Q3 2017 Earnings Call

Company Participants

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

Other Participants

- Amit Kumar, Analyst
- Brian Meredith, Analyst
- Elyse B. Greenspan, Analyst
- Jay A. Cohen, Analyst
- Jay Gelb, Analyst
- Kai Pan, Analyst
- Meyer Shields, Analyst
- Randy Binner, Analyst
- Ryan J. Tunis, Analyst
- Sarah E. DeWitt, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good morning, ladies and gentlemen. Welcome to the third quarter results teleconference for Travelers. We ask that you hold all questions until completion of formal remarks, at which time you'll be given instructions for the question-and-answer session. As a reminder, this conference is recorded on October 19, 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 third quarter 2017 results. Hopefully, all of you have seen our press release, financial supplements 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, Chairman and CEO; 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 available in the Investors section on our website, travelers.com.

And now, Alan Schnitzer.

Alan D. Schnitzer {BIO 3529437 <GO>}

Thank you, Gabby. Good morning, everyone, and thank you for joining us today.

This morning, we reported third quarter net income of $293 million or $1.05 per diluted share and core income of $253 million or $0.91 per diluted share. The fact that we made a considerable profit in one of the costliest hurricane seasons on record demonstrates the earning power of our franchise, which is built on strong foundation of underwriting and investment expertise. This is reflected in our manageable catastrophe losses, underlying underwriting gain of $292 million and after-tax net investment income of $457 million.

Our catastrophe losses were well within what we would expect from the events in the quarter. Balancing risk and reward to generate leading results over time is in our DNA. While that's evident in our results this quarter, our underwriting discipline would have been even more evident if Hurricane Irma had taken the track to Miami and up to East Coast to Florida, which was projected just 48 hours before landfall.

Notwithstanding ten years of relatively moderate Atlantic storm activity, our investors should know that we were well positioned for the very real possibility of $150 billion industry event. That's not to say that we'll never have a substantial or even an outsized loss from an event, it's just to say that balancing risk and reward is always front and center for us.

Our catastrophe underwriting also incorporates lessons learned over the years from events like Hurricane Katrina and Superstorm Sandy. Those lessons are reflected in our disciplined approach to terms and conditions, which make outcomes more predictable; risk controlled initiatives which make a difference in risk mitigation, selection and pricing; and proprietary flood underwriting down to the address level.

Our experience with the storms this quarter also reaffirms the competitive advantage in our claim model in terms of the value it delivers to our customers and agents and for our shareholders. Through military-like logistics capabilities and a sophisticated cross-training strategy, we have the capacity to conduct and we did conduct virtually 100% of our claim inspections for Hurricanes Harvey, Irma, and Maria with Travelers employees and that would have been the case even if Irma had taken that East Coast to Florida track, and even in that scenario, our flexible model would have given us capacity to spare.

As compared to an independent adjuster, we're confident that a highly trained and committed Travelers Claim professional produces a better experience for our customers and a much more efficient outcome for us. To that point, we were successful this hurricane season in meeting our objective of having the vast majority of our property claims closed within 30 days of the event.

Our response to the storms also included our largest deployment of our drone fleet to date. We conducted more than 1,000 inspections with drones, which significantly accelerates the speed and reduces the cost of handling those claims. Again, a better outcome for our customers and a more efficient outcome for us. We own and operate all of our drones and we're on track to have more than 650 drones in regular operation around the country by the middle of next year.

Moving beyond catastrophes, we're very pleased with the underlying performance of our businesses. In Business Insurance, the underlying combined ratio of 96.4% was solid, particularly in light of a high level of non-cat fire related losses. To a large degree, we believe it was normal period to period volatility.

Bond & Specialty Insurance produced another impressive quarter with an underlying combined ratio of 77.7%. In Personal Insurance, the underlying results reflect loss trends within expectations, the continued success of the pricing and underwriting actions we began implementing in our auto business a year ago and the successful performance of our property business.

Notably, our consolidated expense ratio has improved 90 basis points year-to-date. The result is maintaining expense discipline while investing strategically. For example, in Personal Insurance, over the last few years, we've invested in product and marketing initiatives, platform improvements and distribution managements, resulting in significant net written premium growth.

In Business Insurance, we're investing in technology and enhancing work flow to be a better partner for our agents and brokers, deliver compelling value for our customers and improve our operating efficiency. We've made those investments on about flat G&A expense dollars. We're looking forward to sharing more about these initiatives with you at our Investor Day next month.

Turning to the top line, we were very pleased with the success of our marketplace strategies, which resulted in 4% net written premium growth to a record $6.7 billion. Across our commercial businesses, we continue to be successful in achieving historically high retention rates, positive renewal premium change and an increase in new business. In business units accounting for around two-thirds of our Business Insurance premium, pure rate change in the quarter was higher both year over year and sequentially.

In our Personal auto business, our execution was spot on plan and we were again pleased to see continued momentum in our industry-leading homeowners business. There's been no lack of speculation around the outlook for pricing in the wake of an unprecedented hurricane season, which still had six weeks to go and in the midst of an ongoing unprecedented wildfire season in California. Big events impact pricing, when a material amount of industry surplus is eroded and/or when the events change the market's view of risk. It's not hard to make the argument that we've experienced both.

