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SIGI.OQ - Q3 2023 Selective Insurance Group Inc Earnings Call

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PRESENTATION

Operator

Good day, everyone. Welcome to Selective Insurance Group's Third Quarter 2023 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, Brad Wilson.

Brad Bryant Wilson - *Selective Insurance Group, Inc. - Senior VP of IR & Treasurer*

Thanks, and good morning. We are simulcasting this call on our website, selective.com, and a replay will be available until December 1. 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 measures, which we believe 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.

Adjusted book value per common share differs from book value per common share by excluding total after-tax unrealized gains and losses on investments included in accumulated other comprehensive loss or income. GAAP reconciliations to any referenced non-GAAP financial measures are in our supplemental investor package found on the Investors page of our website.

Third, we make statements and projections about our future 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 in detail in our annual, quarterly and current reports filed with the SEC. We undertake no obligation to update or revise any forward-looking statement.

Now I'll turn the call over to John Marchioni, our Chairman of the Board, President and Chief Executive Officer; Mark Wilcox, our Executive Vice President, Chief Financial Officer, will follow John.

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

Good morning, and thank you for joining us. We delivered strong earnings in the third quarter with excellent top line growth. Our annualized non-GAAP operating ROE was 15%, bringing our year-to-date result to 13.2%. This puts us ahead of our 12% operating ROE target we strive to consistently meet or exceed. We continue to see a meaningful increase in ROE contribution from investment income and solid underwriting performance. With a quarter ago, we are well positioned to deliver our 10th consecutive year of double-digit operating ROEs.

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Since 2014, our average operating ROE is 12%, a few in our industry can match this track record. As we proved across pricing cycles over the past dozen years, we have consistently achieved renewal pure rate equal to or exceeding expected loss trends. We are focused on ensuring this continues going forward as we manage our new and renewal portfolio. The ability to underwrite at a granular level enabled by sophisticated tools is a key reason for our strong and stable underwriting performance over time.

We have highlighted the industry's elevated uncertainty of loss trends influenced by economic inflation, social inflation, the unusual frequency and severity patterns resulting from the pandemic and a heightened frequency of catastrophe losses. These factors have put pressure on loss costs, necessitating continued industry focus on adequate pricing. We achieved standard Commercial Lines renewal pure price increases of 7.1% in the quarter and 6.9% year-to-date versus our expected loss trend of 6.5% coming into 2023.

Our 2023 accident year loss estimates are generally holding up as expected, but pockets of pressure exists, particularly in personal and commercial auto liability. Mark will discuss some of the actions we have taken.

Within general liability, we have been embedding higher severity picks in our initial estimates in recent years, and they have come to fruition. Lower frequency has largely offset the higher severities in the most recent accident years. If the favorable frequency trend moderates and severity has emerged higher than expected, we could see additional pressure on this line. We believe this is an industry-wide dynamic, and therefore, expect pricing to reflect these elevated trends.

Despite the higher interest rates that are providing a meaningful tailwind to investment income, we are maintaining our long-term target combined ratio of 95%. This reflects elevated uncertainty about emerging casualty loss trends, inflationary impacts in property and increased weather event frequency. Standard Commercial Lines and excess and surplus lines, representing approximately 90% of our business are running at this target or better due to our consistent efforts to achieve renewal pure price consistent with expected loss trends. As a result, we can avoid more draconian actions that some competitors may need to take to address profitability challenges, disrupting our customers and agents.

The remaining 10% of our business, Standard Personal Lines, is clearly short of target profitability, which we are addressing through aggressive rate increases. These filed rate increases began to take effect on a written basis during the first quarter of 2023. We expect our overall written renewal rate will be approximately 9% in the fourth quarter and in the range of 20% to 25% in 2024, subject to regulatory approvals. As we file these rate changes, we are also refining our pricing for both cat and non-cat perils, including severe convective storm.

At the same time, we are seeking to further improve homeowners' performance through terms and conditions. We are introducing actual cash value rather than replacement costs on older roofs. And in states most exposed to severe convective storm, we are implementing mandatory wind and hail deductibles. We expect these and other coverage changes to take greater hold as the market continues to evolve.

