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Selective Insurance Group, Inc. (SIGI)

Q2 2013 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good day, everyone. Welcome to the Selective Insurance Group's Second Quarter 2013 Earnings Release Conference Call. At this time, for opening remarks and introductions, I would like to turn the call over to Senior Vice President, Investor Relations and Treasurer, Ms. Jennifer DiBerardino. Thank you, you may begin.

Jennifer W. DiBerardino
Senior Vice President, Investor Relations & Treasurer, Selective Insurance Group, Inc.

Thank you. Good morning, and welcome to Selective Insurance Group second quarter 2013 conference call. This call is being simulcast on our website and replay will be available through August 30, 2013. A supplemental investor package which includes GAAP reconciliations of non-GAAP financial measures referred to on this call is available on the Investor page of our website, www.selective.com.

Selective uses operating income, a non-GAAP measure, to analyze trends in operations. Operating income is net income excluding the after-tax impact of net realized investment gains or losses, as well as the after-tax results of discontinued operations. We believe that providing this non-GAAP measure makes it easier for investors to evaluate our insurance business. As a reminder, some of the statements and projections that will be made during this call are forward-looking statements as defined by the Private Securities Litigation Reform Act of 1995. Forward-looking statements are not guarantees of future performance and are subject to risks and uncertainties. We refer you to Selective's Annual Report on Form 10-K and any subsequent Form 10-Qs filed with the US Securities and Exchange Commission for a detailed discussion of these risks and uncertainties. Please note that Selective undertakes no obligation to update or revise any forward-looking statements.

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

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

Dale A. Thatcher

Executive Vice President & Chief Financial Officer, Selective Insurance Group, Inc.

Thanks, Jen. Good morning. Second quarter results exceeded our earnings expectations as we achieved another quarter of strong rate increases and consistent retention.

For the quarter, we recorded operating income per diluted share of $0.42 versus $0.01 a year ago. While $0.12 per diluted share of the improvement is due to lower catastrophe losses year-over-year, the primary drivers of results were the improvement in pricing and underwriting. The second quarter statutory combined ratio of 97.7% was an 8.5 point improvement from a year-ago.

Catastrophe losses in the quarter were $20 million pre-tax or 4.6 points, down from 7.7 points a year ago. Also in the quarter, we had favorable prior year casualty development of $2 million or 0.4 points. Total statutory net premiums written was up 9% in the quarter, with Standard Commercial Lines net premium up 9%, and Excess and Surplus Lines up 15%.

Standard Commercial Lines retention increased to 83% from 82% a year-ago, and renewal pure price was up 7.2% for the quarter. The statutory combined ratio in the quarter was a strong 95.6%, including 2.8 points of catastrophe losses. All standard commercial lines of business were under a 100% combined ratio in the quarter with the exception of workers' compensation. Results range from a 76% statutory combined ratio in BOP to a 95% statutory combined ratio in commercial auto.

Workers compensation results were 118.3% in the quarter, were driven by adverse prior year casualty development of $3 million or 5 points, primarily from the 2012 accident-year. We have a number of initiatives in place to address the profitability of this line of business, including rate increases that, in general have outpaced our overall renewal rate increases.

Personal lines net premiums written grew 3% in the quarter to $79 million, and the statutory combined ratio was 102.9%. Results included 10.7 points of catastrophe losses, compared to 16.5 points in the prior year quarter. The cat losses in the second quarter were from scattered storms and tornados throughout our footprint without any single particularly large event. Personal lines pricing was strong in the quarter, with renewal rate of 8.3%, and we continue to see the benefits of our pricing success in underlying results. Retention held steady at 87%.

Net premiums written for our E&S operations grew to $33 million in second quarter, up 15% from a year ago. The statutory combined ratio of 106.8% was impacted by 8.5 points of catastrophe losses in the quarter, which were primarily driven by weather events in the South and Southwest. Additionally, we had $2 million or 6.7 points of adverse prior year casualty development, which was partially offset by better than expected non-catastrophe property results. Given the relative size of the E&S operations, there will be some volatility in quarter-to-quarter results.