By some estimates, 10% or more of industry surplus and counting. The first time more than one Category 4 hurricane has made landfall on the U.S. mainland in one season. As devastating as it was, a very close call with Irma, and in the fourth quarter, forest fires that are burning not in forest but in subdivisions. And that's not to mention two earthquakes in Mexico and a cyber event impacting more than 140 million U.S. consumers.

And while those events have understandably captured everyone's attention, that's only part of the story. Interest rates remained at historically low levels. Loss trend has outpaced rate and exposure for a few years now to a degree that many others in the industry are probably not earning their cost of capital. And insured losses from PCS cat events in each of the last four quarters have exceeded the ten-year average for that quarter. I can't predict what the market is going to do, but I will share with you what we're planning to do.

As a component of our strategy to manage all the levers available to us to meet our return objectives, for more than a year now, we've been discussing our efforts to improve renewal rate change. And for more than a year now, we've been making incremental, but steady progress. The circumstances I've just described strengthen our resolve. We'll seek rate thoughtfully and in close coordination with our distribution partners. And in that regard, we believe our customers are well served by a stable and predictable market that keeps pace with inflation as opposed to the higher pricing swings of the past.

Two final comments before I pass the microphone to Jay. First, I want to add my voice in support of the corporate tax reform efforts in Washington. As a country, addressing the corporate tax rate is important for enabling U.S. businesses to compete more effectively at home and abroad against our foreign counterparts.

Beyond just the tax rate, we were particularly pleased to see that the Big Six framework for tax reform promotes leveling the playing field between U.S. and foreign companies. In addition to contributing to the country's tax base, it's important in addressing the decades-long streak of U.S.-based insurance companies losing U.S. market share and American jobs to offshore companies. Case in point, a $2.5 billion transaction announced just yesterday.

And finally, I'd like to thank our Claim organization for an extraordinary effort over these past few months. They've certainly risen to the occasion. It's an understatement to say that events like Harvey, Irma, and Maria and others that have been in the news are devastating, and our thoughts and prayers are with all those who have been impacted. Events like those serve as reminders that in the end, we sell a promise. We work hard to make sure that our agents and brokers are proud to sell that promise and that at every opportunity we demonstrate the value of that promise to our customers who buy it.

And with that, let me turn it over to Jay.

Jay S. Benet {BIO 2456473 <GO>}

Thanks, Alan.

Core income was $253 million, down from $701 million in the prior-year quarter; and core ROE was 4.5%, down from 12.5%. As in the first half of the year, these reductions in core income and core ROE were not driven by fundamental changes in our underlying performance. Rather, they were reflective of the high level of cat activity this quarter.

Beginning with underwriting results, our underlying underwriting gain remained strong, as evidenced by our 92.8% underlying combined ratio, which was 0.7 points higher than the prior-year quarter. This slight increase was primarily due to a relatively high level of non-cat fire-related losses in Business Insurance this quarter.

Catastrophe losses were $455 million after tax compared to only $58 million in the prior-year quarter. This increase of $397 million was driven by estimated losses from Hurricane Harvey of $319 million pre-tax or $207 million after tax, Hurricane Irma of $242 million pre-tax or $157 million after-tax, and Hurricane Maria of $82 million pre-tax or $54 million after tax.

Net favorable prior-year reserve development, which I'll discuss in more detail shortly, was $10 million after tax, down from $27 million in the prior-year quarter. Net investment income of $457 million after tax continued to be strong, although down $15 million from the prior-year quarter. Fixed income NII, as anticipated, was lower by $20 million after tax due to the continued low interest rate environment, while non-fixed income NII increased by $5 million after tax due to the strong private equity returns.

Interestingly, when we look at the long-term bonds we hold that are maturing through the end of next year along with growth in the size of our fixed income portfolio and higher short-term interest rates, our outlook for after-tax fixed income NII during the remainder of 2017 and into 2018 is only slightly lower, $10 million or less quarter over quarter, as compared to the corresponding quarters in 2016 and 2017, an improvement from what we've been experiencing in recent years.

Consolidated net favorable prior-year reserve development was $15 million pre-tax compared to $39 million in the prior-year quarter. Business Insurance's net favorable reserve development was $9 million pre-tax compared to $4 million in the prior-year quarter, including an increase to asbestos reserves of $225 million pre-tax, the same amount as in the prior-year quarter. Excluding the asbestos reserve increase, BI's net favorable reserve development was $234 million pre-tax, primarily driven by better than expected loss experience in domestic workers' comp and GL, partially offset by higher than expected loss experience in domestic commercial auto.

As has been the case in recent years, the asbestos reserve increase, which related to a broad number of policyholders, was driven by higher estimates for projected settlement and defense costs for mesothelioma claims than we had previously assumed. Notwithstanding these higher cost estimates, the underlying asbestos environment remained essentially unchanged from recent periods as compared to our expectation that the environment would improve.

As you may recall, the current asbestos environment, which has continued to result in periodic reserve strengthening for us and the industry, is still much improved from the high severity environment of 10 to 15 years ago when risks from pre-packaged bankruptcies, direct actions filed against insurers, and products/non-products coverage litigation among others led to very expensive settlement activity and a high degree of uncertainty in terms of the outlook.

