S&P Capital IQ

The Travelers Companies, Inc. NYSE:TRV

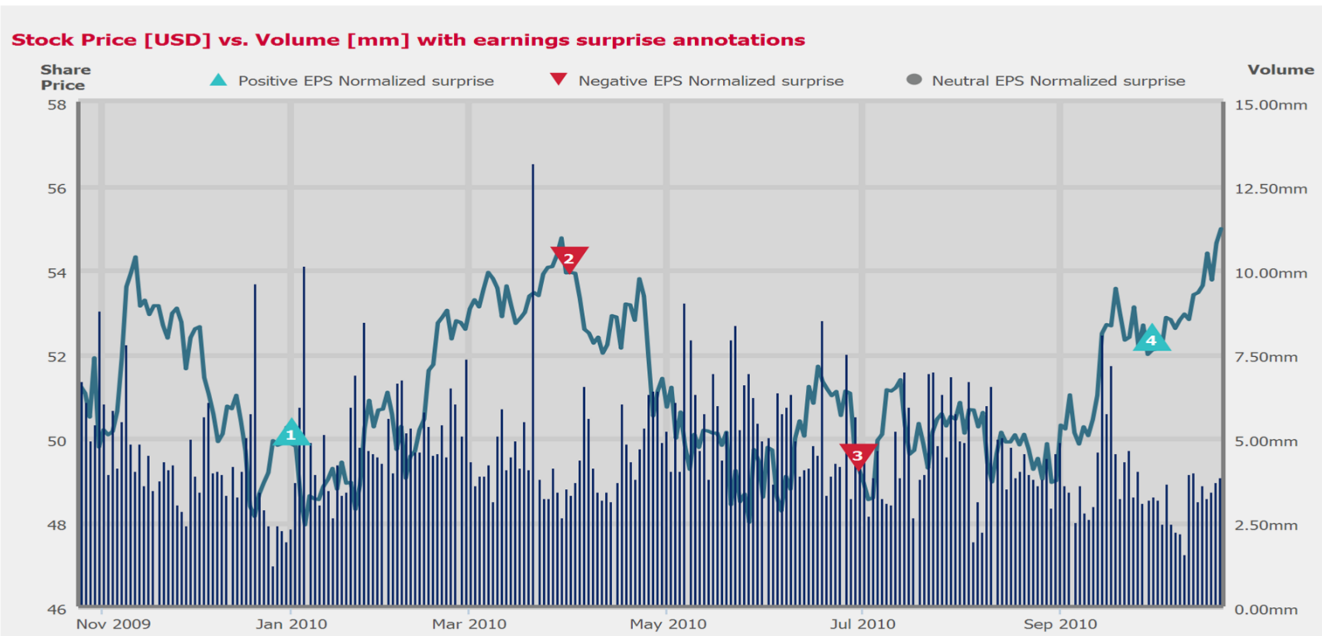
FQ4 2010 Earnings Call Transcripts

Tuesday, January 25, 2011 2:00 PM GMT

S&P Capital IQ Estimates

	-FQ4 2010-			-FQ1 2011-	-FY 2010-	
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	ACTUAL
EPS Normalized	1.67	1.89	13.17	1.56	6.05	6.26
Revenue (mm)	5441.45	5440.00	(0.03 %)	5712.68	21875.88	21432.00

Currency: USD
Consensus as of Jan-25-2011 1:40 PM GMT



- EPS NORMALIZED -	CONSENSUS	ACTUAL	SURPRISE
FQ4 2009	1.49	2.12	1 42.28 %
FQ1 2010	1.37	1.22	2 (10.95 %)
FQ2 2010	1.50	1.39	3 (7.33 %)
FQ3 2010	1.46	1.81	4 23.97 %

Call Participants

EXECUTIVES

Alan David Schnitzer
Chairman of the Board & CEO

Brian W. MacLean
President and Chief Operating Officer

Gabriella Nawi
Senior Vice President of Investor Relations

Gregory Cheshire Toczydlowski
Executive Vice President and President of Business Insurance

Jay S. Fishman
Former Executive Chairman

Jay Steven Benet
Vice Chairman and Chief Financial Officer

William E. Cunningham
Former Executive Vice President of Business Insurance

William H. Heyman
Vice Chairman and Chief Investment Officer

ANALYSTS

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Keefe, Bruyette, & Woods, Inc., Research Division

Gregory Locraft
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Presentation

Operator

Good morning, ladies and gentlemen, and welcome to the Fourth Quarter and Full Year 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 begin.

Gabriella Nawi
Senior Vice President of Investor Relations

Thank you, Sharon. Good morning, and welcome to Travelers' discussion of our fourth quarter and full year 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 and the current market environment. They will refer to the webcast presentation as they go through prepared remarks, and then we will open it for questions.

Before I turn it over 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 our website.

Thank you. And I'd like to turn it over to 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 the results that we're reporting today, not only for what they say about 2010, but also for how they continue to demonstrate the strength of the Travelers' franchise and how well-positioned we are for the future.

Our operating return on equity for the full year was 12.5% and our growth in book value per share for the year was 11%, both including or excluding net unrealized gains on our investment portfolio. Since the beginning of 2005, our average annual operating return on equity is 14.1% and our compound annual growth in book value per share is 12.9% or 11.5%, excluding the impact of FAS 115.

Since we began our share repurchase program in the middle of 2006, we have repurchased nearly 289 million shares for $14.5 billion at an average price per share of $50.15. The shares repurchased now total approximately 42% of the shares that were outstanding at the time we began the program. We have accomplished all this notwithstanding an operating environment that, over these years, can only be described as complex. Positively, loss cost trends during this period have been relatively benign and have certainly contributed to the significant favorable prior year reserve development we've experienced. Negatively, the difficult economic conditions over the last three years have contributed to declining exposures, deteriorating pricing, challenging credit markets and historically low interest rates.

