

Q1 2017 Earnings Call

Company Participants

- Alan D. Schnitzer, Chief Executive Officer & Director
- Brian William MacLean, President & Chief Operating Officer
- Gabriella Nawi, Senior Vice President, Investor Relations
- Gregory C. Toczydowski, President, Business Insurance & Executive Vice President
- Jay S. Benet, Vice Chairman & Chief Financial Officer
- Michael F. Klein, Executive Vice President and President, Personal Insurance, and Head of Enterprise Business Intelligence & Analytics

Other Participants

- Amit Kumar, Analyst
- Brian Meredith, Analyst
- Elyse B. Greenspan, Analyst
- Jay Arman Cohen, Analyst
- Jay Gelb, Analyst
- Jon Paul Newsome, Analyst
- Kai Pan, Analyst
- Larry Greenberg, Analyst
- Meyer Shields, Analyst
- Randy Binner, Analyst
- Ryan J. Tunis, Analyst
- Sarah E. DeWitt, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good morning, ladies and gentlemen, and welcome to the First Quarter Results Teleconference for Travelers. As a reminder this conference is being recorded on April 20, 2017. At this time, I would like to turn the conference over to Ms. Gabriella Nawi, Senior Vice President of Investor Relations. Ms. Nawi you may begin.

Gabriella Nawi {BIO 2211991 <GO>}

Thank you. Good morning, and welcome to Travelers' discussion of our first quarter 2017 results. Hopefully, all of you have seen our press release, financial supplement and webcast presentation released earlier this morning. All of these materials can be found on our website at www.travelers.com, under the Investors section.

Speaking today will be Alan Schnitzer, Chief Executive Officer; Jay Benet, Chief Financial Officer; and Brian MacLean, Chief Operating Officer. They will discuss the financial results of our business and the current market environment. They will refer to the webcast presentation as they go through prepared remarks, and then we will take questions.

In addition, other members of senior management are in the room, including Bill Heyman, Chief Investment Officer; Michael Klein, President of Personal Insurance; Tom Kunkel, President of Bond & Specialty Insurance; and Greg Toczydlowski, President of Business Insurance.

Before I turn it over to Alan, I would like to draw your attention to the explanatory note included at the end of the webcast. Our presentation today includes forward-looking statements. The company cautions investors that any forward-looking statement involves risks and uncertainties and is not a guarantee of future performance. Actual results may differ materially from those expressed or implied in the forward-looking statements due to a variety of factors. These factors are described in our earnings press release and in our most recent 10-Q and 10-K filed with the SEC. We do not undertake any obligation to update forward-looking statements.

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. One final note before I turn it over to Alan, as a result of recent SEC insurance industry guidance relating to the use of terminology, what we previously referred to as operating income, we now refer to as core income. As we explained in the press release, we have also relabeled related terms. To be clear, this is a wording change, and there were no changes in the calculation of these amounts.

And now Alan.

Alan D. Schnitzer {BIO 3529437 <GO>}

Thank you, Gabby. Good morning, everyone, and thank you for joining us today. This morning, we reported core income of \$614 million and core return on equity of 10.8%, both of which are impacted by \$226 million of after-tax catastrophe losses. About half of those losses arose out of storms occurring in the last two weeks of March. That kind of weather volatility is certainly in our playbook, but we normally expect it a few weeks later in the second quarter.

To give you some context, according to the National Weather Service reported hail, tornado and wind activity in the quarter was almost 2.5 times higher than the five-year average. The quarter also had 12 PCS wind and hail cat events, an all time record for Q1. That surpasses the record that was set just last year. As sometimes happens in this business, the weather in the quarter obscures what was otherwise a very good start to the year.

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Our underlying combined ratio was strong at 91.7%. Importantly, our personal auto bodily injury losses were within expectations and the same is generally true for loss trends across all our businesses. In addition to underwriting profitability, we were also pleased with our investment results this quarter with net investment income increasing 9% over the prior-year quarter.

Turning to production, for all our business segments we were pleased with our execution in the marketplace, including the record level of premium we wrote in the quarter. In our commercial businesses, the markets in which we operate remain stable. We continue to achieve historically high levels of retention of 85% in domestic Business Insurance and 88% in Bond & Specialty Insurance.

Renewal rate change improved somewhat over recent quarters, and as always, what's important is the texture underneath the headline numbers. For example, in our core middle market business, renewal rate change improved more than 1 point compared to the first quarter of last year. And during the current quarter, middle market renewal rate change was positive on 59% of our accounts compared to 53% of our accounts in the prior-year quarter. This is the result of our efforts to seek rate selectively and thoughtfully to meet our return objectives in light of the persistently low interest rate environment, and the fact that rate change has been below loss trend for a few years now. It's a similar story in our management liability business.

Contrast that to our select business, where rate change has been positive and stable for three quarters, but modestly below where it was a year ago. Given the returns in this portfolio, we were comfortable with the renewal rate change and pleased to see retention in new business levels up both sequentially and year-over-year.

In Personal Insurance, we are encouraged that so far we have been successful in implementing the pricing and underwriting actions that we discussed with you last quarter to improve profitability in our auto business, and we were very pleased to have maintained momentum in growing our very profitable homeowners business. All in for the company, net written premiums were up 5% compared to the prior-year quarter.

Brian will take you through the production data and top line results in more detail, but I'll note that to a very large degree the growth reflects a combination of higher levels of retention and higher renewal rate change. That speaks to the quality of the premium growth.

During the quarter, we were pleased to have announced our agreement to acquire Simply Business, a technology company and a leading digital provider of insurance to small businesses in the United Kingdom. In addition to a number of immediate benefits, like a profitable and growing business in the UK and access to talent with leading expertise in digital commerce in our industry, this is a medium and long-term strategic transaction for us. It's about building important capabilities. It's digital R&D that will give us important insights into serving our customers and working more efficiently with our distribution partners. It's about making sure that we're positioned to serve the customer however, whenever, and from wherever they choose to engage with us.

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We would've undertaken to develop these capabilities in any event, and teaming up with the company and people that have been at it for over a decade, and that are leading the way, gives us an important head start. Our agreement to acquire Simply Business is an example of our investing thoughtfully and strategically in the business, building on the meaningful competitive advantages that have enabled us to deliver industry-leading returns over time. And just as we have for more than a decade, we'll make investments like that for the long term, and continue to right-size capital by returning excess capital to our shareholders. There's no change in our capital management philosophy.

