Company Name: Travelers
Company Ticker: TRV US
Date: 2016-04-21
Event Description: Q1 2016 Earnings Call

Market Cap: 31,809.61
Current PX: 108.79
YTD Change($): -4.07
YTD Change(%): -3.606

Bloomberg Estimates - EPS
Current Quarter: 2.255
Current Year: 9.681
Bloomberg Estimates - Sales
Current Quarter: 6784.111
Current Year: 27130.727

Q1 2016 Earnings Call

Company Participants

- Gabriella Nawi
- Alan D. Schnitzer
- Jay S. Benet
- Brian W. MacLean
- Doreen Spadorcia

Other Participants

- Kai Pan
- Ryan J. Tunis
- Charles Joseph Sebaski
- Vinay Misquith
- Jay Gelb
- Michael Nannizzi
- Paul Newsome
- Sarah E. DeWitt
- Brian Robert Meredith
- Meyer Shields
- Jay Cohen

MANAGEMENT DISCUSSION SECTION

Gabriella Nawi

Financial Measures

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

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

Alan D. Schnitzer

Q1 Review

Q1 Highlights

- This morning, we reported first quarter operating income of $698mm, or $2.33 per share, and operating return on equity of 12.5%
  - Especially in light of a relatively high level of catastrophe losses in the quarter, our underwriting results across the board remain strong, as reflected in our combined ratio of 92.3%

- To put the weather in some context, our catastrophe losses were about $100mm, after-tax, higher in the quarter than they were last year, and these are the highest first quarter cat losses we've had since 2010
- The timing of catastrophes is, of course, unpredictable, but this level of weather volatility is certainly within our playbook
- We're confident in our ability to model and manage our exposures and that we're pricing appropriately for the risk

Market Share

- In this case, it just so happens that, by design, we have a healthy market share in the Dallas/Fort Worth Metroplex, where severe hailstorms were concentrated
- Doreen will have more to say about the severity and about our claim analytics
  - The real story this quarter is about our execution in the marketplace
  - And across all our businesses, we couldn't be more pleased

Commercial Businesses

- In our commercial businesses, we continued to be successful in our efforts to maximize retentions on our best-performing accounts and improved profitability on poor-performing business
- Retentions in the quarter were again at very high levels by historical standards and renewal premium change was positive
- We believe these production results were right on target, given our view of product returns, but as we've explained before, we don't manage the business on an aggregate basis
  - We execute deliberately, account-by-account or class-by-class

Middle Market Accounts

- And you can see this on Slide 13 of the webcast, which displays the distribution of rate changes for our Middle Market accounts in Q1
- As you can see from the slide, most accounts received a single-digit rate increase and there were a number of accounts that had a rate increase of greater than 5% or even 10%
- So even now with the headline pure rate change just slightly negative, we continue to achieve rate gains in excess of loss trend on our poorer-performing business
- The real takeaway from this slide is that the aggregate rate number is simply an average of thousands of individual account actions, and that success in this business is not about the aggregate rate number
  - It's about taking the right action on each account and generating an appropriate return over time

Pricing Environment

- Our execution in the quarter also benefited from a commercial lines pricing environment that, from our vantage point, continues to be remarkably stable

- The outlook that we provided this morning in our 10-Q for our BII and BSI segments suggest more of the same: continued high levels of retention and broadly consistent underlying underwriting margins

Personal Insurance Business

- In terms of execution, we were just as successful in our Personal Insurance business, with strong retentions and higher PIF counts in both Agency Auto and Agency Homeowners
  - Importantly, Quantum Auto 2.0 continues to meet our expectations on all fronts
- The successful execution across all our businesses resulted in consolidated net written premiums that were about 5% higher in the quarter than they were in the prior year
- Both new business levels and historically high levels of retention, particularly in our Middle Market business, contributed significantly to the top line growth
- The quality and breadth of our products and services, our extraordinary talent in the field and the strength of the relationships that we have with our agent and broker partners put us in a great position to win
  - In addition to that, we believe that we benefited in the quarter, both in terms of new and renewal business, from the stability and consistency we provide in the marketplace compared to some of our competitors, who are experiencing varying degrees of disruption

Capital Management

- Turning to capital management, as a reflection of the confidence that we have in our business, today, our Board of Directors declared an approximately 10% increase in our quarterly dividend to $0.67 per share
  - The 12th consecutive year of dividend increases, and bringing the compound annual growth rate of the dividend to almost 10% over that time
- All-in-all, despite an active quarter from a catastrophe perspective, a great start to the year

