year quotes that we might have expected. We've reported that our conversion is attractive, and our retention is attractive. So the 4% is definitely down, but still a relatively acceptable result based on what we believe the quoting behavior is in the marketplace. And as we go into next year, frankly, I'll guess we'll just play the ball where it lies in terms of seeing if 2011 is a stronger year, quoting-wise, than 2010. But I do think '10 over '09 has been a little bit of an anomaly given the strength of 2009.

Brian C. Domeck
Former Vice President

This is Brian. Just to add to that, we've talked about this a fair amount in terms of advertising spend. We measure cost per sale relative to our target acquisition costs. And I think I've talked a little bit about that in June in terms of what we have incorporated in our pricing. And as long as cost per sale remains less than target acquisition costs, we feel comfortable with spending. Obviously, one of the things we try to measure as best we can, and this is where it gets a little more difficult, is on the margin and on the incremental spend. But we try to have as much discipline as we can on the incremental and marginal spend to try to ensure its meeting our objectives and in certain, trying to ensure that we stay true to the aggregate measure of 96% combined ratio or below.

Vinay Gerard Misquith

Crédit Suisse AG, Research Division

My follow-up question is actually on the competitive trends. Are you seeing competitors raise pricing less now than they were in the past? And do you think that's negatively impacting shopping behavior near term?

Glenn M. Renwick
Non-Executive Chairman

Looking at an aggregate, in fact, a scatter plot [ph] (25:36) of many competitive pricing changes, I would say, we are still seeing very slightly positive rate change. During the last several months, we have had a couple of large competitors go in different directions, one taking rates up a little and one taking rates down. But overall, I would say rates are still slightly positive, but for slightly maybe the real emphasis there, Vinay, and I think that to the extent that consumers are not getting as disrupted by their renewal quote from a larger number of companies, it could very well be a reason that people have less of an impetus to go out and shop. That will obviously put a greater emphasis on the catalyst that we employ to suggest that shopping is in their best interest and something -- certainly not the only thing. But something we are somewhat excited about for next year is our Snapshot that we've talked about, simply because it provides another reason over and above the reason for us being in the marketplace for people to reconsider their options. So we're excited to be able to have that, and really look forward to that getting up to full speed.

Operator

Our next question is from Keith Walsh with Citi.

Keith F. Walsh
Citigroup Inc, Research Division

First question around policy duration. You talked about this in the Q and Direct continues to be positive, but it's decelerated the past several quarters while Agency has accelerated. So maybe you could talk about the dynamics behind both of these channels. And then what are the key data points that drive how you estimate policy duration?

Brian C. Domeck
Former Vice President

In terms of policy, our key measure is policy life expectancy. So that, you can think of as the average expected length of policy life, and we currently measure it in terms of month as our current denominator. Hopefully, someday we will get to more of a measure of years. But right now, it's in terms of months. And in terms of Agency being a little bit greater in terms of percentage increase versus Direct, one of the reasons for that is, and we've mentioned this a little bit, in terms of our new application growth in the Agency channel, we are seeing a greater percentage increase in what you might call the more preferred markets, those that tend to stay with you longer. And so by writing more of the preferred Auto business, we are seeing a continued increase in aggregate policy life expectancy in the agency channel. I will mention also -- in Direct, we continue to see some increase in terms of the policy life expectancy. Year-over-year, it's now up 2%. And you're right, it is a slowing increase, but it still continues to increase. And right now, our policy life expectancy in Direct in terms of just absolute months is slightly higher than the Agency month. So in terms of that, that's also up a faster [ph] (28:38) in terms of the percentage growth that we could obtain. But we're pleased that both are growing. Measures that we look at in addition to absolute policy life expectancy, we look at what we call like the decay curve throughout a policy life. So what percentage of policies are staying with us one month after they've incepted, four months after they've incepted. We pay particular attention to what we call our renewal rates so those -- what percentage that receive a quote retain with us or renew with us. So we look at retention rates throughout the whole decay curve, and from that is how we extrapolate the average policy life expectancy. And we try to influence what we can throughout that whole decay curve. And it could be things that we do in terms of on-boarding policies, and that might be more applicable in the Direct channel than the Agency channel. Things that we do as policy holders are with us, both in terms of policy servicing, claims activities, et cetera, and then trying to make the renewal event a good renewal experience for folks. So we look at all of them, we try to improve along the way. And net-net, we're pleased with the increase of policy life expectancy, but certainly not satisfied, and we want to see it continue to increase.

