Company Name: Travelers
Company Ticker: TRV US
Date: 2014-10-21
Event Description: Q3 2014 Earnings Call

Market Cap: 33,775.94
Current PX: 101.9201
YTD Change($): +11.3801
YTD Change(%): +12.569

Bloomberg Estimates - EPS
Current Quarter: 2.468
Current Year: 9.917
Bloomberg Estimates - Sales
Current Quarter: 6797.000
Current Year: 26809.429

Q3 2014 Earnings Call

Company Participants

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

Other Participants

- Jay H. Gelb
- Michael S. Nannizzi
- Kai Pan
- Vinay Misquith
- Jay A. Cohen
- Larry Greenberg
- Albert S. Copersino
- Meyer Shields
- Paul Newsome
- Josh C. Stirling

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

Jay S. Fishman

Business Highlights

Opening Remarks

- As I'm sure you've read, the results this quarter were just terrific, as demonstrated by our operating return on equity of 15.2%
- In addition to posting very strong financial results, the underlying dynamics in our businesses are showing very solid performance and give us continued optimism about our future financial results

Personal Insurance

- Starting with Personal Insurance, Quantum 2.0 is proving to be a real success
- New Auto business is a clean double from last year's third quarter and loss experience, while still early, is very much consistent with our original plans
- Retention on our entire Auto book remains high
- On a sequential quarter basis, total Auto policies in force increased for the first time since Q2 2011 and we expect to see sequential policy growth again in Q4
- Lastly and positively, we believe our Homeowners business is actually showing some lift from Quantum Auto

Business Insurance Segment

- In our Business Insurance segment, it's business as usual
- We continue to achieve rate gains where needed, and we see no fundamental change in the competitive environment
  - That is trends remain generally the same
- Retention is actually up in almost all of the business units and we remain optimistic about our ability to continue to successfully execute our granular pricing strategy and achieve improving returns

Bond & Specialty Insurance Business

- In our Bond & Specialty Insurance business, we couldn't be more pleased that we've navigated through the financial crisis and the Great Recession, as successfully as we have, as evidenced by consistently strong results
  - This performance demonstrates the underwriting thoughtfulness and skill that are such a part of the fabric of our organization

Investment

- And we're particularly proud of our investment department performance
- In a challenging environment, they've maintained their investment criteria and done the right things, another example of our discipline
- While it's always nice to post a strong quarter; I think it's important to remember that we're committed to running this organization successfully over the long-term

Strategies

- The results that we posted this morning were driven by decisions made years ago that have been translated to successful marketplace strategies
- Our long-term performance is really the result of thoughtful analysis, of commitment to analytics, insightful discipline applied to a risk-taking business, and to be candid, a little bit of good fortune
- Our energy is going to be committed to two things:
  - First, more of the same, first rate execution of thoughtful data-driven strategies

- Second, notwithstanding, the more of the same approach, we are also committed to challenging our own conventional wisdoms to identify opportunities and making the decisions today that are necessary, perhaps even critical to making sure that our financial performance remains top-tier

Jay S. Benet

Financial Highlights

Operating Income and ROE

- We were very pleased with our results this quarter, with operating income per diluted share of $2.61, and an operating ROE of 15.2%, driven by very strong underwriting and investment results
- Underwriting results benefited from a slightly lower level of catastrophe losses this quarter, $83mm pre-tax is compared to $99mm pre-tax in the prior-year quarter
- In contrast to the lower level of cats, we incurred higher non-cat weather-related losses this quarter, as compared to the prior-year quarter, which more than offset the benefit of earned pricing increases that exceeded loss cost trends in each of our business segments and drove a slight 0.5 point uptick in our underlying combined ratio

Net Favorable Prior-Year Reserve Development

- Underwriting results also benefited from net favorable prior-year reserve development of $113mm pre-tax, down from $158mm pre-tax in the prior-year quarter
- Current quarter net favorable prior-year reserve development included $250mm pre-tax increase to our asbestos reserves, driven mostly by increases in the company's estimate of projected settlement and defense costs related to a broad number of policyholders, due to a higher level of litigation activities surrounding mesothelioma claims than we previously anticipated; as well as $77mm pre-tax increase in our ULAE reserves for the accrual of interest resulting from a recent court decision relating to the asbestos direct action litigation

Pre-Tax Benefit

- On the positive side, current quarter reserve development included $64mm pre-tax benefit resulting from better-than-expected loss experience related to an old workers' compensation reinsurance pool that we participated in, along with another pre-tax benefit of $98mm that resulted from the final commutation of assumed and ceded reinsurance treaties associated with that pool
- Current quarter reserve development also benefited from better-than-expected loss experience in GL, property and fidelity & surety in recent accident years
- And YTD, on a combined stat basis, for all of our subs including A&E, all accident years developed favorably
- Over time, we've generated much more capital than what is needed to support our business
  - This has allowed us to return over $900mm of excess capital to our shareholders this quarter, we paid dividends of $186mm and repurchased $751mm of our common shares, consistent with our ongoing capital management strategy
  - And YTD, we returned almost $2.9B of excess capital to our shareholders through dividends of $553mm and common share repurchases of $2.3B

Capital Management Strategy

Share Repurchase Program

- Shifting from the current year; let me provide a historical view of how our capital management strategy has performed over time
- Our board of directors initiated the current share repurchase program on May 2, 2006, a little over 8 years ago
- On May 1, 2006, the day before the board authorization, Travelers market cap was $30.2B, and we had approximately 696mm shares outstanding
  - Since that time, we've repurchased over 416mm shares at an average price of $56.50 per share, issued a net amount of approximately 51mm shares, mostly in connection with share-based incentive comp awards, and now have 331mm shares outstanding at the end of the current quarter, a 52% reduction in our common shares

