S&P Global
Market Intelligence

Kemper Corporation NYSE:KMPR

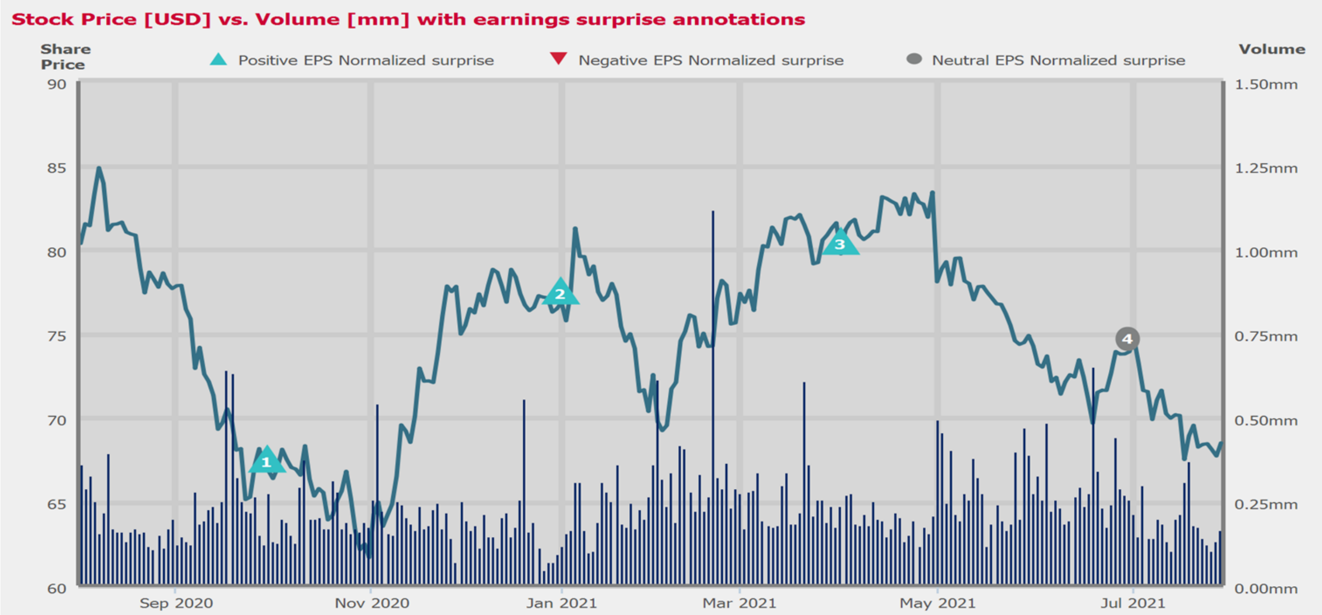
FQ2 2021 Earnings Call Transcripts

Thursday, July 29, 2021 9:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ2 2021-			-FQ3 2021-	-FY 2021-	-FY 2022-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	1.37	(1.54)	NM	1.47	5.47	NA
Revenue (mm)	1359.92	1458.60	7.26	1389.48	5478.77	NA

Currency: USD
Consensus as of Jul-19-2021 12:36 PM GMT



- EPS NORMALIZED -			
	CONSENSUS	ACTUAL	SURPRISE
FQ3 2020	0.97	1.36	1 40.21 %
FQ4 2020	1.54	1.59	2 3.25 %
FQ1 2021	1.29	1.31	3 1.55 %
FQ2 2021	1.37	(1.54)	NM

Table of Contents

Call Participants

EXECUTIVES

Duane Allen Sanders
Executive VP and President of Property & Casualty Division

James J. McKinney
Executive VP & CFO

Joseph Patrick Lacher
President, CEO & Non-Executive Chairman

Michael Anthony Marinaccio
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Matthew John Carletti
JMP Securities LLC, Research Division

Paul Newsome
Piper Sandler & Co., Research Division

Presentation

Operator

Good afternoon, ladies and gentlemen, and welcome to Kemper's Second Quarter 2021 Earnings Conference Call. My name is Grant, and I will be your coordinator today. [Operator Instructions] As a reminder, this conference call is being recorded for replay purposes.

I would now like to introduce your host for today's conference call, Michael Marinaccio, Kemper's Vice President of Corporate Development and Investor Relations. Mr. Marinaccio, you may begin.

Michael Anthony Marinaccio
Investor Relations

Thank you, Grant. Good afternoon, everyone, and welcome to Kemper's discussion of our second quarter 2021 results. This afternoon, you'll hear from Joe Lacher, Kemper's President, Chief Executive Officer and Chairman; Jim McKinney, Kemper's Executive Vice President and Chief Financial Officer; and Duane Sanders, Kemper's Executive Vice President and the President -- and the Property & Casualty Division President.

We'll make a few opening remarks to provide context around our second quarter results and then open the call for a question-and-answer session. During the interactive portion of the call, our presenters will be joined by John Boschelli, Kemper's Executive Vice President and Chief Investment Officer; and Erich Sternberg, Kemper's Executive Vice President and Life & Health Division President.

After the markets closed this afternoon, we issued our earnings release and published our second quarter earnings presentation, financial supplement and Form 10-Q. You can find these documents on the Investors section of our website, kemper.com. Our discussion today may contain forward-looking statements within the meaning of the safe harbor provisions of the Private Securities Litigation Reform Act of 1995.

These statements include, but are not limited to, the company's outlook and its future results of operation and financial condition. These statements may also include impacts related to the COVID-19 pandemic. Our actual future results and financial condition may differ materially from these statements. For information on potential risks associated with relying on forward-looking statements, please refer to our Form -- our 2020 Form 10-K as well as our second quarter earnings release.