Jay S. Benet

Financial Performance

Operating Income

- I'll start by saying that we were pleased with our first quarter results, operating income of $698mm and operating return on equity of 12.5%, despite their being lower than the prior year quarter
- As page 4 of the webcast indicates, the $129mm decrease in operating income from last year's first quarter did not come about due to lower underlying underwriting results
- Our consolidated underlying combined ratio is 90% this quarter, 30BPS better than the prior year quarter
- Rather, the decrease in operating income, along with the decrease in operating ROE, resulted from two items: cat losses that were $101mm higher on an after-tax basis than those in Q1 2015
  - And, as we anticipated in the Outlook section of our 2015 10-K, $24mm after-tax reduction in fixed income net investment income that was driven by the continuing low interest rate environment
- Page 4 also provides an analysis as to how our reported results compared to analyst estimates

- As best we can tell, analyst estimates for cat losses were significantly lower than what actually occurred, which more than accounts for the difference

Net Investment Income

- Our net investment income was $439mm, after-tax, this quarter, which was $39mm lower than the prior year quarter
- In addition to the lower fixed income returns, non-fixed income NII was down $15mm after-tax, due to lower hedge fund returns that resulted from the more challenging capital market conditions in recent months

Reserve Development

- Each of our business segments once again contributed to net favorable prior year reserve development which totaled $180mm on a pre-tax basis
- In Business and International Insurance, net favorable development of $93mm resulted from better than expected loss experience in Workers' Comp excess coverages for accident years 2006 and prior; and General Liability, primarily for excess coverages for accident years 2011 and 2013; in Commercial Auto for accident years 2010 and prior; and in our European and Canadian operations
- In Bond & Specialty Insurance, net favorable development of $60mm resulted from better than expected loss experience in Surety for accident years 2012 through 2014
  - And in Personal Insurance, net favorable development of $27mm resulted from better than expected loss experience in Homeowners and Other for liability coverages for accident year 2014, and in Auto for accident year 2014
- On a combined stat basis for all of our U.S. subs, all accident years developed favorably, other than the 2015 accident year, which is currently showing $65mm of unfavorable development, due to a few large property losses that occurred late in 2015 and a decision we made to rebalance personal insurance reserves among various accident years
  - In addition, other than commercial multi-peril, all product lines either developed favorably or had de minimis unfavorable development this quarter
- While CMP developed unfavorably by $35mm, 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 was subsequently determined to be CMP-related

Operating Cash Flows

- Operating cash flows of $850mm remain very strong, and we ended the quarter with holding company liquidity of over $1.7B
- All of our capital ratios were at or better than their target levels
- Net unrealized investment gains were approximately $2.7B pre-tax, or $1.8B after-tax, up from $2B and $1.3B, respectively, at the beginning of the year, while book value per share of $82.65 and adjusted book value per share of $76.63 increased 4% and 2%, respectively, from the beginning of the year
- We continue to generate much more capital than we need to support our businesses, allowing us to return $790mm of excess capital to our shareholders this quarter

Capital Management

- We paid dividends of $181mm and repurchased $609mm of our common shares this quarter, including $550mm under our publicly-announced share repurchase program, consistent with our ongoing capital management strategy
  - And $59mm to partially offset shares issued under employee incentive plans, mostly to cover employee withholding taxes due upon the vesting and payout of performance and restricted stock awards
  - And as Alan said, the board raised our quarterly dividend from $0.61 to $0.67 per share

Brian W. MacLean

Business and International Insurance

Net Written Premiums

- In Business and International Insurance, operating income was $476mm, with a combined ratio of 94.8%
- The underlying combined ratio, which excludes the impact of cats and prior year reserve development, was 93.3%, up about 0.5 point compared to Q1 2015, reflecting a typical level of quarterly fluctuations within both the loss and expense ratios. This result is in line with our expectations, and we continue to feel very good about our underlying results
- Net written premiums for the quarter were up 3% y-over-y, with Domestic Business Insurance premiums up about 5%, driven by the strong production results across all our businesses

Domestic Business Insurance

- In Domestic Business Insurance, we remain pleased with the continued execution of our pricing strategy
- Given the attractive returns that we are generating in this business, our focus continues to be on retention and, accordingly, we're very pleased that retention is at a historical high of 85% for the quarter
- Renewal premium change came in at 2.2 points, while renewal rate change was down slightly in the quarter and about flat overall
  - New business increased to $575mm, reflecting strong results across all our businesses

Individual Businesses

- Turning to the individual businesses, beginning with Select, we achieved strong retention of 81%, and renewal premium change of nearly 7%
- Rate change was down about a point vs. Q4 2015, driven in large part by recently filed rate changes in Workers' Compensation
  - We generated new business of $103mm, up slightly y-over-y

Middle Market

- In Middle Market, retention reached a historic high of 88%, with renewal premium change of a point, in line with Q4 2015

- Importantly, retention of our best-performing business was approximately 90%, while for our poorer-performing accounts, we achieved rate gains in excess of loss trend
  - New business of $321mm was up 8% y-over-y, due in large part to strong results in our Construction business

