# Q2 2017 Earnings Call

## Company Participants

- Alan D. Schnitzer, Chief Executive Officer & Director
- Brian William MacLean, President & Chief Operating Officer
- Gabriella Nawi, Senior Vice President- Investor Relations
- Gregory C. Toczydlowski, President-Business Insurance & Executive VP
- Jay S. Benet, Vice Chairman & Chief Financial Officer
- Michael F. Klein, Executive Vice President And President, Personal Insurance, And Head Of Enterprise Business Intelligence & Analytics

## Other Participants

- Brian Meredith, Analyst
- Elyse B. Greenspan, Analyst
- Jay A. Cohen, Analyst
- Jay Gelb, Analyst
- Jon Paul Newsome, Analyst
- Joshua D. Shanker, Analyst
- Kai Pan, Analyst
- Larry Greenberg, Analyst
- Meyer Shields, Analyst
- Sarah E. DeWitt, Analyst

## MANAGEMENT DISCUSSION SECTION

### Operator

Good morning ladies and gentlemen and welcome to the Second Quarter Results Teleconference for Travelers. We ask that you hold all questions until the completion of formal remarks, at which time you'll be given instructions for the question-and-answer session. As a reminder, this conference is being recorded on July 20, 2017.

At this time, I would like to turn the conference over to Ms. Gabriella Nawi, Senior Vice President of Investor Relations. Ms. Nawi you may begin.

### Gabriella Nawi {BIO 2211991 <GO>}

Thank you, Kelly. Good morning and welcome to Travelers' discussion of our second quarter 2017 results. Hopefully, all of you have seen our press release, financial supplement and webcast presentation released earlier this morning. All of these materials can be found on our website at www.travelers.com, under the Investors section.

Speaking today will be Alan Schnitzer, Chief Executive Officer; Jay Benet, Chief Financial Officer; and Brian MacLean, Chief Operating Officer. They will discuss the financial results of our business and the current market environment. They will refer to the webcast presentation as they go through prepared remarks, and then we will take questions.

In addition, other members of senior management are in the room, including Bill Heyman, Chief Investment Officer; Michael Klein, President of Personal Insurance; Tom Kunkel, President of Bond & Specialty Insurance; and Greg Toczydlowski, President of Business Insurance.

Before I turn it over to Alan, I would like to draw your attention to the explanatory note included at the end of the webcast. Our presentation today includes forward-looking statements. The company cautions investors that any forward-looking statement involves risks and uncertainties and is not a guarantee of future performance. Actual results may differ materially from those expressed or implied in the forward-looking statements due to a variety of factors. These factors are described in our earnings press release and in our most recent 10-Q and 10-K filed with the SEC. We do not undertake any obligation to update forward-looking statements.

Also, in our remarks or responses to questions we may mention some non-GAAP financial measures. Reconciliations are included in our recent earnings press release, financial supplement, and other materials available in the Investor section on our website.

And now, Alan Schnitzer.

## Alan D. Schnitzer {BIO 3529437 <GO>}

Thank you, Gabby. Good morning, everyone, and thank you for joining us today. This morning we reported second quarter net of income of $595 million and return on equity of 10%. Core income was $543 million and core return on equity was 9.5%. Our results this quarter were impacted by $262 million of after-tax catastrophe losses, as well as significant non-cat weather losses, particularly in Personal Insurance. This has been an active weather year with first half after-tax catastrophe losses of $488 million or six points on a combined ratio.

To put that in some context, this was our highest level of first half catastrophe losses since 2011. While relatively high, the level of weather losses this quarter and year are within an over-time range that we plan and price for, and we're confident that we're appropriately managing our exposures. Putting aside the weather, we were very pleased with the underwriting results in our commercial businesses and the progress we've made in Personal Insurance.

In Business Insurance, we improved our underlying combined ratio compared to the prior-year quarter. We were able to maintain a flat underlying loss ratio year-over-year, in part by managing the non-rate levers that we talked to you about from time to time; things like risk selection, mix, segmentation, risk control and claims handling. We also improved our expense ratio by about half a point.

Our Bond & Specialty business delivered another quarter of excellent results with a combined ratio of 68.7%. In Personal Insurance the underwriting results in both auto and home for the quarter were significantly impacted by catastrophe and non-cat weather losses. Within personal auto, bodily injury loss trends remain consistent with our expectations and we're on track with the actions we have taken to improve profitability.

In terms of our investment results for the quarter, after-tax net investment income increased 6% over the prior-year quarter, benefiting from strong private equity returns. Our results enabled us to return $676 million to shareholders in the quarter, including $475 million in share repurchases.

Turning to the top line, we were very pleased with the success of our marketplace strategies, which resulted in 5% net written premium growth to a record $6.64 billion. Across our commercial businesses, we continued to be successful in achieving historically-high retention levels, while also delivering positive and in some cases somewhat higher renewal rate change from recent quarters.

In our core middle market business, we achieved positive renewal rate change on an increasing portion of our portfolio, from a little more than half our accounts in the first quarter of last year to almost 60% in the first quarter of this year to just over 60% in the current quarter. And we did so while simultaneously maintaining retention at a very high 88%.

As you've heard us say many times, our production is the result of deliberate account-by-account and class-by-class execution. Our efforts this quarter and over recent quarters reflect the continued low interest rate environment and the fact that rate, together with the component of exposure that has the same impact on margins as rate, have been below loss trend for a few years now. We'll continue to execute to meet our return objectives, including by managing the non-rate levers and by seeking rate increases selectively and thoughtfully.

In Personal Insurance, we continue to improve the profitability in our auto business by implementing the pricing and underwriting actions that we've discussed with you over the last few quarters. We're on track to achieve double-digit renewal premium change on a written basis for the end of the third quarter, and loss trend remains consistent with our expectations. Given that progress and the continued growth in our very profitable homeowners business, we feel good about the trajectory of our Personal lines business.

