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SIGI.OQ - Q4 2022 Selective Insurance Group Inc Earnings Call

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PRESENTATION

Operator

Good day, everyone. Welcome to Selective Insurance Group's Fourth Quarter 2022 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. Sir, you may begin.

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

Thank you and good morning, everyone. We are broadcasting this call on our website, selective.com. The replay is available until March 5. We use three 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 from common share by the exclusions of total after-tax unrealized gains and losses on investments included and accumulated other comprehensive income. GAAP reconciliations to any reference non-GAAP financial measures are in our supplemental investor package found in the investors page of our website.

Third, we make statements and projections about our forward performance. These are forward-looking statements under the Private Securities Litigation Reform Act of 1995. They are not guarantees of future performance and are subject to risks and uncertainties. We discuss these risks and uncertainties details 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 Chairman of the Board, President and Chief Executive Officer, who will be followed by Mark Wilcox, our Executive Vice President and Chief Financial Officer. John?

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

Thank you, Rohan and good morning. We're pleased to report strong fourth quarter results capping off another excellent year for Selective, with an operating ROE of 15.6% in the quarter and 12.4% for the full year. 2022 marks our ninth consecutive year of double-digit non-GAAP operating returns on equity. Over that timeframe, our operating ROE averaged approximately 12%, exceeding our weighted average cost of capital by about 400 basis points. We deliver these results along alongside disciplined net premiums written growth that average 8% annually, nearly doubling the size of the company over that timeframe. Tangible book value per share plus change in accumulated dividends which we view as the best longer-term indicator of value creation in our industry increased 10% annually over the past 9 years. And our annualized total shareholder return over that

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period was 15.9%. Few in our industry can match that track record of consistent growth and profitability. Although we face several industry wide headwinds, as we look out to 2023, we expect to continue to maintain our performance level well into the future. I'll come back to this point shortly. But first I'll review a few highlights of our performance for the quarter and year.

Net premiums written were up 14% in the quarter and 12% for the full year. All three insurance operating segments contributed to this result. Growth for the year was driven by overall renewal pure price increases that averaged 5.1%. Solid renewal retentions, exposure growth and strong new business. Our 95.1% combined ratio for '22 included 4.3 points of net catastrophe losses, partially offset by 2.5 points of net favorable prior year casualty reserve development. Our net catastrophe losses for the year were only marginally above our expectation of four points despite Winter Storm Elliott being a significant loss, reflecting our catastrophe risk management efforts. The underlying combined ratio of 93.3% for 2022 reflected elevated non-catastrophe property losses from inflationary cost pressures in our property lines. Underwriting results contributed 5.4 points to our full year ROE. Net investment income after tax was $232 million for the year. We actively managed our fixed income portfolio to optimize risk adjusted returns in a rising interest rate environment. During 2022, we increased the pretax embedded book yield in the fixed income portfolio by approximately 115 basis points, while also moving up in credit quality.

The overall investment portfolio generated 9.4 points of ROE for 2022. In addition to delivering excellent financial results, I want to highlight some of our other key accomplishments. We have built the organizational muscle in a decade long track record of effectively managing commercial lines pricing in a dynamic loss trend environment, positioning us favorably coming into 2023. Our long history of underwriting discipline positioned our property portfolio with strong insurance to value ratios, and our underwriters have worked hard to maintain ITV against this backdrop of rapid inflation. Our top line growth was very strong in 2022, a testament to our excellent distribution partner relationships and sophisticated pricing tools. Our unique field underwriting model remains highly valued by our agency partners. Our MarketMax(R) 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 high quality new business opportunities.

We expanded our commercial lines footprint into three additional states in 2022, opening Vermont, Idaho, and Alabama. And we remain on track to open Maine and West Virginia in early 2024. We completed the implementation of our new automation platforms for both standard commercial lines small business and E&S both of which dramatically enhance ease of use for our distribution partners. And we appointed 118 new agencies during the year, bringing the total to approximately 1,500 agencies represented by 2,600 storefronts. While pleased with our overall performance in 2022, our team is steadfast in our focus on addressing the areas in need of improvement. Factoring in our operating leverage, invested asset leverage and long-term investment return expectations, we target a 95% combined ratio to consistently meet or exceed a 12% operating ROE hurdle over time. Our 2023 combined ratio guidance is 96.5% or 92%, excluding catastrophe losses. Reflected in our combined ratio guidance is an overall loss trend of approximately 6.5%, which is up from 5% a year ago largely due to inflationary impacts in the property lines.