This afternoon's discussion also includes non-GAAP financial measures we believe are meaningful to investors. One such measure we are reintroducing is as adjusted for acquisition. It's important to understand our reported results, including the impact of American Access acquisition has to Kemper overall. However, investors have also expressed an interest in understanding the underlying organic performance of the combined businesses.

Since our as-reported financials don't include American Access's historical information prior to the closing of the acquisition, and our current results include the impact of purchase accounting, the underlying trends are not easily discernible. In an effort to provide insight into the underlying performance of the combined businesses, we also display our financials as adjusted for acquisition.

This [fee removes] the impact of purchase accounting and includes historical American Access information for periods prior to the acquisition to more readily provide a meaningful year-over-year comparison.

In our financial supplement, presentation and earnings release, we have defined and reconciled all non-GAAP financial measures to GAAP where required in accordance with SEC rules. You can find each of these documents on the Investors section of our website, kemper.com. All comparative references will be to the corresponding 2020 period unless otherwise stated.

I will now turn the call over to Joe.

Joseph Patrick Lacher
President, CEO & Non-Executive Chairman

Thank you, Mike. Good afternoon, everyone, and thank you for joining us on today's call. This quarter, the country took a significant step forward in its recovery from the pandemic, and it's clear we're in the middle of a strong economic rebound. Last quarter, we indicated the reopening would create a very dynamic environment with expected increases in auto frequency and severity.

Further, we anticipate decreasing mortality. The reopening is happening faster than projected. As a result, frequency in auto increased significantly and a supply chain that was already stressed, especially related to auto was further pressured. Although we largely expect these effects, the speed of the reopening magnified their financial impact in this quarter's results.

In our auto businesses, the increasing activity seen through an increase in miles driven led to elevated frequency. The environment also has significantly increased severity driven by supply chain issues, labor shortages, social inflation creeping into lower limit policies and Florida PIP court rulings that impact multiple policy years.

Alternatively, in our Life business, we saw increased demand for our products, historically high persistency and a reduction of COVID-related mortality. Our balance sheet and business model remain well positioned to navigate the reopening. We're taking appropriate action to ensure we meet the needs of our customers and continue to create long-term intrinsic value.

For a few specifics on the quarter, please turn to Page 4. We generated a net loss of $63 million or $0.97 per share as reported and $53 million or $0.82 per share as adjusted. We also produced an adjusted consolidated net operating loss of $99 million or $1.54 per diluted share as reported and $89 million or $1.39 per share as adjusted.

As highlighted before, the speed of the reopening and other environmental challenges negatively impacted these results. Duane will discuss these issues in greater detail.

Let's discuss the key metrics we use to evaluate our performance. Tangible book value per share, excluding unrealized gains, declined by 1%. The goodwill created from the American Access transaction contributed to the majority of this decline.

Note, as we stated at acquisition announcement, we expect a relatively short earn back and remain enthusiastic about how the transaction will expand our specialty auto franchise value. Return on tangible equity, excluding unrealized gains, was 11%. In addition, we continue to produce strong cash flow. Over the past year, we generated $422 million of cash from operations. These metrics highlight how even in a challenging environment, Kemper remains financially sound.

Turning to segment results. The swift reopening and the referenced environmental challenges led to an increase in both frequency and severity this quarter. Further, these inflationary factors and the Florida PIP court rulings I mentioned earlier, drove adverse prior year reserve development. As a result, the Specialty P&C segment generated an adjusted underwriting loss of $60 million and an as adjusted underlying combined ratio of 106%. We believe this to be a short-term obstacle that will extend a few quarters while we take appropriate corrective actions. We expect to return to a more normalized underlying combined ratio within the next few quarters.

In April, we highlighted how the uneven reopening from state to state impacted shopping behavior. This quarter, we saw demand for our products return, and we experienced strong growth. Policies in force grew 5.5% as adjusted and direct written premium on a normalized basis grew 13.2%. The business remains well positioned for attractive long-term growth and through proactive corrective measures appropriate long-term returns.

Our Preferred segment faced the same environmental challenges in our Specialty P&C segment, we continue to work to enhance this business.

Turning to our Life & Health segment. We continue to experience strong policy retention and increased demand. The heightened level of mortality we experienced earlier in the pandemic is beginning to subside. The business is positioned for our ongoing profitable growth.

On the capital deployment front, we continue to take actions that enhance the long-term intrinsic value of the company. We closed on our acquisition of American Access on April 1 and repurchased roughly $160 million worth of shares through the end of the quarter, while maintaining a high level of financial flexibility.

In summary, we experienced expected environmental challenges in auto this quarter. Their impact was magnified by the unanticipated rapid speed of reopening. On the flip side, our Life business has begun to return to a more normalized level of profitability. We have a strong balance sheet and a business model positioned to navigate the reopening and ensure we continue to deliver long-term value to our customers and investors.

I'd now like to turn the call over to Jim to discuss our second quarter operating results in more detail.

James J. McKinney
Executive VP & CFO

Thank you, Joe. Turning to Page 5. You can see the impact that the recent environmental challenges had on our business. In short, financially, it was a tough quarter. While top line growth returned to a more normalized rate, 2 years of increasing severity, additional supply chain challenges and a swift frequency return more than offset last year's premium credit and this year's mortality improvement. This resulted in a reported net loss of $63 million and adjusted loss of $53 million, a reported consolidated net operating loss of $99 million and an adjusted net loss of $89 million.

It is likely to take a few quarters for the environment to normalize corrective actions to begin to earn in and profitability to return to appropriate levels.