Looking forward, across all our businesses, we're engaged strategically to maintain and strengthen our competitive advantages. We're focused on our digital agenda: on advancing the way we leverage data; on exploring and piloting smart investments in things like AI and robotics; on setting the standard in terms of the experience for our customers and distribution partners; and, as always, on being as productive and efficient as possible.

So as much as we're relentlessly committed to day-to-day execution, we're just as committed to our long-term strategic position. And speaking of our digital agenda, we couldn't be more excited to welcome Simply Business under the Travelers umbrella in the third quarter.

To sum it up, I'm pleased and encouraged by our execution in the first half of the year and with our franchise value, strong balance sheet, superior talent and capital management strategy, we remain well-positioned to continue to deliver industry-leading results.

And with that, let me turn it over to Jay.

## Jay S. Benet {BIO 2456473 <GO>}

Thanks, Alan. Core income was $543 million, down from $649 million in the prior-year quarter. And core ROE was 9.5%, down from 11.6%. As was the case in the first quarter, these reductions in core income and core ROE were not driven by fundamental changes in our performance, rather they were reflective of lower net favorable prior-year reserve development and another quarter of relatively high levels of cat and non-cat weather activity.

Beginning with underwriting results, net favorable prior-year reserve development, which I'll discuss in more detail shortly, was $132 million after-tax, or $60 million less than the prior-year quarter. This decrease was almost entirely in Bond & Specialty, where net favorable development decreased from a very high amount in the prior-year quarter.

Cat losses were $262 million after-tax, $40 million higher than the already high $222 million in the prior-year quarter. And while remaining strong, as evidenced by our 93.5% underlying combined ratio, underlying underwriting gain was lower than the prior-year quarter primarily due to two things, as we had anticipated the timing impact of personal auto bodily injury loss estimates that were consistent with the higher loss trends that we recognized in the second half of 2016 and normal quarterly fluctuations in non-cat weather.

Investment results were once again strong. Net investment income of $468 million after-tax increased by 6% or $26 million as compared to the prior-year quarter. Non-fixed income NII increased by $46 million after-tax due to strong private equity returns, which more than offset the fully anticipated $20 million after-tax decrease in fixed income NII, driven by the continued low interest rate environment.

Consolidated net favorable prior-year reserve development was $203 million pre-tax, compared to $288 million in the prior-year quarter. Business Insurance's net favorable reserve development was $125 million pre-tax, the same as in the prior-year quarter and net of a $65 million pre-tax or $42 million after-tax increase to environmental reserves. BI's favorable development was driven by better-than-expected loss experience in our domestic businesses for workers' comp, CMP liability and GL.

Bond & Specialty's net favorable development was $78 million pre-tax, down from a very high $159 million in the prior-year quarter, driven by better-than-expected loss experience in our domestic management liability business, and there was no net prior-year reserve development in PI this quarter.

On a combined statutory Schedule P basis for all of our U.S. subs, all accident years across all product lines in the aggregate and all product lines across all accident years in the aggregate, developed favorably or had de minimis unfavorable development in the first half of the year.

Operating cash flows of $810 million remain very strong, and we ended the quarter with holding company liquidity of $2.6 billion, up from $1.7 billion at the beginning of the year and higher than what we'd consider to be normal. This $900 million increase, driven mostly by the $700 million of 4% 30-year senior notes that we issued on May 30, allows for the funding of our acquisition of Simply Business, expected to close in the third quarter, as well as the repayment of our $450 million of senior notes maturing in December.

All of our capital ratios were at or better than target levels. Net unrealized investment gains were approximately $1.6 billion pre-tax or $1 billion after-tax, up from $1.1 billion and $0.7 billion respectively at the beginning of the year, while book value per share of $86.46 and adjusted book value per share of $82.71 increased 4% and 3% respectively from the beginning of the year.

We continue to generate much more capital than we need to support our businesses, allowing us to return $676 million of excess capital to our shareholders this quarter. We paid dividends of $201 million and repurchased $475 million of our common shares, consistent with our ongoing capital management strategy. And, year-to-date, we returned $1.15 billion to our shareholders through dividends and share repurchases.

Before turning the mic over to Brian, there's one additional topic I'll cover. On page 19 of the webcast, you can see an update of our cat reinsurance treaties that renewed on July 1. There were no significant changes to these treaties and their cost was modestly lower than last year. As for our one remaining cat bond, which runs through May 2018, its attachment point maximum limit were reset, as required annually, to adjust the modeled expected loss of the layer within a predetermined range.

For the year beginning May 16, 2017, we will begin recovering amounts under this cat bond if losses in the covered area for a single occurrence reach an initial attachment point of $2.346 billion up from the previous attachment point of $1.968 billion. The full $300 million of coverage amount is available on a proportional basis until such covered losses reach a maximum of $2.846 billion.

With that, I'll turn the microphone over to Brian.

**Brian William MacLean** {BIO 4679150 <GO>}

Thanks, Jay. Starting with this quarter's results in Business Insurance, we're pleased with segment income of $429 million and a combined ratio of 96.5%. The underlying combined ratio was 94.8%, down a half a point compared to the second quarter of 2016, driven by a lower expense ratio. The decline in the expense ratio resulted from slightly lower expense dollars and growing earned premium.

Turning to the underlying loss ratio; as Alan mentioned earlier, our active management of the non-rate levers along with favorable non-cat weather in Business Insurance contributed to a comparable loss ratio year-over-year. We were especially pleased that we were able to achieve this result in an environment of relatively modest price increases.

Net written premiums of $3.5 billion for the quarter were up more than 2% year-over-year, with domestic net written premiums up about 2% driven by strong production results in select and middle market. International net written premiums were up 8%, driven by the timing of certain adjustments in the second quarter of 2016 in Lloyd's.

