Company Name: Travelers
Company Ticker: TRV US
Date: 2017-01-24
Event Description: Q4 2016 Earnings Call

Market Cap: 33,189.43
Current PX: 116.84
YTD Change($): -5.58
YTD Change(%): -4.558

Bloomberg Estimates - EPS
Current Quarter: 2.487
Current Year: 9.605
Bloomberg Estimates - Sales
Current Quarter: 6938.143
Current Year: 27981.091

Q4 2016 Earnings Call

Company Participants

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

Other Participants

- Michael Nannizzi
- Kai Pan
- Jon Paul Newsome
- Larry Greenberg
- Meyer Shields
- Brian Meredith
- Jay Arman Cohen
- Amit Kumar
- Ryan J. Tunis
- Elyse B. Greenspan
- Jay Gelb

MANAGEMENT DISCUSSION SECTION

Gabriella Nawi

Non-GAAP Financial Measures

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

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

Alan D. Schnitzer

Business Highlights

Operating EPS and Income

- This morning we released solid underwriting and investment results with record net and operating EPS for the quarter
- Operating Income was $919mm, generating an operating return on equity of 16.4%

- This brings our full year operating income to nearly $3B and operating return on equity to 13.3%
  - That's in line with the 13.5% average annual operating ROE we've delivered over the last ten years
- During the year, we grew adjusted book value per share by 7% after returning more than $3.2B of excess capital to our shareholders

Underwriting Results

- Overall, our underwriting results for the year were strong as evidenced by our consolidated combined ratio of 92%
- Underwriting results in Business and International Insurance were solid, and once again, we posted impressive underwriting results in Bond & Specialty Insurance
- Despite the disappointing impact of higher than expected personal auto bodily injury losses, our Personal Insurance combined ratio for the year was 95.1%, demonstrating the value of having a balanced homeowners and auto personal lines business

Commercial Business

- In our commercial business, we continue to be successful in the execution of our marketplace strategy
- That resulted in continued historically high levels of retention and positive renewal premium change in the quarter, all of which reflects stable environment

Core Middle Market Business

- In our core middle market business, pure renewal rate change improved by a full point from Q3 as we continue to execute at a very granular level to achieve our return objectives
- As you will hear from Brian, in terms of new business, we continue to be quite active in terms of submission and quote activity, but also thoughtful in terms of underwriting discipline

Personal Insurance

- Turning to Personal Insurance, as you've seen, the results by line were mixed
- Our homeowners business, once again, produced excellent results and grew net written premium for the first time since 2011
- In our auto business, we're clearly disappointed by the underwriting results
- During Q4, bodily injury losses were higher than expected, and they developed unfavorably for the first three accident quarters of 2016, and the back half of 2015

Quantum Auto Product

- Our claim data, the public chatter we hear from others in the marketplace and other third-party data, all cause us to continue to believe that our experience is principally environmental as opposed to specific to us or a Quantum Auto product
- Loss trends change in our business, and as I said before, our objective is to recognize it and react to the data we have as quickly as possible

- We're taking actions to improve the personal auto profitability, and Brian will address this in more detail

Conclusion

Before I pass the mic to Jay Benet, let me conclude with this, 2016 was another strong year, adding to our long-term track record of delivering superior results

We entered 2017 with a great deal of momentum, and we're well positioned for continued success

Jay S. Benet

Financial Highlights

Net and Operating Income

- As Alan mentioned, we're very pleased with our results this quarter
- A record net and operating income per diluted share of $3.28 and $3.20 respectively, operating Income of $919mm, up 4% from the prior-year quarter, and operating ROE of 16.4%
- These results were driven by the continued solid underwriting performance as evidenced by our consolidated combined ratio of 90%, which included the favorable impact of prior year reserve development, which I'll discuss shortly, as well as the unfavorable impacts of cat losses of $137mm pre-tax that related to Hurricane Matthew and the fires in Tennessee, and higher than expected auto BI losses in Personal Insurance

After-Tax Net Investment Income

- The quarter also benefited from the settlement of a reinsurance dispute and higher after-tax net investment income, which after increasing sequentially quarter-by-quarter this year, increased 12% this quarter over the prior-year quarter, all due to higher non-fixed income returns
- Fixed income NII of $405mm after-tax was down $17mm from the prior-year quarter due to the continuing impact of the low-interest rate environment

Interest Rate Environment

- Looking forward into 2017, and based on the current interest rate environment and the specific securities that are scheduled to mature in 2017, we expect approximately $15mm to $20mm of lower after-tax NII on a quarterly basis in 2017, when compared to the corresponding periods of 2016
- This is $5mm per quarter improvement from what we communicated last quarter, due to the recent rise in interest rates and, of course, if interest rates were to continue to rise from their current levels, this expected decrease in fixed income NII would be reduced even further

Equity Returns

- In contrast to the decrease in fixed income NII, non-fixed income NII of $96mm after-tax was up $71mm from the prior-year quarter, driven by significantly higher private equity returns
- We continue to experience net favorable prior-year reserve development on a consolidated basis, which totaled $264mm pre-tax this quarter, down a bit from the $292mm pre-tax in the prior-year quarter