The asbestos environment in more recent years has been frequency driven, the result of people developing mesothelioma and unfortunately dying soon thereafter. Interestingly, the most recent data from the Center for Disease Control, which we've included on page 19 of the webcast, shows deaths from mesothelioma in 2015, the most recent data available, was 7.5% lower than in 2014. And importantly, the age distribution of these deaths has shifted towards higher age groups, possibly due to more people who worked with asbestos prior to the mid to late 1970s, the high usage years, "living into the disease."

What that means is that recent medical advances that have successfully treated a variety of other deadly diseases seem to have enabled more people in this highly exposed cohort to live well into their 70s and 80s and then develop and die from mesothelioma. As nature takes its course, this high-risk cohort will get smaller over time. And accordingly, we continue to expect the currently high frequency claim environment to improve over time.

Bond & Specialty's net favorable development was $6 million pre-tax compared to $46 million in the prior-year quarter, while Personal Insurance had no reserve development compared to $11 million of unfavorable development in the prior-year quarter. Excluding A&E, year to date on a combined stat Schedule P basis for all of our subsidiaries, all accident years across all product lines in the aggregate developed favorably and other than some modest reserve strengthening for commercial auto, all product lines across all accident years in the aggregate developed favorably or had de minimis unfavorable development.

Operating cash flows of over $1.6 billion was very strong and we ended the quarter with holding company liquidity of almost $2 billion, up from $1.7 billion at the beginning of the year. This higher than normal level of holding company liquidity, provides funding for our $450 million of senior notes that mature in December.

All of our capital ratios were at or better than target levels, net unrealized gains were $1.5 billion pre-tax or a $1 billion after-tax, up from $1.1 billion and $0.7 billion respectively at the beginning of the year, while book value per share of $86.73 and adjusted book value per share of $83.06 increased over 4% and 3% respectively from the beginning of the year. Despite the high level of cat losses, we returned $528 million of capital to our shareholders this quarter through dividends of $200 million and share repurchases of $328 million, bringing total capital return to shareholders to $1.68 billion year-to-date.

As we've stated for many years and repeated in this quarter's 10-Q, the timing and actual number of shares we will purchase in the future will depend on earnings among a variety of other factors. So consistent with our ongoing capital management strategy, we're keeping our eyes on the California wildfires, which we expect will be a significant cat for us as we evaluate share repurchase activity for the fourth quarter.

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 Insurance, segment income of $105 million and the combined ratio of 109.8% were both impacted by the significant catastrophe events in the quarter. The underlying combined ratio of 96.4% was 2.3 points higher than the third quarter of 2016 with the underlying loss ratio increasing 3.4 points. The quarterly loss ratio was impacted by an unusually high number of large non-cat property, primarily fire losses and so the year-to-date results are better indication of how the business is performing.

On the year-to-date basis, the underlying loss ratio is up 1.7 points, 70 basis points of which is due to the large loss volatility I just mentioned, with the remaining about a 1 point driven by loss trend in excessive earned pricing. For the quarter, the underlying expense ratio decreased 1.1 points year over year. As with the loss ratio, there were normal fluctuations impacting the quarterly comparison. The year-to-date decline of about a 0.5 point is a better indication of our current run rate with the decline driven by both growing earned premium and slightly lower G&A expense dollars.

Net written premiums of $3.4 billion for the quarter were up more than a 1-point year over year with domestic net written premiums up about 2% driven by strong production results in Middle Market. International net written premiums were down 3% driven by reinsurance reinstatement premiums related to the cats that occurred in the quarter. Excluding the impact of reinstatements, international was up 1%.

Turning to domestic production, we were pleased that retention for the quarter of 85% remained at a historically high level. Renewal premium change was strong at about 3 points in the quarter with rate change that was up slightly from last quarter and up a 0.5 point from a year ago. New business of $434 million was up 6% versus the prior-year.

Looking at the individual businesses, I'll begin with Select where production statistics remained strong. With retention for the quarter of 83%, renewal premium change was nearly 5 points, while new business premiums of $98 million were up 4% year over year. In Middle Market, our results reflect consistent performance in the marketplace as demonstrated by another quarter of strong retention at 87%. Renewal premium change of 3 points was down slightly from the second quarter due to lower exposure growth, while rate increases of nearly a 1 point were up year over year and in line with the second quarter.

New business of $267 million was up 12% versus the prior-year quarter. We attribute a large portion of this to great execution in the market by our field organization, particularly as it relates to larger accounts in industry segments that we like. We're also encouraged by how our investments in technology are enabling our underwriters to be more active in the market. We'll talk more about that at our upcoming Investor Day.

So all in, a quarter that was significantly impacted by the weather and we were pleased with our execution in the marketplace. Our fundamental marketplace strategy remains unchanged. We seek to retain our best performing business while thoughtfully managing the profitability of the book. Importantly, the market and environmental circumstances that Alan outlined earlier further support our ability to successfully execute on this strategy.

I'll now turn to Bond & Specialty Insurance where segment income for the quarter was strong at $136 million though down somewhat from the prior-year quarter due to a lower level of net favorable prior-year reserve development. The underlying combined ratio improved nearly a 1 point from the prior-year quarter, to under 78%.