Other Business Insurance

- In Other Business Insurance, retention of 82% was up both y-over-y and compared to Q4 2015
- Renewal premium change of about a point was in line with recent quarters, while new business of $151mm was up 24% vs. the prior year, driven by Inland Marine, Boiler and Transportation lines of business
- So across Domestic Business Insurance, we achieved strong retention and saw an increased level of new business opportunities in the marketplace
  - As Alan mentioned, our agents and brokers view us as a stable market with industry-leading products and services, which we believe had a favorable impact on both retention and new business, particularly in this environment, where several significant competitors are experiencing some degree of disruption

International Business

- Turning to International, net written premiums for Q1 were down about 10% y-over-y, primarily due to the adverse impact of foreign exchange rates
- Excluding the impact of foreign exchange, net written premiums were down about 4%, driven by disciplined underwriting in the face of highly competitive market conditions in the property lines at Lloyds
- Retention for the quarter was strong at 82%
- Renewal premium change was slightly negative, but above recent quarters, and new business of $76mm was up more than 30% y-over-y, driven primarily by Optima, our new strategic personal lines auto product in Canada
  - This product was modeled after our U.S.-based Quantum Auto 2.0 product
- And while we're still in the early days of the rollout, we're encouraged by the response, as we continue to see a significant increase in new business volume
  - In summary, in the segment, we achieved strong underlying underwriting and production results, a great start to 2016

Doreen Spadorcia

Bond & Specialty Insurance

Operating Income

- Bond & Specialty Insurance started 2016 with a strong first quarter
  - And we remain exceptionally pleased with the financial returns in this segment
- For the quarter, operating income was $144mm, up from Q1 2015, due primarily to a higher level of net favorable prior year reserve development
  - We've also improved underlying underwriting results

Combined Ratio

- The underlying combined ratio of 81.1% was almost two points better than the prior year, driven by two items:
  - One, the favorable expense impact of certain customer-related intangible assets, which became fully amortized during Q2 2015
  - And second, lower loss levels in certain management liability businesses
- Underlying returns in this segment were once again very strong and remain well within our target level
- Results like this do not happen by accident
- Insights provided by our deep industry expertise and analytics, along with disciplined execution of long-term strategies, has positioned us to successfully navigate arising economic challenges, the most recent being the disruption in the coal and broader energy sectors
- As for top line, we generated higher net written premiums for the quarter as compared to 2015 in both our Management Liability and Surety businesses
  - The increased Surety production reflected higher contract bond activity from mid-sized construction accounts

Management Liability Businesses

- Across our Management Liability businesses, retention remains strong at 87%
- New business premium was up more than 20% from Q1 2015, and renewal premium change was up from recent quarters, driven by the non-rate components of RPC, including slight increases in average policy duration and insured exposures
- These results reflect the execution of our strategy to retain our best accounts and write more business in our return adequate product segments
  - In sum, strong top and bottom line results for Bond & Specialty and we continue to feel great about this segment's performance

Personal Insurance

- I'll now turn to Personal Insurance
- Operating income for the quarter was $139mm, down $113mm from the prior year quarter due to $69mm in higher tax and $68mm in lower net favorable prior year reserve development
- The segment's underlying combined ratio for the quarter was 86.1%, 1.4 points better than the 2015 quarter
- This improvement was driven by a lower expense ratio, which was due, in large part, to higher premium volume
- We continue to be pleased with production results and underlying financial returns in both Agency Auto and Agency Homeowners & Other

Agency Auto

- Looking at Agency Auto, we once again generated strong top line results and the loss experience of Quantum Auto 2.0 continues to perform in line with expectations
  - The combined ratio of 95.2% for the quarter was five points higher than the prior year quarter, due primarily to higher tax and a lower level of net favorable prior year reserve development

- The underlying combined ratio of 94% was up 1 point from last year, in line with our expectations for the quarter
- As we've discussed before, the significant levels of new business we've added in the last couple of years will result in a higher CY loss ratio in the early years, and improve over time
- Quantum Auto 2.0 is priced to our long-term target return and is maturing in line with our expectation
- As for our overall view of loss trend, blended frequency of severity remains unchanged at around 3%
- Production results continue to be exceptional at Agency Auto, with net written premiums up 13% y-over-y, driven by higher new business premiums and strong retention
    - We continue to grow policies in force, which increased 55,000 during the quarter

Agency Homeowners & Other

- Turning to Agency Homeowners & Other, we generated a combined ratio of 90.4%, even including catastrophes of 16 points
- While cats were higher this quarter, the underlying combined ratio of 76.2% improved more than three points from the prior year quarter, driven by favorable non-cat weather
- As you all know, weather will be volatile from period-to-period
    - As Alan mentioned, this quarter was particularly impacted by severe hailstorms in the Greater Dallas/Fort Worth area

CAT 21

- Slide 21 of the webcast is an extract from our Hail Dashboard, which many of you will recognize from our Investor Day
    - This view is CAT 21, the most substantial event in the quarter, and shows you how much of the area was impacted by two and even three-inch hail
- This demonstrates our proprietary capability to get near real-time data about hail size and duration, as well as potentially impacted policies
- Using this information facilitates a more effective claim response and assists us in estimating losses
- Using these tools, as well as our on-site work in the area, we identified this as a significant event early on and were somewhat surprised at how low the industry estimates were
- As more information has become public, it would appear that industry estimates for this event will rise

