S&P Capital IQ

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The Travelers Companies, Inc. NYSE:TRV

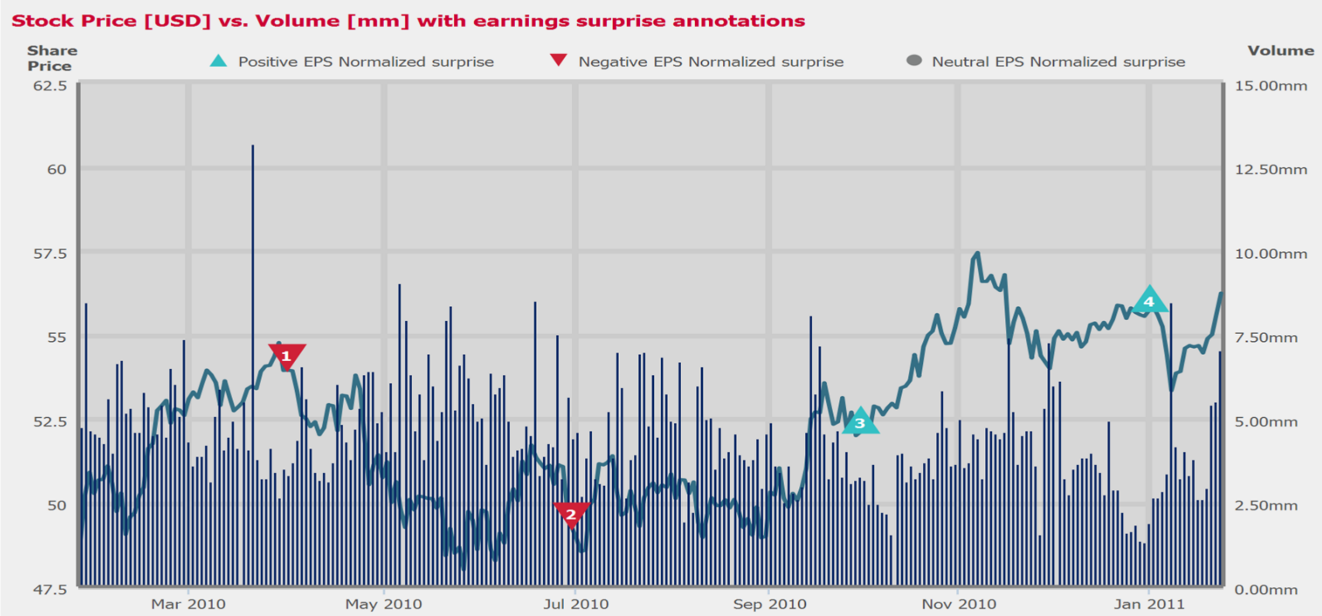
FQ1 2011 Earnings Call Transcripts

Thursday, April 21, 2011 1:00 PM GMT

S&P Capital IQ Estimates

	-FQ1 2011-			-FQ2 2011-	-FY 2011-	-FY 2012-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	1.49	1.89	▲26.85	1.55	6.12	6.10
Revenue (mm)	5373.77	5371.00	▼(0.05 %)	5675.41	22922.85	23109.44

Currency: USD
Consensus as of Apr-21-2011 1:14 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ1 2010	1.37	1.22	▼1 (10.95 %)
FQ2 2010	1.50	1.39	▼2 (7.33 %)
FQ3 2010	1.46	1.81	▲3 23.97 %
FQ4 2010	1.67	1.89	▲4 13.17 %

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

ANALYSTS

Gregory Locraft
Morgan Stanley, Research Division

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Jay H. Gelb
Barclays PLC, Research Division

Joshua David Shanker
Deutsche Bank AG, Research Division

Keith F. Walsh
Citigroup Inc, Research Division

Lawrence David Greenberg
Janney Montgomery Scott LLC, Research Division

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

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

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Crédit Suisse AG, Research Division

Presentation

Operator

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

Gabriella Nawi
Senior Vice President of Investor Relations

Great, thank you, Shante. Good morning, and welcome to Travelers' discussion of our first quarter 2011 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 up for questions.