The industry has also faced three significant catastrophe years in the period that is 2005, 2008 and 2010. And two years, 2006 and 2007, that had low levels of cap losses. We believe that our consistent top tier performance over these six challenging years demonstrates a fundamental competitive advantage that we have in assessing risk and reward on both the liability and asset sides of the balance sheet.

Risk selection has been a key driver of our performance over this period and, with our investments in talent and infrastructure, will continue to drive our performance in the future. In terms of the current operating environment, Brian will take you through it in more detail. Given some of the trends we saw in the fourth quarter, we are somewhat more optimistic than we were a few months ago.

In Business Insurance, exposure changes, one element of demand for our product, was positive for the first time in nine consecutive quarters. With respect to pricing, as we've shared with you previously, renewal pricing in Business Insurance has been about flat for most of 2010, results that are obviously better than those that have been reported in the CIAB surveys. In the fourth quarter, renewal pricing in Business Insurance not only improved versus the third quarter but also within the quarter as the months progressed. While these comments are not intended to forecast future pricing, these results suggest that our pricing strategy is beginning to have some traction and we hope it continues.

Given our strong retentions as well as the new business and account growth we've achieved over the last few years, we have significant positive leverage to an improving environment. The final thing I'd like to leave you with, and again Brian will take you through the details, is our performance and position in Personal Insurance.

In our Agency Homeowners business, we grew policies in force by 3% and, despite the significant catastrophe activity during the year, we delivered a combined ratio of 95% for the full year. Let me spend just a moment on what that performance really indicates.

The 95% combined ratio that we posted reflects 15 points of catastrophe losses for the year, as well as the impact of some favorable reserve development in the line. But even excluding the impact of favorable prior year reserve development in the line, we would still be well under a 100 combined ratio. We believe that this performance meaningfully demonstrates the success of our Homeowners strategy.

In our Agency Auto business, we grew policies in force by 2% and delivered improved profitability, posting a combined ratio of 97%. Personal Insurance now represents 35% of our net written premiums. And we're pleased with what we have achieved and optimistic with what we believe we can continue to deliver.

To conclude, we're confident in our ability to select and manage risk regardless of the operating environment. We're hopeful that we'll see an improving operating environment in Business Insurance. We're pleased with the solid performance in Financial, Professional & International businesses, and we're optimistic for our prospects in Personal Insurance.

And 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 fourth quarter and full year results shown on Pages 4 through 7 of the webcast.

Fourth quarter operating income of $864 million is lower than our very strong fourth quarter of 2009 in which we earned $1.155 billion. There are a few easily understood reasons for this. Favorable prior year development was higher by $100 million after tax in last year's quarter. Cat [catastrophe] losses were lower by $45 million after tax in last year's quarter. Fourth quarter 2009 included the benefit of a favorable re-estimation of current year loss ratios for the first three quarters of 2009, amounting to $52 million after tax. And the current year quarter included costs of $39 million after tax, which reduced fourth quarter fully diluted operating income per share by $0.09 related to our purchase and retirement of a large portion of our hybrid debt.

Operating results, excluding the impact of these items and including net investment income, remained in line with our original expectations, taking into account normal quarterly fluctuations and non-cat [non-catastrophic] weather and large loss activity, as well as the timing of expenditures.

We had another quarter of net favorable prior year reserve development in each of our segments, concentrated once again in BI and FP&II. And although somewhat higher than in the prior year quarter, cat losses in the current quarter were lower than what we would normally plan for. And finally, fourth quarter operating ROE was 14.5%.

Turning to the full year. The very large cat activity during the first half of the year resulted in significantly higher catastrophe losses as compared to full year 2009. This significant increase in full year cat losses, coupled with slightly lower net favorable prior year reserve development and the costs of purchasing and retiring our hybrids, accounted for almost all of the reduction in full year operating income as compared to 2009.

Book value per share, while down 1% in the quarter due to the recent rise in interest rates, was up 11% from a year ago; and all of our capital, leverage and liquidity measures compared favorably to our target levels.

Some additional items are also worth noting. Given the historically low interest rate environment in the early part of the fourth quarter, we issued $500 million of 10-year, 3.9% senior notes and $750 million of 30-year, 5.35% senior notes, using $885 million of the proceeds to purchase and retire the more expensive hybrid securities we had outstanding.

We ended the year with holding company liquidity of $3.6 billion, more than 3x our target due to strong earnings and the timing of dividends from our operating companies to our holding company. And our earnings strength, coupled with the strength of our balance sheet, allowed us to significantly increase share repurchase activity in the fourth quarter. We repurchased 1.6 billion of our common shares during the quarter, bringing total share repurchases for the year to 5 billion and leading our Board to authorize another 5 billion of future share repurchases in addition to the 1.5 billion remaining under the prior authorization. Overall, for the full year 2010, the total cash we returned to our shareholders through share repurchase and dividends amounted to $5.7 billion.

Our strong holding company liquidity and operating company surplus enables us to plan for 2011 dividends and share repurchases that we expect will be well in excess of projected 2011 operating income. A simple way for you to estimate our 2011 share repurchases would be to start with your estimate of our after-tax operating income, and add to it our additional capacity for share repurchases, which we currently estimate to be approximately $1.5 billion. This, I should stress, is in addition to our normal dividends. Remember, we're not saying that our share repurchases will only be $1.5 billion, rather we expect share repurchases will be the total of the $1.5 billion plus estimated operating income.

Total dollars to be returned to shareholders will, therefore, be this amount plus our dividends. Hopefully, this is clear. I remind you that anytime we provide information concerning future share repurchases, we're assuming no significant changes in the operating and investment environments, relatively normal cat and no prior year reserve development, among other assumptions.

I'd also like to make a few comments relating to Page 8 of the webcast. During the third quarter earnings call, I referred to the historically low interest rate environment and provided an illustration based upon our investment portfolio scheduled bond maturities in 2011, 2012 and 2013, of the impact on net investment income in those years if the then-current interest rate environment persisted through 2013 and all other variables, such as average assets mix, credit quality and duration remain constant. Since then, interest rates have risen by approximately 75 basis points.

