Company Name: Travelers
Company Ticker: TRV US
Date: 2016-10-20
Event Description: Q3 2016 Earnings Call

Market Cap: 30,777.77
Current PX: 108.35
YTD Change($): -4.51
YTD Change(%): -3.996

Bloomberg Estimates - EPS
Current Quarter: 2.590
Current Year: 9.509
Bloomberg Estimates - Sales
Current Quarter: 6891.625
Current Year: 27135.778

# Q3 2016 Earnings Call

## Company Participants

- Gabriella Nawi
- Alan D. Schnitzer
- Jay S. Benet
- Brian William MacLean
- Michael F. Klein

## Other Participants

- Kai Pan
- Randy Binner
- Amit Kumar
- Elyse B. Greenspan
- Jay Gelb
- Charles Joseph Sebaski
- Michael Nannizzi
- Jay Arman Cohen
- Ryan J. Tunis
- Sarah E. DeWitt
- Larry Greenberg

## MANAGEMENT DISCUSSION SECTION

### Gabriella Nawi

#### *Financial Measures*

In our remarks and responses to question, we may mention some non-GAAP financial measures

Reconciliations are included in our recent earnings press release, financial supplement, and other materials that are available in the Investor section on our website, travelers.com

### Alan D. Schnitzer

#### *Opening Comments*

Unfortunately, I need to start on a sad note this morning

This is my fourth earnings call as CEO, but the first since we lost our friend, Jay Fishman

I know I'm not alone in feeling his loss

Many of you sent thoughts and prayers

- Thank you, we appreciate it

All of us at Travelers take a great deal of comfort in knowing that we're carrying on in a culture of excellence, performance and innovation that Jay left behind

It outlives him

It's an enormous part of his legacy, and we're grateful for it

To sum it up in Jay's words, we all feel remarkably fortunate to have known him and worked with him

## *Q3 Results*

### *Operating Income and ROE*

- At this point, Jay would, of course, demand that we get back to work, so let's get to the results
- This morning we reported third quarter operating income of $701mm or $2.40 per share, and operating return on equity of 12.5%

### *Underwriting Results*

- Our underwriting results remained strong, as reflected in our 92.9% combined ratio, and our net investment income was down only slightly from the prior-year quarter
- Across all our businesses, Q3 was another example of the successful execution of our marketplace strategies
  - And generally speaking, underlying trends have not changed

### *Pricing and Retention*

#### *Commercial Businesses*

- Pricing and retention remain stable and consistent with recent trends
- In our commercial businesses, retention continues to be at historic highs with positive renewal premium change

#### *Domestic Business Insurance*

- In domestic Business Insurance, renewal rate change has improved a little bit for two sequential quarters, led by our Middle Market business where rate has also increased sequentially month to month in the quarter
  - Underneath that Middle Market, we again achieved rate gains in excess of loss trend on our poorest performing segments
- We also benefited from a mix shift in our better performing segments as the loss ratio on the retained business in those segments was better than the loss ratio on non-renewed business, the result of managing the business on a very granular level

#### *Personal Insurance*

- In Personal Insurance, we continued to achieve strong top line growth in the quarter with continued growth in policies enforced in both our Agency Auto and Homeowners businesses

- We believe that being able to deliver an account solution to our customers and agents is an important and meaningful competitive advantage
    - More than half of our personalized premium comes from accounts for which we write both auto and home policies
- When we write both the auto and the home, we can be more competitive in the pricing for our customers since it creates higher customer lifetime value for us through higher retentions and a more complete view of the risk
- While we managed the profitability of the auto and home lines independently, we also managed to a portfolio return
- We'll be focusing more than usual on the performance of the auto business this morning, but we shouldn't lose sight of the fact that the all-in combined ratio for our personalized business was 94.1% for the nine months, a very good result

### *Factors Influencing Underwriting Results*

- Turning back to consolidated results for all three segments, underwriting results for the quarter were impacted by lower levels of net favorable prior-year reserve development, higher non-cat weather-related losses, and in personal lines, higher than expected losses associated with auto bodily injury
- Jay Benet will have more to say about the prior-year development
- The higher bodily injury severity in personal auto had $29mm after-tax impact on the current accident year, $20mm of which related to Q1 and second quarter, a modest impact
    - Brian will discuss it in more detail
- I'd like to highlight that we believe that the increase in auto bodily severity is an environmental and not specific to the Quantum Auto 2.0 product, as we see it across all our Personal Insurance auto programs and in our commercial auto and trucking books
    - In anticipation of this trend continuing, we are addressing it through pricing, and we believe that the product remains positioned to deliver target returns over time
- I'd also add that it's important to understand that when trends change in any part of our business, and they will, what's important is having the ability to recognize it and react quickly
- We believe our leading analytics give us an important advantage in this regard

### *Net Investment Income*

- In terms of net investment income, fixed income returns declined in line with our expectations, and we were pleased to see an improvement in our returns from the non-fixed income portfolio
    - All of this resulted in a very strong operating return on equity in the quarter and YTD
- Given the continued historically low interest rate environment and the other items impacting our results this quarter, we're particularly pleased with that result

