The Travelers Companies, Inc. NYSE:TRV

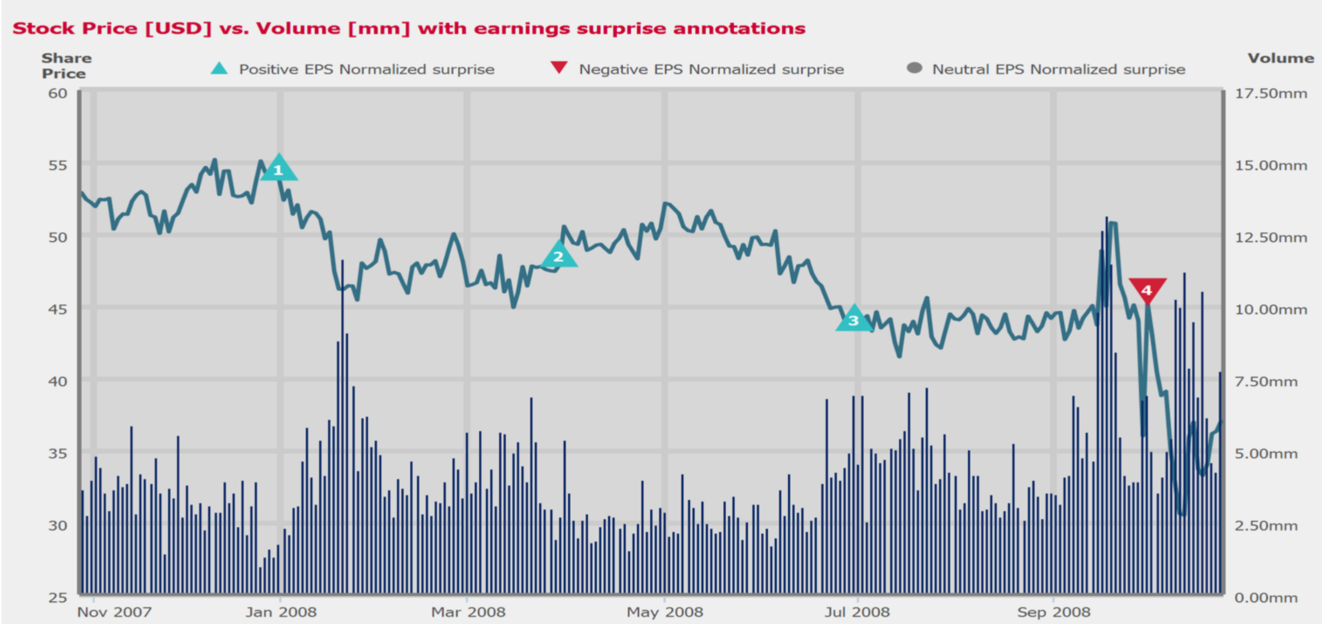
FQ4 2008 Earnings Call Transcripts

Tuesday, January 27, 2009 2:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ4 2008-			-FQ1 2009-	-FY 2008-	
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	ACTUAL
EPS Normalized	1.45	1.58	▲8.97	1.45	5.10	5.27
Revenue	-	-	▲0.22	-	-	-
Revenue (mm)	5421.97	5434.00	-	5137.00	21588.56	21579.00

Currency: USD
Consensus as of Jan-27-2009 12:32 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ4 2007	1.60	1.63	▲1.88 %
FQ1 2008	1.54	1.61	▲4.55 %
FQ2 2008	1.45	1.50	▲3.45 %
FQ3 2008	0.60	0.55	▼(8.33 %)

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Call Participants

EXECUTIVES

Alan Schnitzer

Brian MacLean

Gabriella Nawi

Jay Benet

Jay Fishman

Joe Lacher

Tom Kunkel

ANALYSTS

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UBS

Ian Gutterman
Adage Capital

Jay Cohen
Bank of America-Merrill Lynch

Jay Gelb
Barclays Capital

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Larry Greenberg
Langen McAlenney

Matthew Heimermann
JPMorgan

Meyer Shields
Stifel Nicolaus

Paul Newsome
Sandler O'Neill

Vinay Misquith
Credit Suisse

Presentation

Operator

Good morning, ladies and gentlemen, and welcome to the fourth quarter and full year earnings review for Travelers

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

Thank you, Lacey. Good morning to everyone and welcome to the Travelers discussion of the fourth quarter and year-end 2008 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.

With me today is Jay Fishman, Chairman and CEO; Jay Benet, Chief Financial Officer; Brian MacLean, President and Chief Operating Officer; Alan Schnitzer, head of our Financial, Professional & International Insurance business; Joe Lacher, head of our Personal & Select businesses; as well as other members of senior management. 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 following on page 1 of the webcast. Our presentation today includes certain forward-looking information as defined in the Private Securities Litigation Reform Act of 1995. All statements other than statements of historical facts may be forward-looking statements. Specifically, our earnings guidance is forward-looking, and we may make other forward-looking statements about the company's results of operations, financial condition and liquidity, sufficiency of the company's reserves, and other topics.

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 our current expectations due 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 Travelers operating income, which we use as a measure of profit and other measures that may be non-GAAP financial measures. Reconciliations are included in our recent earnings press release, financial supplement, and other materials that are available in the Investor section on our website, travelers.com.

With that, I will turn it over to Jay.

Jay Fishman

Thank you, Gabi. Good morning, everyone, and thank you all for joining us today. We have a lot to cover, but I think it is important to put today's reported results as well as some of the other topics that we will be discussing today into the broader context of our organization.

This year's performance is reflective of Travelers long-standing approach to managing risks in order to achieve our targeted results over time. I have said many times before that our fundamental business is one of managing the balance between risk and reward, both on the liability side as well as on the asset side of our balance sheet.

What you see in our results today is an operating return on equity of 12.4%, and importantly, a four-year average annual operating return on equity of approximately 14.5% comes from this core cultural value and from as decisions we have made and actions we have taken or not taken over the past several years, not just this year.

Looking back to what we said this time last year, we assessed the insurance marketplace more or less correctly. We expected it to be more challenging from a margin perspective, and it was.

With that said, we are very pleased that our initiatives over the last few years have paid off, for example, an increased flow. We're also pleased that our metrics suggest that we continue to maintain our underwriting discipline.

On the investment side, market conditions were clearly much more challenging than anyone anticipated. However, all things considered, I could not be more pleased with our performance and the position of our investment portfolio. We have received a number of questions in the last few months on how we are able to avoid so many of the investment issues which plagued the market this year.

The answer is not that we saw everything coming. But in many areas, we believe that risk was underpriced. In that regard, we were fortunate. As I have also said if certain asset classes had been better priced, we would likely have been somewhat invested in at least a few of them.

As it relates to pricing, I have noted in the last six months that the world feels like a riskier place. Recent data suggests that we may now be starting to see an improvement in the pricing environment. We are by no means ready to declare a bottom, but we like the data and we will discuss it in more detail with you this morning.

On the investment side, we are still seeing a big spread between the bid and ask, but conditions in some investment areas in 2009 may provide more opportunities. Our results over the last few years have demonstrated a consistent and successful approach to assuming and managing risks in order to achieve an appropriate return for our shareholders.

Nothing in that approach or in our culture has changed. I believe we continue to be well positioned to meet both the challenges and opportunities posed by the current environment, and deliver on our long-term strategy. While I will not go through the specifics of the quarter, I just want to highlight our strong results, superior returns and importantly increased book value in 2008.

With that let me turn it over to Jay.