Turning to tangible book value per share. Excluding unrealized gains, tangible book value per share declined $0.30 compared to last June. Looking at this relative to last quarter, it declined $5.10. The primary driver was our investment in AAC and its corresponding goodwill that accounted for $3.7 of the change. We continue to expect this transaction to be accretive to franchise value.

On Page 6, we highlight our view of operating income. As mentioned, this quarter was negatively impacted by certain environmental challenges that led to higher frequency and severity as well as adverse prior year reserve development. Our Specialty P&C segment's as adjusted underlying combined ratio of 106% reflects an approximate 45% to 50% change in frequency and an approximate 8% to 10% increase in severity due to supply chain issues, such as commodity prices and labor shortages.

On the bottom half of the page, we display sources of volatility. You can see the impact that the increased litigation and social inflation had on the prior year reserve development and in our financial results. In a moment, Duane will provide additional details on this.

On Page 7, we displayed some of the key capital metrics we use to track our performance, including growth in tangible book value per share and tangible return on equity. Over the past 12 months, return on tangible equity excluding unrealized gains, was 11%. As discussed earlier, relative to last quarter, tangible book value per share, excluding unrealized gains, declined 12%. This was largely due to the AAC acquisition and its corresponding goodwill.

Going forward, the reference industry environmental challenges will likely pressure near-term tangible book value per share growth relative to historical performance. That said, we believe these challenges to be short term in nature and do not believe they will impact our long-run targets.

Continuing on Page 8, we highlight the strength of our balance sheet specifically, our insurance entities are well capitalized, liquidity remains strong and our debt-to-capital ratio of 20.7% is well within our stated target range of 17% to 22%. This profile provides us with a significant degree of financial flexibility to optimally navigate this environment and make appropriate investments.

On Page 9, we demonstrate our strong capital stewardship. This year, we've taken approximately $580 million of capital actions. Through June 30, we repurchased 3% of outstanding shares totaling roughly $160 million. In addition, as stated last quarter, we repaid the $50 million term loan, increased our annual dividend per share to $1.24 and closed on the acquisition of AAC.

Turning to Page 10. Net investment income for the quarter was $114 million, reflecting the strength of our core portfolio and strong alternative investment performance. Our portfolio construction, which focuses on matching liabilities and total return is designed to provide stable income through various cycles. This is evidenced through this quarter's pretax equivalent yield of 5%.

On Page 11, we rehighlight our solar energy investment with Sunrun. Our investment dollars are being used to finance the installation of solar panels on a portfolio of residential homes. This helps provide a clean alternative energy source to homeowners. From an accounting perspective, returns will primarily be recognized through the income statement as tax credits and deductions with a portion of these items offset by reductions in the fair value of the partnership. While this is a multiyear investment, the tax nature of the transaction front loads the return of cash and income recognition.

Net result, most of the expected lifetime returns will be recognized this year. The largest expected impact took place this last quarter. Cumulatively, the investment has increased net income by approximately [$17 million] or $0.26 per share. This is a great example of how we can use our capital benefit both the environment and our stakeholders.

In closing, while the company's quarterly financial performance was pressured by industry environmental factors, we are confident the corrective actions we have and are taking will return us to our financial targets over the next few quarters.

With that, I would now like to turn the call over to Duane to discuss the results of our P&C segments.

Duane Allen Sanders
Executive VP and President of Property & Casualty Division

Thank you, Jim, and good afternoon, everyone. Before I jump into our segment-specific results, I want to make a few comments about auto overall. So let's turn to Page 12. There are several environmental challenges that are impacting auto loss costs. On the frequency side, a significant rebound in miles driven has resulted in an increase in claims. At the same time, severity is increasing due to supply chain challenges, labor shortages and social inflation.

Recent Florida court rulings have changed some of the rules and requirements regarding personal injury protection. These changes impact multiple policy years. As a result, we reevaluated and increased our prior year reserves. This is part of doing business in Florida and does not change our commitment, our ability to serve this market in a manner that is good for both customers and shareholders.

One of our advantages is the ability to quickly adjust our operating model and pricing to these types of legal changes, and that process is underway. Further, in line with what others in the industry have observed, we are seeing an increase in attorney involvement in claims. With the reduction in claim activity during the pandemic, plaintiff attorneys have now expanded their focus to lower limit policies. This has resulted in a higher level of expected loss costs to which we have appropriately reacted. We continue to monitor the situation and are actively taking corrective actions.

Moving to Page 13. I'll start with Specialty P&C. Given the environmental challenges I just mentioned, the segment experienced a 17.3-point increase in its underlying combined ratio, resulting in an underwriting loss of $60 million. However, the current loss doesn't change our view of long-term profitability of the business. We remain comfortable with our underwriting practices and are taking appropriate actions to return the business to target profitability.

From a top line perspective, we had strong growth across the entirety of the franchise. Specifically, policies in force increased 5.5%, while written premium on a normalized basis increased 13%. This was significantly driven by Florida, Texas and our expansion states, where we have achieved top quartile growth, highlighting the portability of our model into existing and new territories.

Lastly, as I mentioned last quarter, on April 1, we closed the acquisition of American Access. It's been a pleasure working with our new colleagues and we're making great strides on the integration that will enable us to leverage their capabilities to enhance our Specialty business.

Turning to the Preferred segment on Page 14. The Preferred segment is facing similar environmental challenges. As a result, our business enhancements to date were overshadowed by these challenges. Overall, the Preferred segment -- in the Preferred segment, we continue to expect ongoing profit improvement actions to bring us closer to our desired results.

I'll now turn the call back to Joe.

