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SIGI.OQ - Q4 2021 Selective Insurance Group Inc Earnings Call

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PRESENTATION

Operator

Good day, everyone, and welcome to Selective Insurance Group's Fourth 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, everyone, and thank you. We are simulcasting this call on our website, selective.com. The replay is available until March 6. 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 our 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 referenced non-GAAP financial measures are in our supplemental investor package found on our website's Investors page. 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 discussed 3 risks and uncertainties, including supplemental disclosures about the COVID-19 pandemic in 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?

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

Thank you, Rohan, and good morning. I'll focus my opening remarks on our strong financial and operating results, then turn to key industry trends and how we're responding to them. Mark will then provide additional details on our results for the fourth quarter and the year. And I'll return with a few closing comments before opening the call up to questions. 2021 marks our eighth consecutive year of double-digit operating ROEs.

This track record of consistently strong performance is matched by very few in our industry. We are proud of this achievement, and we're pleased by A.M. Best's upgrade of our financial strength rating to A+. This upgrade is a testament to our excellent financial position and consistent superior operating performance. As proud as we are of our performance, we're even more enthusiastic about the opportunities that lie before us. We have built a unique franchise with a strong foundation of great people, sophisticated tools and technologies and deep relationships with a top-notch group of distribution partners.

We generated solid financial results in the fourth quarter with a 13.8% annualized non-GAAP operating ROE. For the full year, our 14.3% non-GAAP operating ROE was extremely strong and well above our target of 11%. Underwriting profitability and investment performance were both meaningful contributors to our financial results for the quarter and the year. For the quarter, drivers of our net premiums written growth included overall renewal pure price increases averaging 4.7%, which were driven by 5% in Commercial Lines and 5.9% in E&S.

Exposure growth of approximately 3.6% on our renewal book for Commercial Lines, strong retentions across all 3 segments and overall new business growth of 11%, including 8% in Commercial Lines and 30% in E&S. Our 93.1% combined ratio for the quarter included 4.5 points of net catastrophe losses, partially offset by 1.9 points of net favorable prior year casualty reserve development. The underlying combined ratio was 90.5%, reinforcing the high quality of our book of business.

Net investment income after tax was $65 million in the quarter, benefiting again from the exceptional performance of our alternative investments, particularly unrealized gains on our private equity limited partnership portfolio. In addition to delivering excellent results, I want to highlight some of our other key achievements for the year. We continued our decade-long track record of achieving renewal pure price increases that have been in line with or above expected loss trend. This track record gives us confidence to effectively navigate through all market cycles. We executed several strategic initiatives that will drive ongoing profitable growth, such as expanding utilization of MarketMax®, our agency-facing platform that helps identify new business opportunities, upgrading our technology platforms for small commercial and E&S business and repositioning our Personal Lines products and services to compete in the mass affluent market.

We also laid the foundation to expand our Commercial Lines footprint by 3 additional states in the latter half of this year. And we made significant progress on our ESG initiatives and disclosures, including taking a number of steps to enhance employee diversity at all levels within the organization. We also ensure our employees were supported throughout the pandemic as we maintained excellent employee engagement and alignment despite the largely remote-work environment. Our success on this front is best demonstrated by Selective being certified as a

Great Place to Work® for the second consecutive year.

The achievement I am most proud of is the unwavering dedication of our employees in serving our customers and distribution partners and helping them navigate through the pandemic-related challenges and the various catastrophic events they've experienced. Their efforts over the past 2 years have further strengthened our reputation in the market with customers and distribution partners. The excellent performance we delivered in 2021 is the direct result of our ability to successfully execute the fundamentals of our business: risk selection, pricing and claims adjudication.

Our strategic competitive advantages in our core Commercial Lines business have us well positioned for the future. Those key advantages are a unique field model, placing empowered underwriting staff in proximity to our distribution partners and customers, a franchise value distribution model defined by meaningful and close business relationships with a group of top-notch independent agents, our ability to develop and integrate sophisticated tools for risk selection, pricing and claims management, delivering a superior omnichannel customer experience enhanced by digital platforms and value-added services and a highly engaged and aligned team of extremely talented employees.

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I'll close by highlighting 2 key market dynamics and how we are managing through this environment. First, there is less certainty in forward loss trends as we emerge from a pandemic-influenced economy. Every company in the market faces this reality. This uncertainty is driven primarily by 3 factors: economic inflation, social inflation and the 2 most recent accident years, presenting unusual frequency and severity patterns.

With regard to economic inflation, the impact continues to be largely on the shorter-tailed property lines and these trends have persisted longer than originally anticipated. On the casualty lines, the social inflationary trends that were evident pre-pandemic are expected to persist. Medical trends, which impact workers' compensation and bodily injury coverages have been more stable.