For property, we are currently incorporating a loss trend projection of about 7% compared to 4% a year ago, reflecting our increased estimate of inflationary impacts on average claims severities. We increased our casualty loss trend more modestly to 6% from 5.5%. The 6% trend for casualty reflects our view of economic inflation, but more importantly captures our view of social inflation impacts as well. We will continue to pursue rate changes in line with trends to support our profitability in these lines, along with claims and underwriting initiatives focused on more granular drivers of profitability. In selecting these trends, we consider both frequency and severity impacts within the portfolio. Whereas 2022 continued to benefit from favorable frequencies in certain lines, going forward we are assuming generally flat frequency. Therefore the trends I quoted can be considered largely severity driven. We remain comfortable with the quality of our portfolio and therefore review rate and inflationary exposure adjustments as the primary tools to address the higher severity trend. In 2022, the combination of pure rate and exposure generated total average renewal premium change of 12% in commercial property, 12% in commercial auto physical damage, 8% in homeowners and 9% for E&S property. Given our recent success coupled with the state of the property marketplace, we expect this pace to continue in 2023.

Our casualty lines overall continue to produce combined ratio in line with our target. As such, our focus remains on achieving renewal pure rate increases that remain in line with our expected loss trend. However, within casualty, commercial and personal auto liability are producing above target combined ratios. And we have a series of rate and underwriting actions to address these. We believe the pricing environment across all three business segments remains favorable. In standard commercial lines, we achieved strong renewal pricing throughout the year, and the third and fourth quarters were strongest with renewal price increases averaging 5.8% and 5.6% respectively. We saw an acceleration of pricing in January

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with renewal pure rate of 6.5%. E&S pricing was also strong throughout the year with four quarter renewal pure rate at 7.9% and the full year at 7.3%.

In personal lines, our ongoing transition from the mass market to the mass affluent market caused us to fall behind the market in pricing trends. We expect to close that gap in coming quarters. In the fourth quarter, we filed rate changes in 9 of our states averaging 8.8% and plan to continue that pace over the next several months.

We expect investment income to positively impact our financial results in 2023. Through active management of our fixed income portfolio, we have optimized for higher investment yields while maintaining conservative credit and duration positions. Based on the projected investment yields and our investments to equity ratio, we anticipate that investment income will contribute over 200 basis points of additional ROE in 2023. Our updated investment income expectations and combined ratio guidance for 2023 translate to an ROE above our 12% target. Our target sets a high bar for our financial performance, challenges us to perform at our best and aligns our incentive compensation structure with shareholder interest.

Overall, I'm pleased with our excellent execution, consistent track record of results and plans to generate consistent and profitable growth. Now I'll turn the call over 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 2023. For the fourth quarter, we reported a strong finish to the year with $1.38 of fully diluted EPS, a $1.46 of non-GAAP operating EPS, and a non-GAAP operating ROE of 15.6%. These results are inclusive of a full retention cat loss for Winter Storm Elliott which reduced our EPS by $0.75 and our fourth quarter ROE by a full eight percentage points. Our results reflect the strong underlying earnings power of our franchise. For the full year, we reported EPS of $3.54 and non-GAAP operating EPS of $5.03. Our non-GAAP operating ROE of 12.4% for 2022 was particularly strong in light of significant industry catastrophe losses, capital markets volatility and the elevated inflationary environment and put upward pressure on loss costs.

Turning to our consolidated underwriting results, for the quarter, we reported a consolidated combined ratio of 94.7%. Included in the combined ratio were $45.7 million of net catastrophe losses or 5.2 points and $38 million of net favorable prior-year casualty reserve development, or 4.4 points.

