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SIGI.OQ - Q3 2021 Selective Insurance Group Inc Earnings Call

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PRESENTATION

Operator

Good day, everyone. Welcome to Selective Insurance Group's Third Quarter 2021 Earnings 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, Rohan Pai.

Rohan Pai - *Selective Insurance Group, Inc. - Senior VP of IR & Treasurer*

Good morning. When time and costing this call on our website, selective.com. The replay is available until November 27.

We use 3 measures to discuss our results and business operations. First, we use GAAP financial measures reported in our annual, quarterly, and current reports filed with the SEC. Second, we use non-GAAP operating income and non-GAAP operating return on common equity to analyze trends in operations. We believe these measures make it easier for investors to evaluate our insurance business. Non-GAAP operating income is net income available to common stockholders, excluding the after-tax impact of net realized gains or losses on investments and unrealized gains or losses on equity securities. Non-GAAP operating return on common equity is non-GAAP operating income divided by average common stockholders' equity and GAAP reconciliations to any reference non-GAAP financial measures are in our supplemental investor package found on our website Investors page. Third, we make statements and projections about our forward performance. These are forward-looking statements under the Private Securities Litigation Reform Act of 1995. They are not guarantees of future performance and are subject to risks and uncertainties. We discuss these risks and uncertainties, including supplemental disclosures about the COVID-19 pandemic and detail in our annual, quarterly and current reports filed with the SEC, and we undertake no obligation to update or revise any forward-looking statements.

Now, I'll turn the call over to John Marchioni, our President and Chief Executive Officer, who will be followed by Mark Wilcox, our EVP and Chief Financial Officer.

John Joseph Marchioni - *Selective Insurance Group, Inc. - CEO, President & Employee Director*

Thank you, Rohan, and good morning. I'll make some introductory comments about our results and highlight some of the higher-level themes impacting the industry and our company. Mark will discuss our financial results, and then I'll return with some brief closing comments before opening the call up for questions.

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We delivered another strong quarter despite elevated catastrophe losses principally related to Hurricane Ida. Our strong underlying profitability allows us to generate an underwriting profit even when net catastrophe losses are elevated as was the case in the third quarter. While negatively impacting our quarterly results, tragic events like Hurricane Ida provide us the opportunity to deliver great value to our customers at their time of greatest need. And I'm proud to say that is exactly what our claims professionals have done. We generated a solid annualized operating ROE of 10.6% for the quarter. For the first 9 months of the year, our annualized non-GAAP operating ROE was 14.5%, well above our full-year operating ROE target of 11%. It also builds on our 7-year track record of generating consistent double-digit operating ROEs, putting us among a very small group of peers that have achieved similar results.

I'm pleased to announce that our Board of Directors, underscoring our strong financial and operating performance, approved a 12% quarterly dividend increase to $0.28 per share. Our underlying underwriting performance remains at expected levels, and our investment performance, particularly from alternative investments, contributed meaningfully to overall results for the quarter and year-to-date.

For the quarter, our strong net premiums written growth of 13% was driven by renewal pure price increases averaging 5.3% for commercial lines and 5.6% for E&S. Exposure growth of approximately 3% on our renewal book for commercial lines, solid commercial lines retention of 86%, and new business growth of 24% for commercial lines, and 20% for E&S. Our 98.6% combined ratio for the quarter included 10 points of net catastrophe losses, partially offset by 1.8 points of favorable prior year casualty reserve development. The underlying combined ratio was 90.4, reinforcing the high quality of our book of business. Net investment income after tax was $75 million in the quarter, benefiting from the exceptional performance from our alternative investments, particularly unrealized gains on our private equity limited partnership portfolio.

I'd like to highlight a few key themes:

First, property losses across the industry remain volatile, and the third quarter was no exception. And there's nothing to suggest that this trend of increased volatility will reverse, and industry pricing does not currently reflect this reality. Individual company results should not be evaluated on an ex-cat basis, but rather over time, inclusive of an expected cat load. In our case, that cat load is 4 points in a typical year. And as noted in our updated guidance, we expect 2021 to be above that level as Hurricane Ida is likely to be one of the costliest events in U.S. history. We seek to manage our catastrophe risk through strong risk modeling and oversight, disciplined underwriting guidelines and pricing actions, and prudent reinsurance purchases.