As to the top line, net written premiums for the quarter were up 2%, reflecting growth in both our domestic management liability and international businesses, with the international growth driven by strong production in both our Canadian surety and UK management liability businesses.

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 record high of 89% for the quarter, the fourth consecutive quarter of 88% or better, while new business was up slightly from the third quarter of last year.

Renewal premium change of 3.5 points was up slightly from the second quarter due to a modest increase in exposure growth. So, Bond & Specialty results remain terrific and we continue to feel great about the segment's performance and our market positions.

Turning to Personal Insurance, net written premiums for the segment grew 9% in the quarter with more than half of that growth coming from higher pricing. Despite 8.7 points of catastrophe losses in the quarter, Personal Insurance generated $77 million of segment income with a third quarter combined ratio of 99.7%. The underlying combined ratio of 91% improved about 1.5 points year over year. The domestic agency auto combined ratio for the quarter was 106% and included 7.2 points of cat losses, far above our normal third quarter auto cat load expectation of about a 0.5 point.

Compared to the third quarter of 2016, the underlying combined ratio is down 2.3 points. As you can see on page 15 of the webcast, 1.3 points of the decrease is due to continued improvement in the expense ratio, as we leverage a consistent level of operating expenses over a larger premium base. The remaining 1 point of decrease is primarily due to the fact that the third quarter of 2016 loss ratio included the year-to-date impact of the bodily injury severity re-estimation.

As we discussed in previous calls, in response to higher bodily injury loss levels, we are taking actions to improve profitability, most notably by improving the pricing of the book. As a result, renewal premium change increased from 7.9% in the second quarter to 9.5% in the third quarter, reaching 10.5% for the month of September. We expect that renewal premium change will remain in double-digits for the fourth quarter. And as we told you previously, by year-end we will have obtained enough rate on a written basis to address the elevated bodily injury loss levels.

Retention declined modestly in the quarter as expected, but remained strong by historical standards even as we implement meaningful price increases to the book. PIF growth has decelerated but remained positive driven by lower levels of new business. Importantly, we remain on track to achieving the goals we laid out for the auto book back in January.

Turning to Agency Homeowners and Other. The combined ratio of 90.3% for the quarter reflects 12.2 points of cat losses. The underlying combined ratio of 78.1% was in line with the third quarter of 2016 as net trend was offset by the impact of volume on the expense ratio. Homeowners net written premiums increased 5% in the quarter, somewhat accelerating the momentum we have experienced in recent quarters.

As a reminder, we have made a concerted effort to generate growth in this profitable line even as we moderate the growth in auto. Process and technology improvements have made it easier for agents and brokers to do business with us, and we have focused on adding more property oriented distribution partners and increasing our average number of policies per customer.

Overall in Personal Insurance, setting aside the significant impact of catastrophe losses in the quarter, both the Agency Auto and homeowners results were in line with our expectations, and both lines continued to make good progress towards the goals we laid out at the end of last year.

So stepping back and looking at across the franchise, while the headline for the quarter is obviously the cats, we feel very good about our underlying results. Considering our significant competitive advantages, the investments that we're making to extend them and to develop additional advantages, and our ability to execute, we believe each of our businesses is positioned for continued success.

With that, let me turn it back over to Gabby.

Gabriella Nawi {BIO 2211991 <GO>}

Thank you. We're now ready to open it up to Q&A, and if I can ask you to please limit yourself to one question and one follow-up. Thank you.

Q&A

Operator

Thank you. . Our first question comes from the line of Kai Pan from Morgan Stanley. Please proceed.

Q - Kai Pan {BIO 18669701 <GO>}

Thank you and good morning. My first question is on the outlook for the core combined ratio for the Business Insurance segments. In your 10-Q, you said broadly consistent into 2018. Could you just walk us through the components of it in terms of your core loss ratio deterioration and also potential normalization of non-cat losses as well as the improvements in the expense ratio? And does your forecast include a property and casualty better pricing outlook?

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

Kai, good morning. It's Alan. Thanks for the question. Let me start with it. We're going to try not to – in the outlook, try to break these down between the components of loss and expense. We give you a sense as best we can, looking at our crystal ball, which is never perfect and the world is never going to turn out exactly as we thought. But we try to give you as good a sense as we can on the overall profitability by segment.

In terms of the rate in particular, you can see the written rate that we've been getting, and obviously you can see, for example, in BI quarter over quarter. And so that will, of course, earn in and that will be a component of what gets reflected in our outlook, as will the impact of the expense ratio that you see in the nine months. But we're going to try not to break it down between the loss and expense ratio components.

Q - Kai Pan {BIO 18669701 <GO>}

Okay. My follow-up question on the reserve side, there are actually two components to that. One is on asbestos. You've been taking charge about $200 million a year for many years that we know. And so why don't you take a big charge up front? Or are you considering reinsurance transaction? The commercial auto side was driving that. And is that like – do you take out – increase your current year accident year loss take on the commercial auto line as well? Thanks.