Joseph Patrick Lacher
President, CEO & Non-Executive Chairman

Thank you, Duane. Turning to our Life & Health segment on Page 15. Overall, the Life & Health segment's profitability is beginning to improve as mortality returns to pre-pandemic levels. For the quarter, segment income was $13 million driven by lower levels of mortality and strong policy retention. Further, for our products, the environment is creating stronger consumer demand. This is seen through increased new issuance and improved policy retention. Issuance levels are above pre-pandemic levels, retention of 94% is at a historic high. The combination of these items produced a net result of a 5% increase in Life earned premium. Overall, our outlook for the Life & Health business remains positive, and the segment is positioned for profitable growth.

In summary, while this quarter's financial results were disappointing, they were not a complete surprise. When we concluded last quarter's earnings call, we stated that we expect to see a decrease in mortality, more auto insurance purchases, increases in auto frequency and loss cost inflation and a robust economy and associated investment impacts. All of these factors came to fruition at a faster than anticipated rate. Our balance sheet provides appropriate financial protection for these types of changes.

Further, our business model is designed to be nimble, efficient and responsive. We expect to quickly improve results and continue to use our competitive advantages to profitably increase market share. Despite this quarter's challenges, we remain in a strong financial position, and we'll continue to deliver on our promises to our customers and to provide attractive long-term results and value creation for our stakeholders.
I'll now turn the call over to the operator for questions.

Question and Answer

Operator

[Operator Instructions] Our first question today will come from Greg Peters with Raymond James.

Charles Gregory Peters
Raymond James & Associates, Inc., Research Division

I wanted to just focus in on the Specialty Property Casualty segment and the results, the underlying results there. I was wondering if you could give us some more color about where the deterioration was most severe. Was it California? Is it expansion states? Or was it Florida?

And the other thing, I went back and pulled up my Infinity Property Casualty model. And I have results going back to guide the early 2000s on a quarterly basis. And I don't think they ever reported a combined ratio this high. I'm pretty sure they never did. So I'm just curious -- I'm sure you're running everything is integrated at this point, but I'm wondering if you're able to isolate it to a pocket of business? Or is it just across the entire spectrum?

Joseph Patrick Lacher
President, CEO & Non-Executive Chairman

Yes. We'll tag team the results a little bit here, Greg, and thanks for the question. What we're seeing is a broad set of reopening with a fairly significant bounce up in frequency and some very significant issues around severity. The supply chain issues have seen a rapid change. You're getting an increase in parts. You're getting increase in cost to get a rental car. You're getting delays and how long things take to run through a body shop because they run through labor shortages or trying to get whether it's chips or parts or the like.

We are seeing some social inflation creep into our business in ways that we weren't in prior quarters. I think part of what you're seeing is that attorneys who had been focusing on higher limit policies when the pandemic saw a reduction in frequency, they started looking for other places and they moved more into lower limit policies where we hadn't seen them before. So that's putting some pressure on that. You've got the normal medical cost inflation that you're seeing.

So sort of all of those are happening fairly rapidly at one time. We foreshadowed those for you last quarter. We described that we expected to see supply chain challenges and somewhat of a demand surge later in the year. Honestly, I thought it was going to be third quarter and fourth quarter, not as much in the second quarter, but it came in largely as expected.

What we normally would have seen in the Specialty business is those things would have crept in a little slower and our capacity to adjust with rate would have been more rapid. Given the last 12 months of particularly low combined ratios, the ability to turn hard on that wasn't there. So it's going to take a little bit of time to do that because when you look back at a rate file and you look back at the more recent history, it shows some positive profitability.

So we're seeing the issues not appear to be anything at all from an underwriting perspective or an underlying model perspective, we're seeing a temperature rise across our book. Honestly, in some ways, the way you watch the progressive combined ratio and underlying combined ratio go up over the last 3 or 4 months, very similarly and very much in parallel the points of the underlying combined ratio change are similar.

James J. McKinney
Executive VP & CFO

Yes. And Greg, maybe what I would add to what Joe was highlighting, I think one of the things you've got some purchase accounting and other noise that are running through here. I'd really encourage folks to look at what the 6-month underlying combined ratio is for the particular business, which is at 99, again, definitely higher than our historical norms. But when you think about the quarter, it has a couple of things that are running through it that aren't necessarily just purely indicative of the quarter.

You've got some intra-year development that is both related to kind of, again, our PIK for the year. And so the more that we have information on this particular quarter and when we think about how that's going to play out in the year in terms of trying to pick an accident year, that basically brings in some elements that create some intra quarter or intra-year development that would -- again, they're accurate when you think about the 6-month view, but they would overstate a little bit what the quarter in and of itself would be.

The second thing that you see there is, again, some revised estimates that we have around the severity piece, not only just the frequency piece now for the year, but the severity piece, we continue to see that uptick. And whether that's being driven by additional rental car days because you've got chip shortages or labor shortages or whatever the driver is, we've further enhanced our thoughts relative to what that is. And so again, you've got a good full year, I think, in that 99, but it does look higher from a quarter perspective.

Duane Allen Sanders
Executive VP and President of Property & Casualty Division

I'm sorry.

James J. McKinney
Executive VP & CFO

No, go ahead.

Duane Allen Sanders
Executive VP and President of Property & Casualty Division

There's one other thought, this is Duane. In terms -- I mean, I think you hit on a couple of things there, but Joe mentioned it, the profile of the business, by and large, hasn't changed. I mean we continue to attract and write the same types of insurance that we've written historically. I do believe there's -- it's nuance, as you would suspect by state slightly. But by and large, we're seeing it country-wide nuance being driven by when states opened up, right? It's pretty much dictated by if some opened up ahead of others, then we saw different outcomes. California was late to the game. So we saw that certainly later in the quarter.