Second, the industry faces increasing headwinds and higher uncertainty relative to loss trends, driven by both economic and social inflation. Neither is a new phenomenon, but both have increased of late. Additional uncertainty has been introduced by the pandemic-related reduction to claim frequencies that meaningfully impacted loss experience in 2020 and continued, albeit at a less significant level through the first nine months of 2021. These factors call for strong discipline around establishing forward loss selections and pricing targets and consistently achieving those targets over the long term. For ten consecutive years, our renewal pure price increases have met or exceeded expected loss trend.

Third, the industry continues to face lower after-tax book yields on their investment portfolios as new money rates on core fixed income portfolios remain close to record lows. Many companies, including Selective, have benefited in recent quarters from the strong returns in alternative investments. These returns are likely to normalize in coming quarters, lowering the ROE contribution from investment income. The ongoing industry-wide pressure on after-tax investment portfolio book yields must be offset by improving underwriting results. It is the strong underwriting companies like Selective that are best positioned to thrive in this environment.

Finally, we continue to execute on balancing our objectives around growth and profitability. Our consistent success is a testament to our excellent distribution partner relationships, sophisticated underwriting, and superior customer servicing capabilities. For the first nine months of the year, commercial lines renewal pure price increases averaged 5.5%. New business was up 13%, and the renewal retention was a solid 85%. For smaller commercial lines accounts with policy premium of less than $10,000, renewal pure price increased 4.7% in the first nine months of the year, while larger accounts in excess of $100,000 in premium generated renewal pure price increases of 6.1%. Across all size cohorts, our highest quality accounts based on future profitability expectations, which constituted 25% of our renewal premiums for the first nine months, produced 3.2% pure rate, and point of renewal retention of 93%. Our most challenged accounts, comprising 11% of our renewal premium, generated 10% pure rate and point of renewal retention of 85%.

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Our ability to understand and price risk on a granular basis has allowed us to maintain strong retention while generating loss ratio improvement through an improved mix of business over time. We remain extremely well-positioned from an operating and financial standpoint. We continue to deliver on our plans to generate consistent profitable growth.

Now I'll turn the call over to Mark to review the results for the quarter and return with some additional commentary before taking questions.

Mark Alexander Wilcox - *Selective Insurance Group, Inc. - Executive VP & CFO*

Thank you, John, and good morning. I'll review our consolidated results, discuss our segment operating performance, and finish with an update on our capital position and guidance for 2021.

For the third quarter, we reported net income available to common stockholders per diluted share of $1.18 and non-GAAP operated earnings per share of $1.18. This translated to an annualized ROE and non-GAAP operating ROE of 10.6%, with a meaningful contribution from investments this quarter. The results were particularly strong in the context of an elevated catastrophe loss quarter. For the nine months ended September 30, our annualized non-GAAP operating ROE of 14.5% is well above our 11% target for the year driven by strong, underlying, underwriting results, favorable reserve development, and alternative investment income. Overall, we are extremely pleased with our performance so far this year.

Consolidated net premiums written for the third quarter increased 13% compared with a year ago. The primary drivers of our top-line growth was strong renewal pure price increases, exposure growth, solid retention rates, and strong new business growth in our standard commercial lines and E&S segments. Year-to-date, net premiums written increased 17% or 12% when adjusted for the prior year COVID-19 related premium items. We reported a consolidated combined ratio of 98.6% for the third quarter. Included in the combined ratio was $76.3 million of net catastrophe losses or 10 points, and $14 million of net favorable prior year casualty reserve development or 1.8 points. The principal driver of catastrophe losses in the quarter was Hurricane Ida, which accounted for $54 million of gross losses. Net losses from Ida were $43 million as we exceeded our catastrophe reinsurance program retention. The majority of our Hurricane Ida losses were incurred in the states of New Jersey, New York, Maryland, and Pennsylvania, and auto losses represented a substantial component. After relatively benign first half of the year for catastrophe loss activity for Selective, year-to-date catastrophe losses are now running higher than expectations, principally driven by Hurricane Ida. On an underlying basis or excluding catastrophes and prior year casualty reserve development, the combined ratio was 90.4% for the quarter. For the nine months of the year, we reported a combined ratio of 92.6% and an underlying combined ratio of 89.8%. This compares favorably to our initial 2021 guidance of a 91% underlying combined ratio and primarily reflects better-than-expected non-cat property losses and a lower-than-expected expense ratio.