Glenn M. Renwick
Non-Executive Chairman

One slight addition to that is that we're also focusing on and deploying what we're calling loyalty programs that sort of recognize that not all renewals are created equal. But as you stay with us longer and your tenure is longer, there are more recognition and rewards for that type of behavior.

Keith F. Walsh
Citigroup Inc, Research Division

And then the second question, just on the Direct side, new applications up 6% in the quarter, but they were up 15% year-to-date. Maybe you could talk a little bit about the deceleration there.

Glenn M. Renwick
Non-Executive Chairman

Yes, I think the answer previously that '10 over '09 is not as strong a year in terms of consumer shopping behavior as we would best measure that. Let me give you a couple of thoughts. I think this is always a difficult story to put together with perfection. But we now have, we, everybody, now has more data on what I'll call sort of same-store sales than we've probably ever had, at least in most the time I've been in insurance. So if you took something like Google searches for things that are related to insurance and the active buying, you would see that actually last year was a pretty strong year. It doesn't seem to be as strong this year. But that's just a point and very hard to reconcile and triangulate from that point. But it's a basis by which I, at least, come to a conclusion that consumers are not as active this year as they were last year. Having said that, we talked previously that our quotes are closer to flat. There are several other sources out there that would talk about unique visitors. Unique visitors are actually up this year to insurance sites, but some of that is servicing. In fact, a fair amount of it is servicing, so we're trying to push more and more of our customers to servicing. But that's not one that I necessarily look at too much. It's great that it's up, but it's up for a lot of different reasons, not just shopping. So we look at quotes and I think the industry numbers and some that report would say quotes were about flat. And we wouldn't dispute that and that seems to be about what we're generating from that. Brian just mentioned that our retention is up and our conversion is up. So with quotes up just a little for us and those two factors, we're able to get the 6% growth. Yes, we would love more, but relative to what we see at the market, we think we're getting at least if not our fair share and at levels that we would've expected. How that proceeds into next year, hard to tell. But we also have sort of a large denominator right now that will probably flow through a little bit and get more normalized in the first quarter next year. Having said all of that, in no defensive way at all, but 15% new business growth, or certainly 15% policy enforced growth, is always going to be hard to maintain that momentum, unless you really have a lot of new business growth. That doesn't mean that we're not set on trying to do that, but there will be some decline in that, and I think certainly, as we've seen this year's denominator be a little bit more normalized relative to growth over last year, we're going to see that in everybody's numbers.

Glenn M. Renwick
Non-Executive Chairman

Just a comment here to Josh that Rival Driver is the name of the commercial I was referencing for local use in some Snapshot markets, not yet nationally, and that is available on progressive.com.

Operator

Our next question is from Raymond Iardella with Oppenheimer.

Raymond Iardella
Oppenheimer & Co. Inc., Research Division

I was wondering if you can maybe talk a little bit about growth and profitability and maybe the California or Florida and New York markets. And then give us an update on what you guys are doing I guess on the rating front in those markets.