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

Let me start with the auto side, and then I'll ask Jay Benet to comment on the reserves. On the auto, we've been seeing and talking about some severity on the commercial auto side for some time, and we've been addressing it. We view this as a tweak to those reserves in prior-year periods and think about it's a $40 billion reserve increase on a couple or $2 billion or $3 billion reserve base – billion, $2 billion to $3 billion reserve base. So we look at that and we don't overreact to it. It's just the normal process every quarter we go through, and we look at our reserves and look at the trends in the cases we've got out there and true it up. So it's not anything that has to any significant degree impacted our view of loss trends or what's happening in the current year period. Jay, do you want to address the asbestos?

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

I think as it relates to the asbestos, like every other reserve, we take our best shot, looking at all the data we have available at points in time to evaluate what the reserve should be. And as part of that, we're making assumptions as to what the future looks like with regard to the level of activity that will take place in terms of meso deaths and also look at what kind of settlement costs or litigation costs we face, and come up with, as I said, our best estimate. And what's been taking place over the last several years, as we said in our description of the environment, is the environment really hasn't changed very much, but the assumptions we've made that possibly would lead to a falloff in the amount of activity just haven't borne out.

So there's nothing about our reserve increase that reflects a dramatically changing environment, and we thought we'd add some color to it this quarter with regard to this page we added to the webcast as it relates to what's been taking place in the various cohorts associated with mesothelioma deaths, and we'll see what happens in the future. But as it relates to making any change in process or whatever, we didn't think that was appropriate.

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

And, Kai, as it relates to the reinsurance, you asked that as well, we certainly try to evaluate as best we can from the outside every deal we see announced by others, and we are talking to the same people that are on the other side of those transactions evaluating them for us, so no lack of analysis on our end or looking into it. If we found a deal that we thought really made a difference from an economic perspective, we would certainly be interested in that. We certainly see transactions that provide some limited duration benefit in terms of the GAAP accounting. But when we look at it from an economic basis and you get down to the cash flows, we just haven't seen one yet that makes sense for us.

Operator

Thank you, sir. And our next question comes from the line of Jay Gelb with Barclays. Please proceed.

Q - Jay Gelb {BIO 21247396 <GO>}

Thanks and good morning. I was hoping to touch base on the Business Insurance outlook for commercial insurance pricing. Alan, I believe in your commentary, you talked about seeking thoughtful rate increases in conjunction with your distribution partners, and keeping pricing ahead of loss cost inflation. Given all of the factors that we've seen driving up large losses in the current quarter and into 4Q, can you talk a little bit more in terms of the outlook there?

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

Yes. We've been saying for some time, Jay, that for over a year now, as we look at our book and we look down the road out at the horizon that we're going to need to improve written rate to meet our return objectives as part of our overall strategy. And we've been doing that for some time, and you can see we've had some incremental but steady success in it. And when we look at the factors, when we look at the weather we had in the third quarter, when we look at some of the other things going on in the world, that's what's captured everyone's attention. I actually don't think that's the bigger part of the story.

I think the bigger part of the story are the underlying dynamics that are driving the overall margins and profitability in this business. And when we look at that and we look at the accounts that we have, we say it's time to move a little bit. And we're not executing towards a headline number. You take all our accounts – we take all our accounts and we segment them very thoughtfully. And for some time, we've been getting rate in excess of loss trend on the accounts that are most return challenged for us, and we're getting to a point where our need to get rate is extending up the continuum. And that's reflected in the fact that this quarter we got rate on a higher percentage of our accounts than we did last quarter and the quarter before that, et cetera, et cetera, and it's been our intention to lean into that. And the events of this quarter and the overall circumstances that I've described cause us to say we're going to lean into it a little bit more, and we feel a little bit more confident in our ability to achieve it.

Q - Jay Gelb {BIO 21247396 <GO>}

Makes sense, thanks. And then my follow-up is on Personal Auto. The underlying combined ratio for auto was improved to around 99%, and I believe last quarter the company was talking about a longer-term target of 96% to 98% plus some tenure impact. Clearly, you're getting closer there. How soon before you think we can get into the range?

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

Hey, Jay. This is Michael Klein from Personal Insurance. Thanks for the question. And first, thanks for noticing that the underlying combined ratio was below 100 and actually improved year on year. That's actually the first time in a while that that's been the case.

Anyhow, Brian gave the main drivers of the quarter-over-quarter change. I think to your question, what's the longer-term outlook, we think really there are two or three really key questions there. One is where are we in terms of pricing for the increased bodily injury loss estimates that we recognized in the back half of last year. The second is, is tenure playing out the way we anticipated. And then the third really is at the core of your question, what's our outlook for Personal Auto profitability, and I'll just take those three real quickly in turn.

Brian did mention, we'll have achieved enough rate on a written basis by the end of 2017 to cover the increased level of bodily injury losses. That's on a written basis. So on an earned basis, we remain on track to have done that by the end of '18, which is consistent with that 18 to 24-month timeframe that we laid out at the beginning of the year.

With respect to tenure, just a couple comments. One, it's important to note that the reason we spiked that out initially was that it had an outsized impact on these kind of period-to-period comparisons due to the elevated levels of new business that we were writing. As we've talked about, the impact of tenure from one period to the next, the delta that it drives dissipates as new business levels return to normal and as the portfolio matures, which is what's begun to happen in 2017. So from this point forward, tenure becomes less of an anomaly quarter over quarter and just one of many factors that you need to think about as you look at our results. I think what's most important to take away this quarter as respect to Personal Auto is we have begun to turn the corner on profitability.