Business and International

- In Business and International, net favorable development of $234mm pre-tax was driven by better than expected loss experience in workers' comp and general liability, while in Bond & Specialty, net favorable development of $75mm pre-tax resulted from better than expected loss experience in fidelity and surety and general liability
- Reserve development was unfavorable this quarter in Personal Insurance, $45mm pre-tax, driven by higher than expected auto BI injury losses related to the latter part of the 2015 accident year
  - This corresponds with the increase in auto BI loss estimates that we made for the current accident year, which Brian will be discussing

U.S. Operation

- In total, for the full year, we had consolidated net favorable reserve development of $771mm pre-tax with approximately $665mm coming from our U.S. operations, and $106mm coming from International
- As I have done in the past, I'm also providing you with some insight into what our combined 2016 Schedule P is expected to show when we file it on May 1
- On a combined stat basis, for all of our U.S. subs, all accident years, across all product lines, in the aggregate will have developed favorably
- On a Schedule P product line basis, all of our commercial products will show favorable development or very modest amounts of unfavorable development

Personal Insurance

- For Personal Insurance, homeowners will show a modest amount of unfavorable development, primarily resulting from the higher than expected loss experience that I discussed in Q3 webcast that related to a small number of liability claims from accident years 2013 and 2014, and private passenger auto liability will show the unfavorable development that I just referred to
- There are two topics I would like to cover relating to reinsurance:
  - First, we're very pleased this quarter to have settled with one of our reinsurers in the USF&G vs AmRe, et al. case, a reinsurance dispute that's been pending for many years
- As a result of the settlement, we recognized $126mm pre-tax or $82mm after-tax gain in our fourth quarter earnings
- I refer you to the Form 10-K (sic) [8-Q] that we filed on November 8 for more information related to this settlement

XOL Treaty

- Second, as shown on page 21 of the webcast, effective January 1, we renewed our corporate cat aggregate XOL treaty that provides coverage for both single cat events and an accumulation of losses from multiple cat events with similar terms as in the prior year and at a slightly lower cost
- The treaty continues to provide $1.5B of coverage, part of $2B excess of $3B after $100mm deductible per occurrence

    - It keeps the same broad peril and geographic coverage and the same positioning of the coverage layer, providing a significant buffer between earnings and capital
  - The treaty has a single limit with no reinstatement provisions
  - And please note that the total cost of this treaty, and therefore the reduction in cost are quite small in relation to our operating income

Operating Cash Flow

- Operating cash flows were very strong this quarter, $1.14B including the proceeds from the settlement of the reinsurance dispute I just mentioned and after making $200mm discretionary contribution to our now fully funded U.S. qualified pension plan, bringing total operating cash flows for the year to over $4.2B
- We continue to generate much more capital than is needed to support our businesses and, consistent with our ongoing capital management strategy, we returned $942mm of excess capital to our shareholders this quarter through dividends of $191mm and common share repurchases of $751mm
- For the full year, we returned over $3.2B of excess capital to shareholders through dividends of $762mm and common share repurchases of over $2.4B.

Liquidity

- Holding company liquidity ended the year at $1.68B, well above our target level and our debt-to-total capital ratio, excluding the impact of net unrealized investment gains, ended the year at 22.3%, well within its target range
- Net unrealized investment gains were $1.1B pre-tax or $0.7B after-tax, down from almost $2B and $1.3B respectively, at the beginning of the year, due to the recent run up in interest rates and spreads

Fixed Income

- As you may recall, we generally use a buy and hold approach with fixed income investing
- So any change in unrealized that relates to a change in the general level of interest rates is something we do not pay much attention to
- Cash flows from the portfolio are what matter to us
- Book value per share of $83.05 grew 4% from the beginning of the year, and, importantly, adjusted book value per share of $80.44, which eliminates the after-tax impact of net unrealized investment gains grew by 7% this year

Brian William MacLean

Operating Highlights

Business and International Insurance

- I'll start with Business and International Insurance, where we are pleased with our full-year financial and production results
- We continue to generate excellent returns achieving a combined ratio of 94.3%

- Retention for our domestic businesses remained at historically high levels and we successfully achieved positive rate change with renewal premium increases of over 2%
- As Alan mentioned, retention for the industry remains very strong, reflecting a stable marketplace, and in that light, we were quite pleased that we were able to generate nearly $2B of new business premiums, up slightly from 2015

Q4 Results

Operating Income

- Looking at the quarter's financial results, operating income of $722mm was higher than the prior-year quarter by $156mm, with a very strong combined ratio of 89%
- Operating income included the $82mm after-tax gain related to the settlement of a reinsurance dispute that Jay mentioned earlier
  - This gain was in other income, and accordingly did not benefit the combined ratio
- The underlying combined ratio, which excludes the impact of cats and prior year reserve development was 93.1%
- The underlying loss ratio was 1.4 points lower than the prior year, due to lower large losses and non-catastrophe weather-related losses, partially offset by a modest amount of margin compression

Production Growth

- Turning to production, given the returns that we are generating in the segment, our focus continues to be on retention, and we are very pleased that retention for our domestic business remained at 85% for the quarter
- Renewal premium change of 2.5 points included renewal rate changes of 0.7 point, which was higher than recent quarters, while new business came in at $439mm for the quarter

Middle Market

- Turning to the individual businesses, in select, retention continued its improving trend and came in at a strong 83%
- Renewal premium change was nearly 6 points, and we generated new business premiums of $92mm, up 7% vs. the prior year
- In middle market, retention of 87% remained at a historically high level, while renewal premium change was over 2 points, including 1.4 points of renewal rate change, a full point higher than Q3