As we pre-announced on January 23rd, we reported $46.1 million of pretax net catastrophe losses related to Winter Storm Elliott, or $57.8 million inclusive of reinstatement premium. The winter storm produced freezing temperatures and strong winds across the majority of our commercial lines footprint. Our $135 million of gross losses were predominantly water-related and were driven by the sustained period of freezing temperatures. This caused considerable water damage as a result of burst pipes, largely from pressurized fire suppressant sprinkler systems within commercial properties. While the losses were spread across our footprint, much of the impact was concentrated in our Southern region. The net impact of the combined ratio was 6.5 points for the quarter and 1.7 points for the year. So despite Winter Storm Elliott being a meaningful catastrophe for us, it was manageable, and an event of this size is not unexpected. Partially offsetting Winter Storm Elliott was a modest reduction in prior-quarter catastrophe loss estimates, including a reduction in our ultimate loss for Hurricane Ian from $10 million to $5 million.

For the year, we reported a 95.1% combined ratio compared to our original guidance for the year of 95% combined ratio. Favorable prior-year casualty reserve development which we don't expect or budget for providing 2.5 points of benefit, but was largely offset by about two points of unfavorable non-cat property losses compared to expectations and slightly higher than expected cat losses.

The underlying combined ratio of 93.3% for the year was about 2.3 points above expectations, and again was largely driven by the higher non-cat property losses. Moving to expenses, our expense ratio was 32.1% for the fourth quarter and 32.3% for the year, both modestly improved relative to 2021. As previously discussed, we have several cost containment initiatives in place. But we do expect some modest upward pressure on our expense ratio in 2023 due to higher reinsurance costs, which is reflected in our 2023 combined ratio guidance. Over the medium and longer term, we remain focused on lowering the expense ratio through various initiatives, while ensuring we're investing appropriately to support our longer-term

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strategic objectives. Corporate expenses which principally include holding company costs and long-term stock compensation totaled $6.7 million in the quarter, and $31.1 million for the year.

Turning to our segments. For the fourth quarter, standard commercial lines net premiums written increased 13%, driven by renewal pure price increases averaging 5.6%, solid retention of 86% and new business growth of 22%. Inclusive of exposure growth and endorsements, the renewal premium change in the quarter was a healthy 10%. The standard commercial lines combined ratio was a profitable 95.5% for the fourth quarter, and included 5.7 points of net catastrophe losses, which were partially offset by 4.7 points of net favorable prior-year casualty reserve development. The impact of Winter Storm Elliott was 6.9 points on the combined ratio, inclusive of the reinstatement premium. The favorable prior-year casualty reserve development was driven by $30 million for the workers compensation line related to accident years 2020 and prior, and $3 million for the BOP liability line. Partially offsetting this was a $5 million increase to the commercial auto bodily injury line for the current accident year.

The commercial lines underlying combined ratio was 94.5% for the quarter. For the full year, net premiums written growth was a healthy 12%. The combined ratio was a profitable 94.8% and the underlying combined ratio was 94.3%. In our personal lines segment, net premiums written increased 20% in the quarter, reflecting our initiatives to expand our presence in the mass affluent market and favorable competitive dynamics. The combined ratio in the quarter was 99.9% and included 5.3 points of net catastrophe losses. The impact of Winter Storm Elliott was 6.1 points on the combined ratio, inclusive of the reinstatement premium. The underlying combined ratio was 94.6%. For the full year, NPW growth was 9%. The combined ratio was 102.4%, and the underlying combined ratio was 88.8%.

In our E&S segment, net premiums written grew 14% for the quarter relative to a year ago. Renewal pure price increases average 7.9%. Retention remained strong relative to a year ago and new business was up 5%. The combined ratio for this segment was an extremely profitable 84.3% in the quarter, and included 1.6 points in net catastrophe losses and $5 million or 5.6 points of net favorable prior-year casualty reserve development. The impact of Winter Storm Elliott was 3.2 points on the combined ratio inclusive of the reinstatement premium. The underlying combined ratio was 88.3%. For the year, NPW growth was 16%, the combined ratio was a very profitable 90.9% and the underlying combined ratio was 89.5%. Overall, our E&S segment has continued to build on its successes in recent years, and reported its strongest year since the platform's inception just over a decade ago.