Moving to expenses. Our expense ratio was 32.6% for the quarter compared with 32.4% for the prior-year period. For the first nine months, our expense ratio of 32.4% reflects some of our cost containment initiatives as well as lower-than-expected travel and entertainment and overhead expenses. We continue to expect ongoing improvements to our run rate expense ratio over time while ensuring we don't sacrifice investments to support our long-term strategic objectives. Corporate expenses, which are principally comprised of holding company costs and long-term stock compensation, totaled $4.3 million in the quarter compared to $3.9 million a year ago. The increase was driven by stronger performance relative to our peer group, which impacted the variable component of our long-term incentive compensation plan, offset in part by a decline in our stock price in the quarter.

Turning to our segments:

For the third quarter, standard commercial lines net premium written increased 13%, driven by renewal pure price increases averaging 5.3%, solid and stable retention of 86%, and new business growth of 24%. Exposure growth from revived economic activity also provided a healthy tailwind. For the first nine months of the year, net premiums written increased 19% or 13% when adjusted for the prior year COVID-19-related items. The commercial lines combined ratio was a profitable 97.2% for the third quarter and included 8.1 points of net catastrophe losses and 2.3 points of net favorable prior year casualty reserve development. The favorable prior year casualty reserve development consisted of $8 million for workers compensation, $4 million for general liability, and $2 million for the BOP line, and related to lower-than-expected claims emergence for accident years 2018 and prior. The underlying combined ratio was 91.4%.

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In our personal line segment, net premiums written declined 2%, reflecting continued competitive market conditions, particularly for personal auto. Renewal pure price increases averaged 1.2% for the quarter, retention was slightly up relative to a year ago at 84%, and new business was down 15%. The combined ratio in the quarter of 115.2% was impacted by 26.7 points of net catastrophe losses with Hurricane Ida contributing 13.6 points. The underlying combined ratio was 88.5%.

In our E&S segment, net premiums written grew 32% for the quarter relative to a year ago. Renewal pure price increases averaged 5.6%. Retention was higher and new business was up 20%. The combined ratio for the segment was 93.7% in the quarter, which included 9.2 points of net catastrophe losses. The underlying combined ratio was 84.5%. And during the quarter, we entered into a transaction with Argo with a 10/1 effective date to purchase the renewal rights for its E&S small commercial contract binding business. The book has a similar risk profile to ours, with a focus on small contractors, habitation, and retail classes with an average premium per policy of approximately $2,000. We currently expect to renew between $20 and $40 million of premium, which is a small portion of Argo's prior in-force book. From a financial standpoint, we view this as an attractive transaction for us, one in which we will not be assuming any legacy reserves or cost. This transaction benefits us strategically by increasing our distribution points with wholesale brokers. As part of the transaction, we are very pleased to welcome nine former Argo E&S employees to Selective, further building out and strengthening our E&S underwriting capabilities and team.

Moving to investments. Our investment portfolio remains well-positioned. As of quarter end, 91% of our portfolio was invested in fixed income and short-term investments with an average credit rating of "A+", and an effective duration of four years, offering us a high degree of liquidity. Risk assets, which include our high-yield allocation contained within fixed income, public equities, and limited partnership investments in private equity, private credit, and real asset strategies represent 10.8% of our portfolio. For the quarter, after-tax net investment income of $74.7 million was up $19.6 million from the year-ago period. The increase was primarily driven by $33.8 million of after-tax alternative investment gains compared to $14.7 million in the comparative period. As a reminder, net investment income from alternative investments is reported on a one-quarter lag. We have now experienced five consecutive quarters of very strong income from our alternatives. The returns over the last five consecutive quarters are well above longer-term expectations and are not sustainable. The after-tax yield on the portfolio was 3.8% for the quarter, delivering a strong 11-points of ROE contribution with alternatives contributing about 5 points. The after-tax yield on fixed income securities was 2.5% in the third quarter, which was slightly down from 2.6% in the year-ago period. The total return on the portfolio was 0.8% for the quarter, primarily reflecting the strong alternative asset performance. The average after-tax new money yield of fixed income purchases during the quarter was 1.8% compared with 2.2% for the year-ago period. Strong operating cash flow of $543 million for the first nine months equated to 22% of net premiums written.