We successfully completed placement of our July 1, 2013 excess of loss reinsurance treaties. Both casualty excess of loss and property excess of loss treaties were renewed with substantially the same terms as expiring. The casualty excess of loss treaty provides $88 million in coverage, in excess of our $2 million retention. While our property excess of loss treaty provides $38 million of coverage in excess of our $2 million retention. Rate on the program was down slightly as reinsurers continue to give credit for underlying primary carriers' price increases.

Turning to investments, second quarter after-tax investment income was essentially flat at $26 million, compared to a year ago. The rise in treasury yields towards the end of the quarter did not materially affect investment income but new money rates for the quarter increased to 1.6% after-tax. Although an improvement, this rate is still below the run rate of the fixed maturity securities portfolio. New money rates reflect our high average credit quality and where we are making new purchases on the yield curve.

The after-tax yield on fixed maturity securities was 2.3% for the quarter, down about 24 BPs from the year ago period. The overall portfolio yield was down 13 basis points. As we stated, for every 25 basis point drop in portfolio yield, we lose one point of ROE, which subsequently requires a one point improvement in combined ratio to offset the decline. Year-over-year fixed maturity income declined 5% while alternative investment income increased 22% as valuations continue to improve.

Private equity strategies benefited from strength in the high yield market and strong equity market performance, while the majority of our alternative investments report on a one quarter lag, equity market performance is not entirely predicative of the performance of our alternative portfolio. This is largely due to the mix in vintage of our investments, which include private equity, mezzanine debt and real estate funds.

Invested assets increased 5% from a year ago to $4.4 billion, driven primarily by increased operating cash flows and the net proceeds from our senior note offering in February. Partially offsetting these increases was the mark-to-market impact of $84 million, primarily driven by higher interest rates on the fixed income portfolio. Compared to June 30, 2012, the overall portfolio unrealized gains position declined from $172 million to $88 million pre-tax at June 30, 2013. Also of note is the quarter end unrecognized gain position in the fixed income held-to-maturity portfolio of $28 million pre-tax, or $0.33 per share after-tax. Our overall fixed income portfolio maintains a high credit quality of AA- and duration of 3.5 years including short-term investments.

Surplus and stockholders' equity ended the quarter strong at $1.2 billion and $1.1 billion respectively. Book value per share at June 30th was $19.72, essentially flat with year end 2012, but down sequentially from the first quarter, largely as a result of the negative impact of rising interest rates on the portfolios unrealized gains, partially offset by positive net income. Our premium to surplus ratio was 1.5 to 1 at June 30th. In the quarter we achieved operating return on equity of 8.5% and total ROE of 9.7%, both exceeding our current 8% weighted average cost of capital, as we continue to make progress towards our 12% ROE goal.

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

John J. Marchioni

Executive Vice President-Insurance Operations, Selective Insurance Group, Inc.

Thanks, Dale. Good morning. Second quarter results reflect a success of our underwriting and claim strategies, and the exceptional employees and agents we have executing on those strategies. We are successfully deploying our underwriting and pricing tools that provide underwriters with specific policy level guidance on an agency portfolio basis, which allows underwriters to target the highest rate increases on the worse performing accounts, while protecting retention on our best accounts.

Year-to-date for Standard Commercial Lines, we obtained 16% pure rate on our lowest quality accounts with a point of renewal retention of 72%. We obtained a 6% pure rate increase on our highest quality accounts, while maintaining a solid 90% retention. As previously mentioned, we achieved 7.2% standard commercial renewal pure pricing in the quarter, while retention remains strong at 83%. Standard Commercial Lines new business improved substantially in the second quarter to $73 million, up 25% from depressed levels a year ago. On a year-to-date basis, new business is up 11% to $142 million, while this is significantly below our capacity, and submission activity remains under pressure, hit ratio has improved in the quarter. We remain very comfortable with the quality and pricing of our new business.

In an otherwise great quarter for commercial lines, workers' compensation require reserve strengthening mainly for the 2012 accident-year. While we continue to view workers' comp in a context of an overall account, we remain very focused on improving this competitive line of business through underwriting, while we achieve renewal pure price increases of 7.8% for the first six months of 2013. We are applying all of the underwriting tools we have to move pricing higher, and write the best risks. We also have a number of claims initiatives aimed at proactively managing return to work programs and higher severity claims. We won't be satisfied until we have significantly improved the profitability in this line, but we are up against industry issues that are not easily solved due to the regulatory environment.