Turning to domestic production; one of our critical objectives is to retain our high-quality book of business and accordingly, we were pleased that retention for the quarter of 85% remained at a historically high level. Renewal premium change was 3.5 points in the quarter, up about a point from the first quarter due to exposure growth in all lines, most notably in our property lines.

Rate change remained consistent with last quarter and up more than a half a point from a year ago. We continue to achieve rate gains selectively and thoughtfully and are pleased that improvement in rate from a year ago has come broadly across the portfolio. New business of $491 million was consistent with the prior-year quarter.

Looking at the individual businesses; I'll begin with select where production statistics remained strong. With retention for the quarter of 83%, renewal premium change was about five points, while new business premiums of $109 million were up 10% year-over-year. In middle market, our results reflect consistent performance in the marketplace as demonstrated by another quarter of strong retention at 88%.

Renewal premium change of about 3.5 points was up about a point from the first quarter due primarily to increased exposure across all lines and included nearly a point of renewal rate change, up a bit from the first quarter. New business of $294 million was down slightly versus the prior-year quarter. So all in, a good financial result for the segment with continued stability in the marketplace.

I'll now turn to Bond & Specialty Insurance where segment income for the quarter was strong at $163 million. Income was down somewhat from the prior-year quarter due to a lower level of net favorable prior-year reserve development. The underlying combined ratio remained a very strong 82%.

As to the top line, net written premiums for the quarter were up 5% across the segment, with solid growth in our domestic surety and management liability businesses. In international, growth was driven by strong production in our Canadian surety and UK management liability businesses, along with some non-recurring policy and reinsurance timing.

Turning to production in our domestic management liability business, we continue to execute our strategy of retaining our best performing accounts, while writing new business in return adequate product segments, so we couldn't be more pleased that for the third consecutive quarter, retention came in at a historic high of 88%, while new business was up slightly from the second quarter of last year.

Renewal premium change of 3.8 points was down slightly from the first quarter, so Bond & Specialty results remained terrific and we continue to feel great about the segment's performance and our market positions.

Turning to Personal Insurance; net written premiums for the segment grew 8% in the quarter with roughly half of that growth coming from price increases. The quarter's combined ratio of 104.1% was significantly impacted by weather with catastrophe losses of nearly 10 points for the second consecutive quarter. The underlying combined ratio of 94.5% was also significantly impacted by weather, with non-catastrophe loss levels that were well above what we would normally expect in the second quarter.

Turning to auto; in terms of production, we are pleased that we were successful in maintaining strong retention while achieving significant price increases. New business was down slightly year-over-year, while PIF growth moderated.

The domestic agency auto combined ratio for the quarter was 106.4%, with four points of cat losses more than double our normal second quarter expectations. The auto underlying combined ratio of 102.4% was also impacted by weather with about 1.5 points of non-cat weather losses, which was above our expectations, but about the same as the second quarter of 2016.

Excluding the impact of weather, auto loss results remained in line with our expectations. Compared to the second quarter of 2016, the underlying combined ratio is up 3.8 points. As you can see on Page 15 of the webcast, the increase is primarily due to the timing of the impact of the higher run rate of bodily injury losses that we recognized in the second half of 2016.

As we discussed in our year-end results call, in response to higher bodily injury loss levels, we are taking actions to improve profitability, most notably by improving the pricing of the book. Renewal premium change increased from about 6% in the first quarter to nearly 8% in the second quarter and we remain on track to reach double-digit increases before the end of the third quarter.

By year-end, we expect to have obtained enough rate on a written basis to address the elevated bodily injury loss levels. The full earned impact of these written rate increases will be realized by the end of 2018, consistent with the timeframe we mentioned in January.

As we have discussed in recent quarters, the combined ratio also continues to be elevated due to the impact of tenure on our book, as the higher levels of new business written in previous periods continue to season. We expect this impact will continue to grow for a few more quarters, albeit at a decreasing rate.

As new business production moderates to a steady state, the tenure impact will gradually diminish. The gradual reduction of the tenure impact along with rate that keeps pace with loss trend over time should result in a combined ratio that aligns with our target.

It's important to note that even though the combined ratio is currently elevated due to the impact of tenure, we expect the new business to add economic value on a lifetime basis as the increased volume brings additional profit dollars.

Turning to Agency Homeowners & Other, the combined ratio of 100.3% for the second quarter reflects 17.5 points of cat losses. The underlying combined ratio of 82.8% was 4.6 points higher than the second quarter of 2016. The year-over-year increase was primarily due to non-cat weather losses, which were also significantly higher than our long-term average.

Continuing the momentum of recent quarters, homeowners' net written premiums and policies in force both grew at levels consistent with the strong results we experienced in the first quarter. We were pleased that we achieved modest price increases in this profitable line, added more property-oriented distribution partners, and focused on account rounding.

So clearly, a significant impact from weather in the quarter, but we continued to grow our profitable homeowners business and made good progress towards the goals we laid out for auto at the end of last year.

With that, let me turn it back over to Gabby.

### Gabriella Nawi {BIO 2211991 <GO>}

Thank you. Kelly, we're ready to begin the Q&A portion of the call. Before we can begin, if I'd ask you to limit yourself to one question and one follow-up. Thank you.

## Q&A

### Operator

Thank you. Our first question comes from Kai Pan with Morgan Stanley. Please proceed with your question.

## Q - Kai Pan {BIO 18669701 <GO>}

Thank you and good morning. My first question on Personal Insurance, could you quantify the impact from those, the non-cat weather as well as the tenure in the second quarter results?

## A - Brian William MacLean {BIO 4679150 <GO>}

Yeah, so I'll start with that. This is Brian, and let me do them in reverse order. On the tenure impact, we said last – I can't remember if it was last quarter or the quarter before that it was about two points and that's up about a point, so right now, it's about three points in total in the combined ratio and that's about 1 point delta from last year.