Turning to capital. Our capital position remains extremely strong, with $2.9 billion of GAAP equity as of September 30. Book value per share has increased 7% during the first nine months of the year to $45.27, benefiting from our strong earnings. We have built significant financial flexibility with $515 million of cash and investments at our holding company. Our net premiums written to surplus ratio is at the low end of our target range at 1.35x. During the quarter, we repaid $50 million of Federal Home Loan Bank debt, which reduced our debt-to-capital ratio to 14.6%. Our significant financial flexibility gives us the ability to grow at rates above our sustainable growth rate, particularly while the pricing environment is strong, and it also allows us to evaluate attractive opportunities to advance our strategic objectives. We did not repurchase any shares during the third quarter or subsequent to quarter-end under our $100 million share repurchase program. We have $96.6 million of remaining capacity under the program, which we plan to use opportunistically.

I will finish this with commentary on our updated outlook for 2021. We now expect a GAAP combined ratio, excluding catastrophe losses, of 88%. This is an improvement from our prior guidance of 89% and reflects strong profitability, inclusive of net favorable casualty reserve development in the first nine months of the year. Our guidance assumes no fourth quarter prior accident year casualty reserve development. We've increased our catastrophe loss assumption to 5 points on the combined ratio from 4 points, reflecting the elevated catastrophe losses in the third quarter, principally from Hurricane Ida. We now are projecting after tax net investment income of $240 million, including $75 million in after-tax gains from our alternatives. This is up from our prior guidance of $220 million and $55 million, respectively, and principally reflects the very strong third quarter after-tax net investment income from alternatives. We continue to expect an overall effective tax rate of approximately 20.5%, which includes an effective tax rate of 19.5% for net investment income and 21% for all other items. Our prior guidance was for an effective tax rate of 19% for net investment income. Finally, weighted average shares remain $60.5 million on a fully diluted basis.

In summary, our ability to generate solid returns despite elevated catastrophe losses speaks to the underlying profitability of our book of business, a well-positioned investment portfolio, and the ongoing successful execution of our strategic objectives. We are very pleased with our year-to-date

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14.5% annualized operating ROE. While our reported results continue to reflect some nonrecurring benefits, such as higher-than-expected alternative investment income and favorable prior year casualty reserve development, our underlying results are very strong. We've delivered on our objective of disciplined growth, and we remain exceptionally well-positioned.

With that, I'll turn the call back over to John.

John Joseph Marchioni - *Selective Insurance Group, Inc. - CEO, President & Employee Director*

Thanks, Mark.

We remain on track for 2021 to mark our eighth consecutive year of double-digit ROEs in an industry that struggles to consistently meet its cost of capital. It is our unique operating model, top-notch distribution partners, and talented and hard-working employees that have driven this performance, and have us positioned to maintain this top-tier performance well into the future. We also remain focused on making the investments necessary to further enhance our competitive position. Our enhanced small business platform is generating strong early returns in a segment of the market in which we have always excelled. To support our strong growth in the E&S segment, we are nearing completion of our new underwriting platform that will improve agents' ease of interaction with us.

In personal lines, the necessary product enhancements to compete in the affluent market have been deployed and are being well received in the market. While a decline in our nontarget segment is masking the growth we are experiencing in the mass affluent market, we expect the personal lines segment to generate growth in 2022. We continue to invest in our digital customer offerings as adoption continues to accelerate. These platforms, along with our ongoing focus on innovation to expand our value-added service offerings are expected to generate future retention benefits. And we invest in our key distribution partners through various agency development programs in support of our goal of achieving a 12% share of their business.

As we look to the remainder of the year and into 2022, we are confident about our ability to build on our long-term track record of superior financial performance. We have a strong market position that is bolstered by our franchise distribution partner relationship strategy. We also have the tools, technology, and people that will help us execute on our plans. Above all, we will remain prudent and disciplined in our approach to generating profitable growth, an approach that has been key to our delivering superior operating and financial performance over time.

With that, we will open the call up for questions. Operator?

QUESTIONS AND ANSWERS

Operator

Thank you, sir. At this time, we will begin the question-and-answer session. (Operator Instructions)

Our first question will be from the line of Charlie Lederer of Wolfe Research.

Charlie Lederer

My first question is your ex-cat combined ratio guide for the full year is a bit higher than the year-to-date performance. Can you talk directionally about some of the factors driving the outlook for 4Q?

