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Selective Insurance Group, Inc. (SIGI)

Q3 2013 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good day, everyone. Welcome to the Selective Insurance Group's Third 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.

Jennifer W. DiBerardino
Treasurer & Senior VP-Investor Relations, Selective Insurance Group, Inc.

Thank you. Good morning, and welcome to Selective Insurance Group's third quarter 2013 conference call. This call is being simulcast on our website and a replay will be available through December 02, 2013.

A supplemental investor package, which includes GAAP reconciliations of non-GAAP financial measures referred to on this call is available on the Investors page of our website www.selective.com.

Selective uses operating income, a non-GAAP measure, to analyze trends and operations. Operating income is net income excluding the after-tax impact of net realized investment gains or losses as well as the after-tax result 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-Q's filed with the U.S. Securities and Exchange Commission for a detailed discussion of these risks and uncertainties. Please note that Selective undertakes no obligation to update or revise any forward-looking statements.

Joining me today on the call are the following members of Selective's Executive Management team, Greg Murphy, CEO; Dale Thatcher, CFO; John Marchioni, President and Chief Operating Officer; and Ron Zaleski, Chief Actuary.

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

Dale A. Thatcher

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

Thanks, Jennifer. Good morning. We're very pleased with our third quarter results as commercial and Personal Lines pricing remain strong and we continue to execute on our underwriting and claims initiatives.

For the quarter, operating income of $0.42 per diluted share was up from $0.34 per diluted share in the third quarter of 2012 with the improvement largely driven by better underwriting results. The third quarter statutory combined ratio improved by 2.1 points from a year-ago to 96.3%.

Catastrophe losses were a $11.9 million pre-tax or 2.7 points, up slightly from $9.6 million pre-tax or 2.4 points a year-ago. The driver for catastrophe losses this quarter was a series of Midwest thunderstorms with the largest one, cat 24, accounting for $7.5 million. We also had favorable prior-year casualty development in the quarter of $3.5 million, or 0.8 points, compared to $7 million or 1.7 points a year-ago.

Overall statutory net premiums written were up 9% in the quarter driven by Standard Commercial Lines, which were up 10% and Excess and Surplus Lines, which increased 20%. Standard Commercial Lines renewal pure price was up 7.9%, and retention held steady at 83% in the quarter. The Commercial Lines statutory combined ratio in the quarter was 95.6%, including 0.7 points of catastrophe losses.

Commercial property generated a 67% statutory combined ratio in the quarter, 14.3 points lower than a year ago to the fewer large losses. General liability, our largest line of business produced a 96.2% combined ratio, this is more than a four point improvement from the third quarter of 2012, with three points of the improvement coming from favorable prior-year reserve development.

Workers' compensation produced a 118.2% statutory combined ratio in the quarter, which included $3.5 million of unfavorable prior-year development driven by older accident years. We have carefully managed growth in workers' comp and year-to-date through September, net premiums written are up only 4%, which includes renewal pure price of 7.8% as compared to 9% growth and 7.6% pure price in our standard Commercial Lines book.

Our workers\ comp business is written as part of an overall account and not on a mono-line basis. Also I'd like to point out that we don't write workers compensation in our contract binding authority E&S business. While our workers compensation results need to improve we have a number of initiatives in place to address this line's profitability, including rate increases that, in general, have outpaced our overall lost cost trends. More importantly given the context of certain industry events of late, it's reasonable to question the quality of any company's workers' comp reserve position.

We do a ground-up reserve analysis of every major line of business every quarter. This allows us to quickly react to any reserve issues we identify. As you've seen, we've taken steps as we recognize developing trends in the workers' comp line of business and booked adverse development as we felt it was appropriate. Although we strive to get reserves right by line of business, we also recognize the impossibility of complete knowledge, and therefore, we maintain an overall conservative reserve position. Over the last 17 years, the variability in our reserve development has had a standard deviation of only 1.1%, while the industry has had a standard deviation of over twice that.

Personal Lines net premiums written grew 2% in the quarter to $81 million, and the statutory combined ratio was 97.6%. Results included 11.7 points of catastrophe losses, which were almost exclusively in the homeowners' line and largely the result of one event that impacted states in the Midwest.