So I've updated the illustration for you. As can be seen on Page 8, the projected reduction in net investment income as calculated in the updated illustration is even less than in the prior illustration, which was not large to begin with. So please note, I don't plan to update this information going forward.

And with that, I'll turn things over to Brian.

Brian W. MacLean
President and Chief Operating Officer

Thanks, Jay. Consistent with last quarter, I will not be going through all the webcast slides, but will take any questions you may have on the disclosures on Pages 11 through 22. Instead, I will share some perspectives on our business and the marketplace. And in short, I'll make three basic points.

In Business Insurance, we're beginning to see early signs of improving market conditions. In Personal Insurance, we're bullish on our business. And in Financial, Professional & International, we're pleased with our underlying results given what is still a dynamic and challenging environment. So with that as a backdrop, let me give a little more detail.

In Business Insurance, we continue to be pleased with our overall production results this quarter. Account retention remained strong. We've seen exposure trend positive and we continue to see strong new business flow. On the pricing side, you can see on Slide 10 that the fourth quarter saw us post the first positive renewal premium change since the first quarter of 2007. And the results of all of this is an increase in gross and net written premium year-over-year. The favorable trends and exposure that we have previously observed have continued to the point where renewal exposure turned positive during the quarter.

On Slide 11, we have graphed our exposure change by quarter from 2006 to the present. Exposures began to drop in late 2008 as the economic downturn began. The decline accelerated into early 2009 and began to moderate throughout 2010. Based on the positive change in exposure in the fourth quarter of 2010, it appears that the impact of the decline in economic activity on our Business Insurance clients has bottomed out and we're seeing some firming.

On the rate side of renewal premium change, while the rate change was slightly negative for the quarter, we've seen a subtle shift in the pricing environment within the quarter as the market seemed more receptive to rate increases. We are hopeful that this pricing trend will continue.

Our underwriting margins for the quarter and full year, after our typical normalizing adjustments, were consistent with our expectations and continued to show modest compression due to loss cost trends slightly outpacing earned rate change. The solid results that we continue to see in this segment demonstrate the value of our underwriting strategy that we have articulated a number of times, and that is: retain our quality business, optimize the profitability on this retained book by getting rate where appropriate, and write new business wherever we see an acceptable balance of risk and reward.

As we begin to see a turn in the broader economy, we believe sustained, focused execution of our strategy will allow us to deliver on our commitments to continued growth and profitability.

For Personal Insurance, I want to follow on Jay's comments to emphasize how positive we feel about this business. Having a robust Personal Insurance franchise with a strong agency channel is a competitive advantage and sets us apart from many of our key competitors. Both our Personal, Auto and Homeowners and Other products have delivered outstanding growth in margins in an especially challenging economy. In fact, in 2010, Personal Insurance delivered record earned premium and policies in force.

In our Agency Auto business, we achieved meaningful growth in a stagnant market while simultaneously improving on our already strong underwriting margins. New business growth was up significantly over prior year, which, coupled with solid retention, led to a 2% increase in policies in force from a year ago. Margins increased both for the quarter and the full year, resulting from continued discipline with our pricing and underwriting strategies. Our strong margins in this business position us well for continued success in a highly competitive market.

Similarly, we feel great about our Agency Homeowners and Other results. Although new business is down slightly from the fourth quarter last year, retention and renewal premium change were both up, leading to substantial growth in topline and policies and in force. Adjusting for catastrophes and prior year development, we saw full year underwriting returns improve from 2009 as earned rate actions exceeded loss costs. Given the uncertain economy and, in particular, the weak housing market, we are very pleased with our results and believe we are well positioned in this market.

Turning to the Financial, Professional & International Insurance segment. Net written premiums were down in the quarter driven by several factors. First, the continued sluggishness in the economy, and particularly the impact on public and private construction spending, has significantly affected the volume of surety business in the marketplace. Second, primarily as a result of a challenging rate environment, we've scaled back the property exposure in our Lloyd's business. And third, in Ireland, we ended an exclusive relationship with a distribution partner in the fourth quarter.

International growth remains a key investment area for us and we continue to look for opportunities in our existing footprint as well as in emerging markets. In that regard, we are very excited about the joint venture in Brazil that we announced in November, and Alan Schnitzer will speak to that transaction in a few moments.

Excluding prior year development, margins in our International business for the quarter remained relatively flat year-over-year. In Bond & Financial products, we continue to see a challenging growth environment. As I said, in the surety business, the economy is resulting in a lack of business opportunity, but our margins remain strong.

In Management Liability, not unlike our Business Insurance strategy, we remain focused on executing a disciplined underwriting approach, retaining the quality business, getting rate where it's needed, writing new business wherever we see an acceptable balance of risk and reward, and positioning for growth when it makes sense.

In summary, we feel great about the execution across all our business segments and how we are positioned going forward. By maintaining our underwriting discipline and commitment to invest in and maximize the long-term value of our portfolio, we've continued to deliver solid results while at the same time, expand our ability to deliver future growth.

With that, let me turn it over to Alan.

Alan David Schnitzer
Chairman of the Board & CEO

Thanks, Brian. As you may have seen in November, we announced that we had entered into a joint venture agreement under which we will invest approximately $370 million for 43% of the common stock of J. Malucelli, the market leader in the surety business in Brazil. And we have an option to increase our interest to 49.9% within 18 months.

Our investment in newly issued shares will significantly increase J. Malucelli's capital level, positioning the joint venture for substantial growth. We currently expect the transaction will close in the first half of this year. We've been carefully considering our emerging market strategy for some time and we're very pleased with this investment as a first step.

We view it as a significant opportunity for us to leverage our leading U.S. surety franchise to enter one of the fastest growing insurance markets in the world, and to do so with the benefit of a local market leader. In addition to the surety opportunity, we believe that the combination of our broad insurance expertise, with J. Malucelli's established distribution network and customer base, gives us an exceptional platform for expanding into the growing P&C market in Brazil.