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Mark Alexander Wilcox - *Selective Insurance Group, Inc. - Executive VP & CFO*

Yes. Good observation. So when you think about the guidance for 2021, we started the year with a combined ratio of 95%, and that included 4 points of catastrophe losses and an underlying combined ratio of 91%. Our current guidance is for a combined ratio of 93%, which includes 5 points of cat losses, and then an ex-cat combined ratio of 88%. So, we have 2 points of improvement from where we started the year. If you look at it on an underlying basis, or ex-cat, ex-favorable reserve development, we're at about 89.8% on a year-to-date basis, which compares very favorably to that 91% when we started out the year. And you can sort of back into the underlying for the full year if you take our year-to-date reserve development and allocate that across the full year. So that would be a 90.2% underlying combined ratio for the full year. When you then take a look at the expectations for the full year versus year-to-date, we are -- you can sort of back into what the Q4 expectations are, which would be a 94.2% combined ratio, 91.6% on an ex-cat basis, or 91.6% on an underlying basis. But really, what we're reflecting is that expense ratio is sort of coming back to expenses coming back to normal expectations that we had going into the year, non-cat property losses going back to kind of original expectations for the full year. But overall, I think we're very pleased to report very strong improvement in the underlying combined ratio versus expectations and an overall combined ratio that is better-than-expected when we started the year.

Charlie Lederer

Okay. Great. And then I guess for my second question, the underlying loss ratio in the excess and surplus lines segment improved quite a bit. How can we think about the trend there? And then just a quick one. Sorry if I missed this, if this isn't in the remarks, but was there any notable benefit in personal lines from your flood program? Or should we expect one in the fourth quarter?

Mark Alexander Wilcox - *Selective Insurance Group, Inc. - Executive VP & CFO*

Yes. Maybe I can start, and John can jump in. So starting with E&S, just to make sure we're looking at the same numbers. If I take the underlying combined ratio and back out expenses, and then back out non-cat property losses, the underlying, call it, casualty loss ratio within E&S is -- I have is a 47.1% versus 45.1% in the comparative third quarter period. So that's actually up a little bit. But if you look at just the pure loss ratio, we did benefit from lower non-cat property losses in the current quarter, which I think is the difference. We are booking the E&S casualty loss ratio a little bit higher in 2021 than we had in 2020.

John Joseph Marchioni - *Selective Insurance Group, Inc. - CEO, President & Employee Director*

But overall, I would say, and Mark hit the key points there. What you're seeing in terms of the outperformance this year is largely related to better-than-expected non-cat property, but we still like the directional improvement that we've seen over the last couple of years in the E&S segment. We like the rate level we're getting there. We're seeing good strong growth. So we're pretty pleased with the forward potential with regard to both growth and profitability improvement in the E&S segment.

Mark Alexander Wilcox - *Selective Insurance Group, Inc. - Executive VP & CFO*

That's exactly right. And then just back to the comments on personal lines. I think the question was, was there any flood benefit? And do we expect any more in the fourth quarter? Clearly, as one of the top writers in the write-your-own flood program, one of our jobs is to adjudicate claims after a big event. And for us, Hurricane Ida, and for the industry was a big event. We had relatively underweight market share in the state of Louisiana. So, the flood claim benefit there was not that significant. But in the Northeast, particularly in New Jersey, we have a pretty healthy market share in the write-your-own program. So we adjusted a lot of claims in Q3 related to Hurricane Ida. We recorded about $2.2 million of claims handling fees within the quarter, about $1.5 million of that related to Hurricane Ida. And that was reflected as a benefit within the personal lines segment in Q3. Essentially, all of that has been recorded in Q3. If we see some development from a flood perspective into Q4, there might be a little bit more to come, but our expectation is that's all been reflected in Q3.

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Operator

Our next question would come from the line of Grace Carter of Bank of America.

Grace Helen Carter - *BofA Securities, Research Division - Research Analyst*

In the past, you all talked about loss cost trend of around 4% for commercial lines. I was wondering, just given the recent uptick in inflation, how you all see that trending from here or if it's still an accurate forecast?

John Joseph Marchioni - *Selective Insurance Group, Inc. - CEO, President & Employee Director*

Yes. I guess -- and I addressed a little bit of this in my prepared comments from an industry perspective, but just in terms of how we think about it. I think the first important point to make is we have always been very transparent about our view of expected loss trends, and we build that into the reconciliation that underlies our combined ratio guidance. And over the last couple of years, what we've seen and you've seen in that guidance is an incremental movement up from about 3% to about 4% on an overall basis. And I would say that was fairly reflective relative to commercial lines as well. As we sit here today, and I know we spent a lot of time on this last quarter as well, there are some dynamics in the current loss trend environment that I think need to be reflected going forward. And from our perspective, there -- we could be looking at an incremental move higher in forward loss trend. But I think what creates the uncertainty is we continue to be in this environment where our frequencies continue to run lower than expected. And while it's not at the level of what 2020 was, it continues to run a little bit lower than expectations through 2021. And then you've got this offsetting impact on the severity side. And the severity is driven in part by that lower frequency, but in part by other factors being economic inflation and social inflation. And I think that's what we work through as part of our year-end process, and we'll be very transparent as we get into January or later January with our 2022 guidance relative to how we think about that. But there's no question that those are impacts. I think you just have to factor in what happens with regard to frequency going forward? And at what point does it return to normal? And then what is the offsetting severity impact if and when that happens?