While Jay Benet will have more to say about our capital management, I'm pleased to report that as a reflection of confidence in our business, today, our board of directors declared 7.5% increase in our quarterly dividend to \$0.72 per share. This marks the 13th consecutive year of dividend increases. Our board also authorized an additional \$5 billion for share repurchases.

So wrapping up, weather was a factor this quarter, but the underlying results of the business were strong, we're well positioned for continued success over the near term, and we're excited about the investments we're making for sustained success over time.

And with that, I'll turn it over to Jay.

Jay S. Benet {BIO 2456473 <GO>}

Thank, Alan. Core income was \$614 million, down from \$698 million in the prior year quarter. And core ROE was 10.8%, down from 12.5%. There were several moving pieces this quarter, so let me spend a few minutes providing you with some further insight into these numbers.

I'll start by saying that the absolute levels, as well as the reductions in core income and core ROE were not driven by underlying performance, rather they reflected the relatively high level of tornado/hail that Alan discussed, along with the impact of the so-called Ogden rate adjustment, the UK Ministry of Justice's decision to reduce the discount rate applied to lump sum bodily injury payouts from a plus 2.5% to minus 0.75%.

Beginning with underwriting, cat losses were \$226 million after-tax, \$19 million higher than the already high \$207 million after-tax in the prior-year quarter. Page 4 of the webcast provides an analysis as to how our first quarter results compare to analyst estimates, and as best as we can tell, analyst estimates for cat losses appear to be significantly lower than what actually occurred, which more than accounts for the difference.

Net favorable prior-year reserve development, which I'll discuss in more detail shortly, was \$44 million after-tax, which was \$75 million less than the prior-year quarter, mostly due to Ogden. While remaining strong, as evidenced by a 91.7% underlying combined ratio, our underlying underwriting gain was lower than the prior-year quarter, primarily due to two things: the first was normal fluctuations in non-cat weather and other loss activity, and the second, as we had anticipated, was the timing impact of personal auto bodily injury loss estimates that were consistent with the higher loss trends that we had recognized in the

second half of 2016. Partially offsetting these reductions in the underlying underwriting gain, but not impacting the combined ratio was a \$39 million tax benefit from successfully closing out our federal income tax exams for 2013 and 2014.

Turning to investment results, which were strong, net investment income of \$480 million after-tax increased by 9% or \$41 million, as compared to the prior-year quarter. Non-fixed income, NII, increased by \$59 million after-tax, primarily due to strong private equity returns, more than offsetting the fully anticipated \$17 million after-tax decrease in fixed income NII that was driven by the continued low interest rate environment.

Consolidated net favorable prior-year development was \$81 million pre-tax, driven almost entirely by Business and International, as compared to \$180 million pre-tax in the prior-year quarter. The quarter included the previously announced reserve increase of \$62 million pre-tax that resulted from the Ogden rate change. Since this reserve increase primarily related to our public liability and commercial auto liability lines of business in the UK, approximately two-thirds of which are in runoff, any impact of this Ogden rate change on our future operating results is expected to be insignificant.

Excluding the impact of Ogden, Business and International had net favorable reserve development of \$133 million pre-tax, up from \$93 million pre-tax in the prior year quarter, and driven once again by better than expected loss experience in workers' comp and general liability.

Bond & Specialty had net favorable development of \$10 million pre-tax, while Personal Insurance had no prior-year reserve development, which was an improvement from the unfavorable development we experienced in the two most recent quarters.

On a combined stat Schedule P basis for all of our U.S. subs, all accident years across all product lines in the aggregate, and all product lines across all accident years in the aggregate developed favorably or had de minimis unfavorable development this quarter.

Operating cash flows of \$775 million remain very strong, and we ended the quarter with holding company liquidity of \$2.1 billion, up from \$1.7 billion at year-end 2016, and higher than normal for us. This increase in holding company liquidity resulted from moving the excess capital that was generated by our highly profitable fourth quarter 2016 from our operating companies to the holding company, coupled with our decision to moderate share repurchases in first quarter 2017 to provide financing flexibility for our pending acquisition of Simply Business.

As Alan said, there was no change in our capital management strategy. In the coming weeks, taking into account then current capital market conditions, we'll finalize our financing plans for Simply Business, which will likely include some combination of debt and internal resources, and once we've made that determination, we'll return remaining excess capital to our shareholders.

All of our capital ratios were at or better than their target levels. Net unrealized investment gains were approximately \$1.3 billion pre-tax or \$0.8 billion after tax, up from

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\$1.1 billion and \$0.7 billion respectively at the beginning of the year, while book value per share of \$84.51 and adjusted book value per share of \$81.56 increased 2% and 1% respectively from the beginning of the year. We continue to generate much more capital than we need to support our businesses, allowing us to return \$476 million of excess capital to our shareholders this quarter.

We paid dividends of \$190 million and repurchased \$286 million of our common shares this quarter, including \$225 million under our publicly announced share repurchase program, consistent with our ongoing capital management strategy, and \$61 million to partially offset shares issued under employee incentive plans, mostly to cover employee withholding taxes due upon the vesting and payout of performance and restricted stock awards. And, as Alan said, the board raised our quarterly dividend from \$0.67 to \$0.72 per share and authorized an additional \$5 billion in share repurchases.

With that, let me turn the microphone over to Brian.

Brian William MacLean {BIO 4679150 <GO>}

Thanks, Jay. Starting with this quarter's results in Business and International Insurance, segment income was \$468 million with a combined ratio of 96.3%, a strong result even with the impacts of above average catastrophe losses and the \$51 million after-tax related to the Ogden rate adjustment.

The underlying combined ratio, which excludes the impact of cats and prior-year reserve development, was 94.5%, up a little more than 1 point compared to the first quarter of 2016, due to normal quarterly variability in weather-related and other loss activity, along with loss cost trends that modestly exceeded earned pricing.

Net written premiums for the quarter of over \$4 billion, a record level, were up 3% year-over-year. Domestic Business Insurance premiums were up 2.5 points, driven by strong production results in select and middle market. International net written premiums were up 6%, due primarily to the timing of certain adjustments in the first quarter of both years.