And as far as history goes, I don't know that if you go far as back as you did with Infinity, that you probably would have seen the environmental challenges that we've seen both as COVID hit and things slowed down, so you would have seen some outcomes there that were very unique. And I think we're seeing unique outcomes in the environment as we reenter. And I think Joe and Jim highlighted those in terms of the severity pressure and the frequency pressure. And I think that's going to take a little bit of time to normalize.

Charles Gregory Peters
Raymond James & Associates, Inc., Research Division

I just -- just as a point follow-up on that. You mentioned that the -- they're coming after -- well, the attorneys started coming after lower limit policies. I guess, legal costs are outside the policy limits for the lower limit policies? Or are they inside policy limits? I'm just wondering what the holy grail, the lawyers see in minimum limit policies.

Joseph Patrick Lacher
President, CEO & Non-Executive Chairman

Yes. Not every one of our policies are minimum limits, Greg, but there are lower limits. So even if somebody is coming after a [$25.50] policy, they're looking at those limit dollars and they're filing a suit on there. And they're coming to the conclusion that maybe they can find another $10,000 or $15,000. It's what I've described a little bit like the rats in Chicago during the pandemic with less activity. They came out of the alleys and we're a little more rampant than they were with less activity.

Some of the trial lawyers are working in places they didn't work before. And again, it's smaller limits, there's not going to be a lot of dollars there, but there are some, and that puts a little bit of pressure. It's not something that I -- that we look at and say, we think we've got something that's a fundamental underwriting issue or problem. We're comfortable with the business we're writing. Two or 3 quarters ago, I think your question was how long are these combined ratios going to stay this low? And we told you we didn't expect that they would. There would be a pandemic rebound.

I wouldn't compare this against the -- picking the worst Infinity quarter. I think what we've seen is the pandemic created an environment that had an abnormal rapid reduction in combined. It's going to have an abnormal return in combined, and then it will balance itself back out. So we're very comfortable with our long-term pricing targets and feel good about growing the business in this environment, and that's the message I take away.

I'd look at the full year numbers Jim was pointing you to and the fact that we're comfortable with our foot on the gas from a growth perspective.

Charles Gregory Peters
Raymond James & Associates, Inc., Research Division

Got it. First of all, I love the analogy of rats. So that's going to go down in the record books. But more seriously, you said you thought that things were going to really deteriorate in the third and fourth quarter when you say it's going to take you a couple of quarters to get back to normalized combined ratio, should we assume that at this point, because it's emerging, getting sequentially core worse month by month that maybe things continue to escalate, but then when we get towards the end of the fourth quarter, we start to see improvement. Is that sort of the cadence of what we should be expecting?

Joseph Patrick Lacher
President, CEO & Non-Executive Chairman

Yes, I'm going to answer your question slightly different, Greg, but try to get you where I think you're trying to go. And I'm going to try to avoid giving forward guidance or giving you a number to pick.

What I would tell you is that typically, in the Specialty auto business, we think we can adjust around a profitability issue inside of a couple of quarters. My sense is this is probably more like a 2 to 4 period rather than 1.5 or 2. That's because of 2 principal issues and all the other noise is working through there, I think you're going to see inflationary pressure on the supply chain, labor shortage and medical costs that are going to continue to stay elevated, higher than normal for at least 12 months, maybe 18 months. That's one.

Number two, rate filings typically require you to look at your historical data and put some sort of projection in for trend. The historical data that we're all showing across the industry has had some periods of very attractive returns. This is going to be a conversation with regulators that we're all going to wind up going through. It's going to be an industry issue of looking at those quarters of attractive returns. We're going to look at the returning frequency, the returning severity and an elevated severity and it's going to wind up being a set of conversations around which of those 2 should we put more weight on, the past or the future.

And ultimately, I think the regulators are going to realize that if they don't let the industry move and respond to the forward-looking loss trend, it's going to cause them -- it's going to cause carriers to restrict availability and it's going to cause a supply problem from an insurance perspective. But that he usually has to occur before the insurance departments recognize all of those issues.

So I think it will take a little bit of time, a little more than normal. It's not something that I think is going to take years, but somewhere in that 2, 3, maybe 4 quarter time period to get back into that mid-90s range that we like to be at.

Operator

Our next question will come from Paul Newsome with Piper Sandler.

Paul Newsome
Piper Sandler & Co., Research Division

So I'm looking at the loss ratios for the Specialty business in like '19 -- in 2019, and you're running about 75%. And then you had -- we had a couple of points of improvement in 2000, which I think most attributed to the stay-at-home orders but that improvement was a lot less than what we saw in other companies that are mostly standard.

Joseph Patrick Lacher
President, CEO & Non-Executive Chairman

Can I stop you for one second, Paul? I just want to make sure I'm understanding which segments you're talking about again?

Paul Newsome
Piper Sandler & Co., Research Division

The specialty personal auto.

Joseph Patrick Lacher

President, CEO & Non-Executive Chairman

The Specialty auto?

Paul Newsome
Piper Sandler & Co., Research Division

Yes, Specialty personal auto.

Joseph Patrick Lacher
President, CEO & Non-Executive Chairman

Okay, because I thought I heard you talking about homeowners.

Paul Newsome
Piper Sandler & Co., Research Division

No, I'm sorry, Specialty personal auto.

Joseph Patrick Lacher
President, CEO & Non-Executive Chairman

I'm sorry. Got it. Got it. Okay. Personal auto. Yes. Sorry.

Paul Newsome
Piper Sandler & Co., Research Division

The point was there was sort of a couple of points of improvement in 2000 that were attributed to the stay-at-home orders. And the thought was that nonstandard was a little different than, say, standard business in that the behavior of drivers was less impacted by state homeowners. Now if I back into the number today, it looks like the loss ratio is probably closer to 80 on a run rate basis.