### *Future Strategy*

- In terms of the strategy going forward, you can expect more of the same

- In this low interest rate environment, where underwriting matters more than ever, we have significant competitive advantages in our data and analytics expertise, claim and risk control capabilities and talent
- Combining that with our active capital management strategy, we remain well positioned to continue to deliver industry-leading returns over time

## Jay S. Benet

### *Financial Results*

#### *Operating Income*

- Consistent with what we had said about the first two quarters of the year, we are once again pleased with our results this quarter: operating income of $701mm and operating return on equity of 12.5%, notwithstanding their being lower than the prior-year quarter
- As in H1, these reductions did not result from fundamental changes in business trends
    - Rather, as Alan said, they were primarily driven by lower net favorable prior-year reserve development and higher non-cat weather-related losses

#### *Net Investment Income*

- Net investment income, which totaled $472mm after-tax, was down only $12mm from the prior-year quarter, entirely due to the continuing impact of the low interest rate environment on fixed income returns

#### *Non-Fixed Income Returns*

- Non-fixed income returns improved from recent quarters to a level that was slightly higher than the prior-year quarter
    - We continued to experience net favorable prior-year reserve development on a consolidated basis, which totaled $39mm pre-tax, down from $199mm pre-tax in the prior-year quarter

#### *Business and International Insurance*

- In Business and International Insurance, net favorable development of $19mm pre-tax, primarily resulted from better than expected loss experience in GL, ex-A&E, for accident years 2006 and prior, and for 2014 and 2015, and workers' comp for accident years 2006 and prior and for 2015, and in commercial auto for accident years 2011 and prior, partially offset by $225mm increase to our asbestos reserves
- The asbestos reserve increased related to a broad number of policy holders and was driven by higher estimates for projected settlement and defense costs from mesothelioma claims than we had previously assumed
    - Notwithstanding these higher cost estimates, our overall view of the underlying asbestos environment remained essentially unchanged from recent periods

#### *Bond & Specialty Insurance*

- In Bond & Specialty Insurance, net favorable development of $41mm pre-tax primarily resulted from better than expected loss experience in fidelity and surety for accident years 2009 through 2015, while reserve development in Personal Insurance, which remained favorable to date, Homeowners and Other had a modest amount of unfavorable development this quarter, $21mm pre-tax

  - Primarily resulting from higher than expected loss experience for a small number of liability claims related to the 2013 and 2014 accident years

- Notwithstanding this current quarter activity, the Homeowners and Other 2013 and 2014 accident years have developed net favorably since their inception
- I should also point out that the unfavorable development in Homeowners and Other this quarter did not result from any change in our reserve setting philosophy or methodologies
- As we've stated in the past and in our 10-Qs and 10-Ks, we always book to our best estimates, and we use our advanced data and analytics to respond as quickly as we can to new information

### *Reserve Development*

- By its nature, reserve development is episodic and in lines like Homeowners and Other, much of it is historically related to truing up estimated losses caused by storm damage
  - The number of severe storms in recent reporting periods, their timing in relation to the reporting period in which they occurred, the causes and severity of the losses such as wind vs. water, the actual size and extent of any hail, the actual amount of additional living expenses provided, et cetera, has and will cause significant fluctuations in reserve development from period to period
  - And changes in levels of reserve development should not be regarded as a "trend"

### *Ex-A&E*

- Ex-A&E, on a combined stat 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 YTD
- While CMP currently looks as if it developed unfavorably YTD by $37mm, as I pointed out in Q2, there was offsetting favorable development in the property product line as Middle Market property losses that had been recorded in the property line at year-end 2015 were subsequently determined to be CMP-related

### *Operating Cash Flow*

- Operating cash flows of $1.77B were very strong this quarter
- We ended the quarter with holding company liquidity of $1.8B, and all of our capital ratios remained at or better than their target levels

### *Net Unrealized Investment Gains*

- Net unrealized investment gains were approximately $3.1B pre-tax, or $2B after-tax, up from $2B and $1.3B, respectively, at the beginning of the year, while book value per share of $86.04 and adjusted book value per share of $78.82 increased 8% and 5%, respectively, also from the beginning of the year

### *Shareholders Return*

- We continued to generate much more capital than we need to support our businesses, and consistent with our ongoing capital management strategy, we returned $755mm of excess capital to our shareholders this quarter through dividends of $193mm and share repurchases of $562mm

- And YTD, we returned nearly $2.3B to our shareholders through dividends and share repurchases

## Brian William MacLean

### *Business Results*

#### *Business and International Insurance*

- I'll start with Business and International Insurance, where we had another good quarter with strong returns and production results
- We were very pleased that retention remained at historically high levels while we achieved positive renewal premium change and solid new business results
- Turning to the financial results for the segment, operating income was $457mm with a combined ratio of 96.1%
- The underlying combined ratio was 94.7%, up 2.2 points compared to the prior year
  - The increase in the underlying loss ratio was driven primarily by non-cat weather which was higher than both the prior-year quarter and our expectation, and about 0.75 point impact from loss cost trends in excess of earned pricing
  - These were partially offset by lower large loss activity