Personal Lines pricing exceeded our expectations in the quarter with renewal rate of 7.5%, and we continue to see the benefits of our pricing success in underlying results. In the quarter, our Personal Lines ex-catastrophe combined ratio was 85.9%, and year-to-date we are at 89.9%, both improved slightly from the comparable 2012 periods. Retention in Personal Lines continues to be strong at 86%.

Net premiums written for our E&S operations grew to $36 million in the third quarter up 20% from a year ago. The statutory combined ratio of 100.5% included 3.1 points of catastrophe losses. We are pleased with the improvement in our newest segment and are on track for E&S operations to perform in line with our overall goal of approximately 95% combined ratio in 2014.

Turning to investments, third quarter after-tax investment income was $25 million up 4% from a year ago. Alternative investments primarily drove the increase with pre-tax income of $2.6 million compared to $900,000 in the third quarter of 2012. Invested assets increased 4% from a year-ago to $4.5 billion, driven primarily by increased operating cash flows and the net proceeds from our senior note offering in February.

Operating cash flows as a percent of net premiums written were 17% year-to-date, which compares to 14% in 2012 and 8% in 2011, partially offsetting these increases was the mark-to-market impact of $122 million on the fixed income portfolio, primarily driven by higher interest rates.

After-tax new money rates of 1.5% in the quarter were lower than our current portfolio yield, which continues to impact on our investment income. As a result, the after-tax yields on our fixed income portfolio were down 13 basis points from a year-ago to 2.3%. In spite of the decline in fixed income yield, the overall portfolio yield was in line with the third quarter of last year. Given the pressure on investment income from low-interest rates, our 95% combined ratio goal for 2014, will approximate closer to 11% ROE than 12%.

In the quarter, we realized almost $9 million after-tax with capital gains in the investment portfolio related to a rebalancing of our domestic equity portfolio. Compared to September 30, 2012, the overall portfolio unrealized gain position declined from $211 million to $84 million pre-tax of September 30, largely due to rising interest rates. Also of note is the quarter-end unrecognized gain position in the fixed income held-to-maturity portfolio of $27 million pre-tax or $0.31 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 at $1.2 billion and $1.1 billion respectively. Book value per share at September 30 was $20.16, up 2% from year end as the negative impact of rising interest rates on the portfolios' unrealized gains, has been more than offset by positive net income. Our premium to surplus ratio was 1.5 to 1 at September 30. In the quarter we achieved operating ROE of 8.6% and total ROE of 11.7% compared to our current weighted average cost of capital of 8.8%.

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

John J. Marchioni

President & Chief Operating Officer, Selective Insurance Group, Inc.

Thanks, Dale. Good morning. Third quarter results reflect the success of our underwriting and claims strategies and the exceptional employees and agents we have executing on those strategies.

This marks our 18th consecutive quarter for Commercial Lines pure price increases. 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 71%. This represents 3% of our Commercial Lines premium. We obtained a 6% pure rate increase on our highest quality accounts, while maintaining a solid 89% point of renewal retention, representing 54% of our Commercial Lines premium.

As previously mentioned, we achieved 7.9% standard commercial renewal pure pricing in the quarter and year-to-date is up to 7.6%, right in line with our projection of 7.6% for the full year. Retention also remained strong at 82% year-to-date. In addition to rate we separately measured the impact of underwriting improvements to our combined ratio. Currently, underwriting improvements are well ahead of our expectations in our three-year plan.

Our Commercial Lines growth is largely a result of the success we've had in pricing and 2% increase in exposure. Standard Commercial Lines new business improved substantially in the third quarter to $75 million, up 33% from depressed levels a year ago. On a year-to-date basis, new business is up 18% to $217 million.

Our new business opportunities are coming from the long-term partnerships we have with our superior agency force. Much of this business is controlled by our agents, meaning they have a very good familiarity with the accounts they are presenting. We run these agent-controlled opportunities to our new business models, which makes us very comfortable with the quality and pricing of our new business.

While pricing and risk selection on new business remains strong, we have seen an uptick in hit ratios across all three segments: small, middle market, and large accounts. Our strategy to refocus our field underwriters, or AMSs, on middle market accounts, while pushing small accounts to a more efficient small business tier model is currently paying dividends, our diversification across industry segments is very strong and we've reduced our workers' comp writings to 19% of new business in the quarter, slightly below the make-up of our standard Commercial Lines' in-force book, which is 20% workers' comp.