Dividends

- And if you add in the dividends that we paid during this time period, we've returned approximately 98% of our May 1, 2006, market cap to our shareholders
- We accomplished this all throughout this period while maintaining capital in support of strategic business opportunities, such as those in Brazil and Canada, very strong holding company liquidity and modest debt levels
- Notably, our ratings increased during this time period from already very high levels to industry-leading levels
  - And even after returning all of this capital to our shareholders, our market cap stands at $31.6B today

Operating Cash Flows and Capital Ratios

- Operating cash flows of over $1.8B were extremely strong this quarter, bringing total operating cash flows to almost $3.2B YTD
- We ended the quarter with holding company liquidity of almost $1.9B
- And all of our capital ratios were at or better than their target levels
- Our debt to total capital ratio of 21.3% was well within its target range

Book Value per Share and Net Unrealized Investment Gains

- And during the quarter, book value per share increased 1% and adjusted book value per share, which excludes net unrealized investment gains and losses, increased 2%; while YTD, book value per share increased 9% and adjusted book value per share increased 6%
- Finally, net unrealized investment gains were approximately $2.9B at end of Q3 as compared to $2B at the beginning of the year

Brian W. MacLean

Operating Highlights

ROE

- I'll start with returns
- We're a return-focused company
- And as such, we're pleased with our reported ROE for the quarter and YTD
- We're especially pleased that we were able to deliver these results in what continues to be a very challenging investment environment, one where 10-year Treasury yields continue to hover between 2% and 2.5%
  - When we look at our returns below this aggregate level, we are also encouraged

Product Profitability

- To understand our product profitability, we look at accident year returns at the line level; and at this more detailed level, we are very pleased both with the improvement that we have seen over the last several years and with the absolute level that those returns are at today
- There are obviously differences line by line; but overall, we continue to see signs of a rational marketplace

Pricing Strategy

- Doreen and Alan will go through the segment production statistics; but as we analyze our results at a very granular level, we see that we continue to be successful in executing our pricing strategy, which is to retain a high percentage of our best business, improve profitability where needed, and write new business that meets our target returns
- I don't have a crystal ball and I'm not predicting the future, but based on what we see today, there is nothing in the market that would cause our ability to continue to execute on this pricing strategy to be meaningfully changed
- We are also encouraged that as overall returns have become more consistent with our long-term objective, we've begun to see improving top line trends

Volume

- We have said many times that volume is never our goal, but that we always seek opportunities to add business that meets our target returns
- We have seen improved retention across most of the businesses and higher new business volume in many of them, and we believe that these trends are the results of our strategic focus on delivering meaningful and sustainable competitive advantages in the markets we serve
- So, overall, through the first 9 months of 2014, fairly stable market conditions and very strong underwriting results

Alan D. Schnitzer

Highlights

Business and International Insurance

- In Business and International Insurance, third quarter operating income was $552mm

- The underlying combined ratio, which excludes the impact of tax and prior-year reserve development, was 94.9% for the quarter, up 1.7 points over the prior-year
- The 1.7 point change resulted from an increase of 2 points, largely from non-cat weather in both our domestic and international businesses, as well as the impact of the inclusion of The Dominion, partially offset by the favorable impact of about 1 point from earned price exceeding loss trend
- We also saw a modest uptick in our expense ratio, mostly attributable to a favorable item in 2013

Production Trends

- Turning to production trends for domestic BI, compared to Q2, overall retention was up about 1 point and total renewal premium change was up slightly as the increase in exposure more than offset a lower level of positive rate change
- Y-over-y, new business was about flat
- In Select, we were pleased to see an improvement in retention to just over 80%, with total renewal premium change of nearly 9%
- We wrote $92mm of new business, representing a 5% increase over the same period last year

Middle-Market

- In middle-market, as a greater percentage of the business has achieved attractive returns, we've increased our focus on keeping the better performing accounts
- Accordingly, we were pleased to have achieved a 2-point increase in retention to a very strong 85% with positive rate change declining less than 0.5 point, and each case is compared to the most recent quarter
- Lastly, new business of $236mm for the quarter grew by nearly 10% as compared to the same period last year
- Overall, we feel very good about the production results, but as you've heard from us many times in the recent quarters, the aggregate numbers don't tell the entire story
  - The detail of where we are getting rate and which accounts we are retaining is key to evaluating the success of our production strategy

Retention

  - In our middle-market businesses, the data beneath these exhibits shows that on our best-performing business, our retention has improved to around 90% and we continue to achieve slightly positive rate increases
  - On our poorest performing accounts, we are achieving low double-digit rate increases with meaningfully lower retention
    - These results are consistent with our marketplace strategy

Production Results

- Looking at production results for our International business, retention remains strong, renewal premium change was down somewhat from recent quarters due primarily to lower rate and exposures in Lloyd's; and new business was up from the prior year due to the acquisition of The Dominion

Margins

- Before I turn it over to Doreen, I'd like to make an observation about margins
- Many industry observers seem to focus – overly so, in our view, on the relationship between written rate change and loss trend
- Particularly with rate change for the quarter of 3.3 points, dipping just below our current estimate of loss trend, which is about 4 points in the aggregate, I'd like to point out that underwriting margins are impacted by a number of other factors, including changes in exposure, underwriting actions, business mix, the impact of new business, weather, and so on
    - So, particularly with written rate and loss trend in such a narrow band, we'd caution you against drawing conclusions about the outlook for underwriting margins based solely on those measures