Turning to domestic production, our focus continues to be on retaining our business. And accordingly, we were pleased that retention for the quarter of 85% remained at historically high levels. Renewal premium change came in at 2.8 points, up 0.5 points from the fourth quarter of 2016, and included positive renewal rate change of about 0.5 points. New business was \$532 million, down from a very strong prior-year quarter.

Looking at the individual businesses, beginning with select, where we continue to make product and technology investments to drive growth, and we're pleased with the progress we're making as evidenced by this quarter's production statistics. Retention of 83% has remained at historically high levels for three consecutive quarters, renewal premium change was over 5 points, and new business premiums of \$121 million was the highest level since the first quarter of 2012.

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In middle market, our results reflect a continued stable marketplace, retention of 88% was at historically high levels, while renewal premium change was nearly 3 points and included about a point of renewal rate change. Our new business writings continue to reflect our underwriting standards and return objectives, and although down from last year, were in line with our expectations. The combination of strong retention, positive RPC, and solid new business levels resulted in meaningful premium growth during the quarter.

In other business insurance, renewal premium change was up slightly compared to the fourth quarter of 2016, with renewal rate change that was flat. Retention came in at 79%, and new business premiums were \$121 million. In International, production results were very strong in the quarter, retention improved to 84%, while renewal premium change was slightly positive, and new business volumes were strong. So all in for the segment, it was a good start to 2017.

I'll now turn to Bond & Specialty Insurance where segment income for the quarter of \$129 million was strong, though down somewhat from the prior year, driven by a lower level of net favorable prior-year reserve development, partially offset by the segment's portion of the tax item that Jay mentioned earlier. The underlying combined ratio of 81.1% was very strong, and unchanged from the prior year.

As to the top line, net written premiums for the quarter were up slightly for both surety and management liability. 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, so we couldn't be more pleased that retention for the quarter, again, came in at historically high levels at 88%, while we continue to add a substantial level of new business. Renewal premium change of 4.4 points was up from recent quarters, reflecting a modest increase in average policy duration, along with improvement in the rate component of RPC.

Shifting from the financials, I'd like to comment on two things that we did in the quarter to advance our product offerings. First we added to our expertise in surety by bringing onboard Family Business Institute, a specialist in strategic planning services for closely-held construction businesses.

We also entered into an agreement with Symantec Corp. to provide our cyber policyholders with leading cyber risk services. These actions will allow us to deliver additional value-added services to our customers, further enhancing our industry-leading product portfolio. So Bond & Specialty results remain terrific, and we continue to feel great about the segment's performance and our position in the market.

Turning to Personal Insurance, net written premiums for the segment grew 12% in the quarter, with a combined ratio just under 100%. As you've already heard, there was a historically high level of tornado/hail activity in the quarter, and as a result, catastrophe losses of 10 points were significantly higher than our expectations. Excluding the impact of cats, the underlying combined ratio of 89.5% was in line with our expectations. Weather aside, both agency auto and agency homeowners got off to a good start towards

achieving the goals we laid out in the fourth quarter earnings call. The agency auto combined ratio for the quarter was 101.1%, and consistent with the segment, the cat component was larger than we would normally expect in the first quarter with catastrophe losses accounting for 2.5 points. The underlying combined ratio came in at 98.6%.

Excluding cats, first quarter auto loss experience was in line with our expectations. Compared to the first quarter of 2016, the underlying combined ratio is up 4.6 points, as you can see on page 18 of the webcast, 3.2 points of the increase was due to the timing of the higher run rate of bodily injury losses that we recognized in the second half of 2016, and that Jay mentioned earlier. The remaining 1.5 points was primarily due to the additional impact of tenure, which resulted from the earning in of the increased levels of new business that we wrote last year. As we explained a couple of quarters ago, while the higher level of new business is creating loss ratio pressure in the short-term, we believe it is a good thing for the long-term economic value of the portfolio.

As we mentioned last quarter in response to the higher bodily injury loss levels, we're taking actions to improve profitability, and our primary response is to improve the pricing of the book. Renewal premium change ticked up in the quarter to 5.9%, reflecting some of the impact of rate changes that have been approved thus far.

As additional rate filings are approved and impact policies at the renewal date, we expect RPC to increase sequentially each quarter, likely approaching double digits in the third quarter. The rate of PIF growth both sequentially and year-over-year slowed modestly in the quarter, while within the quarter, the monthly rate of growth decelerated, reflecting our efforts to manage growth, while profitability improves.

As we said last quarter, it will take time for the actions we're implementing to fully earn into the portfolio, but the first quarter results are on track with our expectations.

Turning to agency homeowners and other, we believe the quarter's results once again reinforced the value of providing portfolio solutions. In a quarter when our combined ratio included 19 points of cat losses more than double our expectation, we still posted a 96.7% combined ratio. The underlying combined of 77.6% was a little more than 1 point higher than the first quarter of 2016, due primarily to higher levels of non-cat weather.

Importantly, net written premium and policies in force both grew at an accelerating rate in the quarter, despite moderation in the growth rates for auto. The 4% growth in net written premiums was the strongest result since 2011. We've said in recent quarters that it was important for us to maintain focus on generating growth in our homeowners book, and we feel good about the results so far in 2017. So for the segment as a whole, we're encouraged by our first quarter results.

Before I turn it over to Gabby, I'd like to comment on a change in the reporting of our segment results going forward. Effective April 1, 2017, the company's results will be reported in three business segments, Business Insurance, Bond & Specialty Insurance, and Personal Insurance. With this change, the company's international businesses, which were previously reported in total within the Business and International segment will now be

disaggregated amongst these three newly aligned business segments. This change doesn't reflect the shift in strategy, but given the progress that we have achieved within our international businesses, we believe that the newly aligned segments will allow us to more effectively engage the product capabilities and talent across both our domestic and international operations.

With that, let me turn it back to Gabby.

Gabriella Nawi {BIO 2211991 <GO>}

Thank you. We're ready to start the Q&A portion of the call.

Before we do that, if I could please ask you to limit yourself to one question and one follow up. Thank you.

Q&A

Operator

Thank you. Our first question comes from the line of Amit Kumar with Macquarie. Please proceed.

