

Company Name: Travelers  
 Company Ticker: TRV US  
 Date: 2019-01-22  
 Event Description: Q4 2018 Earnings Call

Market Cap: 32,254.10  
 Current PX: 122.36  
 YTD Change(\$): +2.61  
 YTD Change(%): +2.180

Bloomberg Estimates - EPS  
 Current Quarter: 2.860  
 Current Year: 11.200  
 Bloomberg Estimates - Sales  
 Current Quarter: 7716.571  
 Current Year: 31429.636

## Q4 2018 Earnings Call

### Company Participants

- Abbe F. Goldstein
- Alan D. Schnitzer
- Daniel S. Frey
- Gregory C. Toczydlowski
- Thomas M. Kunkel
- Michael F. Klein
- William Herbert Heyman

### Other Participants

- Jay Gelb
- Elyse B. Greenspan
- Michael Zaremski
- Kai Pan
- Amit Kumar
- Brian Meredith
- Ryan J. Tunis
- Meyer Shields
- Larry Greenberg
- Yaron Kinar

## MANAGEMENT DISCUSSION SECTION

### Abbe F. Goldstein

#### *Non-GAAP Financial Measures*

Also, in our remarks or responses to questions, we may mention some non-GAAP financial measures

### Alan D. Schnitzer

#### *Business Highlights*

##### *Returns, Profitability, Investments and Catastrophe Losses*

- As we look back on 2018, we're pleased that we improved returns, grew our business and delivered strong underlying underwriting profitability and investment results, while returning significant excess capital to shareholders and taking great care of our customers
- Our results benefited from ongoing strategic initiatives geared toward creating top line opportunities and improving productivity and efficiency
- Of course, our results were also impacted by a high level of catastrophe losses

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### ***Net and Core Income***

- Fourth quarter net income of \$621mm or \$2.32 per diluted share generated a return on equity of 10.9%
- Core income was \$571mm or \$2.13 per diluted share, and core return on equity was 10%
- Net and core income were both impacted by almost \$500mm of after-tax cat losses
- Our full year core income increased by 19% to \$2.4B, generating core return on equity of 10.7%
  - The fact that we were able to generate this level of profit and profitability with \$1.4B in after-tax cat losses speaks to the earnings power of our franchise

### ***Underlying Combined Ratio***

- Our consolidated underlying combined ratio for Q4 improved to 91.1%, the lowest level since Q1 2016, even after the impact on the quarter of a full year's worth of higher loss estimates in the commercial auto line, driven by bodily injury severity
- Commercial auto has been a challenge for the industry and for us for some time and our most recent data reflects further deterioration
- Greg will address in more detail what we've seen and how we're responding

### ***After-Tax Underlying Underwriting Gain***

- For the full year, our record earned premium of more than \$27B and productivity and efficiency initiatives contributed to an after-tax underlying underwriting gain of \$1.5B, the highest in more than a decade
- Our successful and consistent investment strategy also contributed to our results
- After-tax net investment income was up 15% for the quarter and 12% for the year
- The underwriting gain in investment income also reflect the benefit of tax reform
  - These results, together with our strong balance sheet, enabled us to grow adjusted book value per share by 5% during the year after returning more than \$2.1B of excess capital to shareholders, consistent with our longstanding capital management strategy

### ***Production and Net Written Premium***

- Turning to production, we remain very pleased with our performance in the market with each of our business segments contributing to a 4% increase in net written premium for the quarter
- For the year, we grew net written premiums by 6% to a record \$27.7B

### ***Business Insurance***

- Net written premiums in Business Insurance in the quarter increased by nearly \$100mm or 3%, driven by historically high retention and positive renewal premium change
- In our Middle Market business, retention reached a record fourth quarter high of 88%
- We completed the roll-out of our business centers in our Commercial Accounts business during the year

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- All eligible renewals in new business are now flowing through these centers, freeing up our local underwriters to spend more time with our agent and broker partners
- For the year, Commercial Accounts delivered its highest level of new business in more than a decade
- Renewal premium change in Business Insurance, including pure rate and exposure, was nearly 5% in the quarter, up over 0.5 point compared to the same period last year and steady throughout 2018
- We achieved positive renewal premium change in all lines

### ***Bond & Specialty Business***

- In our Bond & Specialty business, net written premiums increased by 8% for the quarter, with continued strong production in both our Management Liability and Surety businesses
- In domestic Management Liability, we achieved record retention and new business for the full year

### ***Personal Insurance***

- In Personal Insurance, net written premium growth in the quarter was strong at 5% with both our Agency Auto and Homeowner businesses contributing
- Two years ago in 2016, we had \$4B book of Agency Auto business with some profitability challenges
- Today it's \$5B business that meets our return expectations, thanks to impressive execution by the team and an improved environment we got there ahead of schedule
- You'll hear more shortly from Greg, Tom and Michael about our segment results

### ***Closing Remarks***

To wrap it up, despite another year of elevated catastrophe losses, we achieved an 11% return on equity

That speaks to excellent underwriting execution and management of risk and reward across a diverse portfolio of businesses, our successful investment strategy and our active approach to capital management

It also speaks to the dedication and commitment of our 30,000 employees

With a talented team, competitive advantages that set us apart and an ambitious innovation agenda along with a very high respect for our shareholders' capital, we remain very well positioned to continue to deliver leading results and meaningful shareholder value over time

## **Daniel S. Frey**

### ***Financial Highlights***

#### ***Core Income, ROE and Underlying Combined Ratio***

- Core income for Q4 was \$571mm, down from \$633mm in the prior year quarter and core ROE was 10%, down from 11.1%
- The decrease in both measures from last year's fourth quarter resulted primarily from a higher level of catastrophe losses and a lower level of favorable prior year reserve development

