

Company Name: Travelers  
 Company Ticker: TRV US  
 Date: 2018-01-23  
 Event Description: Q4 2017 Earnings Call

Market Cap: 39,694.96  
 Current PX: 146.26  
 YTD Change(\$): +10.62  
 YTD Change(%): +7.830

Bloomberg Estimates - EPS  
 Current Quarter: 2.768  
 Current Year: 10.708  
 Bloomberg Estimates - Sales  
 Current Quarter: 7283.500  
 Current Year: 29197.091

## Q4 2017 Earnings Call

### Company Participants

- Gabriella Nawi
- Alan D. Schnitzer
- Jay S. Benet
- Brian William MacLean
- Michael F. Klein
- Gregory C. Toczydowski
- William Herbert Heyman
- Thomas M. Kunkel

### Other Participants

- Kai Pan
- Ryan J. Tunis
- Amit Kumar
- Elyse B. Greenspan
- Yaron Kinar
- Jon Paul Newsome
- Jay Gelb
- Jay A. Cohen
- Brian Meredith
- Meyer Shields
- Sarah E. DeWitt
- Larry Greenberg

## 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 available in the Investors section on our website, [travelers.com](http://travelers.com)

### Alan D. Schnitzer

#### *Business Highlights*

##### *Core Income*

- This morning, we reported fourth quarter core income of \$633mm, generating a core return on equity of a little over 11%

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- That brings our full year core income to \$2.043B and full-year core return on equity to 9%
- The fact that we were able to generate that level of profit and profitability, given the extraordinary catastrophe losses for the industry this quarter and year, on top of a decade of historically low interest rates and several years of a relatively soft pricing environment, speaks to the earnings power of the franchise
- It's the value of our competitive advantages, starting with underwriting excellence and investment expertise

### ***Balance Sheet***

- For the year, catastrophe losses were manageable, and we generated an after-tax underlying underwriting gain in excess of \$1.2B and after-tax net investment income of nearly \$1.9B
- Our results and strong balance sheet enabled us to grow adjusted book value per share by 4% during the year after returning \$2.2B of excess capital to our shareholders
- And as I'll share in a minute, we're encouraged about the outlook for 2018

### ***Commercial Business***

- Overall, we were pleased with our underlying combined ratio of 92.6% for the year, which was impacted by high levels of non-cat weather and non-cat fire-related losses relative to our expectations
- Underneath that, our commercial businesses continued to perform well
- For the year, Business Insurance delivered a strong underlying combined ratio of 94.9%
- Bond & Specialty Insurance delivered an impressive underlying combined ratio of 83.2%, even after a charge in Q4 for a single surety loss outside the United States

### ***Personal Insurance***

- In Personal Insurance, we were pleased with an underlying combined ratio in the quarter of 90.4%, bringing the full year to 91.5%
- Those results reflect continued success in our leading property business, loss trends in personal auto within expectations, and the continued successful execution of the pricing and underwriting actions we've been taking in the auto business all year
- Notably, our consolidated expense ratio was down 80BPS for the year as we grew earned premium by almost 5%, continued to invest in the strategic initiatives we discussed with you at our recent Investor Day and delivered on our objective of improving productivity and efficiency, which resulted in about flat G&A expense dollars

### ***Net Written Premium Growth***

- Turning to the top line, we were very pleased with the success of our marketplace execution, which resulted in full year net written premium growth of 5% to a record \$26.2B
- Importantly, in domestic Business Insurance in the quarter, renewal rate change reached 1.4 points, doubling from Q3 and renewal premium change reached 4 points
- For both measures, that's the highest levels in about three years

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### ***Product Portfolio***

- Brian will give you more texture on the execution underneath the headlines, including a view by line, but I'll note that we achieved renewal rate gains in the quarter more broadly across our product portfolio and our accounts compared to recent periods
- It's an acceleration of a trend and improved pricing we've achieved over the past six quarters as the market started to reacting to two things:
  - First, the hurricanes and wildfires in the back half of the year
  - And second, and more significant in my view, declining margins generally as interest rates remained at historically low levels and loss trend has outpaced rate and exposure for a few years now

### ***Agent and Broker Partner***

- As we've been doing all year and as I reiterated last quarter, we'll continue to seek rate thoughtfully and in close coordination with our agent and broker partners with the belief that our customers are well served by a stable and predictable market that keeps pace with inflation as opposed to more dramatic price swings of the past
- Given our sense of the market and the fact that retentions remain at historic highs, we're encouraged

### ***Pricing Environment***

- Aside from the pricing environment, new business and domestic Business Insurance was up in the quarter and for the year
- We explained at our recent Investor Day that a number of the initiatives we have underway are designed to create more top line opportunities for us
  - It's still early days, but what we can see so far is positive

### ***Marketplace Execution***

- Our marketplace execution in both Bond & Specialty Insurance and Personal Insurance was equally successful
- In our management liability business, we maintained retention at an impressive 88% throughout the year with stable renewal premium change and higher new business volume
- Surety premium was higher both in the quarter and for the year as a result of an increase in large bond activity

### ***Personal Insurance***

- Personal Insurance finished the year with another quarter of accomplishing our objectives of improving auto profitability while maintaining momentum in our leading homeowners business
- We achieved 11 points of renewal premium change in auto, enough to offset the bodily injury severity we identified in H2 2016 on a written basis, and delivered policy in force growth throughout the year in our homeowners business

### ***Tax Rate***

- As it relates to the market generally, there's been a lot of speculation about how corporate tax reform will impact pricing

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- Stepping back, we price our products with return objectives in mind
- The tax rate is just one factor impacting the pricing we need to achieve in order to reach our return objectives

### ***Tax Reform***

- Other factors, for example, include the adequacy of expiring prices, loss trends, expenses, the cost of reinsurance, the impact of claims initiatives and so on
- Speaking for us, tax reform will help shrink the gap between where returns are trending and where we'd like them to be trending but it doesn't completely close the gap
- Also not every participant in the marketplace will benefit from tax reform
- And even among those who do, the extent of the benefit varies
- In short, for us, tax reform helps but we still have ground to cover