Q - Amit Kumar {BIO 16979665 <GO>}

Thanks, and good morning. Two questions. The first question is - I guess going back to the discussion on the personal auto book, you talked about the higher underlying loss ratio, which is not a surprise. I'm curious, how should we think about that loss ratio, either stabilizing at the current level or ticking up or down going forward based on the market environment?

A - Michael F. Klein {BIO 19674145 <GO>}

Good morning, Amit. It's Michael Klein. So, in terms of the underlying, you see the 3.2 points on page 18. When we talked about that last quarter, we talked about the fact that the full-year impact of that in 2016 was about 3.5 points. The fact that that 3.2 points versus 3.5 points, there is some quarterly fluctuation in what that number will be quarter-to-quarter. But underlying coming into the year, we've got a 3.5 point gap that as we talked about last quarter, we're working to close. The amount to which that starts to get reduced will, again, as we talked about, sort of earn in over 18 to 24 months as the rate comes through, so there is a couple of things going on there. The rate that we're taking that will eventually eat into that 3.5 points, but there is certainly an unfavorable year-over-year comparison for the first three quarters of this year because we don't have the full 3.5 points recognized till you get to the basis of the full year 2016.

Q - Amit Kumar {BIO 16979665 <GO>}

Okay. The other question I had - and this is switching gears on - I guess the broader reserve releases and some of the questions we've gotten from investors have obviously

focused on the lower level of reserve releases. Bond & Specialty was higher in Q1 2016 due to the AOY experience back in 2016. I'm curious, was that sort of a one-off benefit we got in Q1 2016? And hence, we should be careful how we think about reserve releases going forward? Or am I over thinking the meaningful decline in reserve releases this quarter?

A - Jay S. Benet {BIO 2456473 <GO>}

Hi, this is Jay Benet. Let me start by saying what we always remind people of, that is that, every quarter we're looking at, literally, all the reserves, doing lots of analysis and when there's an indication that the reserves need to change, we make those changes. So, we always try to get - always get our best estimate of what those reserves are on a quarter-by-quarter basis.

We've seen things take place in all of the segments that in different quarters have led to mostly favorable development, although we did have a little unfavorable development in Personal Insurance last year. So, I don't look at the reserves and try to predict anything in terms of patterns, in terms of intent, in terms of how things are going to emerge. I think of it more as episodic. And that we had larger reserve development in Bond & Specialty last year versus a smaller amount this year I just look at, that's just what the data said and we'll see what the data brings in subsequent quarters.

Q - Amit Kumar {BIO 16979665 <GO>}

Okay. Thanks for the answer. I'll stop here. Thank you.

A - Gabriella Nawi {BIO 2211991 <GO>}

Next question, please.

Operator

Our next question comes from the line of Jay Gelb with Barclays. Please proceed.

Q - Jay Gelb {BIO 21247396 <GO>}

Thank you. Can you hear me okay?

A - Alan D. Schnitzer {BIO 3529437 <GO>}

Yeah, we can, Jay.

Q - Jay Gelb {BIO 21247396 <GO>}

Thank you. For personal auto, I was a little surprised at the persistent high level of policy in force growth at 12%, given the efforts to fix profitability there. Can you give us a bit more insight on that?

A - Michael F. Klein {BIO 19674145 <GO>}

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Sure, Jay, this is Michael Klein. So, the one thing I would point out about policy in force growth, particularly if you're looking at that 12% year-on-year number, that's really a lagging indicator of growth. So think of the 12% as the 12-month weighted average of the growth we've seen over the last 12 months, right. It's this year's policy in force in the quarter relative to the first quarter of last year, so there's - built into that 12% number, primarily is the growth we saw last year.

That said, Brian mentioned growth decelerated within the quarter. So what you'll see as you look forward and what we expect is that annual policy in force growth number will come down, but it will come down relatively slowly, again, because of sort of the embedded volume already in the back half of 2016.

To Brian's comments about growth decelerating in the quarter, we've seen, and you can look at it in the production statistics, a bit of a drop in renewal retention in response to the rate, but also importantly, we're essentially where we expected to be. We continue to see win rates come down as we put rate into the marketplace, and then equally importantly, we talked about at-bats last quarter, the efforts we have undertaken to take underwriting action and manage the flow of quote volume into the business have started to take hold. And so we're actually seeing our quote activity and our win rates come down consistent with expectation and the growth continues to moderate.

A - Alan D. Schnitzer {BIO 3529437 <GO>}

Jay, it's Alan. I would just emphasize what Michael said, that we were generally able to achieve what we wanted to achieve, and we generally are where we expected to be. So a quarter past, we talked to you about last quarter, so far so good.

Q - Jay Gelb {BIO 21247396 <GO>}

I appreciate that. And then my follow up is on the buyback and how the Simply Business acquisition affected that. So, in the Q, it says the Simply Business acquisition was total consideration of around \$490 million. I thought an acquisition of that size might not have slowed the pace of buybacks in the quarter. I'm just trying to think about what the implications are for buybacks going forward.

A - Jay S. Benet {BIO 2456473 <GO>}

Yeah. Hi Jay, this is Jay. The way we manage capital, as you recall, we're preserving capital for organic growth in our business, and for any kind of activity that would add to shareholder value over time. So, what we looked at here was a relatively modest acquisition, given the size of Travelers, but it does impact the resource base that we have.

So in this particular case, what we decided to do in the first quarter was just to hold back a little bit on share repurchases. We know we have an obligation that this thing will close later in the year. We never rely on capital markets being favorable or open or whatever. We take a very conservative look. So what we've done is held back some funds to be able to unequivocally close on the transaction.

As we said before, as we get closer to finalizing our financing plans for it, which will be a combination of debt and some of the internal capital, we'll make a final determination as to what the capital level should be, and then return the remaining excess. So I wouldn't look into it as anything other than some cash planning on our part and no change whatsoever in the whole capital management strategy of the place.

Q - Jay Gelb {BIO 21247396 <GO>}

Great. Thanks, Jay.

A - Gabriella Nawi {BIO 2211991 <GO>}

Next question, please.

Operator

Our next question comes from the line of Sarah DeWitt with JPMorgan. Please proceed.

Q - Sarah E. DeWitt {BIO 18946247 <GO>}

Hi, good morning. Could you talk about what you're seeing in terms of loss trends in Business Insurance? Do you expect any upward pressure there? I know last quarter you talked a little bit about how the propensity to litigate in auto had spread to small commercial.