Earned rate is exceeding loss trend, and it's combining with underwriting and process changes, growth, and expense ratio reduction to drive that improving underlying profitability that you see. As noted in our outlook, we expect underlying profitability in Agency Auto to improve over the next four quarters relative to the comparable prior periods. I would remind you given we're going into the fourth quarter that fourth quarter is a relatively high combined ratio period from a seasonality perspective. So you've got to sort of factor that into your overall evaluation. But, at the end of the day, we feel good about the progress we're making towards our target combined ratio and that progress will continue through 2018 and into 2019.

Q - Jay Gelb {BIO 21247396 <GO>}

Thanks for the answers.

A - Gabriella Nawi {BIO 2211991 <GO>}

Next question.

Operator

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

Q - Randy Binner {BIO 15145081 <GO>}

Good morning. Thanks. I had a question on the cat losses coming in quite a bit lower, particularly with Harvey kind of coming in below the previously guided range. What changed there so dramatically? Did it have to do with the number of total vehicles or your ability to close claims as you commented earlier in the call? Just trying to get a sense of kind of what improved and how settled the claim activity there is on Harvey and the other hurricanes.

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

Yeah, Randy, it's Alan. I'll start and then maybe Jay will have something to add, but the only reason that we gave a view on Harvey is because we were speaking at a conference that wasn't FD compliance, and we wanted to talk about it at that conference, and so we made a disclosure about it. That was relatively near to the event, and so there was a relatively higher degree of uncertainty around our losses at that point. And so the range we gave reflected what we thought and all the information and uncertainty we had at the time. And we've had a significant amount of time elapse from then to now. We've had the opportunity to inspect virtually all of our claims and as I said, the vast majority of our property claims are closed. Not that there's no uncertainty left, but we feel much better from a certainty perspective and are confident in the number we put up. So I would really say nothing dramatic changed. It was the passage of time that gave us more insight into the losses.

Q - Randy Binner {BIO 15145081 <GO>}

Well, given that comfort, and would buyback be able to resume maybe earlier than would have been the case if there was more demand surge or other aspects making the tail longer on the claims?

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

Yeah, in terms of the storms in the third quarter, we ended the third quarter with our balance sheet in very strong shape, so there's nothing from the third quarter where we feel like we've got to build back a capital deficit to any degree at all. So the fourth quarter will be business in usual in the sense that we'll look at what our earnings are expected to be and we'll consider buybacks accordingly. As Jay said in his prepared remarks, the wildfires are out there. That's an ongoing event that will be significant for us and so we'll evaluate that and our fourth quarter outlook for earnings as we make decisions about buybacks.

Q - Randy Binner {BIO 15145081 <GO>}

Thank you.

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

Thank you.

Operator

Thank you. 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 just had a couple I think for Brian. I guess the first one is if you were to just look at accounts where there were 3Q property losses on the Business Insurance side or maybe those that didn't even have losses but were in loss affected geographies. What's been the conversation I guess so far with renewals? What's been the magnitude of rate increases or how those conversations have gone? Thanks.

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

And I missed a little bit of the beginning. You said accounts of 3.2 on the – 3Q, yeah.

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

In 3Q, yeah.

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

Yeah, so I think some of the stuff is obvious. In the really cat-exposed areas, the conversations are very clear. The perspective on the flood risk, the exposure to the wind, we were reminded once again of what those are, so there's more momentum there.

But I think it's more what Alan said in his opening, the overall environment of what we've been seeing in property. Two or three years ago, we were saying that the line was in very healthy condition and although experiencing some price decreases. The largest price decreases we were seeing in the book a couple of years ago, we thought it was a healthy line and we'd manage it. A couple years later, that compounding has impacted the core profitability, so we're looking at that.

We're also seeing a little bit of inflation running through the book of business and that is in the labor and materials side, a number that wouldn't even be big enough to warrant a comment other than the fact that we're beginning to see the line is already under some pressure and the potential for demand surge out of all the cat activity is making that more dramatic. So a bunch of stuff going on in the line today and we think there's an opportunity to improve the profitability there.

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

Okay, I guess my follow-up, I was just thinking about just the potential for further favorable or unfavorable developments from these events. I noticed in the Q that the commercial property IBNR looked like it was up about $300 million quarter over quarter. I guess just as you think about the losses you've reported, where do you see, I guess, the greatest potential for uncertainty from here on out? Thanks.

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

Any time you have large cats, you're settling claims quickly, but generally, those claims that you're settling are the more straightforward ones, so when you look at the level of IBNR, there remains a great deal of uncertainty associated with the cat losses, so we've taken our best shot based on all the information that we have available and we can't predict whether that will actually be higher or lower than what this will ultimately come out to be. I think we have a good track record of being fairly good at these estimates, but there is a lot of IBNR at this point in time.

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

Thank you for the answers.

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

Thank you.

Operator

Thank you. Our next question comes from the line of Amit Kumar with Buckingham Research Group. Please proceed.

Q - Amit Kumar {BIO 15025799 <GO>}

Thanks, and good morning. Two questions if I might. The first question goes back to the discussion on pricing. If I were to take that comment and sort of flip it towards the reinsurance side, how do you expect those discussions with their reinsurers to go? Do you expect to sort of hold the line on pricing based on your outlook or just maybe help us understand that equation a bit better?