### ***Outlook***

#### ***Pricing Environment***

- As I said a minute ago, we're encouraged about the outlook for 2018
- We're well positioned to benefit from continued improvement in the pricing environment, the opportunities afforded by a more level playing field for domestic insurers as a result of tax reform and the prospect of a strengthening economy
- With that wind at our backs and from a position of strength, we'll continue to invest in our competitive advantages, focusing on extending our lead in risk expertise, improving the experience for our customers, agents and brokers and enhancing productivity and efficiency
- We believe we're well positioned to continue to create shareholder value

## **Jay S. Benet**

### ***Financial Highlights***

#### ***Core Income and ROE***

- Core income was \$633mm, down from \$919mm in the prior year quarter while core ROE was 11.1%, down from 16.4%
- As has been the case all year, these reductions in core income and core ROE were not driven by changes in our underlying performance

#### ***After-Tax Benefit***

- Our underlying performance remains strong and actually improved over the prior year quarter, rather these reductions were reflective of a continued high level of cat activity and the inclusion of an \$82mm after-tax benefit in the prior year quarter from the settlement of a reinsurance dispute

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- The strength of our underlying underwriting results is evidenced by our consolidated underlying combined ratio of 92.4%, similar to the 92% we produced in the prior year quarter

### ***Cat Loss***

- Cat losses were \$324mm after-tax compared to only \$89mm in the prior year quarter
- This \$235mm increase was driven by losses from the California wildfires, \$426mm after-tax, comprising \$382mm after-tax for the October wildfires in Northern California and \$44mm after-tax for the December wildfires in Southern California, partially offset by current year net favorable development of \$102mm after-tax for catastrophes that occurred earlier this year, almost all of which related to Q3 hurricanes Harvey, Irma and Maria

### ***Harvey and Irma***

- For both Harvey and Irma, the benefits of our underwriting actions over many years, including management of overall exposure, limits and deductibles, resulted in more favorable claim outcomes than we had expected
- For Maria, given that the storm occurred late in Q3 and access to the impacted areas was extremely limited, our estimate was based on an exposure analysis
  - That initial estimate has come down due to our receiving fewer claims than we had expected

### ***Net Investment Income***

- Net favorable prior year reserve development, for which I'll provide more details shortly, was \$192mm after-tax, up from \$172mm in the prior year quarter
- Net investment income of \$467mm after-tax, while continuing to be strong, was down \$26mm from the prior year quarter
- Non-fixed income NII decreased by \$19mm after-tax due to lower private equity returns, which, although strong, were not as strong as in the prior year quarter
- Fixed income NII, as anticipated, was lower by \$8mm after-tax due to the continued low interest rate environment

### ***Long-Term Bond***

- And taking into account long-term bonds that are scheduled to mature in 2018, growth in the size of our fixed income portfolio, higher short-term interest rates in the new U.S. tax law, we expect that after-tax fixed income NII for 2018 will be \$25mm to \$30mm higher q-over-q as compared to corresponding quarters in 2017, a significant improvement from recent years

### ***Tax Cuts and Jobs Act***

- Relative to what several other companies have disclosed, the passage of the Tax Cuts and Jobs Act of 2017 had a relatively modest impact on our fourth quarter results
- A \$129mm charge reported as part of net income
- This charge resulted mostly from revaluing our net-deferred tax asset as of the enactment date using the new 21% tax rate and to a lesser extent, providing for taxes on the deemed repatriation of our foreign earnings

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### ***Core and Net Income***

- I should also mention that we executed some tax-related actions in Q4 that provided real economic benefits while having an insignificant impact on fourth quarter 2017 core and net income, but slightly increasing our fourth quarter consolidated combined ratio primarily through the expense ratio by about 0.5 points
- Under the new tax law, muni bond investment income will continue to be taxed at 5.25%, while all other US-based income will be taxed at 21% rather than 35%
  - So looking forward, you should update your models

### ***Business Insurance***

- Consolidated net favorable prior-year reserve development was \$293mm pre-tax compared to \$264mm in the prior-year quarter
- Business Insurance's net favorable reserve development was \$244mm pre-tax compared to \$221mm in the prior-year quarter, primarily driven by better than expected loss experience and domestic workers' comp and commercial multi-peril, partially offset by higher than expected loss experience in domestic commercial auto

### ***Bond & Specialty***

- Bond & Specialty's net favorable development was \$42mm pre-tax compared to \$79mm in the prior quarter, primarily driven by better than expected loss experience in domestic management liability, while Personal Insurance had net favorable development of \$7mm pre-tax compared to \$36mm of net unfavorable development in the prior year quarter

### ***A&E***

- For full year 2017, we had consolidated net favorable development of \$592mm pre-tax
- As in prior years, I'm providing you with some insight into what our combined 2017 Schedule P is expected to show when filed on May 1
- Excluding A&E, on a combined stat Schedule P basis for all of our U.S. subs, all accident years across all product lines in the aggregate developed favorably, and except for commercial auto liability, which developed unfavorably by \$87mm pre-tax due to higher than expected bodily injury claims in recent accident years, all product lines across all accident years in the aggregate developed favorably or had de minimis unfavorable development

### ***Corporate Cat Aggregate XOL Treaty***

- Page 19 of the webcast sets forth information about our January 1 cat treaty renewal
- Our Corporate Cat Aggregate XOL Treaty continues to provide coverage for both single-cat events and an accumulation of losses from multiple cat events with similar terms as in the prior year, but at a slightly higher cost
- The treaty continues to provide \$1.5B of coverage, part of \$2B excess of \$3B after \$100mm deductible per occurrence



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

### ***Operating Cash Flow***

- Fourth quarter operating cash flows, which were impacted by the relatively high level of cat claim payments, were \$538mm, bringing total operating cash flow to over \$3.7B for the year
- We ended the year with holding company liquidity of almost \$1.3B and all of our capital ratios were at or better than their target levels

### ***Net Unrealized Investment Gain***

- Net unrealized investment gains were over \$1.4B pre-tax or \$1.1B after-tax, up from \$1.1B and \$0.7B respectively at the beginning of the year, while book value per share of \$87.46 and adjusted book value per share of \$83.36, increased 5% and 4% respectively from the beginning of the year

