S&P Capital IQ

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# The Travelers Companies, Inc. NYSE:TRV

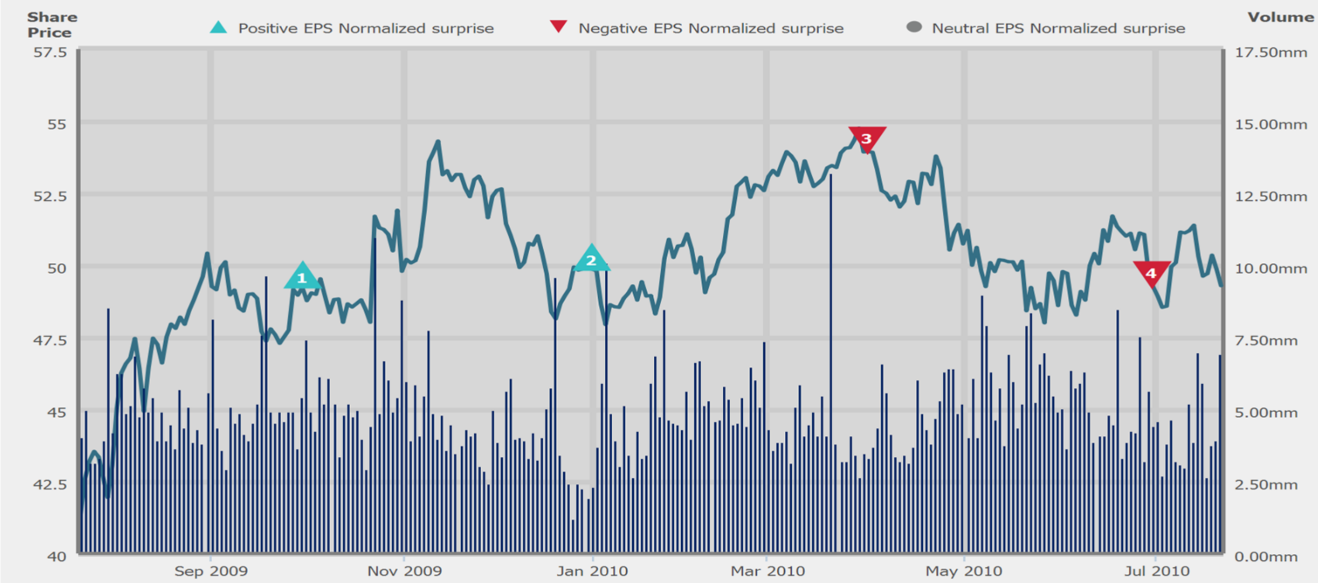
## *FQ3 2010 Earnings Call Transcripts*

Thursday, October 21, 2010 1:00 PM GMT

## S&P Capital IQ Estimates

| | -FQ3 2010- | | | -FQ4 2010- | -FY 2010- | -FY 2011- |
|---|---|---|---|---|---|---|
| | CONSENSUS | ACTUAL | SURPRISE | CONSENSUS | CONSENSUS | CONSENSUS |
| **EPS Normalized** | 1.46 | 1.81 | ▲23.97 | 1.62 | 5.70 | 5.86 |
| **Revenue (mm)** | 5404.21 | 5462.00 | ▲1.07 | 5527.37 | 22311.06 | 22462.25 |

Currency: USD
Consensus as of Oct-21-2010 1:46 PM GMT




- EPS NORMALIZED -

| | CONSENSUS | ACTUAL | SURPRISE |
|---|---|---|---|
| **FQ3 2009** | 1.32 | 1.61 | ▲21.97 % |
| **FQ4 2009** | 1.49 | 2.12 | ▲42.28 % |
| **FQ1 2010** | 1.37 | 1.22 | ▼(10.95 %) |
| **FQ2 2010** | 1.50 | 1.39 | ▼(7.33 %) |



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# Presentation

**Operator**

Good morning, ladies and gentlemen, and welcome to the Third Quarter Earnings Review for Travelers. [Operator Instructions] At this time, I would like to turn the call over to Ms. Gabriella Nawi, Senior Vice President of Investor Relations. Ms. Nawi, you may now begin.

**Gabriella Nawi**
*Senior Vice President of Investor Relations*

Thank you, Frank. Good morning, and welcome to Travelers' discussion of our third quarter 2010 results. Hopefully, all of you have seen our press release, financial supplement and webcast presentation released earlier this morning. All of these materials can be found on our website at www.travelers.com, under the Investor section. Speaking today will be Jay Fishman, Chairman and CEO; Jay Benet, Chief Financial Officer; and Brian MacLean, President and Chief Operating Officer. Other members of senior management are also in the room available for the question-and-answer period. They will discuss the financial results of our business in the current market environment. They will refer to the webcast presentation, and then we will open it for questions.

Before I turn it to Jay, I would like to draw your attention to the explanatory note on Page 1 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 projected in the forward-looking statements due to a variety of factors. These factors are described in our earnings press release and in our most recent 10-Q and 10-K filed with the SEC. We do not undertake any obligation to update forward-looking statements. Also in our remarks or responses to questions, we may mention some non-GAAP financial measures. Reconciliations are included in our recent earnings press release, financial supplement and other materials that are available on the Investors section on our website, travelers.com.

With that out of the way, here is Jay Fishman.

**Jay S. Fishman**
*Former Executive Chairman*

Thank you, Gabby. Good morning, everyone, and thank you for joining us today. We're very pleased with our third quarter results having posted net income of $2.11 per share, an increase of 28% over last year and operating income of $1.81 per share, a 12% increase over last year's math. Operating return on equity was a strong 14.3% and we experienced very solid underwriting results across each of our business segments. Our consolidated GAAP combined ratio was 90.6%. In an insurance pricing environment that remains largely flat in commercial businesses, we were pleased to produce an increase of 2% net written premiums for the quarter. Investment returns remained reduced from historical patterns as remarkably low interest rates, particularly short rates, continue to impact debt investment income.

Lastly, we've grown our book value from year-end 2009 by 13% to $59.11. All in, a very strong quarter. This morning we're going to do things a bit differently than we have in previous quarters. All of the data that we've historically provided is still included in our webcast. However, we're only going to hit the highlights and you can review the details on your own and obviously Gabby is available later to take any questions you may have. Instead, we're going to take the opportunity to share a few additional insights into our business that we think you'll find interesting.

First, we've spoken at length in previous presentations about our programs designed to grow our business organically. This morning, we're going to share with you summary analytics of our Business Insurance account growth and we suspect that a number of you will be surprised at the growth we've achieved.

Second, a number of you have asked about the impact of reduced interest rates on our net investment income. Jay Benet shared an analysis of the impact of reinvestment rates at an investor conference in September and we've updated it for current conditions. We've analyzed the maturities in our fixed income


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portfolio for the next three years and will share with you the projected impact on net investment income, if reinvestment rates remain at current levels.

The municipal bond environment remains a topic of some interest. We've updated an analysis of our municipal bond portfolio that we did for the second quarter webcast based on current ratings and market conditions. As we've said before, it is an actively managed portfolio where we are constantly evaluating risk and return of individual securities. There are never any guarantees, but we couldn't be more pleased with the positioning of the portfolio.