New Business Activity

- New business activity, as measured in submissions and quotes has been up for the year, and in the quarter remained consistent with the prior year
- However, as 2016 progressed, fewer of these opportunities met our underwriting standards and/or return objectives and accordingly new business premiums of $226mm in the quarter were down 9% y-over-y

Other Business

- In Other business, insurance renewal premium change was down slightly with a relatively flat rate environment compared to Q3 2016
- While retention remained strong at 80% and new business premiums of $121mm, new business volumes for other business insurance were impacted by the same market dynamics I discussed in middle market

International Performance

- In International, production results were very strong in the quarter
- Retention remained at 82%, while renewal premium change of over 2 points was higher than recent quarters, with the biggest single driver of the increase being Lloyd's, which due to the transactional nature of that market is subject to variability
- New business volume of $91mm was up 14% y-over-y driven by Lloyd's, including the results of our new global construction and renewable energy groups
  - So, all in for the segment, it was a very good quarter, capping off the year with strong production and profitability

Bond & Specialty

- Before turning to Bond & Specialty, I want to comment on our outlook for operating margins, which we include in our quarterly filings
- Since our 10-K won't be filed for a few weeks, I would note that we expect underlying underwriting margins and the underlying combined ratio during 2017 will be broadly consistent with those in 2016
  - This is subject to the usual caveats and forward-looking statement disclaimers

Operating Income

- I'll now turn to Bond & Specialty Insurance, which continues to perform exceptionally well
- Operating income for the quarter of $161mm remains strong and was in line with the prior-year quarter as an improved underlying underwriting margin was offset by a slightly lower level of net favorable prior-year reserve development, the underlying combined ratio of 79.7% for both the quarter and year, with the full year result being an all-time best for the segment
- On top line, net written premiums for the quarter were consistent with the prior year for both surety and management liability

Management Liability Business

- In our Management Liability business, we continue to execute our strategy of retaining our best-performing accounts while writing new business in return adequate product segments
- And so, we couldn't be more pleased that retention for the quarter was a record 88% while we added $41mm of new business
- Renewal premium change of 2.3 points is down about a 1 point from recent quarters, reflecting a mix change impacting average policy duration
- The other components of renewal premium change that drive profitability were essentially unchanged

- So Bond & Specialty results remain terrific and we continue to feel great about the segment's performance and execution in the market
- In terms of outlook, as with Business Insurance, for 2017, we expect both the underlying underwriting margin and underlying combined ratio will be broadly consistent with 2016

Personal Insurance

- Turning to Personal Insurance, net written premiums for the segment grew 12% in the quarter with a combined ratio of 98.2% and an underlying combined ratio of 93.2%
- For the full year, net written premiums grew 10% with a combined ratio of 95.1% and an underlying combined ratio of 90.1%
  - So, overall strong results for the segment but results by line were mixed

Auto Combined Ratio

- In auto, as Alan mentioned, we booked further upward revisions in our loss estimates for 2016 and for H2 2015
- The auto combined ratio for the quarter was 116.7% and includes both the full year impact of the bodily injury related adjustments that I just mentioned and seasonably higher fourth quarter loss levels
  - So, instead of taking you through a detailed reconciliation of the quarter, it would be more productive to focus on the full year ratios

Book of Business

- For the full year combined ratio, we had a 104.0%, and the underlying combined ratio was 101.8%
- These were both higher than we expected and at a level that does not meet our target returns
- The full year 2016 underlying combined ratio included about 2 points from the tenure effect that we discussed last quarter
- As we said then, when you are growing your book of business, the higher levels of new business will temporarily increase the combined ratio and the impact of tenure in the year was as we expected

Liability Loss

- In addition to the impact of tenure, the full year 2016 underlying combined ratio was elevated by 3.5 points due to the recognition of the increased bodily injury liability losses
- This result represents a gap that we are working to close
- You will recall that we reacted to signs of adverse bodily injury loss development with a reserve adjustment in Q3
- Unfortunately, since then we saw further development in excess of even those increased expectations, which drove our actions this quarter

The National Safety Council Report

- The deterioration is primarily driven by an increase in the trend towards more severe accidents
- Some of the factors that lead us to this observation are a higher percentage of claims involving distracted driving, more accidents involving higher speeds, and more accidents on highways and at intersections
  - This is also consistent with recent industry data; for example, The National Safety Council report of significantly higher traffic fatalities in 2015 and 2016, a two-year trend that we haven't seen in decades

Underwriting Process

- In response to these developments, we are taking action in the marketplace
- Our primary response is to file for increased base rate and in November and December of 2016 rate increases were implemented in 16 states, which cover about 60% of our quote volume
- More rate changes at higher aggregate levels are planned for 2017, along with other ongoing actions to refine and optimize our underwriting process
- The combined impact of these actions should be to both reduce the rate of growth and improve profitability
  - While it will take 18 to 24 months for the actions we're implementing to fully earn into the portfolio, we do expect that the auto combined ratio will improve in 2017

Homeowners & Other

- Turning to Homeowners & Other, our results for the quarter and the full year remain strong and reinforce the value of a portfolio underwriter
- The underlying combined ratio of 70.4% for the quarter, and 75.7% for the year, demonstrate consistent performance relative to 2015
- In terms of top line, 2016 saw growth in net written premiums of 2% and we look to continue the momentum in 2017
- So as I said, mixed results by line in the segment, with challenges in auto mitigated by strong results in home, resulting in a segment combined ratio of 95.1% for the full year