We've known the leadership of J. Malucelli for a number of years and we have the highest regard for them. The opportunity to be in business with them is a key consideration for us. They've built a great franchise by knowing their customers and through disciplined, analytic-driven underwriting, much the same way we built our business. Importantly, we share a common ambition for profitable growth.

With that, I'll turn it back to Jay Fishman.

Jay S. Fishman
Former Executive Chairman

Thanks, Alan. Before we open it up for questions, I just want to take a minute to echo the comments that Alan made a moment ago.

We're very pleased and proud to be partnering with the Malucelli family in the Brazilian venture. We couldn't pick a better partner to have and we firmly believe that our business philosophies are remarkably compatible. I'd just like to personally send my best regards to them and let them know how excited we are about our future together.

Also, I just want to take a moment to thank all The Travelers' employees who participated in the due diligence. It was hard work and it was all very well done.

With that, let me turn it back to Gabby.

Gabriella Nawi
Senior Vice President of Investor Relations

Thank you. We're going to open up for questions but before we do that, if I can ask callers to please limit yourself to one question and one follow-up, so that we can get to everybody. Thank you.
Sharon, we're ready to start Q&A session, please.

Question and Answer

Operator

[Operator Instructions] And our first question comes from the line of Jay Gelb with Barclays Capital.

Jay H. Gelb
Barclays PLC, Research Division

The first is on the municipal exposure, the impact to the marks was somewhat better than we were modeling. Perhaps you can talk a little bit about that in terms of how you're marking the municipals and how you're thinking about that investment class, probably given what's been going on in the past couple months? And the other question has to do with the share buyback. Our sense is Travelers could buy back around $4 billion in stock in 2011. If we look back at what was originally offered for guidance in 2010, the original starting point was $3.5 billion to $4 billion, ultimately it ended up at $5 billion. So I'm just trying to get a sense of what might give upside to your initial view on buyback activity?

William H. Heyman
Vice Chairman and Chief Investment Officer

Jay, Bill Heyman. The first question, in terms of how we mark them, they're marked independently. We obviously don't pick our own prices. But to the second, if you look at the fourth quarter change in mark-to-market, about 80% track the mark-to-market of Treasuries. So what remained wasn't very large. And we attribute that to the high credit quality of the portfolio. As was always true in the high yield market, it has now become true in the municipal market, that the biggest single determinant of prices is the flow of cash in and out of municipal bond funds. And those flows exhibited a lot of volatility in the fourth quarter. What is interesting to me is when municipal bond funds sell holdings in bulk to raise cash, they circulate bid-wanted lists, which we see through the dealers. And we comb them for opportunities. We rarely find bonds that are on our list of bonds approved for purchase. And when we find one, we rarely find it at a price we're inclined to pay. So that means to me that we've set the bar pretty high, which in times like these is good. In terms of the news that has dominated the press in the last quarter, I'm really going back further than the last quarter, I guess I would say some of it's news, some of it isn't news. That state and local finances were stressed has been known to every serious institutional participant in the market and has informed our investment decisions for five or six years, not just recently. It may be news to the general public. And that has had good consequences. It has lead state and local officials to confront these problems in the last three or four months in a way that hasn't been evident before. So, perversely almost, we're encouraged by what we read.

Jay S. Fishman
Former Executive Chairman

And as we were chatting about this before, Jay, in respect to your question relative to the index, I think that the three principal differences are: the mix of securities that we hold relative to the mix that are contained in the index; two, our duration is shorter than the duration of the index; and the third piece, and probably the least significant of the three but nonetheless meaningful, is that the credit quality of our portfolio is at a different level than the credit quality of the overall index. So those who have been using the index to make estimations of change in market values are going to get inaccurate results.

Jay Steven Benet
Vice Chairman and Chief Financial Officer

As for the question on the share repurchases, just going back to last year, when we originally provided some guidance as to what we thought the share repurchases were going to be, it was based upon what we thought our earnings would look like as well as the starting capital and cash positions that we had at the beginning of that year. So to the extent we increased the amount of buybacks, it was a refinement of both of those parameters. We saw earnings that included favorable prior year development last year. We hadn't considered that, of course, in our earnings guidance. And to the extent we have favorable development that adds to our earnings, we adjust our buybacks accordingly. And we'll continue to do that going into the future. As it relates to the capital position at the beginning of this year and the cash position at the beginning of this year, being 2011 now, we factor in where our operating company capital is, what the holding company cash is, points you to the item that I mentioned earlier. We do have $3.6 billion at the holding company that allows us to look at share repurchases in excess of what we think our current year operating income is going to be. So all those things are factored into the estimate that we provided, Jay. And I hope that fully answers your question.

Operator

Our next question comes from the line of Keith Walsh with Citi.

Keith F. Walsh
Citigroup Inc, Research Division

First question, just within the release, you mention that the loss ratio, a potential modest increase in 2011. If you could give us a little more color around that?

Brian W. MacLean
President and Chief Operating Officer

Keith, this is Brian MacLean. I mean it's really just the simple arithmetic of, on the loss trend side, we're expecting what we've been seeing, which is frequency running at near flat levels, which is good.

Jay S. Fishman
Former Executive Chairman

That doesn't mean zero. That means it's not changing from current levels.

Brian W. MacLean
President and Chief Operating Officer

Right. Frequency change, right. Severity trends running somewhat consistent with inflation, and that is low single-digit loss ratio impacts. And across the Commercial business, very modest earned rates. So the net of that would be a slight margin compression. The Personal Insurance dynamic, a little different. Greg, why don't you just kind of run through the same things for Auto & Home.

Gregory Cheshire Toczydlowski
Executive Vice President and President of Business Insurance

Yes, for Automobile, we're certainly seeing a contained environment from frequency. A little offsetting pressures on severity, but you see our RP, our RPC [ph] is offsetting those loss trends. On the property side, just due to the volatility of that line, when we normalize some of the peaks of the weather, we're seeing frequency relatively flat, in the low single digits, and severity upward in the higher single digits, and you see our two consecutive quarters of RPC of 9%, so we feel good about both of the products inside the Personal line portfolio.