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

Amit, I don't think we've got a lot of insight to give you on that. Obviously, we'll be thinking about it over the coming weeks and months. And I guess one reason we're not particularly preoccupied by it is, we don't buy all that much reinsurance. We're a gross line underwriter. We like our underwriting and so we don't buy that much. So on a relative basis, we're less impacted by that. I would hope that our thoughtful underwriting, as was demonstrated in these storms, would factor into whatever pricing we negotiate when it comes up, but it's just not something we spend a lot of time wringing our hands over.

Q - Amit Kumar {BIO 15025799 <GO>}

Got it. That's a fair comment. Switching back to the discussion on Business Insurance, if you look at the mix of BI, 50% of the book is comp, international, and GL. Do you think these cat losses give you an ability to enforce some incremental rate action in the non-cat impacted lines or do you think that these somewhat get relegated to the exposed lines at this juncture?

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

Amit, you've got commercial auto on one end of the spectrum. You've got workers comp on the other end of the spectrum, and everything else falls in the middle in terms of where it is, in terms of rate adequacy. But what I would tell you though and one of the reasons why in my prepared remarks I was so deliberate about talking not just about the storms that have captured everyone's attention, but about the other underlying factors in the business is those are real. Things like where interest rates are, things like what weather has done, we've got pricing and loss trend over several years that that impacts all the lines, so our pricing objectives I should say go beyond the property line, really extend across all our lines and all our geographies. So we're not thinking of this as property related or coastal related. We're thinking about it much more broadly.

Q - Amit Kumar {BIO 15025799 <GO>}

Fair point. Thanks for the answers and good luck for the future.

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

Thank you.

Operator

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

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

Hi, good morning. My first question, I'm just trying to get a feel as we think about flood risk here, obviously a big component of the Harvey loss. How much of flood-related risk came through your commercial lines exposure. And as you think about going forward, is there an opportunity both on the commercial line side and then also maybe depending upon what happens with the National Flood Program to potentially write more flood risk both within your commercial and Personal lines businesses?

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

Elyse, it's Alan. I'll start and see if Brian's got anything to add, but Harvey was by and large a flooding event for us and as it turns out, our underwriting held up and we feel good about it. We have a pretty good market share in the state, and our losses we think are reflective of the fact that we do have proprietary address-by-address flood underwriting that really stood up to it. And so we feel good about it.

Whether there's incremental opportunity, after every one of these big events, we take a step back, and we think about how we feel about our exposures and how we feel about opportunity, and what the lessons learned are from that event and how we apply those to exposure elsewhere. So we will be going through a post-mortem process in assessing how we feel about our coastal flood exposure. And we may look at that and say, boy, we could take on a little bit more. We may look at it and say we're just right, or we may look at it and say we'd like a little bit less, and we're in that process. But it could be if we find more opportunity there.

On the Personal line side, I think that's a much more complicated question and you get into the NFIP. It's really hard to compete with the government program that prices at the discount that it does and as long as there's that program out there, => pricing at a discount to actuarially sound rates, it's not going to be an opportunity for us or anybody.

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

Okay, and then my second question. I know earlier on the call you guys did mention that the California fires would be a significant loss. How do we think through the losses there and the potential business interruption claims from some of the wineries that are obviously very significantly impacted from this event, any color you can just give there? Thank you.

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

Yeah. We're as interested in it as you are. I would say it's early. The event is ongoing and it's hard for us to give a sense right now. So I'm not sure what else to add there.

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

Okay, thank you very much.

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

Thank you.

Operator

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

Q - Jay A. Cohen {BIO 1498813 <GO>}

Thank you. Most of my questions have been answered, just one quick follow-up. The elevated fire losses on the Business Insurance segment, can you talk about or quantify what the impact was in the quarter on the loss ratio?

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

Yeah. In the quarter, Jay, think around 2 points.

Q - Jay A. Cohen {BIO 1498813 <GO>}

Got it. That's really helpful, Alan. Thank you.

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

Maybe a tick higher, but 2 points, 2.5 points something like that.

Q - Jay A. Cohen {BIO 1498813 <GO>}

Got it, thanks.

Operator

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

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

Hi, good morning. Just following up on the pricing discussion, when you talk about pushing prices to keep pace with loss trends, should we interpret that as Business Insurance renewal rates should move closer to about 2% versus the 1% right now?

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

First, good morning, Sarah. Thanks for the question. I think that's a broader brush than we think about it. I think what you should take away is more than the 1% you see now. We talk about loss trend being 4%, and we'd like to get to a point where we've got rate and the components of exposure that behaves like rate offsetting inflation and maybe even improving from there.

But the other thing I would tell you is we're intent on doing this in a way that is thoughtful and controlled and in close partnership with our agents and brokers and doing it in a way that isn't disruptive to our customers, and we think that's actually a much better model for them. So this isn't anything we need to achieve tomorrow or next week or all in one fell swoop next quarter. This is going to be a gradual process over time.

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

Sure, great. That's makes sense. And just when you say the loss trend being 4%, is that what you're actually realizing right now or is that what you're booking your reserves out looking at a longer-term trend? I thought maybe more recently you've been coming in lower than that.