Jay Benet

Thanks Jack. Turning to page 4 of the webcast, let me start by saying that our investment portfolio, reserves, capital and liquidity continue to be in fine shape, despite the continuing turmoil in the financial markets. Our operating company capital remained at or above all of our target levels, our debt-to-total capital ratio of 19.5% was below our 20% target, the midpoint of the 15 to 25% range that arrives from our AA ratings target.

Holding company liquidity was $2.1 billion remaining at almost twice our target of one years' worth of interest and dividend. This is after contributing $450 million to our qualified pension plan, which was funded at a 92% funding level at year-end.

We have negligible amounts of debt maturing in the next three years and do not rely on commercial paper. Book value per share ex FAS-115 of $43.37, increased 5% for the year after purchasing over $2.1 billion of common shares and paying $712 million of common stock dividend and once again we closed the year with over $25 billion of common equity.

On page 5, we updated recent areas of market disruption and their impact or lack thereof on Travelers. Overall, we continue to be unaffected in any significant way. Note that we have no direct investments related to the Madoff matter and are not aware of indirect investment exposures we may have based on inquiries we made of our fund managers.

Page 6 shows a cap and net favorable prior reserve development continue to play a meaningful role in our quarterly results. Prior year reserve development favorably impacted our fourth quarter GAAP combined ratio by 5.1 point and a downward adjustment of estimated costs associated with current year caps, mostly related to hurricane Ike, which included the Texas Windpool assessment and hurricane Gustav, favorably impacted this quarter's combined ratio by 1.6 points.

I would also like to point out that we recorded an $89 million tax benefit related to the sale of Unionamerica our UK runoff business subsidiary. The sale of Unionamerica also produced a small realized gain in addition to this tax benefit. It eliminated $790 million of net reserves, which included $265 million of A&E and it freed up supporting capital.

Ex caps and net favorable prior year reserve development, our GAAP combined ratio was 92.5% and we remain very pleased with the underlying profitability of our businesses.

Page 7 of the web cast shows the three major contributors to our operating return on equity. Fixing income NII plus interest on corporate debt remained the major driver. This passage of time component contributed 8.7 points in the current year, down slightly from the prior years, entirely due to lower short-term interest rates.

A much smaller contributor operating ROE, but one that does vary from period to period is non-fixed income NII, which contributed a negative 0.6 percentage points this quarter, due to the difficult investment marketing conditions we faced as compared to a positive 1.4 to 1.6 points in prior years. And underwriting contributed 4.3 point for the year below the last two years due to the high level of weather-related losses.

Cumulatively from January 2005, we produced an average annual operating ROE of approximately 14.5%, consistent with our stated longer term goal of mid-teens ROE.

The fourth quarter net investment income of $438 million after tax as shown on page 8 was down significantly from recent quarters. The after-tax yield on our fixed income portfolio was 3.7%, consistent with prior years. That is the long-term fixed income portfolio, while the short-term portfolio yielded 1.1%, due to the actions taken by the Feds to lower short-term interest rates.

The non-fixed income portfolio yielded a negative 14.9%, giving back a third of its 2007 NII, as private equity real estate partnership and hedge fund evaluations were impacted by the challenging financial markets.

Consistent with our practice, we were diligent in updating our non-fixed income returns through December 31, despite the usual time lag in which investment managers report results. Accordingly, our fourth quarter non-fixed income portfolio loss of $164 million after-tax included $56 million of after-tax losses that were reported, based upon information requested by us and recently made available to us by certain of our investment managers.

As you will see, in our guidance, we are hoping for considerable improvement in our non-fixed income returns in 2009, but fully realize that they will be subject to evolving market conditions.

The composition of our $71 billion investment portfolio remains unchanged from recent periods. At year-end fixed income comprised 94% and non-fixed income 6% of the portfolio. The quality of our fixed income portfolio remains at AA+. Its duration was 4.2 and the below investment grade portion was only 2%.

And given movements in treasury rates, credit spreads, and equity markets doing the quarter, our after-tax net unrealized investment losses were reduced to $144 million at year-end, an improvement from $818 million at the end of the third quarter.

Our investment portfolio remains well diversified across industries, investment types and individual issuers.

We continue to apply very rigorous processes to identify investments for which write-down should be made. So during the fourth quarter, we recorded net realized investment losses of a $138 million after-tax, including impairment of a $129 million after-tax, bringing full year net realized investment losses to

$271 million after-tax, which represents a very small percentage of both our investment portfolio and our capital.

The information that appears on page 9 is based on a schedule that will appear in our Form 10-K, showing unrealized losses on investments, which estimated market value is less than 80% of amortized cost. This amount has increased from the third quarter. It now stands at $744 million, with the vast majority in this position for 30 days or less. While this still represents a small fraction of both total investments and shareholders' equity, we do closely monitor these investments.

And with that, let me turn the microphone over to Brian.

Brian MacLean

Thanks, Jay. To give some context to the business results, I would like to start by offering some broad comments and then address the business insurance results, specifically. Obviously, the economy is in a turbulent state. It has impacted our industry broadly and for many individual companies in a profoundly negative way. Yet, as our results will show, we're favorably positioned for and have effectively managed this environment, delivering positive results for our customers and for our shareholders.

As an industry, we're sensitive to macroeconomic forces, such as decreased demand for goods and services and higher unemployment. These and other pressures drive down payrolls, receipts, and consumer and business spending, thereby limiting the overall growth and insurable assets and impacting insurers' ability to grow the top line.

In addition, the current economic environment has also resulted in significant dislocation in the financial services industry, driving customers, agents and brokers to more strongly than ever consider the financial and operational stability of their business relationships, including with their insurance carriers.

This flight to quality has complemented the fundamentals we have developed during recent years, including our broad risk appetite, underwriting specialization, ease of doing business and claim effectiveness. The resulting stability we have experienced has allowed us to focus on the consistency of our strategy, and to deliver superior products and services, as well as solid financial performance in these turbulent times.

Given that context, let's review the details beginning with the business insurance results on slide 10.

Business insurance delivered operating income of $619 million, compared to $729 million in the same quarter last year. The combined ratio, as adjusted on the page, was 93.2 for the quarter, a deterioration of 1.8 points from the fourth quarter last year, and still at a healthy level. The deterioration is primarily due to the earned impact of the modest rate decreases and loss inflation we have experienced throughout the year, as well as some large loss activity, which in the fourth quarter was again above normal levels.

Net written premium, as shown on slide 11, declined slightly or 1% overall from the fourth quarter of 2007. The overall economic contraction is affecting the top line of all of our businesses, but most dramatically construction, builders risk policies and inland marine, large property accounts and the trucking business. So given the impact of the environment, we're very pleased that in the aggregate we have basically flat top line.

As we look at the production details on slide 12, we can see how we have been able to maintain level premiums in a contracting economy. First, retention remains high across all our domestic commercial businesses, and has increased to 88% in Commercial Accounts, our core middle market unit.

We have been speaking all year about the importance of high retention, and these results are a direct outcome of our conscious strategy to maintain stability across a variety of marketplace conditions and are a critical factor to our success in today's environment. They also speak to the flight to quality dynamic and the value of our product, services and brand in the marketplace.

Looking at renewal price change data for the BI segment, you can see that the change is generally consistent with recent quarters. But this data is not total price change and we thought this data is total price change and we thought it was important this quarter to look at the components of the change, to see what is really going on with pricing.

So on slide 13, we graphed the two components of price change. That is rate and exposure. And here we see two distinct trends that essentially net out in the RPC. That is for us, rates have been generally improving over the last four months, while exposures have been generally declining. So although premium is relatively flat, all other things being equal, our margin picture is improving.

The magnitude is different by customer group or line. In businesses like National Property, the shifts have been significant with rate change improving dramatically in recent months, while in Commercial Accounts rate improvements and exposure declines have been more moderate but steady.