Before I turn it over to Jay, I would like to draw your attention to the explanatory note included at the end of the webcast. Our presentation today includes forward-looking statements. The company cautions investors that any forward-looking statement involves risks and uncertainties and is not a guarantee of future performance. Actual results may differ materially from those projected in the forward-looking statements due to a variety of factors. These factors are described in our earnings press release and in our most recent 10-Q and 10-K filed with the SEC. We do not undertake any obligation to update forward-looking statements. Also, in our remarks or responses to questions, we may mention some non-GAAP financial measures. Reconciliations are included in our recent earnings press release, financial supplement and other materials that are available on the Investors section on our website. Thank you, and now to Jay Fishman.

Jay S. Fishman
Former Executive Chairman

Thank you, Gabby, and good morning, everyone, and thank you for joining us today. By now you've seen our numbers, and we're very pleased with our results. At 14.1%, our operating return on equity for the quarter reflected solid underwriting and investment income, as well as the continuation of our strategy of returning excess capital to shareholders.

Our average annual operating return on equity since January 2005, coincidentally, is also 14.1%, within our overtime return objectives and meaningfully in excess of our average cost of equity over the period. The total return to our shareholders over this period is also very strong at 86%.

In Business Insurance, we're also pleased to see the continued success of the pricing strategy we have discussed with you previously, as well as a continuation of improving exposure trends. While Brian will take you through the details, in both Business and Personal Insurance, we were able to achieve gains in pricing, evidencing our view that pricing is an active pursuit, rather than a passive response.

In our Business Insurance segment, almost every production indicator improved this quarter. Retention was up, we achieved pricing gains, and exposure, which is unit demand by renewing customers, improved. In addition, we continue to increase our number of accounts during the quarter. We fundamentally believe that a number of these indicators are the result of active management and not the result of a rising tide lifting all boats.

Our pricing strategy is premised on real value added to agents and customers and our industry-leading analytics, which we apply to pricing and risk selection. Most importantly, we have applied this strategy thoughtfully and with the mindset not to be disruptive to either our agents or customers. These analytics give us very important advanced insight into class and account profitability, not only at the management level but critically at the desk underwriting level, allowing us to better determine account rate needs, risk selection and produce superior portfolio returns over time.

The feedback we received is that both agents and customers recognize the value proposition doing business with Travelers. It's not the insurance agreement, which anyone can write, but the combination of the agreement with market-leading product breadth, superior claims execution, risk control skill, and our extraordinary people with underwriting authority positioned in the local market. Simply said, we believe doing business with us creates value for agents and customers.

As we've been saying for some years now, for a number of reasons, we believe that the amplitude, that is the highs and lows of the so-called pricing cycle in our industry, may very well have moderated significantly. Given our position, as well as the analytic skill we just discussed, we are not waiting for some change in the mythical cycle to seek improved returns. We are increasingly optimistic about our ability to succeed in this regard, given the signs we see of a more receptive environment, particularly because we intend to execute this strategy in a targeted and measured way. It is worth a look at Slide 9, where you can see the actual results of this approach. Brian will have more to say about this later, and we will discuss our view on cycles more at our upcoming Investor Day.

In short, we're pleased with the quarter, and we feel good about our competitive position. We've now seen two quarters of improving rate in Business Insurance and five consecutive quarters of positive rate, while growing policies in Personal Insurance. We like what we see.

With that, let me turn it over to Jay.

Jay Steven Benet
Vice Chairman and Chief Financial Officer

Thanks, Jay. As the data we provided shows, we've produced first quarter operating income of $826 million, up 31% from the prior year quarter and up 55% per diluted share, translating into a strong operating ROE of 14.1%. The major drivers of these increases in operating income and operating income per diluted share were a significant reduction in catastrophe losses as compared to the prior year quarter. Cat losses were $122 million after-tax, down from $312 million after-tax in the prior year quarter.

That said, we would still characterize the current quarter as having combined weather and quake-related losses, whether considered cats or smaller events, that were higher than what we would consider to be typical. And we also had tax benefits of $104 million in the current quarter that mostly related to the closing out of recent tax years and the very meaningful effect of our common share repurchase program on per share results.

Net investment income also increased due to solid performance in our non-fixed income investment portfolio. Partially offsetting these benefits was a $37 million after-tax reduction in net favorable prior-year reserve development. Net favorable prior-year reserve development, which we once again experienced in each of our business segments, was $155 million after-tax in the current quarter, as compared to $192 million after-tax in the prior-year quarter.

So, all in all, particularly in light of the higher than typical cat and non-cat weather and quake-related losses that I previously referred to, we are off to a good start for the year.

Book value per share of $59.91 increased 2% in the current quarter, after repurchasing $1.1 billion of common stock and paying $155 million in dividends, and increased 12% from a year ago, after repurchasing $4.7 billion of common stock and paying $657 million in dividends.