Year-to-date our excess and surplus lines contract binding authority business combined ratio was 101.9%. Results are tracking in line with our expectations to achieve between 100% and 102% combined ratio for 2013. New E&S business is up 23% over the third quarter of 2012, as we are continuing to see business migrate back to this market. Having largely completed the integration efforts of our E&S operations we are well positioned to capitalize on the growth opportunities in this segment. Though still early, we are seeing increased momentum in driving business from our retail agency partners to our wholesale agency partners and we expect that to accelerate going forward.

E&S renewal pure price year-to-date is up 6.1% for this predominantly casualty book of business. The same factors influencing the standard market pricing environments are present in the E&S market and we expect this trend to continue. Improved pricing combined with our aggressive underwriting actions on targeted segments have us well positioned to produce consistent profitability in the E&S segment going forward.

Underlying Personal Lines results in the quarter continued to demonstrate improvement, and we are making good progress on our targeted profitability initiatives for both homeowners and auto. In the quarter, we achieved an overall 7.5% renewal pure price increase for Personal Lines while retention remains strong at 86%.

Net premiums written were up 2% in the quarter due to rate increases and total policies in force that were up slightly when compared to September of last year. This increase was partially offset by a shift in business away from New Jersey, which is our state with the highest average premium. At the same time, new policy accounts were down as we have generally seen declining close rates while we carefully push rate and work to improve our mix of business.

Statutory combined ratio year-to-date in Personal Lines remained a profitable 97.6% compared to the 98.4% in the comparable period of 2012, while on ex-catastrophe basis the combined ratio was 89.9% and improvement from 90.6%. We continue to drive profitability in the homeowners' line as we increased rate across the book and make underwriting changes, including raising deductibles to increase cost sharing.

Additionally, in 2013, we have tightened our underwriting appetite for mono-line homeowners. For the nine months, our homeowners' line achieved the statutory combined ratio of 98.4%, including 16.1 points of catastrophes and renewal price increases of 10.4%.

For personal auto, we have consistently been getting price increases above loss cost trend achieving 5.9% year-to-date. We are increasing the geographic diversification of our auto book and have made progress on increasing the age of the book. Operationally, we are very confident in the progress we are making towards our 2014 goals.

Now, we'll turn the call over to Greg

Gregory E. Murphy

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

Thank you, John. Before I give you my perspective on the quarter and marketplace, I'd like to take this opportunity to congratulate John on his new responsibilities as President and Chief Operating Officer. Board of Directors, elevated John to this role as a result of his excellent relationships with our agency force and his efforts that drive our superior underwriting and claims initiatives towards our 2014 underwriting goal.

Our third quarter results for underwriting combined ratio, renewal price increases, new business growth and retention clearly demonstrate the improvements to our underwriting operations and are moving us towards successful achievement of our goal towards a 92% ex-cat statutory combined ratio in 2014.

Renewal pure price increases are at the high end of our previously announced range and retention has remained strong, an important indicator of market stability. As we just completed our 18th consecutive quarter of renewal pure price increases, we read the commentary about the lack of sustainability for Commercial Lines renewal price increase, but we don't agree. While it's clearly not a hard market like the ones in the past, Commercial Lines prices are still firm and ahead of loss cost trends. In addition to loss trend, higher pricing levels must offset the following industry-wide trends.

Single A corporate bonds for the industry they are yielding about 350 basis points below where they were five years ago, and reported calendar year results that are about 4.5 points better than the 2013 accident-year results due to ongoing favorable reserve development.

Another benchmark is overall Commercial Lines growth versus GDP, for the first six months of 2013, industry-wide Commercial Lines net premium written group 4.6%, while GDP was up about 2%. The net growth 2.6% is clearly not high enough to offset loss trends, lower investment yield and declining favorable development. With an overall industry, ROE from investments projected at 6.3% for 2013. The industry must gain more underwriting discipline in order to achieve the returns on equity or surplus that Wall Street or rating agencies expect.

Renewal pure price increases are the linchpin lowering our combined ratio. The three-year plan has included overall renewal price increased expectations of between 5% and 8%. Standard renewal pure price increased 6.3% in 2012 and 7.7% year-to-date 2013. While standard lines retention remains steady at 84%, we expect overall 2014 renewal pure price increases in the 6% to 7.5% range.