Even in small commercial, which is not shown on the slide, we've seen a shift with marginal month-over-month improvement in rate change and offsetting deterioration in exposure growth in each of the last four months. Obviously, three or four months of activity is not enough to declare a change in the market, and we always remind you that we don't have a crystal ball on where things are going, but the run rate for these measures has clearly shifted since September.

Turning to slide 14, the amount of new business written, in aggregate, is down slightly from the fourth quarter of 2007. In select, our small commercial business, new business in the second half of the year increased as the result of the product and platform expansion we have spoken to you about in the past. Across our other domestic commercial businesses, new business dollars are down or flat, reflecting the current economic environment and competitive new business pricing dynamics.

In analyzing new business, it is important to speak to the new business opportunities or flow of new business that we see. Flow statistics were up in nearly all of our businesses this quarter. This increase follows the trend we've been seeing throughout the last two years and is the result of both our strategy to drive more opportunities across all our businesses, and the flight to quality we're seeing in the market place.

Some of the quarter's increase in flow is attributable to other carriers' instability but most is a result of our new product offerings, platform enhancements and strong positioning with agents and customers. Even though we're seeing strong new business deal flows, the new business pricing environment we have to compete in, remains very competitive. We have been rigorous in adhering to our underwriting standards and therefore our hit ratio or the percentage of quotes that we are writing has declined.

As we have previously emphasized on both new and renewal business, we are maintaining our disciplined underwriting standards. So in the aggregate we're very comfortable with the quality of business we're writing.

So, overall in the business insurance segment, basically level top line, and solid margins. And in these market conditions this is a result we are very pleased with.

With that, let me turn it over to Alan Schnitzer for the financial, professional and international insurance results.

Alan Schnitzer

Turning to slide 15, in the financial, professional and international insurance segment, operating income was a $154 million for the quarter, as compared to $184 million in the prior year. The adjusted combined ratio for the quarter was 92.4%, up 2.7 points from the fourth quarter of last year.

The primary driver was a small number of large losses in the international business, although, our large loss experience has improved from prior quarters.

Net written premiums in the quarter declined 3% from the fourth quarter of 2007. In bond and financial products, the decrease in net written premium is primarily due to lower volumes in the surety business. In international decrease resulted from foreign currency translation.

Turning to slide 16, in our management liability business in the quarter, retention remained high and consistent throughout the year. Renewal price change was slightly positive at 1% all attributable to rates and new business was strong. The new business gains were driven by an increased flow of new opportunities from a flight-to-quality in the public company liability business, partially offset by decline in new business in our financial institutions book, due to disciplined underwriting.

In the international business, retention was at 76% in the quarter, down both year-over-year and over recent quarters, primarily due to intensive underwriting actions. The rate in the quarter was flat after 8 quarters of negative rate change and other RPC was a positive 6%.

This time last year, we provided you with information about what we termed as sub-prime exposure. Over the course of the year, we have broadened the scope of our attention beyond sub-prime to include management liability exposure, arising out of the disruption in the financial markets more generally.

Starting on slide 17, I would like to provide you with an update. We have consistently focused on building a well-diversified portfolio, management liability products, sold through various business units. We believe that this diversification and more specifically, the lack of over concentration in any one area, such as large publicly traded financial institutions, provides substantial mitigation against shock coming from events, such as the financial market disruption we have all seen over the past year.

As you can see, we write approximately $1.6 billion of management liability premiums. In the current economic environment, many of these liability products are certainly subject to some level of increased exposure.

We have broken down our management liability exposure into four product groups: DNO, ENO, fiduciary liability and other. And we have identified the amount of premium within each product group that we estimate is subject to a significant elevation of exposure, emanating from the financial market disruption.

We estimate that the written premium from accounts at elevated risk as a percentage of our overall management liability portfolio is a modest 17% as a percentage of Traveler's overall gross written premium it is only about 1%.

Turning to slide 18; it is important to consider the specific characters of these products and our disciplined approach to underwriting. DNO, ENO and fiduciary coverages are written on claims-made forms that contain defense costs within policy limits. Policies with elevated risk levels contain limits that are generally low, between $1 million and $25 million. But more importantly, average approximately $4 million.

These policies are about evenly split between primary and excess coverages. Average attachment points for excess are relatively high at $46 million for DNO loan and $37 million when including fiduciary ENO. The larger account excess coverages comprise approximately 70% of the total.

Please also note that we continue to use reinsurance to further mitigate portfolio risk. Our current analysis of 2008 claims, indicates little chance that we will approach the $375 million recovery cap. For 2009, we have revised our treaty to respond to frequency more than severity.

On slide 19, I would like to walk threw the actions we have taken over time to address our potential exposure to financial market disruption. Since the first quarter of 2007, we have been proactively incorporating the financial market environment into our underwriting discipline.

As we told you last year we conducted an individual account analysis on all accounts which reported claims, and for those individual accounts that we felt had a high level of exposure. The scope began with the accounts that included credit-related announcements or individual accounts with elevated risk characteristics, such as financial institutions, subprime lenders, bond insurers and home-builders and suppliers.

Throughout 2008 on a monthly basis, we continue to update the analysis and expanded the scope to add more focus on community banks and consider exposures related to the Madoff matter. So, we continue to monitor the situation closely and revise our underwriting accordingly.

Considering our diverse book and the way we have approached the market and managed our exposure, we expect that any potential issue would likely be a more manageable issue of frequency not severity.

On slide 20, let me tell you how all this translates into our results. In case of claim notices arising out of financial market disruption reported in 2008 was consistent with 2007. With average limits and excess attachment points slightly more favorable in 2008, as compared to 2007.

Our estimate of financial market disruption losses for 2007 improved from last year to this year, and excluding our exposure to the Madoff matter, our estimated losses for 2008 is consistent with our current estimate of losses for 2007. Although, it is early days of the firms and individuals identified publicly as having exposure to the Madoff matter, we have identified accounts in our management liability business with total exposed limits of approximately $150 million, net of reinsurance.

We currently estimate that our actual aggregate losses from the Madoff matter, including accounts not yet identified, will be less than $75 million pre-tax, or $50 million after-tax. Some of which we recorded in 2008, and some of which we will record in 2009.

We've recognized estimates for financial market disruption and Madoff losses in our 2009 guidance. After considering all the items I mentioned, we expect our management liability business will remain profitable, as it was in 2008 and 2007.

With that, let me turn it over to Joe for a discussion of personal line.

Joe Lacher

Thanks Alan. Personal Insurance had a good quarter, strong earnings, growth and policies in force. Business continues to demonstrate the sound fundamentals.

Looking at page 21, you can see that operating income is up $25 million, compared to the fourth quarter of 2007, driven primarily by favorable cat results and offset by unfavorable net investment income. The fourth quarter had a favorable GAAP combined ratio of 85.6%, versus fourth quarter 2007 of 90.8%. Our expense ratio decreased one point in the fourth quarter 2007, primarily driven by a favorable adjustment to our estimate for the Texas Windstorm Insurance Association losses from Hurricane Ike.

Adjusting for cats, prior year development, and current year re-estimation our adjusted combined ratio is slightly better than last year. Overall, a written premium increased 4%, despite challenging market conditions. As you can see from our production results on page 22, we continue to see solid business statistics in both auto and property.

Looking specifically at property, production results for the quarter were strong, with policies in force increasing 3%, retention stable at 86% and a consistent renewal price change of plus 6%.

Homeowners new business is somewhat related to home sales. Against the backdrop of significantly declining home sales, we remain very pleased with continuing growth of the Quantum Home product and its ability to increase new business volumes. Quantum Home policies now represent more than 13% of our policies in force.