### ***Ongoing Capital Management Strategy***

- Consistent with our ongoing capital management strategy and despite the high level of cat losses, we were able to return \$549mm of capital to our shareholders this quarter while maintaining our balance sheet strength through dividends of \$198mm and share repurchases of \$351mm, bringing total capital return to shareholders to over \$2.2B in 2017

## **Brian William MacLean**

### ***Operating Highlights***

#### ***Segment Income***

- Starting with this quarter's results in Business Insurance, segment income was strong at \$637mm, and the combined ratio for the quarter of 88.6% was flat to the prior year
- Income was down from the prior year, due primarily to the settlement of a reinsurance dispute in Q4 2016

#### ***Pricing and Expense Ratio***

- The underlying combined ratio for both the quarter and the full year was about 1 point higher than 2016
- In both cases, the increase was driven by the loss ratio with loss cost trends that modestly exceeded earned pricing, while the full-year variance also reflects an unusually high number of large non-cat fire losses in 2017
- The full-year expense ratio of 31.9% was 0.5 points lower than the prior year
- As Jay mentioned, Q4 included the impact of some tax-related actions to the full year as a better indication of our expense run rate

#### ***Net Written Premium***

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- Net written premiums of \$3.4B for the quarter were up about 5% y-over-y with domestic net written premiums up about 4% driven by continued strong production results in Middle Market
- International net written premiums were up 15%, or 11% excluding the impact of the change in foreign currency rates
- The growth in international was driven by strong production results in Europe and Canada, along with some normal fluctuations in the Lloyd's volume

### ***Domestic Production***

- Turning to domestic production, we were very pleased with our results in the quarter
- Renewal rate change was 1.4%, and renewal premium change was 4%, and as Alan said, for both, the highest level in about three years
- Retention remained at a historically high level of 85%, and new business was strong for the quarter at \$478mm, up 16% from Q4 2016

### ***Middle Market***

- Looking at the individual businesses, in Select, production remained strong with renewal premium change for the quarter of over 5%, retention of 83%, and new business premiums of \$100mm, up 11% y-over-y
- In Middle Market, renewal rate change increased to 1.5%, up about 1 point y-over-y, and renewal premium change increased to 3.6%
- Retention remained at a historically high level of 87%, while new business premiums of \$298mm were up 17% vs. the prior year quarter

### ***New Business***

- In terms of new business, the technology, tools and process changes we've been rolling out over the last several years, and we discussed at our recent Investor Day, have allowed us to be more active in our targeted industry segments
- In Select, we're generating more submissions and quotes and having success in closing those incremental opportunities
- In Middle Market, we've been successful in quoting more while also closing more large accounts than a year ago
  - While the normal volatility in writing large accounts was a factor in this quarter's growth, we believe our initiatives are beginning to have an impact

### ***Business Texture***

- So the aggregate production results were very strong but as we have said many times, the aggregate numbers alone don't tell the entire story
- The detail of where we are getting rate and what accounts we are retaining is key to evaluating the success of our execution
- And looking at the results below the headline numbers, we couldn't be more pleased



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- For example, as you would expect, there was significant line of business texture below the headline production numbers

### ***Pricing***

- In terms of pricing, workers' compensation, a line that has had strong returns in recent periods, had renewal premium change that was positive but lower than a year ago
- Conversely, commercial auto, which is a challenge from a return perspective line, had the highest positive price change in the quarter well above loss trends

### ***Product Lines***

- What's also encouraging to us is that across all of the other major product lines, property, GL, CMP and umbrella, renewal premium change was positive and up both y-over-y and sequentially
- And importantly, we were able to achieve these pricing increases while maintaining strong retention and growing new business
  - There was also a significant texture based on individual account performance
- We continued to be pleased that we are retaining our best-performing business as evidenced by retention rates in excess of 90% for our best-performing Middle Market accounts

### ***Middle Market***

- In addition, pricing in the quarter improved across the continuum of Middle Market book, most significantly in our poor performing accounts, where we achieved rate increases well in excess of loss trends
- Finally, in addition to what we're seeing in the numbers, we're also encouraged that there has been some tightening of terms and conditions for catastrophe-exposed risks
  - So, all in, a great quarter and end to the year
- We were very pleased with our execution in the marketplace and how we are positioned for continued success in 2018

### ***Operating Margin***

- Before turning to Bond & Specialty, I want to comment on our outlook for operating margins, which we include in our quarterly filings
- Since our 10-K won't be filed for a few weeks, I would note that we expect underlying underwriting margins in 2018 will be higher than in 2017
- And the underlying combined ratio will be slightly lower than in 2017, assuming lower and more normalized levels of non-catastrophe weather-related losses and other loss activity
  - This is subject to the usual caveats and forward-looking statement disclaimers

### ***Bond & Specialty Insurance***

- In Bond & Specialty Insurance, segment income for the quarter was \$112mm, down from the prior year quarter due to the international surety charge that Alan mentioned as well as a lower level of net favorable prior year

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reserve development

- In surety, losses are episodic, and we remain pleased with the quality of our book
- The underlying combined ratio increased from the prior year quarter to 91.1%, reflecting the impact of the surety charge
- Net written premiums for the quarter were up 5% reflecting growth in both our domestic surety and management liability businesses
  - Surety growth was driven by a higher level of large bond activity in the quarter

### ***Production Growth***

- Turning to production, in our domestic management liability businesses, we continue to execute our strategy of growing our profitable portfolio by retaining our best-performing accounts and writing new business in return adequate product segments
- So we couldn't be more pleased that retention came in at a strong 88% for the quarter, while new business was up 17% from Q4 last year
  - Renewal premium change of 3.4% was up slightly from Q3
- So Bond & Specialty results were solid, and we continue to feel great about our market position

### ***Outlook***

#### ***Underlying Underwriting Margin***

- In terms of outlook, for 2018, we expect that underlying underwriting margins and the underlying combined ratio for the first nine months of 2018 will be broadly consistent with the same period of 2017
- And in the last quarter of 2018, we expect that underlying underwriting margins will be higher, and the underlying combined ratio will be lower than in the same period of 2017