Weather Volatility

- Notwithstanding the weather volatility, we remain very pleased with the underlying financial returns we're generating in this business, as we continue to execute our disciplined underwriting and pricing strategies
- As for production in Agency Homeowners & Other, we continue to make good progress, in line with our expectations
- New business premium was up more than 30% from the prior year quarter
- Retention remains strong at 85%

- And we added 26,000 policies during the quarter, so even with the significant cats during the quarter, a great start to the year for Personal Insurance

QUESTION AND ANSWER SECTION

<Q - Kai Pan>: My first question on catastrophe in the quarter, the $380mm, almost a third of your sort of normalized annual budget of $1B, so does this surprise you? And there were talk about heightened activity in hailstorms. Does it have implication for your pricing as well as your market exposure?

<A - Alan D. Schnitzer>: Kai, good morning. It's Alan. Let me start and I'll see if others want to fill in. As I said in my opening remarks, the timing of catastrophes are always surprising to us, but there's nothing about the level of losses in that storm that are particularly surprising. It's in our playbook and we do feel like our risk selection and pricing is spot on, so nothing about this event that causes us to rethink anything. And if it had been a couple of weeks later in Q2, where we typically expect more frequency of severe storms, we wouldn't really have thought anything about it, so timing off by maybe a couple of weeks but nothing about it that we find surprising.

<Q - Kai Pan>: Okay. My follow-up question is on the BI pricing, looks like continue the downward trends. I just wonder what give you confidence to maintain the good level of core margin or underlying margin, given the downward pricing trend, as well as now you have a higher level of new business. How do you make sure the underwriting of this or will that increase your initial accident year loss pick?

<A - Alan D. Schnitzer>: Kai, if you look at the gradual slope of that pricing trend, yes, pricing is going down, but it's very, very gradual and it's consistent with our product returns. And this is why we wanted to put in Slide 13 that really shows you the redistribution. We continue to look at the execution on a granular basis, and we're very comfortable with the way that we're pricing relative to the returns that we expect, that we're getting on these products.

<A - Brian W. MacLean>: Yeah and, Kai, this is Brian MacLean. I'd just chime in on the new business front. First of all, I'd emphasize that we haven't changed any of our return thresholds or our target pricing. And if we're obsessing about one thing in the business today, it's the quality of the new business that we're taking in, and we remain very comfortable that it's in customer segments, products and industries that we really think we understand. So we feel very good about it.

<Q - Ryan J. Tunis>: My first question, I think, is for Doreen. Just looking at margins, I guess, in Agency Auto, looked like the accident year loss ratio deteriorated by a little more than 1.5 points. And it sounded like you're still attributing that mostly to just the impact of new business. I'm just wondering if that's the type of margin drag we should expect for the remainder of the year from the pressure from new business, or if there's anything else, at least in the short-term, that maybe drove up that accident year loss ratio?

<A - Doreen Spadorcia>: Let me talk about that for a minute. It is really attributable, and I would say solely; obviously, there's always a few things bouncing around, but driven by the volume of new business. What we build in to our modeling curves is the maturity of the book of business. And so what you'll see over time is, each cohort will begin to produce what our long-term returns are. So it is due to the level of new business.

<Q - Ryan J. Tunis>: Okay, understood. And then, I guess my follow-up then would just be for Jay Benet, on the investment income side. And it seems like a lot of the discussion's around lower investment yields, but something that stood out to us a little bit is that it looks like the average invested assets were down about a little more than 1% on the quarter. And it also looked like there was, in the 10-Q, an allusion to $0.5B payment on the asbestos side that's coming in Q2.

So just trying to understand, when you think about that $25mm to $30mm quarterly drag, is that contemplating sort of a lower level of invested assets, or should we think about that as all just being driven by your view of lower reinvestment rates? Thanks.

<A - Jay S. Benet>: Yeah, hi. This is Jay Benet. It is a combination of our view as to what the rate environment looks like, as well as what the average invested assets are and will be. As you'll recall, in Q1 last year, we had a large payment to finalize the direct actions settlement for asbestos. That brought the average down a little bit. And, as you rightly point out, we're expecting to make a final payment on the PPG settlement when other parties finalize some of the remaining issues, which we don't view as significant issues, in Q2. We expect to make that payment in Q2, so that will have an impact as well.

Something else that affects the average invested assets, some of our assets are denominated in foreign currency. So you do have some currency exchange taking place where, in effect, the assets are still the same, just the currency-adjusted value is a little lower. But those are the two primary things, the two asbestos payments, that bring it down.