On the non-cat weather of the 4.6 points variance in the underlying, the vast majority of it, and you can think roundly about three quarters of that number, is due to non-cat weather. And the reason for the lack of total precision there is that we're looking at a lot of loss activity and trying to attribute it, and we're pretty accurate on it. But it's not something that you can specifically tie down. And Michael has got a little bit more detail.

## A - Michael F. Klein {BIO 19674145 <GO>}

Yeah. I think so, again, the 4.6 points Brian's referring to is property year-over-year variance. And, as you said, the majority of that is due to non-cat weather. I would say a couple of things on that front. One, from our perspective, and I think you can look at weather data and see that it was a fairly active first half of the year from a weather standpoint, NOAA talked about nearly 11,000 severe weather events through May of this year, being up over long-term averages and I think, importantly, backing up to what non-cat weather is, right?

So non-cat weather, according to our definition, does include some PCS events that don't meet our catastrophe threshold, but it also includes a variety of much smaller weather events that never make the news. And connecting that to the NOAA data, one of the things that they talked about is through May there were over 6,000 reports of wind damage, which is either wind damage or storms that have significant wind associated with them. Again, not the things that show up on the news. But according to their statistics, that 6,000 is almost double the average of the 2000 to 2016 run rate, and it's the second highest amount of storms of that type since 2011.

So I think our experience is consistent with that, the drivers underneath that non-cat weather, the biggest incurred loss increases we see underneath that estimate are associated with wind and hail. So that's a little bit more color on what's underneath that from a property perspective.

## A - Brian William MacLean {BIO 4679150 <GO>}

Right. This is Brian. So that was a very good long answer to the question you didn't ask. I apologize for hearing that incorrectly. But on the auto side, there was 1.5 points, as I said in the underlying, about 1.5 points of non-cat weather losses which was comparable to what we had in last year's results; and, I would say, a good bit higher than what our normal expectations would be, what our long-term averages are. So hopefully that's responsive.

## Q - Kai Pan {BIO 18669701 <GO>}

I really appreciate the expansive response. My follow-up question is on the expense ratio side. You have seen, quite a bit, improvements in personal auto. Will that continue? And then, were you expanding any of the initiatives into the Business Insurance on the expense side, because we've seen some year-over-year improvement there as well. Are there more to come?

## A - Brian William MacLean {BIO 4679150 <GO>}

Yeah. So let's take the two pieces. Michael can talk a little bit. Expenses, we've been doing a lot in Personal Insurance for the last couple years, and that is continuing. And then, we can talk a little bit about Business Insurance and what we're doing there. So, Michael, on the PI front?

## A - Michael F. Klein {BIO 19674145 <GO>}

Yeah. From a Personal Insurance standpoint, the story continues to be that we're adding volume and holding costs pretty consistent. So I mean that's our continuation of the story we've been talking about, and we continue to see some of that benefit in the quarter.

## A - Alan D. Schnitzer {BIO 3529437 <GO>}

Hey, Kai. Good morning, it's Alan. Let me try to address your question on Business Insurance. So we don't give outlook explicitly on expenses, and there's always from period-to-period going to be some ups and downs in expenses. But we have had a number of initiatives underway. We've got initiatives underway now.

If you looked at our shop floor right now, we'd say that there is improved productivity. You don't exactly see that coming through in the numbers in the moment because, for example, there's other ups and downs and we've got the expenses associated, the costs associated with creating that productivity. But it is a serious and ongoing initiative that we're hopeful that we'll be seeing in coming periods.

## Q - Kai Pan {BIO 18669701 <GO>}

Great. Well, thank you so much for all the answers.

## A - Alan D. Schnitzer {BIO 3529437 <GO>}

Thank you.

## A - Gabriella Nawi {BIO 2211991 <GO>}

Next question, please?

## Operator

Our next question comes from Elyse Greenspan with Wells Fargo. Please proceed with your question.

## Q - Elyse B. Greenspan {BIO 17263315 <GO>}

Hi, yeah. My first question is on – just in going through some of your commentary in the Q in terms of the outlook for the Business Insurance business for 2018, you point to stable renewal price changes and also stable margins. I guess, just how are you expecting your margins to stay stable when, even if we get continued exposure growth, your rate is falling below trend. If you could just provide just some additional commentary on how you see kind of your margins in that business playing out in 2018?

## A - Alan D. Schnitzer {BIO 3529437 <GO>}

Yeah. Good morning, Elyse. It's Alan. Thanks for the question. We do get that from time-to-time, and I think we've addressed that on this call from time-to-time. We get the math you're looking at. It's a very sort of narrow rate versus loss trend. But what we've told you and what I tried to address in my prepared remarks this morning is that there are plenty of levers other than just pure rate that contribute to the margin outlook. And I mentioned some of them in my prepared remarks, things like segmentation, and risk selection, and claims handling, and risk control expenses, all the rest. So all of those things wrap up in margin.

The component of margin that is sort of narrow rate versus loss trend, particularly when you take into account the component of exposure that behaves like rate from margin perspective is and continues to be relatively small and these incremental rate gains that we've been writing for a few quarters now have offset that to some degree.

So, you take all that together and we're comfortable with a broadly consistent outlook. Of course, there's going to be volatility from things like weather, but in terms of the things we control, we feel good about a broadly consistent margin outlook. We've been giving you that outlook for some quarters now and we've delivered on it. So we feel good about it.

## Q - Elyse B. Greenspan {BIO 17263315 <GO>}

Okay. And then just a couple of quick things on the personal auto side. The new business did decline this quarter. Policy counts still loop up sequentially. How do you see the policy count playing out as you continue to push for more rate? And a second question, in the commentary you guys pointed to what you're doing to get back to your target margin in that business? Could you just remind us what your target margin is for the personal auto business? Thank you.

## A - Michael F. Klein {BIO 19674145 <GO>}

Sure, and Elyse, this is Michael. I'll start with the target margin question. I think broadly, combined ratio range of 96 points to 98 points for auto is the range that we're shooting for over time.