Shifting to auto, you can see that our production results remained solid. We continue to see increasing pressure on new business in the marketplace, but our renewal price change increased 4%, retention remained in line with prior quarters. Policies, in force, grew 2% over the fourth quarter 2007, with new business premiums up slightly.

Our combined ratio for the quarter was 100.1% or 5.3 points higher than the fourth quarter of 2007. This is driven by a difference in prior period development, and after normalizing for this prior period development, the combined ratio was consistent with the fourth quarter of 2007.

Page 23 provides a view of our auto loss trends. As you can see, total auto loss trends continue to be relatively flat in the quarter. Severity trend was slightly increasing and was offset by decreased frequency. While the marketplace remains competitive, we're seeing some increasing signs of firming, particularly in the auto line.

We're continuing to monitor loss trends, profitability, marketplace conditions as well as the changing economic climate and will appropriately adjust our tactics going forward. We remain pleased with the growth of our business, its underlying performance and look forward to building on that success.

With that, I will turn it back over to Jay.

Jay Benet

Thanks, Joe. Pages 24 and 25 set forth our guidance for 2009 along with certain supporting information. We're projecting fully diluted operating income per share in the range of $4.50 to $4.90, which should translate into an operating return on equity of approximately 10% to 11%.

Our guidance assumes cat losses of $360 million after-tax or $0.62 per diluted share. No prior year reserve development either favorable or unfavorable. A 2.4% non-fixed income portfolio yield. $1 billion of share repurchases, which would be a reduction from recent years, reflecting potential investment returns, and more properly reflect risk along with the uncertain economic conditions that all businesses face rather than a shift in our capital management strategy. No significant change in average invested assets, ex FAS 115 and a weighted average diluted share count of approximately 585 million shares after share repurchases and employee equity awards.
With that, we will open it up for questions.

Question and Answer

Operator

Ladies and gentlemen, our first question will come from the line of Jay Gelb with Barclays Capital. Please proceed.

Jay Gelb
Barclays Capital

Thanks, good morning. I had a question on the guidance. Jay, could you give us a bit more insight in terms of your comfort level with the 2.4% return on the non-fixed income portfolio, and Travelers is in my view probably be one of a very few property casualty insurers that will be buying back stock in 2009. Can you talk about your comfort level there as well?

Jay Fishman

First with respect to the investment yield, the reason that we provided it, obviously, is because of the uncertain environment that we are in. And one can be more optimistic or more pessimistic, and this really ties to our budget for the year and it is premised on a real estate portfolio for which we continue to collect rents, that will provide a positive return that's offset by what I would characterize as a fairly nominal return in the rest of the alternative investment portfolio. So it is a blend. But it does not assume obviously in the aggregate of continuation of what we saw in the fourth quarter. But one can obviously have a different view, which is why we decided to provide the number more specifically this year.

Jay Benet

You want me to cover the share repurchase?

Jay Fishman

Sure.

Jay Benet

As far as the share repurchases, as we said before, we manage our capital beginning with the operating companies and our operating companies are very well capitalized. So, we look at things that we will impact that and we have got earnings projections, we have got moving dividends out of the operating companies up to the holding companies. We have got what we think is generation of excess capital in the place and we are going to prudently manage it.

We are saying that the million dollars of buybacks, which is --it's not -it shouldn't be viewed as plan. We are going to execute based on what market conditions look like and we are going to execute based on what opportunities look like to invest in our investment portfolio, as I said earlier. But for the purposes of guidance and the overall feel of the place, we will be generating excess capital to the extent we don't have the investment opportunities and everything else, including liquidity and having the appropriate capital cushion to cover it, we will return it to share holders through buyback.

Jay Fishman

And Jay, just to add a bit to that comment, if possible that investment yields become more appropriately reflective of risk in 2009, and there is a consequence, the alternatives for buying back shares may become more robust than they have been in previous years but I'm certainly not making a prediction.

In previous years the alternative was a relatively modest bond yield of 4.5%, even at its highest levels. And it is possible given the markets and given the credit markets specifically, that returns in other highly rated -- I am not speaking now about moving either down in credit quality or long in terms of return. I am really just speaking about more appropriate returns for appropriate risk assets for a property casualty company. They may be more robust.

So one of our alternatives this year as we go through the year is to evaluate what is the best for providing shareholder return over time? If there are investment opportunities in the context of other fixed income instruments that are more reflective of long-term returns, we will do that. If not, we've always said we would right-size capital and will return. I do think Jay's comment about being more reflective generally of a challenging economic environment is a real one. The last thing we would ever want to do, is to be buying back shares in one period, and then finding ourselves in a position of having to issue equity indexed. That is just a head scratcher for us. And so we are going to manage that just judiciously as markets involve.

Jay Gelb
Barclays Capital

Thanks. If I could just ask one more quick one. And could you update us on your outlook for the surety environment in a tough economic environment?

Alan Schnitzer

Sure Tom Kunkel is with us today. He is the CEO of our bond and financial products business. Why don't we let Tom take that question?

Tom Kunkel

Sure, thank you, Alan. The outlook for the surety business clearly there has been some level of drop off in public construction spending. We are looking though to see what kind of impact any public works program may have on -- what we're going to see for surety revenue going forward.

As far as the condition of the contractors in our portfolio, clearly, I think, the larger contractors still have some pretty robust backlogs. The middle market people have seen some backlog shrink and they have seen some increased competition on bids. All that said, but the truth is, is that they're still showing the highest internal credit scores or near the top, that we have actually had.

And in addition to that, I would say that, our underwriting continues to be very robust, we are doing comprehensive financial analysis. We're investigating credit relationships. We are closely monitoring new projects that are acquired and the margins that attained at and closely monitoring the progress of projects proceed towards completion.

All those things said and done, we know management very closely in these companies to the point where we're out walking job sites with them. So, I don't think any one could say that we feel that we're immune to what is happening in the economy. But we do feel like our people are still very well positioned, going into it and being in the middle of this economy.

Jay Fishman

In the context of a loss perspective in that regard, though, is a credit sensitive business, and it will likely show higher losses in a more challenged credit environment than it would have in a less credit-challenged environment. Tom, I think, is providing the perspective of an underwriting oversight and the way the business is managed, but recognizing that it is certainly a more challenging economic environment.

Tom Kunkel

Absolutely, Jay, it certainly is more challenging than it was 24 months ago.

Jay Gelb
Barclays Capital

Thank you.

Operator

Our next question will come from the line of Larry Greenberg with Langen McAlenney. Please proceed.

Larry Greenberg
Langen McAlenney

Thanks and good morning. Just curious about your thought process and putting up about half of the policy limits from Madoff and what would have to change for that number to change materially in either direction?

Alan Schnitzer

We have gone through all of our accounts that we think have exposure to Madoff and we have identified the ones that we think are likely to make claims but haven't yet. So, I think for this really to change dramatically, we have to see accounts coming from a high frequency of accounts that we haven't yet identified as having exposure.

In terms of the amount we have put up, obviously we have analyzed the claims. We have looked at the policies, and we have recorded the amounts that we think are likely to be paid.

Jay Fishman

I think the point there Larry is that it is not a 50% across the board assessment of limits. It's actually a policy-by-policy review based upon the claim and on the claim data and information that we have so far. There are going to be policies that will be exposed. There are going to be policies where there will be significant defenses. There are going to be policies that may not even be exposed. And so the number that's here is not a pro-rata assessment of exposure, but much more an account-by-account analysis.