Finally, before I turn it over to Jay Benet, I want to comment on a topic that we're thinking about regularly. As we've discussed before, we believe the most thoughtful way to run a Property Casualty business for the long term is to produce superior returns on equity. As many of you understand, we can't promise consistent growth in either revenues or earnings and do so maintaining a thoughtful risk profile.

Consequently, a number of years ago, consistent with our aspiration for superior returns on equity, and given what we viewed as typical underwriting in investment environments, we determined that we would target a mid-teens return on equity over time and do so by achieving top-tier profitability and returning excess capital to shareholders. Two very important words in that previous sentence are over time.

Since January 2005, the first full year, after the merger of St. Paul and Travelers, our average annual operating return on equity is 14.1% and we've recorded more than $20 billion in operating income and have returned nearly $17 billion in total to shareholders, $13 billion in share repurchases and nearly $4 billion in dividends. Given the current general economic and investment environments, a few people have asked whether we intend to change our goal now. We're certainly not economists, nor do we know what the future holds. However, the underlying assumption we are making is that the economy will eventually return to a more typical investment environment, particularly with respect to the fixed income world. Consequently, we are not changing our goal now. Having said that, we've been very clear in the recent past that the current environment simply doesn't permit achievement of a consistent mid-teens return right now if one assumes no favorable reserve development and normal catastrophes and weather costs.

If in fact, the market ultimately presents long term, meaningfully reduced investment returns, not only for us but also for the market at large, which for us are not offset by improved underwriting conditions, we will obviously rethink what that means for our aspirations and what investors can expect of us. So for now our target remains intact, and we continue to execute in the marketplace consistent with that goal. We seek rates selectively and thoughtfully where rate is needed especially in those cases where account loss experience has been inconsistent with our underwriting expectations. But we are always managing rate and retention with a clear view of maximizing long-term value to arbitrarily and aggressively seek rate and be a victim of adverse selection and watch our retention drop precipitously would not be a smart or thoughtful reaction to the current environment.

As Brian will explain in greater detail, our field people take their lead from us and right now, their direction is unambiguous. We feel great about how they are executing, and we believe that we will continue to be amongst the best performing property and casually companies around.

With that, let me turn it over to Jay.

**Jay Steven Benet**
*Vice Chairman and Chief Financial Officer*

Thanks, Jay. I'd like to start with a few overall comments about the quarter relating to Pages 4 through 10 of the webcast. Operating results x cat [catastrophes] and favorable reserve development and including net investment income were generally in line with our expectation as they have been all year. Our third quarter results benefited from a relatively low level of cat, so $117 million pretax, which was lower than prior year cat losses of $158 million pretax as well as what we would "normally plan" for in the third quarter.

I would remind you though that year-to-date, cat losses have been quite high over $1 billion on a pretax basis as compared to $441 million pretax in the first nine months of last year, which would approximate a more normal year-to-date amount. We had another quarter of net favorable prior-year


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reserve development in each of our segments concentrated this quarter in BI and FPII. The quarter's reserve development included an asbestos reserve increase of $140 million pretax. Included in this asbestos reserve increase and therefore, in the current quarter's operating income was a $70 million pretax benefit related to the recent favorable ruling we received against Munich Re and certain members of ECRA [Excess Casualty Reinsurance Association]. The total awarded to us by the court in this ruling was $417 million broken down as follows: $251 million owed to us under the terms of the reinsurance agreement and interest of $166 million.

Based upon this ruling, we reduced our uncollectible reinsurance reserve by $70 million, thereby reflecting in our financial statement the full $251 million owed to us under the terms of the reinsurance agreement. Importantly, the benefit of the $166 million interest award was not reflected in either the current quarter's asbestos charge or in the current quarter's operating income since GAAP requires this interest to be treated as a contingent gain, generally until all appeals have been exhausted and/or the dollar amount is received. All of our capital leverage and liquidity measures remain at or better than target levels. We have holding company liquidity of $2.8 billion at the end of the quarter, which was more than twice the target level due to the timing of share repurchase activity and the timing of dividends from our operating companies for our holding company.

During the third quarter, we repurchased $600 million of our common shares, a higher amount than we would normally repurchase in the third quarter due to the strength of our balance sheet and the light wind season we have experienced thus far and paid $169 million in common stock dividends, bringing the total cash we returned to our shareholders in the past nine months to almost $4 billion.

Third quarter operating ROE was 14.3% and book value per share once again increased, up 6% in the quarter and up 15% from a year ago.

Page 4 makes reference to our very high-quality investment portfolio, which includes a $4.6 billion pretax net unrealized gain at the end of the third quarter, up significantly from the $2.8 billion pretax net unrealized gain we reported at the beginning of the year. A little over 60% of the net unrealized gain relates to the muni bond portfolio.

Page 5 provides an update of certain data we previously provided to you related to our muni bond portfolio. There have not been any significant changes in the portfolio recently notwithstanding our active management of the portfolio based upon a risk reward view for each individual holding due to its very high quality. The portfolio currently includes bonds that have gross unrealized gains of $2.8 billion pretax and bonds that have gross unrealized losses of only $8 million. That's right, only $8 million of losses, not billion.

I'd also like to make some specific comments related to Page 9 of the webcast. During the presentation I made at a recent conference, I referred to today's low-interest rate environment and provided an illustration based upon our portfolio scheduled bond maturities in 2011, 2012 and 2013 of the impact on net investment income in those years if the current interest rate environment persists through this period of time and all of the variables such as average assets, mix, credit quality and duration, remain constant. The illustration I provided at the conference was based upon reinvesting at ten-year rates or approximately 100 basis points lower than the combined yield on the maturing bonds rounding the interest rate differential to the nearest 50 basis points.

Since then, interest rates have fallen even further and we have updated the illustration to reflect a 150 basis point interest-rate decline. We've also added another line to the illustration, that shows the differential between 2010 NII and the subsequent years, again, all of the variables being held constant that includes the partial year impact of reinvesting 2010 maturities of lower interest rates. The full year impact of this activity will not be felt until 2011 and subsequent years, since the 2010 maturities will have taken place throughout 2010 rather than on the first day of the year. As you model these years, I would remind you that NII will also be impacted by the reduction in average invested assets that results from our share repurchase program.

And with that, let me give the mic over to Brian.


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**Brian W. MacLean**
*President and Chief Operating Officer*

Thanks, Jay. [Audio Gap] webcast live. Our typical disclosures on the business segment results are on Pages 11 through 22, and we will of course take questions on any topic. Instead of going through the slides, I will give a few perspectives on our businesses and the marketplace.

In Business Insurance, we continue to be very pleased with the positioning of our franchise. Both our account retention and flow of new business opportunities remain near historically high levels, which we believe will enable us to grow premiums if and when the economy improves. Core underwriting margins continued to contract modestly in the quarter, consistent with both prior quarters and our expectations. In short, the lost cost trends slightly outpaced earned rate changes. We continue to see the negative impact the economy is having on our insurance exposures. Audit premiums, which are retroactive premium adjustment charged to reflect changes in insured's payrolls, vehicles, property values or business receipts have improved, but are still negative. The exposure change on renewals, which is a prospective look, has also improved throughout the year and is now approaching zero.