Moving to investments, our portfolio remains well positioned. As of year-end, 92% of our portfolio was in fixed income and short-term investments, with an average credit rating of AA- and an effective duration of 4.1 years. Risk assets represented approximately 9.8% of our portfolio as of year-end, down from 11% a year ago as we modestly de-risk the portfolio against a more uncertain macroeconomic backdrop. For the quarter after-tax net investment income was $65.5 million, slightly relative to $64.5 million in 2021, driven by significant growth in investment income from our fixed income portfolio and offset by a reduction in income from alternatives. Alternatives which are reported on a one quarter lag generated $100,000 of after-tax gains, compared to $19.6 million of after-tax gains a year ago. The after-tax yield on the total portfolio was 3.4% for the fourth quarter, translating to a healthy 11.5 points of ROE contribution.

During 2022, we invested approximately $2.7 billion of new money in fixed income, taken advantage of higher investment yields and simultaneously improving credit quality and liquidity. The average pretax new purchase yield for the quarter was up meaningfully to 6.1% from 2.7% in the year ago period, and was well above the pretax yield on our existing portfolio.

Approximately 10% of our fixed income portfolio remains invested in floating rate securities, although that's down from 14% at the end of the third quarter. The floating rate allocation reset at higher benchmark rates throughout the year, helping increase book yield and investment income. While this was a meaningful tailwind in 2022, more recently, we've been lowering our allocation to floating rate securities in anticipation of a potential decline in short term rates later this year. We have been opting instead to lock in current new money rates for a longer period of time, while managing our duration and credit quality targets.

During 2022, we increased the pretax book yield of our fixed income portfolio by approximately 115 basis points, which includes approximately 34 basis points of incremental yield in the fourth quarter, every 100 basis points of high yield on our total investment portfolio translates to about 2.7 points of ROE. The total return on the investment portfolio was 1.8% of the quarter but negative 7.2% for the full year, reflecting the rapid rise in interest rates in 2022.

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Let me turn to our reinsurance program. We successfully renewed our main property catastrophe program which covers both our standard market and E&S business effective January 1. For the 2023 underwriting year, we went to market with $915 million of limit in excess of a $60 million retention compared to our expiring $835 million of limit in excess of $40 million retention. As a reminder our $40 million retention has been constant since 2006. While our net premiums written and capital base have more than doubled in size over that period. The purchase of additional limit at the top of the program was driven by exposure growth. Net of co-participation, we placed $810 million of limit for 2023 compared to $776 million in 2022.

As of January 1st, a one in 100 or 1% net probable maximum loss, or PML for US hurricane, our peak peril, is a very manageable 3% of GAAP equity, and our one in 250 net PML, or 0.4% probability, stands at 7% of GAAP equity. These are both well within our risk tolerances. At renewal, we also eliminated our E&S only cover given the modest exposure in that portfolio and our strong capital position. Pricing on our cat program was up on a risk adjusted basis but in line with that of loss-free accounts in the US. In addition, terms and conditions tightened modestly for the placement. As a reminder, our reinsurance program also includes our pro-risk treaties, which limit the impact to us from large losses to $2 million per occurrence for casualty and $3 million per risk for property. These treaties renew on July 1.

Turning to capital, our capital position remains extremely strong, with $2.5 billion of GAAP equity and statutory capital and surplus as of yearend. Book value per share increased 4.4% during the quarter, but declined 16.6% for the year due to the after-tax unrealized losses for fixed income securities. Adjusted book value per share was up 5.2% for the year. Our parent company cash and investment position stands at $484 million, which is well above our longer-term target. Our net premiums written to surplus of 1.44x is in the middle of our target range. Our debt to capital ratio of 16.6% is on the conservative side. These metrics provide us with significant financial flexibility to support our growth and execute on our strategic initiatives. We did not repurchase any shares during the fourth quarter. We have $84.2 million of our remaining capacity under our share repurchase authorization, which we plan to use opportunistically in 2023.

Let me finish with some commentary on our initial guidance for 2023. First, we expect the GAAP combined ratio of 96.5% inclusive of 4.5 of catastrophe losses. This assumes no prior accident year reserve development. On an underlying basis, or excluding catastrophe losses and prior-year casualty reserve development, our 2023 combined ratio guidance implies 130 basis points of improvement relative to 2022. The higher cat load reflects the more recent trends in cat losses as well as our slightly higher retention and reinsurance co-participation on our main property cat reinsurance program. After-tax net investment income of $300 million, including $30 million in after-tax gains from alternatives. After-tax net investment income is up $68 million in total or 29% from 2022. An overall effective tax rate of approximately 21%, which includes an effective tax rate of 20% 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.