<Q - Charles Joseph Sebaski>: First question is on that new business growth in Business Insurance, hoping to just get a little bit more color on, if that's coming from sort of disruption? It seems like the growth relative to the pricing trend, or what is talked about in the industry, is a little bit upside down. I mean, it's a little surprising, the size of it, so I would appreciate any help you could give on what's, you think, is really causing that expansion.

<A - Alan D. Schnitzer>: Sure. It's Alan and, again, I'll start. We don't think there's anything different in the pricing, and there's certainly nothing different in the return thresholds that we're seeking that's driving that. At – both increased levels of retention and new business are contributing to it. I think that's an important point. And we really start with what I said in my opening remarks. We think it's the quality and breadth of our products and services, the talent we have in the field, the relationships we have with our producers. All of that always puts us in a great position to win.

And on top of that this quarter, as both Brian and I noted, there was some disruption in the marketplace. And given our stability out there, we do think we benefit from that. It's hard, probably impossible, for any of us to try to put a finer point on the allocation of dollars to one cause or another, but we do think all of those things coming together resulted in the higher new business levels.

<Q - Charles Joseph Sebaski>: All right. And then, I guess for Doreen, I saw earlier in the quarter, you guys had a press release out that you're offering a discount for connected homeowners policies. I'm just curious. Any update on kind of that, or any of the other initiatives using technology into personal lines, be it pricing, be it UBI, et cetera?

<A - Doreen Spadorcia>: Yeah, we're still a little new in the space. I'll tell you a couple of things that we have. You know we have IntelliDrive, where we do offer a discount. It's mileage based. We're actually looking further into that, based on the [ph] apps (31:19) that are available and perhaps moving beyond mileage. So that's obviously on the list. Second, we did roll out, in a couple of pilot states, for use for individuals when they're using their car for Uber. And what it really does is, it covers what's called the trolling period. Until there's a match, then the coverage is clear that there isn't any personal insurance coverage.

And then, this discount for connected homes and if you think about it, similar to what we would do for someone who has an alarm or something of that sort, but we do have both of our homes up at Claim U are connected homes. So we can study how the data comes in. We can study what that changes about the underwriting process and the claim process. And we're also a member of CNET, which has a very sophisticated connected home in Kentucky. And we're the only insurer on that CNET home board looking for all the applications in the connected space, so that's just a little of what we've got going on.

<Q - Vinay Misquith>: So the first question for Doreen, just wanted to follow up on the personal auto side. I believe you said frequency was up 3% this quarter for personal auto. Curious as to what it was last year, and have you seen any negative impact from the warmer weather so far in the northeast in Q1 on your frequency?

<A - Doreen Spadorcia>: I'm going to give you really detailed answer, but the first thing I want do is correct that we've seen frequency of 3%. We've seen a normalized trend of 3%, which includes 0.5 point for frequency and 2.5 for severity. And that's been something that we've basically had baked into our results for two to three years at this point. So let me just go back a little bit on frequency, because I know we've talked a lot about it. We talked a lot about it at [ph] AFA, (34:03) too.

We know that others have commented on frequency in the industry. Some have commented that they're seeing higher frequency. Some have not commented at all. So we don't feel like it's the thing that's just ripping through the industry.

It's affecting very specific companies. And the most important thing for us is where you're starting from. What assumptions have you made? So we have not assumed flat frequency for a number of years. It's been a 0.5 point.

And we may have talked about this last quarter, so I apologize if it's repetitive, but in 2014, there were some observations that frequency was dropping. We analyzed that very, very carefully and really didn't think it was systemic or sustainable. And so at that point, while we recognized the financial impact of that lower frequency for 2014, we went into 2015 assuming that trend was going to go back to where it was, and it did. And so the 0.5 point remains unchanged. The trend remains unchanged, and it really goes back to where you start from.

<Q - Vinay Misquith>: Okay. That's helpful. The second question is just a follow-up on the new business growth on the Business Insurance. And it seems that the growth was faster in Middle Market and Other Business Insurance, where pricing is maybe slightly weaker than the Select accounts. So was that just a coincidence or just curious as to what's happening between those segments. Thank you.

<A - Brian W. MacLean>: Yeah, so this is Brian. I think in Middle Market, in particular, we've been doing a lot of things with our process and our people to be really active in the marketplace. Our flow in new business opportunities there are up a bit. And so I think part of it is the activity we've had. I think it's also linked to, and, again, as Alan said, you can't draw perfect connections here, but there is disruption in the marketplace amongst some significant competitors. And I think our strong position with agents and brokers and the breadth of product that we have in capabilities have really helped us there. So I think we're very comfortable. As I also said, we're obsessing over the quality, so we're looking at all of those deals.

In the Other Business Insurance world, there is some specific opportunities. We've got a transportation company, Northland Insurance, that does the smaller end of the trucking business, so not the large fleets primarily. They've had some neat opportunities. There's been some opportunity in the Inland Marine and Boiler business, again, somewhat a result of some actions that other carriers have taken. So I think all of those things have added up to it. And I think, I guess the main point, it's not tied directly to pricing and price change opportunity.