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- Underlying results were strong as the consolidated underlying combined ratio of 91.1%, which excludes the impacts of cats and PYD, improved by 1.3 points from the prior year quarter
- Recall that last year's fourth quarter underlying combined ratio was elevated by about 0.5 point as a result of tax planning actions taken at that time

### ***Pre-Tax Cat Losses and Underlying Underwriting Gain***

- Our fourth quarter results include \$610mm of pre-tax cat losses, driven by \$453mm from the California wildfires in November and \$158mm from Hurricane Michael in October
- Last year's fourth quarter cat losses of \$499mm included favorable development of \$157mm primarily related to the hurricanes from Q3 2017
- PYD in the current quarter, for which I'll provide more details shortly, was net favorable \$167mm pre-tax, down from \$293mm in the prior year quarter
- Our pre-tax underlying underwriting gain of \$578mm improved by 22% from \$472mm in the prior year quarter, as increases in both Bond & Specialty and Personal Insurance were partially offset by a decrease in Business Insurance, which Greg will address in his comments

### ***Pre-Tax Net Investment Income***

- Pre-tax net investment income increased by 5% from the prior year quarter to \$630mm, as increases in fixed income were partially offset by lower pre-tax returns in our non-fixed income portfolio compared to very strong performance in the prior year quarter
- Fixed income results benefited from the more favorable interest rate environment and an increase in average invested assets resulting from continued growth in net written premiums

### ***After-Tax Fixed Income NII***

- After-tax NII increased by 15% to \$535mm, benefiting from the lower U.S. corporate income tax rate
- After-tax fixed income NII in Q4 increased by \$65mm compared to Q4 2017, and we expect that 2019 fixed income NII will increase by approximately \$20mm to \$25mm per quarter compared to the corresponding periods of 2018, as we project that both the average level of invested assets and the average yield on the portfolio will be higher

### ***Net Favorable Prior Year Reserve Development***

#### ***Personal Insurance and Bond & Specialty***

- All three segments experienced net favorable prior year reserve development in Q4
- In Personal Insurance, recent accident years performed better than expected in the auto book
- In Bond & Specialty, we experienced better-than-expected loss development in the Management Liability book

#### ***Business Insurance***

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- In Business Insurance, net favorable PYD of \$48mm pre-tax was driven by better-than-expected loss experience in domestic workers' comp, which was largely offset by unfavorable development in commercial auto and, to a lesser extent, general liability
- Commercial auto unfavorable PYD in the quarter was \$155mm pre-tax, resulting from elevated severity in recent accident years

### ***General Liability***

- In general liability, where the returns remain attractive, unfavorable PYD in the quarter reflected changes across several accident years in business units
- There is no broad theme, but the largest impact related to a small number of claims from older years in our runoff book
- For the full year, despite the adverse changes in commercial auto and Q3 asbestos charge, net favorable prior year reserve development was \$517mm pre-tax
- When our combined 2018 Schedule P is filed early in Q2, we expect it to show that excluding asbestos environmental, 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 minor unfavorable development, except for commercial auto, and as a result of the change in commercial auto accident year 2017

### ***Corporate Cat Aggregate XOL Treaty***

- Page 19 of the webcast provides information about our January 1 cat treaty renewal
- Our corporate cat aggregate XOL treaty renewed on terms, in line with the expiring treaty and continues to provide coverage for both single cat events and the aggregation of losses from multiple cat events
- As you all know, the industry has experienced an elevated level of catastrophe losses in recent years
- In response, we have updated our actuarial models to reflect the actual results of recent years and to give more weight to recent years when determining our view of normal expectations

### ***Pricing and Underwriting Models***

- As a result, we have recognized a somewhat higher level of expected losses on our pricing and underwriting models
- In further recognition of recent weather activity and ongoing uncertainty, for 2019 we have also added a new catastrophe aggregate XOL treaty, as described on slide 19
  - This treaty addresses qualifying PCS-designated events in North America, for which we incur losses of \$5mm or more, providing aggregate coverage of \$430mm, part of \$500mm of losses above an aggregate retention of \$1.3B
- Hurricane and earthquake events have \$250mm per occurrence cap
- We believe this new treaty provides a reasonable level of protection and an appropriate price

### ***Accounting***

- In terms of the accounting, there will be an impact on the underlying combined ratio in 2019 due to the effect of ceded premiums on total net earned premiums

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- Since the majority of any loss recoveries from this treaty will likely benefit our net catastrophe losses, which are excluded from underlying results, we expect about a 0.5 point impact on the full year underlying combined ratio, but a minimal impact on the full year total combined ratio
- Because the attachment point is \$1.3B, we also expect that any recoveries would likely be recorded in H2 and, accordingly, the impact on the combined ratio will likely be more pronounced in the early part of 2019
- Of course, the actual effect on our total combined ratio for 2019 will be impacted by the level of PCS events we experience

## ***Capital Management***

### ***Operating Cash Flows, Capital Ratios and Interest Rates***

- Turning to capital management, operating cash flows for the quarter of \$948mm were again very strong
- All our capital ratios were at or better-than-target levels and we ended the quarter with holding company liquidity of approximately \$1.4B
- Interest rates decreased modestly during Q4 and, accordingly, our net unrealized investment loss narrowed from \$447mm after-tax as of September 30 to \$113mm after-tax at year-end
- Adjusted book value per share, which excludes unrealized investment gains and losses, was \$87.27 at year-end, 5% higher than at the beginning of the year