#### ***Personal Insurance***

- Turning to Personal Insurance, net-written premiums for the segment grew 8% in the quarter, driven by higher pricing, primarily in auto and modest PIF growth primarily in homeowners
- Catastrophe losses in the quarter were approximately \$200mm after-tax above both prior year and our normal expectations, resulting in \$50mm loss for the quarter and a combined ratio of 108.7%

#### ***Pre-Tax Cat Loss***

- For the full-year, despite pre-tax cat losses of more than \$1B, Personal Insurance generated \$128mm of income
- The underlying combined ratio in Q4 90.4% improved by 3.2 points compared to last year's fourth quarter
- And the full year underlying combined ratio of 91.5% was about 0.5 points higher than full year 2016

#### ***Hurricane Harvey***

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- The domestic agency auto combined ratio for the quarter was 103% including a 1.1-point benefit from catastrophe losses as we reduced our auto estimate related to Hurricane Harvey
- The underlying combined ratio of 104.1% improved by 8.1 points from the prior year

### ***YTD Impact***

- As you can see on page 15 of the webcast, 4.7 points of the decrease is due to last year's fourth quarter having been elevated as a result of the YTD impact of the bodily injury loss reestimation
- The remainder of the improvement is primarily of the result of earned rate from filing actions we have taken over the past year now exceeding loss trend by several points, in line with the planned actions we outlined a year ago
- I would remind you that seasonality inflates the absolute value of Q4 combined ratio

### ***PIF Growth***

- As we have continued to take actions to improve profitability in the auto book, renewal premium change increased to 10.6% in Q4
- Retention declined modestly as expected, given the pricing actions
- And PIF growth has levelled out, again in line with our plans
- We were pleased with the level of written rate in 2017, and looking ahead, we expect that full year RPC for 2018 will be broadly consistent with the full year 2017 result as we look to continue to improve the profitability of the book

### ***Agency Homeowners & Other***

- Turning to Agency Homeowners & Other, Q4 combined ratio of 115.3% included over 45 points from cat losses, driven by the wildfires in California
- The underlying combined ratio of 70.2% for the quarter was consistent with the prior year quarter, as higher non-cat weather losses were basically offset by an improvement in the expense ratio
- For the full year, the abnormally high cat result of 23.6 points drove the combined ratio up to 100.7%, while the underlying combined ratio of 77.1% was about 1.5 points above the prior year due primarily to higher non-cat weather losses

### ***Volume***

- Homeowners volume continued to exhibit momentum with healthy PIF growth throughout the year finished up 5.5% compared to the prior year-end
- We're pleased that our focus on generating growth in this product line has enabled us to steadily increase property PIF count, even as we have intentionally slowed the PIF growth in auto
- We're also pleased to have introduced our newest property product, Quantum Home 2.0 in three pilot states during Q4 with initial response from agents and customers in line with our expectations

### ***Expenses***

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- Overall, in Personal Insurance, while the headlines were all about the significant catastrophe losses, we feel great about having achieved the goals we have established entering 2017
- In addition, we continued our ongoing expense discipline, which resulted in slightly lower G&A expenses while delivering 9% growth in net written premiums for the segment, reducing the full year expense ratio by 1.5 points
- So for Personal Insurance in 2017, we were very pleased with the execution on the key elements needed to position this segment for success in 2018

### ***Outlook***

- Finally, as it relates to our outlook for the Personal Insurance segment as a whole, we expect underlying underwriting margins in 2018 will be higher than in 2017 and the underlying combined ratio will be slightly lower than in 2017
- So stepping back to the enterprise, we generated over \$2B in profits in the year that was dominated by the impact of weather and large losses
  - So we feel good about the result, but more importantly, feel great about the execution across all our businesses and our market position entering 2018

## **Alan D. Schnitzer**

### ***Q4 Highlights***

#### ***Executive Retirement***

- As bittersweet as it is, we have one last piece of business before we open it up for questions
- I just want to acknowledge and thank Brian MacLean who will be retiring at the end of March after a spectacular 30-year career and after today, something like 53 consecutive earnings calls
- He'd never take credit for it, but we owe so much of what we've accomplished over so many years to him
  - He's been a great colleague to so many and he's been an important partner and friend to me

## **QUESTION AND ANSWER SECTION**

<Q - **Kai Pan**>: And first, congratulations to Brian for three decades at Travelers and best wishes for your retirement.

<A - **Brian William MacLean**>: Thank you

<Q - **Kai Pan**>: And that doesn't count as a question. So my first question -- my first one is on pricing. So there's an acceleration of BI pricing and you mentioned that your outlook for 2018 in BI is a lower underlying combined ratio. But the 1.4% increase, do you lower your, like, general loss cost trend of 3% to 4%. Just wondering sort of what's behind the scene. You expect sort of the pricing to accelerate?

<A - **Alan D. Schnitzer**>: Yeah. Kai, good morning. It's Alan. Thanks for the question. It's all the things that we talk to you about q-over-q in terms of our ability to pull levers and manage profitability. And I'll remind you that exposure is a piece of that, and that a significant portion of exposure contributes to it but so does selection and mix in the way we segment, in the way we price the product, claims handling, risk control, expense management, all of those things contribute to our outlook on profitability and the underlying combined ratio.

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**<Q - Kai Pan>**: Okay. Then my follow-up is on the tax rate. What's your sort of overall effective tax rate for the corporation in 2018? And, Alan, from your comments, it looks like most of the tax benefit will flow through to the bottom line.

**<A - Jay S. Benet>**: This is Jay Benet. The reason I gave you the pieces is that the effective tax rate is always going to be a function of the relationship of the tax exempt interest to the total interest.

So in whatever modeling you're doing, you need to come up with what you believe the tax exempt interest is going to be, apply a 5.25% tax rate to that. And then everything else that's U.S. domestic will be at the 21% range. So the effective tax rate is going to move but again, that's the way of calculating it.

**<A - Alan D. Schnitzer>**: Hey, Kai, just reflecting back on your other question, you were talking about the pricing outlook. And I would just remind you that as Brian shared with you, that assumes that in BI, the non-cat weather and elevated fire losses and for that matter, in PI, that non-cat weather will both return to normal levels by historical standards. Obviously, weather and large losses are going to be what they're going to be, but the outlook reflects that as well.

