Bank of America Merrill Lynch Insurance Conference

Company Participants

- Jay Steven Fishman
- Unverified Participant

MANAGEMENT DISCUSSION SECTION

Unverified Participant

Sorry, for the delay, everyone. Stuff happens beyond your control. It's our pleasure to have Jay Fishman, head of Travelers here with us. Jay started out in the financial services business. He transitioned to insurance in the 1990s. Mid? Late 1990s?

Jay Steven Fishman {BIO 1933251 <GO>}

Early. Early 1990s.

Unverified Participant

He served as the CEO of Travelers since the 2004 merger with St. Paul and it's been a busy decade with a lot changing. And so, we're happy to have Jay with us and talk about both the past and also the future.

Q&A

Q - Unverified Participant

I had a question for you that I wanted to ask you and that is in the 1990s when you were at Citi, I guess, and did someone come up to you and say: hey, do you want to run Travelers? Or did you raise your hand or join the Travelers? Did you raise your hand and say: that's what I want to do?

A - Jay Steven Fishman {BIO 1933251 <GO>}

So, first, at the risk of embarrassing you, so I have been around this industry now. Like I always say, I'm new to it but not anymore actually, and you're one of the best. No question, and we're here ...

Q - Unverified Participant

Thanks.

A - Jay Steven Fishman {BIO 1933251 <GO>}

... because you're one the best in a world that's constantly changing. And Gabby, our head of Investor Relations, when she first joined us said: you don't understand; everyone thinks the insurance industry is a mystery meat. Nobody gets it. And you, over many years, you get it, and quality work – and always worth reading. Whether I agree with it or not, different story, but always worth reading, always worth reading.

Q - Unverified Participant

You could say that one more time. We'll tape that for my father, please, this time.

A - Jay Steven Fishman {BIO 1933251 <GO>}

I had joined what was then called Primerica in 1989. I was – previously I was with Shearson Lehman Brothers. Let's see, none of that is left anymore. I was with Shearson Lehman Brothers and left and joined Sandy [Weill] and Jamie [Dimon] and Bob Lipp and a group of others. My initial job was in 1989 to be Bob Lipp's Chief Financial Officer of the Consumer Financial Services Division, consumer lending, credit cards, the bank, Primerica Bank. Bob and I became attached at the hip professionally. We just sort of saw the world in the same way and I was so fortunate to have the opportunity to work for someone who is that experienced in operations and was willing to share it.

In 1992, old Travelers – TIC, New York Stock Exchange – had really hit the skids, lots of reasons for it. Primerica bought 27% of it at the end of 1992 and the remainder at the end of 1993. At that point, old Travelers was five separate businesses: property casualty, and life, asset management, employee benefits, and health insurance, of all things. So it was a lot there.

Q - Unverified Participant

A true multiline.

A - Jay Steven Fishman {BIO 1933251 <GO>}

A true multiline. And Bob, at the beginning or at the middle of 1993, before we bought the remainder, Cindy (2:47) asked Bob to go up and be the CEO and Bob asked if I would come along and be his chief financial officer, and it was easy. So I went up there originally kind of in the middle of 1993 to become the chief financial officer of the entity working for Bob Lipp.

Q - Unverified Participant

Do you have any reservations about joining the insurance industry at that point?

A - Jay Steven Fishman {BIO 1933251 <GO>}

No. It was mystery meat. I didn't know enough to be worried about it. But what was interesting was that the concerns then were quite different. The health insurance business was – that was Hillary Clinton and her initial initiative. It was – Travelers was one of the largest old-fashioned indemnity insurance companies around. That whole world was moving quickly to then managed care. They had clearly fallen way, way, way behind.

And so the issues were: gee, what do we do about the – what do we do about the health insurance business? What do we do about the life insurance? Property casualty was kind of way down the list. And so, it was not something I particularly focused on. They had Chuck Clarke. If you remember, Chuck was...

Q - Unverified Participant

Yeah.