Jay S. Fishman
Former Executive Chairman

So again, just to make sure we say it in English. In the Personal Insurance business, we would anticipate expanding margin risk, and in the Business Insurance line, we expect modestly contracting margins.

Keith F. Walsh
Citigroup Inc, Research Division

And then second question, just going back to munies. If you could just mention, talk to, if we saw a rating agency downgrade on a bond, would that trigger a loss? Then thinking about -- there's a lot of talk about states declaring bankruptcy, what would the implications be there? And then finally, spread opportunities must be actually quite attractive for new money right now. How are you thinking about that?

William H. Heyman

Vice Chairman and Chief Investment Officer

Well, with respect to ratings, as you probably know, in the last year or so, at probably not the best moment, municipal ratings were pushed upward so that a given rating implied the same probability as default based on history as it does on the corporate side. So yes, we watch the ratings carefully for downgrades, but we attach less importance to them than outsiders might think. Yes, we like the aggregate credit rating of our portfolio, but it would be very easy to construct a portfolio with the exact same aggregate credit rating with which we were very uncomfortable. So we're not slaves to the ratings. When ratings change on either the municipal or the corporate side, the first take we do, certainly the first take I do, is does this mean that the probability of the instrument being money good is significantly lower? If not, we generally stick with it.

Jay S. Fishman
Former Executive Chairman

And this is Jay Fishman. Let me cover briefly the issue of the potential change in bankruptcy. Those who don't know there's been some chatter and a New York Times article last week reporting on some consideration about amendments to the federal bankruptcy code that would allow states access to it. Right now, the states don't have such access. It's obviously an extremely complicated issue, both legally as well as politically. And as we parse through it a bit, there are, in addition, serious issues of constitutional law. And it's not at all clear, really, what people are actually discussing and, therefore, what the implications might be. It's been interesting to us over these last few days to listen to a few states actually reject the notion that, even if such an access were provided to them, that they would seek it. It reminds me a little bit like being -- taking a horse to water but not necessarily getting them to drink. So we'll watch carefully as to what happens. But let me just make a couple of points which I think really are relevant. First, there seems to be this bias amongst even sophisticated people to view municipal securities are all the same, as if somehow we own some pro rata share of an aggregate marketplace. And that's just not the case. Everyone understands that in the taxable fixed-income world, the issuer and the specific terms and conditions of the instrument matter. And that's equally as true in the municipal arena. And in fact, something that's not often understood is that a significant portion of our municipal portfolio is actually secured by a pledge of specific revenue streams. And by the way, in the context of municipalities that do have access to the bankruptcy code, the view is that those pledge of specific revenue streams would survive a bankruptcy filing and, in fact, those securities would continue to be paid in the ordinary course. Now, of course, that's an assumption that, that same condition would hold true at the state level if the states were allowed such access. So we'll watch this carefully, and it will always, as Bill spoke earlier, affect our view of risk and reward. And when we think that there is some change that we ought to be making in the portfolio, we'll make it. But let me close with a little bit of data that perhaps you'll find interesting, which is, to Bill's point earlier, this is not new news to us. It's an issue and a concern that we have been watching for a very long time. If one takes the 10 states, 10 states, that at least our analysis suggests are the most challenged, whether that's through pension or medical liability, medical payments, or debt obligations, we own an aggregate in all of those 10 states. And this is excluding pre-refunded bonds, we own an aggregate of $1 billion of state-issued general obligation bonds in those entire 10 states. That represents 3.1% of our municipal portfolio. And in terms of maturity, about 23% of that $1 billion matures in the next three years and about 46% matures in the next five years. So even if one looks at those states that have been spoken about in the press or those that people view as being challenged, our position with respect to those states is actually modest relative to the entire portfolio and it remains an area where we watch and look carefully.

Operator

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

Gregory Locraft
Morgan Stanley, Research Division

I wanted to just explore within the presentation that it looks to me like you guys are now getting rate across most of your business lines, just raw pricing. And I wanted to sort of tie that to your assumption with regards to the loss -- the margin outlook for this year. What is the disconnect there? Because it seems to me that if rate is going up, which I think is different than expectations, why would margins be going down from a loss cost perspective?

Brian W. MacLean
President and Chief Operating Officer

Greg, this is Brian, again. So just to work backwards a little bit, butt to say it. Personal Lines, simplistically, we are clearly getting price and we believe margins are expanding a little bit. So the question I assume is on the Commercial, the Business Insurance side. And there, I think you can see the numbers that, first of all, the rate that we're getting on a written basis is pretty modest at this point. So think of less than a point. Actually, the renewal rate for the quarter on Page 12 is still a fractionally negative number. So we're looking at modest improvement. There's also an earn dynamic here, where if you look at what's going to earn through the income statement as the year plays out, it takes a few quarters. Even if that starts to ramp up, it's going to take a few quarters to have that have an impact on the P&L. So when we look at some modest rate and what, pick whatever number you want, but two, three, whatever loss ratio points of pressure from the loss side, it nets to a modest negative.

Gregory Locraft
Morgan Stanley, Research Division

So there's nothing in your book that you're seeing in particular that has changed?

Brian W. MacLean
President and Chief Operating Officer

We tried to pick the right words but we think subtly, in the fourth quarter, we saw some lift in -- as we went through the months of the quarter, some lift in the Commercial pricing environment. And also, we talk a lot about -- we're a disciplined company, we talk about the numbers. We also do talk to our people, talk to brokers, talk to agents, talk to customers, and so we have a mood. And that mood seems to be marginally more positive or less negative, however you want to say it, in recent months and we're encouraged by that.

Jay S. Fishman
Former Executive Chairman

And Greg as I explained in my comments, written renewal rate in Business Insurance for the year was about flat. That written rate is going to convert to earned as we turn into 2011. We still anticipate, as we always do, a loss trend that has some lift to it. And if you've got flat earned rate and some loss trend, you've got slightly compressing margins. Our hope is, as I said earlier, that what we saw in the fourth quarter continues. It's not a prediction. But if we saw in the fourth quarter and that line continues, one can anticipate getting to positive rate on a written basis sometime in 2011. And obviously, that will get earned in the following months as well. So it's predominantly what's happened over the last 12 months defining what will be recorded over the next 12 months.