Finally, we are taking further actions to accelerate the migration of the portfolio to our target market, which presents greater potential for long-term profitability.

Overall, top line growth continues to be excellent. Our distribution partners appreciate our franchise value, open communication and consistent approach to managing rate and retention. In total, net premiums increased 17% in the quarter to $1.1 billion, and we are on our way to exceeding $4 billion in annual premiums for the first time in our nearly 100-year history. Across all our segments, renewal pure price was 7% for the quarter and new business grew 26%. New states since 2017 added approximately 2 points to premium growth in a quarter.

In our flagship Standard Commercial Lines segment, net premiums written grew 15% in the quarter with 13% growth in new business. Notably, the Commercial Lines marketplace continues to be constructive as evidenced by our renewal pure price of 7.1% in the quarter and strong retention of 86%. Manageable policy count growth of 2.5% also contributed to the top line.

During the quarter, property renewal pure rate was up 12.3% with exposure increasing 4.7% and total renewal premium up 17.6%. In commercial auto, renewal pure rate was 9.6% with increased exposure of 4.3%, resulting in a 14.3% total renewal premium increase. Geographic expansion continues to provide us runway to expand our business and diversify our portfolio. Our deliberate approach to adding new states has manifested in a repeatable process and generated strong results. We are adding West Virginia and Maine to our Commercial Lines footprint in the coming

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months and are excited to announce we expect to launch Washington, Oregon and Nevada in late 2024. Ultimately, we plan to write standard commercial lines in most of the contiguous United States.

Excess and surplus lines continued to perform very well with 25% premium growth in the quarter and an excellent all-in combined ratio of 83.9% or 80.4% on an underlying basis. For the first 9 months, premium growth was 21% with a combined ratio of 89.7% and underlying combined ratio of 82.5%.

I'll now turn the call over to Mark to review our financial performance in more detail.

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

Thank you, John, and good morning. We reported $1.42 of fully diluted EPS in the third quarter, up 115% from a year ago and $1.51 of non-GAAP operating EPS, up 53%. Year-to-date, fully diluted EPS was $3.83, up 77% compared to the prior year period, and non-GAAP operating EPS was $3.95, up 11%. This quarter, significant growth in after-tax net investment income and stable underwriting margins drove our performance. Our consolidated combined ratio for the quarter was 96.8%. With after-tax net investment income up 56%, we generated a healthy 15 percentage points of operating ROE, up 4.5 points from a year ago when we reported the same 96.8% combined ratio.

Despite our strong operating ROE driven by higher net investment income, our full year expected combined ratio of 96.5% is above our 95% longer-term target. Therefore, we will remain disciplined as we work to achieve our longer-term underwriting margins. The third quarter was another frequency-driven catastrophe quarter with 23 designated cats impacting our results, bringing the year-to-date total to 60 events. Catastrophe losses were $65 million or 6.6 points on the quarter's combined ratio. No single storm was significant with the largest event resulted in ultimate net losses of $8 million. As a result of the higher-than-expected cat losses in the quarter, we have increased our full year catastrophe loss ratio guidance from 6 points last quarter to 6.5 points.

We did not report any net favorable prior year casualty reserve development in the quarter. While our workers' compensation line continue to show favorable claims emergence with $7 million of favorable prior year casualty reserve development. This was offset by unfavorable development of $4 million in commercial auto and $3 million in personal auto. As John described, we are closely monitoring casualty lines and continuing our practice of full reserve reviews each quarter for all major lines of business to stay abreast of emerging trends.

As it relates to the current accident year, we took action in our personal auto line in the quarter, increasing loss cost by $4.9 million or 5.2 points on the Personal Lines combined ratio. We also added $4 million in commercial auto, increasing the third quarter combined ratio of 0.5 point for standard commercial lines. We expect these higher loss picks in these lines to continue this year. The underlying combined ratio was a very profitable 90.2% for the quarter, 4.5 points lower than a year ago. Non-cat property losses of 17.6 points were 2 points better than the 19.6 points in the third quarter of 2022 and a bit better than expected. Also a lower expense ratio contributed 1.7 points of improvement.