### ***Dividends and Share Repurchases***

- We returned \$375mm of capital to our shareholders this quarter, comprising share repurchases of \$170mm and dividends of \$205mm
- For the year, we returned more than \$2.1B of capital to our shareholders through dividends and share repurchases
- Consistent with our capital management strategy, that level of return capital takes into consideration a variety of factors
  - For example, the increased level of capital in support of the nearly \$2.8B of premium growth we have generated over the last two years, the amount of earnings, and contributions to the pension plan
- And you'll recall that we made \$200mm contribution in September for tax planning purposes

## **Gregory C. Toczydlowski**

### ***Q4 Highlights***

#### ***Business Insurance***

- For Q4, Business Insurance produced \$391mm of segment income, down from \$637mm in the prior year quarter, bringing the full year total to \$1.64B, a 2% increase over 2017

#### ***Earnings***



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- Earnings for both the quarter and the year included the relatively high levels of catastrophe losses that Alan and Dan mentioned, as was the case in 2017
- Earnings for both the quarter and the year were positively impacted by strong profitability in workers' comp, our biggest product line, as well as higher overall business volumes that resulted from recent earned premium growth and increased operating leverage that has reduced our expense ratio
- Earnings were negatively impacted by a fourth quarter after-tax charge of about \$195mm or about \$245mm on a pre-tax basis related to higher commercial auto bodily injury loss activity
  - Of that amount, about \$155mm pre-tax reduced net favorable prior year reserve development
- The remaining \$90mm pre-tax represents the impact of the 2018 accident year and incorporates re-estimations for the first three quarters of the year

### ***Combined Ratio and Commercial Auto Losses***

- The corresponding combined ratio impacts were approximately 6.5 points on the segment combined ratio for the quarter, and a little more than 1.5 points on the segment combined ratio for the year
- The impacts on the underlying combined ratio from the adverse auto adjustments were approximately 2.5 points for the quarter and a little more than 0.5 point for the full year
- As we've discussed with you, in recent years we've reacted to higher commercial auto losses in different portions of our commercial auto book through various pricing, underwriting and reserving actions
- But during the recent quarter, data emerged that changed our view of the overall loss environment broadly across our commercial auto book

### ***Claim Development***

- We saw more of an increase in the rate of attorney involvement than we had anticipated and a lengthening in the claim development pattern
- As a consequence, we are experiencing a higher level of bodily injury severity than we anticipated
- Because we believe the factors we are experiencing are environmental, our primary plan of action going forward will be to push for more rate
- As we mentioned in the past, the auto line is where we've been getting the most rate over the last couple of years, but we need more of that
- It is important to remember that auto is typically part of an account solution for our Business Insurance customers
  - We generally provide them with some combination of workers' comp, property, general liability and/or other coverages
- Accordingly, we will use our extensive data and the analytics capabilities on an account-by-account basis to improve auto profitability as aligned and as part of the overall profitability of our product portfolio

### ***Underlying Combined Ratio***

- Turning back to the segment results, the underlying combined ratio of 95.4% for the quarter was 1.5 points higher than in the prior year

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- The loss ratio was about 3 points higher than last year, driven by the 2.5 points from auto
- The remaining 0.5 point is due to higher non-weather loss activity in our international businesses with the largest contributor to that coming from Lloyd's, partially offset by favorable variability in domestic loss activity
- The expense ratio for the quarter improved by 1.5 points, with about half of that improvement coming from lower expense dollars and the other half coming from higher premium volumes
  - As always, there are fluctuations in expenses from quarter-to-quarter, so we point to you that the full year expense ratio is a better indication of our run rate
- All in for the year a 95.7% underlying combined ratio, which included large losses which ran about a point over what we would have viewed as a more normal level

### ***Top Line and Production***

#### ***Net Written Premium Growth***

- Turning to top line and production, net written premium growth for the quarter was 3%, bringing the full year total to \$15B, almost \$700mm or 5% higher than in 2017
- We're pleased with our continued progress with our strategic initiatives and we remain encouraged with the feedback from our agent and broker partners that were focused on the right priorities
- In terms of domestic production, we achieved strong renewal premium change of 4.8% in the quarter, with renewal rate change of 1.6%, while retention remained high at 85%, a reflection of the quality of our book
- New business of \$488mm was up 3% from a year ago
  - We're pleased with these production results and continue to operate at a granular level of executing in our marketplace strategy to meet our return objectives with a thoughtful balance towards retaining our best business, improving pricing where it's needed, and pursuing attractive new business opportunities

### ***Select***

#### ***Renewal Premium Change***

- Turning to the individual businesses, in Select, renewal premium change and renewal rate picked up a bit, while retention remained strong at 82%
- New business was up 11% over the prior year quarter, as we continue to leverage our investments in technology and workflow initiatives
- In Middle Market, renewal premium change was 4.5% with renewal rate change consisted with last quarter at 1.5%, while retention remained historically high at 88%
- As Alan said, a record for Q4
- New business premiums of \$281mm were down a bit from a strong level in the prior year quarter

#### ***Core Commercial Accounts Business***

- In our core Commercial Accounts business, where our business and our initiatives are now fully rolled out, new business was up 17% for the quarter, while full year new business premiums of \$561mm were at the highest level in over a decade



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- In this business, we're pleased that the business centers and our strategic investments are having the intended impact
- Submission and quote activity are both up from the prior year, creating attractive top line opportunities

### ***Summary***

To sum up, we feel terrific about our execution in the marketplace and confident about how we're positioned going forward