On a combined basis, these impacts are reducing premiums approximately 2% through the third quarter. So in other words, our data suggests that the economy is bottoming out, but we don't see any evidence of current economic expansion. Given these trends, our underwriting strategy remains consistent: Retain our quality business; optimize the profitability on this retained book by getting rate where it is warranted; and write new business for long-term profitable growth.

Directionally, this strategy may be the same as many of our competitors, but by aligning it with our competitive advantages, namely our talent, technology, actionable management information and breadth of distribution, we believe we are very well positioned. Over the last seven quarters, we've seen significant account growth and as a result, we believe that we're growing market share.

On Slide 16, you can see that since year end 2008, we've grown accounts in Business Insurance by a 8.5% compound annual growth rate. On the next slide, we've taken this data and broken it out for two of our of major business.

In our small Commercial business, or Select Accounts, you can see that it is growing by a 10.6% tagger. This increase has been driven by our Select Express product, that's our no-touch insurance solution for small business customers. Through the combination of our sophisticated rating capabilities and cost-efficient front-line delivery, we are able to provide our agents and customers with an industry-leading product and platform. Within Select, in the plus end, or the larger end of this market, we have allowed our accounts to decrease, decrease due to extremely competitive market conditions. On the slide, you can also see that we've grown Commercial Accounts by 4.4% compound annual growth rate.

The increase in the number of accounts in this business is driven primarily by the continued introduction of new products and the specialization and expertise of these products and our front-line underwriting and claim staff bring to the marketplace. This growth in Commercial Accounts is representative of what we are seeing across our middle market businesses. So we are encouraged by this increase in the number of accounts, and again, if and when the economy improves, the resulting impact on exposures should create a compelling written premium trend. Given both this top line dynamic and the current core underwriting profitability of this book of business, we remain very pleased with Business Insurance's current performance and its position in the marketplace moving forward.

In the Financial, Professional and International segments, I will make just a few overall comments. First, writings in our International businesses are down compared to prior-year quarter as we are addressing risk and pricing in light of catastrophe and other severe weather losses over the past year. Secondly, although we remain very pleased with the market position and quality of our Construction Surety business, the impact of the economy on construction spending has resulted in fewer new business opportunities, and our writings in this quarter reflect this. And lastly, we continue to monitor the analysis on impacts of the financial marketplace disruptions on our Management Liability business and our conclusions remain the same, that is, our losses are developing within or slightly favorable to our expectations.


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Turning to Personal Insurance. We are extremely pleased with both the underwriting and production results in the quarter. In both Agency, Auto and Property, policies in force continued to grow and core underwriting margins expanded as earned rate increases outpaced loss cost trends. In our Property line of business, weather losses were both less than third quarter expectations and a welcome relief from the pattern we saw in the first half of the year. While the continental U.S. was not meaningfully impacted by any of the storms generated during the peak of the hurricane season, the number of near misses this quarter highlights the importance of underwriting controls and risk management policies in this business.

Agency Property production results for the quarter continued to be strong in spite of the difficult housing market, with quarter-over-quarter PIF growth remaining at historically high levels. In Agency Auto, our new business continued to improve and we had our best quarter-over-quarter policies in force increase since the end of 2008. Given the continued expansion in core underwriting margins and strong top line trends, we remained pleased with both our current and going-forward positions in these businesses.

So across all of our businesses, we feel great about our execution in the marketplace. And one of the primary reasons we believe our organization has executed so well in these times of uncertainty is that we have kept our message to the field clear, unambiguous and consistent. And that is, in these market conditions, just like pretty much any other, the role of our underwriters is to maximize the long-term value of the portfolio. To balance the desire to keep our quality business while at the same time optimizing the returns on that portfolio.

Fundamentally, they do that by making sure they understand the account's risk characteristics and can estimate the potential losses from these exposures. They then seek the select risks in the marketplace where the premium level is appropriate for this view of the losses. We believe our field understands their role, has the best tools in the business to execute and as long as they can keep doing this, we will keep competing in the marketplace successfully.

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

**Jay S. Fishman**
*Former Executive Chairman*

Thanks, Brian. Page 23 summarizes our updated guidance for full year 2010. Fully diluted operating income per share, which we've increased from the previous range of $5.20 to $5.45 to a range of $5.75 to $5.95. In round numbers, this should translate into an operating ROE of just under 12%. We're now assuming cat losses of $765 million after tax or $1.58 per diluted share, which incorporates our actual cat losses for the first nine months of the year and our original estimate for the fourth quarter. No further estimates of prior-year reserve development, either favorable or unfavorable. A low single-digit decrease in average invested assets x unrealized gains and losses resulting from a reduction of holding company liquidity due to the share repurchases, full year share repurchases, of $4.5 billion to $5 billion and a weighted average diluted share count after share repurchases in employee equity awards of approximately 485 million shares. Jay would like to say some additional comments before we go to Q&A.

**Jay Steven Benet**
*Vice Chairman and Chief Financial Officer*

Thanks, Jay. Just before we open it up, we've had a pretty good run here for some time and the folks around this table, I think, actually get an undue amount of credit for that performance. We've publicly acknowledged all the folks in the Investment Department who have done a remarkable job in unprecedented conditions of keeping this company moving ahead. But the fact is, and I want folks who listen to these calls and I just want to spend 15 seconds letting 30,000 people know that we recognize the business is done in the field a trade at the time and we couldn't be more appreciative of the underwriting discipline and the thoughtfulness and your attention. And I don't care whether they're Commercial lines underwriters, or Personal lines underwriters, or they're in claim, or technology, or ops, or risk control. This is a complicated business and we've got 30,000 folks who understand it and keep the organization moving ahead and I just want to take a minute to say thanks.
And with that, operator, were going to open it up for questions.


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# Question and Answer

**Operator**

[Operator Instructions] Our first question comes from the line of Keith Walsh from Citi.

**Keith F. Walsh**
*Citigroup Inc, Research Division*

First for Brian, on Auto. Lots of talk in the industry about positive rate trends. So why the decision here to loosen terms and conditions with the 12-month product? And also if you can comment on the direct initiative, where we stand and I've got a follow-up.

**Gregory Cheshire Toczydlowski**
*Executive Vice President and President of Business Insurance*

Keith, this is Greg Toczydlowski, from Personal Insurance. On the annual policy, first of all, I'll take that one. There's a number of dynamics that we look at in the annual policy. Some of them being agency selling behavior, retention and pricing. And we look at all those dynamics together. We thought it was the appropriate time to drive that inside the business and I think the margins and the growth are showing that. That's clearly not the only feature that we've been throwing out there into the marketplace that has a positive impact. But when we look at all them, we feel good about having that in the product.