A - Jay Steven Fishman {BIO 1933251 <GO>}

...running the P&C business for them then and he was terrific. And he could be relied on. He had intellectual integrity, tell you what he really thought. And so, the P/C business was pretty far down the list, actually, at that point.

Q - Unverified Participant

Yeah. So here we are at a little past 10 years past the St. Paul merger. Looking back, what's been the biggest surprises to you? And as you think about it, what went better than expected? I assume a lot of things. And what do you think maybe you could have done better during that time?

A - Jay Steven Fishman {BIO 1933251 <GO>}

That's interesting and this wasn't a set-up, because it was probably a few weeks ago, before I knew that we were going to do this, there were a group of us sitting around with a glass of wine one evening. And people from the early days, and I said: as you look back over these 10 years, what was the single biggest surprise and the single biggest disappointment. And we went around the room with different observations from different perspectives.

The biggest surprise for me: there were – this is an industry filled with conventional wisdoms. And the conventional wisdom at the time was that no agency would allow more than – where this number came from is a mystery – 40% of their business to be with one carrier. You can go back to research 20 years ago and you'll see that. And so the conventional wisdom was you put two companies together, you get some concentration, the agent tends to reduce his exposure to you over time, trying to diversify into more markets. That never happened.

What was fascinating to me was that in each trade, both Travelers and Aetna and then subsequently, every time we became bigger, we ended up doing more business with agents over time. And I can attribute it – I can't prove it to any of you – but I can attribute it to – as we became a more important supplier – when this all started, we were the 11th largest property casualty company in the U.S. We were like nowhere.

As we became more important, they all wanted to be more important to us and they knew how to do that, the way you become more important to a carrier is that you align more closely. You do more business. And not all agents are the same. Not all brokers are the same. Not all carriers are the same. So that was a really - a pleasant surprise, an amazing surprise, actually, that it worked the way it did as quickly as it did.

We had a year or so where it was quite rocky because we had the underwriting profiles of the two companies who are not the same and they had to be aligned. That was a big challenge. But once we got that done and that was not - that was people and underwriting and politics and everything you can imagine. But once we got that done, the agency said: okay, I'm in. I get it. Let's go. And it worked terrifically.

But the disappointments have been more what you learn about yourself than what you learn about your organization. And specifically, these are really hard to do because time is of the essence and I just always had a natural instinct to give people the benefit of the doubt. Give them a chance. They'll see the wisdom in this. They'll get along and go along, and for lots of people that happened. There were some where they never did - they couldn't - for whatever reason, individuals saw the world differently. And somehow I thought by the force of my own personality, you know, that I could bring them along.

And early on, I saw that it wasn't going to happen and that requires you to take certain actions as a leader. My disappointment in myself in that regard was that I probably let that go six months longer than I should have. It just created more turmoil in the organization than it needed to.

And lesson learned. It certainly wasn't in any way really problematic, but it made it - it just made it more difficult for everybody. Make the decisions. You make them and get on. And you'll make a bunch of right ones and you'll make some wrong ones and you'll fix it down the road but speed was - that's always what's in shareholders' interest, I'm convinced of that now.

Q - Unverified Participant

So you had done the Aetna deal in the mid-1990s, then St. Paul, and the feeling was, after 2004, that they'll digest this and there's going to be another big deal coming; and you've done deals but nothing company-defining, nothing on the international side of size, too big. And my question is: why not? You've had a lot of capital; you've bought back a ton of stock, which has been a good investment, but why haven't you done something even bigger than that?

A - Jay Steven Fishman {BIO 1933251 <GO>}

Not to say we haven't tried. So let's start with that. After we did the trade in 2004, we were now of the sufficient size where being bigger by itself really was less of a priority than it had been previously. When you're starting out as the 11th largest carrier, that's a different story; now we were in a different place.

And a group of us spent a couple of days in 2004, 2005, and actually asked each other and ourselves the question: why should someone buy our stock? And of course, the answer is because they think they will eventually sell it at a higher price; and so, okay, how are we going to do that?