Before I turn the call over to Tom to talk about Bond & Specialty results, I want to comment on our outlook for RPC and the underlying combined ratio since we will not be filing our 10-K for a few weeks

We expect RPC will remain positive in 2019 and at the levels broadly consistent with 2018

We expect the underlying combined ratio for the full year 2019 will be lower than in 2018, which assumes that large losses, primarily in the property line, returned to lower and more normal levels

Underneath that full year outlook, we expect the underlying combined ratio improvements to come in the second through fourth quarters of the year

## **Thomas M. Kunkel**

### ***Highlights***

#### ***Bond & Specialty***

- Bond & Specialty delivered another quarter of strong returns and growth
- Segment income of \$220mm nearly doubled from the prior year quarter, due primarily to higher underlying underwriting income and a higher level of net favorable prior year development
- The improvement in underlying income reflects the impact of a single surety loss in the prior year quarter and higher business volumes

#### ***Underlying Combined Ratio and Net Written Premiums***

- The underlying combined ratio was an excellent 78.1%
- Net written premiums for the quarter were up 8%, driven by strong growth in our Management Liability business and solid Surety production that was up slightly from the very strong prior year quarter
- In our domestic Management Liability business, our focus continues to be on retaining our high-quality business and targeting rate where needed, while pursuing attractive new business opportunities
- So, we are pleased that retention remained very strong at 89% for the quarter with a renewal premium change of 3.9 points
- New business of \$53mm was up 8% from the prior year quarter
  - These results reflect our extensive competitive advantages and solid marketplace execution
- We are a leading franchise in our specialty markets with long-term customer, agent and broker relationships across a national footprint

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- We've got exceptional talent and specialized industry expertise, extensive data and advanced analytics

### ***Investments***

- And while we have leading platforms and robust products, we continue to invest in strategic product, marketing and technology capabilities that will further extend our competitive advantages
- So, Bond & Specialty results were excellent
- We continue to feel great about our growth, returns and the opportunities that our strong market positions and competitive advantages present for the future

### ***2019 Outlook***

In terms of our 2019 outlook as compared to 2018, we expect RPC for our domestic Management Liability business to remain positive and broadly consistent and for the segment, the underlying combined ratio to be broadly consistent

For Surety, we expect 2019 net written premium to be slightly higher than it was in 2018

Due to the inherent lumpiness in Surety production, going forward we will no longer be including Surety net written premium in our outlook disclosure

## **Michael F. Klein**

### ***Highlights***

#### ***Personal Insurance***

- In Personal Insurance for the quarter, segment income was \$32mm, an improvement of \$82mm over the prior year quarter, and our combined ratio of 102.6% improved 6.1 points
- The lower combined ratio was driven by improved auto results, lower catastrophes and higher net favorable prior year reserve development

#### ***Segment Income and Net Written Premium Growth***

- For the full year, segment income of \$297mm and the combined ratio of 100.6% are also better than the prior year, driven by the same factors I referenced for the quarter
- Net written premium growth for Q4 and full year was 5% and 7%, respectively
- Our premium growth helped us achieve a 30 basis point improvement in our expense ratio for the full year
- Agency Automobile delivered another impressive quarter with a combined ratio of 95.3%, down 7.7 points from the prior year quarter, driven primarily by a lower underlying combined ratio

#### ***Underlying Margins***

- Underlying margins continued to improve due to earned pricing exceeding loss trend and frequency remaining better than expected
- These factors also resulted in favorable full year loss adjustments in the quarter that further contributed to a better loss ratio than we would have expected

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- The quarter also benefited from higher net favorable prior year reserve development, partially offset by higher catastrophes
- Recall that the prior year quarter included a benefit from the re-estimation of catastrophes, including Hurricane Harvey

### ***Combined Ratio***

- Our full year combined ratio for Agency Automobile of 94.2% was 10 points better than the prior year and returns were well within targets on both an overall and an underlying basis
- In light of these improvements, we continue to moderate renewal premium changes in this line as we seek to balance growth and profitability
- In Agency Homeowners & Other, Q4 combined ratio of 109.8% improved by more than 5 points, despite three significant catastrophes, the Camp and Woolsey wildfires in California and Hurricane Michael
- On an underlying basis, the combined ratio was 72.5% or 2.3 points higher than the prior year quarter, driven by continued elevation in non-weather-related losses which we noted in the prior quarter
- The full year combined ratio of 105.6% reflects a second consecutive year of very high catastrophe losses, which again accounted for approximately 24 points of the combined ratio
- The full year 2018 underlying combined ratio was 81.6%, 4.5 points higher than 2017, driven by higher levels of non-catastrophe weather and non-weather loss activity
  - Consistent with comments we made earlier this year, given this recent catastrophe and a non-catastrophe loss experience and our assumption that some of this elevated loss pressure will persist, we continue to implement granular pricing and underwriting actions to manage our exposure and improve results

### ***Quarterly Production***

- Turning to quarterly production, our Agency Automobile retention remained at a solid 84%, while renewal premium change of 6.3% continued to moderate consistent with our objectives, and new business was up 2% from the prior year quarter
- In Agency Homeowners & Other, we remain pleased with our momentum
- Renewal premium change was 3.9%, nearly 1 point higher than a year ago
- In addition, we delivered 6% growth in policies in force on strong retention of 86% and a 17% increase in new business

### ***Outlook***

#### ***Renewal Premium***

- Turning to our outlook for full year 2019, we expect renewal premium changes for Agency Automobile to be positive, but lower compared to 2018, while renewal premium changes for Agency Homeowners & Other should be positive and higher compared to 2018
- We expect the underlying combined ratio to be broadly consistent in Agency Automobile, Agency Homeowners & Other and for the Personal Insurance segment compared to 2018