Finally, we use prior accident years as a basis to estimate future year loss ratio selections. And accident years '20 and '21 show meaningful decreases in frequency, largely offset by increases in severities. These patterns create additional uncertainty in projecting frequencies and severities in a post-pandemic environment. Taken together, these additional uncertainties have led us to increase the expected loss trend contained in our 2022 loss ratio estimates from approximately 4% to 5%. Second, given these loss trends, combined with continued pressure on investment income from historically low interest rates, elevated catastrophe losses and a firming reinsurance market, we expect the Commercial Lines pricing environment other than workers' compensation to remain favorable.

We have demonstrated for over a decade, our ability to consistently obtain renewal pure price increases that are in line with or above expected loss trend, an approach we will maintain. We also pride ourselves on maintaining a similar level of underwriting and pricing discipline when evaluating new business opportunities. We will continue to leverage our sophisticated underwriting and pricing tools, franchise distribution relationships and superior customer servicing capabilities to achieve our top and bottom line targets.

In our Commercial Lines portfolio, renewal pure price increases, net of any exposure change, remained relatively stable throughout the year. Our fourth quarter pure renewal rate was 5% compared to 5.3% for the full year. While pure price is the primary lever to maintain pace with loss trends and improve loss ratios, we take other actions to improve our loss experience.

These include underwriting actions to improve mix of business and claims initiatives to improve outcomes while maintaining fair settlements for our claimants. On business mix, we have long focused on administering renewal pricing in a very granular fashion, based on expected future profitability of an account. Our underwriters manage the renewal pricing and retention based on profitability cohorts to achieve a favorable shift in portfolio mix.

In 2021, the cohort of accounts with the lowest expected future profitability, which represent about 11% of our portfolio had renewal pure rate increases 7 points higher than our top-performing cohort. And were retained at 6 points lower than our top-performing cohort, which represent 25% of our book.

This favorable shift in mix of business will benefit future loss ratios. On the claims front, we are focused on improving outcomes, efficiencies and customer experience through initiatives, such as centralization of complex claims, incorporation of robotic process automation for first notice of loss, virtual appraisals and digital fast tracking of certain low complexity claims. Overall, I'm very pleased with our strong execution, consistent track record of excellent results and plans to generate consistent and profitable growth.

Now I'll turn the call to Mark to review the results for the quarter.

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 initial guidance for 2022. For the fourth quarter, we reported net income available to common stockholders per diluted share of $1.59 and non-GAAP operating EPS of $1.56. Strong underwriting results and investment performance were both meaningful contributors to the results this quarter.

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For the full year, we reported record EPS of $6.50 and record non-GAAP operating EPS of $6.27, which was up 51% from 2020. Our strong non-GAAP operating ROE of 14.3% was driven by solid underlying underwriting results, favorable reserve development and extremely strong alternative investment income. We also generated excellent top line growth in 2021 and advanced our strategic objectives.

Overall, it was another excellent year for Selective and our shareholders. Turning to our consolidated underwriting results. We reported 9% growth in net premiums written in the fourth quarter. For the full year, net premiums written increased 15%, which makes it the strongest year of growth for Selective in almost 2 decades. We reported a consolidated combined ratio of 93.1% for the fourth quarter. Included in the combined ratio were $35.3 million of net catastrophe losses, or 4.5 points, and $15 million of net favorable prior year casualty reserve development, or 1.9 points.

Catastrophe losses were elevated this quarter with 2 events in mid-December, accounting for approximately half of the losses and primarily impacting Commercial Lines. On an underlying basis or excluding catastrophes and prior year casualty reserve development, the combined ratio was 90.5% for the quarter. For the year, we reported a very profitable combined ratio of 92.8% and an underlying combined ratio of 90.1%. The 90.1% underlying combined ratio compares favorably to our initial 2021 guidance of a 91% underlying combined ratio with the variance driven principally by lower-than-expected non-cat property losses and a lower-than-expected expense ratio.

Moving to expenses. Our expense ratio was 32.5% for the year compared with 33.8% for the prior year period and reflects some of our cost containment initiatives, as well as lower-than-expected travel and entertainment and overhead expenses. We remain focused on lowering expense ratio through a range of initiatives while ensuring we are investing appropriately to support our longer-term strategic objectives.

We have brought our expense ratio down meaningfully since its peak of 35.3% in 2016. While we expect our 2022 expense ratio to be flat with '21, as our continued cost containment initiatives will be offset by pandemic-driven expense savings trending back to pre-pandemic levels, we expect to lower it and achieve our longer-term expense ratio target in 2023.

Corporate expenses, which are principally comprised of holding company costs and long-term stock compensation, totaled $5.4 million in the quarter and $28.3 million for the year. Turning to our segments. For the fourth quarter, Standard Commercial Lines net premiums written increased 8%, driven by renewal pure price increases averaging 5%, solid and stable retention of 86% and new business growth of 8%.

Exposure growth was also positive. For the year, net premiums written increased 16% or 12% when adjusted for the prior year COVID-19-related items. The Commercial Lines combined ratio was a profitable 93.1% for the fourth quarter and included 4.2 points of net catastrophe losses and 2.4 points of net favorable prior year casualty reserve development. The favorable prior year casualty reserve development was driven by $30 million for the workers' compensation line related to accident years 2019 and prior.