Grace Helen Carter - *BofA Securities, Research Division - Research Analyst*

And I guess, just another one on inflation. Across the industry, it seems like a lot of the conversations around inflation are focused on personal lines. So, I was wondering if you are seeing any differences in kind of the elevated severity from repair costs in commercial lines versus personal lines or if it feels pretty consistent?

John Joseph Marchioni - *Selective Insurance Group, Inc. - CEO, President & Employee Director*

I think they've actually become more consistent. I think last quarter, we saw a little bit of a difference, specifically on the property side, where personal lines was more elevated as an impact from inflation than commercial, largely because of the higher prevalence of lumber in personal property repair than commercial property repair. With lumber backing back down, we see current blended construction cost index change in the third quarter that's about the same for personal and commercial property. And I'll come back and hit auto in a second, but it's kind of back down to that 6% sort of range, which you would expect to see come through in severity. But again, we'll continue to live in a lower frequency environment. So there's an offset there.

On the auto side, again, commercial is a little bit different because the range of auto types is a lot different than it is in personal lines. But just to give you a sense from an industry number perspective, in Q3, and this comes from one of the primary auto material damage vendors, the blended claim cost increase on auto physical damage in the quarter is up about 15%, and that's a combination of total loss continuing to be up north of 30% and repair costs being up about 8%. So it blends together that way. And if you look at our results in the auto lines, you can see that non-cat property comes through a little bit higher on a year-over-year basis, and you would attribute some of that to that cost of repair that's running higher. So, I think it is normalizing, but you've got this higher starting point that needs to be worked through. And then the longer-term question becomes when does frequency return to pre-pandemic levels which has been an offset to this point. So, I apologize for the long-winded answer, but that's kind of how we would think about the claim cost impact of economic inflation coming through.

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Operator

Our next question will be from the line of Scott Heleniak of RBC Capital Markets.

Scott Gregory Heleniak - *RBC Capital Markets, Research Division - Assistant VP*

Just wondering, you mentioned personal lines you expect to return to growth for 2022, which I'm assuming is going to be driven by the high net worth and some of the initiatives you have there. You mentioned that you're changing some parts of the portfolio. But could you give an update on, or just expand on where you see that growth coming from? Is that going to be high net worth? And how many -- can you refresh us how many states you're in now? And what your plans are for 2022 on that front?

John Joseph Marchioni - *Selective Insurance Group, Inc. - CEO, President & Employee Director*

Yes, sure. Let me just hit state expansion first. We're currently in 15 states for personal lines. That's been the case for a couple of years. We did expand into Arizona and Utah, along with our commercial -- or right after our commercial lines expansion into those states a few years back. We don't have any near-term plans to open up additional states. So, the growth looking forward, and our current plans will be coming from that existing 15 state footprint. In terms of the growth we are seeing, and again, as I said in the prepared comments, the overall portfolio of growth showing negative in the quarter is masking some of the growth in our target market because we are seeing some pressure on the retention and drop-off in new business in what we would consider our nontarget market going forward. And we do expect, as we move through 2022, quarter-by-quarter, we expect to see that start -- that balance start to shift. And in the latter half of the year, we expect to be in a stronger growth more than we are in the first or second quarter. But that is driven entirely by our new target market business. We still, although it's less dependent on a competitive auto environment to drive the growth. It is still somewhat dependent on that. And what we're seeing with -- over the last 18 months as a lot of the larger players in personal auto rather than just continuing to provide credits opted to modify their rate plans down. We saw a fairly significant move in the competitive landscape on auto, which is still hurting our ability to grow the overall segment. Our expectation is that we'll start to reverse. And you've heard all the public commentary about lower rate filing expectations for a number of players. We opted to handle the pandemic-related drop in frequency through credits as opposed to making a wholesale change to our filed rate plan on the belief that the driving environment would return to normal over time. So I think that puts us in a better position going forward.