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- This underlying combined ratio outlook includes the impact of the catastrophe aggregate reinsurance treaty that Dan mentioned earlier

### *Underlying Combined Ratio*

- In the outlook section of our 10-K, we'll provide some quarterly texture underneath our full year underlying combined ratio expectations, as quarter-to-quarter comparisons will likely vary throughout the year
- All in for the segment, in light of the improved results in Auto and the actions we are undertaking in Homeowners, we are pleased with our position and with the opportunity to profitably grow the business, while continuing to invest in new capabilities and explore innovative opportunities in an ever-changing marketplace

## QUESTION AND ANSWER SECTION

**<Q - Jay Gelb>:** First, I wanted to touch base on the California wildfires. Can you give us some more perspective on how you compare your 2018 exposure to 2017? And whether you feel that some type of public policy solution needs to be addressed here given the annual major exposure for the industry?

**<A - Alan D. Schnitzer>:** Yeah. Michael, you want to start?

**<A - Michael F. Klein>:** Yeah. I mean, I'll start with just sort of the view of the exposure and, Jay, maybe give you a little bit of a view into – a little more detail underneath what we'd mean when we talk about granular underwriting and pricing actions in response. So as we look at the California wildfires, clearly two significant years in a row of losses. I think the discussion and the debate about the environment is pretty broad and pretty public.

In terms of our response, we look at a handful of things. First, we look at our underwriting appetite and our view on terms and conditions in the marketplace, and we have taken actions. We had already taken action in 2017 to begin to restrict our new business underwriting appetite.

We've implemented further action that'll take effect later on this quarter in 2018 (sic) [2019] to further restrict that new business underwriting appetite and also to instill new business underwriting procedures, for example, further inspections around defensible space, as an example, that will again sort of tighten our new business underwriting appetite. We've also discussed with the Department of Insurance in California and begun to implement some non-renewal action in the state of California to address some of the more significant wildfire exposures in the portfolio.

And we are also in discussions with the Department about a filing to increase prices for homeowners in California. So, that gives you a little bit of texture underneath our response to wildfires, in particular, in the Homeowners book.

**<Q - Jay Gelb>:** That's helpful. Thank you. My second question was on the pace of share buybacks in the quarter. So if I look back over the past six quarters, the average quarterly buyback is around \$385mm, which was much higher than the \$170mm in Q4. So, I'm just trying to figure out if fourth quarter lower pace of buybacks was due to the elevated cat losses, or if there's some other factor going on we should take into account when we project buybacks in the years ahead.

**<A - Daniel S. Frey>:** Yeah, Jay, it's Dan. I'll take that. So, really, no change in our underlying philosophy. It's a consistent approach to capital management. And to look at any one quarter's worth of buybacks is probably a difficult way to look at it. We think about it more over time.

As you suggested and it would be true, in Q4, given the magnitude and the uncertainty related to the California wildfires, we did pull back a little bit on the level of share repurchase. But if you look at 2018 as a whole, we generated \$2.4B of core income. We returned a little bit more than \$2.1B through dividends and share buybacks. And remember, we made an additional \$200mm contribution to the pension plan at the end of Q3.

So, really, no change there. We're going to look at what level of capital we think we need to support the business, our projected levels of earnings going forward and the cash needs that we have for things like the pension plan and react

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accordingly. So, what we buy back in shares is going to be an outcome of those things, not really an objective in and of itself.

**<Q - Elyse B. Greenspan>**: My first question, just going to the Business Insurance, the underlying margin outlook for 2019. So if I go through some of your prepared remarks, you guys pointed to about 1 point of above-normal level of large losses in 2018 with an offset partially there from that coming back of the additional aggregate reinsurance cover that you guys are purchasing.

Now, I know that's 50BPS overall. I'm not sure if you can go into the specific details within Business Insurance as we think about the margin improvement this coming year. And then, as you set the margin outlook, are you guys assuming commercial auto gets better or worse when compared to how you guys ended up booking that business in accident year 2018?

**<A - Alan D. Schnitzer>**: Elyse, good morning, it's Alan. So, let me start and, Greg, you can jump in. So, we try not to get too quantitative on these outlooks. We try to keep it qualitative. There's a lot of estimates, a lot of judgments and a lot of things from period to period that are going to cause volatility. So, we try to give you a order of magnitude and direction.

Having said that, Greg did point out the, essentially, one point of property large losses that we would expect to return to more normal level. We do expect to address commercial auto over time, but a significant improvement in that is not otherwise reflected in the outlook for margins. And the overall impact of the new cat treaty on the BI underlying is relatively small. So, I think in broad strokes, that gives you sort of the way to think about the underlying outlook.

**<Q - Elyse B. Greenspan>**: Okay, great. And then, my second question in terms of thinking about the pricing outlooks, you guys pointed to fairly stable renewal premium change in 2019. So, when you think about price vs. exposure, can you give us a little bit of color of how you're seeing potentially thinking of seeing the different components?

And then, in Q4 that's how you kind of annualize really the uptick in rates that we saw in 2017 following on the record cat losses. Did you see anything different in the market as we started to annualize some of that price that would lead you to think maybe the push for price would go one way or the other in 2019?

**<A - Alan D. Schnitzer>**: Between the cat activity, Elyse, and the 01/01 reinsurance renewals, we'll all see together over time how that pricing plays out. We're not going to get any more granular on the outlook than what we have in the outlook section that'll be in the 10-K and that Greg shared.