Auto Results

- We are fully aware that our recent auto results need to improve
- Pricing and underwriting actions we're implementing should put us on track to deliver a more profitable portfolio in the years ahead
- Finally, as it relates to our outlook for Personal Insurance, we expect underlying underwriting margins during 2017 will be slightly higher than in 2016, and the underlying combined ratio during 2017 will be broadly consistent with 2016

Agency Automobile

- In Agency Automobile, we expect underlying underwriting margins and the underlying combined ratio will improve in 2017, compared to 2016
- In Agency Homeowners & Other, we expect that underlying underwriting margins will be slightly lower, and the underlying combined ratio will be slightly higher in 2017 than in 2016, reflecting higher and more normalized

levels of loss activity

QUESTION AND ANSWER SECTION

<Q - Michael Nannizzi>: Brian, maybe a little bit on auto. If you could just give us some indication of how we should be thinking about sort of the starting point for 2017, and given the adjustments you have made through the year, when should we start to see the rate increases flow through and should we expect the starting point to be closer to the developed loss ratio picks that you have set now for 2016?

<A - Michael F. Klein>: Michael, this is Michael Klein from Personal Insurance. I'll take a crack at that. So, I think you will see the rate increases start to flow through in Q1. As Brian said, we began making rate filings in Q4, really in response to what we saw in Q3. The rate filings that we're now making as we look ahead to H1 reflect the increased loss of content that we saw in Q4. Importantly, you don't see a lot of Q4 rate-filing activity in the production statistics, just because of the timing of those rate increases. They went in November and December, largely impacted renewals not until December, and so it's really a timing issue in terms of not seeing that show up in Q4 this year. But we would expect that you'll see the rate momentum start to build in Q1 2017 and continue from there.

In terms of the starting point for 2017, I would say two things. First of all, as Brian mentioned, that 3.5 points that you see on the webcast slide, he mentioned that represents a gap that we're looking to close, and so in other words, that 3.5 points is built into our baseline expectation as we start 2017. And then we're taking trend and forecasting that forward from that point. So the starting point does include that 3.5 points of additional losses and the gap that we're looking to close.

<A - Brian William MacLean>: Yeah. Michael, this is Brian. I would also just emphasize, obviously, thinking through the written vs. earned dynamic with the rate. And as we, obviously, get it on a written basis it has to earn in over time, hence my comment of 18 to 24 months to work through the 3.5 points.

<Q - Michael Nannizzi>: Got it. Got it. Okay. That's helpful, thanks. And then when you think about the – and most of your policies are 50/50 annual vs. six-month policies, is that right? Or it's somewhere in that range?

<A - Michael F. Klein>: It's a little bit more tilted towards annual, so it is about 60/40 annual vs. six months.

<Q - Michael Nannizzi>: Okay. Got it. And then Brian when you mentioned sort of the margin outlook for 2017 vs. 2016, does that contemplate that whatever trend you're seeing is sort of the nadir and that we're not going to see more deterioration? Or does that contemplate that you're going to see that the loss-trend continue to increase at maybe some pace, not at the same level as we have seen, or if you could give some context there? Thanks.

<A - Brian William MacLean>: Yeah. I think, as Michael just said, that the 3.5 point elevation is built into our expectation. Above that, we're expecting kind of normal 3.5% loss trend, which includes a more normal inflation of severity, but we don't expect another spike. Michael, if…?

<A - Michael F. Klein>: Yeah, I would say and just to clarify, so Brian mentioned the 3.5 point loss trend, that is an elevated loss trend relative to where we have been. So the forecast, importantly, I think it's important to take away that it includes both the increased baseline and a higher trend estimate going forward than we had in the past. It's modestly higher, but it is a bit of an increase in trend.

<Q - Kai Pan>: First question is just on the sort of deterioration of fourth quarter. If you are looking back on Q3, what exactly sort of like accelerated in terms of loss cost trend from Q3? And just want to get a confidence level that what you book in Q4, you think that's it, and it probably not be much material like a deterioration from that levels?

<A - Alan D. Schnitzer>: Yeah, so the first thing I would say, Kai, it's all the normal stuff. Now we're talking about very recent accident periods for a very long tail line of business. So, just as a perspective. At the end of 2016, we have paid less than 15% of what we believe the ultimate losses will be for auto bodily injury. So it's by nature a long-tail line of business, so it takes a while to play out. We're looking at all of the activity that we see both in frequency and severity of loss, cut every which way you can think of, and looking at frequency activity, incurred losses, paid losses, and importantly, we're also, as we went into 2016, we're looking at that coming off of 2013, 2014, and early 2015, where we actually had slightly favorable development in the 2013 and 2014 years and consistent experience in the early part of the 2015 year.