<Q - Jay Gelb>: On the Business Insurance rate increase now turning negative, in the 10-Q, I saw in your outlook that for Business Insurance, the expectation is still a stable underlying combined ratio. Can you help me square those two factors?

<A - Alan D. Schnitzer>: Sure, Jay. It's Alan. When we talk about underlying underwriting margin in the outlook, what we're really talking about are dollars, not the combined ratio. And you could look at that as opposite sides of a coin, but we, for instance, would consider volume in there as well. But we've got the outlook being broadly consistent, and obviously we think about that as a margin of something around the prior year period.

But in that outlook, earned margin is a little bit negative, and we've got an expectation for large losses improving and volume also improving, and those two things adding give us an outlook of broadly consistent.

<Q - Jay Gelb>: I see. All right. And then my follow-up question is clearly you had elevated first quarter catastrophe losses; given all the destruction in Houston from the floods, if you can give us your perspective on that. Now, I know flooding isn't typically covered for things like homeowners, but it would impact comprehensive auto or maybe some commercial property insurance, if you could help us out there.

<A - Alan D. Schnitzer>: Yeah, Jay, we're not going to pre-announce second quarter results. I would say we're early in the quarter and we typically expect the typical spring storms in Q2. So again, from a human perspective, human side of the news is terrible, but there's nothing about this that strikes us as particularly unusual. There are bad second quarter storms.

<Q - Michael Nannizzi>: Doreen, just to follow-up then on Ryan's question on personal auto, so is it then fair then if it's a function of sort of new business vs. the older book that's impacting the loss ratio, so is it fair to assume that as long as the Quantum book continues to grow that that drags sort of continue to run through CY results?

<A - Doreen Spadorcia>: Michael, I'm not sure I heard the question, but was it that as long as we're writing Quantum Auto 2.0, we see a drag?

<Q - Michael Nannizzi>: Well, I think the answer to Ryan's question was something like it's not the new business discount so much a part of it, but it's also because the Quantum book is growing faster than the older book, so there's some mix as well. And so I'm just trying to understand like we had about 180BPS of drag in Q1. Is it fair to assume that as long as Quantum continues to outpace your legacy book in growth, that that drag will continue to roll forward?

<A - Doreen Spadorcia>: Well, Michael, in the outlook, what we said is that our combined ratio would slightly deteriorate. And so I think that's fair for 2016. So we did expect that that pressure would come, and a lot of it has to do with the volume of the business.

<A - Brian W. MacLean>: Yes. This is Brian. And I'm trying to get at what I think you're getting at. I'd make the point, the Quantum 2.0 profitability targets and margins are not different from our core book of business.

<A - Doreen Spadorcia>: Right.

<A - Brian W. MacLean>: It's the normal vintaging and aging of business. So if we continue to write significant levels of new business, that will have a comparable impact.

<A - Gabriella Nawi>: And...

<Q - Michael Nannizzi>: Okay.

<A - Gabriella Nawi>: Sorry, Mike, just to draw your attention it to; this is Gabby. Again, in the outlook, we do say the underlying underwriting margin and just to make fulsome, you've asked about the loss ratio, but, in fact, as we had talked about the Quantum product, it's the loss ratio and the expense ratio, given everything we had taken out. So if you look at the success of the product and what we're thinking about in terms of profitability, it all hangs together.

<A - Doreen Spadorcia>: Yeah. And look at the...

<Q - Michael Nannizzi>: Got it. Okay. Thank you.

<A - Doreen Spadorcia>: And to your point, the combined.

<Q - Michael Nannizzi>: Yeah. Great. And then just on the homeowners' side, just quickly, I saw the expense ratio tick down. It looks like that's sort of seasonally first quarter. But on the loss ratio side, is there anything that we should be thinking about in the underlying there or it looks like obviously you had cat activity, but was the non-cat weather element just lower in the quarter?

<A - Doreen Spadorcia>: Yeah. For Q1, it was favorable non-cat weather.

<Q - Michael Nannizzi>: Okay. Got it. And then last quickly, the tax…

<A - Doreen Spadorcia>: That made it favorable.

<Q - Michael Nannizzi>: The tax rate in the quarter, maybe this is for Jay.

<A - Jay S. Benet>: Yeah, I think you're asking the question why is the effective tax rate lower this quarter than it had been in prior year quarter. And the effective tax rate is always going to be driven by the mix of tax exempt income and fully taxable income. So what you're seeing here is the taxable income, fully taxable income, as a proportion of the total getting a little less because of the cat activity primarily. The change in the non-fully taxable income, the tax exempt income, was pretty de minimis. So if you do the math on that, you'll see that's the effect on the effective tax rate.

<Q - Paul Newsome>: Congratulations on the quarter. Is there a similar new business effect on the commercial lines side where the seasoning causes an increase in the accident year? And if we see a continued acceleration of new business in the commercial lines side, would we see a similar pattern that we're seeing on the personal lines side?