Through six months, our excess and surplus lines contract binding authority business combined ratio was 102.6%. The first half of the year included renewal pure price increases of 7.6%, which is contributing for the underwriting improvements as we apply Selective's monitoring tools and discipline to this still, relatively new book of business. Results are tracking in-line with our expectations to achieve between a 100%, and 102% combined ratio for 2013.

Underlying personal lines results in the quarter were strong, but the reported combined ratio was negatively impacted by catastrophe losses, as well as three points of adverse development related to a few 1970's Personal Injury Protection or PIP claims. We still have a small inventory of claims from a period of time in the mid 1970s when PIP was unlimited, and the state's catastrophic funds or UCJF was not yet in place. Due to a lifetime nature of these exposures, individual files were occasionally developed unfavorably.

We are making good progress on our targeted profitability improvements for both, homeowners and auto. We achieved an overall 8.3% renewal price increase for personal lines in the quarter, while retention remained high at 87%. Growth was within our expectations in personal lines as we carefully push rate and work to improve our mix of business. The statutory combined ratio through six months remains a profitable 97.6%.

We continue to drive profitability in the homeowners' line as we increased rates across the book and make underwriting changes including raising deductibles to increase cost sharing. In fact, since June 2012, we have increased the average deductible on our in-force book by 21% to $890 million, from $735 million. Additionally in 2013, we have tightened our underwriting appetite for model line homeowners. We still require additional rate increases to achieve our targeted combined ratios in the high 80's in a normalized catastrophe year. For the six months, our homeowners' line achieved its statutory combined ratio of 97.8%, including 11.8 points of catastrophe losses, and renewal price increases of 11.1%.

For personal auto, we have consistently been getting price above loss cost trend, achieving 6% in the second quarter. We are increasing the geographic diversification of our auto book, and have made progress on increasing the age of the book. We believe that our ongoing rate action and improvement in the underwriting mix of business, and maturity of the auto book will continue to drive improvement in this line for long-term success.

We recently held six producer council meetings throughout our 22 standard – state standard lines footprint, as well as our – as for our E&S operations. Agents tell us that they remained very comfortable with the granular approach we are taking on renewal price increases. They have also indicated that we are well positioned to take advantage of the quality new business accounts that are being pushed into the market by some competitors. We recently received the results of our annual, independently administered agency survey, where we received even higher marks from our agents than a year ago.

Operationally, we are very confident in the progress we are making towards our 2014 goals.

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

Gregory E. Murphy

Chairman, President & Chief Executive Officer, Selective Insurance Group, Inc.

Thank you, John. Our second quarter results through underwriting combined ratio, renewal pure price increases, new business growth and retention, are compelling and demonstrating the improvements to our underwriting operations.

The 97.3% six month statutory combined ratio is a 170 basis points below our full year guidance, and reflects these important contributing factors; standard renewal pure price increases of 7.5%, which have earned in at a 6.7% rate versus a fairly stable loss trend of three points; catastrophe losses, 50 basis points below our full year three point estimate; favorable prior year casualty reserve development of 40 basis points, partially offset by the pension curtailment which increased the combined ratio by 70 basis points.

Despite the commentary that we are hearing in the industry, about pure rate increases losing momentum, we do not see anything that causes us to modify our three year underwriting improvement plan that achieves a 92% ex-cat statutory combined ratio in 2014. For the first six months of 2013, our ex-cat statutory combined ratio was 94.8. Renewal pure price increases are the linchpin of our three year goal, and we are achieving results, well within our stated target for 5% to 8% increases each year through 2014.

We achieved standard renewal pure price increases of 6.3% in 2012, 7.5% for the first half of 2013; while standard lines retention remain steady at 84%. Our renewal pure pricing strategy of 5% to 8% reflects our expectation that 2014 standard renewal pure price levels will be monetarily below the current year, 7.5% rate that we achieved. While fixed income interest rates did move higher in the second quarter, we do not believe these rates lessen the substantial industry need to increase pricing in order to generate 10% to 12% ROEs. In our analysis, if rates were to move up 50 basis points per year for the next few years, book yields would continue to under perform 2012 levels until we reach 2018.