So we're looking at the history that we have coming into the year. As we went into 2016, we started to see a little bit of movement in Q4 2015 and early 2016, but still within our range of expectations. We got to Q3, and those periods, again, Q4 2015, first two quarters of 2016, started to elevate above the expectations, hence we took the activity and the actions that we did last quarter, and this quarter as we look at all of those periods, again, now we're looking at the end of 2015, early first three quarters of 2016, and obviously now another quarter of data, we saw a continuation in that trend that was accelerating. And we took what we think was the appropriate management's best estimate given all of those factors. And we feel good about it. But there's certainly no guarantees that we can see what's going to happen next quarter. I mean, Michael, if you want to…

<A - Michael F. Klein>: Yeah, I think that's exactly right. I think it's a combination of additional development on the periods that we saw before, and an additional quarter's worth of data that, again, reflects the fact that that adverse development continued through the end of the year, and we've made our best estimate based on the information Brian just described.

<Q - Kai Pan>: Okay. Thanks, very comprehensive. My follow-up on the auto side, again, is that, if you look at PIF growth, 13% y-over-y, has actually accelerated from the last few quarters. As you increase price, do you think that one coming down? And do you think the 2 points on the new business penalty impact will be smaller in 2017?

<A - Michael F. Klein>: Thanks, Kai, this is Michael. I would say a couple of things and let me give you a little bit of the moving parts underneath the PIF growth in Q4. We do expect as we put rate into the marketplace and put additional rate into the marketplace that our win rates will decline. So on the business that we quote, do we convert it? We've actually seen in the 16 states that Brian mentioned, our win rates have come down as we put that rate into the marketplace. So think of that as our batting average, right? Our batting average is dropping as we put rate into the marketplace. The reason PIF growth is up in Q4 is actually largely driven by the fact that we ended up with more at-bats than we expected in the quarter. So quote growth is actually elevated, so we've got more plate appearances, if you will, but the batting average, the win rate has actually come down in response to the rate.

Again, we think some of that is timing. Some of that, as we mentioned last quarter, the ultimate impact of the actions we take depends somewhat on the fact that we're in a competitive environment and the impact on growth depends a little bit on what happens in the marketplace. And so our perception of what happened in Q4 is we took rate, so did the market, the rate impacted our batting average, but the rate also drove business into the market, which drove that quote growth. So the PIF growth is really a quote growth story, not a conversion rate story. In terms of your question about expectation as we look ahead, our actions are focused on two things: improving profitability and managing growth.

So I gave you a little bit of an outlook for 2017 rate looking ahead into Q1. We would expect rate will rise and growth will drop as we look into Q1. What ultimately happens will depend on how those actions play out in the marketplace.

<Q - Jon Paul Newsome>: I wanted to switch the question on to the commercial business a little bit. And I was wondering if you could give just a little bit more color on the pricing environment in the domestic insurance business, and it's a little bit tough to read the tea leaves, but is it better, is it worse, is there really any change from a competitive perspective in that business?

<A - Brian William MacLean>: Yeah, so Paul, this is Brian. I'll start. I'm sure there will be follow-ups to this. But broadly speaking, we feel good about the trends that we see. When you look across the data on the renewal book, we continue to see some, albeit modest, but pretty consistent improvement in what we're seeing and we're encouraged by that. We think that might be somewhat a reflection of the market, but fundamentally I think it's a reflection of our execution. Our strategy on our portfolio remains incredibly consistent, and that is to look at it on a very granular account-by-account, or class-by-class basis, and simplistically for the really well-performing businesses, keep it at the best price that we can keep it at, and the appropriate price, and then work hard at improving the rest of the portfolio, and when we look at that granular level, we feel really good about the momentum, and also feel good about the aggregate statistic. So directionally we feel positive.

<A - Alan D. Schnitzer>: Paul, it's Al. I would add to that that it's not just a market dynamic, it's our execution dynamic. It's very granular, as Brian said, account-by-account, class-by-class, and I think, in some respects and importantly it's the franchise value we bring to the marketplace. So, we look at an account and we figure out what we need to do to achieve the written objectives that we have. And I would say broadly speaking we've been successful.

<Q - Jon Paul Newsome>: How closely does the commercial auto business or has the commercial auto business tracked the results of the private passenger auto?

<A - Alan D. Schnitzer>: Paul, I'd say that we see a lot of the same trends in the businesses. They are different businesses. They have different starting points. The coverages aren't exactly the same. For example, on the Personal line side, you've got uninsured and underinsured motorists, that's not such a factor on the commercial side. So, I would say broadly speaking, the trends are consistent, we see consistency across them. But the results don't actually come out the same for a whole host of reasons.

<Q - Jon Paul Newsome>: So, we haven't seen the severity issue, even at a lower level in the commercial line.

<A - Alan D. Schnitzer>: No, no, I wouldn't say we haven't seen it. We have seen it. It has impacted recent years. We see a lot of the same trends, but on the auto side, it's largely private passenger, on the commercial side you got a lot of trucking, so you got different dynamics there. Also it just manifests itself differently. On the Personal line side, auto is obviously a bigger contributor to the segment, more in terms of volume. So it just manifests itself more prominently on the BI side. Obviously, commercial auto is a smaller piece of the whole, so it manifests itself differently. So we do see very consistent trends across both books.

<Q - Larry Greenberg>: So I want to go back to the auto, and I appreciate that you think it's mostly environmental on top of the tenure issue. But I guess I just want to challenge you a bit on this, and just question whether you think it's fair to say that that maybe you picked up on some of these environmental factors later than some of the others did. And if you agree with that, why do you think that's the case?

And I kind of say this in the context of, when you were growing rapidly in auto, and before you picked up on the BI trends, I know you talked about being keenly focused on what was driving that growth, so I'm just curious on your thoughts on all that.