Overall I would say that about 5 points of price changes is pretty good change. If you look back at just a history of price change in BI, a plus 5 would be in that historical context pretty good. And we've seen relatively stable allocation of that between exposure and rates. And so, we feel pretty good about that overall.

**<Q - Michael Zaremski>**: First question regards to the expense ratio improvement story, would you say this will be – is this in its early innings and could this be kind of a multiyear trend? It seems to have picked up in H2 in terms of the improvement?

**<A - Alan D. Schnitzer>**: Well, what's definitely ongoing for us is the thoughtful and disciplined management of both productivity and efficiency as a strategic effort and that goes across the entire company, everything we do. So, you will see more activity from us in that regard.

In terms of how it's going to come through in the numbers, you may or may not see that in the expense ratio. We've been saying for a while that our objective here is to create incremental operating leverage and we think that's very helpful to us, but really in the sense that it gives us a lot of flexibility, we can let that fall to the bottom line in the form of a low expense ratio, we can take those savings and reinvest it into important strategic initiatives or we can decide to put it into price without compromising our return objectives. So, it's definitely an ongoing objective for us across the company. I think Greg gave you a sense of what a run rate is for BI. And I don't know you want to, Dan?



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**<A - Daniel S. Frey>**: Yeah. And for the enterprise, I'd say similarly. If you look at the full year expense ratio, that's a pretty good indication of where we're probably heading going forward. It has improved quite a bit over the last couple of years. I think we've reached a level that we're more happy with. As Alan said, we'll continue to focus on productivity and efficiency, but I wouldn't expect to see a continued level of dramatic decrease in the expense ratio from the levels we're at now.

**<Q - Michael Zaremski>**: Okay, great. And my last follow-up question is in regards to workers' comp where margins remain healthy. If we think about work comp pricing, is that expected to become more or less of a headwind as 2019 progresses? And then, maybe you could also update us on loss cost trends in comps? Thanks.

**<A - Alan D. Schnitzer>**: Yeah, workers' comp, it's been under some pricing pressure, but completely rational given where the profitability of the line has been. We're not going to break out pricing outlook by line. We give it to you for the segment, but the profitability continues to be good and generally speaking, we would expect continued pressure in the comp line.

We've got no change in commentary on workers' comp loss trend from what we shared with you last quarter, which is to say that we – frequency and severity are – those are selections, those are picks for us that go into loss ratios. And then, data comes in over time and you look at reported activity over time and you compare that to what your selections are and decide if there is anything you're seeing that requires you to move off that. And as we shared last quarter and we would reiterate again, we're not seeing anything in the data that causes us to move off our loss picks.

**<Q - Kai Pan>**: My first question on the sort of new aggregate reinsurance program, so how much your cat loss would be in 2017 and 2018 if this program is applied retroactively?

**<A - Daniel S. Frey>**: Yeah, Kai, so we looked at modeling what things would look like going back a number of years and, in particular, over the last two years probably not surprisingly given the elevated level of cash, we would have seen a full recovery under the treaty in each of the last two years.

**<Q - Kai Pan>**: Is that safe to assume like your core loss ratio will be 50 basis point higher given you get aggregate cover, but your normalized, like, cat loss will be 50 basis point lower going forward?

**<A - Daniel S. Frey>**: Yeah, I wouldn't say that's an exact offset. I think if you go back to my comments, it's definitely about 0.5 point on the underlying combined ratio with the mitigating factor on the overall normal cat expectation to get us back to a pretty de minimis impact on the combined ratio all in, if we had a normal year of cats which as you know in the last seven years we haven't.

**<Q - Kai Pan>**: Okay. In other word, if cats this year come in lighter than your normal, you actually – the loss combined ratio will be worse than in a normal year.

**<A - Daniel S. Frey>**: The combined ratio would be worse because we'd had ceded away premiums and had no recovery, correct.

**<Q - Kai Pan>**: Okay. Great. My second question on personal line side and your prior guidance for 2019 was improvements in underlying margin in both Homeowners as well as Auto book. Michael just gave like new guidance 2019 pretty much consistent with 2018. Is that because 2018 actually improved better than you were previously expected, or you are reinvesting in the business for growth?

**<A - Michael F. Klein>**: Sure, Kai. It's Michael. I think it's – so it's actually a little bit of both, right? If you think about Auto, Auto came in better than we expected and so a broadly consistent outlook just reflects the update of the actual results compared to the outlook.

On the property side, it's a little bit of a change in the outlook. Again, we've been talking about catastrophes and non-catastrophe, weather and non-weather loss experience and talking about the fact that we continue to put more weight on more recent periods, as Dan mentioned. And so, the broadly consistent outlook for property is partly a reflection of that as well as the impact of the accounting of the new cat agg treaty which, as Dan just talked about, is a drag on underlying and, in particular, impacts the property line. So, those are kind of the pieces.



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**<Q - Amit Kumar>**: Maybe just a couple of quick questions for Michael Klein. Number one, if you go back, I guess, to Alan's opening remarks, it seems like a lot of the work which was needed in personal auto has been done. And I think the comment was that we got there ahead of expectations. Maybe just update us on the loss cost trend environment out there and maybe the trajectory of rate filings.

**<A - Michael F. Klein>**: Sure, Amit. So, I think loss cost trend fairly consistent with what we've talked about, right? We see continued severity trend particularly in collision and physical damage, increased cost to repair vehicles and again many of those dynamics we see as being relatively consistent with what we would have talked about a quarter ago. There's been some commentary about a little bit less pressure on bodily injury loss cost trend in the environment.