Underwriting improvements are ahead of our expectations. Our granular pricing capabilities through sophisticated underwriting tools are driving the results. Additionally, we're on-track with our claims improvement plan to achieve two points of benefit on our loss and loss adjustment expense ratio through initiatives such as medical cost containment through extensive network re-negotiations, enhanced nurse case management, sophisticated fraud and recovery predictive modeling tools, legal fee management, and a complex claim unit.

Our strategy to write small-to-mid sized accounts, which naturally have a lower profit volatility, allows us to use higher leverage at both, our underwriting operations and investments to enhance results. Most importantly for Selective, one point of combined ratio equals one point of ROE, for the industry it takes two points of combined ratio to generate one point of ROE. Competitors need to drive their combined ratios into the low 90s to achieve acceptable ROEs. Due to these dynamics I do not anticipate any major barriers in achieving our 92% ex-cat statutory combined ratio goal for 2014.

Although our results are better than expected for the first six months, our underwriting guidance for the full year 2013 remains an ex-cat statutory combined ratio of 96%, including no additional prior year casualty development, and a three point estimate for catastrophe losses. However, we are fine tuning our after-tax investment income to be approximately $95 million for the year. Weighted average shares are expected to be approximately $56 million.

Now I'll turn the call over to the operator for your questions.

QUESTION AND ANSWER SECTION

Operator: Thank you [Operator Instructions]. Our first question comes from Vincent DeAugustino with KBW. Your line is open.

Vincent M. DeAugustino
Analyst, Keefe, Bruyette & Woods, Inc.

Q

Hi, good morning, all.

Dale A. Thatcher
Executive Vice President & Chief Financial Officer, Selective Insurance Group, Inc.

A

Hi.

John J. Marchioni
Executive Vice President-Insurance Operations, Selective Insurance Group, Inc.

A

Good morning, Vince.

Vincent M. DeAugustino
Analyst, Keefe, Bruyette & Woods, Inc.

Q

John, one of the comments that you had made about the regulatory environment, specifically on workers comp, I guess, I've always thought about for some lines being up a little bit generally tougher from a regulator standpoint and commercial lines are a little bit more flexible. So I was just curious that is there anything new or any specific challenges that you are seeing now that speak to that comment or if that was just more of a general and consistency in that with no change underlying?

John J. Marchioni
Executive Vice President-Insurance Operations, Selective Insurance Group, Inc.

A

Yes – Vince, I think it's a good question and I do think it's fairly consistent overtime but when you think about the difference between personal auto or home for that matter and comp, while in certain stage it is sometimes more difficult to get rate increases through, you are still facing those rate filings on your own individual performance and your own expectations about loss cost going forward. Whereas in workers comp, you require – you're relying on either NCCI or an individual state bureau to develop the loss cost and build-in expectations for medical inflation going forward. So, you have a little bit less control over what you actually filled and what you support with regard to your rate level indications, so I think that is a little bit of a different approach than we see in personal lines generally, the best and consistent overtime.

Vincent M. DeAugustino
Analyst, Keefe, Bruyette & Woods, Inc.

Q

All right, perfect. And then, Just since you mentioned it on the medical loss cost side, just curious how you guys are feeling about medical loss cost inflation in the context of – some of the workers' comp development, and some of the yield claims that have come up? I'm just looking out a year or so, how much do you think medical severity might do? It is still – at this point we're getting on the cost of – at the bay between whether rising interest rates kind of foretell rising at wealth cost inflation, and just always curious, have your guys thought on the topic?

Dale A. Thatcher
Executive Vice President & Chief Financial Officer, Selective Insurance Group, Inc.

A

Vince, this is Dale. I mean, obviously, we're paying very close attention to it but we are stuck a lot like you trying understand exactly what's going to happen with Obamacare, and with all the other different initiatives that are going on out there, we're very careful about what we monitor, and we are obviously assuming some higher level of loss cost inflation on the workers' comp line and the general liability line, and both of those are related to the medical costs, but your guess is as good ours as to where that's ultimately going to play out.