#### *Production*

- Turning to production, given the returns that we are generating in the segment, our focus continues to be on retention
  - And so we're very pleased that retention for our domestic business remained at 85% for the quarter
- Renewal premium change was nearly 3 points, including renewal rate change that was slightly positive, while we produced new business of $431mm

#### *Select Business*

- Turning to the individual businesses, in Select, retention continued to remain strong at 82%, while renewal premium change was over 5 points and we're quite pleased that new business was up 7% over the prior year
- In Middle Market, retention of 87% remained at a historical high, with renewal premium change of over 2 points
- New business dollars were essentially consistent with prior year, with submissions, quotes and the number of new accounts written in the quarter up
  - The average size of accounts written was down slightly vs. last year, but we're encouraged by the increased activity

#### *Other Business Insurance*

- In Other Business Insurance on page 12, you can see that rate and RPC both improved in the quarter and retention remained strong

- New business of $124mm was down compared to Q3 2015, reflecting continued disciplined underwriting for larger accounts where we don't feel that market pricing will allow us to achieve target returns

### *International*

- In International, we achieved 82% retention with positive renewal premium change and a 46% increase in new business volume, resulting in a 4% increase in net written premiums, excluding the impact of foreign exchange
- These increases were driven by our new global construction and renewable energy groups in Lloyds, and continued success in Canada with our recently introduced personal lines auto product, Optima
  - So, all in, a good quarter for the segment with strong production and profitability

### *Bond & Specialty Insurance*

- Turning to Bond & Specialty Insurance, this business continues to perform exceptionally well
- Operating income for the quarter of $146mm was down from the prior-year quarter, driven primarily by a lower level of net favorable prior-year reserve development
  - The underlying combined ratio of 77.4% remained strong and well within our target return levels
- On top line, net written premiums for the quarter were flat to the prior year
- Across our management liability businesses, retention remained at historically high levels and new business volumes were up as we continued to execute our strategy of retaining our best accounts and writing more business in our return adequate product segments
  - So Bond & Specialty results remain terrific, and we continue to feel great about the segment's performance and execution in the marketplace

### *Personal Insurance*

- I'll now turn to Personal Insurance
- Alan touched on the highlights
- We once again had a solid quarter with a combined ratio of 92.9% and net written premiums reaching an all-time high of $2.2B
- Auto continues to be the bigger factor driving the growth, but Homeowners' growth continues to accelerate as well
  - And both products generated strong retentions and new business levels
- We believe being a portfolio provider sets us apart in the marketplace, and we remain pleased with the financial performance of the overall segment
- Q3 underlying combined ratio of 91% was impacted by an adjustment to our Auto loss ratio that I'll discuss in a moment, and YTD underlying combined ratio of 88.9% remains strong, a very good result

### *Auto Profitability*

- Looking at Auto profitability, the underlying combined ratio for the quarter was 101.1%, up about 5 points from the prior year

- About 4.5 points of this increase was due to the YTD impact of an adjustment we made to the loss ratio related to bodily injury severity for 2016, which for the most part reflects higher severity in our smaller claims
- About 3 points of that increase relates to the first two quarters of this year
- With respect to this change I want to emphasize a few points:
    - First, as Alan said, we believe this is environmental in nature, that is, we are seeing it across all our auto products, both in personal and commercial lines
    - Second, what we are seeing is from the last four accident quarters and for a long tail line like auto liability that is very recent activity
    - Lastly, while we have been closely watching and talking to you about auto bodily injury severity for a number of years and reflecting it in our underwriting claim, pricing and reserving, recently severity has increased to a level that's a little more than we anticipated
- In response to this recent trend, we're taking the appropriate pricing actions

### *Auto Frequency*

- Looking at auto frequency, overall YTD 2016 frequency is generally in line with our long-term view
- That said, we have seen some texture within the year
- Collision frequency for H1 was favorable to our long-term view, while Q3 was unfavorable
- We believe the frequency volatility that we've seen in 2016 reflects normal period-to-period fluctuations
- As always, we are watching the data closely and will adjust if and when appropriate, but as of now we have not changed our long-term frequency expectations
- For perspective, the net adjustments we have made YTD related to collision frequency have less than $3mm after-tax unfavorable impact
    - Normally we wouldn't talk about a variance this small, but given the amount of recent industry discussion on the topic, we felt the disclosure would be helpful
- We've also been talking to you about the impact of tenure on our auto loss ratio for a while

### *Impact of Tenure on Loss Ratio*

- So let me take a few minutes to walk you through the slide on page 19 that we've added to demonstrate the impact of tenure on a loss ratio
- Exhibit 1 in the upper left illustrates the underlying dynamic that drives the impact of tenure
- Namely, that the loss ratio of a given cohort of business improves over time as poor performing business defects and pricing segmentation improves on the business that is retained
- Moving to exhibits 2 through 4, of course, any given calendar period consists of a number of cohorts ranging from new to multiple years of age
    - In these exhibits, the curved line represents loss ratio by tenure, think policy year
- The vertical bars represent premium volume remaining for those years, and the horizontal line is the calendar period loss ratio for all cohorts, which is a premium weighted average of the loss ratio of each cohort of business during that calendar period