As John mentioned, this guidance implies a healthy ROE outlook for 2023 and one that is above our 12% target for the year. With that I'd ask the operator to open up the call for questions.

QUESTIONS AND ANSWERS

Operator

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

Michael Zaremski

I guess a first question is on loss inflation. You guys have been kind of very , you guys have given very good disclosure over the past year plus or really forever about kind of what you're seeing puts and takes. I'm curious, it looks like from the data you, Selective has seen an uptick in loss inflation a little sooner than some peers that are now talking about loss inflation. Just curious, do you ever analyze whether you feel that some of the loss inflation you're seeing is just simply due to -- Selective-specific due to business mix. And that and maybe other the rest of the market -- some of your peers are more immune to inflationary pressures taking into account appreciating there's some different business mixes like you're underweight workers comp relative to some but just curious if you feel like Selective is much more unique.

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

Well, so Mike, I would say we're unique in a lot of ways relative to our operating model, and how we interact with our agents and what our underwriting philosophy is. But with regard to loss trend, I would say no, you did say line of business mixes, which could differ and clearly loss trends vary based on the individual line of business. But the trends we've seen, and the trends we've incorporated on a go forward basis, are largely driven by environmental factors. And I think that's both on the frequency and the severity side. And as we've talked about in the past, I think it's always important to have a discussion around loss trends, specifically for casualty, and then for property because there you really have to think about them differently.

For casualty, we have been over the last couple of years, moving up our loss trend expected. Part of that is evident in movement in historical loss trends. But remember, your historical loss trends are impacted not just by inflationary considerations impacting severity, but actual changes in frequency and severity. And as we've talked about, in the past, frequencies, generally speaking, have leveled off a little bit below where they would have been pre pandemic. And when you look at your historical loss trends, that provides a little bit of an offset to some of the severity impacts that were more inflationary driven - be it economic or social inflationary.

We've moved that again, and as we talked about our peer comments have increased our casualty loss trend by about 50 basis points. And we do attribute much of that to our outlook for social inflationary impacts going forward. And again, everybody seems to be talking about social inflation and return to social inflationary trends, we're actually showing you how we're specifically building it in to our loss ratio selections for casualty. But again, there's nothing different in our portfolio. For those others that write standard commercial lines, kind of small mid-market and lower end of the large commercial market. Property is a little bit of a different story. Property, if you look at where we are, we've got a 7% forward loss trend on property. And looking back, our historical loss trends have also had some of that benefit of lower actual frequencies, and a really high severity year in 2022. And that, along with our forward outlook for inflation going forward, we've got that set at seven. And we feel good about that. So, again, I appreciate you recognizing, we've been transparent about this for a long time. But we also think it's important that we're not just talking about social inflation, we're showing you how we incorporated into our forward view of loss trends and how that's embedded in our loss ratio selections.

Michael Zaremski

Okay, that's helpful. My next question is on the return on equity guidance, and I'm asking it in a positive light, appreciative of the volatility of Selective ROE has been much lower than peers too, but just curious, a lot of management teams or maybe a mix of investors too expect your commercial peers to operate or many of your commercial peers to operate at usually higher ROEs if we're thinking about '23 and '24 versus their historical averages for the industry. That's, that's a bit of a case for Selective, but not as much. So there was just a management team, I know you guys couldn't hear all the conference calls that lifted their ROE guidance by a full 100 basis points attributable mostly to higher interest rates. So just kind of curious, anything structurally that you think that Selective, is this something you're thinking about? Or is it just the opportunity set is to a low double digit ROE is the right way to think about things in order to kind of continue growing and at a faster pace than your peers?

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

Yes, so let me tackle this first, this is John. And I'm sure Mark will want to add some additional commentary. First thing I would say is, our ROE target that we set and provide you every year is not an aspirational target. It's a target we expect to consistently achieve over time. And in fact, we set that as our target for our variable compensation for all of our employees, including the executive team. So that's the important point number one. The other point I would make is, when we see years like we have coming up, where you would expect your investment income and the ROE contribution from your investment income to be higher than your long term expected return on your portfolio, we expect to generate higher than our target ROEs in those years.