**Jay S. Fishman**
*Former Executive Chairman*

And maybe just an observation on that, that agency costs matter very much in the equation too, and instead of dealing with obviously two renewals year, you deal with one. Not any significant difference. On the direct initiative, we don't actually have a lot to say. We continue on course with the plan that we set. We said we were going to be investing and losing money, and in fact, we are. On the positive side, we're beginning to learn a fair amount about that customers that respond. What they find attractive in the value equation and I'll let you know we're doing about 5,000 policies a month in our direct initiative now. And so we're on our way to learning. But make no mistake, we do it as a very long-term investment.

**Keith F. Walsh**
*Citigroup Inc, Research Division*

And Jay, just a follow up on pricing. I acknowledge your comment that you said you've always been very strong last several years, but the charts show clear price deterioration. Why the continued focus on growing in certain business lines here when clearly the accident year ROE is probably sub-10% at this point.

**Jay S. Fishman**
*Former Executive Chairman*

I think the second half of your question, or the statement, is actually just in error. We look at a lot of data. In fact, I'm not sure anyone analyzes data any better or more robust than we. And I will tell you that even assuming current reinvestment rates now, current reinvestment rates now, the portfolio, meaning the combination of renewal and new on our Business Insurance business is not in single digits. It's actually better than that. Now, the dynamic is we're focused on -- I thought my comments really were fairly specific about this. We are focused on retention and I would say taking new business selectively. No one should come to the conclusion that we are focused on growth. There isn't anything in the comments or in the data that should point anyone to the conclusion that we're focusing on growth, as the words you used. It is a very selective approach. It is not only based on price, but it's risk selection. We spend most of the time on these calls speaking about rate. Our folks in the fields spend most of their time focused on risk selection. So it's as I said, a complex business where you balance the elements, I just couldn't be more pleased with how we're managing through this largely unprecedented environment.

**Operator**


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

**Jay Adam Cohen**
*BofA Merrill Lynch, Research Division*

I'll just ask about what you guys addressed then. The first is, Brian, I think you mentioned that your core combined ratio in Business Insurance have gotten worse. But it looks like it's gotten better. And I'm wondering what's driving that? That x development, x catastrophes. And then secondly, maybe for Jay Fishman, when you think about your ROE, are you making any adjustments for your own cost of equity capital? Given the changes in interest rates, presumably that has to come down as well.

**Brian W. MacLean**
*President and Chief Operating Officer*

Frist on the combined ration, and I'll throw it to Jay Benet, for some of the specifics. But obviously, every quarter, there's stuff running through the combined. We still see when we net out everything that we think is unusual, a slight deterioration in what we call the core combined ratio. But, Jay, why don't you go through some of the changes?

**Jay Steven Benet**
*Vice Chairman and Chief Financial Officer*

Yes, Jay, in any period of comparison, we try to look at, as Brian said, what are the key core underlying trends of pricing and loss costs. But there are also things that will impact it. Small weather, non-cap weather in one quarter versus another or year-to-date one year versus another. We've talked in the past about large loss activity. Last year, we made a re-estimation of the full year loss pick for Business Insurance in the fourth quarter. We also did that in the third quarter. When you do that, it impacts prior quarters of the current year. So I think when you see the full year results, you'll see more of what Brian is talking about and if there are acts associated with large loss activity and small weather, we'll try to point that out as well.

**Jay S. Fishman**
*Former Executive Chairman*

In terms of the return on equity, it's actually an awfully simple story. The return on equity that we publish in our press release and in our financials is straightforward GAAP return on equity, which is the earnings that we reported for the period divided by average equity for the period. And Jay and Doug can take you through all of that. We obviously understand that if our entire $70 billion investment portfolio were repriced today at today's reinvestment rates, what we would end up with a different return -- we understand that. Internally, the analytics that we have, we actually do look at it that way. We actually do evaluate products and businesses and lines based upon investing cash flows at today's available rates. And it's those analytics that form the basis of our pricing strategy and our volume strategy, and they are proprietary. They are important, they are the subject of substantial discussions here and it's that return that gives us our approach to whether we're aggressively growing, not aggressively growing or willing to shrink. Bryan spoke today about letting the large end of select shrink, because the pricing was such and the risk selection was such that the returns simply aren't adequate to support the business. So we're letting that shrink somewhat. And certainly, we understand that one of the reasons that Jay presented the schedule about investment income is that if these investment markets continue, if they are what they are, and the underwriting environment never changes and there's no more favorable development, yes, we're not going to be able to achieve the mid-teens return on equity and we certainly understand that and it's actually not all that difficult to model up the business and see what you think it is. We certainly do it all the time, and it can be achieved. It's all pretty simple, the numbers that you get in the press release are GAAP, things that we're all accustomed to getting. And internally, we have robust analytics that let us evaluate the current, underlying profitability based upon today's reinvestment rate and that's what establishes our underwriting energy or enthusiasm.

**Jay Adam Cohen**
*BofA Merrill Lynch, Research Division*


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My question really is around the hurdle rate, what you need. In other words, if you're comparing your ROE versus your own cost of equity capital, if that cost of capital has come down, shouldn't the hurdle rate come down as well naturally?

**Brian W. MacLean**
*President and Chief Operating Officer*

That actually gets to the comments that I made and it's just absolutely spot on. There has, at least in my career, never been a period where the gap between the cost of debt and the cost of equity has been any wider than it is today. I find it actually remarkable that there are high-quality equities where the dividend yield is actually higher than the debt yield on the ten-year debt, high-quality companies. So it tells you that the marketplace is at the moment, somewhat upside down. And the real question that you're asking, and I think it's an extraordinary relevant one, is that going to continue? Can you possibly be in an environment where the two-year Treasury is at 2.4% and the cost of equity is a 10%. Or will there not be other Treasury activities that will take place? But in one fashion or another, we'll lower that gap, reduce that gap into a more normal historical range. We're extremely attentive to it. One can speculate that one way that the cost of equity will go down is a rising equity market. And some folks have asked me, gee, why do you think the market generally is rising now? One of the answers to it, is that it's reflecting a decline in cost of equity. It's somewhat counterintuitive to think of it that way. But frankly, it's entirely possible. So I don't know what the cost of equity will be in a few years. My guess is, is that if you've got a financial company three years from now, in today's environment, and you look back three years from now and the company has achieved a 10% period on return on equity, you'll feel great. You won't feel good, you'll feel great. And if you look broadly at the financial services arena, and we do and I do, and you look at the returns that institutions are producing, particularly in the banking arena where the rules and regulations and leverage dynamics are changing so much, I think that the dynamic of what returns are going to be over the next few years is a fascinating question and what it is that investors are going to seek. But my comment was for now, our goal is our goal. We will do the best we can. We are not going to act arbitrarily and go out to the marketplace and say, worst thing in the world to do is to go out to the marketplace and say we want five points of rate on every account. You'll get five points of rate on accounts that need ten, and you'll loose accounts that don't need any. The easiest way to get adverse selection is to take away the underwriter's authority to evaluate risk and return on an individual trade. So no mystery here. We acknowledge the environment is not possible right now. Not you that can't achieve mid-teens returns, but the two words, over time, are just critical to us. And that's how we think about. This is a long-term business and we manage it over time.