Gregory Locraft
Morgan Stanley, Research Division

And just totally to shift gears in the last question, is at the holding company level, the liquidity jumped considerably sequential. Did you all do a special dividend through the quarter? How much? And how can we, from the outside, sort of think about that going forward? Because you've been great in terms of the capital management visibility into this year, but the one thing we can't see is what you're taking out of the subs and the willingness to do that.

Jay Steven Benet
Vice Chairman and Chief Financial Officer

Well, in some respects, you can see it, if you take a look at the statutory surplus levels that we describe in the supplement. So that won't give you a reconciliation, but at least give you a feel for what the subs are carrying. But your specific question of, in the fourth quarter, what did we do? We did take out dividends out of the operating companies. Given the size of the dividends, we did require regulatory approval, which we got with no issues whatsoever. We have good relationships with the states. We're very forthcoming in terms of what our levels are, what our plans are. And we took out about $2 billion in the fourth quarter, brought it up to the holding company and ended up, as I said, with operating company capital that, for all our operating companies, were at or above our target levels.

Gregory Locraft
Morgan Stanley, Research Division

So did you take about $3 billion out in 2010 then in total?

Jay Steven Benet
Vice Chairman and Chief Financial Officer

It was actually more than that.

Operator

And our next question comes from the line of Cliff Gallant with KBW.

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

I was interested in the Brazilian joint venture and just wondering if this is a sign that perhaps you're more interested in international expansion. Generally, what is your appetite for international acquisitions?

Jay S. Fishman
Former Executive Chairman

Cliff, we have talked before with you all about having an interest in what I would characterize as a fairly limited number of developing markets. We talked about having an interest in developing a joint venture in India. We actually were in the preliminary stages at one point and had identified a partner there. Ultimately, concluded that the partner's business interests and their business philosophies were not compatible with our own and we broke that off. We still have a desire to enter into a business relationship in India. There's 1,300,000,000 people with an economy growing at 9%, 10%, more for the next generation of leadership of this company than the one that's here now. I think you just got to believe that, that will eventually turn into a very robust insurance market. And one that remains nascent, tiny, by any standard and very much up for grabs. So we want to be there. The Malucelli situation was really very opportunistic. And it really came about because of an outreach from the folks in Brazil. And I'll have Alan speak about this. The Malucelli group reaching out to our surety business, obviously, the leading by market share surety business in the United States, to talk about learning about doing business together, and out of that grew this opportunities.

Alan David Schnitzer
Chairman of the Board & CEO

That's right. We've been thinking doing about the emerging market opportunities for some time and evaluating what might be best for our first step. And as we were spending time in Brazil, the Malucellis reached out to us. And just given the really high compatibility of operating philosophies and ambitions, both short term and long term, it just seemed like a great opportunity for us to make a first investment in the emerging markets. And we'll continue to look in other emerging markets and evaluate those opportunities over time as well.

Jay S. Fishman
Former Executive Chairman

It's not a global ambition. Our view is that our goal is to create shareholder value by producing mid-teens return on equity over time. And whether we do that with more in the emerging markets or a little less in emerging markets, we always keep in mind what our target is. We don't have any ambition to be a global company and we will look for our spots in the international arena very carefully, where capital can be deployed at a reasonable level of risk, but the returns are commensurate with. The projected returns are commensurate with the risk that one takes on. Again, tying it right back to where I started my comments this morning of thoughtful evaluation of risk and reward. It's not about size.

Alan David Schnitzer
Chairman of the Board & CEO

And as Brian mentioned before, we like our existing footprint and we'll continue to look for opportunities to leverage our sense of U.S. product set in those geographies as well.

Operator

And our next question comes from the line of Matthew Heimermann with JPMorgan.

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

First, when you think about your outlook or your hope for pricing and loss costs in 2011, can you just maybe give us a handicap of whether or not you think the risks are more to the upside or the downside in terms of how you might be surprised on rate and loss cost? And then the second question would be on workers comp. I was wondering if you could just give us an update on some of the trends you're seeing both in the loss sensitive side of the business as well as the guaranteed cost side?

Jay S. Fishman
Former Executive Chairman

With respect to the first question, Matthew, I think the only way I can respond is to look back historically, which is that over the last several years, loss trend has been less than we had assumed it would be. And that's happened in large measure because frequency was less than we had assumed it would be, but also because inflation has been -- from a severity perspective has been quite benign. So that's been the trend over the last four, five years. I'm not an economist and I'm not going to attempt to make any predictions or forecasts. Relative to pricing, we've been pretty transparent about what our pricing strategy has been, which is that we've been attempting to get rate where we need it. And that's especially true in circumstances where an account's loss experience has been inconsistent with that which we anticipated or projected when we underwrote the account. There's nothing new about our pricing strategy. It was just interesting to us that, in the fourth quarter, it was more the market, and I hate to use that phrase because it always sounds like our pricing strategy is not active. It's a very active one. But we were able to effect that pricing strategy with greater success than we had previously. And so I think that's the answer I'm at. But one thing that is interesting is if the exposure projections are what they are, if you look at what's happened to exposure over the last 12 months, it's not too hard to project a line of increasing exposures into 2011. And that, given the account growth that we've had over the last several years, would be a nice factor. So that's the best way to service that, that I think.

Brian W. MacLean
President and Chief Operating Officer

And Matt, this is Brian. On the comp side, I'd start by saying, our data would say we've been pretty good in this business. Our combined ratio for a good number of years has run up a fairly significant favorable delta to the industry. And we think that's due to a real disciplined selection process, and so that's by industry, that's by state. And secondly, we believe we've got a real claim advantage in how we manage those claims, both the lost time and the medical dimension to that. So we feel great about our Comp book. With that said, there are clearly pockets of heat coming through Comp line. And there are certain states and certain environments that have become more challenging and we're watching those closely. The favorable side there would be that it's probably the line that's got a little bit of pricing energy to it. And so we hope that, that will continue. I don't think -- I'll throw the book on you. I don't think we're seeing anything fundamentally different on the guaranteed cost versus the lost sense of the book.