John J. Marchioni
Executive Vice President-Insurance Operations, Selective Insurance Group, Inc.

A

And Vince, this is John. Just add to that, you heard references during the prepared comments relative to medical cost containment and other claims initiatives, we are absolutely focused on some of the more significant and longer term comp claims, and some of the improvement we're making. So, while we don't have a lot of control of our medical inflation, we can try to better manage severity, at least where the big dollars are relative to the claims inventory and that will help offset some rise in inflation going forward.

Vincent M. DeAugustino
Analyst, Keefe, Bruyette & Woods, Inc.

Q

Okay.

Gregory E. Murphy
Chairman, President & Chief Executive Officer, Selective Insurance Group, Inc.

A

The only – this is Greg, hi. The only other comment I would add is, obviously, when we look at inflation, and medical inflation, which we look at specifically within the comp line, we're looking at a long period of time. So there is a pretty high inflation rates built into the base period. And so, we are looking at that, we have seen from time to time some increases in our tail factor but nothing that is outside the ordinary. I think this situation that you are talking about relative to some of these claims, more on a severity basis, on an individual claim basis then there is any over – you know, overarching inflationary matter.

Vincent M. DeAugustino
Analyst, Keefe, Bruyette & Woods, Inc.

Q

Okay, perfect. Actually your guys have commented, I think you are ahead of the game as far as where some of your other regional peers stand on analytics standpoint. So, you are quite comfortable there. If I can throw one other one, just you guys have mentioned, just with the sequential changes in TNT rates lately, from my standpoint if you guys fair pretty well – and when I – one of that comment goes to where the fourth quarter 2012 is at? So I am just wondering, since Sandy kind of barreled through your backyard, if there is any commercial pricing benefit in the first quarter from, maybe Sandy knee-jerk reaction that maybe diminished a little bit making the sequential rate comparison a little bit more unattractive with kind of not really based in reality. So – at this point, based on your earlier comments, are we seeing any sort of – just, change in the overall environment? I don't think that you guys are seeing that but as far as large account versus small account.

John J. Marchioni
Executive Vice President-Insurance Operations, Selective Insurance Group, Inc.

A

Vince, this is John. With regards to the first part of your question, we didn't really see any significant fist quarter change coming off of the large events, Hurricane Sandy in the fourth quarter. You look at commercial property, for us and for the market generally, it continues to be a very profitable line of business. And I think while people may have changed their cat assumptions going forward, we didn't see a real meaningful tightening of capacity or change in the pricing environment because of that, and the first quarter of that would have been back down again in the second quarter. I would say, what we saw in the second quarter was pretty consistent with what we've said in the first quarter, which is we think we've reached a point where we feel like rates will stay in the kind of range that we've been seeing now, the last couple of quarters. And that's what we saw, is pretty stable rate environment across all lines of business, and retentions that are holding up very well. So we feel like we're at a pretty good place, and certainly expect to continue to see that going forward.

Gregory E. Murphy
Chairman, President & Chief Executive Officer, Selective Insurance Group, Inc.

A

Yes, the only other comment I would add to that, I mean obviously, some – certain carriers came out of the box. One, one hard on renewal price increases, some are doing it across board, some are doing it respective to individual account performance, we refer to that sometimes as socialized rate. And I think some carriers have found a gap in their retention dropping, and then all of a sudden, a lot of top line pressure. So I think there has been a little bit of the rebalancing of that but I want to make sure that when you sit there and you look at what we laid out as our three year plan, at the beginning – at the end of 2011, before our 2012 time period, we were pretty consistent in our message about what we needed to do in price, how we thought price would manage. And I would say that, this is just normal noise quarter-to-quarter, and we're still bouncing around for 7.3 rate in commercial lines for the first six months for the year, and we are not in anyway uncomfortable with that. When you pick the mid-point of our 5% to 8% increases, that's 6.5%, so that's still running a healthy 70 basis points over that mid-point. So, we feel that rate in the balance of the year will continue to kind of be, in that – slotted in that area, and as I mentioned in my comments, we believe that 14 rate will be not below that level, but still within our three year pricing targets to reach our goals.