<A - Brian W. MacLean>: Yeah. In short, yes. There's a new business vintaging kind of concept, where if you've got disproportionately more new business, that would affect your performance on the current year stuff.

<A - Alan D. Schnitzer>: And, Paul, it's Alan. That's one of the reasons we point out that when we look at the higher levels of premium, it's pretty much evenly distributed between retention and new business. So it's not all coming from…

<A - Brian W. MacLean>: Yeah.

<A - Alan D. Schnitzer>: New business at higher loss ratios.

<Q - Paul Newsome>: Understood. Is it more or less pronounced, in your opinion, than we see in the personal lines business?

<A - Alan D. Schnitzer>: We're looking at each other. It's hard to say. It's probably similar, maybe a little less.

<Q - Paul Newsome>: Okay. And then separately, I'd love to know a little bit more, from a product perspective, where we're seeing the disruptions from the competitive perspective?

<A - Brian W. MacLean>: I mentioned some of them. In the construction space, there has been action by other underwriters in the larger account size on the casualty side. There's been some action in the loss responsive businesses. But I think it's also broadly across middle market, and this is where, as Alan said, you can't triangulate to precisely what the numbers are. I think that we have a very strong position with distribution. We've got quality products, and we're viewed as a very stable market. So I think the broad market conditions, even beyond specific products, have been helpful, maybe uniquely to us [ph] there. (46:15)

<A - Alan D. Schnitzer>: Yeah, Paul, we definitely saw it in those lines of business where we know some of our competitors were taking some actions, but we also saw retention just up generally across middle market. And so, when we look at the flow we're seeing and the businesses that we're seeing it in, it's pretty broadly based.

<Q - Sarah E. DeWitt>: Following up on the Business Insurance underlying margin, is it fair to say that it's stable this year mostly because there was higher non-cat weather in 2015, but then, as you look out going forward, it would probably deteriorate because prices are below loss cost inflation? Is that a fair assumption, or am I off?

<A - Alan D. Schnitzer>: Yeah, Sarah, it wasn't so much weather in Business Insurance as it was a higher volume of large losses in the last three quarters of last year.

<Q - Sarah E. DeWitt>: Okay.

<A - Alan D. Schnitzer>: And one of the reasons that we give outlook for three or four quarters is because it's just, our perspective beyond that gets unreliable, so I don't know. But what I would point you to is the way we've been able to manage returns across all three business segments over a long period of time throughout a bunch of different conditions. And so, you look at what Doreen and Greg and Michael have done in Personal Insurance by taking some difficult actions and repositioning that business and rolling out a new product; you look at what Tom Kunkel did in Bond & Specialty in a bunch of credit-sensitive businesses through a very difficult period in a financial crisis; think about what we've done in Business Insurance going back to 2010, when you look at the – we went back then, we looked at the outlook for returns and realized that we had to do some things differently.

So your perspective that it might fall off beyond where we're giving guidance for suggests purely current course and speed. And I would say that we're current course and speed now because we like product returns, and when we get to a point in time where we don't like product returns, then we'll do different things. So I wouldn't necessarily draw the conclusion you were drawing. But I don't know for sure.

<Q - Sarah E. DeWitt>: Okay.

<A - Alan D. Schnitzer>: We're all speculating beyond three or four quarters.

<A - Brian W. MacLean>: One of the other things that makes it very challenging is, we do talk about loss trend, and the loss trend is off of a starting point, and sometimes we adjust the starting point. You've heard us talk about base year movement. That comes about when we see favorable development and try to evaluate, well, what does that mean for the very loss picks that we had, that were the starting point for the loss trends that go forward. So it is, as Alan said, a pretty complicated set of variables that go into it, and the ability to look out much beyond three quarters or four quarters is a bit challenging.

<Q - Sarah E. DeWitt>: Okay, great. Thank you. And then just on, in Auto Insurance, the top line growth there was very strong. Could you just elaborate on what was driving that? And is that a level that we should view as sustainable?

<A - Doreen Spadorcia>: Well, what we've talked about, Sarah, is that the percentages probably won't be the same, because our base is growing. And, as you probably recall, Quantum 2.0 rolled out over a couple of years, and even including three more states this year, California, North Carolina and Massachusetts. And so, we think that the percentage will moderate, but we're not anticipating that the product would be less competitive.

We also are pleased to see, and so were our agents, that they're actually getting a disproportionate share of their new business from captives in the direct marketplace, which is something that we talked to them about.

So, I would say the percentage, we definitely don't think will stay the same, but probably from a count perspective, we expect it to continue to perform at similar levels.

<Q - Brian Robert Meredith>: A couple of just quick questions here, first, Doreen, I think you spoke at [ph] AFA (50:54) a little bit about increasing limits on homeowners. I'm just curious, kind of initial success you're having with that. How are agents responding?