And we got very granular about this. We challenged each other because it's easy as management to say: oh, we'll grow. No one knows how. Or we'll do something magic and we said: no, we think this – the cash flow dynamics of who we are now – and it was different then – was impressive and that we were going to generate a lot of capital, more than we needed to support our business organically, internally. To the extent acquisition opportunities would come along, we'd look at them. But if they didn't, we saw – something Sandy taught me – we weren't going to sit on capital and wait for something to happen. If we had a trade that really made sense – we still feel that way now – we'll get it financed. We'll get it financed. If we can't get it financed, then maybe the trade shouldn't be done. So we think that way.

So now, we're all about returns and have been for the last seven or eight years. So for a transaction to be interesting to us, it either has to enhance our returns and our ability to generate more cash, in effect, or make our returns less volatile. That would be okay, too.

So U.S. transactions with $1 billion of premium – and there's four or five companies – wouldn't matter. It's way too much risk. In the insurance business, you get whatever is on those books whether you know it or not and it doesn't change anything. It doesn't change the cash dynamics. It doesn't change the returns. It doesn't make them less volatile.

Dominion was different because we were way undersized in Canada and really wanted to do something. If we hadn't bought Dominion, the chances are we would eventually decide to exit what we had up there. It wasn't big enough to be sustainable. We were the 25th largest property casualty company in Canada. Couldn't hire anybody. Who'd want to come to work for us? So it was becoming more challenging. So that was both opportunistic and fit the return profile.

Now that we're past all these things, whatever confidentiality agreements we have are obviously long gone. We took a hard look at Safeco when it came up. That, again, the Northwest was our least robust geography. You know, Northeast is our strongest; Northwest was our weakest. Safeco would have obviously addressed that. My recollection is that went for $68.25 a share. We were running out of breath in the mid-50s. I couldn't – I mean, I just – it has to make sense being bigger. There's no such thing as damn the torpedoes, full speed ahead. It doesn't work.

Q - Unverified Participant

No, if you were a mutual company, it would have been a little easier.

A - Jay Steven Fishman {BIO 1933251 <GO>}

Well, yeah, I guess. And $68.26 would have taken it. There was no confusion about the nature of that auction. And obviously, in the financial crisis there were a couple of things that were floating around before TARP came to be, and we were obviously interested and involved, and the government solved that problem before we could.

So, we try, but I would say that our list of things that would really be interesting, appealing, that would matter, that would make a difference to a shareholder, is pretty small. It's pretty small.

Q - Unverified Participant

There's - smaller. There's still pretty big, but relatively smaller deals you've been doing. Are there more of those to be done? Are there regions that you can invest in through M&A?

A - Jay Steven Fishman {BIO 1933251 <GO>}

Well, it's becoming - so, the easy one that won't matter is I'd say - I really would love to position us in India, now particularly if the regulations have changed to 49%. It'd be a modest investment. The market is tiny. Maybe 20 years from now, it won't be tiny, and there's going to be a point at which the regulators there will say: you don't need any more new entrants here, and I'd like to be one of those.

And so we're looking for the right partner, and we've been public about that and have gone through long, long lists of partners and discussions and all of the rest. That won't move the needle one bit, certainly in my tenure, maybe not even the next one, but I think 1.3 billion people is worth the investment.

I'm just wary, a lot, of continental Europe. We love to compete against really good companies that demand really good results from their operations because the rising tide will just go and lift all boats. I don't see it on the continent. I don't - there's - the level of performance, broadly speaking, that you've got to compete against accepts a different kind of value creation than I think our investors could relate to. And so it might be appealing ego-wise to have a bigger platform, but I have no interest in that. We're zero ego here. None. I have more than enough to do with it.