And that's why this is an important point, we, in my prepared comments, I went through how we get to a target combined ratio of 95% on a long-term basis. So that assumes our operating leverage, it assumes our invested asset leverage, and it assumes a normal GAAP equity environment, essentially adjusting for the impact of either an unrealized gain or loss position, and then how we think about the expected returns on that portfolio. So in a typical year, that 95% would produce the 12% ROE. Our guidance this year of a 96.5% is obviously above that. Now, because of that higher

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return from our investment portfolio, as we talked about, that will produce a combined ratio in excess of our target ROE of 12% but that 96.5% is still a point and a half above our combined ratio target. And therefore, we would pay out lower from a variable compensation perspective. So that's how we put it all together. And we do specifically tie that combined ratio target to our compensation plans. And again, it goes into the idea that when you have outsized investment income, you should be delivering higher than average or higher than expected ROE. I am not sure, trying to I got out your question here, Mike, but that's how we think about it. And that's how we structure our targets internally and compensate all our employees.

Michael Zaremski

Okay. And to your point, we can see in the proxy that some of those peers don't see their bar isn't as high as I guess where use the term aspirational. So they're not comped on that maybe higher ROE. My last question was just curious when I, when we think of one of Selective's competitive advantages, you're closer than many of your competitors to your agents, insurance brokerage agents, in terms of your model. Now that we're a couple years into the pandemic, has anything changed, are your insurance brokers not in the office as much and you've had to kind of maybe change your kind of your strategy a bit in terms of how you are interacting with your insurance brokers, or is it mostly business as usual now?

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

There's clearly been some change. Now, also, I'll say this, I would say the significance of agency relationships from our perspective, and from the agents perspective is no different. I think how you build and maintain those has shifted, because like much of the US, our agents have modified in office schedules, and therefore, they're in office on a less regular basis than they used to be. And that just changes the manner in which our field underwriters operate, but a balance of their time was always split between field work and office work from an underwriting perspective.

And they just had to shift how they manage that balance. And then I think just the other point of this is having long standing relationships and being able to maintain those in a more heavily virtual environment. I think it's been a huge benefit for us. And I think a lot more of that in person focus, which is more limited than it used to be, is focused on building new relationships whether people within an existing agency relationship or for the newly appointed ones. So definitely a shift in how you build and maintain those. But I would say there's also been a significant efficiency gain on the part of our field underwriters, because of the virtual tools, they and our agents have become a lot more comfortable using over the last couple of years.

Operator

Our next question comes from the line of Mark Dwelle of RBC.

Mark Alan Dwelle - *RBC Capital Markets, Research Division - Director of Insurance Equity Research*

A couple of questions. With respect to the 96.5% combined ratio guide, as Mark pointed out, that's about 130 basis points of improvement relative to this year, I guess what I wanted to do was kind of drill down in terms of thinking about out of that improvement, what portion of that is loss ratio relative to expense ratio. And then similarly, just kind of what are the key levers that are driving your ability to get that improvement relative to last year.

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

So this is Mark, maybe I'll start and John, I am sure will jump in, there are a couple of different ways to think about the guidance for 2023. One is 130 basis points of improvement from actual in 2022 on an underlying basis, but it is also up about 100 basis points from our expectations a year ago, we'd expected an underlying combined ratio of 91% going into 2022. And then we felt the pressure, particularly as we've talked about all year on the short tail property lines that impacted the non-cat property losses. So that's why we have a target of the 95% versus the guidance of the

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96.5%, we really feel like there's more work that we need to do to improve the underwriting profitability of the organization. But when you think about the 96.5%, we talked about the 4.5 points of catastrophe losses. That is up a little bit from the four points we expected in 2022.

We came in a little bit above that on the back of Elliott late in the year. But when you look at the more recent trend, particularly over the last five years of catastrophe loss activity, we do think there is an elevated level of frequency and severity of catastrophes. And so we raised the cat loss element to that. When you look at the expense ratio, we came in at 32.3% for 2022, I talked a little bit about the upward pressure on that in 2023, on the back of slightly higher reinsurance costs, as well as the impact of inflation. And I would say that the expense ratio, and better than that guidance is called at 32.6%, there's the dividend component, which was about 20 basis points in '22, we're expecting that to come down a little bit to 10 basis points in 2023.