Glenn M. Renwick
Non-Executive Chairman

Let me take those in a couple of order. The California marketplace for us, to be fair, our Agency business there has not been generating the kind of growth that we would prefer and like. We've made several changes in our rates and presentation to the marketplace and are starting to see some return to growth in our Agency marketplace in California. Again to be very fair, we've got plenty of room to grow to catch up to levels that we believe we can achieve. So California actually is starting to look quite brighter. On the Agency side, from a growth perspective, the Direct has done very well, did very well last year, and it's maintaining that, but not necessarily at significant clips above the prior year. But we're happy with the performance of Direct in California and actually quite excited about some renewed growth in our Agency business. And we look forward to that state being a little bit more of a contributor to 2011 growth because it really hadn't been, at least in Agency, for this year. Florida, we've discussed in a couple of different calls and written material, Florida, frankly, the effort for the most of this year and even the latter part of last year was really to make sure that we got on top of the PIP emergence that we saw there. We've taken a lot of rate action. We've taken a lot of underwriting actions that we feel are all appropriate for that marketplace. Those are in place, and without disclosing more than we normally would disclose, I will tell you that we are much comfortable with the profitability in Florida in recent months. And again, my expectation would be that Florida could be a much stronger contributor to growth for 2011. So as we look into 2011, I talked about some of the advertising-type things, Florida and other large states that haven't been big catalysts to growth this year, could be a different story next year. Again, that's not the guidance; it's just what we always work to get our big states positioned very well. And Florida hasn't been, and we're more comfortable that it's heading in that direction. New York has had a lot of action for a long period of time. Still some areas that we would like to see New York profitability be improved a little bit over what it's currently doing. But both channels there are in a similar situation. And probably with a little bit more work that's already gone on, I look forward to better results in New York as well. But not nearly the problem that it has been in different times in the past.

Operator

Our next question is from Doug Mewhirter with RBC Capital Markets.

Doug Mewhirter
FBW

In your past presentations, you said you've been trying to target maybe a slightly more upscale customer or one that maybe fits a profile of one that would be more likely to be retained at renewal. I noticed that in your 10-Q, you said that your average premium per policy in the Direct channel was down slightly. And you attributed that to mostly a business mix, where they were buying lower limits. Is that a slight change in the customer profile, or is that a similar type customer just buying lower limits on the margin?

Glenn M. Renwick
Non-Executive Chairman

No change to the original comment, and when I say target upscale, I think we really, hopefully, say increased our targets to include more upscale buyers because we really are in a position now to offer product to every motorist on the road, and that's a goal for us, and that continues to be very really true. Brian mentioned earlier that our Agency business, which has actually shown some nice growth but is also providing a good lift in some of the preferred customers. And that's really delightful for us. The average premium, as you see, is different in Agency, a bit more flat in Agency, down in Direct. I wouldn't read too much into that. There's a lot of factors going on there. Clearly, there are a mix of what people buy. There's geographic mix. I just finished saying that some of our largest states, specifically in Florida, which is by far our largest state, has not been a major growth state and is a higher premium state. So there a lot of factors that go into average premium and while we try to explain that in some general mix context, which is absolutely correct, if I were you, I would take away a slightly different view. We target to a 96% and we try to get that in every market and every segment of customers. And that's more important to us than overall what happens in average premiums as long as all of the targets, all of the states, all of the individual pricing tiers, we get as close to our targets as possible, then we're very comfortable. Now a declining average written premium clearly has some negative effect on expense ratio and we'd all like the opposite to that. But I'm very comfortable and very happy growing in all of our segments as long as we're getting the targets that we shoot for. And the minus 3% in Direct is just a mix-adjusted outcome, not something that is sort of an input [ph] (38:51).

Doug Mewhirter
FBW

My follow-up question is regarding the legal environment in Florida. With the elections, there seems to be a changing of the guard in Florida coming up next year, and the incoming governor seems to be fairly insurance-friendly. He had a couple comments when he was campaigning about things like tort reform and homeowners insurance reform. Is there anything in his, I guess, platform that would seem to be more specifically friendly to the auto insurance tort environment, PIP reform or any type of medical or liability tort reform?

Glenn M. Renwick
Non-Executive Chairman

I would, at this stage, prefer really not to comment on that. Not because I don't want to comment. I just -- let's just let it play out. Progressive will play in any environment as long as we understand the rules and the rules are applied consistently. While on a very personal level, I have views on different things in different states, we have to deal with 51 jurisdictions, and we find ways to present our product and do what we think is right for the consumer as many as possible. And while these things are important, they are not necessarily things that drive our behavior until we get a clearer view of exactly what's going to happen. We're probably looking at something like about 20 new commissioners across the country, post the election, three elected, I think that was Oklahoma, Georgia and California. And then you've probably got about 17 others, is the estimate I'm working with. So there will be some regulatory changes, but generally, I just don't think that's going to change our game plan in any significant way at all.