So should I -- am I wrong to say that essentially the return to stay-at-home orders is really just a couple of points and that the remainder of that is these environmental issues, the PIF count to give me a magnitude of what is really what the frequency impact versus what is the other pieces here that -- or I guess the converse of that is that maybe there was things happening in 2000 that was masking problems that started earlier. And so what we're seeing today is sort of the culmination of underwriting issues that started not just this year, but for this quarter, but actually back in 2000.

James J. McKinney
Executive VP & CFO

Yes. No, thanks for the question. This is Jim. Paul, I think I might encourage -- first, I'd start with -- I think it was more than a couple of points of potential impact. Now some of that was offset by premium credits or effectively, there was some increasing severity, right, that was on the other end that kind of brings you to that net answer that you're referencing.

But now when you step forward, you've now had 2 years of severity trend running through, right? And instead of having like this quicker or some way to come back and say you've got rate that would be similar to the premium credit that we gave up on the other side, right, that would have extended that instead of having a couple of point benefit you might have a 4- or 5-point benefit, right, that was coming through there.

We now have the other end where you've come almost instantly kind of back. And I think -- again, I'm [not going to point too much] of progress, but I think they do a nice job right with the monthly financing when you see that 47%, 48% type frequency increase, the speed with which that came back isn't like anything even in the way going down to some extent other than a month. And now you have nothing to match that against both for rate to offset the severity pressures and the other that are coming back on the other side.

And so it's unfortunate in terms of how these things align. If it would have taken a few more quarters for this to kind of normalize from a frequency perspective, I don't think you get quite the same level of impact from the severity side because you don't put the same pressures on the supply chain that, quite frankly, are being put there now.

On top of that, you've got an increased period of time to provide data to the regulators work with them so that this is more matched. And so your rate can be a little bit more balanced, right, in terms of how it comes in versus what you're seeing now, which is just quite frankly, these 2 things are disjointed. And again, it's unfortunately, but it's not something that we won't fix or not used to.

I'd highlight how we responded with AU and how quickly we brought that to fruition. Now we've got an unusual [severe] time, we'll work through that. But this isn't going to change the long-term underlying profitability of this business or the benefits that we're going to bring and continue to bring to customers or our ability to take medium- and long-term market share. So again, unfortunate. It's definitely got our attention. That's an understatement, but we'll respond and we'll get back to where we were.

Paul Newsome
Piper Sandler & Co., Research Division

Could you contrast the situation underlying all these is with the preferred versus the nonstandard auto? And is it basically the same themes with the same magnitude? Or there are other differences that we should think about between the 2 segments and how [we've sort of into it].

Joseph Patrick Lacher
President, CEO & Non-Executive Chairman

Sure, Paul. They're largely the same themes. There's a few things that are exacerbating in the specialty space. the Florida PIP issues are Specialty only because we don't do Florida business inside a preferred. So those are unique and understandably different there.

What we saw in the preferred business was a little bit of a difference in the frequency changes. You highlighted this before. In the pandemic, the specialty business didn't see as much of a frequency good guy when people went home as the preferred did. And the rebound has actually been bigger in the specialty business. Those folks were less likely to have worked from home before. As a rule, they were less likely to be able to continue to work from home.

So as there's been some increase in miles driven that gives you a little bit of a difference in frequency delta and distribution around those. I think our Specialty business just saw that a little differently. I think the biggest issue between them is probably coming around the PIP and the slope of the frequency numbers.

I think if I were measuring where they were net-net but down to the up, the preferred probably is still a little ahead in total net-net from those 2. You get warranty percentage change when you're comparing period-over-period. But net-net, those specialty is a little worse off than that on the combined.

Operator

Our next question will come from Brian Meredith with UBS.

Brian Robert Meredith
UBS Investment Bank, Research Division

A couple of questions here. First, Joe, I'm just curious, why wouldn't you just step off the accelerator a little bit on growth right now while you kind of figure out what this ultimate loss cost situation is going to be and what regulators are going to give you from a rate perspective?

Joseph Patrick Lacher
President, CEO & Non-Executive Chairman

Sure, Brian. We're very comfortable where we are from an underwriting perspective and what the underlying business model is going on inside of Specialty. We were -- to some degree, we're looking at what the 2 years combined look like '20 and '21. And what's happened, net-net, is we got a little less rate in that time period than we would have expected from a normal time period.

We've got a little bit of a severity increase right now that's running hot, that more than a normal period. And we're highly confident that we can adjust with whatever we pull with our rate levers and non-rate levers over the next 6 months to put ourselves into an appropriate position.

We're also confident that the competition is going to continue to move and have to respond inside of that environment. We believe we've seen the issues earlier and are responding earlier. And we're confident that while some folks -- the same issues are out there. They just probably haven't seen it and described it yet, and they're ultimately going to do that, and we're going to be there like it's often the case to catch the business during the market disruption. It's a confidence inside of the Specialty model and the knowledge of what we've got in our capacity to move quicker.

Brian Robert Meredith
UBS Investment Bank, Research Division

Okay. And then I guess my second one, just on the Florida PIP situation. Is that purely just prior year policies being affected? Or did it have an effect on your current year kind of underlying loss ratios in the Specialty segment? And is that something you need to price for? Or is it simply just a one-off situation?

Joseph Patrick Lacher
President, CEO & Non-Executive Chairman

Yes. There was a PIP ruling and it changes the way whether you're paying fee schedule or limited numbers and there's some technicality around it, the $50 million, $55 million associated with that, not only impacts the current year, but there's a 5-year open statute of limitations, if you will. So I would really think about that as if it were running over 5 policy years.