So that's about 30 basis points of deterioration in the overall expense ratio, including dividends. And that gets you to kind of an underlying loss ratio of about 59.3% for the full year 2023. Now when you think about that 130 basis points of improvement, another way to look at that is about half of it is really normalizing out the unusual reinstatement premiums we had in 2022. We had the casualty ceded reinstatement premiums in Q3, and then the Elliot driven cat reinstatement premiums in Q4 to the tune of about $20 million in total between the two and then about the other half really represents a mix of business. So I would kind of put it into those bullet strokes in terms of reconciling from 2022 to 2023.

Mark Alan Dwelle - *RBC Capital Markets, Research Division - Director of Insurance Equity Research*

Truly helpful that pretty much nails it. The second question that I had was related to personal lines in the fourth quarter specifically, the accident year loss ratio was kind of the highest of the year, the expense ratio in the quarter was kind of the lowest for the year nearly, was there anything particular to either of those or is it just kind of the obvious pressure on loss trend on the former, any expense saves on the latter?

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

I'd say for personal lines in the quarter, we, personal lines did absorb its share of losses from Elliott and there is the offsetting reinstatement premium and that does put a little bit of a drag on the ratios when you have a lower denominator on the back of the reinstatement premium. We did also see some pretty significant non-cat property losses within personal lines in the first quarter to the tune of 45.7 percentage points. If you look at the run rate on those, it's a meaningful increase. And it's actually if you compare it to our total expectations that's a full 10 percentage points above what we would have expected for the quarter and that was really the driver on that underlying loss ratio.

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

And then I think the expense benefit, there's probably a little bit more flood income from claims probably related to the fourth quarter storms as a positive item in the personal lines commission line, that would be the only other offsetting item but with regard to casualty movement, either current year or prior year, there was none in personal lines.

Operator

Our next question comes from the line of Meyer Shields of KBW.

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

When you look at, I think predominantly the regional maybe the mutual competitors that are out there, is there a sense that they're less able to grow because of their exposure to the same sort of higher attachment points and higher reinsurance costs that are out there?

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

Yes, I think it's a great question, Meyer. I think, without having full insight into what happened with everybody's 1/1 renewals, I do think that in many cases, those competitors will be more highly dependent on reinsurance. That's certainly assuming they're loss effected. And even if they weren't likely under the same pressures as everybody else in the market to raise the attachment point and meaningfully impact the costs. So I would assume that you're seeing a more outsized impact on that group. Now, and I mentioned this, I think this is indicative of what's happening in the market. Just broadly, it was in my prepared comments, and I want to make sure it didn't get lost is that our January commercial lines pricing was 6.5% up almost a full point from Q4. And my sense is actually more than my sense, it was driven by a pretty meaningful movement in the property line. So I think that's indicative of a shift in the marketplace. And whether that's smaller versus larger or across the board. I couldn't really tell you, but I think your original point is pretty accurate in terms of whether the impact of the reinsurance renewal was felt more than others.

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

Okay, no, that's tremendously helpful. And that also, I guess, answers my next question, which is your willingness to add a little bit more net property risk, given pricing conditions for commercial property? Sounds like you're saying, yes.

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

Yes, I, so that's really not how we manage the business in terms of opportunistically looking line by line, we continue to be a package underwriter, we continue to acquire new business based on the individual risk underwriting and the individual risk pricing guidance we provide to our underwriters, I think they make, do make really good decisions. And our growth will be driven more by that individual decision making in the context of the opportunities that are presented, than it will be opportunistic around our current view of where pricing is or isn't.

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

Okay, no, that's fair. That's more sophisticated than the way I was looking at it. And it's a quick question if I can. First is it reasonable to assume that your year-end '22 casualty reserves incorporated the 7% trend that you're looking for '23?