Scott Gregory Heleniak - *RBC Capital Markets, Research Division - Assistant VP*

Okay. That's definitely helpful. And just moving on to the -- you mentioned the Argo renewal rights transaction, the $20 million to $40 million in premium. Was there any premium included in Q3 within that? And then also, could you talk about if there's any difference between that loss ratio of business versus SIGI's E&S loss ratio? Is there any material difference in there?

John Joseph Marchioni - *Selective Insurance Group, Inc. - CEO, President & Employee Director*

Great question. First question is, no, there's really no third quarter premium impact from that. This will largely be a fourth quarter and then into the first 3 quarters of 2022. With regard to the pricing or profitability impact, I think it's important to recognize, and that's why we have the assumption we have relative to the premium we will acquire, which is a portion of the premium that's currently in that portfolio because this business will be offered a renewal on our forms on our -- with our rating structure and our terms. So we do expect to see a certain retention level that is underlying that $20 million to $40 million number that Mark gave you. So we fully expect this to mirror what we write, not just by class of business, but in terms of price per unit of exposure and the terms and conditions.

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Scott Gregory Heleniak - *RBC Capital Markets, Research Division - Assistant VP*

Okay. That makes sense. And then lastly, just wanted to touch on the dividend. Really nice dividend increase. Obviously, good to see. And I believe this is the second year in a row, a pretty significant dividend increase. So just wondering if you could share the dividend policy. Obviously, you look at payout ratio, a lot of different factors that you would obviously consider. But anything you can share on that, how we should be looking at the dividend going forward compared to maybe how you looked at it in the past?

Mark Alexander Wilcox - *Selective Insurance Group, Inc. - Executive VP & CFO*

Yes. Good question. Perhaps I'll start, and then John can provide some additional color as necessary. So generating good returns for our shareholders, for us, means, one, generating strong operating ROEs as well as the good stewards of our shareholders' capital. And I think the dividend strategy is a reflection of that. So for us, we are focused on disciplined and profitable growth. And the key contributor of funding that growth is profitability and retained earnings. So, we as a company that has a relatively high growth rate relative to the industry as a whole, focusing hard on the dividend payout ratio, ensuring we have a good sustainable growth rate, is something that we focus on. So, we think about a sustainable growth rate is a function of our forward ROE and the dividend payout ratio, and we target a dividend payout ratio from around 20% to 25% of earnings. We'd like to get through the third quarter, get through hurricane for the most part get through hurricane season before we reset the quarterly dividend. But we think it's a good way to return some capital to our shareholders while also retaining profitability in the form of capital to fund our future growth. So we felt very good about the 12% dividend increase up to $0.28. I think our Board felt very comfortable with our capital position, our growth prospects, and our forward earnings expectations. And that's how we think about the dividend.

Scott Gregory Heleniak - *RBC Capital Markets, Research Division - Assistant VP*

Okay. That's a good comprehensive answer. I appreciate all your answers. Thanks.

Operator

Our next question will be from the line of James Bach of KBW.

James Paul Bach - *Keefe, Bruyette, & Woods, Inc., Research Division - Associate*

Can you discuss a little bit more what some of your plans are to achieve more savings outside of kind of the T&E movement that's going on with the pandemic, kind of explain what the cost containment efforts are focused on and how you're sort of balancing that with your growth plans?

John Joseph Marchioni - *Selective Insurance Group, Inc. - CEO, President & Employee Director*

Yes. I'll start, and Mark can certainly provide some additional commentary.

From our perspective, this is all about continuing to gain operational efficiency, working smarter, leveraging technology, to allow our employees to handle an additional workload without needing to create more effort on their part. So we really think about managing our fixed expenses and the growth in our fixed expenses at a lower rate than our top line is growing as a way to build those economies of scale. And again, that's a combination of working smarter, but also better leveraging technology. And we've made a lot of investments in this area. I know we've highlighted some of them in the past, but there's been a number of investments towards underwriting tools, best management tools that really help our underwriters become more efficient. The net result of that is they could handle a larger renewal portfolio with the same result from an underwriting perspective. And I think that's really where our focus is. This is not about cutting expenses out. And as Mark indicated previously, we're going to continue to make the investments. And I highlighted a couple of them relative to technology, from a small business and an E&S perspective or personal lines product development we're going to make those investments. This is not about cutting expenses, it's about making sure that we're

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better leveraging the resources we have and growing our fixed expense rate at a much lower rate than we're growing our net premiums written. And I think that will be to continue to be the primary driver.