**Operator**

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

**Brian Robert Meredith**
*UBS Investment Bank, Research Division*

Jay, if you could talk about the general administrative expenses in the business and it shooted a big, big drop this quarter. Anything unusual going on there?

**Jay S. Fishman**
*Former Executive Chairman*

I'm going to sound like I'm repeating myself a little bit from Jay Cohen's question, but as it relates to the expenses, again, in any quarter you can have some things go up and some things go down. I think last year, we had some assessments that came through in the third quarter. This year, we had some credits that came through in the third quarter. I think overall, we've been very thoughtful in trying to manage our expenses and keep the expense ratio in line. And those are the kinds of things that have created the period-to-period variability. But there's nothing in particular from an operational standpoint that's driving it. We do have differences in timing of things like advertising costs and travel that go through. I can't think of anything in particular that I'd point to that says this is a fundamental change.

**Brian Robert Meredith**
*UBS Investment Bank, Research Division*


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Is there like an underlying kind of rate we can think about or were expenses kind of flat? Are they down a little bit? Just trying to kind of think about it going forward. I don't want essentially drop expenses by 10% a quarter here going forward.

**Jay S. Fishman**
*Former Executive Chairman*

I would say relatively flat, particularly if you look at it on expense ratio basis.

**Brian Robert Meredith**
*UBS Investment Bank, Research Division*

The second question for Bryan. Loss cost inflation in the Commercial lines area. We've heard a little bit this quarter about some pickup and some loss cost inflation from some other companies. I'm wondering what you're seeing?

**Brian W. MacLean**
*President and Chief Operating Officer*

So splitting it into two pieces. Frequency, for us, has been very flat and granted that is compared to last year and the year before where we were having some significant declines in frequency in some of our businesses. So the declines have leveled off, but we're still pretty pleased with where they are leveling off at. The core loss inflation or severity component of it, is pretty benign. It's not a zero, it's a plus number, but it's a mid-to-low single digits-plus number. So overall, loss inflation continues to be in a pretty good place for us.

**Operator**

Our next question comes from the line of Cliff Gallant from KBW.

**Clifford Henry Gallant**
*Keefe, Bruyette, & Woods, Inc., Research Division*

There was recent news about Chinese drywalls and a settlement that like State Farm was reaching. I was wondering if you have any comment or update on your view on Chinese drywall. And second, I was wondering if you could care to speculate on sort of a larger basis what you think the industry accident year combined ratios or should say the industry accident year ROEs look like in comparison to what you're reporting.

**Jay S. Fishman**
*Former Executive Chairman*

We have enough trouble keeping track of our own. We're going to pass on trying to estimate what the industry is.

**Doreen Spadorcia**
*Former Vice Chairman of Technology, Claim Svcs, Ops & Risk Control*

Good morning, this is Doreen Spadorcia, I'll take your Chinese drywall question. Bottom line, we haven't seen anything that would cause us to change our view that we talked about previously. I think we showed you slides in the first quarter. We just don't think it creates a significant exposure to us. And basically, what's changed since the first quarter, is we probably got a few more insureds that have made claims against us. And then on the positive side, we actually had a ruling in the district court in Virginia finding that our Homeowners policy does not provide coverage for Chinese drywall. The State Farm settlement, there have been some multi-district issues. There are two cases pending that have a lot of class action in places as well as a number of defendants. And some companies that have had large homeowner populations, have chosen to participate with some of those settlements where you've seen some of the Chinese drywall manufacturers and some distributors putting in some dollars. But for us, we have not participated in those given where our exposure is and the positive ruling that we received.

**Operator**


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Our next question comes from the line of Matthew Heimermann from JP Morgan.

**Matthew G. Heimermann**
*JP Morgan Chase & Co, Research Division*

First, could you give us a little bit more color on the BI account growth slide you showed? I'm curious, one, whether or not there's a dramatic difference in account size for the new accounts versus maybe the existing book if you back to year end '08. And also just given what we've seen in premium, could you maybe just discuss how the exposure trends at those new accounts maybe contrast with exposure change on the existing book?

**Jay S. Fishman**
*Former Executive Chairman*

For starters, on the mix dynamic within the account growth. We tried to break out the Small Commercial from the middle market, and obviously, in small Commercial, we are absolutely growing it from a mix perspective in the smaller end. So that's driving some of the dynamic of the total. But within that, the expressed component of Small Commercial, which would have a fairly consistent account size is growing dramatically, so we feel good about that.

**Jay S. Fishman**
*Former Executive Chairman*

Importantly, Select Express is the technology platform that we introduced now, I don't know, maybe three years ago, that has really dramatically changed the way the smallest end of our Small Commercial business is processed. I discussed this before, but the predecessor platform was 20% underwritten in the technology, 80% was referred out to underwriters for review. This is a very slow approach to the smallest end of the business, 80% now is done in the technology and only 20% comes out for human intervention. So it is dramatically different. That forms the basis of the flow. The significant increase in quote activity that we've seen from ages. We are just being quoted a whole lot more with this platform because it's easier and more efficient. And as a result, that business is growing significantly. It is at the smallest end of the Small Commercial business.

**Brian W. MacLean**
*President and Chief Operating Officer*

I think, Matt, I mean correct me if I'm wrong, the gist of your question is, are we getting the growth just because we're shifting mix? Or do we think we're actually growing like type of accounts. And the answer is, there's a piece of it that's mixed but the bulk of it is we're growing like type of accounts.

**Jay Steven Benet**
*Vice Chairman and Chief Financial Officer*

In the middle businesses, the average account size of what they needed to do was fairly consistent with our renew book of business. And the difference between the account growth and [indiscernible] is basically the exposure, the audit premium and the renewal exposure change your -- not increase in year-over-year.

**Matthew G. Heimermann**
*JP Morgan Chase & Co, Research Division*

The other question I had was I needed to follow up on Brian -- actually maybe I'll ask a different one, on the direct side, are you -- I think you used the word experiment, Jay, but it looks like the premium volume is starting to settle at sequentially low to mid-$20 million on a quarterly basis, would expect that to grow, I would assume. But I guess are you proactively kind of trying to restrain the growth in that channel, to you ensure, you kind of understand the dynamics, or are you now at a point where growth will be what it will be, you kind have a more clear view of the appetite and some of the variables that you want to pay attention to?

**Jay S. Fishman**
*Former Executive Chairman*


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I'll give you my perspective and I'll ask Greg to chime in as well. It sure is closer to the former than the latter. We're actually -- I wouldn't say constraining, that's not quite the word. But what we are doing is really only doing that amount of business that we need to do to continue to advance the learning. And the learnings are, how do we get a customer to respond to an ad? How do we get that customer either through our call center or our technology platform to actually end up with a quote? How do we convert that quote to a sale? And then most importantly, who are we bringing in? And what's the loss experience? What we've said, the pricing track we're using for direct is the same pricing track we use at our agency plant. It is our presumption that the loss experience between those two groups will be different, that the act of where one purchases is an identifying characteristic, a projecting characteristic of loss experience. So we're just trying to do enough to keep the learnings moving ahead. We are not remotely at the level now where it's go invest in advertising dramatically, and whatever we can do, we can do. But, Ed, please...