This was partially offset by $15 million of reserve strengthening for the commercial auto line, related principally to higher-than-expected bodily injury severities for the 2016 through '19 accident years. The Commercial Lines underlying combined ratio was 91.3% for the quarter. For the full year, the combined ratio was a very profitable 91.9% and the underlying combined ratio was 90.6%.

In our Personal Lines segment, net premiums written increased 1% in the quarter, but were down 1% for the year, reflecting continued competitive market conditions, particularly for Personal Auto. We started to gain some traction in our new mass affluent target market for Home, which is encouraging and an early indicator that our new strategy is working.

However, it will likely take some time to get back into a consistent growth mode. Renewal pure price increases averaged 1.1% for the quarter. Retention was slightly down relative to a year ago at 83% and new business was down 9%. The combined ratio in the quarter was 97.6% and included 9.9 points of net catastrophe losses. The underlying combined ratio was 87.7%.

For the full year, the combined ratio was 98.6% and the underlying combined ratio was 85.9%. In our E&S segment, net premiums written grew 27% for the quarter relative to a year ago. Renewal pure price increases averaged 5.9%. Retention remained strong relative to a year ago and new business was up 30%. The Argo renewal rights transaction had incepted in the fourth quarter was not a meaningful contributor to premium growth, although we expect renewals on that book to pick up in the coming quarters.

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The combined ratio for this segment was an extremely profitable 88.8% in the quarter and included 1.6 points of net catastrophe losses. The underlying combined ratio was 87.2%. For the full year, the combined ratio was 94.3% and the underlying combined ratio was 88.7% and net premiums written growth was a very strong 23%. Overall, 2021 was our best year for our E&S segment since we launched it about a decade ago.

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 3.9 years, offering a high degree of liquidity.

Risk assets, which include our high-yield allocation contained within fixed income, public equities and alternatives represent 11% of our portfolio. For the quarter, after tax net investment income of $64.5 million was up 16% from the year ago period. The increase was primarily driven by $19.6 million of after-tax alternative investment gains compared to $13.9 million in the comparative period. As a reminder, net investment income from alternative investments is reported on a 1 quarter lag. We expect the contribution from alternatives to return to more normal levels in the coming quarters. The after-tax yield on the portfolio was 3.2% for the quarter, delivering a strong 9.4 points of our ROE contribution with alternative investments contributing 2.8 percentage points.

The after-tax yield on the fixed income securities portfolio was 2.5% in the fourth quarter, which is slightly down compared with a year ago. The average after-tax new money yield on fixed income purchases during the quarter was 2.1%, which is up sequentially from 1.8% but down from 2.2% in the comparative quarter. The total return on the portfolio was 0.41% for the quarter and 2.74% for the year.

With regard to our reinsurance program, we successfully renewed our CAT program on January 1. We retained our existing structure for our core CAT program, including our $40 million retention, although we added $50 million of limit in response to our growing book of business. We maintained a 1 in 100, or 1% net probable maximum loss or PML for U.S. hurricane at a very manageable 1% of GAAP equity and a 1 in 250 net PML or 0.4% probability at 4% of GAAP equity.

We also renewed our noncore footprint property CAT program. We restructured this cover to be an E&S only cover and it now covers all states for our E&S business, but does exclude Standard Commercial Lines for our 5 newest states. We increased the retention to $10 million from $5 million and increased our co-participation from 15% to 34%.

Pricing on our CAT program increased modestly on a risk-adjusted basis, but was in line with that of loss-free accounts in the U.S. As a reminder, our reinsurance program also includes our excess of loss treaties, which limit the impact to us from large losses to $2 million per risk per casualty and $3 million per occurrence per property.

Turning to capital. Our capital position remains extremely strong with $3 billion of GAAP equity as of year-end. Book value per share increased 9% during the year, with strong earnings, partially offset by dividends and a reduction in net unrealized gains. Cash flow was extremely strong in 2021 with $771 million of operating cash flow or 24% of net premiums written. Our financial position is now the strongest in our company's 95-year history and offers us significant financial flexibility as we look to grow and execute on our strategic objectives. Our cash and investment position at our holding company stands at $527 million, which is above our longer-term target. Our net premiums written to surplus ratio of 1.33x is slightly below our target range of 1.35 to 1.55x. Our debt-to-capital ratio of 14.5% is also very conservative.

We did not repurchase any shares during the fourth quarter or subsequent to the quarter end, under our $100 million share repurchase program. We have $96.6 million of remaining capacity under this program, which we plan to use opportunistically. As we transition and look ahead to 2022, each year, we established an operating ROE target based on at least a 300 basis point spread over our weighted average cost of capital, as well as considering other factors, including market conditions.

For 2022, we have maintained an 11% non-GAAP operating ROE target, which is about 350 basis points over our weighted average cost of capital. Our target ROE sets a high bar for our financial performance and aligns our incentive compensation structure with shareholder interest. Over the years, our actual reported results have, of course, varied from our targets, given the inherent volatility in our business, but over the last 8 years, we have delivered strong returns for our shareholders with an 11.9% average non-GAAP operating ROE. We have also grown tangible book value per share plus accumulated dividends by 12.1% annually during the same time period.