Vincent M. DeAugustino
Analyst, Keefe, Bruyette & Woods, Inc.

Q

Perfect, that color is actually really helpful. Thanks.

Operator: [Operator Instructions] Our next question comes from Mark Dwelle with RBC Capital Markets. You may ask your question.

Mark A. Dwelle
Analyst, RBC Capital Markets Equity Research

Q

Yes, good morning. A couple of questions, first, just a clarification on the number. You mentioned on the personal lines commentary, three point average development related to the very old claim, so is that – that was – three points on the auto combined ratio or on the overall personal lines combined ratio?

John J. Marchioni
Executive Vice President-Insurance Operations, Selective Insurance Group, Inc.

A

On the – it's on the overall personal lines...

Dale A. Thatcher
Executive Vice President & Chief Financial Officer, Selective Insurance Group, Inc.

A

On the overall.

Gregory E. Murphy
Chairman, President & Chief Executive Officer, Selective Insurance Group, Inc. A

Yes, overall.

John J. Marchioni
Executive Vice President-Insurance Operations, Selective Insurance Group, Inc. A

It's almost twice that amount if you look at it just purely on auto.

Mark A. Dwelle
Analyst, RBC Capital Markets Equity Research Q

Okay, but all of it was in fact, auto?

John J. Marchioni
Executive Vice President-Insurance Operations, Selective Insurance Group, Inc. A

Correct.

Dale A. Thatcher
Executive Vice President & Chief Financial Officer, Selective Insurance Group, Inc. A

Correct.

John J. Marchioni
Executive Vice President-Insurance Operations, Selective Insurance Group, Inc. A

It's all New Jersey.

Mark A. Dwelle
Analyst, RBC Capital Markets Equity Research Q

Right. Why I figured that – I figured that's what it was related to and it was just – I was just trying to match to the right bucket. The...

Dale A. Thatcher
Executive Vice President & Chief Financial Officer, Selective Insurance Group, Inc. A

$2.4 million, Mark.

Mark A. Dwelle
Analyst, RBC Capital Markets Equity Research Q

Okay. Okay, second question on, any – how of your Sandy reserves developed since you last reviewed them? It looked like they were pretty good running through the first quarter, just trying to get an update on that.

Dale A. Thatcher
Executive Vice President & Chief Financial Officer, Selective Insurance Group, Inc. A

Right. Basically, as of year-end, we were at a $136 million, and as of June 30th, we're at a $136 million. So, we're pretty spot on, we continue to have some additional IBNR. So we feel very confident that we'll come in at or above that $136 million number.

Mark A. Dwelle
Analyst, RBC Capital Markets Equity Research
Q

Two questions. Just kind of – underneath that topic, you guys do a lot of work with flood claim handling, has that book settled more substantially than where it was at the end of the first quarter or is there still a lot of open claim activity? I know the flood doesn't affect your results, but just, more kind of a market curiosity question?

Dale A. Thatcher
Executive Vice President & Chief Financial Officer, Selective Insurance Group, Inc.
A

In terms of the percent of claims that are close at this point, it's just under a 100%, right around 99% closed at this point.

Mark A. Dwelle
Analyst, RBC Capital Markets Equity Research
Q

Okay, good to know. Next question, in your guidance you talked about $56 million average share count, from that should we infer some plans to do buybacks during the back half of the year since you're running a little bit above that level so far year-to-date?

Dale A. Thatcher
Executive Vice President & Chief Financial Officer, Selective Insurance Group, Inc.
A

No, that's just an average number, Mark. There is no buyback authorization, and no current plans for share buybacks.

Mark A. Dwelle
Analyst, RBC Capital Markets Equity Research
Q

Okay, that answers that then. And then, the – I guess my last question, and particularly in the auto book – I mean that, that's a line of business that has been extremely competitive, a lot of people are trying to get rate in that line. When you look at that line strategically, obviously you're committed to it, there is not something – I'm not suggesting a change there. But tactically, with everybody being so aggressive on auto rates, is that a line that you should just let kind of – I will say, idle or grow fallow overtime, and just allow the market shares to go where they will?