**Brian W. MacLean**
*President and Chief Operating Officer*

To echo Jay's comments, we spend a lot of time watching the economics and the operational expectations of the business and they're both right within the targets of where we want to be. As Jay said, the function of the top line is how we advertise, how we entertain ourselves out in the digital space and clearly, that's the amount of investment that we've put in this. I think it's a fair assumption that if you look at the last three quarter's run rate, that's a fair assumption of what we could expect for this business to continue running that 12 months going forward. And as Jay said, we're really trying to really maximize our learnings with minimizing the investments inside this business, and as we get more of those learnings, we'll continue to grow the business, so very cautious in how we're doing it.

**Jay S. Fishman**
*Former Executive Chairman*

Wouldn't characterize it by the way as an experiment. An implication of that is, is that we're committed to making this work. And it will take years, it will take years for us to get to the point where it gets to breakeven or frankly becomes profitable. But we are committed to getting there and what we're doing is to Greg's exact point, is balancing the cost of investment with the value of the learnings that come out of it.

**Matthew G. Heimermann**
*JP Morgan Chase & Co, Research Division*

Based on your last comment then it isn't fair to kind of think about Quantum has a parallel in terms of -- because I think there was about a 24-month period of kind of rolling that out into the point where you were fully comfortable just letting it run.

**Jay S. Fishman**
*Former Executive Chairman*

No, it takes much longer than that.

**Operator**

Our next question comes from the line of Jay Gelb from Barclays Capital.

**Jay H. Gelb**
*Barclays PLC, Research Division*

I want to ask a broader picture question on the situation with the bank dislocation with regard to mortgage servicing. Could you talk about how or what the implications might be from the insurance side on that, from a directors and officers and as a remission's perspective? As well as what the implications could be for Travelers' investment portfolio.

**Alan David Schnitzer**
*Chief Executive Officer and Director*


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Jay, it's Allan Schnitzer, let me take that first piece of that related to the Insurance business. It's early days, and when I say early days I mean, in the context that we're still learning about the facts and circumstances. And so it's hard to really come up with a definitive insurance exposure perspective in that environment. But having said that, we've taken a look at our exposure to the top 15 Mortgage Servicers and our exposure is really very, very limited there. That is in some respects a fall-out of the credit crisis underwriting we've been doing going back to the first and second quarter of 2007. So all of the big names that you and we've been reading about in the news where -- we have very, very limited exposure there. We don't view it as an exposure, really, to the community banks and we think that's because they just haven't been foreclosing in the kind of volumes that would've involved the processes that are really in question here, and we haven't seen any indication that, that's the case. So at least early days from an insurance perspective, we're not viewing it as an outside issue for us.

**Jay Steven Benet**
*Vice Chairman and Chief Financial Officer*

On the investment side, just first a couple of facts. First, our entire portfolio of subprime in [indiscernible] ABSs are actually $300 million and $200 million of that was 2004 and prior. We've added $100 million selectively since the crisis began, so not a significant investment there. Still very highly rated. On the residential CMO side, we've got $2.3 billion of that, again virtually all 2004 and prior. We turned away from the market as both the mortgage market and the real estate market really heated up. $862 million of it is agency and $1.4 billion is non-agency. The facts and circumstances of this -- of what actually is happening and the implications are as confusing as I've ever seen it, it's not at all clear what the long-term issue really is. If we're talking about episodic, relatively short-term delays in foreclosure activity, our assessment is no problem with respect to the investments. And we've already seen some of that episodic, short-term delay. At the other extreme is the notion of a long-term, industry-wide, broad-based foreclosure moratorium. We don't know how to assess that. I don't know how to assess something that actually has never happened before. And frankly, I think of all of the issues that will occur, the impact on asset-backed securities may actually be the smallest in that kind of an environment. So I don't know how to size up that kind of long-term, broad-based moratorium. Again the episodic short-term stuff, we could be wrong on this, but our assessment is no underlying problem. With respect to the flip side of the issue, which is the ability to put mortgages back to the originating institutions, of course the GSEs have always had that. There's nothing particularly new on that front. And again, we could be wrong on this, but our assessment has been that it's hard for us to figure out a scenario where mortgages get put back to their originating institution and the bondholders lose. The originating institution seems to me could be in a position to lose, but we have some difficulty figuring out the scenario where the bondholder loses. But early days on this would even be an understatement. It's right at the beginning.

**Jay S. Fishman**
*Former Executive Chairman*

I wouldn't add much, you obviously read the story about PIMCO and the Federal Reserve Bank of New York, and semi weather to Bank of America with a list of 150 new pools where they would like to see mortgages put back. We looked at that base, by the way, we found we own three of them. I think there are three cross currents, one, the validity of foreclosures which have taken place. Two, would be ability on a prospective basis to foreclose, and of course they're beginning to get more particular in terms of what they demand and that's probably good. And three, the whole put-back phenomena. And they would cut differently across the portfolio. My guess is the probability of any of the three having a significant impact to us or anyone else, it might be more remote than the newspapers are suggesting and whatever happens is going to happen over time. To the extent that there's a put-back phenomenon, we would benefit. It's easier for GSEs to put back mortgages than non-agency pulls, because all the GSEs have to do is to prove they weren't performing. So we'd be beneficiaries, but we're not counting on much.

**Jay H. Gelb**
*Barclays PLC, Research Division*

Just to circle back to the property casualty exposure, is there a stand-alone mortgage servicing ENO type of coverage that would be meant to respond to that? Or is that all sort of lumped into the broader bank DNO and ENO programs if there's availability for that these days.



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**Jay S. Fishman**
*Former Executive Chairman*

When we think about our exposure, it's way heavily weighted towards the DNO and ENO side. And again, underway on the larger institution, there is coverage that I think is available in that market, we just don't write a lot of it.

**Operator**

Our next question comes from the line of Vinay Misquith from Credit Suisse.

**Vinay Gerard Misquith**
*Crédit Suisse AG, Research Division*

On the personal order side, could you provide some color on your PIF growth in the agency channel? Some of the buying that the direct ways, the way it's going, you seem to be growing in that channel pretty well.

**Gregory Cheshire Toczydlowski**
*Executive Vice President and President of Business Insurance*

This is Greg Toczydlowski again. We've been focused very much on a couple of areas. One that we've talked about earlier is some of the features in the Automobile and, two, is some of our geographic expansion. We've seen an under-penetration in the Midwest and the West, and we've been appointing agents out there over the past few years. And based on those two really has been driving some of the sequential tip growth that we have inside the book of business.

**Vinay Gerard Misquith**
*Crédit Suisse AG, Research Division*

It appears that you're happier to take maybe pricing down just a tad just to keep your business and to grow little. Just wanted your perspective on the risk to that strategy. We are at all-time historical lows in terms of frequencies. Do you think that this is the right time maybe to grow your business?