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Let me finish with some commentary on our initial guidance for 2022. First, we expect a GAAP combined ratio, excluding catastrophe losses of 91%. This assumes no prior accident year reserve development. Catastrophe losses of 4 points on the combined ratio, after tax net investment income of $200 million, including $20 million in after-tax gains from our alternative investments, 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 and weighted average shares of $61 million on a diluted basis, which does not reflect any share repurchases we may make under our authorization.

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

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

Thanks, Mark. Looking forward, we remain focused on achieving our objectives around profitable growth and generating strong ROEs relative to our weighted average cost of capital. We have a decade long track record of successfully balancing our goals around growth and profitability, while driving improvements in our business mix. I would like to highlight some of the key strategic initiatives that will contribute to our ongoing success.

In Commercial Lines, we remain focused on 3 fronts: strategically increasing agent appointments to represent at least 25% market share in our footprint states; increasing selected share of our agent's premium to 12%; and executing our geographic expansion plan. During 2021, we made meaningful progress on each. We appointed just over 100 new agencies, increasing our total agency count to approximately 1,430 and our total store fronts to approximately 2,500. We expect this pace to remain steady.

We continue to generate organic growth with our existing agency partners.

Our MarketMax tool, which provides our distribution partners with insights into their overall portfolio and identifies target accounts to grow their business with us, has been instrumental in generating new high-quality business opportunities.

And finally, our Commercial Lines geographic expansion plans remain on track. Over the next year, we plan to open the states of Alabama, Idaho and Vermont, with others planned for subsequent years.

Our new small business platform has been deployed for BOP, commercial auto, general liability, property, workers' comp and other supporting lines of business, enhancing the ease and speed of transacting with us in this important market. We also expect to complete the rollout of our new E&S automation platform for general liability, property and package business by the end of this quarter.

Our updated personal lines product and service offerings to compete in the mass affluent market are showing early signs of success. Finally, we continue to invest in and build out our digital customer offerings, adoption of our self-service platform and MySelective mobile app continue to accelerate. These platforms, along with our ongoing focus on expanding our value-added service offerings should generate future retention benefits. For the remainder of 2022, we are confident about our ability to sustain superior financial performance. We will stay true to our historically prudent and disciplined approach to generating consistent and profitable growth. With that, we will open the call for questions. Operator?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) We have the first question from the line of Mike Zaremski of Wolfe Research.

Michael David Zaremski - *Wolfe Research, LLC - Research Analyst*

First question, I was hoping to further unpack the increase in the expected loss trend from 4 to 5. And I also -- maybe I'm wrong, I believe, in past years, it's been in the 3s, but you can correct me if I'm wrong. And maybe you can kind of further unpack. You gave a lot of color, John. Is it being

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driven by property, or is it just a mix of a number of things? So there's some good guys and some bad guys. And we can see some of your lines are running kind of hot commercial auto, but maybe that's a separate question. But maybe we could start there.

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

Yes. Thanks, Mike, and I appreciate the question. So there are a lot of pieces to this, and I think you've highlighted a couple of them. The first thing I'll say though is, I think it's always important when we talk about loss trend to separate historical loss trends, which is the actual changes in frequency and severity looking back to prior accident years from expected loss trend. And just to clarify that point, our expected loss trend, which we're saying is 5%, and that's embedded in the 2022 loss pick that underlies the guidance that Mark took you through, isn't reflective of some shift in our pattern looking backwards.

So our historical loss trend, which actually for the last couple of years have been running about 4%. Just a shade under 4%. If you look back in a few more years, it was in the 3% range, where we had moved that up over the last couple of years to 4%, and now it's 5% on a go-forward basis. But again, I want to stress, that's more a forward-looking assumption on our part in terms of directional shift, driven by 3 primary factors. And we've pointed to these in the prepared comments and in prior discussions.

Number one is economic inflation, and you've alluded to that impacting some lines more so than other. Number two is social inflation and embedded in our assumption here in moving from 4 to 5 is that some of the social inflationary trends, which are more of a driver on the liability lines that existed pre-pandemic are going to emerge. And then the third consideration, and I would put this more in the uncertainty category is the fact that we all in the industry have the last 2 prior accident years, which certainly play a role in our '22 pick that present very different frequency and severity patterns that we've seen historically. Now I'm assuming like most companies, we've got a lot of discipline around making loss selections.

But the first thing we do is take the last, call it, 4 or 5 accident years, bring them to present rates, which accounts for the cumulative impact of the rate earned over the last several years and then also fully trend those for actual changes in severity and frequency. And that's why it's so important, and you hear us always emphasize this point. If you look back over the long term, we've been matching or exceeding our rate level relative to loss trend.

So that's your starting point for your upcoming loss ratio selection by trending around leveling and then blending those last 5 accident years. We then roll that forward by adding to it our expected trend of 5% and you could make your own view as to whether or not that's conservative or aggressive, as well as our expectation for earned rate level.