- Exhibit 2 demonstrates a steady state growth scenario, think base case
  - During periods of consistent growth, the newer cohorts blend with the older ones and the calendar period loss experience will generate the target loss ratio
- Exhibit 3 illustrates the impact of a higher new business growth environment, where calendar period results are more heavily influenced by the newer cohorts of business that naturally have a higher loss ratio
  - This drives the calendar period loss ratio higher
- Exhibit 4 illustrates a return to steady state growth at the higher levels of premium volume
  - The balance between the older and newer cohorts improves, the calendar period loss ratio returns to target levels and in addition increased volume brings additional profit dollars
- So obviously these are theoretical illustrations that raise a few important questions for our business
  - First, what is the current impact of tenure on our auto loss ratio? And the answer is that our loss ratio is about 2 points higher than it would've been excluding this tenure impact
  - Second, do we believe that our Quantum Auto 2.0 product is performing as expected? And the answer to this is that it has been maturing in line with our loss ratio expectations
- Of course, we manage the business at a very granular level and monitor the book across multiple dimensions; for example, loss costs, retention and other proxies of profitability such as limits profile, prior experience and insurance score
- In aggregate, based on all the data we have, we believe this business is on track to produce appropriate returns
- We clearly realize that the product is still relatively new in the marketplace, having launched late in 2013, but three years in, we are very pleased with the performance

### *Homeowners Business*

- Turning to Homeowners, the underlying combined ratio for the quarter was a very strong 78.3%, although up about 7 points y-over-y due primarily to an unusually low amount of non-catastrophe weather-related losses last year
- The current quarter result is in line with our expectations, and we remain very pleased with the returns we're seeing in this business
  - So stepping back from a lot of moving pieces in the quarter, this is a franchise with a YTD combined ratio of 94.1% and 9% premium growth, results we feel very good about

# QUESTION AND ANSWER SECTION

**<Q - Kai Pan>**: First, our condolences to the Travelers' family. My first question is on the personal auto. Thanks for the detailed explanation. If I look at the y-over-y like for the first nine months, the deterioration by 2.6 points underlying combined ratio, you explained about 2 points coming from new business and another 1 point may be coming from the rising severity we estimate is about $29mm for the first nine months. Is that right way to think about it? Is that these two factors has driven the underlying combined ratio going higher? And then if you see your outlook, you're expecting actually improvements in the combined ratio into 2017. I just wonder what's that coming from? Is that coming from less drag from the new business penalty going forward or anything else? Thanks.

**<A - Brian William MacLean>**: So, Kai, it's Brian MacLean, and let me clarify just a couple of things. So the two points that I referenced in my comments are that the loss ratio is elevated. You went through the delta y-over-y that's about 1 point. So if you're thinking of where our combined ratio or loss ratio is relative to what it should be without it, it's 200BPS but the y-over-y change only 100BPS.

Another thing that when speaking a lot of our commentary was to loss ratio. And importantly, remember in this business, as we rolled out Quantum, it was really built around a pretty decent change to our cost structure. So the expense ratio is seeing some benefit, and going forward we'll see more as volume increases. So if you're talking combined ratio, there's an expense ratio good guy in there. The basic dynamics of what you were mentioning though are the right components.

**<A - Alan D. Schnitzer>**: And, Kai, it's Alan. As to the outlook, you're right, we did suggest it was going down slightly. And we identified in the outlook three moving pieces: one, a lower level of loss activity just returning to a more normal level; rate vs. trend given our outlook for rate and loss trend; and that's offset by the continued adverse impact of tenure.

**<Q - Kai Pan>**: Okay, that's great. Then a follow-up question, do you have any early indication from potential losses from Hurricane Matthew in Q4.

**<A - Alan D. Schnitzer>**: Yeah, Kai, we anticipated that and we're happy to give you an early range. But I do want to indicate that we're just three weeks post storm so it is still early for us. And it could be influenced from here to the end of the quarter by large BI claims that come up that we haven't identified yet. So we would say our range at this point is $75mm to $150mm and that's pre-tax. And, again, the risk factor going forward is going to be claims that we haven't seen or don't know of yet, but they could come in between now and the end of the quarter.

**<Q - Randy Binner>**: I wanted to just talk on severity and just to understand what it is a little bit better. Is it that the actual injury and the bodily injury and these accidents is worse? Or is it a process by which claims are being used more to cover various medical conditions, or is it a function of more aggressive trial bar? Or is it all three? Just kind of trying to understand what it is that's actually driving the severity higher on the auto?

**<A - Alan D. Schnitzer>**: Yes. Randy, it's Alan. I'd say you got it right across the board. Generally speaking we are seeing a higher level of severity generally in the smaller claims, and it's a little bit more aggressive litigation and a little bit more complexity in those smaller cases. You can't turn on the TV without seeing some kind of advertisement from the trial bar. So it's hard to pinpoint it with a high degree of specificity, but generally all those things.

**<Q - Randy Binner>**: But the follow-up then is you mentioned that you're seeing it across your commercial and personal auto book in smaller case if I got that right. So what's the similarity across the classes? And is it more people being involved in accidents? Is that a piece of it too?