**Jay S. Fishman**
*Former Executive Chairman*

I'll let Brian step in, I -- I want to start off with the premise that we have to go and strategic imperative number one, two and three is retention. And again somehow the conversation always seems to kind of drive to growth, but we start out with a focus that the book of business that we have is the book of business that we understand that's priced appropriately, that has the highest return. And so we approach our retention book in a very, very thoughtful kind of way. The growth dynamic that you're seeing here in the charts, the account growth I'm going back and talk to the fact that one is driven by Select Express, which is a technology platform that lowers costs, lowers agent cost, lowers our costs significantly and so it's been a platform-based dynamic of growth, not price based, a platform-based dynamic of growth. And in Bill Cunningham's, in his middle market business, it's really been about new product development and rollout. We've provided lots of information about that previously, not a price-driven strategy. And again the data is so clear that it supports this. You're looking at retention that is at historical highs and renewal pricing that's more or less at flat, a little below or flat. And so our focus is not -- and it just seems to get confused to some folks, is not to cut price to aggressively grow our book. It's to use our competitive advantages where they exist like Express, like the new product development in middle market that allows us to work the geography that Greg spoke about. Where there are ways to grow your business without being pricing competitive to do it.

**Brian W. MacLean**
*President and Chief Operating Officer*

And then the other dynamic within pricing, and you used the right words, I mean, if you look at any of our Business Insurance statistics that are in the package, the negative price we're talking about is somewhere around a negative one. And we've talked about this a lot in the past and Jay, touched on it. It's the spread across the portfolio that really matters there. If we were getting minus one on each and every account,


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that's one strategy. We've got accounts in here where we're getting plus tens, and we've got accounts that are certainly getting minus tens. It's blending to something pretty close to neutral. We feel good about the profitability of our book, and we wake up every morning wanting to retain most of those accounts. So I think to characterize our strategy is taking down prices to grow in our minds is not consistent with how we think about it.

**Jay S. Fishman**
*Former Executive Chairman*

I want to take the opportunity to clarify something because I'm quite certain Gabby will get ten calls before the end of the day on this, and it gets back to the analytics that I was speaking about before that evaluates returns on an investment return basis today. Let me be a little more specific. So we're talking about allocated capital. Each of our products, each of our businesses is based upon the duration and the volatility our actuaries assign an amount of capital to. The embedded return that we calculate for the portfolio assumes that the premium dollars come in at new investment rates, but that the capital, because the capital sits and just continues to roll, has a much longer duration so the capital that supports it is somewhat more reflective of the historical capital embedded in the portfolio. So premiums come in entirely at new money rates. Again, this is the analytics that we use. The capital based upon allocated capital to that product reflecting more of a historical duration kind of -- because again, it supports the business. As one piece of business rolls off, a new piece of business comes on, the capital has a different duration than the new premium base. And if you look at the Business Insurance segment in the aggregate, as we did just yesterday in making sure that we can answer this question, the policy view, the return that we see in the business that we're writing today, is very low double digit. That's where it falls. I don't want to get more specific than that because obviously, it's reflecting of our pricing strategy. But it wouldn't take much to move into high single digits, but it's very low double digits.

**Operator**

Our next question comes from the line of Greg Locraft from Morgan Stanley.

**Gregory Locraft**
*Morgan Stanley, Research Division*

I wanted to follow up on the holding company liquidity and get an update. I can't get the math to reconcile. I'm looking at the end of the second quarter. I added net income, took out share repo and dividends. And it looks like liquidity was almost a couple hundred million higher. Could you help reconcile the math there? Was there a dividend in the quarter perhaps?

**Jay Steven Benet**
*Vice Chairman and Chief Financial Officer*

At beginning of the quarter, for holding company liquidity, we had about $2.4 billion. The mechanics of this thing are taking dividends out of the operating companies and bring them up to the holding company. There are other things that impact it like stock option and equity awards, that's a relatively small number. Taxes come into play. Going on the other way, interest on the corporate debt, shareholder dividend, stock repurchases themselves, any pension plan funding we do. So those are the components of it. I'm not sure you can really have full visibility to all those components, but what ends up happening is that the $2.4 billion grows to $2.8 billion. And the two major drivers of that are the size of the dividends coming up from the operating companies versus the amount of share repurchases that go out.

**Gregory Locraft**
*Morgan Stanley, Research Division*

But there was no special dividend? If I recall in the first quarter, did you take a special dividend up? And there was nothing in the quarter.

**Jay S. Fishman**
*Former Executive Chairman*


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We had a dividend in the quarter. Let me clarify what's going on with the dividends. I'm thinking about 10-K at the beginning of the year, of course, we had indicated that we could take dividends up without special authorization of something around $3.5 billion is my recollection. Somebody's going to look that up for me, but we also said during the first or second quarter, I'm not sure which one, was that based on the capital positions of the operating companies, which had gotten very robust, we were actually going to go to our regulators and say that we wanted to take capital out of the operating companies at a higher level than that would have indicated and get their authority to do that, which we did. And we did that in the first quarter and when you do that, it also changes the dynamics going forward of what constitutes a normal dividend versus what constitutes a special dividend. So in each of the quarters, we have gone to our regulators and said, we'd like to take x out and in each of the quarters, we've been given permission to do that. But it's all in conjunction with the strategy, as Jay has talked about, as always rightsizing the capital to place. And you've heard me say before that we managed to a certain level of capital in the operating companies to support the AA ratings and that's all we're doing. So our regulators understand that, the rating agencies understand it, and it's just what's going through right now.

**Gregory Locraft**
*Morgan Stanley, Research Division*

Just to be clear then, so when we take your end-of-period holding company liquidity and all we get is kind of what net income is and then we know what you're buying back and we know what your dividend is to shareholders. What you're saying is there is an amount that you guys are going to the regulators, intra-quarter and requesting to take up from the subsidiaries and that doesn't necessarily correlate one-to-one with net income?

**Jay S. Fishman**
*Former Executive Chairman*

That's correct. We take monies out of the operating companies each quarter because we're making money in the operating companies each quarter. And if you look -- if you take a big picture view of what we've been saying for the year, our guidance is for share repurchases of $4.5 billion to $5 billion that you look at what our year-to-date net income is and that certainly doesn't equate to a picture for the year of $4.5 billion to $5 billion. So those two numbers alone are showing that we're taking capital out of the place.

**Gregory Locraft**
*Morgan Stanley, Research Division*

So to push one more level on that then is, so therefore, the payout can sustainably be ahead of net income for the foreseeable future?

**Jay S. Fishman**
*Former Executive Chairman*

You get to a point where you've taken out the excess capital, so you eventually get to a steady state where the payout is going to be based upon what is your net income, what are your capital needs in the company and what are your various targets for holding company liquidity and debt and everything else. So eventually you do get to admit these things.

**Brian W. MacLean**
*President and Chief Operating Officer*

Greg, we had talked previously and you all know that we're going to stop the practice of giving guidance when we get to next year, but one of the things I think that we probably do have to provide some continuing visibility on is our projected share repurchases because, to exactly to your point, you really can't independently make an assessment of what our capital position is and what's available. So my guess is, is that when we get to the fourth quarter, we've got our plans and budgets all squared away for next year, not withstanding that we're really not going to speak to EPS, but we will give you a robust understanding of what our capital management plans are.