Again, I think when you put it all together and combine it with our view on frequency, I would say it's consistent with Alan's comments earlier of we have a pick, we observe results and we sort of see most of that as variation around the loss cost trend we've estimated and so don't see a significant change in our loss trend outlook there. In terms of outlook for price change going forward, again, our RPC outlook for auto is that RPC will remain positive, but be lower in 2019 than it was in 2018.

**<Q - Amit Kumar>**: That's helpful. The only other question I had was on the press release on Lyft. And I think Lyft has 1.4mm or so drivers. And I was curious, if you could just maybe broadly talk about this opportunity. How we as outsiders should sort of handicap this going forward?

**<A - Alan D. Schnitzer>**: Yeah, Amit, on Lyft we think it's an exciting opportunity for us to participate in a changing economy. It's a service offering for them. We wouldn't expect from an economic perspective for it to meaningfully move the numbers in the near term. But it's a great partner and we're excited to work with them and excited to bring our leading claim capabilities to benefit for them.

**<Q - Amit Kumar>**: And any thoughts on expanding into another TNCs down the road?

**<A - Alan D. Schnitzer>**: We don't have anything to announce at the moment. We're always thinking about whether there are opportunities for us to participate in an evolving economy and we'll continue to do that as we think about innovation and what insurance means in a changing world.

**<Q - Brian Meredith>**: A couple quick questions here for you. First, just going back to the cat loads or the cat treaty that Kai was talking about. Is there a simple way to think about this, kind of going forward should we kind of assume \$1.3B cat load for you guys? Is that kind of a good way to think about it?

**<A - Daniel S. Frey>**: Brian, it's Dan. So, I'll say we don't give earnings guidance and so we won't give guidance on the specific pieces of the components that go into earnings. You could see historically we'll disclose from time to time in the proxy what our expected level of catastrophes had been on sort of a backwards-looking basis.

You should take that number and probably think about it trending up over time for two reasons. One is we've seen growth in the premium volume and the overall exposure level in the business. And two, as we mentioned in my comments, a little bit more weight on recent periods that gives us a bit of an uptick in terms of our view of each dollar of those premiums that would need to go into cat. But I'm going to avoid giving a specific number.

**<Q - Brian Meredith>**: Got you. Great. And then my second question, I'm just curious, you guys had really good, strong new business growth in your Select business, small commercial. I'm just curious does that have any pressure on your underlying loss ratios when you're seeing that type of new business growth?

**<A - Gregory C. Toczydlowski>**: Hey, Brian, this is Greg. Yeah. In the Select business, you can see the 11% new business growth y-over-y. We feel terrific about that growth. We've been spending quite a bit of investment in the technology, in the workflow and the product management across all of the Select business. You can see the quality of the book looks really good with really strong retentions in the 82%, 83% range. So, we haven't seen any meaningful deterioration in the underlying based on that new business.

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**<Q - Brian Meredith>**: Great. So, there's really – like in auto, you'll see that tenure impact, you don't get that in small commercial?

**<A - Gregory C. Toczydlowski>**: Not as much just because you have the comp, you have the property, the GL in the auto in addition to it.

**<Q - Ryan J. Tunis>**: First question just for Alan. Looking at the 95.7% underlying combined ratio in Business Insurance, we factor in some elevated large loss activity, but then you throw in kind of a normal cat load in the 3 point to 3.5 point range. It feels like we're running at a normalized level here at like 98%, which is only a 2% underwriting margin. That doesn't feel like a double-digit ROE. I'm curious if there's a level on the combined ratio where you'd be looking to kind of hold the line, if there's a place we should be thinking about where you get a little bit more of a sense of urgency around rate increases. Thanks.

**<A - Alan D. Schnitzer>**: Yeah. Ryan, I'm not going to get into calculating those returns with you. And clearly, there's been some headwinds in pockets of BI, right? We've talked about the commercial auto. We've talked about large losses. Greg mentioned today some of the pressure outside the United States and the largest piece of that coming from Lloyd's. So, there are some aspects of that in which we would expect improvement over time.

And we continue to get the 5 points of rate. So, there are margin opportunities outside of the pure rate trend dynamic. Again, the BI large losses outside the U.S., commercial auto, the fixed income NII helps as those rates are where they are and the bond portfolio turns over. Again, you've heard us talk about expense leverage, that's been pretty good.

And just in terms of earnings dollars, the volume helps as well. So, we're not feeling badly at all about where the returns are underlying basis and where they're trending. And if you take a step back and look at the whole company, Ryan, and you could do this math as well as we do, but if you take out prior year development and you put in whatever you think is normal for cats, you get a return that's somewhere in the low-double digits.

And given where the 10-year Treasury is today, again, that doesn't feel altogether bad to us, particularly with some opportunities we would see going forward. And one of the benefits of having a company this size is you've got a diversified portfolio of businesses. So, we always feel a sense of urgency around here. There's no question about that. We are, at the heart of who we are, optimizers and everything is not perfect. We're going to work with a sense of urgency to optimize it, but there's no sense at all here that there are problems.

**<A - Gregory C. Toczydlowski>**: Ryan, one thing I would add – this is Greg – is when you do that math, keep in mind that we do have different combined ratio targets depending on what the net investment income has generated based on those product lines. So, think workers' comp where we have the largest weight, where we could run a higher combined ratio relative to a shorter tail line, like property. So, I'd just ask you to keep that in mind also when you do that math.