A - Alan D. Schnitzer {BIO 3529437 <GO>}

Sarah, good morning, it's Alan. I would say, broadly speaking, we haven't seen any significant changes in loss trend in really any of our commercial businesses. And I think you mentioned propensity to litigate. That's not exactly right. What we've seen is a little bit of an increase in attorney representation, and that actually, we're typically seeing it at smaller less complex cases, so not necessarily increased litigation, just to factor that it takes longer to settle the cases, and sometimes results in ordering more medical diagnostics, things like that. That's impacting severity. But that's actually not new. We've been seeing that manifest itself in our commercial businesses probably over a couple of years. But I would say broadly speaking, Sarah, no real change in what's been a pretty favorable loss trend environment.

Now, in terms of the way we think about that and price and set reserves, we always assume things will return to longer-term normal, but I would say, maybe with the exception of auto that's been persistently difficult, really no change.

Q - Sarah E. DeWitt {BIO 18946247 <GO>}

Okay. Great. Thank you. And then in Business Insurance, you've been taking modest renewal rate increases for the past two quarters, but you mentioned it's still below loss trend. What would need to happen for you to take rate to keep up with loss trends?

A - Alan D. Schnitzer {BIO 3529437 <GO>}

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Well, first of all, we'd have to keep going. And I guess I'd step back, Sarah, and I would say that what we were able to do in the quarter reflects what we were trying to do in the quarter. It was very small, very thoughtful, very subtle shifts, and it's just a reflection of what we thought we needed to do given what's happened to interest rates, and where pricing has been relative to loss trends over a couple of years now.

And so, we were really encouraged by what we were able to accomplish, and we'll see where that goes in the future. I would point out that we've told you in Business Insurance broadly loss trend is about 4%. Rate would not need to get to 4% in order to be flat because, as we've said before, there's real economic impact from incremental exposure that we're getting. And there's other levers we can pull to improve profitability. And we've talked about this before, terms and conditions, mix, expenses, claims handling, other strategic investments. So, all those things add up, Sarah.

Q - Sarah E. DeWitt {BIO 18946247 <GO>}

Okay, thank you.

A - Alan D. Schnitzer {BIO 3529437 <GO>}

Thank you.

A - Gabriella Nawi {BIO 2211991 <GO>}

Next question, please.

Operator

Our next question comes from the line of Kai Pan with Morgan Stanley. Please proceed.

Q - Kai Pan {BIO 18669701 <GO>}

Good morning, and thank you. First question, just follow up on the personal auto side. The 140 basis point deterioration, if you are excluding the re-estimates, that's assuming mostly coming from the new business track or tenure impact. If your PIF growth is gradually slowing down, is that impact will drag on for a little bit longer?

A - Michael F. Klein {BIO 19674145 <GO>}

Sure, Kai, this is Michael. Couple of comments, and one just to remind everybody, there is also seasonality in the overall underlying combined ratio in Personal Insurance. So, the 98.6% for the first quarter is reflective of, generally speaking, a lower underlying loss ratio in the first quarter than for the balance of the year. So, I just wanted to clarify that point.

In terms of the 1.5 point or so drag from tenure, you are right, that will mitigate over time, but remember that it's not just the new business we've just recently written. It's the cohorts of business we've written over the last couple of years earning their way through the book. So as we've talked about in the past, the reduction in the tenure impact is something that we measure in years not quarters, so it will take a while for that to roll off.

Q - Kai Pan {BIO 18669701 <GO>}

Okay. Great. My follow up question is on Simply Business. So, Alan, I just wonder, could you explore a little bit about the strategic rationale behind it, and why do you do that in the UK rather than do that in the U.S.? And do you expect to expand that platform in the U.S. market, because you have a dominant, kind of like a leading position in small business insurance here?

A - Alan D. Schnitzer {BIO 3529437 <GO>}

Sure, Kai, good morning, thanks for the question. We've been thinking about everything changing in the world for a long time. And clearly, one of the things changing most significantly and maybe poised to have the biggest impact on us is the world becoming more digital and more mobile.

And so, every aspect of our business has to get more digital and more mobile. And so that's the way we engage with our customers, the way we engage with our agents. We've got to be there when and however they want. It's the way we manufacture our products and underwrite our risk. It's the way we market our products. It's the way we manage our internal operations. It's about creating a better experience really for all of our constituencies internally and externally.

We've got to be faster, we've got to be more efficient, and we've got to be more flexible. So, we look around the world and we think, how are we going to develop those capabilities? And we've got two choices. We can develop it internally or we can see who is great at it, and see if we can bring that expertise in house. And so you scan the world, and we see Simply Business. They've been a hugely successful, customer-focused technology company for a dozen years. So, it's not a startup. They've been at this a long time and they've got a real demonstrated success in this. They've got technological capabilities, they've got know-how, a winning approach to innovation, all things that we think that we'll benefit from.

And so we were going to develop these capabilities, as I said, one way or another. And it turns out that we thought that the best solution for finding those capabilities and bringing them in house in terms of where they resided, a great cultural fit, and who we actually think the market leader is, it was Simply Business and they happen to be in the UK. That fits nicely with us. We've got a business in the UK, we've got a very small budding, direct small commercial business there, fits nicely. And even before we had started conversations with Simply Business, they had made a decision to bring their model to the United States. So that's even before early stage. I would say that's just getting started. But our ability to help them accelerate that in the U.S., I think, was really attractive to them. And the capabilities they bring to us is attractive to us. So, it started in the UK and we'll bring it to the U.S. and potentially other geographies.

Q - Kai Pan {BIO 18669701 <GO>}

Great. Thank you so much.

A - Alan D. Schnitzer {BIO 3529437 <GO>}

Thank you.

A - Gabriella Nawi {BIO 2211991 <GO>}

Next question, please.

Operator

Our next question comes from the line of Paul Newsome with Sandler O'Neill. Please proceed.

Q - Jon Paul Newsome {BIO 3522950 <GO>}

Good morning. I'm curious about the change in the international business, could you – in one sense you said that the strategy isn't changing, but it sounds like there is some change going on there, either from a – who is in charge kind of position, or something else that would drive the segment change. Could do you just give us a little bit more color on what actually is changing from a business perspective as opposed to reporting perspective?