While our fixed controllable expense dollars were right on budget for the quarter and year-to-date, our expense ratio continues to benefit from strong premium growth. Year-to-date, our expense ratio was 31.6%, 80 basis points below the same period in 2022 and in line with our longer-term target. Over the medium and longer term, we will continue to drive operating efficiencies and manage our expense ratio while ensuring we continue to make the significant investments necessary to support our strategic objectives.

Regarding our insurance segments, I would highlight the strong underwriting performance in standard commercial lines, which had a 94.7% combined ratio and underlying combined ratio of 90.4% and 15% net premiums written growth. Our E&S segment also had an excellent quarter with 83.9% combined ratio, an underlying combined ratio of 80.4%, and net premiums written growth of 25%.

Personal Lines had another quarter of elevated catastrophe losses, higher-than-expected non-cat property losses, modest adverse prior year development and continued pressure on the current accident year in personal auto. As John discussed, we are addressing this with aggressive rate and underwriting actions. The bright spot was the expense ratio, which came in lower than the run rate due to our flood business. In our NFIP right your own flood business, we continue to grow and take market share due to our servicing and technology capabilities. And as a result, we received a healthy growth bonus, which was earned this quarter and benefited the expense ratio.

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Turning to investments. After-tax net investment income for the quarter was $80.2 million, up 56% from a year ago. This reflects our work over the last 21 months to aggressively manage our fixed income portfolio and build book yield in a rapidly rising interest rate environment. Since the start of the rise in benchmark interest rates 21 months ago, we have put $4.8 billion to work in fixed income and our results are benefiting from these actions. The after-tax yield on the total portfolio was 3.9% for the third quarter, translating to a strong 13.1 points of investment ROE contribution, up from 8.9 points in the third quarter of 2022.

Alternative investments reported on a 1-quarter lag, generated $5.1 million of after-tax income, up $9.5 million from a year ago's $4.4 million loss. Our portfolio remains very well positioned. As of September 30, 92% of the portfolio was in fixed income and short-term investments with an effective duration of 4.1 years. Risk assets were approximately 10.6% of the portfolio, up modestly from last quarter, but near the low end of our target range.

During the quarter, the average credit rating of our fixed income and short-term investments declined marginally to A+ from AA-. The decrease in the average credit quality was driven by Fitch downgrading the United States long-term issuer default rating to AA+ from AAA in August. In the future, we expect our credit quality to remain in the A+ to AA- range. Importantly, our investment strategy and underlying credit quality is unchanged. We continue to find attractive opportunities to deploy new money into high-quality securities while increasing the portfolio's book yield.

During the quarter, we invested $443 million of new money at an average pretax yield of 6.4%, improving our book yield by 12 basis points to 4.58%. Our book yield has improved by approximately 160 basis points since the start of 2022. As a reminder, every 100 basis points of pretax yield on the entire investment portfolio equates to approximately 260 basis points of ROE.

Our capital position remains extremely strong with $2.6 billion of GAAP equity and statutory capital and surplus as of quarter end. Book value per share is up 5% this year or 7% adjusted for dividends. Operating cash flow through September 30 increased 8% to $522 million compared to the first 9 months of 2022. Our parent company's cash and investment position totaled $486 million on September 30, above our long-term target of $180 million, providing us with ample dry powder.

Net premiums written to surplus increased to 1.53x driven by strong premium growth while our target operating range for premium to surplus continues to be 1.35 to 1.55x, we'd be comfortable moving above 1.55x for a period of time, and we have the flexibility to downstream capital to our insurance subsidiaries to reduce this ratio if appropriate. Debt to capital was stable at 16%, and we have significant financial flexibility to support our strong growth and execute our strategic initiatives. We did not repurchase any shares during the quarter and have $84.2 million in remaining capacity under our share repurchase authorization. Our view remains at the most attractive opportunities to deploy capital towards organic growth within our insurance operations.

Reflecting our continued profitable growth as an organization, our Board of Directors declared a quarterly dividend of $0.35 per share, an increase of 17%.