**<A - Alan D. Schnitzer>**: In some cases there are more occupants of the vehicles and in some cases that is driving it. And generally we can just tell you that we see the same phenomenon across both books, commercial and personal.

**<Q - Amit Kumar>**: I was wondering, the first question is, if you could better help me understand the auto BI uptake. You've obviously cited outside environmental factors. Yet there was a modest reestimation for H1 2016. Why would that not be a Travelers-specific issue? And if you look at other companies such as Allstate and The Hartford who’ve had similar issues, what we've learned is this is rarely a one-quarter issue. So maybe just help me understand why it's external and not internal.

**<A - Brian William MacLean>**: So this is Brian. Let me do a couple pieces of that. First, when we look at claim experience across our business, and we see it in personal lines, in recently written business, legacy long-tenured business across pretty much the entire spectrum of customer profile, and we see it in our commercial business from small to large trucking. That tells us that this isn’t something specific to our underwriting some product we have in marketplace. So it would be in our view highly unlikely that we’d see it that broad-based and have it be just our issue.

I would completely agree with the comment that auto liability, any liability line of business, it’s hard to see clarity in the near term, and so we’re constantly watching these events. I am very confident, though that we’re as on top of this as anybody. And for reference, I’d just comment – I’d say look back to commentary we had going back as far as 2011, 2012 into 2013, we were talking about liability trends, what we were seeing in the auto product relative to distracted driving, relative to increased litigation, relative to increased utilization of medical diagnostic tools, and the impacts on bodily injury. And to be totally honest, there were a couple years there where we were getting a lot of questions from folks on this call about why are you seeing something that no one else is talking about. And over the years I think everybody has been talking about it.

So I'm not saying that we've got it perfectly right or we ever do, but we're looking at the trends very, very closely. And what we've seen in the last three or four accident quarters has been somewhat of an elevation, as we said, particularly on the lower end of the claim size but driving more complexity, so…

**<A - Alan D. Schnitzer>**: I would also add, it didn't take us completely by surprise. Our loss picks had anticipated some increased severity. This was just a tick higher than we anticipated.

**<Q - Amit Kumar>**: My second question is in the opening comments you talked about pricing actions. Does that indicate that we should anticipate a slowdown in Quantum growth? Why or why not? Thanks.

**<A - Brian William MacLean>**: So I'm going to let Michael Klein jump in on that one.

**<A - Michael F. Klein>**: Sure. This is Michael. I would say, the impact on growth will depend upon how our pricing actions compare to those taken in the marketplace. What I can tell you is – and it's very incremental, but if you look at the production statistics in the webcast, you'll see our pricing rise q-over-q relative to where we were in 2015 and yet the growth has increased. So our view of where we sit currently is while we have taken some price increases above where we were running, our competitive position so far has actually remained consistent, if not improved, and you're seeing actually increased growth this quarter relative to the couple quarters before.

To the degree that we're right about this being environmental and we think it is, we believe the marketplace will respond, and we think that our pricing actions will be absorbed in the market. Could it have an impact on growth? It certainly could. But, again, to the degree we think it's environmental, we think we'll be in line with what's going on in the marketplace.

**<Q - Amit Kumar>**: Just a quick follow up to that. Wouldn't actually it be prudent to say we're trying to get a better handle on this issue, let's just pull back on growth, let's get this piece right, and then come back on the growth trajectory?

**<A - Michael F. Klein>**: What I would say to that is we are addressing what we're seeing with our pricing actions and focused on making sure we've got the right price in the marketplace. The growth will be what it will be as a result, but our focus is on getting the right terms and conditions in the market to respond to this change that we've just seen.

**<Q - Amit Kumar>**: Thanks for the answers.

**<A - Brian William MacLean>**: That's exactly right, Amit. We're trying to get the right price on the right account, and based on that and the market reaction, we'll determine the rate at which we grow.

**<Q - Elyse B. Greenspan>**: First on the personal auto book as well. When you guys think about your margin outlook in Q4 and into 2017, what type of increase in rates are you expecting from what we saw in Q3? And then as we think about the margin in Q4, I guess, given the fact that you added to the current accident year, should we look for a sequential improvement in the auto underlying margin? And then one other, you guys did mention adding to the four recent accident quarters. So was there prior year adverse development on the auto book for 2015?

**<A - Alan D. Schnitzer>**: That was a lot and quickly. So let me try to address what I caught and then maybe I'll ask you to repeat what we didn't get to. So I think you asked for the outlook on rate in auto. We don't give outlook on rate. We do provide outlook on overall price. And so I think you'll see that generally we are forecasting an increase in renewal price change, which is all-in rate and exposure. We don't quantify it any more than that other than to say an increase. And I'm sorry, Elyse, what were the other questions?

**<Q - Elyse B. Greenspan>**: Well, you guys had mentioned adding to the auto losses for the four most recent accident quarters. So was there adverse development on 2015?

**<A - Alan D. Schnitzer>**: There was a very little bit of adverse in Q4. It's obviously in the overall net PYD number, but it's a very small – think after-tax single-digit number.