**<Q - Ryan J. Tunis>**: Understood. And then my follow-up is, I get the commercial auto, the increase [ph] was there just this (00:53:50) more lawyer involvement. But what's not completely clear to me is why that wouldn't translate to some elevated trend in the other liability lines. So just curious, what gives you guys comfort that the things you're seeing in auto are auto-specific and we shouldn't be seeing more broadly in general liability?

**<A - Alan D. Schnitzer>**: Yeah. So, Ryan, we certainly watch that carefully, and just to walk you through the lines and our thinking on it, so you've got GL, think GL large for a second, excess umbrella, and I would put Management Liability in this group, too. You already have very, very high levels of representation in those claims. So, that's again already a high percentage, already pretty active there. On the smaller side, the GL small, we are seeing a little bit more of the attorney rep, but it doesn't seem to be quite as active as it is in the auto.

And we just speculate that's probably not as attractive of a business opportunity for the plaintiffs' bar. You've got a much more varied portfolio of claims there, harder to make the case in many cases. So, it's just not as low-hanging fruit, at least for now. When you get into the really small, when you see the liability component of CMP, again we have seen the pressure. This theme, in other words, does cross the liability lines, but to a lesser degree than we see in auto.

**<Q - Meyer Shields>**: I'm probably beating on a dead horse here, but when you discuss the impact on the core loss ratio from the incremental treaty, that's completely separate from the 1 point of elevated large property losses. Do I

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have that right?

<A - **Daniel S. Frey**>: Yeah, two totally separate topics.

<Q - **Meyer Shields**>: Okay. And second, the 50 basis point increase that you mentioned, that's not compared to 2018, that's compared to what 2019 would be otherwise. Is that fair?

<A - **Daniel S. Frey**>: It is compared to what 2019 would otherwise have been, correct.

<Q - **Larry Greenberg**>: Just on investment income, wondering if there's anything to say about non-fixed income in Q1, given the volatility in equity markets and fixed income markets in Q4. And then, just given some of the spread widening that took place in Q4, have you done any asset reallocations, given some of that volatility or what some might view as opportunity?

<A - **William Herbert Heyman**>: Hi, Larry. It's Bill Heyman. Let me take them in reverse order. With respect to the second question, we haven't really changed our strategy. We regard increased spreads as you say as opportunity, assuming our credit judgment is good which historically it has been. As you know, the yield on the 10-year Treasury dropped from 3.06% at the end of the quarter to about 2.69% at the end of the year. It's back up to about 2.75%.

So, that's been partly compensated for by spread widening. So, we're still pretty comfortable with what we're seeing out there. In terms of private equity, we occasionally make internal projections of what we think the portfolio will throw up, and we have been notoriously inaccurate. We're generally far too pessimistic. I agree that the developments in public equity markets in Q4 taken alone wouldn't augur well for 2019, but we've seen similar situations where developments like that have been followed by perfectly good years. So, your guess is probably as good as ours.

<Q - **Yaron Kinar**>: Just wanted to go back to Business Insurance and the underlying combined ratio there. So, I think you said that you had about a 1 percentage point of non-cat large losses in 2018. I think that was roughly the same number that you had in 2017. So, if I look at the underlying combined ratio, it seems like there was a little bit of deterioration y-over-y. Maybe if I adjust for the commercial auto, it's flat to slightly worse. Can you maybe talk about what is driving that this year? And then, what gives you the confidence that 2019's numbers would look better?

<A - **Gregory C. Toczydlowski**>: Hi, Yaron. This is Greg. Number one, you're correct that we do our best job possible of trying to normalize our large losses and that's how we price and manage the business and we were over expectations in 2017. And as I disclosed in my prepared comments, we were also over our normal expectations for 2018 and that was roughly the 1 point.

The difference and maybe a point to the full year underlying combined ratio where you can see an 80BPS difference between the full year 2017 and the full year 2018, and again in my prepared comments, I mentioned auto driving a little bit more than 0.5 point there. The international business is also driving about a little more than 0.5 point and that's predominantly driven based on the Lloyd's business. And then, we had, as I disclosed, some favorable expense activity that offsets some of that. So, those are all the pieces that get you there.

<Q - **Yaron Kinar**>: So, if you expect the expense ratio to maybe not improve to the same magnitude in 2019 and you still expect some improvement in 2019 for the overall underlying combined ratio, can you maybe talk about where that improvement will be coming from given the current loss trends?

<A - **Gregory C. Toczydlowski**>: It's basically that 1 point of large losses.

<Q - **Yaron Kinar**>: Okay. Okay. And then, maybe a quick one on the prior year development. It sounds from the scripted comments that the slowdown in net prior year favorable development was really driven by an increase in adverse development and not so much by maybe a decrease in gross favorable development. Is that fair?

<A - **Alan D. Schnitzer**>: Let me just start and then I'll key to Dan. The question almost implied that there's a trend in prior year development. There is no trend in prior year development. Our obligation at the end of every quarter is to come up with management's best estimate and we do that. And then, every quarter we go through the process of reevaluating our reserves and making adjustments where we feel like we need to. For any given period, the level of

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prior year development is just a net of those adjustments to best estimates.

<A - Daniel S. Frey>: Yeah. I'd echo that which is why I think we're pretty careful to always characterize it as net favorable prior year reserve development or net unfavorable prior year reserve development because they're our business lines in accident years that go both ways.

And if you step back and look at the full year, a little more than \$0.5B of pre-tax net favorable prior year reserve development, not that big in the scheme of the balance sheet. If you look at the right side of the balance sheet, you're seeing loss and loss adjustment expense reserves of around \$50B. So, we're pretty good at estimating losses, but every quarter we're going to update and refine them

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