<A - Brian William MacLean>: So, Larry, this is Brian. And I'll start with – there's a lot in your question. And we do believe it's a fundamentally environmental issue. We would never say it is definitively, exclusively an environmental issue. As I think I said last quarter, as I'm sure I said last quarter, Quantum 2 is a relatively new product that we're working out, and accordingly, we are very attuned to looking at how it is performing, and always looking to improve it. I would not agree with your statement that we are late to seeing the fundamental trend of what's going on in bodily injury severity, and without doing a long history, you can go back 2011, 2012, 2013, we were talking about this a lot. Distracted driving and speeds are not brand new things, and we were talking about it then.

We got to 2013 and talked about a elevated level of bodily injury, and we were hoping that that would remain pretty constant, and we went through about a two-year period, 2013, 2014, into 2015 where we saw very constant, again, elevated levels, but constant with our expectations of what we were getting in bodily injury. In fact, 2014 has developed favorably and we continue to see that. And what we are talking about now is another increase in that trend and we're talking about very, very recent accident periods, and looking at the data and responding, I think, pretty quickly. And so, I think there's a bunch of things.

Further on the comment of you're sure it's not Quantum 2, we're sure it's not exclusively Quantum 2, because when we look across our business, the same fundamental trends are in the legacy book of business, are in the Quantum 1 book of business, are in the Quantum 2 book of business, are in the Business Insurance business, it's in industry data, it's with other carriers. So it's not exclusively a Quantum issue. With that said, we are very granularly looking at how that product is performing, state-by-state, cell-by-cell, and reacting. So, I know that's probably sounding way more defensive than I should, but it...

<A - Alan D. Schnitzer>: The one thing I would add to that – Larry, it's Alan. The profile of the business that we're attracting, we actually like it. So, we look at the profile of all the business coming in, and if we didn't like that profile, we would have a different answer for you. But fundamentally we like it. We just like it at a higher base rate.

<Q - Meyer Shields>: One, I guess, question on the actual quarter. There was a slowdown in exposure unit growth within the middle market. I was hoping you could talk to that a little bit.

<A - Michael F. Klein>: Meyer, there's nothing fundamental in terms of trends changing there. There is always going to be some normal volatility from quarter-to-quarter in things that drive the exposure. But there's really nothing fundamental that we would identify as a trend.

<Q - Meyer Shields>: Okay. So, not related to the improving renewal rate changes?

<A - Alan D. Schnitzer>: No.

<A - Michael F. Klein>: No.

<Q - Meyer Shields>: Okay. And then, more broadly speaking, when you look at the targeted after-tax returns, would a change in tax rate change what you are targeting?

<A - Michael F. Klein>: Yeah. It's an interesting question, and I guess – instead of answering that specific question, Meyer, let me just back up because, my guess is there is a lot of questions on the call in terms of changing administration, macro environment, how it's going to change a lot of different things. So maybe I'll just back up.

We are very return focused in the way we think about this business. It is the lens through which we evaluate just about every decision that we make. And so, we calibrate our return expectation to our cost-of-capital. And so, there are couple of things going on that could impact our cost-of-capital. For example, if the risk-free rate goes up, cost of equity goes up. If the tax rate goes down then our after-tax cost of borrowing theoretically goes up. There could be other things in a change in tax policy. But, if you just started with those two simple assumptions, you'd look at that and say, gee, if the risk-free rate goes up and if the tax rate goes down, you would speculate that our overall cost of capital would go up. If our overall cost of capital went up then our return objectives would go up with it.

<Q - Brian Meredith>: A couple questions here. Just, first, on the personal lines, do you think that the rate actions you're taking on auto insurance will have an impact on homeowners growth here going forward?

<A - Michael F. Klein>: I think that's possible. We've certainly talked about the fact that our auto growth has – one of the benefits of our auto growth has been growth in home. That said, we're doing what we can to mitigate that impact. And we have specific actions we're taking from an agency management and a distribution standpoint and in other areas to try to make sure that any impact from the rate actions in auto don't have an impact on our ability to grow home. We're trying to continue the momentum that we have in the home line into 2017.

<A - Alan D. Schnitzer>: In other words, they definitely correlate, but we think they're – we're hopeful there are things we can do to offset that and try to lever up the home growth.

<Q - Brian Meredith>: Got you. And then the second question, on the domestic Business Insurance, we have seen your rate activity kind of modestly increased the last several quarters. Is that a trend we should continue, and are you getting to a point now where you're saying, all right, can't let the underlying loss ratio deteriorate kind of anymore on an underwriting year basis?

<A - Alan D. Schnitzer>: I know this won't be totally satisfying, but I think we're going to go back and answer we give, which is we look at the accounts that are up for renewal every quarter, and we try to figure out what we need to do to achieve our written-return objectives. And it's every single one of those transactions or every portfolio on the flow stuff really evaluated one at a time that rises up to that number. So we don't paint with a broad brush. We don't go out to the market and say, get 1.4 points of rate in middle market, we say this is our overall return objective and go out and execute one account across at a time to get there and we will when we get to the 10-K give you an outlook on RPC. So we haven't shared that yet. It will be in the 10-K when it comes out. But we never forecast uniquely on pure rate.