And in terms of the benefit from tax reform and what's going to happen to it, as I tried to express in my prepared remarks, it goes into the mix of everything else that we used to generate the prices we need. So, yeah, I do think that it will fall to the bottom line.

**<Q - Ryan J. Tunis>**: Just for Alan and a follow-up to Kai's question. Just thinking about the fact that last quarter we had a 2018 outlook for broadly consistent margins and now three months later, the outlooks do improve. I just wanted to drill down a little further on what it is you've seen over the last three months. Because I think your outlook on pricing then was also pretty positive. But I guess, over the last three months what's given you more confidence to really think that margins will be better?

**<A - Alan D. Schnitzer>**: Yeah. You got to remember that when we talk about underwriting margins, we're talking about dollars and in combined ratio, we're talking about, like, combined ratio points. And that's a function of the written volume for example and everything else that goes into the mix. So it's a combination of all the things that impact margins and the combined ratio. I'm not sure how else to express that.

**<Q - Ryan J. Tunis>**: Okay. I guess, just on auto then, I think what you've said is you think that RPC will be at similar level to this year as it was last year. And it seemed like this year it was several points above loss trend.

If you could just talk a little bit about what you're seeing there because that sounds like a decent amount of rate. I don't know if there's a severity uptick beyond what you've expected or something along those lines. Thanks.

**<A - Michael F. Klein>**: Hey, Ryan, its Michael Klein. Thanks for the question. The short answer is no, it doesn't reflect anything beyond what we expected. It's just the follow-on steps in our existing game plan.

And I think when you think about pricing, sort of think of it in three pieces, right? So the written rate we're going to achieve in 2018 is partly based on the rate we have already filed in addition to the rate we'll file in 2018. And so that drives a lot of our rate outlook. What I think you'll see as you look ahead to 2018 is the RPC in H1 will be higher than the numbers you see on the page from H1 2017. In the back half of the year, it will be lower than the numbers you see for the back half of 2017.

Importantly, on an earned basis, since written rate has accelerated through 2017, earned rate will actually rise in 2018 relative to 2017. So that's sort of the way that we think about it. But, no, the broadly consistent RPC outlook doesn't reflect anything unanticipated in our loss experience.

**<Q - Amit Kumar>**: Maybe just staying on personal auto with Michael Klein, you gave some good color on RPC. How should we think about the PIF growth from here, just based on the fact that majority of your book is 12 months? When should we see some change in that number down the road?



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**<A - Michael F. Klein>**: Thanks, Amit. I appreciate the question. I think if you think about just sort of the broad themes on auto, what we talked about in 2017, is our objective was to improve profitability and manage growth, manage being reduced, right? As we think about our objective for 2018, it's really to try to achieve more balance between growth and profitability in auto.

And I think you can certainly see, as we talked about last quarter, we felt like we turned the corner on auto profitability in Q3. You're seeing in the year-on-year adjusted underlying combined comparison that improvement accelerating, but again, consistent with our RPC outlook, still work to do there. And so, again, we're looking to achieve a balance between profitability and growth in 2018. And then as that profitability continues to improve, we'll look to resume growth. But we're right now trying to sort of level off and then move it forward.

**<Q - Amit Kumar>**: Thanks. That's actually helpful. And my follow-up, switching back to, I guess, commercial lines, and I know there was some good texture on the pricing change. I'm curious if we were to step back and think about the active cat quarter for Q3 and Q4 and its impact on the marketplace, would you say that it's early days for, I guess, a broad-based firming of the small and middle commercial market, or is it more isolated? Is it more isolated near-term?

**<A - Alan D. Schnitzer>**: Amit, it's Alan. We tried to give you a perspective by line to really address that because putting workers' comp aside, and that is its own story, the price increases we were able to achieve in the quarter were broader than just the property lines. And as I shared in my prepared remarks, I think the more significant factor driving the pricing is where margins were, certainly for us, and that's probably true relative to the industry. So I can't tell you exactly what the industry's going to do or what's going to happen, but I can tell you what we're going to do, and that's to thoughtfully and in close coordination with our agent and broker partners continue to push for rate where we need it, improve the outlook and trend of returns.

**<Q - Elyse B. Greenspan>**: My first question, in terms of the margin outlook for Business Insurance for next year, can you quantify the impact that non-cat weather had this year so we know kind of what to adjust for when thinking about 2018? And in your margin outlook, how are you thinking about the expense ratio vs. the loss ratio as we think about you potentially earning in better rate next year?

**<A - Gregory C. Toczydlowski>**: Hey, Elyse, this is Greg Toczydlowski from Business Insurance. In terms of your first question, think about 1 point in terms of where large losses in non-cat weather are relative to our longer-term expectations for 2017, and that would be a good way to think about a going-forward perspective.

**<A - Alan D. Schnitzer>**: And Elyse, on your question about expenses, we're going to try to resist the temptation to break out the go-forward perspective on the loss ratio vs. the expense ratio. We give you an outlook on the combined ratio, at least qualitatively, because you get into some judgments and a level of precision that is probably too further than we'd like to go, at least for an outlook perspective.

Jay Benet did say in his opening remarks or maybe it was Brian that looking at the full year was probably a better perspective on the outlook. And I will add, just following up on our comments at our recent Investor Day, that productivity and efficiency are important strategic initiatives for us. We've seen the benefit of that this year. We've got real productivity and efficiency enhancements on the shop floor right now, and we think there's more to come.

And what that does for us? It's not necessarily that we're trying to dial in a much lower expense ratio, what we're trying to do is create all the benefits that come from operating leverage. So we can take those incremental dollars, and as I've said before, we can let them fall to the bottom line. We can use it to invest in important strategic capabilities, or we can put it into pricing, and it really is that flexibility that we're looking for going forward. But in terms of the outlook, we're going to stick with the broader commentary on overall margins.

**<Q - Elyse B. Greenspan>**: Okay. And then my second question, in terms of the pricing environment, going back to Business Insurance again, you said in your opening remarks that you want rates to keep pace with inflation. What are you pegging inflation at right now within your commercial lines book? And when you make that comment, I guess that's what we should compare when we think about the RPC going forward within Business Insurance?