Closing Remarks

To wrap it up, I'm pleased with our strong results for the quarter; and in terms of execution going forward, we intend to pursue more of the same

Doreen Spadorcia

Highlights

Opening Remarks

- I'd like to begin by saying how excited I am to again work with Tom Kunkel and his leadership team in managing our market leading Bond & Specialty Insurance business
- Also, I'm really proud of the progress we've made in Personal Insurance and look forward to continuing to work with Greg Toczydlowski and his team

Bond & Specialty Insurance Segment

Operating Income and Combined Ratio

- Now for the results; in the Bond & Specialty Insurance segment, operating income of $165mm was 38% higher than the prior-year quarter
- The increase was driven by higher levels of favorable prior-year reserve development, along with improved underlying underwriting margin
- The underlying combined ratio for the quarter was a very strong 81.7%, a 4-point improvement from the prior-year, primarily due to exiting our management liability excess-of-loss reinsurance treaty, as well as earned pricing in excess-of-loss cost trend across the segment

Net Written Premium

- Net written premium for the quarter was $556mm, an increase of 1% compared to the prior-year
- Across our management liability businesses, retention of 84% was consistent with recent periods in the prior-year, while new business of $34mm was down slightly from recent periods

- Renewal premium change, which can be somewhat lumpy due to variations in things like limits written, liability attachment points, and policy duration, was 4.6% for the quarter, up somewhat from Q2
- In sum, strong profitability through Bond & Specialty's continued underwriting discipline and market leadership

Personal Insurance

Operating Income and Combined Ratio

- Turning to Personal Insurance; operating income of $239mm for the quarter was down 9% compared to Q3 2013, driven by lower favorable prior-year reserve development in Homeowners
- The underlying combined ratio was 84% in the quarter, an improvement from 2013, of more than 1-point, primarily due to the benefits of earned pricing that exceeded loss cost trends, our previously announced expense-reduction initiative, and lower Homeowners commission, partially offset by a higher mix of new business
    - As it relates to our expense reductions, to-date, we have executed on initiatives responsible for about 90% of the $140mm run-rate savings target
    - As we've mentioned in the past, about half of these reductions relate to claim management expenses, the impact of which shows up in the loss ratio
    - We remain on track to achieve the full run-rate savings by the end of this year in line with our original expectations

Agency Auto

Retention

- Looking at Agency Auto, retention remained strong at 82%, while renewal premium change was about 6%
- We also are extremely pleased with the progress we've made on new business production, driven by the impact that Quantum Auto 2.0 is having
- New business premium of $166mm is more than double Q3 2013, with 90% of the $166mm coming from Quantum 2.0
    - This increase in new business drove a y-over-y increase in net written premium of 3%
- And as Jay noted, policies in force increased from the most recent quarter for the first time since Q2 2011
- As for the rollout, Quantum 2.0 is now live in all, but a handful of prior Quantum states
    - And our expectation is that these remaining states will go live over the next quarter or two

Auto Profitability

- Turning to Agency Auto profitability, the underlying combined ratio of 96.1% for the quarter was an improvement of 1.5-points over the prior-year, driven primarily by the expense initiatives and earned pricing that exceeded loss cost trends, partially offset by the impacts from higher new business volume
- Our current view of overall Auto loss cost trend is about 3%, a slight improvement from what we communicated in recent quarters, driven by some moderation in bodily injury severity

- And looking at the improvements in revenue and profitability, we believe our fundamental changes have made our Auto product more competitive

Agency Homeowners and Other

Production, Renewal Premium and Retention

- Looking at Agency Homeowners and Other, production was strong in the quarter with renewal premium change of about 6%, while retention remained at 84%
- New business volume of $95mm was up about 30% from the prior-year quarter, due to some lift from higher volumes in Quantum 2.0
- Overall, Home production is in line with our expectation

Profitability

- From a profitability perspective, the underlying combined ratio of 70.1% was an improvement of 1.5-points over Q3 2013, driven by earned pricing that exceeded loss cost trend as well as lower expenses
- So, overall, in Personal Insurance a great quarter with both strong financial results and production metrics and we remain pleased with the results of the Quantum 2.0 rollout so far

QUESTION AND ANSWER SECTION

<Q - Jay H. Gelb>: I wanted to touch base on exposure growth in Business Insurance. It appears to be accelerating in the middle-market commercial business, and Select is showing more stable growth. Can you talk about the differences that are driving that?

<A - Alan D. Schnitzer>: Yes, the difference in middle-market vs. Select?

<Q - Jay H. Gelb>: Yes, in terms the rate of change in exposure growth being stronger in middle-market than Select.

<A - Alan D. Schnitzer>: Yeah. The exposure impact really isn't from sales and payroll. And if you look at the starting and ending point, you're probably looking at the webcast. If you look at the starting and the ending points, it's actually a pretty straight line from those two end points. The way we calculate the number, the impact of audit premium creates a dip a quarter or two after we report exposures and particularly in the middle-market. And so, we would expect that to develop over time into more of a straight line.

<A - Brian W. MacLean>: This is Brian. The other point on Select, a lot of that exposure growth is values on the property component of CMP.

<A - Alan D. Schnitzer>: And that's been an affirmative effort on our part to try to improve the values.