Jay S. Fishman
Former Executive Chairman

Let me just ask Eric [ph] here, because he used the phrase, "pockets of heat." That has a certain energy to it. Do you want to expound on it just a little bit?

William E. Cunningham
Former Executive Vice President of Business Insurance

Sure. I mean as we look at our worker's compensation approach, we're looking at it state-by-state, industry-by-industry. And as we look at some states, given some jurisdictional issues, we see more pressure on loss. And as a result of it, we see more need for rate. We're not going to get into our individual state strategy for competitive reasons. In those states where things have been heating up on the loss side, we have been getting more rate. And again, on an overall basis, we look at the line and we make very thoughtful overall decisions. At the end of the day, it also boils down to individual risk decisions. And so going into guaranteed cost versus loss responsive, I guess the one comment I would make is the larger loss responsive buyers in terms of economic impact, that business gets impacted both based on payroll as well as losses. And as loss experience in general for the line, frequency is wrapped in on some of those larger risks. So that large loss response business for the ease [ph] under management, that's where the pressure came from, as exposure was down even more on the larger loss responsive business. But coupled -- look at that trend now, that is actually starting to bottom out as well. We're starting to see the large loss responsive business starting to flatten out on the exposure side as well.

Operator

Our next question comes from the line of Mike Nannizzi with Goldman Sachs.

Michael Nannizzi
Oppenheimer

Just first question on the direct-to-consumer business in Personal lines, about three points it looked like, three expense ratio points there. It's a bit more than last year. Can you just kind of talk about how that buildout strategy works? Is it kind of a stair-step function as you allocate resources? Or was that advertising that you kind of paid upfront in the fourth quarter?

Jay S. Fishman
Former Executive Chairman

Those questions are actually more specific than even -- not that I'm not willing to respond, but we're capable of responding to. This is a long-term program and it will take years for us to develop a direct-to-consumer business that meets our own profitability and return thresholds. We are still in the early stages of the learnings that we have to go through. Those learnings extend all the way from how to drive a customer somewhere, whether to a call center or at a website, and then how to get them through the process, convert to a quote and then convert to a sale. So these are just the -- they remain the early days and the loss that we're experiencing in that business is about what we expected it would be because that's how we're planning it. We're actually -- our mindset is to incur that loss, which is necessary to maximize the learnings from the experience. And so it's really driven more by what do we have to learn than we have to of what do we need to spend. The encouraging thing -- and there are some encouraging things. The encouraging thing that we've discovered about the direct-to-consumer business is that we're increasingly pleased with the customer that's responding to The Travelers solicitation, whether that's through direct mail or digital media or through a broad-based media. We weren't sure what kind of customer -- we understood generally, at least we thought we did, what kind of customer responded to the existing direct-to-consumer businesses, but we weren't sure what our brand name and our value proposition brought to the market and, therefore, who the customers were who would respond and who the customers were from a socioeconomic perspective that would ultimately respond to the proposal. We're encouraged by that. What we're seeing are young versions -- at least we think what we're seeing are young versions of our future independent agent customer. And that just fits hand in glove. So we're at the early stages of it and we will lose that which is necessary to keep the learnings moving in the right direction and maximize the long term business opportunity.

Michael Nannizzi
Oppenheimer

And then just one question, Bill, if I could. Back to munies just for a second. Where would that -- I realize most of the movement in pricing in the fourth quarter was rate-related driven by Treasuries. Where would that be today, like if we were to think about where that sort of mark would be today given some of the volatility, at least so far this quarter? And then if you think about that book and these potentially just temporary rate or technically-driven price changes, how does that impact your thought process around buybacks, if at all?

William H. Heyman
Vice Chairman and Chief Investment Officer

Well, in terms of where the portfolio is this month, it would be hard for me to make a guess. My guess is very little change because most of the appreciation or depreciation is correlated to Treasuries. So on the 24th of the month, I wouldn't hazard an estimate of the month-to-date progress.

Jay Steven Benet
Vice Chairman and Chief Financial Officer

As far as the buybacks, it really doesn't factor into our discussion about buybacks at all. We don't -- as I said before, we don't take great pleasure in seeing the unrealized gains in the portfolio at any particular level, and say, "Gee, this is great. Let's go buy back more of our shares." And when change, it doesn't really enter into it.

Jay S. Fishman
Former Executive Chairman

Specifically, the mark-to-market in the bond portfolio, whether municipal or taxable, is not a capital item. It doesn't -- the mark-to-market positive does not add to capital and a mark-to-market negative did not delete from it. So we're driven very much by earnings and cash flow and the ability to realize excess capital from the balance sheet. That's what drives this.

Operator

And our next question comes from the line of Vinay Misquith with Credit Suisse.

Vinay Gerard Misquith
Crédit Suisse AG, Research Division

The first question is for Bill Heyman. What percentage of your municipal bond portfolio do you actually manage to get quotes from the market? Or is it just really based on interest rates because it is a liquid market?

William H. Heyman
Vice Chairman and Chief Investment Officer

It's based on more than interest rates. In terms of what percentage we get dealer quotes, I wouldn't say. The portfolio is 90-something percent in I guess what is called Level Two pricing, whatever that implies, which is sometimes dealer quotes. For what it's worth, we have a lot of confidence in the liquidity of this portfolio. We rarely see these bonds put up -- much of what we own put up for sale. And when we do, when it's an attractive price, we snap it up. We think, similarly, if we had to realize liquidity from it, even on a large scale, it would not be very difficult.

Vinay Gerard Misquith
Crédit Suisse AG, Research Division

Second question is on the Personal Lines. You've managed to improve the profitability in 2010 versus 2009. Where do you see your profitability going in 2011, both on the Homeowners and on the Auto side?