Shifting to our outlook. For 2023, our full year expectations have improved modestly compared to last quarter and the start of the year. We continue to expect consistent underwriting margins with an all-in GAAP combined ratio expectation for the year of 96.5%. We are increasing our after-tax net investment income by $10 million to $310 million. Our GAAP combined ratio guidance of 96.5% now includes 6.5 points of catastrophe losses, up 0.5 point from our previous guidance of 6 points and up 2 points from the start of the year. Our guidance, as usual, assumes no additional prior accident year casualty reserve development. Our after-tax net investment income guidance of $310 million includes an assumption of $20 million in after-tax gains from alternative investments. Although down from $30 million in after-tax gains assumed in last quarter's guidance, the expected income from our fixed income portfolio more than offsets the decline in our assumption for alternatives.

Other elements of our guidance remain unchanged with an overall effective tax rate of approximately 21%, with an effective tax rate of 20% for net investment income and 21% for all other items, and weighted average diluted shares of $61 million, which does not reflect any share repurchases we may make under our authorization.

Lastly, this is, of course, my last earnings call with Selective. Serving as Selective's CFO for the last 7 years has been an honor and a privilege. I'm very proud of what we have accomplished, notably the significant value we have created for our shareholders. I want to thank John for his

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extraordinary leadership and our excellent working relationship, leaving Selective is not easy. I also want to thank our Board of Directors, talented employees and tremendous distribution partners who I admire greatly. Thanks also to all of you who cover Selective. I've enjoyed interacting with you and look forward to being able to do the same in a not-too-distant future. Over the long term, I believe Selective will continue delivering profitable growth, and I look forward to its continued success.

Now I'll turn the call back to John.

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

Thank you, Mark. Before we open the line for questions, I would like to briefly comment on our CFO transition. First, on behalf of the Board of Directors and our entire team, I want to thank Mark for his many contributions to Selective over the last 7 years. Mark has been a trusted partner, and we're pleased he could assist us in a seamless transition, closing the quarter and participating in today's call. We wish Mark well.

Tony Harnett, is currently our Chief Accounting Officer, and we are fortunate to have someone of his caliber step into the interim CFO role while we search for a permanent replacement. Importantly, as we stated in our announcement, we do not expect the transition will impact our performance or strategy. I am confident that Tony and our strong finance team are equipped to support the continued execution of our financial priorities. Overall, Selective is well positioned with excellent prospects going forward. We have the capital strength to support attractive growth opportunities and the tools and organizational capabilities to effectively manage our business through various market cycles.

With that, operator, please open the call for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of Michael Zaremski from BMO Capital.

Michael David Zaremski - *BMO Capital Markets Equity Research - MD & Senior Equity Research Analyst*

This is Jack on for Mike. I know you provided some data points earlier on this topic, but I wanted to ask about the potential relationship between falling year-over-year reserve release levels and whether they've had an impact on Selective's perspective view of lost cost inflation, particularly for longer tail casualty lines. And I know some insurers have cited that higher interest rates could be correlated with the potential for higher levels of inflation. I was just wondering if you have any thoughts on that topic.

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

This is Mark. Why don't I start? I think that we had a little bit of a tough time, Jack, hearing your question, but I think it related to reserve releases over time and how that impacts loss costs going forward, if I'm not mistaken. But just for the record, from our perspective, every quarter, as I mentioned in my prepared comments, Selective does a very detailed ground-up reserve review of all of our major lines of business. And each quarter, we respond to the emergence from a frequency and a severity perspective by line of business. Over the last 17 years, plus 9 months of 2023, we've had favorable claims emergence across our portfolio and across our book of business. in each quarter, each line responds differently, and we've had periods of time where general liability has been favorable and workers' compensation has been unfavorable.

Most recently, the trend has been towards favorable frequency benefits, particularly in workers' compensation, that's driven some considerable favorable reserve development. But we've also had some offsets, including from commercial auto. And most recently, personal auto has been a little bit of a drag from a prior year development perspective. This quarter, we saw the consistent trend with workers' compensation generating favorable claims emergence and we had $7 million of favorable reserve development in workers' comp, but that was largely offset by $4 million

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of unfavorable development in commercial auto and $3 million of commercial -- of personal auto prior year adverse development. On net, it was 0.