<Q - Jay H. Gelb>: Okay. So any other underlying difference in terms of exposure growth on the small business vs. middle-market?

<A - Alan D. Schnitzer>: No, there isn't really. Other than on the small side, we've really been working on the insurance to values; and in middle-market, it really is a function of how we account for the audit premium in the exposures.

<Q - Jay H. Gelb>: Okay. Then I had a separate question on capital return. So, YTD, if my math is right, share buybacks plus dividends are $2.9B; operating income $2.6B. So, clearly capital return running well ahead of operating income, on the order of around 110%. Could you give – and you had a prior comment also saying that there's a continued level of excess capital being generated. I don't know if you'd care to update us on the capital management strategy in terms of – could that gap between capital return and operating income continue to grow over time, somewhat similar to what we've seen this year?

<A - Jay S. Benet>: Hi, Jay. This is Jay Benet. Thanks for asking the question. I think, what you're really seeing is a timing difference in the generation of the excess capital vs. the timeframe in which it's repurchased. So, when we look at, particularly year like 2014, one of the things you have to take into account is, how did the end of 2013 come out. And it was a very strong fourth quarter.

When we did our year-end capital calculations, we found that we had some excess capital that we carried into this year, so we're playing a little bit of catch up now. But there's no change in strategy, there's no change in execution. It really goes back to the words that we used to describe the program, which is, we're generating it over time, primarily through income and maintaining the capital we need to support our businesses, so that the ratings are maintained and the posture of the balance sheet doesn't change.

And then to the extent, we have the excess capital that's getting generated; we're buying it back over time. But, it's really driven by earnings. And you have to look at it more broadly than just a nine month period.

<Q - Jay H. Gelb>: Okay. So based on that, we should still generally think about buybacks and dividends being roughly equal to annual operating earnings?

<A - Jay S. Benet>: I'm not saying it's roughly equal. In our 10-Q and 10-K, we talk about having enough capital to support the growth in the business; and occasionally, we make pension contributions to our qualified pension plans. So, there are other things that will utilize capital in the place. But, the creation of capital is from the earnings.

<Q - Michael S. Nannizzi>: Just a couple of questions. In terms of the Auto business, we're trying to figure out, you talked about 6% rate increases, and we're trying to square that with the rate declines that you've taken and talked about taking on the Quantum business that you've re-priced. Can you help sort of square those two things? Thanks.

<A - Doreen Spadorcia>: Michael, this is Doreen. Are you looking at the webcast with renewal premiums change?

<Q - Michael S. Nannizzi>: Yes.

<A - Doreen Spadorcia>: That would be also our existing book on the renewal book of business.

<Q - Michael S. Nannizzi>: Okay. So for a business that you're – Quantum is for new business only? Is that – so that's your – okay?

<A - Doreen Spadorcia>: Quantum 2 is for new business only.

<Q - Michael S. Nannizzi>: Got it. Okay. That makes sense. And then, one question on Business Insurance, we're kind of looking at the margins there and what has happened. How much of an impact on the y-over-y comparison is Dominion having, if at all? And how should we think about that trend? I know you mentioned some non-cat weather, but just trying to parse out sort of rate vs. loss trend in underlying margin. Thanks.

<A - Alan D. Schnitzer>: Hi, it's Alan Schnitzer. On The Dominion, as we get sort of a year-in, post close, we're going to try to resist the temptation to break out the impact of that, in particular.

I will tell you that, at least, in the current period, it's sort of – leaving out the unusual weather that we've had in Canada – there was that hailstorm in Alberta and floods in Toronto. So, leaving that out, The Dominion was probably about 0.5-point on the loss ratio, a couple of tenths on the expense ratio. But, we'd really like to move away from quantifying the impacts of that transaction; it just gets harder and harder to do as we integrate.

<A - Gabriella Nawi>: Sorry. And it's Gabby, just to be clear, that's because it wasn't in the prior quarter. He's not setting a level for Dominion.

<A - Alan D. Schnitzer>: That's right.

<Q - Kai Pan>: Just on the margin, just follow on that, is that you mentioned some non-cat large – like a weather-related losses. If you can quantify that in terms of how much that to drag on the 50 basis point deterioration y-over-y. And also is that a pattern, the way I'm seeing in the past few quarters, because I guess your peers reported some sort of non-cat large losses in past few quarters as well?

<A - Alan D. Schnitzer>: We've been observing for a couple of years that the weather seems to be getting more extreme. And so this is consistent with what we've been seeing over a couple of years. In the quarter, weather was worth something like 1.5-points on the delta.

<A - Jay S. Benet>: This is Jay Benet. I'd add though to that that when you're asking, are there trends involved, we are always going to have q-over-q differences associated with things like non-cat weather or large losses, and what we try to do is point that out to give you some insight into what's taking place.

But, I wouldn't say that, in all cases, when we say the weather is higher, it means the weather was terrible, I mean it's just higher than it was last year. So, I wouldn't call this a really bad, bad weather quarter, but last year's third quarter was actually a little on the favorable side.

<Q - Kai Pan>: Great. My second question is on the reinsurance side. Just given what's happening in the marketplace in reinsurance, basically pricing coming down, there's alternative solutions, and just wonder what's your overall reinsurance strategy? Are you thinking about setting up some alternative structure, including internal or captive reinsurers?

<A - Jay S. Fishman>: Hi, it's Jay Fishman. So, we're certainly looking at everything. There's obviously a lot of activity in that space. We're not a big utilizer of reinsurance, broadly speaking. When you look at the amount of ceded premium that we put out to the marketplace, it really isn't enough to jump through a lot of hoops and incur a lot of cost to create something that looks snappy, but doesn't really accomplish much financially.