To your question on PIF and PIF growth, as we've talked about, our strategy is to improve profitability in auto while growth moderates. We're very pleased with the trajectory that the PIF growth in the new business is on.

We're also, I'll say, particularly pleased with the strength of retention in the face of the increased rate. You see retention in the production slide at 85 points, actually above our long run average for that number, a number we're very pleased with as we moved rate up almost a couple of points quarter-on-quarter.

In terms of the outlook for PIF growth, again our plan remains consistent. We're looking for moderate growth, while we continue to improve profitability.

## A - Alan D. Schnitzer {BIO 3529437 <GO>}

And, Elyse, it's Alan. I would just add on the margin target, there is some advantage we have to being an account solution. The fact that we have such a good homeowners book enables us to – gives us some advantage in the combined ratio target for the auto and not from a subsidization perspective, but from a synergy perspective.

For example, the impact on retention and things like that. So we think the fact that we're an account solution provider is a big help from that perspective.

## Q - Elyse B. Greenspan {BIO 17263315 <GO>}

Okay. Thank you very much.

## A - Alan D. Schnitzer {BIO 3529437 <GO>}

Thank you.

## A - Gabriella Nawi {BIO 2211991 <GO>}

Thank you. Next question please?

## Operator

Our next question comes from Jay Gelb with Barclays. Please proceed with your question.

## Q - Jay Gelb {BIO 21247396 <GO>}

Thanks and good morning. With regard to the small commercial business market, Travelers is clearly a leader in that space. We've seen a number of other large companies looking to either enter that business or more InsurTech-focused operations trying to disrupt that business. Can you talk about how Travelers is defending its position in that profitable market?

## A - Alan D. Schnitzer {BIO 3529437 <GO>}

Yeah, good morning, Jay. It's Alan. So, we read the same rhetoric that you read and to one degree or another, occasionally, we see it in the marketplace. I think different competitors and others are at different stages of their engagement in the marketplace and just a couple of things. One, we do have a – start with a great position. We think that's important from a competitive perspective. We've got great technology. We've got great talent. We've got great data. We've got great relationships with distribution. We think all that's very important and we're not standing still, so some of the investments I mentioned in my prepared remarks are directly related to those businesses. That's important for us.

And you look at investments like Simply Business. That is meant to make sure that as we look around the landscape and see how the world is changing that we're positioning Travelers to continue to be effective and very competitive in that marketplace. And lastly, I would add that small commercial, in fact, all of our businesses have always been competitive and we've got lots of arrows in the quiver that I guess I should say competitive advantages that enable us to compete effectively, so we feel good about the outlook.

## Q - Jay Gelb {BIO 21247396 <GO>}

As competition increases in that space and it moves more towards technology focus, I mean we see a number of these companies saying essentially one or two clicks and you get to quote the bond, is Travelers where it needs to be from that perspective?

## A - Alan D. Schnitzer {BIO 3529437 <GO>}

Yeah, there's a lot of rhetoric out there, how much business is actually being transacted on that basis and how much is aspirational from the perspective what others are saying is something that is worth looking into, but I'd say that we're as engaged as anybody on all those areas and as aspirational as everybody in all those areas, so yeah, we think we are where we need to be to make sure that we continue to be competitive.

And again, just think about the innovation going on around here, the investments that we're making and we're not flat footed. These aren't things that we're starting with today. These things in many, many cases we've been thinking about for many years and again I'll just point to the Simply Business transaction. That's something that we announced a couple of quarters ago, but it's nothing we stumbled on a couple of quarters ago. That was the result of having been thinking about the exact issue you're talking about over a number of years and planning and being thoughtful and strategic about it. So I would say yes, we are where we need to be.

## Q - Jay Gelb {BIO 21247396 <GO>}

Appreciate it. Thank you.

## A - Alan D. Schnitzer {BIO 3529437 <GO>}

Thank you.

## A - Gabriella Nawi {BIO 2211991 <GO>}

Next question please?

## Operator

Our next question comes from Jay Cohen with Bank of America Merrill Lynch. Please proceed with your question.

## Q - Jay A. Cohen {BIO 1498813 <GO>}

Just one follow-up, maybe two follow-ups on the personal line side. One is that the PIF growth in the homeowners business seems pretty resilient in the face of rising auto insurance premium rates. Would you expect to maintain that or could your effort to improve auto have some spillover effect on the homeowners side?

## A - Michael F. Klein {BIO 19674145 <GO>}

Jay, this is Michael. I think that's something that we've been talking about and focusing on and is why in addition to our objective to improve profits and moderate growth in auto, our other key objective is to maintain the momentum in home. To Brian's prepared remarks, we've made some specific efforts to sustain that home growth in the face of seeking the auto rate, focusing more on rounded business. The good news underneath both the auto and the home PIF growth is the strongest growth we see is in rounded accounts, where we're writing both the auto and the home or writing the auto or the home with other lines of business.

We're focusing on property intensive distribution relationships, focusing on distribution management and working with agents and brokers to make sure they're giving us at least our fair share of the property business that goes with the auto we write. So, I think through a series of specific tactics and strategies, that's what's helped us sustain the home growth so far and we're hopeful that we can continue that.

## Q - Jay A. Cohen {BIO 1498813 <GO>}

That's a good answer. Thank you. The other just quick one on the auto side, if you look at second quarter underlying loss ratio versus first quarter, that did get a bit worse, I'm assuming some of that's non-cat weather and I'm assuming some of that is seasonality. Is that a fair assessment?

## A - Alan D. Schnitzer {BIO 3529437 <GO>}

Jay, tell us again what number you're looking at? I want to make sure that we're looking at the right thing.

## Q - Jay A. Cohen {BIO 1498813 <GO>}

I'm looking at personal auto, second quarter underlying loss ratio versus first quarter underlying loss ratio, first quarter 2017, so consecutive quarter.