A - Alan D. Schnitzer {BIO 3529437 <GO>}

Yeah, good morning, Paul. It really is a way – this is completely borne out of the way that we plan to manage the business, and really it's the opportunity we think we have to leverage our terrific know-how and capabilities in the U.S. to deliver those capabilities outside of the U.S. It's really – not that that's not significant, but it's nothing more significant than that. It's not a different approach the way we think about the opportunity outside the U.S., it's just a different approach to how we think we can best deliver our capabilities.

And we've been on a journey for eight or so years now in trying to invest in and improve our international businesses. We've invested in technology, we've invested in talent, we're running the better railroad. And we've had a lot of success. And so the leadership that's brought us there will continue to be actively involved in managing those businesses as a portfolio. We'll have an ongoing obligation to manage those companies on a standalone basis because we've got regulated entities in the various countries, and we'll continue to do that with the great leadership that has always done that. But we've got an opportunity with our – the talent and the capabilities in the U.S. to just do a better job of leveraging that outside of the U.S.

Q - Jon Paul Newsome {BIO 3522950 <GO>}

But there's nobody – is there actually a change in who reports to who or anything like that in those segments?

A - Alan D. Schnitzer {BIO 3529437 <GO>}

Well, it's – we've always had a matrix reporting structure, and we'll continue to have a matrix reporting structure, the international business and the people that run the countries will continue to report to Kevin Smith and he'll have responsibility for that. But beneath

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that organizational alignment, we'll look at Greg Toczydlowski for Business Insurance, and Tom Kunkel for Bond & Specialty, and Michael Klein for Personal Insurance, and they will, on a matrix basis, manage their product delivery outside the United States.

Q - Jon Paul Newsome {BIO 3522950 <GO>}

Okay.

A - Alan D. Schnitzer {BIO 3529437 <GO>}

It's actually not that different than the way we've thought about it all along, it's just an opportunity to reinforce the engagement on a product level.

Q - Jon Paul Newsome {BIO 3522950 <GO>}

Okay. Thank you very much. Appreciate it.

A - Gabriella Nawi {BIO 2211991 <GO>}

Next question, please.

Operator

Our next question comes from the line of Randy Binner with FBR. Please proceed.

Q - Randy Binner {BIO 15145081 <GO>}

Hey, good morning, thanks. I had a follow-up to Amit's question earlier. The question is, how are actual severity trends developing relative to the assumption you made, call it late last year? And if there's commentary on frequency as well, this is in auto, of course. I'm just wondering, I know that you are repricing against elevated trend, but anecdotally, we all observe, I think continued challenges in auto accident frequency and severity. So, the question is, how is the actual loss environment developing relative to that repricing assumption that started late last year?

A - Michael F. Klein {BIO 19674145 <GO>}

Yeah, so, Randy, it's Michael. The actual development is consistent with the repricing assumptions. Whether that's the 3.5 points of elevated bodily injury losses that are now in the underlying, or whether it's the elevated level of loss trend that we talked to you about in the fourth quarter that we added to our pricing. So, as we sit here today, the experience in the first quarter of 2017 developed consistent with those expectations.

The only thing I just want to add a point back to the question from Kai, and I think it was implied in my answer, but the 1.5 point of tenure impact that we're talking about year-on-year, is year-on-year, and therefore that's not the full amount of tenure impact, right? There was tenure impact in the base in 2016, the 1.5 point – an additional 1.5 point on top of that, just to clarify. But to your questions, the experience thus far this year has been consistent with both the elevated starting point and the elevated trend that we factored into our expectations.

Q - Randy Binner {BIO 15145081 <GO>}

Okay. Great. And then I guess the follow up there is understanding that and understanding the price that you're moving, you're putting into the market, do you see Travelers as an auto insurance company that's going to gain market share because of the dislocation out there with some of the mutuals really having to push very high pricing? Or do you see yourself, kind of in the middle or potentially losing market share as we see market share dislocation in U.S. auto insurance?

A - Michael F. Klein {BIO 19674145 <GO>}

Sure, so just a couple of points. First of all in 2016, we gained share ever so slightly, 0.1%, based on the growth that we experienced last year. Certainly, coming into this quarter, you see the PIF growth at 12%, you see the period-to-period PIF growth at 2%. We would view in the first quarter, our growth probably outpacing the market. That said, our objective is to improve profitability and manage growth.

So our - the glide path we're trying to move the business down is, one, to reduce the growth rate, but continue to grow as we manage profitability. What that amounts to in terms of market share, really depends on what happens with the other players in the marketplace. We would tell you that the pricing actions that we're putting into market, again, consistent with our view of the loss trends being environmental, we're not alone in terms of driving rate, but what that ultimately amounts to in terms of share, we'll have to wait and see.

A - Jay S. Benet {BIO 2456473 <GO>}

And Randy, we don't really manage to market share. We manage to return to profitability, balancing that with growth, and market share will fall out of that.

Q - Randy Binner {BIO 15145081 <GO>}

Understood, thanks a lot.

A - Alan D. Schnitzer {BIO 3529437 <GO>}

Thank you.

A - Michael F. Klein {BIO 19674145 <GO>}

Next question, please.

Operator

Our next question comes from the line of Elyse Greenspan with Wells Fargo. Please proceed.

Q - Elyse B. Greenspan {BIO 17263315 <GO>}

Hi, good morning. First question, I was hoping to get some additional color on your outlook for the Business Insurance pricing environment. In the Q, you guys point to the

renewal premium change basically being consistent with the Q1 for the balance of the year. So, I mean, how do you view pricing compared to expectations for any changes in the U.S. economy when you came to that outlook for the RPC?

A - Jay S. Benet {BIO 2456473 <GO>}

So, Elyse, RPC obviously includes rate and exposure, and so it's a broader measure, and there is obviously a corridor around the words broadly consistent. And so we're probably not going to break that down into pure rate and exposure. We'll - obviously we thought we needed to get more pure rate in the first quarter, and as I said, we were encouraged we were able to do that. I will say that the trends that led us to do that, namely lower interest rate environment and where rate has been for a while relative to loss trends, those trends still persist out there, and so we'll have to take that into account. And so we'll take it from there. Obviously, we operate in a competitive marketplace, and so that will be a factor. So we'll - we're encouraged and we'll see where it goes.