So that doesn't mean we're giving up. I'm mindful of the fact that it's getting a tremendous amount of attention, so I've actually been spending some of my own time in making sure I can actually understand it and make sense of it.

So far, without a lot of effect, to be completely blunt with you; but we will obviously keep looking. I don't anticipate for us – not to say that somebody else. I don't anticipate that the change in reinsurance pricing in any broad measure will have a meaningful impact on us. Again, not because – for example, our property cat treaty wasn't less expensive; it was. But it's just not enough on a premium base of our size to make a substantial difference.

I've also been asked whether we would be interested in building a book of business and in effect arbitraging it against the reinsurance opportunity. And I'm always mindful that when you take on a risk on the right side of your balance sheet, there's some permanence to it; and the reinsurance profile on the left may or may not be permanent. And you've got to be very cautious and careful about not finding yourself in an un-reinsured position or in a mismatch, which can happen and has happened. I think back to September 11 and what a bunch of reinsurers did shortly in the days thereafter; and lots of us found ourselves with primary exposure without underlying reinsurance to cover. So, there's a lot of moving parts here, and we're sure looking at it pretty hard. But so far, I'd say nothing that really excites me at least a great deal.

<Q - Kai Pan>: Thank you so much for the answers.

<A - Alan D. Schnitzer>: Michael, let me just clarify, just so we pull these two questions together and don't leave any confusion here. So, what we said was, there was about a 2-point increase in the combined ratio due to both weather and The Dominion. That was 2-points all in; about 1.5 point of that is weather and about 0.5 point of it is Dominion.

<A - Jay S. Fishman>: And again, just speak to direction, please.

<A - Alan D. Schnitzer>: Increase.

<A - Jay S. Fishman>: An increase of 1.5-point due to weather and an increase of 0.5 point due to Dominion.

<A - Alan D. Schnitzer>: That's right.

<Q - Vinay Misquith>: The first question is on pricing and loss cost trends. I believe you said not to focus too much on pricing being up at about 3.3% and loss cost trend at about 4%. But just thinking about it at a 50,000-foot level, should we expect a small amount of margin compression next year? And also, looking at the loss cost trends, if you could help us understand, I mean, peers are looking at loss cost trend in the 2% to 3% range; your 4% number seems a little bit high. Just wondering, if there is some amount of conservatism in that?

<A - Jay S. Fishman>: Well, I think perhaps we'll split the question, between myself and Alan. First, the reason that we're just cautioning against evaluating 3.3% vs. 4% is that that arithmetic is pretty easy to do, but doesn't take into account all of the factors that affect the profitability of our business.

We've reminded people frequently that a not insignificant amount of exposure base, particularly, for example, in our small commercial business, will act as an increase in rate, absent a change in loss profile.

As an example, to the extent we collect more premium due to inflation adjustments on property, unless the loss exceeds what would have been the previous total insured value level, that increase in exposure functions exactly the same as rate. And so, it's easy to talk about a widening margin; and I'm going to make up numbers here. It's easy to talk about it when you've got, to make up a number, 7% rate and 4% loss trend. And I suspect it would be easy if we were talking about 1% rate and 3% loss trend.

But in and around the number, it's just not that precise to conclude that within 7/10 of a point that margins will necessarily contract or not contract. Candidly, our 10-Q is going to say in Business Insurance or does; I don't know if we filed it this morning; we did file it – says that we anticipate margins to be flat, equivalent, in Business Insurance into 2015. And that is our best judgment at the moment. It's funny, people seem to think that there is a stunning amount of difference between talking about plus 0.2 vs. minus 0.2, but they understand that there's no big difference between plus 2.2 and plus 1.8. It's the same 4/10; it just happens to be around a different baseline number.

So, our caution is simply to let you know that notwithstanding all of our analytical skill and insight into the numbers, this is getting pretty precise to make arithmetic calculations based on these numbers. We just caution against it.

<A - Alan D. Schnitzer>: On the second question on loss trend, hard for us to comment on anybody else's loss trend. But I would suggest you might want to look at mix.

<Q - Vinay Misquith>: Okay. That's helpful. Just as a follow-up, the Homeowners commission expense ratio was low. I was just curious to why that was? Thanks.

<A - Jay S. Fishman>: Can you repeat the question please?

<A - Doreen Spadorcia>: I couldn't hear it. I'm sorry.

<Q - Vinay Misquith>: Yeah. Sorry. On the Homeowners, I believe the commission expense ratio was lower…

<A - Doreen Spadorcia>: Yeah.

<Q - Vinay Misquith>: …this year vs. last year. I was just curious, why?

<A - Doreen Spadorcia>: We did reduce the Homeowners commission rates.

<Q - Vinay Misquith>: Okay.

<A - Doreen Spadorcia>: Yeah. We implemented those in probably the middle of 2013, maybe a little bit earlier than that.

<A - Brian W. MacLean>: And some of the expense initiatives we had...

<A - Doreen Spadorcia>: Well, in the…

<A - Brian W. MacLean>: …from – relative to Quantum was also impacting Homeowners.

<A - Doreen Spadorcia>: Yes, exactly. So, about 25% of our expense reductions fell to the Homeowners line.

<A - Jay S. Fishman>: But the Homeowners commission expense number fell because of a change in the rate that we pay on Homeowners business. We implemented that, again, in the middle of 2013. That's the driving factor there.