## A - Alan D. Schnitzer {BIO 3529437 <GO>}

So, Jay, I think that – as you can see in the webcast the lion's share of that is the timing of the recognition of the bodily injury losses and then there's the tenure component that Brian mentioned.

## A - Michael F. Klein {BIO 19674145 <GO>}

But if you're comparing Q2 this year to Q1 this year, Jay?

## Q - Jay A. Cohen {BIO 1498813 <GO>}

Exactly.

## A - Alan D. Schnitzer {BIO 3529437 <GO>}

Oh, I'm sorry.

## Q - Jay A. Cohen {BIO 1498813 <GO>}

The timing shouldn't be an issue.

## A - Alan D. Schnitzer {BIO 3529437 <GO>}

Yes, I'm sorry, I was thinking you were talking about...

## A - Michael F. Klein {BIO 19674145 <GO>}

Right. So I think to your point, there's seasonality in that expectation is a key driver of that. Again, when you look at – when we look at underlying consistent with the comments that Brian made, you do have non-cat weather impacting that. We have a higher loss ratio expectation in the second quarter than we do in the first largely related to weather and driving activity picking up.

## Q - Jay A. Cohen {BIO 1498813 <GO>}

Got it. Helpful. Thank you.

## A - Alan D. Schnitzer {BIO 3529437 <GO>}

Thank you.

## A - Gabriella Nawi {BIO 2211991 <GO>}

Next question, please?

## Operator

Our next question comes from Meyer Shields with KBW. Please proceed with your question.

## Q - Meyer Shields {BIO 4281064 <GO>}

Great, thanks. Brian, you mentioned, when you're discussing Business Insurance that there was lower non-cat weather in the quarter. Is that just sort of randomness or is there some reason why you would see a divergence in non-cat weather losses between business and Personal Insurance?

## A - Brian William MacLean {BIO 4679150 <GO>}

Yeah. I think it's mostly randomness and when you think of what's driving the non-cat weather, as Michael said, it's not the big, big catastrophe events, the smaller events or the ones that don't even make PCS events, and those things are more likely to have a frequency on the homeowner's side than they would on the Business Insurance side. So it's probably mostly randomness and then some the nature of the beast.

## A - Alan D. Schnitzer {BIO 3529437 <GO>}

Yeah. So Meyer, you think about hail for example, and the types of things that individuals insure are more susceptible to hail damage for example than commercial property that's more resilient.

## Q - Meyer Shields {BIO 4281064 <GO>}

Okay. That makes sense. The second issue, when we look at the pricing changes in Business Insurance, they're hovering around 60 basis points, which is appreciably different than the preceding four quarters. I'm saying appreciably, so less than a point. Does that translate into sort of different expectations for core underwriting margins? Is it a little easier as that 60 basis points turns in?

## A - Alan D. Schnitzer {BIO 3529437 <GO>}

Sure. I mean it's just math, right? As the pure rate goes up – and by the way, I'd point out that the exposure's up too. We're not calling that a trend, but it's broadly enough across our portfolio that for the most part, we're attributing it to economic activity, but you look at that incremental price and you look at the component of exposure that behaves like rate and sure, it's math. It's a good guy from a margin perspective for sure. It's not – we're not at the point where they're equal to each other, but we're getting closer.

## Q - Meyer Shields {BIO 4281064 <GO>}

Okay. Thanks so much.

## A - Alan D. Schnitzer {BIO 3529437 <GO>}

Thank you.

## A - Gabriella Nawi {BIO 2211991 <GO>}

Next question, please?

## Operator

Our next question comes from Sarah Dewitt with JPMorgan. Please proceed with your question.

## Q - Sarah E. DeWitt {BIO 18946247 <GO>}

Hi, good morning. First, just on the personal auto insurance combined ratio target of 96% to 98%, does that include the tenure impact and what I'm trying to get at is when you say you can get back to your target margins by the end of 2018, should we be thinking 96% to 98%, plus a couple of points for tenure?

## A - Brian William MacLean {BIO 4679150 <GO>}

So Sarah, to your point and let me just make sure I say this accurately. So when we say at the end of 2018, we're not talking about the tenure, so it is 96% to 98%, plus a tenure impact. So I think it's the way you just said it. And then...

## A - Michael F. Klein {BIO 19674145 <GO>}

And, specifically, your comment about the end of 2018 is rate covering the increased bodily injury loss estimate.

## A - Brian William MacLean {BIO 4679150 <GO>}

Right. Right. And so, I think as you put those things together, it answers, I think, the other way you asked it, which is when we say 96% to 98%, we're assuming that tenure has moderated and we're at kind of a steady state there.

## A - Alan D. Schnitzer {BIO 3529437 <GO>}

But I'll go back just to highlight something Brian included in his prepared remarks, which is we don't look at tenure as a bad guy because it's part of the plan, it's adding economic value. And so, it's deliberate.

## Q - Sarah E. DeWitt {BIO 18946247 <GO>}

Of course. But it wouldn't be zero by the end of 2018, right?

## A - Brian William MacLean {BIO 4679150 <GO>}

No, no. No, no, no, no. I think Michael said this in the last quarter comments, so I'll just repeat it is that when we talk about the timing of tenure unwinding, we're talking in terms of years, not quarters.

## A - Michael F. Klein {BIO 19674145 <GO>}

Correct.

## A - Brian William MacLean {BIO 4679150 <GO>}

So.

## Q - Sarah E. DeWitt {BIO 18946247 <GO>}

Right, of course. Of course.

## A - Brian William MacLean {BIO 4679150 <GO>}

Yeah.

## Q - Sarah E. DeWitt {BIO 18946247 <GO>}

And then, my follow-up is just, could you revisit again what you're seeing in terms of loss trends this quarter? Are they consistent, are there any signs of it picking up or moderating? And if you could talk about commercial versus personal, that would be helpful.