So I think understanding the 2 dynamics of historical versus expected loss trend is an important consideration. I think it's also important to put the economic inflation in the context of where it impacts the business most significantly and where it doesn't. And I think I made reference to this in the prepared comments, when you look at economic inflation, we're not seeing a meaningful move in medical inflation.

And medical is where you really have the bigger leveraging effect but that has been remaining relatively stable, call it, in the 3 -- maybe mid-3% range. It's really driven more so by what we're seeing in the building side of things and the used cars and body work. But you also have to put that in context. So let me just focus on auto for a second. And remember, all of this discussion around severity and inflationary impacts on severity has to be considered in the context of the frequency dynamic that we all still see, which is frequencies while they bounce back compared to '20, at least in our portfolio, still remain a little bit below pre-pandemic levels. So you still have a lower frequency than you do pre-pandemic, which provides some bit of an offset to the economic inflationary impacts on the severity side.

But if you focus -- and let's just -- let's stay on auto physical damage, which I know is a really important consideration. First of all, you want to put that in the context of what percentage of your overall loss, net ultimate losses does that make up? And for us -- personal auto physical damage is about 2% of our premium and probably about the same level in terms of ultimate loss dollars and commercial auto physical damage is about 6.5%.

Personal auto in total is about 24% of premium, physical damage about 6.5%. So think about it in terms of a little bit under 10% altogether of total earned premium and, therefore, total earned losses. So that inflationary impact, which doesn't apply to 100 cents on the dollar for losses is at a

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much smaller context in terms of the overall portfolio. So again, I know I spent a lot of time, and I can actually go into a lot more detail if you want on some of the other lines. But that's really how you want to put this in context.

We view the 4% to 5% as a reasonable expectation going forward. And we think that other companies might not be that meaningful in their movement, but the trends we're pointing to that are having us increase our forward loss trend by 1 point are pretty universal for everybody in our business. So I'll pause there and happy to follow up on any area that -- Mike that you wanted to explore more because I think it's an important topic.

Michael David Zaremski - *Wolfe Research, LLC - Research Analyst*

Okay. No, definitely, and that was helpful. Maybe would some of the upward movement in trend, is it due to maybe Selective's overweight in commercial auto or kind of in more kind of blue collar trade? I'm just trying to think if this is more specific to Selective? I know that's -- maybe that's my job to figure that out. But just maybe if you could talk maybe if it's certain lines specifically being -- that are driving this?

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

I don't know that I would point to certain lines. Auto is certainly one that we have a little bit of a higher expected forward trend. But I would say that's -- we view the liability side as much as the physical damage side from that perspective. But I will say when it comes to building out our expected loss trend, yes, there's an influence from your historical loss trend. But then we take the component parts of the CPI and break those down very specifically by line of business and how they impact each individual line and that gets embedded into our expected loss trend. So to that extent, you will see a line of business distribution that might vary from one company to another, when you think about their percentage of property, the liability writings, when you think about their auto and specifically their auto liability to auto physical damage, those ratios or those relative premium volumes will move the number around.

But generally speaking, those inflationary impacts are going to impact everybody, but the mix of business might vary. But there's -- I would say there's nothing in our portfolio that would currently suggest that the forward trend expectation for us should be any different than anybody else.

Michael David Zaremski - *Wolfe Research, LLC - Research Analyst*

Okay. That's helpful. Maybe shifting gears quickly to the investment guidance, probably for Mark. I believe the implied yield on alternatives is -- it feels a little -- maybe you can talk about what -- why the guide on the alternative yield guide is kind of lower than peers of the industry? In terms of -- I think most peers are guiding to high singles, maybe even some low doubles.

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

Yes. Good question, Mike. Just to level set, 2021 was a record year for us in terms of after tax net investment income at $263 million, including $93 million of after tax net investment income for the alternative portfolio. We've now delivered 6 consecutive quarters of really strong returns from alts.

And while we have great expectations for the portfolio to continue to produce very strong and attractive returns for us and our shareholders, we do think that the strong returns we've enjoyed for the last 6 quarters will revert back to longer-term expectations. So our guidance for 2022, $200 million all in, $20 million after tax for alternatives, that is an after-tax number. If you were to gross that out to a pretax number, it implies an 8% return for alternatives for 2022.

And the way to think about that is we probably think that portfolio, which is a mix of private equity, private credit and real asset strategies long term will run between about 8% and 10%. We will have the benefit of a healthy capital markets return from Q4 coming through Q1. But if you were to cut the quarter off today for Q1 coming through Q2, we've had tremendous amount of volatility. And when you think about public equity market

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expectations, the transition to a higher interest rate environment, slower economic activity, likely slower corporate revenue, corporate profits, lower valuations, we do think it's appropriate to be kind of on the lower end of the range in terms of our expectations for our alternative portfolio for 2022. So again, about an 8% return is the expectation built into the guidance. So hopefully, that provides some context.

Operator

We have the next question from the line of Meyer Shields of KBW.