John J. Marchioni
Executive Vice President-Insurance Operations, Selective Insurance Group, Inc.
A

This is John, Mark. I would say that if you looked at our personal auto hit ratios and our new business growth over the last year, it has been – you know, to use your phrase, idle. And I think we made a conscious decision to get the rate level to where we thought it needed to be, and allow hit ratios in new business to effectively slow down as a result of that. So, till we are comfortable – and it certainly varies state by state as to where the market is, and where we are comfortable relative to our pricing level, but we're going to allow that to continue to play out. Now the other dynamic I would add to that however though, is, when you look at what is going to – we expect to continue to be a diminishing availability of mono-line home in the market, I think, our ability to leverage a good home product to gain more of that package business from the target audience that we sell our product to – I think that will start to change the landscape a little bit, and while it's not going to take auto too far from where it is in terms of the commoditization of that product, I think it will help move it a little bit closer for the package buyers, to – more of a consultative buy, and I think it helps companies like us in the process.

Gregory E. Murphy
Chairman, President & Chief Executive Officer, Selective Insurance Group, Inc.

A

And if I could, I would say strategically, I think you are starting to see a change. So [ph] AMC (32:32) companies growth home openly what we're extended periods of time, when you look at the historical profitability of homeowners, it's 20 years, 30 years, and it's running at the 109, 110 level. And I think holistically, when you look at some of the key carriers, you're seeing a change in that philosophy, you're seeing a change in rating, you're seeing a change in expectation or how volatility affects their result. And I think you find now that as the home product becomes priced more properly, and isn't just given away, because that product – write that on a loss, that's what's created a bigger opportunity to siphon off the mono-line auto business, John's referring to is a more aggressive strategy to write a whole account piece of business.

John J. Marchioni
Executive Vice President-Insurance Operations, Selective Insurance Group, Inc.

A

And we've seen that come through. If you look at our mix of new business, with an account credit on it, so it's got the companion home attached to it, it's pushing up near three quarters of our new business at this point, which is up well over where the historical levels were. And those three states that we're not writing mono-line home in right now; New Jersey, South Carolina and Virginia. So, we've already kind of, advanced that initiative through our network.

Mark A. Dwelle
Analyst, RBC Capital Markets Equity Research

Q

Thanks very much, I appreciate the comments and the color.

Operator: Our next question comes from Sam Hoffman with BlueCrest. You may ask your question.

Sam A. Hoffman
Portfolio Manager, BlueCrest Capital Management (New York) LLP

Q

Yes, good morning.

Dale A. Thatcher
Executive Vice President & Chief Financial Officer, Selective Insurance Group, Inc.

A

Good morning, Sam.

Sam A. Hoffman
Portfolio Manager, BlueCrest Capital Management (New York) LLP

Q

I just have a question on the loss ratio in the quarter. There is a significant step down in the loss ratio excluding cats and developments sequentially, I think it was 64.3% in the first quarter, 64.6% in last fourth quarter, and they had it at 61.5% in the second quarter. So, can you talk a bit about what caused the step-down? How much was pricing versus underwriting in claim initiatives, and were there only one-timers in the quarter? Thank you.

Dale A. Thatcher
Executive Vice President & Chief Financial Officer, Selective Insurance Group, Inc.

A

Sam, I don't have all of those components [ph] parched (34:30) out sitting in front of me, but I can tell you that it is the combination of continuing our earned price increases that are impacting the combined ratio, its non cat property losses came in substantially ahead of where we expected them to come in. So those are the two biggest drivers with regards to the improvements in the loss ratio for the quarter. We can always later kind of sit down and bite through the numbers, and get to the more precise pieces of that if you'd like to do that, but clearly, we are happy with the improvement that we're seeing in the loss ratio.

Gregory E. Murphy
Chairman, President & Chief Executive Officer, Selective Insurance Group, Inc.