## A - Alan D. Schnitzer {BIO 3529437 <GO>}

Yeah. So I'll take that, Sarah. In our Personal Business, loss trend came in as we expected and I think we've told you in the past what our expectations were. But there's nothing happened this quarter or the first half of the year that was inconsistent with our expectations. And I'd make the same comment about Business Insurance. It's very stable and consistent with our expectations.

Now, I'm addressing in a sentence frequency and severity over $15 billion of business, so there's always going to be ups and downs and one line versus another. But, broadly speaking, we view loss trend in our commercial businesses as nothing remarkable, consistent with expectations.

## Q - Sarah E. DeWitt {BIO 18946247 <GO>}

Okay, great. Thank you.

## A - Alan D. Schnitzer {BIO 3529437 <GO>}

Thank you.

## A - Gabriella Nawi {BIO 2211991 <GO>}

Next question, please?

## Operator

Our next question comes from Brian Meredith with UBS. Please proceed with your question.

## Q - Brian Meredith {BIO 3108204 <GO>}

Yeah. Thanks. Two questions here. First one, could you talk a little bit about what you're seeing with terms and conditions in the Business Insurance segment? Any changes going on? Is the market getting maybe a little bit more generous in that area?

## A - Brian William MacLean {BIO 4679150 <GO>}

The short answer is, no, we're not seeing anything significant. There's obviously always little movements up and down, but nothing dramatic that we're seeing.

## A - Alan D. Schnitzer {BIO 3529437 <GO>}

Again, hard to address billions of dollars of premium in one sentence, but by and large there's nothing that we're looking at that's causing us to think differently about current results or outlook.

## Q - Brian Meredith {BIO 3108204 <GO>}

Got you. The deductibles are covered. Okay, great. And then, a second question. Just curious, I mean, if I look at your commercial auto, some premium growth going on there. Is that largely rate-driven or you're actually seeing opportunities in the commercial auto to pick up business here?

## A - Gregory C. Toczydlowski {BIO 16615940 <GO>}

Yeah. This is Greg Toczydlowski. The short answer on that one is, it's predominantly rate-driven across the portfolio. Our commercial auto book, as we've shared in the past, certainly hasn't been immune to some of the pressures that we're seeing across the entire industry on automobile. And, accordingly, we've been pursuing rate on that. So that's what you're seeing move through that top line. Because we are so much of an account solution, the retention has been pretty strong. And so, that gives us that net impact on the top line. So we're going to continue pursuing that strategy.

## Q - Brian Meredith {BIO 3108204 <GO>}

Great. Thank you.

## A - Gabriella Nawi {BIO 2211991 <GO>}

Next question, please?

## Operator

Our next question comes from Paul Newsome with Sandler O'Neill. Please proceed with your question.

## Q - Jon Paul Newsome {BIO 3522950 <GO>}

Good morning. Thanks for the call. I'd like to revisit the little tick up we saw in the domestic Business Insurance from a rate perspective and renewal rate perspective. Could you talk about how much that is you versus maybe the environment, if we're seeing maybe a little bit of a tick up or lightening up of competition? We've seen a couple of surveys that suggest maybe sort of flattening of pricing, and I just don't know how much to read into it. Of course, you...

## A - Alan D. Schnitzer {BIO 3529437 <GO>}

Well, I would say, it's definitely both to some degree, right? I mean, it's us. We transact very deliberately on an account-by-account and class-by-class solution. So the rate we're getting is because we're trying to get the rate, but we're getting it because we operate in a very competitive marketplace. And if the marketplace weren't letting us get it, we wouldn't be getting it. So certainly not, given the premium growth we have. So I would say it's a combination of both.

Now, I do think that we do have some advantages here maybe relative to the market. One, franchise value matters when it comes to pricing, so product breadth, relationships with distribution, which is valuable to our customers and our distribution, claims handling, risk control. Those things, I think, really matter when it comes to the value we can deliver.

And secondly, I'd say, we've got really important data and analytics and that helps us from a granular pricing perspective as well. So I would say it's the combination of the efforts, the franchise value and competitive advantage that we have and the marketplace.

## Q - Jon Paul Newsome {BIO 3522950 <GO>}

Is there nothing in the competitive environment that you've seen any swings, competitors moving in and out or vice versa, or is it basically just kind of a general trend?

## A - Alan D. Schnitzer {BIO 3529437 <GO>}

A little soft. Can you repeat that?

## Q - Jon Paul Newsome {BIO 3522950 <GO>}

Sorry, the world's softest voice. Have you seen any actual trends or changes in your competitors themselves, anybody moving in and out or making any changes from a pricing perspective?

## A - Alan D. Schnitzer {BIO 3529437 <GO>}

It would be so hard without taking it through competitor-by-competitor, business-by-business, geography-by-geography, to give you a sense of that. But there's always movements competitor-by-competitor, business-by-business, geography versus geography. And so, to the extent we see any of that occurring now it would be consistent with the way we see that type of dynamic over time, so in that respect, not really.

## Q - Jon Paul Newsome {BIO 3522950 <GO>}

Okay. Thanks very much.

## A - Alan D. Schnitzer {BIO 3529437 <GO>}

Thank you.

## A - Gabriella Nawi {BIO 2211991 <GO>}

Next question, please?

## Operator

Our next question comes from Josh Shanker with Deutsche Bank. Please proceed with your question.

## Q - Joshua D. Shanker {BIO 5292022 <GO>}

Thank you. A couple questions on non-cat weather, I guess, or maybe one. Allstate has taken the tact of reporting a much lower threshold for what they call catastrophe, but we should assume that of course there's going to be some level of cat activity in every quarter or every time they announce their numbers. When you talk about non-cat weather activity and look over your data of the last three years, five years, ten years, does that net - does the benefit and hindrance of non-cat weather net out to zero or is it a negative profit layer on the top of how we should look at things?