Meyer Shields - *Keefe, Bruyette, & Woods, Inc., Research Division - MD*

I really only have one question. And I'm asking in the context of what's already been a very thoughtful explanation, but I'm trying to understand why you're not assuming the, call it, 5% average loss trend on earlier accident years if they're subject to the same external catalysts?

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

Well, I guess you really want to think about how much of that is subjected to the same catalyst versus how much is in a lot of these economic inflationary items because medical is not the driver, doesn't really impact your reserve portfolio from the same perspective. And I think that's the biggest change that would be different on a forward basis, which is more of a shorter tail line impact as opposed to any meaningful impact on the reserve portfolio.

And we evaluate every prior accident year, and you could see where the movement has been coming from. And the '20 and '21 accident years, we have not acted on. And when I say that, there was clearly some frequency benefits, but this question around severities has what's led us to maintain those loss selections in both the '20 and '21 accident year. So you could say our stance relative to increasing severity expectations and not reacting to the frequency drops in '20 and '21 may be somewhat reflecting a view that some of those inflationary considerations are driving some of the severities in the more recent accident years. But again, those are all contained within our '20 and '21 accident year loss picks, which we continue to remain very comfortable with.

Operator

We have the next question from the line of Grace Carter of Bank of America.

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

Thinking about the combined ratio guidance for this year, paired with the outlook for a flat expense ratio. And it applies a little bit of underlying loss ratio deterioration. I mean we talked about the commercial loss trends and there's expectations for pressure industry-wide in Personal Lines. But I was wondering if you could just walk us through a little bit the contribution by segment to that potential deterioration in the loss ratio and just kind of how to think about that in the context of the ongoing pricing increases on the Commercial Line side?

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

So Grace, this is Mark. Maybe I'll start and John can certainly jump in. One thing I would just highlight is it is an expectation for the year. And as I mentioned, our results or the industry results tend to have a little bit of volatility. So it represents kind of our base case and expectations going into 2022.

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If you look back at the last couple of years, in 2020, we had an underlying combined ratio expectation of 91.5 and we delivered 90.1. Last year in '21, we had an underlying combined ratio guidance of 91, and we delivered 90.1. So we have come in better than expected for the last couple of years, but the last couple of years have been unusual, given the pandemic-driven frequency benefits and how that came through the results.

As we look to 2022, you're right, if you go from 90.1 to 91 with the flat expense ratio, it implies 90 basis points of loss ratio deterioration year-on-year. And I would attribute almost all of that to non-cat property losses. So we've had 2 years now where the non-cat property losses have been much lower or lower than expected. We expect those to revert back to pre-pandemic levels. And that's really the majority of the increase. There's always other moving parts. We have the rate versus trend, we have the underwriting mix and claims benefits, we have a slightly firmer reinsurance marketplace to put some pressure on loss ratios, but non-cat property is the biggest contributor to the movement in the loss ratio year-on-year.

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

So just to clarify the point or reinforce the point Mark's making, it's very similar to how you think about catalyst expectations. We take a longer-term view in terms of non-cat property. And even if we have a good year or 2 good years in a row relative to expectations, we're generally going to look at longer-term averages and set that non-cat loss expectation where we think it should be based on historical patterns.

So that's not a statement that we think non-cat property losses are going to deteriorate, but we just think about that in a longer-term view, as opposed to just reacting to 1 year that was better than expected or in this case, 2 years that were better than expected.

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

I'm thinking about the pivot towards mass affluent in the Personal Line segment. It feels like maybe the new business that you're looking at adding as the year goes on, probably has a higher liability component than property component versus the older business. So I'm just kind of wondering how you expect loss costs in that segment to evolve in that context?

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

It's a great question. I don't actually see a big shift there because, I mean, the fact of the matter is your property values on both the auto and the home side are going to be moving higher as well. So there might be a little bit drift higher in liability limits, but you're going to see the same thing on the property limit side of the house. So that -- we don't anticipate a meaningful shift from that perspective.

Operator

We have the next question from the line of Scott Heleniak of RBC Capital Markets.

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

Just wanted to ask first on the E&S premium growth, which has been strong for a while now. And I'm assuming that you're getting a lot more quote activity probably expansion with your distribution partners. But is there really just a pretty big shift in the way you're viewing E&S and you're obviously coming off a record year for that business. Are you just more comfortable in expanding that kind of over the long term based on the favorable trends?

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

Yes, we like the business. And as Mark indicated, we've hit our stride and are delivering really strong results when you look back over our track record since getting into that business about 10 years ago. What you see, I mean, is clearly a pickup in both new business and even strong retentions

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and business and E&S generally retains at lower levels. But even in that context, retentions are stronger. We haven't meaningfully shifted our underwriting appetite. And the mix of business we're seeing is pretty consistent. I think we're hitting our stride relative to agency relationships. I think we're hitting our stride relative to our processes and the underwriting platforms that we continue to develop and introduce and it's better execution.