We remain encouraged our growth opportunities as market conditions continued to modestly improve. In addition to the benefit of pure price increases, we are gaining traction in our E&S business, expanding our agency force and implementing new products. At the same time, our field employees and small business teams are working together to grow our book. At year end 2012, in 18 of our 22 standard line states, we had market shares below 1%. We had ample opportunity to increase our penetration in a targeted manner as we utilize our sophisticated underwriting tools to write business with the best agents.

Reflecting on the improved results, we are updating our full year 2013 guidance as follows: an ex-catastrophe statutory combined ratio of approximately 95.5%, excluding 2.5 points of capacity losses, which is a net improvement of one point from our previous guidance; no prior-year casualty development in the fourth quarter; after-tax investment income of between $95 million and $100 million; weighted average shares of approximately 57 million.

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

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] We have a question from Vincent DeAugustino with KBW. You may ask your question.

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

A

Good morning, Vince.

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

Q

Good morning everyone and thanks for taking the questions. Greg and John, you've had this 92% core combined ratio target for 2014, and when it was first issued, that looked out pretty foreign. And that's actually been really helpful in training where you're driving the business, but in some ways more importantly, how you plan on getting there. And so now that 2014 is a bit closer and the 92% ex-cat core combined ratio target is looking [indiscernible] (21:20). I'm curious if you're of planning on growing that goal forward another year and also continue to use that figure, which has been pretty helpful.

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

A

Yeah, I would say that, of all the carriers out there, I think we've been probably the most transparent in terms of our three-year plan and the elements of the profit improvement, and we are currently assessing that right now and figuring out how we will update that and what fashion we will roll that out. So, I don't have anything for you right now, but we are working on that.

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

Q

Okay, good. Very much look forward to that. And, John one of the things you had mentioned was the strategy between small commercial and mid-market, and how there's benefits of leveraging a straight-through processing model on small commercial and just so we can benchmark kind of the ease of use for agents, do you have thoughts on how long it might take a CSR to entering the data for a quote on [ph] Vanilla Bob (22:15) account? I'm just trying to balance that off of what your commentary has been this quarter?

John J. Marchioni
President & Chief Operating Officer, Selective Insurance Group, Inc.

A

Yeah, so clearly, I mean you're hitting on a very important point relative to how companies are perceived in terms of ease of doing business and the ability to go straight through relative to small account. That is something we benchmark, we bring together our Commercial Lines customer service reps and producers from our agents' office to come in and evaluate our system and give us feedback on others.

I don't want to sit here and quote actual transaction time, but I will tell you the bigger issue, I would say, that we're focused on is the percentage of those accounts that they enter into the system that they actually have the ability to bind on a stock as opposed to the percentage of those accounts that actually headed out of the system due to an underwriting or pricing added and require manual intervention by an underwriter at Selective.

I think that's – if you were to ask a small commercial producers or Personal Lines producers for that matter, in agents' office, that's the bigger issue. I think for the most part, companies that are focused on small commercial are pretty tightly grouped in terms of the amount of time it would take. It varies, obviously, if you're talking about it a straight BOP, or if you're talking about it a BOP that's going to have an auto attached to it or an umbrella attached to it and/or a comp account attached to it, that'll determine the amount of time it takes, but it's really more of a focus on what percentage of the business they can actually issue at the end of the process as opposed to waiting to hear back from one of our underwriters to finalize the issuance.

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

Okay, good. That color is helpful. And Dale, just you had mentioned Selective's conservative reserving philosophy and extended the track record and in our own analysis completely agree with that. And just on a go-forward basis, I'm curious if my understanding of the new strategy draft is correct in the sense that, at least on a GAAP basis, you won't be able to take that same conservative deterministic approach that you've been doing. And then, really, the question gets to how should we think about reconciling that methodology versus statutory results if your current methodology prevail within stat or in this framework. Were they actually – would you not have a divergence in methodologies at all? I'm just trying to get a sense of how both would look if this actually goes through.