Jay S. Fishman
Former Executive Chairman

I think -- I'll ask Greg to comment, but I think we've already answered the question, which is we actually expect widening margins, meaning lower combined ratios in both the Auto as well as the Homeowners business, driven by earned rate gains that will exceed loss trend. But is there anything specific you want to add to that?

Gregory Cheshire Toczydlowski
Executive Vice President and President of Business Insurance

And the only thing I'd add is that's obviously based on the loss trends that we're watching today that has so much to do with miles driven. And as those things change, we'll change our pricing philosophy also, but those are the assumptions we're working with right now.

Brian W. MacLean
President and Chief Operating Officer

And weather will be weather.

Gregory Cheshire Toczydlowski
Executive Vice President and President of Business Insurance

Yes.

Jay S. Fishman
Former Executive Chairman

Yes.

Operator

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

Paul Newsome
Sandler O’Neill + Partners, L.P.

Do you think you're gaining share in Personal Lines, to focus on that little bit, or is it exposure gains? And if you are gaining share, and it does look like that to me, could you maybe think about or talk about where it's coming from in that business?

Gregory Cheshire Toczydlowski
Executive Vice President and President of Business Insurance

Yes, absolutely. This is Greg Toczydlowski. We do believe we're gaining market share, when you look at our unit growth and our topline growth. And when we look at the source of that business, we look at that at a very local level. So there's over 1,000 competitors in this marketplace, so we have regional players. But predominantly, when we look at the Agency business or even in the direct channel, the thrust of our new business is coming from non-independent agency-type carriers. And again, we watch that very locally and we'll continue to do that, but we feel good about our market share expansion in that product line.

Paul Newsome
Sandler O’Neill + Partners, L.P.

Non-agency independent, that's basically career agencies, is that right?

Jay S. Fishman
Former Executive Chairman

It could be captive, it would be career, it could be direct. But when we look at our new business flow and we ask who the prior carrier is, and that is an underwriting question that we ask, a significant percentage are moving from non-independent agency channels, direct captives, career such, into the independent agent channel.

Paul Newsome

Sandler O'Neill + Partners, L.P.

I may be just missing something, but completely separately, I was looking at sort of the other investment category, this may be a Jay Benet question, and it looked like the book yield fell significantly but the gross investment losses were up significantly. Am I sort of missing something? Is there some reason why the book yield would go a different direction?

Gabriella Nawi
Senior Vice President of Investor Relations

Maybe I'll take that offline with you. We're not sure we understand the question here. So maybe we can get to the next question and I'll give you a call after the call?

Operator

Our next question comes from the line of Larry Greenberg with Langen McAlenney.

Lawrence David Greenberg
Janney Montgomery Scott LLC, Research Division

I guess my simple question is, what's your level of confidence that what you saw in the fourth quarter in Business Insurance really marked kind of an inflection in the operating environment?

Jay S. Fishman
Former Executive Chairman

No declarations here, Larry. Sorry. One quarter does not a trend make. It's interesting. It's encouraging. It's consistent with the strategy that we brought to the market. But our share of the business, while significant, is not sufficiently large to be a price leader. And so we do what we do and competitors react and they'll react independently and we'll see where we go. I don't know.

Gabriella Nawi
Senior Vice President of Investor Relations

Okay. Operator, this would be the last question, please?

Operator

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

Jay Adam Cohen
BofA Merrill Lynch, Research Division

The first is, when you look at the claims frequency, and you've described the environment as still fairly accommodating, are you seeing any early signs of a change there? That obviously has been a pretty important factor in the profitability.

Brian W. MacLean
President and Chief Operating Officer

The short answer is nothing.

Jay S. Fishman
Former Executive Chairman

I'm looking at Brian because two really separate questions. We experienced a number of years where frequency was declining in many lines of business, and over a period of time here that has leveled out. So I certainly would not say to you that frequency is continuing to decline. It may, but it's not what we're seeing at the moment. What we are broadly seeing, and it's very much a function of individual line and product, is flattening of frequency. I don't know, other than in the little area that Bill Cunningham was speaking about in workers comp, if there's anything. And even that was small by -- just trying to be very thoughtful about the response.

Brian W. MacLean
President and Chief Operating Officer

But to your point, a couple years ago comp frequency was falling from that. And that clearly has mitigated. But for the last year, it's been very stable.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

The other question was on exposure and I'm wondering what are the key things driving it. I'm assuming it's mostly just payroll and revenues at your insureds going up?

Brian W. MacLean
President and Chief Operating Officer

The biggest driver is business receipts and the second driver is payroll. So most of our liability products are rated off of business receipts. And as those have rebounded -- and actually the right words would be as those were falling less throughout 2010, the exposure change was less negative and it's back up to a slight, slight positive. And then payroll is a piece of it.

Jay S. Fishman
Former Executive Chairman

It's important to remember, Jay, though, that these are estimates that our insureds are making about the next 12 months. So at policy renewal, they make estimates of payroll and sales and square footage and trucks on the road. And so the first thing that we're seeing here, interestingly, is a change in the sense of optimism about the insureds themselves. They see a projected change in exposure. Then, of course, we come back in at the end of the policy period, we do an audit, and we make a determination of what the actual exposures were, we bill accordingly. We have had negative audit premiums for the last several years, which really speaks to how rapidly and how deep the decline in the economy was, because it actually exceeded the expectations that the insureds have. So now, sort of first derivative, interesting to see that insureds are beginning to have a different view of what their business prospects are. And now, we'll see ultimately what their real numbers end up being as the months go on and we're able to go back and begin to do audits. And if we get back to historical patterns, most importantly, if we get back to historical patterns, we would expect to end up with positive audit premium billings because customers tend to understate their exposures. At least historically that's been a true pattern. Now we'll see how insightful our customers really are.

Operator

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

Gabriella Nawi
Senior Vice President of Investor Relations

Thank you very much for joining us today. Of course, as always, Andy Hersom and I are available in Investor Relations for any follow-up questions. Thank you and have a great 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.