Alan Schnitzer

That's right. And I think for there really to be a significant change from our expectation, we have to see claims from a large number of accounts that we're just not expecting claims from.

Larry Greenberg
Langen McAlenney

Great, fair enough. Follow-up, Jay, assuming that some of the positive pricing signs get some legs and the market were to continue to firm. There is always an elasticity of demand in the industry, and as buyers see their prices rise they tend to reduce their buying habits. Do you think, given the economy today that under that scenario, there would be a materially greater, let's say elasticity for a demand?

Jay Fishman

Exposure is certainly going to continue to be negative, I suspect. As we think by the way exposure for us means risk units for existing customers. And so if payrolls decline, workers comp premiums decline, that's a reduction in exposure.

Larry Greenberg
Langen McAlenney

Right.

Jay Fishman

If previously there were five trucks in the fleet and now they sell three, there is obviously less exposure. New business is impacted by new accounts. You are going to have a few things here. We're going to have obviously less business growth and arguably business shrinking, in that regard exposure will be either less than it would have been or perhaps even negative.

And on the new business front, you're really talking about churn, moving of accounts from one carrier to another. That to me is a sort of a more predictable dynamic in that. That is going to likely continue. There is a flight to quality I think going on, and it would be not prudent to not anticipate declining exposure.

I do think that as companies, particularly on the commercial side, and perhaps even on the consumer side tighten their belts you will see rising deductables, that circumstances that we have seen before. I don't know that we have seen, I have to go back and look. I don't know that we have seen declining limits.

I think generally what we have seen is that people bought business in particular, is willing to self insure more at the bottom than they are to buy less at the top. But so, you're trading, working layer-oriented exposure, in that case, and its impact on profitability less than if it was at the top of the profile so to speak.

But I would certainly anticipate declining exposure and rate will see. The last three or four months have been encouraging and we will have to wait to see what happens.

Larry Greenberg
Langen McAlenney

But I guess just in terms of relative to historical cycle hardening, would you expect these trends to be much more pronounced given the economic climate today?

Jay Fishman

I am not answering, candidly I don't know. I am not sure that we have seen a circumstance before of the combination of as you describe it your words now, not mine, a hardening market, and a declining economic environment. The last couple of times that we have faced changes in cycles, they have been in some relatively robust economic times.

And so we are at least from my experience going back into the '90's, I think this is somewhat unchartered and I just don't know. I don't have an experience to look back to and point to. I have said before that I think that that there are plenty of good reasons to believe that the cycle behavior has changed. We said that several years ago. I think the statistics continue to bear that out.

If, in fact, rates beginning to change, you wouldn't have bet that that would have happened with retentions being at all time highs. Historically, retention has been much lower, I remember in the middle market again in the high '60s, before the market really began to turn. We have a middle market retention of '86.

So, I think that this cycle has been and continues to be different, behaviorally different than cycles that we have experienced before and I just don't know how to answer your question because I don't have a basis to have a conclusion on it. I do believe that exposure will continue to go down. That's about as much as I see in a crystal ball.

Larry Greenberg
Langen McAlenney

That's fair. Thanks very much.

Operator

Our next question will come from the line of Jay Cohen with Bank of America-Merrill Lynch. Please proceed.

Jay Cohen
Bank of America-Merrill Lynch

Thank you. Good morning. It looked like there was an unrealized gain in the quarter after-tax of about $674 million. However, if you look at the AOCI line in your balance sheet presentation, it didn't change that much. It looks like there is some offset. I am assuming it's currency but could you discuss that?

Jay Benet

Yes Jay, this is Jay Benet. It is not currency. Without getting into the details of pension accounting, which as you know is very complex. The AOC is also going to be impacted by changes that take place in the pension plan, which are for actuarial purposes, not fully reflected on an immediate basis.

So, even though we funded the pension plan to get it up to the 93% funding level, think of that as a change in cash to investment the way the pension accounting works. And then the unrealized loss that the pension assets experienced in particular this quarter, but for the year, gets reflected as a downward adjustment in the AOC to be recognized over time, as an actuarial loss in this particular case through the pension expense. That's what causing it.

Jay Cohen
Bank of America-Merrill Lynch

Okay. That's helpful. And then secondly, it is probably too early to even have a comment on this, but some of the claims that you have seen related to the broader credit crisis, is there anything to read into yet, some of the decisions that have, probably very few decisions that have come out on the trials or settlements related to these claims?

Jay Benet

I don't think so. I think it's little early for that.

Jay Fishman

I think it is too early to draw conclusions from that.

Jay Cohen
Bank of America-Merrill Lynch

Yeah, that is what I suspected. All right, thanks a lot.

Jay Fishman

The only comment perhaps and this is anecdotal and not just kind of reacting to your question, I think that there tends to be an emotional reaction to these things that eventually works its way through. I am thinking back to the perception that option backdating was somehow going to be a very significant event in the D&O professional liability area. And so far, it hasn't.

And I think you can look back over the last few years of several events where the reaction, the analytical reaction tends to be my goodness there is significant exposure here and yet when the cases come and the litigation begins, circumstances often turn out differently. I think we're here way too early to come to any predictions. But I just think back to how many conversations we have had over the last few years of issues that people perceive to be confronting the professional liability business.

Jay Cohen
Bank of America-Merrill Lynch

Got it. Thank you.

Operator

Our next question will come from the line of Vinay Misquith with Credit Suisse. Please proceed.

Vinay Misquith
Credit Suisse

Hi, good morning. With respect to your financial institutions, D&O, I believe you have around $274 million worth of gross written premiums in 2008. I was wondering whether you could give us the gross exposure that you have out there, and what level of reserves have you put on that?

Alan Schnitzer

I think the $274 million you're looking at is not just financial institutions. That is the total of the gross written premium that we have identified as having elevated exposure to financial market disruption more broadly. So, I just want to clarify that point.

In terms of the gross limit you're looking for, that is not a number we have disclosed in the past and not something that's really I think is meaningful in terms of perhaps trying to draw the conclusion that you may be looking for.

Vinay Misquith
Credit Suisse

Okay, and in terms of market share, what do you think market share for financial institutions would be?

Alan Schnitzer

Let me ask Tom Kunkel to answer that question, but I think the thing you've got to think about though is, you had a subsegment of the financial institution market that has, our market share among the large financial institutions isn't all that significant relative to our overall financial institution portfolio. Tom, do you have anything to add to that?

Tom Kunkel

Alan, I think you hit the key point so before estimating a figure, you would say we're again just various aspects and highly diversified across the whole financial marketplace. So to say a market share really does lump everything together.

All that said and done, you could say that possibly there is an 8% or 9% market share. But a lot of it is in community banks, smaller institutions privately held, you see some mutual fund business. So, it is really diversified across all aspects of that business and more so, that is a part of a more highly diversified management liability business across the place.

Jay Fishman

And I think important, it often gets I think confused but a meaningful position for us is in community banks and I'm going to go back in my recollection is it is 85% privately owned, right? Only 15% of which are public institutions. We're talking about, my recollection was again, total assets of is a $5 billion or less predominantly in the books.

And we were going back to an old webcast where we gave the information on this community bank business, but it's been our experience at least so far that these are institutions that are generally not exposed to the kinds of issues that many of these questions are directed to 87%, I have got the statistics here 87% have assets less than $1 billion and 11% from $1 billion to $3 billion.

And again, 85% of them are privately held. The average limit of D&O coverage for that bank is $3.8 million. So, one of the comments that we have made is that we're not a severity book. We're not writing significant numbers of 50 or 75 or $100 million of limits where one account can become problematic to our results.