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

Well, you're trying to get a sense of it and quite frankly, so are we and so is every other accountant in the world. It's still early. It's still difficult to tell how does that ultimately get put into play on a practical way. Obviously, it's clear in the guidance that the old concept of management's best estimate is going by the wayside. The problem that I think that they don't fully recognize is that there is still a lot of art to the actuarial science in terms of understanding trends and recognizing trends that aren't always completely and purely decipherable into a mathematical formula. So it's going to be a evolutionary process as we see how that actually hits the road. All I can tell you is that Selective has always and will remain committed to a strong balance sheet. And that's the only thing that we can put out there, and I don't think of anybody in the accounting world would ever be against that. So we will implement it to the spirit and the letter of the law, but we are also very committed to a strong balance sheet.

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

Good. Great. Thanks for the color, and talk to you soon.

Operator: [Operator Instructions] We have a question from Mark Dwelle with RBC Capital Markets. Your line is open.

Mark A. Dwelle
Analyst, RBC Capital Markets LLC
Q

Yeah, good morning. A couple of questions, first related to your flood insurance servicing business, were you impacted at all by the government shutdown at the beginning of the month on that business?

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

No. No. No, we were not.

Mark A. Dwelle
Analyst, RBC Capital Markets LLC

Q

Okay. Second question is to the extent that they delay the implementation of the rate increases in the flood insurance business. Will that have any impact on you? Or you're really paid based on kind of a fee-per-account, it doesn't really matter what the premiums are?

John J. Marchioni
President & Chief Operating Officer, Selective Insurance Group, Inc.

A

This is John. I would say the only way that impacts us is when we think about our premium forecast for that line of business or that segment of business going forward, because clearly, we anticipate the rate level to come through as passed by the act, but we understand the political pressures that are on there that roll some of that back. So we do get paid a servicing fee relative to premium, and that will be impacted, but again, that's more about our planning going forward in terms of how we factor that in.

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

A

It's a straight commission rate that we get paid from the federal government. So right now, there would be no real change in the operational, as John mentioned, in terms of what happens with our expectations in terms of premium growth?

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

A

But it is a percentage of premium...

Mark A. Dwelle
Analyst, RBC Capital Markets LLC

Q

All right.

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

A

But it's also that percentage is revisited annually. So it's uncertain what the federal government may or may not do if the rate increases actually did go through. They would have the option of lowering that percentage, but if they did nothing with the percentage, clearly then our revenues would go up, but so are the commissions that we pay in the agents.

Mark A. Dwelle
Analyst, RBC Capital Markets LLC

Q

So, I guess the – it would seem like, paraphrasing those various comments, the status quo would be the status quo if they don't implement the rate increase. If they do implement the increase, possibly, there is some upside, but that would remain to be seen.

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

A

That's correct, [ph] characterization (28:18) margin.

Mark A. Dwelle
Analyst, RBC Capital Markets LLC

Q

Okay. Third – second question, I hear you comments, Greg, in terms of what the industry needs as far as rate increases and why that would be the right thing for us to do or for the industry to do. But just to apply, double of that could have been – I mean we've seen time and again that not everybody is as disciplined as Selective as far as continuing to go after the rate that they actually need.

When you have your conversations, just a question may be for both Joe and John and Greg. I mean when you're in conversations with your customers and you're asking them for 10%, 7.9%, whatever the answer is, I mean inevitably, they're starting to hear from other carriers who are dangling more attractive improvements. I mean, how does that conversation go at this stage? I mean we're starting to see some inflection where there is a little more or let's call it, rate aggressiveness starting to emerge in certain areas and certain companies.

John J. Marchioni
President & Chief Operating Officer, Selective Insurance Group, Inc.

A

This is John, I'll start and then Greg can certainly follow on. There's no question that the longer our rate level continues at this pace, the more difficult some of those conversation become. I will say the way we've approached it from the start, dating back to early 2009 and continue to approach it, and we'll always approach it that way going forward, is too make sure we're very targeted. So the conversation with the customer, there is some underlying review relative to where that account is priced, what the quality of the account is, what the loss experience of that account is and our rate variation between those buckets is fairly significant.

So what that assumes is if certain accounts go to market, they are going to realize that in fact, the pricing we're putting out there is still fair relative to the exposure presented. So that, I think, protected us in a lot of ways from losing our better accounts, because as we've said earlier, that's where we're at the lower end of our overall rate levels in terms of what we're achieving. But I would say the other thing is the way we've administered our rate changes and our relationship with our agents allows us to have a very good conversation relative to their overall portfolio and what we're trying to achieve.