So I put continental Europe kind of to the side. We're interested in South America. Obviously, we just did the start-up thing in Colombia through our joint venture in Brazil. But when you look at even South America, there's probably three countries - and we're in two of them now - where you'd say: gee, that's a thoughtful investment and the environment is stable and the rule of law is sufficient. And 10 years ago, you wouldn't have thought Colombia would be one of those either. So things can change but we look for those types.

So, I - yeah. I - I'm not - we'll look at anything, we'll look at everything, but what we have here right now is powerful, and you don't muck with it too lightly. You got to have a real purpose for these things, and sometimes the purpose is obvious, and sometimes it's less so.

Q - Unverified Participant

Well, let's talk about...

A - Jay Steven Fishman {BIO 1933251 <GO>}

These things being an acquisition, right? (15:12)

Q - Unverified Participant

Right. Exactly. Exactly. Let's talk about some of the businesses. Auto insurance – reasonably big business for you. What's your – give me your big-picture view of what this is going to evolve into, this business?

A - Jay Steven Fishman {BIO 1933251 <GO>}

So, first, I would – and I'm happy to share it. Don't take my comments as expertise. They're not. It's an observation from where I sit, but that doesn't – I'm no fortune teller here. What I do think is obvious is that the auto insurance business is changing and changing pretty rapidly.

We like to think of ourselves as being in the personal lines business. Half of our business is auto and half is home. And the home results have been stunning. Some are going to say, they really are. In one year in the last 10, we had a combined – in the homeowners business – in excess of 100 (16:06), and that was the year of Tuscaloosa and Joplin and – it was 2011. And Irene, is that what that was that year? I think it was Irene or Emily. I always forget which. But that was the only year that we were over 100 (16:26). Every other year, we've been Rita, Katrina, Wilma, Ike, Gustav, Dolly. It didn't matter. We're pretty good at it. I like it, and I'm pleased that we like it.

So, here's my take on it. I think it's possible if the world of weather continues to be as volatile as it is, that it's possible that 10 years from now, the lead in personal lines could be home and the follow-on could be auto as opposed to the way it has been forever, which is auto is the lead and the home is the follow-on.

Now, if we – the factors that tend to move in that direction are the changing weather. The lack of success that many companies have had capacity is not what people I think believe it is. There's – it's a struggle in some places, and so capacity is not robust. The cost of goods sold in the form of weather looks like it's changing. Those are interesting factors for people who compete successfully.

On the auto side, it's possible – I don't mean to sound like a dinosaur here. Clearly, I see the trends on – what is happening, so far, is that frequency, safer cars, more robust systems: it matters. So far, what's been happening is that frequency – because (17:54) affected is when frequency begins to really go down. It has not yet. It did in the past 10 years for more systemic reasons, I think, than safer cars. But what's happening is the severity goes up. You have a modest front-end collision and now you're replacing a camera and six radar systems and a computer chip and things that we never – it used to be replace a bumper. It's just not that way anymore.

So you got two competing dynamics there. You got frequency not yet going over the edge and severity rising. You're going to need a greater adaptation, more embracing of the technology in more of the fleet. So it's going to take a longer time for frequency to begin to trend down. And when frequency does trend down – I personally think it eventually will – I think it will be longer than most people think. When that does come down, I think it trumps severity. So 10 years out, 15 years out, automobile loss cost could be less than they are today.

If loss costs go down, premium is going to go down. It's just a function of the business. And so the size is going to matter more, scale is going to matter more, efficiency, and the ability, and I think what you've seen in the industry in the last couple of months with some interesting trades. I mean, generally, it's coming to the conclusion that being able to offer a homeowner's product has some real value to it.

And so I'm pleased, I really am very pleased that we are not a monoline auto company. I'd be just really struggling strategically with that now. And I sort of like the fact that we were – that we're not. But I can envision the time where property is a more substantial, more important line of business and auto less, and that will be interesting to watch.

Q - Unverified Participant

Certainly, it can be commoditized more quickly.