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**<A - Alan D. Schnitzer>**: Yeah. Elyse, we've said for a long time that our long-term outlook, and again, that's long-term perspective for all of Business Insurance is about 4%, and really no change on that. There's some texture underneath, by line, for example. I'm not sure what your question was about RPC, but rate contributes to margin, and there's a portion of exposure that's, obviously, part of RPC that also contributes to it. So I'm not sure if that's the texture and color you were looking for.

**<Q - Elyse B. Greenspan>**: I guess, what I was thinking about was your RPC was about 4% in the quarter and then you're saying that kind of inflation is about 4%. But then to your commentary, it seems like you are pushing for more price across your book of business from where we were at in Q4. So I was just trying to tie those two comments together.

**<A - Alan D. Schnitzer>**: Yeah. So Elyse, I would say that of – think of RPC as having two components: one, pure rate; and two, exposure. Of the piece that's exposure, a portion of that behaves like margin, and there's a portion of it that has real loss content in it and doesn't.

So RPC needs to be above the overall loss trend in order for us to consider margins to be expanding. And you could look at those numbers and you'd say, at least on a written basis we're getting close.

Although I do think over time that insurance, like most other businesses, pricing ought to keep up with inflation. But I would say that given where we are now in terms of the outlook and trend for returns, we're looking to do a little bit better than just offset inflation, we're looking to expand margins.

**<Q - Yaron Kinar>**: I guess, my first question is with regards to the rate increases in Business Insurance. If I strip out commercial auto, I think, if my calculation is correct, I get to roughly flat rates for the rest of the business. Am I thinking about that correctly? Or are there maybe areas or lines where you are getting more rates outside of the commercial auto?

**<A - Brian William MacLean>**: Yeah. Yaron, yeah, I don't think you're doing the math entirely correctly. There's a lot of different pieces underneath the net written premium change, which I think you're trying to back into.

So we're certainly, as Alan said earlier, very much focused on where some of the more distressed lines are, automobile and the catastrophic exposed areas of property, but we're also pushing ahead on all the products. So the math doesn't come out where we're flat on all the other product lines.

**<A - Alan D. Schnitzer>**: Yeah. And I would just direct you back to Brian's comments, where he gave you a view of pricing by line. So price is positive in every line and outside of workers' comp, higher both sequentially and y-over-y.

**<Q - Yaron Kinar>**: Okay.

**<A - Alan D. Schnitzer>**: So we can follow up with you and walk you through the math if that's helpful.

**<Q - Yaron Kinar>**: Yeah, we'll do that. And then maybe one other question on tax reform, so, Alan, if I understand your comments correctly, basically, you're looking at the results of – or you're targeting a certain return and tax reform ends up helping that return. I'm just trying to get a sense of are you expecting any change in investment allocation that would further boost or decrease the effect of tax reform?

**<A - Alan D. Schnitzer>**: Yeah. Let me turn that over to Bill Heyman, ask him to respond to that.

**<A - William Herbert Heyman>**: I think it is possible there will be, over time, some reallocation. The elimination of corporate AMT removed a ceiling in terms of the amount of municipals we can own although that's very theoretical.

Every day, we look at what the market throws up in terms of, assuming roughly equal credit quality, which is really the case, where is the highest after-tax return. I think more – going forward that will more often in certain segments of the curve be in the taxables rather than municipals.

It may even be that we buy taxables and sell municipals in certain parts of the curve. And the reason for that is that for the first time I can remember, individual investors and corporate investors have very different utility functions.

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So in many parts of the curve, the municipal is not worth as much to us as it used to be, but it's worth more to an individual investor than it is to us. So there may be opportunities to pick up after-tax yield on advantageous terms but, obviously, we can't guarantee them or quantify them. But I suspect if you looked at the portfolio three years from now, the mix would have changed.

**<Q - Jon Paul Newsome>**: I want to ask whether or not the outlook for M&A for Travelers has changed with tax reform. Does it make it easier or more interesting to buy something outside of the U.S. for Travelers?

**<A - Alan D. Schnitzer>**: Yeah, good morning, Paul. What I can tell you is that tax reform for us and others who are similarly situated, obviously, just makes us a more competitive buyer relative to a non-U.S. taxpayer who previously had the benefit of some structural advantages – structural tax advantages. Those advantages have gone away, so that levels the playing field. And so relatively speaking, we're a more competitive buyer. So that's changed for sure.

What hasn't changed, Paul, is either our lens or our propensity to do transactions. And by that, I mean, we are always looking for opportunities, both organic and inorganic. And when we can make them happen on terms that are attracted to us, we're going to try hard to do that.

And as I've said before and just to reiterate it, we're going to try to do deals when it improves our return profile, lowers our volatility or provides us with other important strategic benefits. So maybe our positioning relative to others changes, but our lens or propensity doesn't.

And the other thing that won't change is our capital management strategy. We will continue to think about and allocate capital the same way we have historically. I guess, given tax reform and all other things being equal, there's, probably, higher earnings in capital to put through that capital management filter. But our thought process around capital management doesn't change.

**<Q - Jon Paul Newsome>**: That's it for me. Thanks. Congratulations on the quarter.

**<Q - Jay Gelb>**: My first question is on capital deployment in 2018. Should we still consider a 100% of operating earnings as being deployable for share buybacks and dividends absent another opportunity emerging?

**<A - Jay S. Benet>**: Yeah. Hey, Jay, it's Jay. As Alan just said, the way we think about capital management hasn't changed. So we're always going to try to fund growth. We're always going to look for opportunities to create shareholder value. And to the extent that we continue to create excess capital, we'll manage it the same way, returning it to shareholders through dividends and share repurchases. And the driver of that is the earnings of the play, so no change there. And what we've said in the 10-K and 10-Q all along with regard to that still holds.

**<Q - Jay Gelb>**: I appreciate that. And then if I can try one on tax, if I – using your supplement, if I look at the tax-free municipal income and apply the rate you mentioned, I guess I get kind of driven down to a 15.5% to 16% overall effective tax rate. Am I in the neighborhood on that?