But agents are also very open with us about where they really have competition on [ph] the account (30:49) and where they have less competition, so it allows us to flex based on that, but it is clearly an account-by-account negotiation, and our view has been for that worst 10-or- so percent of our business, we're going to put rate recommendations out there that we're going to stick to. And if push comes to shove, we're going to lose that account. And on the other side of it, we're going to put rate indications out for our base business and if push comes shove, we'll make a decision in certain cases to back off a little bit, but again, within the context of our overall rate targets.

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

A

And if I could, Mark, there is a little fatigue out there from the consumer standpoint too, in terms of all the ongoing shopping and there is a number out there that we constantly hear that trips a wire where people are going to go-to-market, but I think it could stamp the point that John made in terms of, "Hey, where we're pushing that hard at that high level, we've got conviction to stand behind the account, we've got conviction to stand behind our inside underwriters relative to that", conversely you heard our conversation or comments earlier that our target rate level for 2014 is between 6% and 7.5%. We're going to be doing that very granularly so it will be differently applied to, probably, how it's going to be applied to 80% of our business than the remaining 20%.

And then, if could come back to overarching comment at 6.3% investment yield – or 6.3% ROE from the investment portfolio, there is not a lot of places to hide. So the industry has to underwrite a sub-100% combined ratio to have any shot of hitting any kind of reasonable ROE in the 8%, 9% range. And the industry benefit that we garner is that, given our premium leverage of 1.5 to 1, I mean, for every one point of combined ratio, we're generating almost one full point of ROE, the industry is just around half of that. So not only do they have the pressure to improve their results, but they've got to drive their combined ratios much lower than we do to generate the equal amount of return.

So there is a little bit of advantage, thus, in this marketplace, and to be – frankly, I don't see anything that's going to change that dynamic for several years. I just don't see there's a lot more pressure on renewal price increases. U.S. analysts are putting a lot more heat on companies in terms of where is their renewal pure price, why aren't you quoting that to me, where is it, what your expectation of 2014, what your loss trend look like, what's the medical part of the loss trend feel like, and then overall, I don't even need to tell you, I mean this has been – there's been a fair amount of favorable development that still continues and at some point, that well is going to run hard. And when it does, that's going to be a big turnaround in industry performance.

Mark A. Dwelle
Analyst, RBC Capital Markets LLC **Q**

It's very helpful color. If I can follow-up, one other question just kind of in that same thing. In broad terms, what percentage of your customers would you say actively shop their book of business in any given year and does that vary between kind of large, medium and small?

John J. Marchioni
President & Chief Operating Officer, Selective Insurance Group, Inc. **A**

Yeah. It's a great question, it's one that we talk with our agents about. It's going to vary agency by agency. So we tend to have, and as you well know, we have a smaller group of agents. Our view is higher premium volume per agency. Our agents tend to be those that are less sensitive to pricing from a sales perspective. They tend to lead with coverage. They tend to lead with exposure analysis. They tend to lead with service. So our expectation is they generally shop their renewals less than most of our other agents do. But your – other part of your question is more about that the consumers' end to that and how much are they asking to be shopped.

I would say, generally, it happens less on the small commercial side, because the agents or any clients have spent a lot of time and energy re-quoting that business every year. It's just not cost effective for them. Whereas you move up the scale and your more sophisticated buyers in the middle market, large account side, who have better understanding of our insurance program, maybe more likely to come to their agents and say, "I like you to shop me". So really it really does vary agency by agency.

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

And Mark, I would say that one of the things that we do measure internally to get a little bit out of that, and that's why we measure retention at point of renewal, which is entirely different measurement, because that measures every account that our inside underwriters have the opportunity to touch renewals. That point of renewal attention runs approximately 8 points higher than our regular retention. So we quote to you retention levels of 82%, 83% when the renewals are more in the 90%, low high 80s, low 90s, and that's telling you that we renewed close to 90% of the business that we had the opportunity to renew, which means 10% would leave for various reasons, obviously.

Hey, if we put out too higher, the rate relative to that, they may have found in other market, or may be actively shopping. So it's kind of cuts too a little bit, that's why we measure that as a – and then we look renewals. When we lose those renewals, when we don't write that business, we're actively looking at that to find out why we didn't write those accounts. So I want you to make sure we understand that it's something we closely stay on top of.