A - Jay Steven Fishman {BIO 1933251 <GO>}

Could be. It could be. Now, the funny thing is the closer you get to the right price for you, the less it's insurance. Like fundamentally, insurance is a subsidy one customer to another or one time period to another. If we actually get the right price for you, then you got self-insurance, and you're going to keep moving around your carrier trying to arbitrage one against another.

So it's an interesting – really fascinating time to think all the way through. I don't – I have a view about telematics, but I don't know enough about it yet for it to be particularly substantive. One: usage – and I don't mean by that behavior. I don't drive. I only go to the supermarket once a week. I believe that in that regard, the ability to record use, the telematics is useful, interesting.

I don't know yet whether you really get different underwriting outcomes, and that's really important because that's really all that matters. Do you really get better underwriting outcomes? I don't know. I guess other companies know that probably better than we do, and part of it is that the Travelers – there's a tendency to talk about the auto business as if all the customers are the same. It couldn't be further from the truth.

There's a set of behaviors and dynamics, and I will use the IFS, the insurance credit score, as a proxy for what I'm about to say. There's a set of behaviors around a 700 that are enormously different from the set of behaviors around a 600. Not a little different and not even the records, which are clearly different. But the behaviors are different too.

And so far, the Travelers historical customer base means more to the 700 by a lot than it does to the 600. That customer has not yet been so ready to embrace telematics. And you can get into all sorts of speculation as to why that is: your privacy concerns, and (22:01) so I'll save $100, who cares, or the agent doesn't really want to attempt to sell it because then he worries if the customer will perceive that privacy is an issue. I mean, you get to all sorts of human behavior, so the take-up rate for telematics in that, I'll call it the more right side of the spectrum, has not been substantial. It just hasn't been. That may change. It's possible over the next 20 years (22:24) will say sure, I get it.

And then, of course, you've got the basic structure itself. You got cars. You don't need – pretty soon, you're not going to need that box. You're not going to need the box. Then I wonder who owns the data? Is it the auto company's data? Is it your data as the driver? There's a lot of moving parts here and so we're – I don't know where – Greg (22:45) isn't with us (22:48). We're active in, I don't know, maybe eight states or something with telematics, or 10 states. It's not big time but even where we're active in it the takeup rate is just not significant. Now that can change too. The world's flat, right?

Q - Unverified Participant

Part of it is your customer base may not be the kind of people that would normally want to be tracked like that.

A - Jay Steven Fishman {BIO 1933251 <GO>}

At least so far in the personal line space. And by the way, this has nothing to do with us; this dates way back, the old – the real old days. Basically, you divvied up customers into three buckets, maybe four, non-standard, standard, preferred, and highly preferred. And then really smart companies got into this segmentation. Travelers was a preferred and highly preferred market, always was.

And so the expertise that has developed: its claim service, the way it responds, the way it bills. There's a billing difference between non-standard and highly preferred. You got to make sure you have equity in the policy as you get closer to non-standard. Otherwise, you end up with cancellations without premium. It happens a lot. So the billing systems are different. It's a different platform.

Travelers is historically really good at that end, and those are typically customers who come through agents, independent agents, sometimes captive agents over, but they're typically not doing it themselves. That may change. It certainly has changed slower than most observers of the industry would have contemplated 10 years ago.

The perspective was: in 10 years from now, there won't be an independent personalized agent left. Everybody will be buying direct. Well, not so much. So it's happening slower. It's good for our agency business, and we continue to invest in the direct channel. But as I – it just doesn't have the take-up rate yet.

Q - Unverified Participant

Yeah. I'm a Travelers insured, by the way, Miata (24:42).

A - Jay Steven Fishman {BIO 1933251 <GO>}

I could be your claims handler.

Q - Unverified Participant

Hopefully, there's no claims. Any questions from the audience? I've been monopolizing this conversation, but I'm sure there are some questions out there. If you have one, just raise your hand. We'll get you a mike.