But overall, again, we book our best estimate in quarter in, quarter out. We don't think that the trend of a slightly diminishing look back in terms of impact on the combined ratio from reserve development has any meaningful impact on our forward look of trend at this point. But there are some -- John mentioned some observations around general liability and some things that we're keeping a close eye on.

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

And the other point -- this is John. I would just sort of reinforce and we've always been quite transparent around this is we've been building in an increase in our expected loss trend over the last couple of accident years. As we've pointed out, we view that as largely driven by severity. And frequencies were expected to remain fairly stable. So those trends emerge over time. And as we put out our 2024 guidance, we'll give you an updated view of how we see those trends emerging into the future.

Michael David Zaremski - *BMO Capital Markets Equity Research - MD & Senior Equity Research Analyst*

And then my second question is on the construction-related portfolio and which we appreciate is a strong industry niche for Selective. I guess, given that interest rates have been meaningfully higher for a while now, the media has been all over covering some macro data points showing that new construction starts are at decade lows. Thinking back to the post-financial crisis era when construction spending also declined meaningfully, are there any potential implications that you're thinking about this cycle?

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

So I think we always stay on top of estimating -- making sure we have our exposure base right and estimating our accrual for audit premium. I would say exposure across the Commercial Lines portfolio, including our construction classes continues to be strong, but that's something we evaluate on a regular basis to make sure we stay ahead of that and get exposures right on every policy we renew and every policy we write new and then a disciplined process around auditing to make sure those exposures are right, looking back once the policy expires.

The other thing I would point to is our -- we talk about the construction class. It's not one monolith class of business. We write a lot of different artists and contractor classes, and housing starts are not necessarily the best indicator of growth in those classes. Because I think the other thing that's happened is with the significant turnover in housing over the last several years, you still have a lot of pent-up demand for home remodeling that I think will continue to remain robust looking forward. So I think we'll see what happens in the economy. That certainly has the potential to impact exposures, not just in construction, but in all sorts of classes of business, but that's something we've always been diligent about making sure we get the exposure base right and then auditing it after policy expiration to capture any increases or decreases.

Operator

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

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

Looking at the new business trends in personal lines, there's been some really strong growth there for the past few quarters. I was hoping you can maybe help us think about that as broken down in some policy count growth versus just growth from pricing. And if we should expect any sort of deceleration there as the book continues to kind of reprice and works towards reaching target margins?

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

Yes. I'd say you would expect to certainly see some deceleration in growth, and I think it's likely driven by a couple of factors, and we'll start we're starting to see this already on a policy count basis and expect to see this on a go-forward basis, which is we've restricted the quoting of certain types of new business and comparative rating platforms that agents use specifically for accounts that aren't in our mass affluent target market. So that certainly has had an impact on new. I think with regard to the renewal portfolio and how that impacts growth, you heard us in the prepared comments talk about the increase in rates that we're starting to see on a written basis, but more importantly, the significant ramp-up in the rates as we move into '24 and that expectation of a written rate over the course of the year in the low 20% range. And I think that will also have an impact on growth.

So certainly, new business pricing continues to be a little bit higher. Our new business pricing in the quarter was about a little over 11% because we're getting the immediate impact of the filings that are being approved. But -- so that's a driver. But policy count is still up on new business.

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

And sticking with personal lines, I was hoping maybe you could help us think through where the target combined ratio for this book is and if that's changed versus where it was prior to the mass affluent transition and just kind of if we should think about the 95% goal for the entire organization kind of applying to each segment or the degree to which it varies.

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

Yes. Great question. So I would think about the $95 million that we have overall as applying to all 3 of our business segments, including personal lines. Now again, in today's interest rate environment, that 95% will generate an ROE well in excess of our 12% long-term target. But we think it's important for the underwriting organization to remain focused on that on a consistent basis. So that would apply. It hasn't changed with regard to how we view mass affluent. Obviously, we think about casualty lines in the personal lines segment, we think about personal auto different than home in terms of that target. But when you roll them together, 95% all in is the way to think about it on a target basis.