And Florida for us, that's about $2.5 billion. So it's not a big number when you put it over a $2.5 million policy base -- $2.5 billion. It will -- it impacts the current year and it will impact going forward. But if you look at the combined ratios in Florida over the last 5 years, they've been highly attractive. And even with $55 million of losses on the $2.5 billion base remain highly attractive. So we'll factor that into our thought process. But it doesn't change our view on the market.

And if you do the math just on the Florida stand-alone basis, it doesn't change the view that you'd love us being in the state and you'd be happy that we were growing it.

Operator

Our next question today will come from Gary Ransom is with Dowling & Partners.

Gary Kent Ransom
Dowling & Partners Securities, LLC

I think in specialty, most about what you've been talking about has been on the personal line side, personal auto. Can you talk a little bit about the commercial? I know it has better -- I see it has better combined ratios. But are some of same trends you've been talking about affecting that part of the business as well?

Duane Allen Sanders
Executive VP and President of Property & Casualty Division

Gary, this is Duane. Yes, I think you are correct. It's a little more, I would say, subtle inside of the commercial line side, but we're obviously seeing the frequency impact. There's a little bit on the severity side. It's distributed in terms of volume, slightly different than the personal auto side is.

But again, it continues to generate decent returns, and we're watching it closely. And to Joe's point, where we're making changes along the way as the market moves on us, we're doing that inside of that business as well.

Joseph Patrick Lacher
President, CEO & Non-Executive Chairman

We're not really seeing a change in the social inflation there. So whatever was there, was there before. It obviously doesn't have any impact of the PIP that we saw in the PI side of the house and it had a little bit of a better starting point. So it's just got the general environmental issues, but some of the idiosyncratic things that we're running through the rest of the personal auto in the specialty space aren't there?

Gary Kent Ransom
Dowling & Partners Securities, LLC

Right. Okay. And then in terms of the actions you want to take, are there -- obviously, there's rate as you were talking about. Are there other things you can do that might change things a little more quickly, whether it's how you treat new business or payment plans or other things like that, that might have -- be a meaningful lever to pull.

Duane Allen Sanders
Executive VP and President of Property & Casualty Division

Gary, this is Duane again. Yes, you're exactly right. And we continue to manage the underwriting side, I'll call it that -- kind of we constantly monitor that. And to Joe's earlier comments about how we're reacting, we've already pulled a lot of those and have been pulling those over the last 30 days, if not 60 days as we've seen the market and the environment start to change. And we continue to do that certainly within the guidelines that we have to abide by while we're positioning ourselves for the rate change that we're queuing up.

We have several of those, as you can imagine, across all of our business lines to get those in play as soon as we can. But in the meantime, we are adjusting through segmentation levers that we have, underwriting levers that we have to try to respond to what we're seeing. So your answer is long -- short answer is yes, we are.

Joseph Patrick Lacher
President, CEO & Non-Executive Chairman

We're taking, Gary, in our thought process. We're not taking a quarter at a time view. We're taking a longer-term view. And what I'll point you to as you remember, when this management team first came in, we had an Alliance United acquisition that was running 125 combined ratio and growing at 30-some-odd percent. We had a relatively quick fix on that, and we never slowed the growth in that business below 20% because we believe the best long-term intrinsic value creation was to be able to grow that business and produce returns over the long term. And that's what we did inside of that.

So if we thought it was going to be a longer-term trade, we might have a different point of view. But when we look at it, we're saying what produces the best long-term NPV and growth in tangible book value, and that's going into our thought process. So it impacts the confidence we have on the speed.

Operator

[Operator Instructions] Our next question will come from Matt Carletti with JMP Securities.

Matthew John Carletti
JMP Securities LLC, Research Division

Just a quick one on the prior year development. We spent a lot of time on the accident year, but just wanted to ask, I guess, one, how do your confidence or conservatism level that kind of went into getting there, really trying to get out your confidence that at least from a prior year perspective it's kind of hopefully put behind you?

And then second question along those lines, just from a PIP perspective. What's been your experience in terms of kind of the real tail in that business? I know the statute of limitation in 5 years, but kind of which accident years did that 76 really relate to? And kind of -- I'm trying to get at -- once we get a certain distance away from things kind of when effectively, do you have a good feel on that tail?

James J. McKinney
Executive VP & CFO

Okay. So a lot there. Let me try to unpackage it and a couple of things, and I'm sure we'll tag team this a little bit. In terms of the development question and confidence. I would tell you there's a wide air bar in the environment, but I do believe that we have as we try to put our best foot forward from an estimate, but also trying to be at the higher end of that confidence range versus the lower end in terms of where it's at.

And we are -- we definitely try to take a view forward and think about, okay, how are these curves developing. So if we think about severity impact that's here today, what do we think is happening from an ongoing severity that is going to end up with our resolution of those particular claims. And so that's not a different process for us, it's the same level of same viewpoints that we would have there. And I think you'll see from a preference standpoint, we always want to have a strong balance sheet. And so from that perspective, we tend to be more I don't -- conservative is the wrong word. And so I'm trying to say , but we tend to -- if we're going to lean one way or another, we tend to lean more towards the item that is going to ensure that we have the right view of the balance sheet than not.

So let me pause there and see if there's any follow-up questions on that before we try to unpackage the second part of your question.

Matthew John Carletti
JMP Securities LLC, Research Division

No, that makes sense.

James J. McKinney
Executive VP & CFO

Okay. In terms of the -- I think it's going to be a little hard, and I'll ask Duane and Joe to I mean here to fully appreciate like when we'll have the for PIP item 100% big from [Page] or rather coming in because, quite frankly, some of the court cases just shook out in June.