I don't see any hands jumping up unless I'm being blinded. Let's move to just commercial lines for a bit. You've obviously done a good job of improving the margin. Then you've said that as we look into 2015, you may not see the margin improvement the way you've seen it. My question is: why not? Only because, yes, pricing has leveled off. It may not be exceeding claims inflation. But there's other stuff you as a company can do and have been doing.

A - Jay Steven Fishman {BIO 1933251 <GO>}

Yeah, and that's a good question, really good, actually. All of this conversation about margins started - really I'm going back to 2010 when we started trying to raise prices, and the conventional wisdom at that time was: won't work. It can't happen. If you don't try, nothing happens. So we tried, and - a whole variety of factors, but we were successful at it. And then we went into the period, if you remember, of can they get rate on rate? That was the deal - whatever that was: 2011. And then can they get rate on rate on rate? It's like it became silly. The whole conversation became silly.

But there was a point at which it was easy to say that margins are going to expand. If you're getting written rate of 7 points and your loss - your best estimate of loss trend is 4, it's easy to say that those two factors will result in a widened earned trend. Now, that could be completely offset by weather or large losses or anything else, but the conversation that many analysts were driving us to was: tell us about written rate and tell us about loss trend, because we get that. So, okay. Here it is. You asked the question. We'll answer it.

In the last couple of quarters, when the rate was at or around loss trend or even slightly below, we said: look, I don't - this is too close to call. I don't know. We're always trying to drive efficiency and economies - always. A good part of exposure that we measure is actually has the effective rate, but there's no way to really measure it. And so we said: we don't know. It's - I just don't know.

So I'm certainly not at the point, to your point, of saying to you that margins can't expand next year. I'm going to go back to the question that I get asked, which is everything else being the same, is written rate in excess of loss trend? No. It's not anymore. Written rate is not in excess of loss trend. By the way, I would tell you that we're not really trying to. We're not - we don't run the business for next year's margin. We run it for long-term customer value.

We want our best customers to be with us 5 and 10 and 15 years from now. We want them to feel good about the quality of service and the coverage that they received and we want to feel good about the return that we've earned from them as a group because, obviously, it's insurance, some accounts actually have losses.

So we're mindful of that, and we're all about the customer and the agent and the specific relationships. So we tell our field people: don't get hung up. Don't get hung up on loss trend being four (28:11), therefore I got to get four (28:05). There was a company, I don't know, maybe 10 years ago where – it was more than 10 actually. The piece went out to the field. We need 5 points on renewal for every account or don't bring it in.

So you get 5 points on anything that needs 10 and you lose all the accounts that need zero. But the numbers at the end of the quarter were 5%. So it looks great. And everybody says: we're really making good progress. Unfortunately, you've actually just diminished profitability.

So we give our field people, I suspect, more data at the point of sale than anybody and we say: use your judgment, be thoughtful and manage for the long term. So if an account has had terrific experience and the relationship with the agent is good and they've gotten increases two or three years in a row and our local field person thinks that it's best to renew it flat, fine, no problem. Good. Use your judgment. Locally, you know what's going on much better than we do.

So we don't perseverate nearly as much as many analysts do about the headline rate number. We're about returns over time and we're trying to figure out how do we drive claim efficiency, how do we improve our systems.

And we let the local field people with all their tools manage the individual rate conversations. Let me just give you a sense of the quality of data. I don't know what the number will be, but I know what our models say that our new business for the month of December, the return on allocated capital for that new business. Now ultimately, it's a model. The losses will be what they'll be.

But when I first started in the business, no one even talked about it that way. I can now – if someone says: what was the return on capital on the new business we wrote in December, I know the answer. Now I don't know what it'll end up being, but I know what the analysis tells us, pretty powerful stuff.

A - Unverified Participant

Unfortunately, that clock keeps going in the wrong direction now. We just passed the time. This has been a great discussion.

A - Jay Steven Fishman {BIO 1933251 <GO>}

I enjoyed it. I don't know if it's been interesting to anybody else, but I enjoyed it.

A - Unverified Participant

Well, me too. Yeah. Join me in thanking Jay, please.