<Q - Jay A. Cohen>: I guess, maybe the first quick one for Doreen. You had mentioned, I think it was the specialty and professional liability business that you had changed your reinsurance cession there, and that helped earnings. Can you talk a little bit more about that?

And then separately, asbestos. Surprised no one has asked you yet about it, but another very sizable charge. Can you talk about really what you're seeing there now? It just feels as if this is an annual sizable charge, and you're almost going on a pay-as-you-go basis, and we should almost expect this kind of charge going forward. I'm wondering if you can give more insight into the asbestos?

<A - Doreen Spadorcia>: This is Doreen. I'll talk first about the Bond & Specialty Insurance reinsurance treaty, and then I'll turn it over to Jay Benet for asbestos. But, as I think we reported in the past, the decision was made to exit from our management liability excess-of-loss reinsurance treaty; and that decision was made at the end of 2013.

And essentially what you're seeing is that, as we looked at our book of business both from a limit standpoint, the quality of the underwriting, we just felt like the ceded premium didn't make sense given the performance of the book.

And so, if you were to look at the underlying combined ratio being up about 4 points, it's about 3-points of that underlying improvement. And it's really just looking at what premium you wanted to pay for your loss content. So, a great decision was made, and we see it in the results.

<Q - Jay A. Cohen>: That's helpful. Thanks, Doreen.

<A - Jay S. Benet>: Hi, Jay. It's Jay. As it relates to asbestos, as you know, we follow this very closely every quarter and we supplement the quarterly procedures with, what we refer to is the, very in-depth claim study that gets done annually and we've been completing it in Q3.

So, what's going on with the data, first of all, every time we put up an asbestos reserve, it's our best estimate, of what the totality of losses will be. And as you know, there are pages and pages in our 10-K and 10-Q describing all the uncertainties associated with asbestos and what's taking place, we're not taking place in the environment.

So, in terms of the overall environment, I'd remind everybody that, we've had the asbestos exclusion in our policies for decades at this point. The product isn't used the way it was formerly used decades ago. And the assumptions that we build into the reserves are that there'll be a tailing off of claims over time, based on the aging population and all the other dynamics that go along with that. So, we are making these estimates. And then, periodically looking to see, are the estimates holding up in terms of the data that's emerging.

And what's been happening in the last couple of years and we can come up with anecdotes as to perhaps why it's happening, but what keeps happening over time is that our estimates which are the best estimates of the point in time are proving to be a little short as new information emerges.

And in talking to our claim people who deal with this and asking the age-old question, why doesn't this stuff drop off at the rate that we had expected, some of the anecdotal answers tend to be and I underscore anecdotal, that well, perhaps we have a situation where, years ago – given where, general medicine was at that point, people were dying of different things like heart attacks or forms of cancers, and with medical advances they're perhaps living longer and by living longer and not dying of those particular diseases, mesothelioma might develop; and suddenly, now you have an asbestos claim.

So, part of this is, the estimation process; part of this is just, trying to understand the trends that are going on, but I welcome the day, when we can all watch a sporting event and not to see a plaintiff's attorney ad saying, if you ever heard the word mesothelioma, call this number.

But that's the environment, but I will say that there isn't a fundamental change in the environment, it's not new theories or anything like that, it's more a matter of trying to estimate, what's actually out there. I hope that was helpful.

<Q - Larry Greenberg>: I respect that you don't want to get into too much detail on Dominion; but given Q4 will be the first where we're on an apples-to-apples basis, it would be helpful to just know what Dominion is growing at organically. And I think when you did the deal, you expected it to be modestly accretive to 2014. And I'm wondering if that's coming to fruition?

<A - Alan D. Schnitzer>: Larry, it's Alan, I'm just trying to process the questions here. On Dominion, I should just take a step back and say that we're very pleased with the transaction, the integration is going very well, they're very pleased with the local team in Canada and the way the two teams are integrating and very pleased with the way that the both teams in Canada and our U.S. businesses are integrating.

So, I should really start off and I think this is the important message about The Dominion, it's going very well, there's no surprises and we're enthusiastic about the deal today as we were when we signed it.

<A - Jay S. Fishman>: And let me just add in, because it's the right time to do it. A not insignificant portion of the rationale here was to export and make available in the Canadian marketplace, product and expertise that we had here in the U.S. that had not been developed up in Canada. That is still very much the plan. So, we are at the early days here, we are very much at the early days. I'm sorry, but that was helpful.

<A - Jay S. Benet>: Larry, in terms of your specific questions, I think, we'd really prefer on a business this size probably not to go down to that level of detail, other than to say, it's on track, whenever you do a deal this size, there's always some surprises that are a little bit good and a little bit bad, but all of those are within the range of expectations and we're very, very pleased with the transaction.

<Q - Albert S. Copersino>: I was wondering if you all had available or were willing to share for the Bond & Specialty segment and for the Personal segment. We have the renewal premium change in the slide deck; but I was curious, if you were able to give us the rate changes specifically?

<A - Jay S. Benet>: I'm sure, Brian and I will chat here, but those businesses in particular, it's really quite difficult to parse rate change and renewal premium change, because they operate so much together.

For example, the policy limits, right? So, if you've got an inflation element in the underlying property, for example, that's going to affect premium, but that happens in many cases, in effect automatically. So, we don't track rate and renewal premium change at the granular level that we can in other businesses to provide that breakout. It's not that it's not an appropriate question; it's that the business dynamics under it operate differently, and therefore, really can't be parsed with quite as much precision, okay?