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

The 4% is a broad number, and it covers our whole Business Insurance premium base. So obviously, there's variation among the products and businesses within that. And the fact that we've had as much PYD as we've had over recent years suggest that it's come in lower than that. We don't in terms of our pricing expect that that's going to continue forever. We expect that over time loss trend is going to return to a longer-term average, and so our longer-term outlook continues to be 4%. But again, that's a very broad observation.

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

Sure, thanks for the answers.

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

Thank you.

Operator

Thank you. Our next question comes from the line of Meyer Shields from KBW. Please proceed.

Q - Meyer Shields {BIO 4281064 <GO>}

Thanks, good morning. How does the fact that people are living into the asbestos-related diseases impact your thinking about permanent injuries on the workers compensation side?

A - Gabriella Nawi {BIO 2211991 <GO>}

Say it again, Meyer.

Q - Meyer Shields {BIO 4281064 <GO>}

Okay. So on the asbestos side, one of the factors driving the adverse reserve development is the fact that people are living longer, so asbestos-related diseases are manifesting themselves there. There are claims associated with that. I'm wondering if people are living longer, how is that impacting workers compensation reserving?

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

So this is Brian. I'll take a shot. So obviously, we are factoring in to everything we look at in workers' comp and permanent injuries, lifetime injuries – we're looking at the actuarial life expectancies. And given injuries that the workers have, what is their lifespan. And no question that advances in medicine in general have extended that period over time. So I think it's a lot of the same information, but that's been embedded in our numbers forever, really. We've always looked at it that way. So I don't think there's anything fundamentally new there.

Q - Meyer Shields {BIO 4281064 <GO>}

Okay, and then one small question I guess. Within BI there's a $21 million expense for non-insurance G&A. I was wondering if you could talk to what is going on there and what that is.

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

What you say – we closed the acquisition of Simply Business this quarter. So what you're going to start seeing is the G&A expense is going to be influenced by what's taking place with regard to their expense base. And from the other side of the coin, the other revenue line is where their revenue numbers are getting consolidated. So that will just work its way through our consolidated results going forward.

Q - Meyer Shields {BIO 4281064 <GO>}

Okay. Is this is good run rate, the $21 million of expenses?

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

We acquired them. We closed on the acquisition in August, so it's not quite a full quarter.

Q - Meyer Shields {BIO 4281064 <GO>}

Okay.

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

I'm also not sure that on such a small component that we're necessarily going to give a perspective on a run rate expense for a strategic initiative like that. It's all factored into our outlook in margins for the segment.

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

There's also cost associated with the acquisition itself that are flowing through that, so I wouldn't look at it at this point as a run rate but you can develop it over time. I think ultimately, what you'll see is if you look at what's taking place with regard to revenues versus expenses, in total it's not a big delta.

Q - Meyer Shields {BIO 4281064 <GO>}

Okay, perfect. Thanks so much.

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

Thank you.

A - Gabriella Nawi {BIO 2211991 <GO>}

And this will be our last question please.

Operator

Thank you. This question comes from the line of Brian Meredith from UBS. Please proceed.

Q - Brian Meredith {BIO 3108204 <GO>}

Yes, thank you. First question, I think for Michael. On the Personal auto business, is there a way to kind of a dissect it where you can give us a perspective of how much the improved frequency the industry is seeing that's benefiting you versus what's happening with 10-year and some of the other underwriting initiatives that's happening?

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

Sure, Brian. I would say as respect to the industry trend information, we've seen the second quarter ISO Fast Track data, taking a look at it. I would make I think the same comment we typically make about the data which is it's paid data. It's an interesting data point, it's certainly not complete.

But as we look at the ISO Fast Track data, we look at our own trend experience, we think those results are relatively consistent with what we're seeing. As I mentioned in the earlier question sort of dissecting the components, not a lot of - and I think I mentioned this. I mean, as you think about all the dimensions underneath the underlying combined ratio, there's not really any significant change in any of them this quarter.

Q - Brian Meredith {BIO 3108204 <GO>}

Okay, great. And then my second question just curious you mentioned the cyber loss obviously with Equifax upfront and there has been some others. Any change in kind of your view of the cyber business here as a result of what's going on? What does the market kind of look like right now for cyber? Is that becoming more an attractive growth area at this point?

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

Yes. Stepping back I would say that there's an increasing awareness and consciousness in the mind of the risk manager and whether that's a job description for somebody in a big company or a proprietor in a small business. I think there's a greater sense of the need for the product and we think that's a healthy thing and we think to a degree that we'll be there to help solve that problem.

Having said that, we are extraordinarily mindful that it's an emerging risk and there's a lot about it we know and there's a lot about it we don't know and that gets factored into the way we think about the industries we want to write in, the individual risks we want to write, the lines we put out, the reinsurance programs that we have and so we do think that it will continue to be a growing opportunity and we will continue to be cautious in the way we approach it.

Q - Brian Meredith {BIO 3108204 <GO>}

Great, thank you.

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

Thank you.

A - Gabriella Nawi {BIO 2211991 <GO>}

Very good. Thank you very much for joining us today, and also, we look forward to seeing a number of you at our Investor Day on November 13. Thank you very much and have a good day.

Operator

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