Do we think our opportunities to potentially expand? We do, but we're going to still stick to our knitting here, which is a lower limits profile business, sort of lower hazard within the E&S context. And we think the opportunities continue to be there and continue to be there in a meaningful way. With regard to longer term, we still view this as a business we'd like to be in that call it, up to 15% of total premium. We don't want it to be our predominant business. We think we've got a very unique set of competitive advantages and a very unique market position in standard commercial, and some of those skills are able to be leveraged to help us in the E&S space. So we love the business.

We think we've got a good growth path in front of us. But we're not just out there chasing different types of opportunities that we don't have experience in. We're really growing in the areas that we feel like we've got a lot of confidence in from an underwriting and a pricing perspective.

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

Okay. It sounds like it's pretty similar thinking what you're talking about before, just kind of pushing full steam ahead. And then the personal lines side, I'm sure -- I'm assuming in personal auto, you're seeing the same trends everyone else is on the frequency and severity. Are there any plans to take significant rate actions there? I noticed that the Personal Lines renewal premiums were -- increases were up 1.1% for the quarter. And I was wondering if you might expect to take further rate actions on those in 2022.

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

I think when you look at our profitability in the personal auto line, and this is not just a reflection of some shift in the last couple of quarters with regard to frequency or severity, we have work to do from a profitability perspective.

We do think there are some underwriting actions that will drive some of that, but there's clearly a rate need there, and we expect to begin to increase the rate level on that business on a go-forward basis.

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

Okay. And then the 4% to 5% loss cost inflation change, is that across the board? How much of that is Personal Lines versus Commercial Lines? Is that just across the board? I'm just trying to get a sense of what...

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

That's an all-in number. Again, it varies by line of business. And it varies a little bit by segment, but Commercial Lines is really the primary driver being 80% of our business, and Commercial Lines is right in that 5% kind of range. So it's all lines and Commercial lines is the big driver, but think about it in terms of 5% overall.

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

Okay. All right. And I just had one last one. The -- you guided to the expense ratio being flat for 2022. Mark, I didn't quite catch your comments about 2023. Did you -- was there a target range that you expect to see improvement for 2023?

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

Yes. Good question, Scott. I didn't mention the target this quarter, but we've put it out there in the past, which is the longer-term target for us, which we believe is appropriate to compete effectively given our mix of business between Commercial Lines, E&S and Personal Lines given the current marketplace, is 32.

And our plan, as we sit here today, points to us achieving that target in 2023. So that's the plan as we sit here today and think about all the strategic objectives and growth initiatives we have in place as well as some of the significant efficiency plans we have in flight as well.

Operator

We have the next question from the line of Paul Newsome of Piper Sandler.

Paul Newsome - *Piper Sandler & Co., Research Division - MD & Senior Research Analyst*

Just based upon the e-mails I get, it seems like folks are pretty concerned about the uptick in the claims inflation number. Just -- you've said this a million times, but I think it's worth reiterating, when you have enough of an increased view in claims inflation, that goes directly into your pricing model, right? So you would expect all things being equal to offset that over time. So it would not necessarily mean a margin decrease just because you have a more aggressive view on what's claims inflation. I think you said that in the past...

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

Yes. Thank you. I appreciate the question. And I would say we point to our long-term history. This is not just a recent phenomenon, but that has always been our philosophy, which is depending on where our margins are relative to our target and what our outlook for loss trend on a forward basis is, our pricing indications and pricing targets are set accordingly. And that continues to be the case. And I just want to just go back to Mark's point, because I think this really reemphasizes the important consideration here, which is if you look at the roll forward from '21 underlying to '22 underlying, it's really just the resetting of non-cat property based on long-term averages that is creating that what appears to be a movement a little bit higher in the underlying by a little bit under 1 point, which would suggest that our expectation is that loss trend on a forward basis and written rate or earned rate on a forward basis are relatively comparable.

So you're keeping that underlying the same when you take out that resetting of the non-cat property to the longer-term average. So I think it's actually embedded in there. I understand that the reaction to going from 4% to 5%, I think that the key point in all of this is all of these loss trends are manageable, as long as you identify them and recognize them and respond to them.

And I think our history over a long time now should show that we get out in front of these things, and we price for it. And we focus on delivering very stable and very strong margins on a consistent basis over the long term and that philosophy will continue. We're highly transparent about how we think and how we make our loss ratio selections. Sometimes that transparency might create a negative reaction, but we think it's still the right way for us to interact with our shareholders.

So I appreciate the question and the opportunity to clarify that point, Paul.

Paul Newsome - *Piper Sandler & Co., Research Division - MD & Senior Research Analyst*

Great. Yes it's actually an actual question. The -- one of the things I thought I was curious, at least this quarter so far, is that as we're listening to the various conference calls, you're seeing a fairly wide range of views on whether or not pricing is getting better in workers' comp with Brown & Brown saying, it's bad and going down and Gallagher staying, it's up. And so I'm just curious from your perspective because I know you're pretty thoughtful about this, what might be the characteristics of the market today where you would get this sort of different view on workers' comp pricing? And how would that sort of square with your view?