<Q - Brian Meredith>: Right. But you are forecasting for a flat underlying combined ratio, right for the next year, and that's – if I remember correctly, that was part of it. But yeah, there's going to be better non-cat weather [ph] lease (46:17) normalization and then deterioration from rate below trend, right?

<A - Alan D. Schnitzer>: Yeah. So the margin compression that we've had this quarter and the last few quarters has been relatively modest, and this quarter and past quarters it has been within other things that caused volatility in the period-over-period comparison, most notably this quarter, and probably recent quarters, weather and large losses. So, when we give you that outlook, and yes, we did say broadly consistent, and we're certainly not measuring to the basis point. But broadly consistent within a relatively narrow range, that takes into account lots of things: rate, loss trend, mix, claims handling initiatives, other strategic objectives. So it really is sort of an all-in assessment, and we try not to focus too narrowly on that narrow rate loss trend, you've got exposure in there too contributing to margins. So it really is a broader perspective when it comes to our outlook on margin.

<Q - Jay Arman Cohen>: Yeah. One more question, I guess, about the new administration. Obviously, something that has been talked about relative to taxes is a border adjustment tax. And I'm wondering if you could share your thoughts on how that may affect your purchase of reinsurance from non-U.S. companies?

<A - Alan D. Schnitzer>: Jay, good morning, it's Alan and let me start. It's really hard to answer that question without knowing what the border adjustments is going to look like. We've all read it depends on whether it gets characterized as an export or an import and whether the dialogues are defaults to the Neal Bill, and we'll see where that comes out.

I think broadly speaking, as it relates to us and reinsurance, I think our answer would be we're by and large a gross line underwriter. We like our underwriting, we like to keep it and we buy reinsurance in pretty modest amounts. And so, if there were a tax adjustment that changed the cost of reinsurance, obviously we could look for alternative providers of reinsurance, we could buy a little bit less, buy a little bit more. But it would come down to evaluating the individual transaction, but I think the broader point for us is reinsurance just isn't that big a deal for us.

<Q - Amit Kumar>: Two quick follow-ups on personal auto. The first question I have is if I go back and look at the rates that were put in place for 2016, I guess, average rate filings were in the range of, let's say, 3% or so. So when you talk about the rate filings in November, December, and going forward, how should we think about that number compared to the historical 3% average number?

<A - Alan D. Schnitzer>: Good morning, Amit, it's Alan. I would say it's a pretty broad range. It depends on the state, and even there, it depends on two things. One, our experience in that state, and the rate need, but also, recent rate filings in that state, right, because there's a cumulative nature to it. But certainly, it's getting bigger than what you had seen earlier in 2016, and we expect more of the same during 2017 to try to close that gap of the 3.5 points.

<Q - Amit Kumar>: Okay, so probably more than that. Is that a fair way to look at it?

<A - Jay S. Benet>: Definitely.

<A - Alan D. Schnitzer>: Yes, definitely. Definitely.

<Q - Amit Kumar>: Okay. The second question, and the final question I have is you talked about 60% of your book, 16 states. You said more filings were in the pipeline. Is that immediate? Is that like a Jan-Feb thing, or is that more spread out vs. the actions taken in the past?

<A - Michael F. Klein>: Amit, this is Michael. I would say just to first clarify the comment, so the comment was 60% of our quote volume. So, again, think of that as if that's a new business statistic, right? So the 16 states that we filed insofar, those represent roughly 60% of our new business quote volume. Not exactly the same as 60% of the book, just a point of clarification.

I would say the majority of the rest of the states have rate filings planned for Q1. And so, broadly speaking, we will have made rate filings in the majority of the states where we have the auto product by the end of Q1. We also have additional rate actions planned for later in the year. And that obviously is all subject to regulatory approval and regulatory constraints as to the timing and the amount. But I would say the first round ought to be in market by late in

Q1, and then we've got follow-up actions on the drawing board as we look into the remainder of 2017.

<Q - Ryan J. Tunis>: My first question, I guess, is for Brian and it's on the new business penalty. It doesn't sound like the thinking has really changed on the impact of the new business penalty. I guess, even though the environment revealed itself to be a bit more of an issue maybe than we thought a couple quarters ago. Just what gives you confidence to continue to compartmentalize the BI severity vs. the new business drag, especially when we think about the fact that a pretty good size of the book is new business. And, I guess, along those lines, if there still is a big tenure impact, why wouldn't we assume that a lot of that strain alleviates itself in 2017 with the growth pull back?

<A - Brian William MacLean>: Yeah, so a couple of things. So, I think of the tenure impact as being discrete from the bodily injury trend. And, so the tenure impact is just the math of the maturing of the book-of-business. And, in fact, where it goes in 2017, is a function somewhat of what growth rates do. It will likely increase in 2017 slightly, as the growth that we've seen in the back half of 2016 earns through the business. But, I think of the tenure impact as more of just the arithmetic of – I don't think of it as a new business penalty as in a BI where you are pricing differently.

<A - Michael F. Klein>: And again, this is Michael, I would say just to reinforce what Brian said, when we talk about the tenure effect, what we're really trying to do is just isolate the impact on the loss ratio from the relative age of the business, if you will, right? How tenured it is, what renewal it is at?

And as Brian said, it's essentially a mathematical exercise to estimate what that component is worth, and then the rest of it, the environmental trend that we talked about, the 3.5 points that's in the full-year loss ratio is absolutely the gap that we're actively working to close.