Operator

Our next question is from Vincent D'Agostino with Stifel Nicolaus.

Vincent D'Agostino
Stifel Nicolaus

Just looking at the Snapshot Discount, now that you're in some more states and gaining additional penetration, any sense what the average discount is starting to look like?

Glenn M. Renwick
Non-Executive Chairman

Yes, please don't take this as being rude, we do. And I'm not going to be, perhaps, as open with Snapshot details as we have in other situations because this is clearly something that we feel we have something unique in the marketplace that entitles us to understand it well without necessarily communicating all of the issues. So I will tell you that the take rate on Snapshot has met, maybe slightly exceeded our expectations, our expectations being set not on a wealth of data but on prior versions. So Snapshot is being very well received in that regard, which I point out only because our prior versions had an upfront discount. Snapshot does not. So interesting that, that would result in that outcome. But our estimates of discounts have been off just slightly from our original expectations, but not in any concerning way. And the quality or the class of people showing interest in Snapshot, again, is slightly more preferred, which is very pleasant for us. It's another way to get into a part of the marketplace that we've signaled that we want to be a much bigger player in. We have a lot of the tools necessary. But this one could be very helpful for us to getting into that. And at this stage, average discounts, we're just not going to disclose publicly.

Vincent D'Agostino
Stifel Nicolaus

You had mentioned earlier in the call in the 10-Q filing that you're seeing favorable severity trends as well as flat frequencies. I guess what just stands out to us is that, that gives you lost cost trends [ph] (42:32) that have shifted decidedly more unfavorable this quarter. And without discussing the results or observations of a competitor, are you anticipating any meaningful frequency or severity pressures within your book in the near future?

Glenn M. Renwick
Non-Executive Chairman

I'll let Brian, maybe comment on that. A way that I think about this, which has been useful to me, is we went through our own diagnosis here, is that at the end of 2009, we essentially thought for claims in 2009, that they would be about 3% higher severity than the claims from the year before, 2008. And again, I'm just going to give you my personal views here. That, from a pricing perspective as the Product Manager, having done a lot of rate revisions, that was always a very comfortable number, if not 5%. So I always think about medical claims and severity getting more. So we had in our estimates, we're reserving that 2009 claims to be about 3% more than 2008. Now with the benefit of data and time, we recognize that those claims for 2009 actually settled at roughly the same amount as 2008; about 0.1%, if I remember correctly, higher than 2008. So clearly, we had over-estimated and you're seeing some of that release now. So most the release is really accident year 2009 and that if there's any skew in there, it's to the higher limits. As we go forward, we're still estimating claims to be sort of at least 1% to 3% higher than the prior-period comparison. And I think that's a very responsible thing to do when you don't have any information to the contrary because there's no good reason to believe that base will be less. But as I just pointed out, our estimate for 2009 claims ended up to be high and you're seeing some of that release now. What do I think going forward? I think we sort of watch it day in and day out. But it doesn't appear that bodily injury severity is sort rocking away. It didn't seem to follow the PIP trend, which was of some concern earlier in the year. Brian, do you want to talk a little bit more about...

Brian C. Domeck
Former Vice President

Yes, just a few additional comments. You're right in terms of our frequency being relatively flat, and that's a little bit decomposed into collision being modestly down and bodily injury and property damage on a year-to-date basis being up slightly. On the severity front, we continue to see a small, small decrease on the collision severity, and aggregate severity down 3%, a large part of that is driven by bodily injury incurred severity for the year being down, some of it a function of the favorable development, as Glenn mentioned, that we have seen and we've pointed out that so far this year, we've had $271 million of favorable development, some of it in defense and cost containment costs, but a fair amount in bodily injury coverage. And again, most of that is material to the 2009 accident year, but that is factored into that minus 3% severity that's in the Q.