<A - Doreen Spadorcia>: This is Doreen. We do look at it, to Jay's point; but we find the combination of them with renewal premium change to be the more meaningful way to look at the business. And we've never really disclosed that level. So, we can look at it, but we just want to make sure…

<A - Jay S. Benet>: Yes, in most cases in our personal line business the fundamental exposure is not changing and it is the total price change that is really reflective. And Doreen, you could talk about the Bond.

<A - Jay S. Fishman>: You get deductibles; you can get changes, but we just don't parse at that level.

<A - Jay S. Benet>: Bond?

<A - Doreen Spadorcia>: On the Bond side, I would say and we've talked a little bit about the – in management liability, in particular, on RPC and rate, it's such, again, to Jay's point, a combined concept of what the limits are, the attachment point, the term of the policy, so we look at them blended together. It's not that we don't look at them. It's more meaningful to combine them for us for the business performance.

<Q - Meyer Shields>: Doreen, has there been any change in the competitive environment for personal lines, specifically Auto, over the course of the year?

<A - Doreen Spadorcia>: What we've seen – and we've watched this pretty closely to see, particularly with our commission changes and Quantum 2.0, what's going on out there. And I would say in the independent agency channel, we've seen some very targeted but not broad follows in terms of a little bit of people changing commission, a little bit of targeting specifically on price reduction. What we haven't seen in that channel is anybody really address broadly the cost structure. And so, no, it's not a major change; we just continue to watch it.

<Q - Meyer Shields>: Okay. That's good news. Jay, you talked earlier about the other factors that can drive margin improvements aside from the gap between rate increases and lost cost trends. I was wondering, are those other issues – is that expected trends changing at all?

<A - Jay S. Fishman>: Sorry, I don't, is that expected trend changing at all? Help me, I don't understand quite the question.

<Q - Meyer Shields>: No, I'm asking it poorly. Is the impact of other factors besides the rate/loss trend gap and its impact on margin expansion, is that translate – given the improvements that you've had so far, for example, in the granularity of pricing and so on, should we expect less margin expansion from those other factors going forward than we have the last couple of years?

<A - Jay S. Fishman>: I got it. I got it. The answer is, I sure don't think so. The reason for the caution is simply because it would be, I think, inappropriate to leap to a conclusion that 4% vs. 3.3% will, in effect by definition, result in a narrowing margin. It may. I'm not saying it's not. But there are other factors that go into whether the margin gets bigger or smaller, and you're in the range now of the gap between these two numbers that is, loss trend and rate, to be such that these other factors, which always operate, they always operate, could actually produce a different outcome than the simple arithmetic would demonstrate.

And again, the example I used before, with a rate of 7% and loss trend of 4%, this is just a loss trend of only 3%. It's an easy call. And with loss trend of 4% and rate of 1%, it would also be an easy call. But you're at a range now, where it's not an easy call. I'm not saying from the outside looking in, by the way; I'm saying even from the inside, it's not an easy call to absolutely say, it's going to expand or it's going to contract. It is on the line, in effect, right now, and we don't know how to be any more precise than we're being with you. This is as good as we have to offer.

<Q - Paul Newsome>: Just recently, I was doing an agent tour, and they were talking about a little bit more aggressiveness in the spread between new business and renewal business on the commercial business. I wanted to see if you perceived any change there in that either in Travelers or in the marketplace?

<A - Alan D. Schnitzer>: Hey, Paul, it's Alan. Let me comment on us; and I'm not sure we're going to comment more broadly on the market. But it's always dangerous, I think, to take one conversation with an agent and extrapolate from that. I would say from our data, we see that over the last couple of years, seven quarters or eight quarters, there has been a pretty consistent gap between new and renewal. But if you look back over a longer period of time, I'd say that gap is reasonably tight at the moment on a longer-term view.

<Q - Paul Newsome>: And then as a separate question, it's been a long time since we've talked about some of the direct channels and other experimentation that you've been working on over several years. And I'd like to know, if Quantum 2.0 is where we're at with respect to what we're looking at for the future of Travelers for the next couple of years, or if there are some ongoing efforts still to build out other channels?

<A - Doreen Spadorcia>: This is Doreen; I'll just speak to that. So, I will tell you that Quantum 2.0 is definitely a positive for direct-to-consumer as well as the agency channel. It was a product that we thought would be attractive across channels. So, as we look at our metrics around conversion and sales, we believe that Quantum 2.0 has definitely had a positive in that.

In addition to that, we always look for process improvements. We've also been very focused on looking at digital marketing and how to use our dollars in a very targeted way for direct. We also have plans, and I think we've talked to all of you in the past. This is not just direct, but we will continue to look at where we can enhance the property products as well as looking at how we bring accounts together, and that will be both a benefit for the agency channel as well as direct.

<Q - Josh C. Stirling>: So, Jay, pricing has been slowing. It's come off, what, 3% in the past year; and if you sort of simplistically project forward another year, at last year's pace pricing probably would be zero or maybe even a slight decline. And so, I think big picture, we're all just trying to figure out whether the industry's pricing decline is going to stop at something like inflation. Does it go to zero, or does it go negative? And I recognize you guys don't want to talk about other companies. But to keep it focused on Travelers, if I understand all the sort of back and forth around the margin outlook and Alan's comments, I think you're basically saying that you'll keep pricing more or less in line with inflation over the next year or so. Is that right?

<A - Jay S. Fishman>: Well, I can certainly tell you what our strategy is. I have no problem sharing that. And obviously, the ability to execute in a business environment: we may succeed; we may not.