What we do in the meantime is we monitor the performance of the tenuring...

<A - Brian William MacLean>: Yeah.

<A - Michael F. Klein>: And try to isolate that and make sure that that is developing as we expected, and that analysis has remained relatively consistent and is why we continue to have that same 2% estimate a quarter later.

<Q - Ryan J. Tunis>: Okay. That's helpful. And then a couple quick ones for Jay Benet. First, on the workers' comp and then general liability, just curious the accident years and those reserve releases. And also, just any color on how new money yields have changed, I guess, today vs. the end of Q3? Thanks.

<A - Jay S. Benet>: As it relates to the accident year question, it's really spread amongst a number of accident years. We, in the past, in our disclosures have said at times it's related to accident year X and Y, and when we're preparing a disclosure this time, the laundry list of accident years was exceptionally long, and we just said well, why don't we just say what it relates to. So there isn't any particular accident year for either one of them. It's just spread amongst various ones.

As it relates to the new money yield, just looking up some stats, as it relates – let's see. We generally tend to focus on the 10-year Treasury. So if you look at where the 10-year Treasury was at the end of September, it was 1.6 and ended December at 2.45, and spreads moved in that timeframe as well. So, I think, you could look at the public data as to what took place but a considerable rise in interest rates from one period to the next. Bill, do you want to add something?

<A - William Herbert Heyman>: I thought I might add a little. Obviously, the question goes to at what point will new money yields exceed maturing yields? And obviously the action of Q4 gets us closer to that point but we're not yet where we need to be.

We have done a fair amount of work on it in the last few weeks and using a whole bunch of assumptions which would take a long time to relate. We think that for taxables being replaced by taxables, we reached that point sometime in H1 2017. For municipals replacing municipals, closer to H1 2019. Obviously, a lot is going to be determined by the shape of any tax legislation. At the very extreme, if you needed a revenue-neutral bill, and the municipal exemption itself were affected that would be non-trivial. If corporate rates and individual rates were simply lowered and the relative value of municipals were affected, and they have already cheapened, that would be less important to us. I mean, the bottom line is what I think you're getting at, we're not quite there yet.

<Q - Ryan J. Tunis>: Okay. That's really helpful, thanks, guys.

<A - Jay S. Benet>: And this is Jay Benet again. If I could just add one thing not relating to your questions. But, during my remarks, one of my colleagues tapped me on the shoulder indicating that instead of referring back to November's filing of the Form 8-K, I inadvertently said 10-K. So, we don't file a 10-K in November. We did file an 8-K about the settlement. So I just wanted to correct the record.

<Q - Elyse B. Greenspan>: One question first, on the personal auto book. As you pointed to your margin outlook for 2017, can you talk about, I guess, the components of the expense ratio and the underlying loss ratio? The expense ratio did tick down in Q4, so it's part of helping to get to your margin goal for next year, some kind of improvement in the expense ratio to offset potentially a continued deterioration on the loss side. Can you just take us through the components a little bit?

<A - Alan D. Schnitzer>: Elyse, good morning. It's Alan. I would say that we go about as far as we want to go in giving outlook and we're pretty hesitant to start breaking it down into the component pieces. Part of our strategy, at least on the auto side, was obviously reducing expenses, and you have seen that come through to some extent already. But, going forward, we prefer not to break out the pieces.

<Q - Elyse B. Greenspan>: Okay. Thank you. And then one other question. The Business Insurance reserve releases picked up materially y-over-y as well as sequentially. I know you referenced it spanned numerous accident years and the workers' comp and GL lines. As we think about potentially an environment where we'll see higher inflation levels going forward, just wondering if you can just provide some commentary surrounding the picks that you are using on some of your longer-tail lines and what gave you confidence for such high-level reserve releases, given the uncertainties surrounding forward inflation levels. Thank you.

<A - Brian William MacLean>: As it relates to reserving, as well as pricing and loss picks for a particular year, we're not assuming in any of the work we do, this year or any previous years that whatever the inflation environment that currently exists, and I'd have to say it's an inflation environment related to the specific drivers of losses in our product, as opposed to the general level of inflation. We never assume that things are going to stay stagnant. There's an underlying assumption that things will over time revert back to the mean. And, as you can well imagine, there's a great deal of actuarial judgment, management judgment as to what that means.

So, looking at the reserves as they exist today, looking at how the development patterns have manifested themselves in the loss triangles, we come up with what our best estimate is of the future payments that we will be making. And if those best estimates are lower than what the carried reserves are, we'll make adjustments for it, but it is factoring in a long-term view as to what the levels of inflation might be.

<Q - Jay Gelb>: I had a question on your asbestos exposure. Earlier this month, the Hartford announced economically favorable transaction in Berkshire Hathaway to buy retroactive reinsurance contract. The size of Hartford's exposure is very similar to Travelers at $1.8B for asbestos environmental. And there has been $300mm annual pre-tax drag on Travelers' earnings for the past two years. I'm wondering what your thoughts are now that other companies are taking steps to address these legacy exposures?

<A - Alan D. Schnitzer>: Yeah, thanks for asking, Jay. There is nothing fundamentally novel about those transactions. As you can imagine, we look at them from time to time. So far we haven't seen terms on one of those deals that we found attractive enough to do. And I'm not sure what else to say about it.