Operator

(Operator Instructions) And your next question comes from the line of Andrew Lambrecht from Piper Sandler.

Andrew Lambrecht

I'm just wondering if you can update us on your expectations for alternative investments over the long term, sort of been a little bit all over the place in recent quarters and you guys lowered guidance for the year. I'm just trying to better understand how to think about them prospectively.

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

Yes. This is Mark here. Let me kind of walk you through that. So as you know, alternatives is an asset class that has generated very, very strong returns for us. Within alternatives, that's a relatively broad description. We have a pretty healthy allocation to private equity. We have an allocation to private credit, and we have an allocation to what we call real assets, and that includes real estate and infrastructure. And it's about call it, 70%, 22% and 8% split between those 3 categories. Each of those asset classes are going to generate different returns over the longer run.

Overall, when we think about it on a prospective basis, we've put probably about a, call it, about a 10% return expectation out there for those asset classes. This year, we've had a dial back expectations. We had a $30 million after-tax gain expectation for alternatives in 2023. We had a good start to the year. But as you saw, the S&P 500 was down about 4% in Q3. So when you go through the math on year-to-date old income versus guidance of $20 million, we're basically saying 0 return in the fourth quarter, and that's sort of our best estimate at this point. If you were to take a look back

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at our portfolio over a multiyear period and sort of call it ex-legacy, we had a portfolio that came out of the financial crisis. But since the new investment team came in and started to ramp the alternative portfolio back up in 2016, it's been just under a 20% IRR. So it's generated very, very healthy returns. And you might recall, in particular, 2021 having very, very strong returns with a gain and seem to remember about $90 million, $93 million after tax. So it tends to bounce around a little bit. But I think longer term, I would go with about a 10% return expectation for the portfolio.

Operator

Our next question comes from the line of [Dean Cristello] from KBW.

Unidentified Analyst

My first question was about the E&S line. I was a bit surprised to see the deceleration of pricing increases within the non-admitted line. Is there any additional color you could provide there? Or are you guys still seeing strong submission flows into those lines? Or have you seen sort of a change in the market dynamics recently? And if you could sort of like bifurcate that between property and casualty, that would be great as well.

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

Yes. Sure. So I guess I'd hesitate to use the term deceleration. It was 6.6% in the quarter and 7.1% on a year-to-date basis. So that's strong. And that's extremely strong in the context of an all-in combined ratio of 89.7% on a year-to-date basis and an underlying of 82.5%-- so despite those higher-than-expected cats in that segment, we're still producing a 90% combined ratio. So with regard to the pricing overall, I would consider that more stable than I would a deceleration. And from a casualty to property perspective, casualty was 6.2% in the quarter and property was 7.3% in the quarter. So we see strong growth. I think the business we're writing and that's driving that growth is business we have a long track record with. We haven't really stretched from an underwriting appetite perspective. We continue to see ample opportunities and continue to see a favorable market dynamic.

I will say just generally speaking, and I think this is around the edges, as a lot of players in that market have started to really move away from property you've seen a little bit more competition for casualty-driven business, but I would still call that around the edges, as you could see from our growth overall and the pricing we're getting on both property and casualty. We think the market dynamics there remain pretty constructive.

Unidentified Analyst

My follow-up question was back to the personal lines mass affluent market. We've noticed recently a number of competitors have sort of pulled back from certain markets in certain regions. Do you guys have plans to sort of expand into certain regions to sort of capitalize on that? And is there any chance you could quantify what percent of your total personal lines portfolio is from that mass affluent market?

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

Yes. So with regard to the distribution at this point, we're a little north of 50%, 5-0, 50% on mass affluent relative to nontarget at this point. But obviously, you're seeing -- and certainly in the last couple of months, in particular, a much higher proportion of that from a new business perspective being tilted more towards the mass affluent space than the nontarget space. We don't have any near-term plans to expand. Our focus right now is on making sure that we could achieve our profit targets for that segment of business in the 13-state footprint -- that we 13,15-state footprint, my apologies that we currently have. There are some states that we have on the board for potential expansion down the road. But it's really, generally speaking, not going to be the states that you see companies really pulling back from. If you look at our portfolio, we're not a heavy coastal writer and don't plan on being a heavy coastal writer. That's not how we're building this book of business. So we see ample opportunities in our current footprint. And as we approach our margin targets, which we expect to do over the next couple of years based on pricing and underwriting actions we're taking, then we'll contemplate further expansion.