Q - Elyse B. Greenspan {BIO 17263315 <GO>}

Okay. Thank you. And then just a couple of numbers questions, and going back to the personal auto book. If I look at your underlying loss ratio this Q1 compared to the adjusted last year, it seems like there is about 2.5 points of deterioration. You guys said year-over-year the delta was about 1.5 points the change from tenure. So, what else am I missing when I look at that calculation, since it's adjusted with the elevated trends last Q1?

And a second part question in terms of the auto margins. Your expense ratio in the personal auto book came down in the fourth quarter, and then also was at that kind of lower level this quarter. How do you think about the expense ratio for the auto book when you think about your margin outlook for that business for the balance of 2017?

A - Michael F. Klein {BIO 19674145 <GO>}

Yeah, so, Elyse, it's Michael. To your point - so, I'll start with expense ratio. We continue to manage expenses on a pretty disciplined basis inside PI, and we're enjoying the benefit of the increased volume over relatively flat expense base, and that continues to be our plan going forward.

In terms of the other components of loss ratio, it's really normal period-to-period fluctuation. There's nothing - there are some puts and takes underneath that, but it's really normal period-to-period fluctuation, explains those other changes in the underlying.

Q - Elyse B. Greenspan {BIO 17263315 <GO>}

Okay. Thank you very much.

A - Gabriella Nawi {BIO 2211991 <GO>}

Next question, please.

Operator

Our next question comes from the line of Ryan Tunis with Credit Suisse. Please proceed.

Q - Ryan J. Tunis {BIO 16502263 <GO>}

Hey, thanks, good morning. I guess my first one was just a follow-up on Alan's comments about in domestic, the positive rate indication this quarter on 59% of the book versus 53% a year ago. And I guess just thinking a little bit more granularly, what is leading to the upward rate indication? Is there pressure on certain accounts or is it - I think the point you made, just several years of rate running below loss cost trend?

A - Alan D. Schnitzer {BIO 3529437 <GO>}

Yeah, good morning, Ryan. So, we manage the business on a very granular level with a return objective in mind. And we had a bunch of years going back to 2010 or 2011, where we had a rising rate environment and that put us in a very good position in terms of where our earned and written returns were. And since, I don't know, beginning of 2014 or so, we've been in an environment where rate's been below loss trend, and we've had a continued low interest rate environment. I think the tenure this morning was slightly over 2.2 or something like that.

And so, over time those things have an impact. And while today we're satisfied with our written returns, we look out the windshield into the future and see where things are going, and it causes us to, again very selectively, very thoughtfully in a way that we think makes sense given our portfolio, our returns, working with our distribution partners in a way that's never intended to be disruptive to them or our customers, we try to improve the return outlook. And not everywhere, I made the point our select business was in a different position from a return perspective, and we were happy to take the rate where it was, where it's been over recent quarters, and so it's just very granular execution with a return objective in mind.

Q - Ryan J. Tunis {BIO 16502263 <GO>}

Thank you, that's helpful. And then, I guess just following up on the line of questioning in auto. And I guess, thinking about weather in Q1. It seemed like January, February weather was somewhat benign. You had warmer temperatures. I'm wondering how you'd characterize the impact of weather on auto in 1Q, in the first quarter. I think the way to ask it is, how did frequency trend year-over-year?

A - Jay S. Benet {BIO 2456473 <GO>}

Yeah, again, I would say broadly speaking, frequency and severity in the first quarter came in consistent with our expectations. I think we talk about the impact of the weather, and we'll talk about warm temperatures above freezing in cold months can give you sometimes higher speeds and higher severity. Cold temperatures below freezing will give you ice and will give you more high frequency low severity bumping into things. But you see those period-to-period fluctuations, and again, that's part of my point in the response to Elyse is we've got just normal period-to-period fluctuations. But we didn't see anything in the first quarter significantly different than our expectations.

A - Brian William MacLean {BIO 4679150 <GO>}

Well, and specifically, this is Brian, when you think of the first quarter cat activity, it's the tornado, hail, and specifically the hail.

A - Jay S. Benet {BIO 2456473 <GO>}

Correct.

A - Brian William MacLean {BIO 4679150 <GO>}

That is driving the numbers, and that is usually the case. So especially in auto, hail will bring about an immediate uptick.

A - Jay S. Benet {BIO 2456473 <GO>}

Correct.

A - Brian William MacLean {BIO 4679150 <GO>}

And that's what we saw in March, as Alan pointed out.

Q - Ryan J. Tunis {BIO 16502263 <GO>}

Got it. So, maybe over March, weather normalized some. Okay. Thank you.

A - Gabriella Nawi {BIO 2211991 <GO>}

Next question, please.

Operator

The next question comes from the line of Larry Greenberg with Janney Montgomery Scott. Please proceed.

Q - Larry Greenberg {BIO 16478161 <GO>}

Good morning, and thank you. Just staying on auto, are you seeing anything new in how you think about the long-term value of the business that you've put on in the last couple, few years? Probably undeniable that you'd like to have repriced some of that a little bit earlier. But are you seeing anything new that would support or refute that this is business that you ultimately want, and will be value-enhancing over the long term?

A - Michael F. Klein {BIO 19674145 <GO>}

No, Larry, we're not. I mean, as we've talked about over the past several quarters, we are slicing and dicing it 18 ways to Sunday. But from a quality perspective, the quality of the business, the profile of the business is very consistent with what we targeted when we designed and developed and launched the Quantum Auto 2.0 product.

Again, the profile of the business coming in the door is consistent with what we've been looking for. We continue to evaluate and examine that tenure impact and make sure that the business is tenuring consistent with our expectations. And so to your point, from a long term value economic perspective, it's tracking with our expectations. Again, we would have liked to have charged more for it, but that was really the primary conclusion, and that's why the strategy to improve the profitability to go after it with base rate.

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A - Jay S. Benet {BIO 2456473 <GO>}

And to the extent that we do keep it and improve profitability from an economic perspective, it'll be a good thing in terms of creating economic value.

Q - Larry Greenberg {BIO 16478161 <GO>}

Great, thanks, that's all I had.

A - Alan D. Schnitzer {BIO 3529437 <GO>}

Thank you.

A - Gabriella Nawi {BIO 2211991 <GO>}

Thanks. Next question, please.