Our exposure and we have said this before in the financial arena, it would change if in fact somehow the community banks broadly were dragged into the financial crisis. We don't see that happen. So, it is always possible it may but we haven't seen that happen yet. We have some difficulty perceiving the circumstances that that could happen.

These are typically not institutions that underwrite securities. These are typically local deposit-taking, loan-making banks that operate, again very locally. So I think if you look just to the market share, can produce an inappropriate analysis of what our exposure to these events might be.

Vinay Misquith
Credit Suisse

Sure, that's fair. Just one follow-up, claim notices appear to be same in '08 versus '07. Just curious given your exposure to mostly smaller accounts, would it be fair for a person to think that in the first instance, the larger financial institutions would usually be sued, but then later on, you would have more of the smaller financial institutions being targeted.

Jay Fishman

I think the answer to that would be typically not. The first half correct, where suits tend to go is where assets exist and where there are deep pockets, and where the ability to martial class-action suits can produce a significant outcome.

And so, I think you will see, obviously, an attraction of this kind of litigation to larger financial institutions. Many people will often ask who insures them. The answer, by the way, sometimes is in fact no one, or in fact no one in working layers. These are institutions that often self insure. Significantly amounts of DNO exposure and they buy relatively high up and this is not a universal statement

But it is true that larger financial institution, the great big money center banks or at least the ones that used to be great big money center banks often self insure working layers of exposure. And it's not been our experience. Obviously, it can be different any given time, but it has not been our experience that litigation starts at higher institutions, and indeed, inevitably filters downs to smaller ones. That's not been a trend we have seen before, may be different this time but again it is difficult to attach the community bank business, not impossible, but difficult, to attach it to these circumstances.

Now that's different from investment advisors, it is different from those institutions that Alan and Tom have spoken about. Let's say specifically in reference to the Madoff matter where we have a name and a policy and we have identified it and put it on the schedule. So, there it's different, but in the broader sense of the financial dislocation, we continue to feel pretty good that our exposure is diversified and tends to be of a lower smaller institutions.

Vinay Misquith
Credit Suisse

That's clear. Thank you.

Operator

Our next question will come from the line of Brian Meredith with UBS. Please proceed.

Brian Meredith
UBS

Yes, thanks I have a couple of questions here. First, Jay, the fact that you guys are looking to potentially buy back a $1 billion of stock. Does that at all indicate your appetite or view of some of the properties that are available out there in the marketplace? Just given the liquidity and excess capital that you have, I figured you would be in a pretty good position to maybe pick up some attractive assets.

Jay Fishman

No, it doesn't. It is a number to be used for the purpose of establishing guidance. We look at lots of things. Will Heyman looks at investment opportunities that come along in our asset portfolio. And to the extent that business opportunities come along, it would imprudent of us not to look and evaluate and consider. So no, it really is a number, a starting point, if you like, for the purposes of calculating guidance.

Brian Meredith
UBS

Great, and then to the next question. If I look at your guidance for this year, it comes out to be 10% to 11% return on equity. Would you view that is kind of a trough ROE going through the market for Travelers?

Jay Fishman

Well, I would hope so. I mean that would be a pretty good outcome. If you look at the bottom, again you're getting into sort of questions about cyclicality in debts and all the rest, the last time the cycle turned I think most people in the industry would have given anything to produce a 10% or 11% return at the bottom. So I don't know. I mean again it's a crystal ball question.

All I can do is tell you that the rate data for the last several months has been encouraging and it would certainly be a nice place to begin to make a bottom, again with retentions at all time highs and with projected returns in that 10% to 11%, it would feel good to be making a bottom there if it happens.

Brian Meredith
UBS

Great. And then the last question quickly for Brian. You mentioned the hit ratios continue to decline here, although your flow is moving up. I am just curious, can you get into a little bit on why you think that is happening. Is it some of the struggling carriers out there, perhaps or getting even more aggressive in trying to retain business? Do you see any kind of shift in the hit ratios during the course of this year?

Brian MacLean

Yeah, I think that's a function of two fundamental things. One is, there are clearly some distressed carriers out there and without question, more of their businesses in the market than would be traditionally so. So a lot of business in play, and they are doing the logical thing which is competing very aggressively to keep it.

But we're getting our shot at reporting on it and we're writing some of it when we feel we can get it at the right rates terms conditions. I think the other thing is, we feel pretty confident about our capabilities in the marketplace, and so really starting over two years ago we started to see more flow.

We have been much more aggressive in pushing out more products and being more proactive with the agents. And I think that's really made a difference. So, I think it is those things together that are driving the flow. And the market conditions are kind of as we just talked about.

Brian Meredith
UBS

I mean, on the hitters when you're losing the pace of business, are you finding the Delta between your price and perhaps the incumbent carrier is getting greater, is it less, are you barely mission it or is it?

Brian MacLean

In general, it's not, barely missing it. I would say we win the jump off more often than not.

Jay Fishman

This is a bit anecdotal because we actually do keep track of hit ratios very precisely, what we don't keep track of because we don't always know. What we don't keep track of is the extent to which when we don't take business, whether we lost a price or frankly we lost for something else. So, what we're answering here is an anecdotal.

In some cases price may be the same but coverage limits may be a lot higher. We don't know how to answer that other than anecdotal observation from what we're hearing in the marketplace. So our sense is, I mean marketplace meeting our own folks, sort of a reports from our own folks say when we're close, we're in there. And when we're not close we're not.

Brian MacLean

And don't take our comments to imply that hit ratio is plummeting. I mean flow is going up a little bit and hit ratio is coming down a little bit.

Jay Fishman

And again, forgetting about the hit ratio for a second, what I find encouraging is that this has been, in this more challenging market over the last couple of years, the product development whether it is Quantum Auto, Quantum Home, Travelers Express, the new products in middle market, these things have made a difference. They have clearly and we have seen it, they have clearly made a difference in the amount of business that we have an opportunity on which to quote.

The more challenged competitive environment, and by that I mean, the position of certain other companies has certainly augmented that. It is very difficult for us to sort out how much is a result of our product work in development and how much is in fact the flight to quality, but it is pretty clear to us they are both working.

And the notion that we could in fact see improving margins. And Joe by the way, made a very good point earlier, Brian, said improving margins from where they would have been if rate hadn't picked up.

Brian MacLean

Right.

Jay Fishman

That doesn't mean the rate in picture. That's right. The rate is still negative. We're still not above that zero line, but nonetheless, that rate line picks up, it is improving margins to where they otherwise would have been. The combination of an underwriter's willingness to be more aggressive in the marketplace because they feel better about the rate picture combined with that increased flow has the potential, no prediction here, has the potential of being pretty powerful.

And that's exciting to us and we will see. Maybe it occurs, maybe it doesn't. But my comment about being well positioned really speaks to that. We're seeing more flow. We have got the things we need to deliver on it and as price changes underwriters' attitudes will also and that can be pretty powerful.

Brian Meredith
UBS

Great. Thank you.

Operator

Our next question will come from the line of Matthew Heimermann with JPMorgan. Please proceed.

Matthew Heimermann
JPMorgan

Hi. Just two quick questions, if I may. First, on the FI or actually the way you term the high risk professional lines book. Can you give us a sense of loss ratio wise, what your booking it at in the fourth quarter?

Jay Fishman

I don't think that we have broken down loss ratio at that level. I don't have the data handy actually and I'm not sure we're inclined to disclose loss ratio at that ground level.

Matthew Heimermann
JPMorgan

Could you just maybe provide color because you made a big comment with respect to the whole book that you still expect the book to be profitable, I think you said in '09 in one of the comments in the press release. So, I just be curious whether or not that comment would then hold for the at risk book.