<A - Doreen Spadorcia>: Brian, let me just make sure that I reset, because what we talked about at [ph] AFA (51:14) was we had pilots underway with 10 agents in a couple of states and we took all of those suggestions: some, few coverage; a lot of process changes; and some guidance on pricing. And all of that work is getting done now.

<Q - Brian Robert Meredith>: Okay.

<A - Doreen Spadorcia>: So we're anticipating later in the year, beginning of 2017, that that would be broadly available. So all the work's being done, but it's not yet broadly in the marketplace.

<Q - Brian Robert Meredith>: Is that going to require an increase in just your overhead expense, i.e. different types of claims adjusters as you get into that higher limit stuff; different types of underwriting, product, that kind of stuff?

<A - Doreen Spadorcia>: No, Brian. What we did as part of this assessment was looked at whether our current infrastructure, our current claim handling and our current product, could support that. We'll need to make a few tweaks to that, but we're not building this super high-end home capability. This is really the mass affluent and we think we have a really good match with our current capabilities in that marketplace.

<Q - Brian Robert Meredith>: Great. And just a quick one for Jay; Jay, it looks like your pension expense [ph] down, earned benefits (52:39) down about $17mm on a y-over-y basis. Is that something we should expect kind of going forward? And where does that hit in your P&L?

<A - Jay S. Benet>: Okay. Well, in terms of the P&L, it's in a couple of places because pension expense, of course, relates to head count. And head count ends up in G&A as well as ULAE. So it's in more than one spot. But as it relates to, you know, what's taking place in the pension area, you may recall in the 10-K, we provided a disclosure saying that we were adopting a new methodology that went into the estimation of pension, and that dealt with using a yield curve approach rather than a spot rate for looking at the interest and service costs to coincide with how the PBO was being calculated. And that did have a benefit, and that'll be a benefit that carries on into the future.

<Q - Meyer Shields>: I think this is for Doreen. When you have a quarter like this where catastrophes are a little bit higher, does that actually affect the G&A expense? I'm asking specifically homeowners, because that was down sequentially.

<A - Doreen Spadorcia>: Yeah, I didn't hear it.

<A - Alan D. Schnitzer>: I think it was about G&A expense?

<**A - Doreen Spadorcia**>: Yeah. No, not...

<**A - Jay S. Benet**>: No. Yeah, I think the answer is no, it doesn't really. There's obviously some claim expense that could be impacted, but...

<**A - Doreen Spadorcia**>: Right.

<**A - Jay S. Benet**>: But in that case, nothing unusual this past quarter.

<**A - Doreen Spadorcia**>: Yeah. And the only thing down the road I would say about G&A is if we have a very, very profitable year in home, that's where we would add contingent commission, and so we'd be really happy if that went up because it was a great year.

<**A - Meyer Shields**>: Okay. Yeah, that makes sense. And then more broadly speaking, I think you've mentioned the disruption in the marketplace a few times. Is there enough disruption out there to make it worthwhile to look at sort of building out the skill set into more specialty lines?

<**A - Alan D. Schnitzer**>: Well, there's nothing about the current level of disruption that's causing us to look at that, in the sense that we look at that all the time. We're always looking for opportunities to expand our product set and to drive our competitive advantages and capabilities into new lines of business, new products. So we certainly don't wait for a moment in time to do that.

<**Q - Jay Cohen**>: I guess question on the retention in Business Insurance; is it fair to say that this retention would have been at the upper end of what you might have expected given market conditions?

<**A - Brian W. MacLean**>: Yeah, Jay, this is Brian. Yeah. I mean, the 88% retention in Middle Market was very, very strong, and clearly would be at the upper end. We dissect where we're getting the retention. We feel great that it's about 90% in our best business. But it's our experience in the business would be that those are very tough levels to sustain.

<**Q - Jay Cohen**>: So given that, Brian, then did you guys ever think, gee, we could push a bit more on pricing, maybe let that retention settle in at a still phenomenal 84%, 85%? I know it's a tough balancing act, but is that part of your thought process?

<**A - Brian W. MacLean**>: So every single day in the marketplace, with every transaction, that's what our underwriters are doing. They're working with agents and brokers in the Middle Market and in the Other Business Insurance stuff account-by-account, and they're trying to determine what's the appropriate thing to do for that account. You can get caught up in the arithmetic of what you just said. And we do ourselves at times, but it's not as straight a line to say, well, if you reduce retention two points and you raise prices X, that's not exactly how the marketplace dynamics work.

But we are always trying to look at the retention rate trade-off and looking at that in the context, first and foremost, of the return that we believe we're generating on that account or that book of business and is it appropriate and where do we want to go.

<**A - Alan D. Schnitzer**>: Yeah.

<**A - Brian W. MacLean**>: So we're balancing it all the time.

<**A - Alan D. Schnitzer**>: I would take you back to the conversation about account-by-account execution.

<**A - Brian W. MacLean**>: Yeah. The graph that Alan referenced in his opening comments and...