Operator

Our next question comes from the line of Brian Meredith with UBS. Please proceed.

Q - Brian Meredith {BIO 3108204 <GO>}

Yeah, thanks. A couple quick questions here. First, Brian, Alan, could you talk a little bit about the competitive dynamics right now in the workers' compensation insurance area? Your premiums are down a little bit the last couple quarters. And are you seeing any impact in the marketplace from perhaps a competitor having some issues?

A - Alan D. Schnitzer {BIO 3529437 <GO>}

Yeah, so thanks, Brian. And I always preface our comments with we feel great about our workers' comp capabilities. We clearly feel we're the industry leader. We've got, between our underwritten book and our service book, the largest portfolio in the industry. So we know the line well. We know the difficulty there can be with any long-tail line, and more than any business we have, incredibly granular industry by industry, state by state, account size by account size, so we look at that a lot.

Yeah, pricing is – so directionally, there is definitely good news on the loss trend side. Now, it's a very long-tail line of business, so short-term movements in loss trend get blended in as we look at long-tail loss trend. But loss trends have been positive, but pricing is reacting and probably overreacting to that in the marketplace. So, we're looking at it very closely. There's been some disruption with carriers out there in the market. And we are looking at that business closely. It's still got to meet the economic hurdles that we

have and the profitability. So to the extent that there are opportunities out there that we think we can write at appropriate prices, we're excited about it, but we're looking at that closely.

Q - Brian Meredith {BIO 3108204 <GO>}

Okay, great. And then next question, I'm just curious, in the management liability area, what are you seeing with loss trends there?

A - Alan D. Schnitzer {BIO 3529437 <GO>}

Yeah, nothing significant. There has been a lot written about securities class actions being up.

Q - Brian Meredith {BIO 3108204 <GO>}

Right.

A - Alan D. Schnitzer {BIO 3529437 <GO>}

And the numbers may be up, I would say as it relates to us, we've got a very diversified management liability book. We manage positions in the tower and limits very carefully. And the activity that we've seen that's been at elevated levels is in industries where we're underweighted. It's been biotech, pharma, healthcare, and we're underweighted there.

I'd also add that, as you look at that commentary out there that suggest that numbers of security class actions are up, sometimes the methodology in counting the cases distorts the numbers. You got to look at cases that were previously brought in state court that are now being brought in federal court for reasons you would have to ask the plaintiffs' bar about, but you really have to look at the aggregate of those two numbers to see the trends in claim counts.

Q - Brian Meredith {BIO 3108204 <GO>}

Great. Thanks for the answer.

A - Gabriella Nawi {BIO 2211991 <GO>}

Next question, please.

Operator

Our next question comes from the line of Jay Cohen with Bank of America Merrill Lynch. Please proceed.

Q - Jay Arman Cohen {BIO 1498813 <GO>}

Yes, thank you. Most of my questions have been answered, but just one question, when you look at the difference in the renewal rate change versus renewal premium change, that difference is much bigger in select than it is for the broader commercial or Business

Insurance segment. And I'm wondering why that is? Why is there a bigger difference in select?

A - Gregory C. Toczydlowski {BIO 16615940 <GO>}

Hey, Jay, this is Greg Toczydlowski. In the select business, just given the smaller nature of those policies, we have a certain segment of the business that we call Express business, and the CMP or the BOP portion has some inflationary guards inside there. So that's automatically applied, typically, to the property line. So underneath the CMP or the BOP product. So that's one of the drivers.

The other one is around workers' comp. Workers' comp, we continue to see the type of mix that we're writing, some wage increases and some increases in payroll. So the combination of the two is really giving us that exposure lift that we're getting in that business.

Q - Jay Arman Cohen {BIO 1498813 <GO>}

And workers' comp, that has a bigger piece of the select business than it is of the overall segment business?

A - Gregory C. Toczydlowski {BIO 16615940 <GO>}

Is the question as a percentage of the overall premium? It's got a similar mix profile, if that's the question.

Q - Jay Arman Cohen {BIO 1498813 <GO>}

Okay. I'll follow-up offline. That's helpful, though. Thanks, Greg.

A - Gabriella Nawi {BIO 2211991 <GO>}

Great. And this is our last question.

Operator

Next question comes from the line of Meyer Shields with Keefe, Bruyette & Woods. Please proceed.

Q - Meyer Shields {BIO 4281064 <GO>}

Great. Thanks, good morning. Very briefly, when you talk about reallocating the international business to the individual segments, can you talk broadly about what impact that would have on the reported underlying combined ratios?

A - Michael F. Klein {BIO 19674145 <GO>}

Just procedurally, one of the things we're in the process of doing is reconstituting the 10-K information, as well as the supplement. So just in line with your question, we'll be providing this kind of data to you in advance of the webcast for the second quarter. We

expect late in the second quarter to get the information out into the public. But I think, when you look at the overall size of the various segments versus the size of the international operations, I think the impact on the combined ratios would generally be pretty modest.

Q - Meyer Shields {BIO 4281064 <GO>}

Okay.

A - Alan D. Schnitzer {BIO 3529437 <GO>}

And just to state the obvious. When you look at the consolidated number for prior periods, there'll be no change, right?

A - Michael F. Klein {BIO 19674145 <GO>}

Correct.

A - Alan D. Schnitzer {BIO 3529437 <GO>}

It will be modest reallocation among the segments, but relatively small impact.

Q - Meyer Shields {BIO 4281064 <GO>}

Right. No, that makes sense. And then the Simply Business acquisition, where are we going to see those earnings in the segments in the income statement?

A - Michael F. Klein {BIO 19674145 <GO>}

Simply Business, we expect it to be part of the Business Insurance segment. So it will be there, but we'll see how we'll present that. I mean it will be part of the segment, it will be wrapped in. But again, just in terms of the size of the Business Insurance segment, Simply Business will be a pretty small piece of that.

Q - Meyer Shields {BIO 4281064 <GO>}

Okay. Great. Thanks so much.

A - Alan D. Schnitzer {BIO 3529437 <GO>}

Thank you.

A - Gabriella Nawi {BIO 2211991 <GO>}

Excellent. That concludes our call for today. Thank you very much for joining.

Operator

Ladies and gentlemen, that does conclude the conference call for today. We thank you for your participation and ask that you please disconnect your lines. Have a great day, everyone.

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