**<A - Jay S. Benet>**: If the calculation you're doing is looking at the supplement, taking some view as to what the average asset base would be for the munis, applying the rate that we show in the supplement as the earnings rate on that, you'll get the pre-tax muni NII, apply 5.25% to that, and you'll have that component of the tax accrual, and then the rest, whatever you're assuming with regard to the non-muni income, not just NII but underwriting, apply the 21% to, and you'll get an effective tax rate.

**<Q - Jay A. Cohen>**: Back-to-back Jays. A couple of questions. First is the surety premiums went up and you said there was just more activity. I mean, do you see this being a function of the economy? And should we expect the top line on the surety side to possibly expand, especially if we've got more infrastructure spending?

**<A - Thomas M. Kunkel>**: Jay, this is Tom Kunkel. Good morning. I think the way we're looking at the surety production in the month is, it really can be episodic. And those are some very well-performing businesses and accounts that we were doing that volume with. But I wouldn't say that we, in any way, view it as indicative as an increase in activity for the type of work that drives surety bonding. So as they say, a little lumpy.

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**<Q - Jay A. Cohen>**: Got it. Other question, on the commercial lines market, your effort to raise prices a bit more aggressively has been met with a retention that has stayed at a historically high level. It suggests the rest of the market is coming along as well. And I'm wondering if you could speak qualitatively about what you're hearing from agents and brokers regarding how your competitors are responding to the same pressures that you are.

**<A - Alan D. Schnitzer>**: Jay, it's Alan. We don't talk a lot to our distribution partners about the way our competitors price. It's a competitive marketplace, and they do what they do, and we do what we do. I will tell you that just in terms of our process, we do a lot of work, and we've got a lot of talent out there in the field, and our underwriters are out talking to our distribution partners about accounts 90, 120 days out to make sure that we're working in partnership with them and making sure that we're sharing with our customers why we're doing, what we're doing. So we've got, I think, just a tremendous field organization, and I think that they've done a great job.

Obviously, we do operate in a competitive marketplace. And so I do think that what you see in our results is to some degree a reflection of the market. I've always thought that there are probably two reasons that maybe we have a little bit of incremental pricing power at. One is just the franchise value we bring to the marketplace and product breadth and risk control and claims – unbelievable claims organization. And I think that our agent and broker partners are proud to sell that and I think our customers see value in it.

And the other advantage, I think, we have to some degree is data and analytics. It's about risk selection and pricing. And we've been a pioneer for a long time in not just data and analytics but delivering that data and analytics to the screen of the local underwriter at the point of sale. So I do think those two things probably give us a little bit of an advantage, but certainly there's a marketplace dynamic to what we're able to achieve.

**<Q - Brian Meredith>**: Two quick questions here for you. The first one, I'm just curious, could we parse a little bit Business Insurance as far as what's going on from a rate perspective? And I'm just curious, one small commercial, not a lot of rate, it just doesn't need it, more competitive pressures. And then also on your large ticket property business, that's one that you had excluded a while from your rate calculations, which was so competitive. How is that trending now and maybe relative to your expectation? And then I have one follow-up.

**<A - Gregory C. Toczydlowski>**: Yeah, Brian, hey, this is Greg. I'll start with the small commercial one. We've been focusing on the small commercial business for a number of years now, really trying to get the margins to a place where we feel very comfortable with them in.

We are very much within our target thresholds of where we want to be from a small commercial. So we've had a deliberate set of execution around our rate plan there. So that's the first element around why you see a smaller level of rate in small than middle.

The second one really is around our express business, which is, think of it as the straight-through processing of small commercial, really has a more prescriptive like flat rating environment. And so when we see some of the pressures of rate reductions and workers' comp, given the extraordinary profitability on that line over time, we see that more immediately impact that business. So those are two reasons that are driving the small commercial.

**<Q - Brian Meredith>**: And on the property, large account property?

**<A - Gregory C. Toczydlowski>**: What was your question on the large property? Can you repeat that?

**<Q - Brian Meredith>**: I guess, just how is that – the large account property, how is that panning out from a rate perspective right now? Is it – you're getting the rate that you kind of need in that area or not?

**<A - Gregory C. Toczydlowski>**: Yeah. Given that the hurricanes were in Q3, we're very pleased with our agility one quarter in, in terms of what we've been trying to do on the National Property side.

And as Alan said, we think franchise value matters, and we're seeing that inside our numbers, where we've been able to push thoughtfully and at the same time, retain the book of business.

**<Q - Brian Meredith>**: Great.

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**<A - Brian William MacLean>**: Yeah, Brian, this is Brian. Just one comment on top of that, and looking back over significant cat events over the years, the impact in the large property book on rate is usually two, three, even sometimes four quarters out, the peak of that. So we're optimistic that there could be more to come, but that's just looking at the historical trends.

**<A - Alan D. Schnitzer>**: And we made good progress in the quarter.

**<A - Brian William MacLean>**: Yeah.

**<Q - Brian Meredith>**: Great. And then just on personal lines and just on tax, I appreciate the comments on how kind of it's going to fall to the bottom line. I guess, my question more on the personal line space is as you look out, understand you need more rate to get to the right returns that you really want that business, but should we expect that kind of your combined ratios, where you'd like them to get, are going to be higher here going forward as a result of tax?

And specifically, related to at least certain states have return on capital type benchmarks they look at, they're going to be pushed back from those regulators on returns here with a tax reform.

**<A - Michael F. Klein>**: Sure, Brian. It's Michael. Thanks for the question. I would say where you started is probably where we start, which is we're not at target returns yet and we got work to do. I think consistent with Alan's comments in the opening, a lower tax rate sort of helps move us closer but doesn't get us all the way there.

And so when you think about it from a filed rate and a regulatory standpoint, we certainly see and actually have seen just this week news from some regulators on the fact that they are thinking about the tax rate and looking to apply it in some of those conversations.

But generally speaking, it doesn't change the direction we need to move rates, particularly in auto. We still have work to do there to get to target returns, and we're going to continue down that path.

**<Q - Brian Meredith>**: Right. It's just the magnitude you need going forward is probably less today than it would have been before tax reform.