Glenn M. Renwick
Non-Executive Chairman

I think we can all expect that at some point, and this should be a little bit more correlated with new automobile sales, that ultimately the age of vehicle on the road will start to change, it's been declining. It will start to change, and that will be reflected in PD and collision severities over time, just a mix issue.

Operator

Our next question is from Ian Gutterman with Adage Capital.

Ian Gutterman
Adage Capital

I was just thinking about few years back at Investor Day when you talked about the different segments that customers from sort of the single driver to the family with the multiple cars in the home and so forth.

When you look at your current customer base, do you just have to kind of wait for someone to call you and say, "I got married, I want to add a second driver," or "We bought a home, we want homeowners insurance," or are there things you guys can do with your data to try to prospectively identify who's going to move up into those more desired tiers of -- go from standard to preferred over time, go from one product to multiple products over time. Are there things that you do to try to identify those customers and maybe give them better rates so they'll be a long term Progressive customer?

Glenn M. Renwick
Non-Executive Chairman

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Ian, I'm glad you remember the customer segments because they do affect our thinking a great deal internally, and I'm going to answer this with sort of a little bit looser answer; we are much more attuned now to those customer segments since we introduced them. And through a lot marketing around those, the transitions between customer segments is something we're very aware of. I would say, there's a lot more that we can do to be quite as predictive as you're suggesting in terms of life events. We do have a lot of other life events that we try to predict and contact our insureds prior to. And that's an area of marketing that I think we're getting stronger in, and still I would tell you in all fairness, we've got a lot of opportunity to get better at. With regard to homeowners, I think I've mentioned this before, but it does get somewhat at your question, the majority of our homeowners' business actually comes from people that are already in our book of order business. Cross marketing is actually something that's very important to us. There are other life events, as I just acknowledged, that I think we could get better at. Another area that we actually do quite well in is cross marketing with our special lines customers. We do have, historically, a much more preferred book of business in our special lines, whether that be the motor home, motorcycle. And we're definitely reaching many of those, specifically in our direct book where we have more appropriate contact with the insured to be able to invite them to become an auto customer as well.

Ian Gutterman
Adage Capital

And related to that is, as you see that someone has moved up into that more complicated type of customer with multiple needs, do you feel you can handle that as well as you want to in the Direct channel? Or is there a point where you want to or are you unable to maybe -- is there a point where you want to hand them off to a Signature Agent, with the theory being that, they're at the point where they're probably going to want an agent anyway; let's try to turn them over to one of our Signature Agents rather than just walking into their locally and maybe leaving Progressive? Or do you have the capabilities in Direct that they're not going to want to make that choice?

Glenn M. Renwick
Non-Executive Chairman

I would say we have the capabilities right now but I won't foreclose the fact that there are people -- we're very comfortable there are people that like to have an agent and carrier for lots of reasons, and if their situation is slightly more complicated, that's fine. We're very comfortable there are individuals -- I would say I'm one, that feel very comfortable just buying online and servicing online and frankly quite comfortable with that outcome. There may very well be a class of customers that start at a comfort zone, but as their needs get more complex, that they may need an agent. Those sorts of things are definitely things that we would look at. It's not something we're doing today proactively, but if that was in the best interest of the customer, we would probably find ways to make that happen.

Operator

Our next question is from Brian Meredith with UBS.

Brian Robert Meredith
UBS Investment Bank, Research Division

The first one, Brian, is it possible to get what the year-over-year impact of the increase in the gain share accrual was on the operating expenses?

Brian C. Domeck
Former Vice President

Well, we don't talk specifically about what the effect is on the expense ratio and LAE, because remember the gained share would apply to both of those component pieces. But obviously, it's up significantly in terms of the accrual. But if you can think of the magnitude between the two lines is something close to about 0.9 of a point, something like that, between LAE and the expense ratio, it's in two lines. But if you take our year-to-date numbers, that's about the effect.