We haven't changed anything about the way we're approaching individual accounts. I remind everybody of this all the time. Right now, there is an underwriter in Kansas City – right now, who is sitting with an agent having a conversation about one account. And they're not thinking about the overall market; they're not thinking about inflation; they're thinking about the return on that account and how do I improve it. So you've got to start with the premise that this really does start at the bottom and work its way up.

As accounts have become – as increasing number of accounts have now had several years of increases and are now producing profitability, returns, however, you like to look at it, that really fall into the boy, we're glad we have that account category, we ask our people to be thoughtful, to be judicious about the way they approach every individual account. It doesn't have to be a straight line. It can be a stair-step. It can be driven by the local market. It can be driven by the relationship with an agent. It can be driven by the size of the book that we have with the agent. It can be driven by whether there has been claim problems or not on that account. All of those things go into the pricing of an individual account.

Now, what we're trying to get to is a point where over time – we come back to over time all the time that we manage to offset the impact of loss cost by either rising prices or self-help through efficiency or expense reduction. And I point to the kinds of things that Greg Toczydlowski and the group have done in Personal Insurance. That dollar saved in expense is as good as a dollar raised at the point-of-sale in rate, in fact, arguably even better.

And now I'll speak really just personally, because I'm not sure, I'm speaking for the whole place. I am hopeful, maybe even cautiously optimistic, that we will not – and I said this by the way 10 years ago – maybe not 10 years, maybe 8 years ago. I personally believe that the property and casualty business will have a meaningfully lower level of cyclicality. Never said zero, but always said a less, lower amplitude of that cyclicality. There are a host of reasons why I believe that. Analytics and data are just one, but a very important one.

And I think it's proven on the way down before we entered into this cycle. I think it's been proven here on the way up. I'm hopeful, maybe even optimistic, that that will turn out to be true on the way down. We don't see anything in the way in which business is done at the point of sale in the market that would suggest that we are at a precipice, that would suggest that something fundamentally is going to change next month, next quarter, or frankly even next year.

Now, we could be dead wrong about all this; it's possible, we could be dead wrong. But we're focused on over time maintaining our margins. It doesn't mean that an individual account has to have a price increase every year. It doesn't mean that in a quarter the rate won't come under loss trend. I'd like to know where the mix of business is that's coming up for renewal. The answer to success for us is in the granular analysis more than the headline numbers.

So, that's honestly how – we're never anything but honest – but that's how we see the marketplace environment. That's how we intend to operate. We'll see if it's sustainable. Again, I'm hopeful and maybe even optimistic. There is a thoughtfulness. We understand – but we're not unique in this – we certainly understand the world of risk-taking. I have a lot of respect for a lot of other companies out there, because I see how they operate, and they also have a great respect for risk-taking.

And that I think is kind of different than it was perhaps 15 years ago. There's a different level I think of understanding and perception of what it means to commit your shareholders' capital to a risk or a series of risks and turn out to be dead wrong.

And I think there's a healthy regard for that, and that has resulted in a set of industry-wide better analytics, better risk-taking profile that I think, by the way, is good for the customer; I think it's good for the agent; and I think it's good for the markets. Wild cyclicality up or down is actually bad for everybody. And better insight, better data, better analytics, is actually better for everybody. You get better analysis, you get better, more thoughtful pricing related to risk. So, that's a somewhat fulsome answer, but that's how I feel about it.

<Q - Josh C. Stirling>: That's really helpful, Jay. I guess just one other question. Related to the personal lines business, you guys have made big inroads with Quantum 2.0, stabilizing your volumes there, getting a more competitive product to market. I'm wondering what your plans are for Homeowners. A decade ago, probably wasn't a very good business, but it sure seems like a very profitable one now. But it's been shrinking for many years. And I'm wondering, when maybe we see you guys turn the corner there and start to use it as a growth engine? Thank you.

<A - Jay S. Fishman>: I'm going to ask Doreen to answer. But just, because I'm allowed to be so proud of what the organization has done. So, as far back as we see the data having, I'll say, integrity, and that's at least 10 years and maybe more on a comparable basis, we've had 1 year in our Homeowners business with a combined ratio over 100 and that was 2011. That was the Joplin storms and the Tuscaloosa storms. So, whether it was Ike, Gustav, and Dolly or Rita, Katrina, Wilma, it didn't matter.

The way that business – actually I'll come back to my previous comment about risk-taking. I am just so proud, candidly, of the way that whole organization has operated and thought about risk-taking. So, we love the business, and it's been a terrific performer for us. And actually I personally think in the future as the potential shift between Auto and Homeowners, I think it could very well do some shifting over the next 10 years. I love where we are; but with that, Doreen, you can take the rest.

<A - Doreen Spadorcia>: Thank you. And obviously, following on what Jay said, I'll tell you that we spent and it goes back to I think one of the earlier questions, just about looking at weather. And you probably recall, we looked at pricing, we looked at underwriting, we looked at concentration, and we feel really that we're operating now from a position of really great returns. And we see that when we have a competitive Auto product that also helps drive Home, and we are going to look for those opportunities where we can tune the product, so that in those areas that we think it makes sense to grow, that we will.

So again, we weren't planning just – we talked about Auto, where we thought we were going to be flat to comparing ourselves fourth quarter to last year. We knew Home was going to lag a little bit behind that. So, everything we're looking at with production is really according to what our expectations were. But as Jay said, we really were a property underwriter; we like the product; and we're going to look for the opportunities going forward