So that becomes a little difficult to say 100%. But when you look back over time periods, even like this, it tends to be a 9- to 18-month window before you have a -- are you going to move 1 or 2 points down from your mean development factors at that point or up there are not huge deviations from those components at those standards.

I would also indicate that we've thought about what we think that development pattern is that is included. We tried to be really thoughtful with it. We tried to set it aside. I prefer not to, and I think the entire team. I don't want to talk about this next quarter and the quarter after, right? So we tried to give what the best pick is and what those ultimate claims are going to be. And within 9 to 10, 12 months, maybe 18th the longest will really have strong paid patterns that will validate and there -- could you have a little bit up or down? Sure, but I don't think it'd be a whole lot. And I'll ask Duane and Joe to maybe give some comments.

Joseph Patrick Lacher
President, CEO & Non-Executive Chairman

Maybe I'll jump in here, Jim. And Matt, I want to make sure we're answering the question the way you were asking it. I think Jim was giving you a balance sheet confidence on the PIP question. Were you asking that? Or were you asking sort of changing PIP environment? And how long does it take to sort of work through it environmentally and from a business perspective?

Matthew John Carletti
JMP Securities LLC, Research Division

It was a little bit of both. And I think the balance sheet question is pretty clear, but any color on the latter would be helpful.

Joseph Patrick Lacher
President, CEO & Non-Executive Chairman

Yes. From an environmental perspective, Matt, Florida PIP is always a little bit of a mess. There's always some group of trial lawyers, some group of medical providers trying to work the system to squeeze a little more juice out of the orange. That's part of why it's a good specialty environment. It creates a challenge for folks who aren't really good at it and strong at it. I -- there's nothing about this particular set of rulings that we look at and says it's rewritten fundamentally the way PIP is going to operate in Florida.

It's a court decision that changes the way most carriers were interpreting whether you pay the fee schedule or you pay the limited amount. We believe those were intended to be written into the law for different purposes. The legislature changed the law a little bit and there were some verbiage and word changes. This might be a couple of hundred bucks a claim that is having an impact on a per claim level. $50 million, $55 million on $2.5 billion is a couple of points on a business that for us had a combined ratio, high 8s, low 9s starting point for the last 5 years at different points, depending on which period you picked.

It's been an attractive business for us. It's not fundamentally changing our view on Florida, it's changing how we work through some existing inventory and how we think about that on new arisings. But if that's the only thing that happened, we wouldn't be changing much about what we were doing in Florida, except a handful of practice changes and a little bit of a review on some open claims.

Operator

Last question will come from Jeff Schmitt with William Blair.

Jeffrey Paul Schmitt
William Blair & Company L.L.C., Research Division

Was any of the adverse reserve development related to American Access? Or was it all Kemper and IPCC. Just curious how reserve levels are sort of looking there?

James J. McKinney
Executive VP & CFO

No. The development that's being referenced is Kemper and Infinity combined book. There's no AAC there, it's inside those numbers. And I think we continue to be appropriate and strong, and we've dug through AAC multiple times, and we'll continue to do that, is very happy with the acquisition, very happy with the strength of the balance sheet, underwriting nothing there that has changed any of our thoughts, assumptions or other at this stage.

Jeffrey Paul Schmitt
William Blair & Company L.L.C., Research Division

So -- I mean it doesn't look to be in the same boat as Kemper?

Joseph Patrick Lacher
President, CEO & Non-Executive Chairman

What we're seeing is the same issues that you're seeing environmentally on increased frequency, increased severity and the supply chain issues, labor shortages, the like, it's working through all of those issues. There was no significant PIP running through that environment. So -- and if you take the PIP out the prior year, we're not a huge set of numbers that we're running through there. So it's just not -- it's got the same -- these are similar drivers on similar roads and similar environments. So the frequency and severity issues we're seeing on the whole book are there.

Jeffrey Paul Schmitt
William Blair & Company L.L.C., Research Division

Okay. And then you provided some color on just social inflation moving down into those lower limits. Do you know what percentage of claims have attorney representation now versus maybe a year ago or maybe versus like historical levels?

Joseph Patrick Lacher
President, CEO & Non-Executive Chairman

Yes. We have a sense of it. It's not something we typically disclose, Jeff. We've got -- depending on which of the different entities we picked up from acquisitions, they count claims a little differently, claim counts and feature counts, where some will count an accident, some will count the number of cars involved, some will count the number of people in the cars. You get any of these different issues. There was a different counting mechanism. So those rates become a little differently when we look across the books going historically. It's a significant change, but not multiples.

Jeffrey Paul Schmitt
William Blair & Company L.L.C., Research Division

Okay. Got it. And then inflation upon the homeowner side, what is that trending at? I mean we've heard from others that it could be as high as 10% increase in loss cost trends. Are you seeing that there too?

James J. McKinney
Executive VP & CFO

Yes, that -- yes, we are. I think we're again, just like the rest of the environment, whether it's body shops or lumber prices or labor rates, it's -- we're fairly consistent with what others are seeing in that space.

Operator

Ladies and gentlemen, this will conclude our question-and-answer session. I would like to turn the conference back over to Joe Lacher for any closing remarks.

Joseph Patrick Lacher
President, CEO & Non-Executive Chairman

Thank you, operator, and thanks, everybody, for joining us on the call today. We appreciate your time and interest. We know that the pandemic created a lot of interesting challenges, as we all sort of started working from home and staying at home and it's going to create an interesting set as we reopen. But we're very confident about our overall business model and our long-term prospects and are excited to talk to you again next quarter. Thanks a lot.

Operator

The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.