## A - Alan D. Schnitzer {BIO 3529437 <GO>}

I'm not sure, Josh, what you're asking. I mean we have an expectation of what non-cat weather is going to do over time in a range and we set our prices in part based on that expectation, so whether it's a positive or a negative over time is going to be a function of over time whether we're getting the right price for the losses. So I don't, if you're asking sort of where it is in any particular period relative to a long term average, we can give you that information too, but as I said in my opening remarks, what we're seeing is certainly relatively high. There's no question about it, but not outside of what we would expect in the context of an over-time range.

## Q - Joshua D. Shanker {BIO 5292022 <GO>}

So when you say three quarters of the personal lines deterioration is due to non-cat weather, that's non-cat weather above and beyond a layer of normal expectation?

## A - Alan D. Schnitzer {BIO 3529437 <GO>}

Actually, I think the number that you're talking about was a property number, but I think what we're explaining is a year-over-year variance, so I think that the year-over-year variance, if I'm remembering a number right, it's something like 4.6 points, at least in home and I think what Brian's comment was is the lion's share of that is non-cat weather that was worse in the current quarter as compared to non-cat weather in the prior-year quarter.

## A - Brian William MacLean {BIO 4679150 <GO>}

And then I did - so that's what I meant by the three quarters. I did also say in my comment that it was also significantly higher than our long-term average, so maybe a little less than that other number whatever it might be. But still, significantly higher than our long-term average, and but within a volatility as Alan said that isn't totally out of pattern.

Remember - one of the tricky things with this, Josh, especially when we're talking about homeowners, but also with our commercial property, weather in totality makes up something between 40% and 50% of our total loss content, so you are - at some point you're almost talking about the loss ratio in aggregate, which if you are trying to include every single weather-related loss, so it's...

## Q - Joshua D. Shanker {BIO 5292022 <GO>}

That's totally reasonable. And then just another avenue I guess of discussion. You guys - your results in Business Insurance continue to be very, very good regardless of weather -

the variance from a quarter ago. If you would accept a 100 basis points or 200 basis points lower level of profitability in that line of business, could you grow materially? Are you being – is there an opportunity here that's not being met because you are being so profitable that maybe you should relax profitability goals and instead grow?

## A - Alan D. Schnitzer {BIO 3529437 <GO>}

Josh, we've always thought that lowering price to generate incremental premium is fool's errand because we operate in a very competitive marketplace and you just end up with same relative market share at lower profitability. And once you lower the price and consequently lower the margins on the business you're keeping, then you've got to write a whole lot of new business to get that margin back, so we don't like that strategy. We like the strategy of, again as I probably sound like a broken record, but on a very granular basis looking at the accounts and classes of business that we're writing. We look at our loss cost in a yield curve and we calculate a price that we think meets our return objective and that's the way we run the railroad. So we don't like the strategy of lowering price to generate volume.

## Q - Joshua D. Shanker {BIO 5292022 <GO>}

Okay. Well, good luck and thank you for the answers.

## A - Alan D. Schnitzer {BIO 3529437 <GO>}

Thank you.

## A - Gabriella Nawi {BIO 2211991 <GO>}

Great. Thank you. This is what appears to be our last question. Please go ahead.

## Operator

And our last question comes from Larry Greenberg with Janney Montgomery Scott. Please proceed with your question.

## Q - Larry Greenberg {BIO 16478161 <GO>}

Good morning and thank you. Just wondering, can you give us any color on the environmental strengthening, whether the complexion of that was any different than it has been in the past? I know it was a little bit better than a year ago. Is there anything maybe to extrapolate from that related to the third quarter asbestos review? And are you guys thinking any differently about how you should be managing these exposures?

## A - Jay S. Benet {BIO 2456473 <GO>}

Hey, Larry. This is Jay Benet. So, in relation to the environmental charge this year versus what we saw last year, you're right. It was moderated from the levels of the prior year. It continues to be an area of frustration. I'd call it at the level of a nuisance at this point in time. We aren't talking about very large dollars, but as you know, every year we take a crack at what we think is going to happen with regard to new policyholders, what happens with regard to the active policyholders, what's taking place in relation to defense cost versus our actual cleanup cost, and we have to make lots of assumptions associated with that.

A year goes by or six months or whatever the period of time is and we look at what's actually taking place versus those assumptions, and what we say in the Q is what I'm going to repeat here that the favorable trends we have been seeing for a number of years continue. They didn't continue quite at the level that we expected, but they were still favorable when it came to policies presenting new claims or policyholders with new claims or what's taking place with regard to other aspects of it, but as we refine those estimates, in this particular case, we came up with an additional increase to the reserve.

So, I'd say that's the lion share of it. I will say that there are parts of the country, the Pacific Northwest in particular, where cleanup costs are being a little more elevated than what we had anticipated. So, you do have certain jurisdictional elements associated with this that will change what your estimates of cost are, but I'll go back to what I said before that in the overall context of our reserve levels and Business Insurance and the company as a whole, this is a fairly de minimis item at this point in time.

## Q - Larry Greenberg {BIO 16478161 <GO>}

And nothing defense cost wise to extrapolate to asbestos or anything else?

## A - Jay S. Benet {BIO 2456473 <GO>}

No. I don't think you can really extrapolate what takes place in environmental to asbestos, but I think if you can extrapolate anything, you can probably look at what other companies have said about the same subjects of asbestos and environmental and recognize that we're no different than everybody else. So, I think we'll continue to address each one of these things. We have our claims study ongoing as it relates to asbestos and when we have more news to tell, we'll tell it.

## Q - Larry Greenberg {BIO 16478161 <GO>}

Thank you.

## A - Gabriella Nawi {BIO 2211991 <GO>}

Excellent. This looks like we're wrapping up. Thank you all for joining us today and as always, we're available in Investor Relations for any follow-up questions. Have a great day.

## Operator

Ladies and gentlemen, that does conclude the conference call for today. We thank you for your participation and we ask that you please disconnect your lines.