**<A - Michael F. Klein>**: I would say all else being equal but, again, to Alan's point earlier, you've got expenses, you've got loss experience, you've got investment yields, a whole bunch of things that go into that mix, and it's just one factor that we need to consider.

**<Q - Meyer Shields>**: I don't know if I'm over thinking this but I guess I was surprised that the outlook for 2018 for Personal Insurance was only a slightly lower combined ratio with auto earned rates likely to approach double digits. Am I missing something there?

**<A - Michael F. Klein>**: Meyer, this is Michael. Thanks for the question. And appreciate it because Brian did give you the overall outlook for the segment. There's a little bit of texture underneath. So if you think about auto specifically, when you see the 10-K outlook, what you're going to see is our commentary there is for improved margins and combined ratio. The home outlook, on the other hand, is broadly consistent both from a margin and a combined ratio standpoint, assuming more normalized levels of non-cat weather activity. When you put those two pieces together, you get improved margins and a slightly improved combined ratio in the aggregate. Part of that, I guess, the other factor is as auto premium is growing more than home and auto, carries a higher combined ratio, mix impacts the adjustment in the combined ratio.

**<Q - Meyer Shields>**: Okay. That makes a lot of sense. Thanks. Second, I guess, is a broader question, you've talked a lot in the past about how some elements of exposure act like rate. Are those elements more, I guess, reflective of the price of the exposures for the values that are being insured, or of exposure unit growth or on a real basis?

**<A - Alan D. Schnitzer>**: I'm not totally sure I understand the question, but I think it's more of a value than it is unit, right? You increase the value of a unit, and it's that increase in exposure that behaves more like rate. When you actually add another unit of exposure, you have another unit of loss content. So I think that's the right way to think



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about it.

**<Q - Sarah E. DeWitt>**: I just wanted to try one more on the tax rate. What would the pro forma tax rate have been this year under U.S. tax reform?

**<A - Jay S. Benet>**: Actually, it's not something we actually calculate it. So I think we would suggest you do the same thing, just look at what the NII was for the tax-exempt portfolio. And then for everything else, apply the 21% rate. But we haven't done the calculation.

**<Q - Sarah E. DeWitt>**: Okay. Yeah, I'm coming up with some slightly different numbers than in the previous question. So, I mean, if you were willing to disclose that, I think that would be helpful.

**<A - Jay S. Benet>**: Well, just to add, the information is in the supplement, so maybe it's something Gabby can follow-up with you on.

**<Q - Sarah E. DeWitt>**: Okay, great. Thank you. And then secondly, just on the auto insurance underlying combined ratio, improved nicely this quarter, but it's still above 100%. How long should we be thinking about it will take to get below 100% given some of the pricing actions you're taking offset by the new business penalty?

**<A - Michael F. Klein>**: Sure. Thanks, Sarah. It's Michael. I want to just put a point on Brian's comment earlier about reflecting seasonality to start with. So if you're looking at page 15 and you're looking at the 101% for the full year vs. the 104% for the quarter, that is pretty consistent with the seasonality we would typically see in the quarter.

In terms of how long it takes, I think we're certainly optimistic. And as we said last quarter, we feel good about the progress we're making towards our target combined ratio and see that continuing as we look ahead into 2018 and 2019.

I think with the outlook that we've given you for RPC, you can sort of make your own estimate of what the earned rate will be, apply a loss trend and get to an earned combined ratio pretty quickly. And, I guess, at this point as we look at our experience, we don't see anything that would cause us to tell you to do it any differently.

**<Q - Sarah E. DeWitt>**: Okay, great.

**<A - Alan D. Schnitzer>**: Just as a follow-up to your tax question, in terms of the going-forward approach to calculating an effective tax rate, what I said is absolutely on point. There is a little bit of foreign income that's taxed at a slightly different rate, but that shouldn't matter. That will matter more this year than in the future because of today's 35% tax rate vs. the future.

But one of the other things that we should point out and you'll see it in the press release, we did have a favorable tax settlement earlier in the year that would have affected this year's effective tax rate. So if you're going to do a pro forma for this year, you have to take that into account. And then in addition to that, I mentioned in my commentary that we did some tax planning initiatives in the year that had some impact on the effective tax rate as well. So really, the calculation you want to do is not about this year, it's about going forward.

**<Q - Larry Greenberg>**: If you can believe it, I still have a question to ask. So going back to tax reform and a level playing field, aside from the benefits that might be there on the M&A side, from an operating standpoint or from a business line standpoint, where do you think the most concrete benefits might arise given the more level playing field?

**<A - Alan D. Schnitzer>**: I guess the way we think about that is the tax line is an expense line, like any other expense line that we work into our pricing models. And to the extent that we've got a level playing field and aren't at a disadvantage in that regard, I think, again, on a relative basis, from a pricing perspective, that helps. And I would say, after M&A and maybe even before M&A, that's a significant factor in terms of level playing field.

**<Q - Larry Greenberg>**: But in terms of Business Insurance, specific lines, there's none that necessarily jump out more than others?

**<A - Alan D. Schnitzer>**: I think the same math applies to all of our pricing models for all of our products. So I don't think I would make a distinction there.

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**<Q - Larry Greenberg>**: Okay. And then just with better economic growth, perhaps, on the horizon, do you think that, all things equal, small commercial premium growth should maybe catch up to the Middle Market and maybe even grow faster in an improving economic environment?

**<A - Alan D. Schnitzer>**: I'm not really sure how to answer that question. I do think across all of our businesses, we're pretty well leveraged and pretty well positioned to benefit from an improving economic environment.

In terms of, if you're asking about growth in GDP by small enterprise vs. large, I don't know that I've got a better view on that than you or anyone else. And if you're talking about our own market position, small vs. large, there's so many things that go into growth and we actually don't think about it that way.

We execute, as you've heard us say many times, at a very granular level. So whether it's small or large, we're trying to keep our best business, improve the profitability on the business where we need to and do a lot of hustle and leveraging our competitive advantages trying to generate new business.

And when that very granular strategy adds up to growth, we grow. So that's the way I think about it, and we don't really think about the small differently than the large from that perspective.

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