**<Q - Elyse B. Greenspan>**: And I'm sorry...

**<A - Gabriella Nawi>**: Elyse, it's Gabby. I think if I've understood your question correctly on the current year prior quarter addition, it was $30mm pre-tax related to the first six months, which means $15mm a quarter, which continued in Q3 2016 and continued in Q4 2016. Is that your question?

**<A - Brian William MacLean>**: I interpreted your question to be is there anything in prior-year development related to this?

**<Q - Elyse B. Greenspan>**: Yes, that was the question.

**<A - Brian William MacLean>**: And the answer to that is in the overall net number of prior-year developments, there is a single-digit after-tax $1mm number in Q4.

**<A - Michael F. Klein>**: And this is Michael Klein, offset by other items, so there is no adverse prior-year development in auto.

**<A - Brian William MacLean>**: Right

**<A - Michael F. Klein>**: That number is zero in the aggregate [indiscernible] (37:17).

**<A - Brian William MacLean>**: And there are always things in PYD over the various accident years that are going one way or another. And the aggregate of those things was zero.

**<Q - Elyse B. Greenspan>**: Okay. And then one, if I may switch topics a little bit. In terms of your commercial line pricing view, with inflation levels looking like they could be picking up and reserve cushions for you guys and maybe some others starting to slow overall for the industry, do you think that it's time that some companies look to take price to kind of get ahead of the inflection point if current trends continue as they are?

**<A - Brian William MacLean>**: Yes, it's hard to answer that. I mean I certainly can't answer that question for anybody else. You can see what our pricing has done and our pricing is – the headline number you see is really the aggregate of the many thousands of transactions that we complete during the quarter. And you can see that it ticked up a little bit. I will tell you that generally speaking we feel like we are achieving the written margins that we're seeking to achieve today and feel pretty good about their product returns given where the tenure is. We do give you some outlook in the 10-Q for underwriting margins, so we'll see where the market goes.

**<Q - Jay Gelb>**: Thanks very much. On the excess capital position for the company, clearly Travelers continues to buy back stock and increase its dividend, although that pace of capital return has slowed for the YTD compared to the same period in 2015. I'm trying to get a perspective on how much excess capital you feel Travelers holds now in excess of rating agency requirements?

**<A - Jay S. Benet>**: Hi, Jay. This is Jay. You've asked the question in the past and let me go back to what we've said at those times as well as in our Qs and Ks. Ultimately it's going be the earnings level of the company that's going to drive how much we return to our shareholders through dividends and share repurchases. As it relates to the specifics of excess capital, we try to manage the operating companies to what the rating agencies require of us as it relates to being a AA company.

In any given quarter, based on profitability of that quarter, we might end up with a little extra capital. I think it's very, very rare that we end up with anything less than we need. So it's not a significant number and it's just going to vary from timing. Ultimately, we carry our rating agency capital level in line with the AA over time, and we return the excess. We don't sit on the excess capital.

**<Q - Jay Gelb>**: All right. Thanks for clarifying that. And then, Alan, on the merger and acquisition front, a lot of the – or essentially all the growth, it seems at Travelers this year is coming from personal lines with little overall top line growth in commercial insurance. Is there any interest in accelerating the commercial insurance growth through acquisitions?

**<A - Alan D. Schnitzer>**: Yeah, Jay. We always give the same answer to that question. I can't tell you whether we will or we won't, but I can tell you that I think our shareholders should demand that we have a view on what the attractive businesses are in every market that we operate in or might want to operate in and have a view on whether we want to do them. We do think that we've come together over a couple of decades through a lot of transactions. We feel like it's a competitive advantage for us. We're good at finding them. We're good doing the diligence. We're good at negotiating them. We're good at integrating them. So we feel highly qualified to do it, and under the right terms and conditions, interested in doing it.

Having said that, over the years we're also highly attentive to the risks. You buy the entire balance sheet. You buy systems issues. You buy people issues. So I'd say we're very aware on both sides of the analysis. But we are certainly interested in doing things if we can get them done on the right terms. And generally speaking for us, those are, we think about it through the lens of returns. Will the transaction improve our return profile? And/or will it improve our volatility? And so that's the lens, and we're always interested in looking.

**<Q - Jay Gelb>**: That makes sense, Alan. Would that include large deals as well? Something that might require issuing shares?

**<A - Alan D. Schnitzer>**: Jay, I wouldn't make any distinction between a large deal and the small deal. All I can tell you is what the lens is through which we would evaluate it.

**<Q - Charles Joseph Sebaski>**: I guess the first one just a follow-up back on personal auto really quickly. And I guess the question is on the timing of the rate actions that you guys took. And what I'm trying to figure out is with regard to the growth. While the PIF growth was obviously very strong, I'm wondering if the severity issues were recognized at the close of the quarter and the rating actions are going to be prospective or these were rating actions that were taken at the beginning of the quarter and the 11% PIF growth was after those rating actions took place.

**<A - Michael F. Klein>**: So, Charles, this is Michael. I would say that we have been putting some rate into the market, first of all, throughout the year. The filed rate has started to rise in the quarter. I would say the growth in the quarter reflects some of that activity, but just a little bit. And there's more to come.