Brian Robert Meredith
UBS Investment Bank, Research Division

Back on the severity topic, just quickly here on the physical damage side, I'm wondering if you've got any sort of statistics where you look at with the potential impact of the rise in commodity prices that we've seen over the last call it three to six months could potentially have on PD severities going forward?

Glenn M. Renwick
Non-Executive Chairman

Fair question, but I think the answer is no. We certainly haven't got that kind of linkage to the commodities market. We'll get to observe them, frankly, maybe not the most sophisticated answer in the world, but we just try to observe what we see and what we pay and how those costs factor through. And given the number of checks we write every day for physical damage, that's not something that we're going to miss by any significant time period. We'll see those changes come through pretty quickly.

Operator

[Operator Instructions] Our next question is from James Engle with John W. Bristol and Company.

James Engle
John W. Bristol & Co.

My question is, where are you in terms of your progression with version 8.0 in the segmentation pricing strategy and how has that played out?

Glenn M. Renwick
Non-Executive Chairman

Could someone give me the number of states, was it 14? I think we're in 14 states, I'll just check that right now, I'm doing it from memory. 14 states with our version 8.0 or what we call integrated product and continuing to roll that out. So we are very comfortable with that. We've put another, I think, it was five states since the second quarter. And we expect to put more this quarter, and we should be well into the full countrywide rollout first quarter, second quarter next year.

James Engle
John W. Bristol & Co.

And is it meeting all expectations?

Glenn M. Renwick
Non-Executive Chairman

It is. And the R&D group, for some of you who got to meet Jim Haas at our June meeting, we already have, and this is just the natural cause of things, so don't perhaps read too much into it, but we already have new ideas that we're able to incorporate into this platform. So there's an 8.2 and an 8.3 already planned. So not only in the rollout is it the product rolling out, the general platform is rolling out, but it's also improving as it goes along. And the simple answer to your question, yes, it's actually meeting all expectations, doing a nice job of it and helping us with some of the comments we've made during the course of this call with regard to preferred customers. So it was directed a little bit to attract more preferred customers and to meet their needs.

Operator

[Operator Instructions] Our next question is from Vinay Misquith with Credit Suisse.

Vinay Gerard Misquith
Crédit Suisse AG, Research Division

Could you talk about the total cost of the package of homeowners plus auto insurance versus competitors? And in thinking of this, would it be fair to assume that the pure homeowners product offered by your affiliates may be slightly more expensive than traditional carrier, who might have more economies of scale and more of a vested interest in keeping your policy customers? So how does homeowners plus auto just compare with peers?

Glenn M. Renwick
Non-Executive Chairman

I can see that reasoning and when you start comparing prices, it's always all over the board. I think the way I would address that is that as we get into this marketplace, we didn't necessarily have quite the same level of multi-policy discount that others might have, if they were offering both products themselves. In other words, the discount on both the homeowners and the auto, that is something that we are now in the position to do. So I think that to the extent that we, perhaps, had any kind of impediment there, it would be not quite on the same grounding as ultimate costs to the consumer. We've resolved that. And that will actually be rolling out over the next several months, and we're comfortable that, that will put us on a very equal footing and attractive footing. I think the results that we've been able to achieve have actually spoken to the sense that the combination of auto and home that we offer as a package has been an attractive price in the marketplace. Perhaps an additional discount can only serve to improve that. Another element that is not necessarily price related, but of interest, is that we will be able to do what we call multi-product quoting. So instead of thinking of this as an auto and then a home, which are two somewhat separable actions, we'll be able to integrate the quoting process for individuals. So the answer that I give to you is that generally, we've been very competitive. We're moving now to have both multi-product quoting and multi-product discounts available. Two very important steps. So we continue to be quite excited about our penetration into that marketplace, and it certainly seems to be working.

Clark Khayat

It looks like that was our last question. So we'll move to close the call.

Operator
Thank you. That concludes the Progressive Corporation's Investor Relations Conference Call. An instant replay of the call will be available through November 26 by calling 1 (800) 262-4947 or can be accessed via the Investor Relations section of Progressive's website for the next year. Thank you for joining. You may now disconnect.