Mark Alexander Wilcox - *Selective Insurance Group, Inc. - Executive VP & CFO*

Yes. That's exactly right. And I think from our perspective, in order to generate continued consistent profitability being efficient in terms of how we think about expenses is important. As we've mentioned in the past, when we think about our mix of business, a heavy weighting towards standard commercial lines and E&S. So a slightly lighter weighting towards personal lines than some of our players, we think, an appropriate expense ratio for us on a long-term basis is around 32%. And if you go back a couple of years, we were in the low 35% range from an expense ratio perspective. Our guidance for this year was 33%, with 32.4% year-to-date. So we've been able to make those significant long-term investments to drive underwriting profitability to support our organization, to hire really strong and talented underwriters and individuals, but also drive the expense ratio down and as we look ahead to 2022, and in particular, 2023, we do have line of sight on the pathway to getting down to that 32% expense ratio.

John Joseph Marchioni - *Selective Insurance Group, Inc. - CEO, President & Employee Director*

And James, the only other point I'll make, and I think this might be stating the obvious, but I think we've also learned a lot through the last 19 months about our ability to deliver services virtually that used to be delivered in person and whether it's in the claims area and virtual inspections for certain claim types or in our safety management area, where we can now deliver much more efficient safety services to a broader population of our customers and do that much more efficiently by leveraging a lot of these virtual capabilities. I think that's a permanent benefit that will help on the efficiency side going forward, but also help on the customer experience side. And I think that's a real beneficial outcome over the last 19 months.

James Paul Bach - *Keefe, Bruyette, & Woods, Inc., Research Division - Associate*

That covers it for me. Thank you.

Operator

(Operator Instructions) Our next question will be from the line of Matt Carletti of JMP.

Matthew John Carletti - *JMP Securities LLC, Research Division - MD & Equity Research Analyst*

Just a couple of questions. One, just a follow-up on the Argo renewal rights book. Your current E&S book is about 2/3, 1/3 split casualty versus property. Should we expect something similar of that $20 million to $40 million that you expect to renew? Or is there a reason to believe that it will be materially different?

John Joseph Marchioni - *Selective Insurance Group, Inc. - CEO, President & Employee Director*

We don't expect this will change our mix. And this is largely in the binding segment. We think about our E&S business in two in -- predominantly two distinct segments, one being the Binding Authority segment, which is where this renewal rights portfolio is. And the other for us is our brokerage segment, which is the smaller end of the brokerage, it's really the business that just falls outside of our binding constraints. This is all in the binding area. And actually, if you were to look at the split in our binding area, it's probably a little bit higher casualty weighted, whereas brokerage is a little bit more of a 50-50, 60-40 split casualty to property. So, no change in that mix. If anything, it's a little bit more casualty-driven.

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Matthew John Carletti - *JMP Securities LLC, Research Division - MD & Equity Research Analyst*

Great. And then for Mark, could you give the split of the cat losses in standard commercial in the quarter? And then I apologize, I know you mentioned it, but you talked too fast for me to keep up the prior-year development, I think you gave by line. I just wasn't able to catch it all.

Mark Alexander Wilcox - *Selective Insurance Group, Inc. - Executive VP & CFO*

Yes. So let's start with the catastrophe loss activity in the quarter in standard commercial lines by individual line of business. So in total, it was $50 million or 8.1 percentage points on the standard commercial lines combined. In commercial property, it was $32.8 million or 29.3 points on the commercial property combined; commercial auto, $8.2 million or 4.4 points, BOP was $8.9 million or 38.7, and rounded, that should get you to $50 million or 8.1 points on standard commercial lines. And then in terms of the casualty reserve development, it was $14 million in total or 2.3 points on the standard commercial lines combined ratio in the quarter. Where all the development was in standard commercial lines. It was $8 million favorable in workers' comp, $4 million favorable in GL, and $2 million favorable in the BOP line.

Operator

I see no further questions. I would like to turn the call back over to you, sir, for closing remarks.

John Joseph Marchioni - *Selective Insurance Group, Inc. - CEO, President & Employee Director*

Great. Well, thank you all very much for joining us this morning, and we look forward to talking to you again soon. Thank you.

Mark Alexander Wilcox - *Selective Insurance Group, Inc. - Executive VP & CFO*

Thank you.

Operator

Thank you, speakers. Thank you for joining the conference call today. You may now disconnect.

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