**<Q - Charles Joseph Sebaski>**: Excellent. Thank you. And then follow-up on the weather and the commentary on higher losses from non-cat weather. You guys already provide a lot of detail, which is very helpful. I'm just wondering if you could help us out a little further and give some kind of baseline of what weather losses are intended. I guess particularly maybe in like a homeowners line of business. I guess the commentary that losses are higher or lower in a particular period due to higher non-cat weather that isn't specifically identified without a baseline color that's hard to model or understand. I don't know if there's some clarity you could give on a baseline for us on what non-cat weather should be and what the volatility is that through the year?

**<A - Alan D. Schnitzer>**: Hey, Charles, it's Alan. I do appreciate the question and why you want to know and also I would – I just thank you for acknowledging the fact that we do give a lot of color and texture, and we try to be very thoughtful about that. This is one that we think a lot about and we think it's hard to do for a couple of reasons. One is weather is just inherently unpredictability. There's a lot of volatility obviously and we don't know. We do have a plan. We do price for weather but that reflects generally speaking longer term trends.

So we just don't feel like it'd be particularly meaningful for us to give you a plan for next quarter or next year just given the volatility. So we shy away from getting that specific relative to our expectations. But what I will tell you in case it's helpful is on a YTD basis, for the company, weather was about $70mm – non-cat weather was about $70mm worse after-tax than it was in the prior year. So I know that's not exactly what you asked for, maybe that's a little bit of color that will be helpful, but we're just a little bit hesitant to start giving you plan numbers.

**<Q - Michael Nannizzi>**: Thanks so much. Just back to auto for a second if I could. Is it possible to kind of understand where the accident quarter loss ratio is here at the beginning of Q4? Or just post these adjustments that you made to the current CY in Q3? And then where's that relative to kind of where you wanted that business to be running when the sort of Quantum 2.0 effort began?

**<A - Alan D. Schnitzer>**: I guess we're looking at each other trying to understand exactly what it is you're asking. If you're looking for a view on fourth quarter, we're not really inclined to giving you information about Q4 yet.

**<Q - Michael Nannizzi>**: How about where did Q3 end? I mean, in terms of – so you made the adjustments to Q3, so I would imagine if you're thinking about your prospective trend then you're going to start with Q3. You're going to look at rate and then you're going to look at loss. I'm just trying to get an idea of what's your starting point for new business today?

**<A - Alan D. Schnitzer>**: So stepping back, if you look at it on the nine months and you look at PI auto, the underlying combined ratio was about a 98%. Is that helpful?

**<Q - Michael Nannizzi>**: Yeah.

**<A - Alan D. Schnitzer>**: That's for the nine months in PI.

**<Q - Michael Nannizzi>**: Okay.

**<A - Alan D. Schnitzer>**: And that's on an underlying basis, ex-CAT and ex-PYD.

**<Q - Michael Nannizzi>**: Okay. And so that's [indiscernible] (47:14) has that changed throughout the year or is that just kind of that's a fair representation.

**<A - Michael F. Klein>**: Michael, this is Michael. I would just say so for context on that underlying, right, Brian talked about the fact that there's a point of impact from tenure year-on-year in that number. The other thing is if you take the bodily injury severity number and decompose that $45mm by quarter, it's about a 1.5 point on a run rate basis for the YTD. That 1.5 point we expect to go forward into Q4.

And the other thing I would say just clarification on Q4 outlook, Q4 outlook says that we expect the combined ratio to be higher in Q4. There is a seasonality impact underneath that number, right?

The combined ratio and the loss ratio in Q4 run higher in Q4 than they do in the first three quarters of the year. And so that's part of what's underneath that outlook number as well.

**<Q - Michael Nannizzi>**: Got it. I guess one question I had is, I mean Quantum is – it sounds like it's been very effective in a lot of ways. We've seen PIF growth acceptance in the market. All of those things seem like a real positive. And then we have this sort of the environmental trend that has been occurring in like fits and spurts over the last couple of years. So taking those things separately, I mean, is it possible that the growth that you've seen just might have occurred at a difficult time sort of before some of these loss trends emerged? And following up on a prior question, should that imply that at some point we should see that growth revert back until you calibrate those things? Or is this still within your sort of expectations when you rolled out Quantum?

**<A - Alan D. Schnitzer>**: Yeah. So let's go back a few years to where we were three or four years ago or two or three years ago when this business was shrinking at double-digits. So we put Quantum Auto in and we took a lot of cost out and we've dramatically improved the overall profile of the business. So we shouldn't lose sight of that. This has been a big success. And a lot of the growth you're seeing is high in percentage terms because it's off a smaller base after a couple of years of shrinking. So that's I think just important context to keep in mind.

We don't go out there and try to manage the growth. We try to go out there based on everything that we see and price for the return that we're looking for. And based on the market, we'll grow or we won't grow. And we feel very good about the growth.

Maybe we don't have it exactly right. Maybe we'll have to adjust. I'm not really sure and honestly, we could be adjusting up or down, not really sure. And this isn't unusual for any line of business that we have. As I said before, loss trends are going to change for one reason or another. We've got other trends in other parts of our business that have emerged favorably. And so we watch these things. We think having the diagnostics and the ability to understand it, to diagnose it, to price for it, is what's really important.