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

Yes. I think the one big driver of difference in views might be geographic concentrations. So what I can tell you, and -- I mean, our rate on an all-in basis for comp has been running right around zero. But I think you also want to look at what is the impact on a market-wide basis of the filed loss cost changes by the NCCI and the various state rating bureaus. And I'm going to give you rough numbers, and -- so don't quote these as specific.

But if you look back in '21, in the states that we're in for the entire market, the impact of those changes were in the 5% to 6% negative range. For the filings for '22 by those same bureaus that have been implemented at this point, it's about 200 basis points lower, so more negative in '22 than it was in '21. So that's the context in terms of loss cost changes. They're negative, and they're slightly more negative in '22 than they were in '21. Now again, that's only one pricing consideration.

Clearly, you have individual scheduled credits and debits based on the qualities of the account -- individual account and your expectations for performance of that account, which is how you wind up generating your ultimate rate change. And as we indicated for us, it was zero in 2021. So that would suggest that through '22, you're actually going to see a little bit more deterioration in comp pricing based purely on loss cost filings.

Again, there's more to it than that. And those are -- but those are the dynamics that everybody is dealing with right now. And again, comp results have been really strong. We focus on the accident year numbers. And when you strip out all the favorable development, they're still strong, but they're not strong to the point where you could support a 5% or 6% or 7% rate reduction for another year, and we talked a lot about loss trend and economic inflation and medical has been stable, but the leveraging effect of an increase in medical inflation for all workers' comp writers is meaningful.

So you just want to always keep that in mind, 0.5 point or 1 point increase in medical inflation does hit the entire reserve inventory. So I think that's why we've been fairly conservative in our pricing on comp and that's why our growth has been fairly muted in comp in the last couple of years.

Operator

We have the next question from the line of Karol Chmiel of JMP.

Karol Krzysztof Chmiel - *JMP Securities LLC, Research Division - Associate*

I just have a simple question. Can you please just give me the breakdown of the cats in the Standard Commercial, please?

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

Certainly, this is Mark here. I can give you that number. So in Standard Commercial Lines, so assume this is for the quarter, we had $26.8 million of catastrophe losses, or 4.2 points, on the combined and that breaks down to $23.6 million in commercial property, $900,000 in commercial auto and $2.3 million in BOP and that should get you back to $26.8 million in total for the quarter.

Operator

(Operator Instructions) We have the next question from the line of Mike Zaremski of Wolfe Research.

Michael David Zaremski - *Wolfe Research, LLC - Research Analyst*

Great. Just a couple of follow-ups. Curious, you talked about a frequency lull during the pandemic. Are you seeing that frequency lull kind of fade? And is that going away? Is that -- any data points there? And then I guess just next question I want to make too big of a deal of the loss trend

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changing from 4% to 5%, but just does it kind of change your expectation of kind of maybe pulling off the gas in terms of top line growth in certain areas in the near term?

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

So just with regard to frequency, and I think I might have made a passing reference to this earlier, frequencies continue to be a little bit below expected, and I would say pretty much across all lines of business, but not nearly as significantly lower than we saw in 2020. So generally speaking, they've come back up, but still remain a little bit below what we saw pre-pandemic.

Whether or not that continues, I think it's one of the uncertainties that we point to on a go-forward basis. And I know this loss trend increase from 4% to 5% is becoming the focal point. And probably appropriately so, that's an uncertainty that we factor into that decision. Because we don't -- none of us in our business fully understand what a post-pandemic environment will look like. And that's not just about driving behaviors, okay? So miles driven have largely come back, frequencies have not bounced all the way back, probably because the time of day that the miles are being logged is a little bit different. You could also suggest on the general liability side that the dramatic increase in online shopping might be a more permanent shift.

So therefore, in-store traffic and traffic in parking lots might not be the same as it used to be. That might be a permanent shift that lowers frequencies. And then the question is if frequencies are more permanently lower, what does that mean for severities. And how much of the severity increase was purely driven by the drop in frequencies versus other macro factors.

So I think that's kind of how we think about it, and that's why we put it in more of the uncertain category and when there's uncertainty our response would be to build a little bit more into our forward loss trend, which is what we've done. With regard to your other question, and I mentioned this briefly in the prepared comments, we have a very similar level of discipline on new business pricing and new business risk selection as we do on our renewal portfolio.

We've got great monitors around that. And at this point, we remain comfortable with what we're seeing coming in relative to new business. I think our history has shown and there have been lines of business or segments where our growth hasn't been as strong, and those are cases where we don't feel as comfortable with where the pricing is in order for us to be significant players in that market.

That will always be our philosophy, and I would say, continues to be our philosophy going forward.

Operator

At this time, speakers, there are no questions on queue. You may proceed.

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

Well, thank you all for participating. We appreciate the active engagement, as always. And if anybody has any follow-ups, please feel free to reach out to Rohan. Thank you.

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

Thank you.

Operator

And that concludes today's conference. Thank you so much, everyone, for joining. You may now disconnect, and have a great day.

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