**Gregory Locraft**


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*Morgan Stanley, Research Division*

The other one on capital management, is just the dividend policy. Could you just remind us how you set that? Because the dollar is allocated to dividends obviously been flat for a while, while the share count has gone down. So just how do you think about that going forward? Well how have you thought about that historically? Whatever you're comfortable on.

**Brian W. MacLean**
*President and Chief Operating Officer*

We take a look at what the dividend yields are for comparable companies in the property casualty space. We look at payout ratios. We recognize that we're in a business where the wind blows and the earth shakes, so we take that into account. In the past, and what we've been fortunate enough to be able to do over the last couple of years is look at well, we have a very solid earnings stream. And we paid out roughly $700 million, if you look at the dollar amounts in each one of the years, you're absolutely right, our share count has gone down as a result of the repurchases. So we've been increasing the dividends to bring the dollar payout roughly back up to the same level, which has basically kept the payout ratio and the yields very competitive.

**Gregory Locraft**
*Morgan Stanley, Research Division*

Totally shifting gears from capital management, can you comment at all on the workers' comp pricing environment? We're hearing stuff out of Florida and others. What are you seeing at the margin there?

**Brian W. MacLean**
*President and Chief Operating Officer*

This is Brian, and if you'll look at our numbers, you'll see that we've been growing our workers' comp business and actually we've been growing it for about ten years. We've been growing it fairly gradually. In the aggregate for our book, we feel very good and while the economy has clearly impacted the exposures and payroll changes, in some places have been dramatic, we've been adding accounts and seeing some moderate growth in the line. The bottom line is comp, maybe more than any other product we do is a state-by-state industry-by-industry, account size by account size kind of dynamic. So we look at a very granular level and really believe it's the classic risk selection game and feel good about it. One thing I would comment on, and maybe I'll throw it to Bill Cunningham, is the A.M. Best data on comps got a good bit of play, and that's just a slice of the industry and you need to understand what it is that's looking at.

**William E. Cunningham**
*Former Executive Vice President of Business Insurance*

The A.M. Best data that Brian is referencing was a composite of the state fund business and the Monoline workers' comp market business. As you look at that, many of those state funds are markets of last resort. And obviously if you talk about selection and the things that we have in place, selection is not possible when it's the market of last resort and the pricing is not always appropriate. So as we look at the profile of our book and our results are much more different from that.

**Brian W. MacLean**
*President and Chief Operating Officer*

So Greg, we would agree that there are certain states and certain industries where we'd be very concerned with comp and be pulling back, but in the aggregate, we feel good about our book.

**Gregory Locraft**
*Morgan Stanley, Research Division*

Are rates at the margin, is pricing going up or down for that line?

**Jay Steven Benet**
*Vice Chairman and Chief Financial Officer*


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Again, it's a state-by-state and for competitive reasons we're not going to get into state-specific territory. On an overall basis, our workers' comp pricing has been fairly consistent because we've been taken over the last few quarters. We have not seen a dramatic change.

**Gregory Locraft**
*Morgan Stanley, Research Division*

Just on Direct Auto, just because there's a lot of money that's being spent in that direction. Just so I understand, your pricing that business the same to both agents as you are to the direct customers? So there's no benefit for going direct to the Travelers at this point? To the customer?

**Jay S. Fishman**
*Former Executive Chairman*

Relative, yes. Relative to the agent. They get the same price whether they go to the agent or they come direct. It's the only pricing track we have. We don't have -- we have no experience with the direct channel, so we don't have the ability to create a pricing track yet based on experience.

**Operator**

Our last question comes from the line of John Hall from Wells Fargo Securities.

**John Arthur Hall**
*Wells Fargo Securities, LLC, Research Division*

The first one has to do with whether you're utilizing any enhanced commission structure as you go after any new business, whether that's part of your program on the Commercial line side. And the second one has to do with the comments that Brian made. You talked about the economy or if and when the economy improving and having a very positive effect on exposure and potentially a premium trend. I was wondering if that notion is factoring into your retention strategy, and how so?

**Brian W. MacLean**
*President and Chief Operating Officer*

First on the commissions side. Nothing unusual. We pay base commissions and we pay supplemental.

**Jay S. Fishman**
*Former Executive Chairman*

We don't have any specials on with respect to growing or anything else

**Jay Steven Benet**
*Vice Chairman and Chief Financial Officer*

We're doing well. It's not a change that we've been doing.

**Brian W. MacLean**
*President and Chief Operating Officer*

Our fundamental programs there over the last several years have remained very constant and both in structure and in amount. We will obviously through predominantly our fixed value-based commission, differentiate one producer, one agency versus another. Those that grow more will have a higher fixed value-based supplement than others. But with nothing -- no special on with respect to growing this month or anything like that.

**John Arthur Hall**
*Wells Fargo Securities, LLC, Research Division*

So you're not utilizing any of the platform savings you talked about in that direction?

**Jay S. Fishman**
*Former Executive Chairman*


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In Small Commercial, I don't think we changed the commission structure with Express. Did we when we put it out? We did for a little, maybe, years ago but not currently. No, is the answer. And the second question is -- it's been an interesting phenomenon that we speak about a lot, and we've talked about it for literally years, that the renewal market has had a remarkable stability to it that actually is consistent with those of us who were in the business in the '90s experienced then. There is a robust competitive environment for new business but yet the renewal book seems to be -- and this is universal by the way, it's not just us. You look at any carrier, any quality carrier, you speak to agents, you speak to brokers, they will all comment and all -- the ones we speak to, will observe that the renewal market has a remarkable stability. Customers are just happy. Most customers are happy just staying where they are. And in effect, as long as the premium doesn't go up, they are happy with the broker, they're happy with the carrier, the experience is good and the business just stays there.

**John Arthur Hall**
*Wells Fargo Securities, LLC, Research Division*

On the exposure change, if your comment is getting at is there anything of --

**Brian W. MacLean**
*President and Chief Operating Officer*

Let me answer it directly, there's nothing explicitly in how we're evaluating business or pricing business that contemplates a growth in exposure and therefore, a different profitability dynamic on the account going forward. Obviously, we think about in these -- we're hopeful in these conditions that if you've got accounts and you feel comfortable with them today, as the economy expands they're going to get bigger and that'll be a better thing. But we're not building it into the economics of how we're viewing the trade.

**Jay S. Fishman**
*Former Executive Chairman*

And the notion in today's environment, I'm sure like most of your employers, the ability of the willingness of your employers to take on added costs that aren't justified with underlying activity is a substance of issue for every business and it's a substance of issue for our customers. It's not particularly easy nor well received to go to a customer that's barely getting through a challenging economic environment and suggest that we just raise the price for insurance. So our retention strategy is molded by the environment we're in, by the economic environment we're in. And a realization that there are real life customers on the other side of the transaction and you've got to be responsive to the overall economic environment and manage the business for the long term, and that really defines the approach.

**Operator**

Ms. Nawi, I will now turn the call back to you.

**Gabriella Nawi**
*Senior Vice President of Investor Relations*

Great. Well thank you all for listening. And if you have any follow-up questions, please contact myself or Andy Hersom in the Investor Relations department. Thanks very much, and have a good day.

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


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