Mark A. Dwelle
Analyst, RBC Capital Markets LLC

Q

Thanks very much for a very thorough answer.

Operator: Our next question comes from Robert Paun with Sidoti & Company. Your line is open.

Robert E. Paun
Analyst, Sidoti & Co. LLC

Q

Good morning.

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

A

Good morning, Robert.

John J. Marchioni
President & Chief Operating Officer, Selective Insurance Group, Inc.

A

Good morning, Robert.

Robert E. Paun
Analyst, Sidoti & Co. LLC

Q

I wanted to just follow-up on that pricing discussion, in terms of the workers' comp business, can you talk about the pricing in that business? How do renewal rates today compared to, say, what you were seeing about six months ago or a year ago?

John J. Marchioni
President & Chief Operating Officer, Selective Insurance Group, Inc.

A

So for the quarter workers' comp pricing is pretty much right on target with our overall Commercial Lines pricing levels and on the year-to-date basis slightly higher. I would say, generally speaking, what you're seeing in terms of filed rate levels from the various Bureaus NCCI and the various rate bureaus, it's probably down slightly year-on-year for what we saw last year, in terms of what they're filing for and in certain cases, what they're getting.

Now that does vary by jurisdiction. You are seeing some states whose individual rate bureaus or NCCI are now getting higher rate levels filed, but I would say, generally speaking, 2012 was a higher filed rate level by the bureaus than 2013, and I think you'll continue to see a little bit more pressure on that on a go-forward basis in terms of file rates. That's only one component of the rate increase you are getting. You also are able to move around individual schedule miles on an account-by-account basis to get rate level.

But again, that vary state to state. There are some states where you got a early high level of schedule credits on your book and other states where you have fairly little to move around, but I would say, year-on-year. The bureau file rates levels are down overall slightly, but it's still relatively high relative to trends.

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

And Robert, I would just say that when you look at the calendar year versus the accident-year results, our comp is just trading slightly over 110% and 111% range and as John mentioned, we're getting right around 7 8%, 7 9% rate increases. So that's not enough to do what we need to do, this is a line that's got the highest degree of focus on our claim side for efficiencies and other improvements that are dedicated to really driving better results, better outcomes in that line. And so, we know that we're not going to be able to do this all through rate, there's some t hat has to happen through different underwriting initiatives, claims initiatives.

But also remember that we write this as part of an account that we were on account-basis underwriter as Dale and John had in their comments. So that's where our focus is aro und comp. We're very careful with it, but we also are trying to drive as much rating underwriting on claims improvement as we possibly can through that line.

Robert E. Paun
Analyst, Sidoti & Co. LLC
Q

Okay, thanks and also just second question. Can you talk a little bit more about the E&S business? What drove the top line growth in the quarter? And maybe you can talk about what drove the combined ratio improvement in that business as well?

John J. Marchioni
President & Chief Operating Officer, Selective Insurance Group, Inc.
A

Yeah, so this is John. Two distinct questions here, I would say on the top line growth side, the predominant driver is we're now completely through our integration efforts at those operations, and clearly, when you go thr ough significant integration, it is a distraction for the operation. That's done. It's behind us. I think we've started to better execute in terms of appointing new wholesale agents in places where we had gaps in our agency plan, and I think we're starting to have more success within the Selective footprint of driving business from our retail agency partners to our wholesalers.

So new business, generally, has been a positive in terms of the lift in the overall top line growth in our E&S operations. In terms of the bottom line improvements, there were a couple of segments in a couple of specific geographies that were really driving the performance in that book of business in a negative way that we aggressively addressed through price and in certain cases, underwriting actions, and in other cases, specifically targeted actions with a couple of wholesale partnerships. And because of the nature of that business and your ability to take fairly aggressive actions over the short term in terms of pricing and underwr iting where we really able to drive that loss ratio down fairly quickly relative to what we're able to do in our standard book of business. And then the final piece is you're getting the benefit of expense improvement year-over-year as well, not over through the integration costs, the integration cost as well as the premium coming through.

Robert E. Paun
Analyst, Sidoti & Co. LLC
Q

Right. Thank you for the answers.

Operator: [Operator Instructions] . We have no further questions at this time.

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

Well, thank you. If you have any follow-up comments, please contact Dale and Jennifer. Thank you very much for participating in the call this morning.

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