Jay Fishman

When we make that comment we're making a comment with respect to the portfolio overall and intentionally not breaking it out into any particular piece. And really the sense we're trying to give you there is that there are no shocks coming to that book and that will continue to be a profitable book as a portfolio. We weren't intending to give you a more granular, but I mean it is insurance in the following sense. Once you begin to identify the accounts that are likely to have losses, it becomes unlikely that, that book narrowly defined would be profitable.

I mean ultimately insurance is a combination of those accounts that have losses, and those accounts that don't. And what you have actually just kind of asked is if you identify those accounts that you think are going to have losses, do you think that they will still be profitable. The answer I think is pretty obviously no.

Matthew Heimermann
JPMorgan

Yeah, then I get the large numbers. I guess my question is to one thing we're all sitting from here is, it is one thing to say the losses in the financial institution book even if things go bad may not really be that material from an earnings standpoint.

I frankly I would agree with that. But I guess the only thing I'm trying to get that is trying to get a gauge of if I think there are going to be losses there, whether or not how big the Delta is me and you, either side. So, that's just what I am struggling with.

Jay Fishman

No, I mean I understand the direction of your question, and I simply come back to kind of Alan's comments. If you can take a look at the FPII business broadly, and the detail that's been provided here with respect to '08. And I don't think it is terribly difficulty to analytically make a projection on into '09. There is an observation in here that '08 claim activity was about the same as '07.

We made a comment about how the '07 estimate has developed, short of saying that accounts with losses have losses. I think we have really tried to give you, not for the purpose of giving you information, but there is enough information here to have a view on how FPII would perform next year.

Matthew Heimermann
JPMorgan

Okay. The other, just with respect to the Lloyd's business and I know the capital is moving around a lot because of the currency, but is that is a business where not as you think about allocating capital in '09 you're likely to increase your appetite?

Jay Fishman

If you're holding constant that the capital requirement from the appetite in the business, then I would say that you wouldn't expect a significant change in the appetite, may be we will pick up a little bit, but I don't think that we would expect the whole sale change there.

Jay Benet

I think the Lloyd's business just like all of our business is subject to internal capital allocations and the returns that we calculate based upon premiums and loss estimates going forward. So, we will factor in to those processes, whatever the costs are associated with it.

And in the case of Lloyds, what we and other carriers use instead of part capital or letters of credit that support the Lloyd's business. So in our case, what you will see is a higher cost associated with those letters of credit. But again, it is all factored into the pricing line.

Jay Fishman

And I think that is the relative of the point, which is we're not capital constrained in any way, if there are business opportunities to write more business in Lloyd's at attractive prices. We can and we will. There is nothing that limits our ability to do more business, to write more profitable business there or frankly in any line of business that we have.

We're in an unusual position, when evidenced by the share repurchases of actually being in a position where we're still generating excess capital. Well, if we can write more insurance business, we're all for it. We love the business. And if we can do it profitably and thoughtfully, we will.

Matthew Heimermann
JPMorgan

Okay. And then last one if I can sneak it in if just…

Gabriella Nawi

Matt, you know what we got four more other people. So, can you take it offline?

Matthew Heimermann
JPMorgan

All right, that's fine.

Operator

And our next question will come from the line of Paul Newsome with Sandler O'Neill. Please proceed.

Paul Newsome
Sandler O'Neill

Good morning. There has been a lot of conversation by many of your peers about hiring teams that have a number of companies including AIG. But, I was wondering if you are participating in that process, as well as, so many of your other peers are?

Jay Fishman

There are certainly people from AIG who have joined us. There are people from other companies who have joined us. And I don't know that we're out hunting for teams of people to bring in teams of people in books, but we are an organization of 33,000 employees. There are always people from other carriers who come and join us. So I wouldn't, my answer to the question is yeah, we've had people from AIG join. But I wouldn't particularly perceive that is hiring teams of people to bring in books of business.

Gabriella Nawi

Sorry, in the interest of time, because we want to get everybody in, just, if you could just keep it to one question and make it the one you really want the answer so. So Paul, I didn't warn you, so I give you one more, but then we got a couple of other people.

Paul Newsome
Sandler O'Neill

No, no. Go ahead with the next. I play nice.

Gabriella Nawi

Thank you.

Jay Fishman

Thanks, Paul.

Operator

Our next question will come from the line of Meyer Shields with Stifel Nicolaus. Please proceed.

Meyer Shields
Stifel Nicolaus

Thanks. Good morning. I hope you didn't discuss this already. Are you seeing any changes in the frequency and severity of either uninsured or underinsured motorists who then personalize?

Jay Fishman

We didn't discuss it already. And, when you go in aggregate, not something that we're seeing is significant. When you get the individual local geographies, there are always nuances, but I'm assuming what you really asking is, is there something related to the economy?

Meyer Shields
Stifel Nicolaus

Right.

Jay Fishman

Which is causing there to be a higher number of uninsured or underinsured motorists in the environment, and at this point through our book, we're not seeing that. Is that - was that what you were targeting?

Meyer Shields
Stifel Nicolaus

That's exactly it. Thank you.

Jay Fishman

I don't know what's going to happen going forward, but we're not seeing it, in our experience yet.

Operator

And our next question will come from the line of Joshua Shanker with Citi. Please proceed.

Joshua Shanker
Citi

Thank you. The question is that it's easy I suppose, but maybe a longer answer. What do you like in terms of the investment space and how much risk is appropriate for Travelers in viewing, suppose an investment corporation rather than an insurance corporation?

Brian MacLean

Well, I'll start with two observations and that is the first. We've always believed that we are an insurance company, which invest its money, rather than an investment organization, funded by insurance premiums. Second, as we look at the landscape, we're looking to buy assets of the type we bought before, at better prices, rather than to buy assets that we wouldn't have bought before, and simply because they are now at lower prices.

In terms of looking at risk, we think risk is a combination of price and reasonably expected scenarios. And simply because price is lower, it doesn't mean the combination has changed. And paradoxically, we could look at assets selling at much lower prices than they sold much lower a year or two ago. And conclude that, they are even riskier now. But that being said, we think there will be opportunities, believe it or not in private equity, although to capitalize on them, one will likely have to have commitments to funds existing now which we do.

We think there will be opportunities in high-grade corporate debt. We're worried about, so-called distressed assets notwithstanding the rush into them because we think that corporate reorganizations may be very different, the lack of dis-financing maybe, the recoveries are lower, more companies are liquidated as oppose to reorganize. And the world that you enter when an obligation defaults maybe very different than the one you entered two years ago, when it defaulted.

And therefore, we like not to experience that. We were certainly solicited by every opportunity fund in the last year or so and passed on them. They either performed poorly or grew up. I guess the short answer is we're going to do very much what we've been doing, and just hope we get better prices.

Joshua Shanker
Citi

And no indications on which asset classes we should just be referring to, want to give us any idea?

Brian MacLean

I think you could make a case that every asset class is cheaper than it was. Our allocation is not likely to change a great deal.

Joshua Shanker
Citi

Okay. Thank you very much.

Operator

And our next question will come from the line of Ian Gutterman with Adage Capital. Please proceed.

Ian Gutterman
Adage Capital

Hi, everybody. I just wanted to ask a little bit more about the impact of the economy on both, your business and strategically what it might do to your competitors. I guess, I'm thinking in a couple of areas. One is just, if there is less exposure in the industry and therefore less growth, but you have -- you still spend a same amount of time servicing account that would seem to cause some expense pressures for yourselves. So, how are you dealing with that?

And then competitively, you're obviously faced with a large number of very small competitors. Could this be a crushing blow to them and that they can't -- the lack of skill they have already, does this make the scale benefit that you have even more compelling?