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Unidentified Analyst

And if I could sneak one more in. Can you quantify the cat losses by line for the commercial lines of business?

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

Yes, certainly. So this is Mark here for the quarter. And let me just walk you through the cat. You want just standard commercial lines?

Unidentified Analyst

Yes.

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

Okay. So for Q3, commercial auto, $2 million commercial property, $30.3 million and BOP, $4.4 million to $36.7 million or 4.7 points on the combined.

Operator

Our last question comes from the line of Bob Farnam from Janney.

Robert Edward Farnam - *Janney Montgomery Scott LLC, Research Division - MD of Insurance & Equity Research Analyst*

A couple of more questions on the personal lines book. Just -- so the mass affluent market as the book grows and it's more of a percentage of the mass affluent, is the -- are you expecting the same type of combined ratio? And if so, are you expecting a difference in terms of the loss ratio versus expense ratio components. In other words, is the affluent markets with a higher expense ratio but a lower loss ratio. I'm just trying to figure out kind of how this is going to flow through going forward?

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

Yes, sure. So I would go back to Grace's question earlier. I think our target will be at 95%. And that's how we think about it on a risk-adjusted basis for both home and auto, and that's what we're striving for. I do think the one longer-term benefit in this space is you do expect to see over time higher retention rates based on this class of business. And generally speaking, in the personal lines market, aging of a book of business creates enhanced profit margins. And I think that's where you might see some additional benefit. But again, we look at this on a risk-adjusted basis as 95% being the target, and that applies to how we think about this particular segment of the market that we're moving into.

Robert Edward Farnam - *Janney Montgomery Scott LLC, Research Division - MD of Insurance & Equity Research Analyst*

All right. And is it -- are you finding these types of customers demand more services from Selective? Or is that just something that is not really a factor at this point?

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

So I think from a product perspective, including optional coverages, we've dialed up those offerings, and we are seeing a higher adoption rate, that higher adoption rate of those additional coverages is what also drives retentions higher because they're not matched by everybody in the marketplace, and we are starting to see that. From a claims perspective, on the service side, we've always had a service philosophy around claims

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that's applied to our Commercial Lines business and our personal lines business, and I think we are well suited to meet the expectations of this customer base from a claim servicing perspective.

Robert Edward Farnam - *Janney Montgomery Scott LLC, Research Division - MD of Insurance & Equity Research Analyst*

And one question specifically on the personal auto. I mean, the combined ratio of 127%. If I heard Mark right, it sounds like maybe 5 points of that was adverse reserve development. So you're still looking at 122%. I don't know how much of that was related to cats, but I'm still going to get a feel for it, it's a long way to get back down to that 95% is -- in terms of how long do you think it's going to get down to 95%, it's probably more were of getting to, but it just seems like it's still a long way to go.

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

Well, there's no question there's a gap that we're looking to overcome. And I think the pricing that we put out there and our expectations for pricing next year at that, call it, low 20% kind of range will have a big impact. The open question is, where do loss trends ultimately settle out? And we have an expectation for loss trends, but we've also highlighted the fact that loss trends remain somewhat uncertain when you think about some of the drivers that are impacting everybody in the industry. But from from the -- what you piece together from Mark's commentary, the, call it, accident year, when you strip out the impact of the prior year development, the starting point is around a 116,116.5% and that 95% target is how you want to think about that gap. So that's the gap that we're looking to close. We have clarity around our rate plan. We have an assumption relative to forward loss trends that we expect and how those 2 pieces come through on an earned basis over the next several quarters will ultimately determine the time frame to get to that 95%.

Operator

Thank you. At this time speakers we don't have any questions in queue. You may proceed.

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

Well, thank you all for your participation and look forward to talking to you soon. Thank you.

Operator

Thank you. And that concludes today's conference. Thank you all for participating. You may now disconnect.

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