**<Q - Jay Arman Cohen>**: Yes. Thank you. I guess we hit most of the issues on the auto side. Just can you give us an update on the workers' comp business? It feels like it's been relatively stable. Are you seeing any changes in that environment, both either pricing or claims?

**<A - Alan D. Schnitzer>**: I would say continued stable environment. No real change in the trends. Obviously we had a couple of court cases in Florida that the overall market has reacted to and we've reacted to. Those dollars weren't enormous for us. I think last year we had something on the order of $34mm, $35mm pre-tax that we added to reserves for those two court cases. So, relatively minor for us. But other than that, no real trends in workers' comp.

**<Q - Ryan J. Tunis>**: My first question is just on thinking about the BI severity on the commercial auto side. I mean, it sounds like you guys are flagging this as an environmental issue kind of across all the wheels business. Is there a way that you can maybe help us think about the impact that had y-over-y on the loss ratio in commercial just from the severity in commercial auto?

**<A - Alan D. Schnitzer>**: Yeah, Ryan, what I'll tell you is on the Business Insurance side, the proportion of premium that comes from auto is just much smaller than the same is true for the PI segment. So overall the numbers are just less significant to that segment. There were some small numbers but nothing all that significant. The other thing I'd point out is on the commercial line side we have more flexibility to change pricing more quickly than we do on the personal line side.

**<A - Brian William MacLean>**: Yeah, the other thing I would add, Ryan, this is Brian, is when you really look at the commercial exposure, when you're thinking of smaller claims that could be more of a PI thing. So the actual – we did have some activity on the severity side in BI this quarter. The dollars were actually less than PI. Obviously, as Alan said, the percentage was dramatically less. We actually had a little bit of good news from frequency in the current year. Again, small dollars, but – so you don't see the impact as much, so a bunch of different factors going into it.

**<Q - Ryan J. Tunis>**: Okay. Understood. Then I guess a follow-up for Brian I guess on the impact of tenure. So, I guess, over the last couple of years it's been 2 points. If we would have had this conversation a year ago, it would have been 1 point. So the new business penalty I guess has grown y-over-y. And I guess it introduces the question of just how and over what time period can we really get that 2 points back? I guess especially when you think about the fact that Quantum 2, you know, it seems like it's supposed to be a more competitively priced product. So over time, there should be a higher percentage of premium and new business. So, yeah, I mean, just anything you can give us on getting that two points back, and whether or not you can get it back and keep growth anywhere close to where it is for Quantum? Thanks.

**<A - Brian William MacLean>**: Yeah. So a couple of things and, again, this is back to the theoretical example. Although not possible, if you keep growing, you keep kind of chasing it. But if you keep growing with business that you believe has lifetime value that's meeting your returns, then it's all a good thing. And I guess that that's a theoretical comment.

And we're not going to disclose exactly what the timing is because that would lead someone to be able to triangulate exactly how we're pricing and the returns that we're – or specific returns we're targeting, but the answer is, it's kind of a function of what do you think is going to happen to our growth. It's not going to reverse in the next year or two. It's going take a while to play out. The other thing that is certainly worth noting is we talk a lot about the ratio. As we grow and it performs, we're generating profit dollars that are incremental to the franchise, and obviously that's a good thing.

**<Q - Sarah E. DeWitt>**: In the Q you provide guidance that the personal auto combined ratio on an underlying basis could improve in 2017. What are your assumptions in terms of auto BI severity there? Do you assume any further uptick or is that a risk?

**<A - Michael F. Klein>**: This is Michael. I would say what we've said is, right, that auto severity uptick is about 1.5 point on a run-rate basis. We assume that continues on a go forward basis. I mean, there's always a risk it could change from here. It could change up. It could change down. When you look at the outlook, the outlook reflects the comments we've made this morning and that we're responding with price. And so the outlook I think literally says we believe price will exceed loss trend which will be a good guy. The outlook says, I believe that that offsets some continued adverse impact from tenure. And then the other big component is an expectation about more normalized loss levels, which relates a little bit to the non-CAT weather conversation we've been having this morning and just a broader more consistent expectation on loss levels.

So, again, I think the pricing and the outlook anticipate that the bodily injury severity, the higher levels of bodily injury severity are with us going forward. But we're responding with price and believe that we will get price ahead of loss trend in 2017.

**<Q - Larry Greenberg>**: Just about all my questions were answered, but I have one nerdy one. In the Bond line, the – were you waiting for that, Gabby?

**<A - Gabriella Nawi>**: No. It's just such a great business and nobody ever asks questions. So it was inadvertent here [indiscernible] (57:20).

**<Q - Larry Greenberg>**: The underlying loss ratio improved a few points and I'm just wondering was there any re-estimation of H1 here similar to what you did a year ago in Q3?

**<A - Jay S. Benet>**: There was a re-estimation in the quarter, yes. And it was an improvement loss ratio of 2.3 points. And so that's when you pull the first two quarters back in and add what's in to Q3. So yes, that's correct.