And then operationally for you guys, how might we see, maybe as claiming behavior changes, maybe some of those truckers are facing bankruptcy and become more aggressive in their claims or maybe the automated underwriting box, isn't quite calibrated for a different economic environment, doesn't perform as well as you like. Are there things you're doing operational reviews to make sure the people at the field level are aware that, your business might respond a little bit differently than it would in a more normal economic environment?

Jay Fishman

I will take a shot at it. Let me and just to give everybody notice, Jay -- after I finish the question or we finish the question, Jay Benet is going to I hope provide some other insight into the bond and financial products loss ratio. Some of the questions, I think have been centering on this and there may be some confusion. And I think he can add some clarity to it. So, we'll get to that as soon as we finish.

First, in the context of our own business, I have enough trouble figuring out what's going on in our own shop, forgets trying to figure out what's going on in other people's shops. But I can tell you in our shop that volume is up, not volume being written, but flow is up. And so, underwriters are busy. It is not as if the moment, we have a lot of excess capacity, sitting around in the field, waiting for something to happen.

Universally, everyone I talk to in the field and the people I interact with are folks are reviewing accounts, they are out in the market, they are visiting with agents, and it's not a quiet time, at the instant. And that's driven again by our own product development over the last several years. And I think some of the competitive challenges that you see which have caused agents to shop certain accounts more dynamically than perhaps they might have in the past. That's pattern that we have talked about in the third quarter and it continued on into the fourth.

The claim organization is in fact, I would say busy, they've got -- so there's still the [remnants] of Ike and Gustav and all the rest of the cat season that we dealt with this year. So, in terms of resources in our organization, people are hopping and there is not a lot of idle time.

Ian Gutterman
Adage Capital

So, are they getting paid less dollars for the amount of work they are doing, just because if the account that might have 500 employees and now has 400 employees, they're doing the same amount of work, but less premium dollars associated with it.

Jay Fishman

Yeah, again, and this is an important thing to understand. As I said before, I would anticipate exposure continuing to decline. But remember that a dollar of exposure has lost costs associated with it. For instance, one of the great and in fact normality's of our business, if you lose $100 in premium with losses associated with it, you've got business that's even on the margin in a 85 combined ratio, you've got $0.85 in saved losses and 15 points in commission that's saved and premium taxes that aren't paid.

So, the bottom-line impact of exposure, it's not zero, but it is not nearly as powerful as people think. And of course, you see that on the way up. When we add exposure, it doesn't change the bottom-line as quickly or as dramatically as some people think it will, the marginal costs for dynamic in our business is pretty high. Make a distinction between that and rate. Rate is extremely powerful from the bottom-line perspective.

You pay 15 points round numbers of commission, and the rest falls to the pretax line. So a point of rate, quite, quite powerful in terms of profitability, a point of exposure, far less powerful in terms of profitability. So, as we look at the situation right now, and again, not forecasting, but what we've seen in the last several months, is generally speaking improving rate and declining exposure, that remains pretty powerful from a margin perspective.

Brian MacLean

And some of it is, as Jay said, we're obviously speaking to our length. So, if you're a company that has got a significantly different as in lower retention experience than we have got, that pressure is going to be a lot more intense. But we are keeping the business that we want to keep and we have got lots of opportunities. And so, we feel pretty good about it.

Jay Fishman

And in the context of a recession, certainly we have talked this before, our trucking business is already reflecting declining volumes and some higher losses, and has for some time. That's not a new dynamic in our Northland operation. If you speak, very, very broadly about recessionary times, experience suggests that workers comp losses tend to rise. That is a phenomenon that we have seen before.

And that may be, I said, I think about our book of business, the principal loss dynamic. Again I will put the surety business also to aside for a second because that has its own unique dynamics that can be somewhat more severity-driven. You can have an individual name obviously get into financial distress.

But if you're looking for a pattern, I would say workers comp loss is rising. We watch for that and try to underwrite to it.

Brian MacLean

Yeah, in consistent with Joe's comment on the loss trends of specifically the UM, UIM stuff, but more broadly we're obviously watching very, very closely our claim experience. We see little, but not dramatic impacts from the economy. We expect that they will become more dramatic. Many of those are negative. Some of them are actually positive. People drive less, etcetera. But we're watching closely, but there haven't been big spikes. Trucking is one where we have been seeing experience.

Ian Gutterman
Adage Capital

I know we're out of time, but just quickly, is it easier or harder for you to identify those changes, and that after you do more automated underwriting. Does the automation make it easier to spot or does the lack of underwriters going scrubbing every account one-by-one and you don't get anecdotal information make it harder?

Joe Lacher

It probably makes it easier in the businesses where we're doing it because you can capture the data in a more consistent fashion, but it does make it different. I'm not arguing that one is necessarily better than the other, but it does make it very different in terms of what you have to do to see it and spot it. Anecdotal information by its nature is anecdotal and colored and harder to assimilate rapidly and have a consistency to it.

And when you're dealing with smaller accounts with a large, large numbers applies, that becomes very distorted. So, we feel better about it there. What you get in this and it is why we built significant product management organizations and a significant investment in our management information infrastructure is the ability to crunch all the data and look at it.

There are different things, symptoms that push sometimes in different directions. As Brian points out, we may see less driving exposure in an auto environment. But over time, we're less likely to see less maintenance investment as people can't quite afford the brake job or the new set of tires. So that may push up, one pushes down frequency, one pushes up. They will come at different periods of time along that economic downturn and we're watching for all of those different components very carefully.

Ian Gutterman
Adage Capital

Very thorough answer. Thank you, guys.

Jay Benet

This is Jay Benet. The thing I wanted to add some color to, just to look, to take some of Jay's comments about, if you look at businesses that have loss, of course, they have losses. And if you look at other businesses, within FPII in particular, because Alan had Tom had said, this is a very diversified portfolio.

So we don't want to give the impression that when you look at FPII's combined ratio of 87.2, that that's uniform amongst all the different businesses within FPII. We certainly don't close our eyes to the loss experience of any one of these individual businesses. And what you're seeing in our numbers or potentially not seeing in our numbers is that.

Ian Gutterman
Adage Capital

But we're seeing that you may not, you don't have access to.

Jay Benet

Is that when you look at things like the financial institutions book, the professional liability book, public company liability book within, I mean there are some higher loss ratios, combined ratios associated with those businesses that are being offset by very favorable results because of the lack of loss activity that is taking place in areas like commercial surety and construction services.

So, this is all blending as Alan said to the 87.2. But we don't want to give anyone the impression that we're not fully looking at the loss experience that is taking place in some of these businesses.

Jay Fishman

The financial institutions portion of bonded financial products. Its combined ratio reflects the loss experience that we're speaking about here. So, does the professional liability book within bond and professional products. And if you're asking if those were profitable as I said before, no in 2008, those individual books of business within bonded financial products were not.

But the commercial surety business was. The construction services business was. The private and nonprofit bonding financial product business was. So there is a big book with lots of lines and those two lines, to Jay's point do reflect the claims, experience and the adverse development that we anticipate in those lines. I think that will be helpful in understanding how the numbers roll together.

Operator

And ladies and gentlemen, that concluded the question-and-answer period for today's conference. I will now turn the call back over to Ms. Gabriella Nawi for closing remarks.

Gabriella Nawi

Thank you all for joining. And before we go, Matt Heimermann, I owe you an apology and you will get first call next quarter. Also, if you have any other questions, please refer to myself or Andy Hersom. Our details are at the bottom of the press release. Thanks very much for joining.

Operator

Thank you for your participation in today's conference. This concludes your presentation. You may now disconnect. Good day everyone.