A

And if I could, Sam, obviously the easiest one that that Dale mentioned is, when you look at the earned rate at 6.70%, I mean, the fast math to look at how much we're getting from rate is just getting 6.70% minus 3% and multiple that by 70%. The fast math to say, okay, that's what is leveraging down your performance coming from earned rate. So that's the number – as that number continues to move higher, and that earned rate starts to move north of 7% that's when – as long as loss ripped trends stay stable, which we not see anything right now, that's going to modify that, that's where you will see the biggest lag down in the commodity ratio, the other things that push that are the underwriting improvements which are better than expectation, which John mentioned, and I mentioned in my part, and the fact that we aren't pushing claims. So there – it's all three of the pieces that are coming together to actually get that improvement. But that is not out of the expectation when you look at what we laid out and when we went through the whole – the different issues that are driving, when we said it was lowering our combined ratio relative to our expectation.

Sam A. Hoffman
Portfolio Manager, BlueCrest Capital Management (New York) LLP

Q

So the 61.5%, that maybe a little bit better than you expected in the quarter, but it's not out of line with overall, it's not way out of line, it's kind of roughly on the trend line that you were expecting?

Dale A. Thatcher
Executive Vice President & Chief Financial Officer, Selective Insurance Group, Inc.

A

I would agree with it, it's modestly better than we were expecting because the – the non cat property, which is obviously the unknown in the overall scheme of things came in better than expected, but it's certainly close to the overall trend line.

Sam A. Hoffman
Portfolio Manager, BlueCrest Capital Management (New York) LLP

Q

Terrific, thank you.

Operator: [Operator Instructions] We have another question from Vincent DeAugustino with KBW. Your line is now open.

Vincent M. DeAugustino
Analyst, Keefe, Bruyette & Woods, Inc.

Q

Hi, and good morning again, and thanks for taking the follow-up. Just on the commercial auto, the margin there this quarter was pretty much flat year-over-year which is a lot better than some of your peers. And so, I guess what I am kind of surprised by on this line is the issue that the industry kind of appears to be having a little bit more recently – and just in the context of where rates and loss cost trends are, and the fact that generally its a little bit easier of a line relative to something like workers comp. So, given that the context of the industry issue, and just if not – more dramatic loss ratio improvement for you guys, I mean, again still better peer comp. I am just curious if you're seeing anything new on the loss cost side emerge, just with kind of more recent trend is not being so much more favorable. So, maybe you got it more right than everybody else but always curious of your thought.

Dale A. Thatcher
Executive Vice President & Chief Financial Officer, Selective Insurance Group, Inc.

A

Vince, one of the things that always keep in mind is, particularly on the commercial auto, because we have had a number of questions from investors over the last couple of quarters as our commercial auto book looks a lot different than just a broad industry commercial auto book. The broader industry has much more exposure to long haul trucking, and issues like that. Remember that about 35% of our book is contractors. So a lot of our commercial auto business is basically light local delivery, and the contractor vans, and pickup trucks and things like that, so that actually causes the dynamics to be a bit different in our commercial auto book than you see from the broad industry. So I think that that's why we are performing better but as the economy has picked up a little bit, yes, we've had more miles driven but it's not the type of miles that have the same kind of volatility and loss exposure as you're seeing in the broad industry.

Gregory E. Murphy
Chairman, President & Chief Executive Officer, Selective Insurance Group, Inc.

A

And the other thing I would add to that, when you look at rate, this has been a strong line from our standpoint on a rate. We're getting 7% on a written basis, and in terms of great level, and that's held very standard – very level from the first Q to the second Q, sequentially. And then, from a – on an earned basis, the frequency and severity relative to its effect on overall loss trend has been pretty flat. But – Dale mentioned, I think part of it is a make up of the book, and I know from an industry perspective, there is a lot of attention to the type of business that you're writing and where some of the problems are manifesting in this line of business.

Vincent M. DeAugustino
Analyst, Keefe, Bruyette & Woods, Inc.

Q

Okay, great. Thanks for taking the follow-up, and look forward to talking to you soon.

Operator: [Operator Instructions] I am showing no further questions from the phone lines at this time.

Dale A. Thatcher
Executive Vice President & Chief Financial Officer, Selective Insurance Group, Inc.

Well, thank you very much. If you have any follow-up items, please contact Jennifer and Dale. Thank you very much.

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