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

So I now, yes, that's a question that's a little challenging to answer. I would say that our casualty reserve position at the end of the quarter continues to reflect our best estimate as it always has. And I think, and we don't plan for this, we don't budget for it. But we have a track record of favorable emergence in casualty that we're proud of. And I think it speaks to the manner in which and this was part of my response to an earlier question the manner in which we actually build our forward expectation of loss trend into our casualty loss pick. But that initial casualty loss pick is influenced meaningfully by actual historical loss trends. So the actual changes in frequency severity over the last number of years is your historical loss trend that sets your starting point for a casualty loss pick. We then add that 6.5% for casualty forward loss trend. I'm sorry, 6% for casualty forward loss trend into the assumed loss ratio. So it's in there on a go forward basis with the starting point is influenced by your actual historical trends.

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

Okay, no, perfect, that helps. And then Mark, I can be tedious and get the cats by product line for the quarter?

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

Sure, certainly. So going through the different lines of business starting with standard commercial lines for the quarter: in commercial auto $0.8 million, in commercial property $29.9 million, in BOP $9.5 million, that should add up to $40.2 million for standard commercial lines. Within personal lines: auto $0.9 million, home $3.2 million. And then property within E&S $1.4 million for a total of $45.7 million for cat losses for Q4.

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Operator

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

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

Hi, I'm going back to the loss ratio guidance on an underlying basis, a little bit over 59% for this year, I guess just looking at the non-cat property loss ratio last year trending up a little bit. What sort of expectations for that particular component are you all thinking for this year just kind of considering the expectations for loss cost trends versus the firm pricing environment? Just trying to I guess, understand how property versus casualty contributes to that improvement?

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

Yes, it's a good question, the way we disclose the non-cat property loss ratio, it's non-cat property losses divided by the total net earned premium. And if you think about '23 expectations versus '22, it's basically flat. So I believe we came in at about 18.4 for the full year across, let me just double check that number 18.3%, for the full year across all segments, in 2022. And we'd expect that to be basically that, our expectation for 2023 better than the guidance is that something essentially the same.

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

Okay. And in personal lines, there is a pretty big uptick in new business this quarter. I guess I'm just curious about what you're seeing in the shopping environment for personal lines in the target mass affluent segment of the market, and just how considering the last cost environment, how you're thinking about any potential new business penalty as you work on that pivot towards the mass affluent segment?

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

Yes, sure. So as we do in our planning across all lines of business, but in personal lines, in particular, to your question, we do plan for a different loss ratio for new than renewal. And that's factored into our loss ratio expectations, segment by segment. And that's no different for personal lines. But I think it's important to keep this in the proper context with regard to our growth, whether a new business or total premium in personal lines. We like the mass affluent segment, but recognize that we're relatively new into this. So our growth, while it looks big on a percentage basis, in terms of a real dollar basis, these are not big numbers, we grew the segment by $28 million in the year and for $14 million in the quarter and new business was $22 million for personal lines in the quarter. And that was compared to a very low Q4 of '21, where we were really just starting to transition and only wrote $10 million of new business. So I guess my point in saying that is I don't know that that's necessarily indicative of what's happening in the broader market. But that's a segment of business we like and we're showing some really good results relative to our ability to compete in that space.

Now, the other important point here is, when you look at the loss ratio environment broadly, and you're looking at the loss ratio for us, in our personal line segment, I think we acknowledge we've got work to do. And as we've made our way through this meaningful transition from mass market to mass affluent and updated our rating plans accordingly. That led to us falling a little bit behind the market in terms of pricing trends. And you saw in the prepared comments, and I'll reinforce this point, the impact of our filed rates in the 9 states that we took action, and in the fourth quarter was 8.8%. And that'll drive what we start to have on a written and ultimately earned basis, and I would expect that pace to continue. So more work to do from a profitability perspective. But I think the other important point is on the homeowners side, the exposure change we've kept up with. So we've always had a lot of discipline around getting exposure right in our home book. We've automatically fed through the updates in estimated replacement costs and the exposure I feel like we kept pace with it was more in the pricing that we needed to do a little catch up on.

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Operator

At this time speakers, we show no further questions. You may proceed.

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

Great. Well, thank you all for joining us. As always, free feel to follow up for any additional questions and look forward to speaking you, speaking to you in the future.

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

Thank you.

Operator

That conclude today's conference. Thank you everyone for participating. You may now disconnect.

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