Our cash flow remains very strong. Operating cash flow was $633 million in the current quarter, up from $531 million in the prior-year quarter, and we could not be happier with our balance sheet.

And finally, our continued strong results and financial position allowed the company to increase its quarterly dividend per share by 14% from $0.36 to $0.41. We ended the quarter with holding company liquidity of $2.9 billion that was once again well in excess of our target but down from the $3.6 billion we held at the end of 2010. This reduction in holding company liquidity was in line with our plan and relates back to our $1.1 billion common share repurchases in the quarter.

Entering the year, our original estimate for full year 2011 common share repurchases was based upon our estimate of after-tax operating income plus $1.5 billion, which translated into a particular dollar amount at that time. Currently, we have chosen not to change that dollar amount for full year 2011 share repurchases, notwithstanding the first quarter's favorable reserve development which our estimates never incorporate, due to it still being very early in the year and the inherent uncertainties in our business.

Brian is now going to provide some further insight into our underwriting results.

Brian W. MacLean
President and Chief Operating Officer

Thanks, Jay. We had a great quarter, and we're pleased to be starting out the year in such a positive way. In addition to posting strong earnings, we are particularly pleased with what we are seeing in the underlying business dynamics.

Business Insurance delivered strong results this quarter. Let me begin with operating earnings, which increased over last year, driven by lower cats and the tax benefit that Jay mentioned. While cats are lower than last year, it was still a very active weather quarter, and cat losses were higher than what we considered typical. In addition, prior year development was somewhat less than in 2010 but still significant at $93 million after-tax. Core underwriting margins remained solid but contracted modestly as loss cost continued to slightly outpace earned rate changes, in line with our expectations.

Net written premiums grew almost 7 points year-over-year. The increase was driven by improved pricing, renewing customers purchasing more insurance as the economy improved and account growth. Higher business receipts and/or payrolls for these customers drove increased exposure in [ph] units, in our renewal premium. Additionally, audit premiums were positive for the first time since the second quarter of 2009.

Our price change or pure rate was positive quarter-over-quarter and even trended up month-to-month within the quarter. At the same time, retention rose 2 points to 84%. New business flow remained strong, while new business written premiums were down slightly from last year.

Page 8 demonstrates the significant improvement in renewal premium change that we've experienced since 2009. Some of this is clearly driven by the broader economic environment, but it is also a result of how we execute in the marketplace. Much of the market commentary implies that there's only one marketplace and that all accounts renew at the same or similar rates. At least for us, that's not the case. So we're not waiting for a market cycle change. Instead, we believe in a much more active strategy, a strategy based on superior analytics, a broad breadth of products, excellent positioning in the distribution channel and great local point of sale talent.

The data on Slide 9 shows the distribution of price changes on our Commercial Accounts business in the first quarter. This is a midsized account business with over 5,100 accounts renewing in the quarter. In the aggregate, 2/3 of these accounts got some level of increase. But importantly, there's a wide distribution of price changes, with some accounts getting greater than 10% increases and others, 10% decreases. So we believe this clearly demonstrates that it's not one pricing environment and that given our competitive advantages, we can target the accounts that need price and take the right actions deal by deal. Through this thoughtful and targeted execution, we can get rate where needed and minimize disruption to our agents and customers. We believe this dynamic is one that is not well recognized or appreciated by industry observers, and we believe it is meaningful.

Turning to Financial, Professional & International Insurance segment. Operating income was up over the prior year quarter, primarily due to lower catastrophe losses. While written and earned premiums have been reduced in the current and recent quarters, the work we have done to improve risk and reward in the catastrophe-prone lines in our Lloyd's syndicate successfully mitigated losses this quarter.

Net written premiums were down in the quarter, primarily due to the Lloyd's initiative I just mentioned, the timing of renewal of some accounts written in the first quarter of last year that will become available for renewal later this year and the termination late last year of an exclusive distribution relationship in Ireland that we mentioned previously.

Looking at Bond & Financial products. In Surety, we continue to see a market challenge for growth, due largely to the continued sluggishness in construction spending. In addition, we're beginning to see evidence of more aggressive competition, including relaxed terms and conditions in order to win business. We will continue to maintain our underwriting discipline and look to grow where it makes sense.

In Management Liability, while growth remains a challenge, this is an area where we've invested in new product and technology, and we believe we are well positioned to grow as the market improves.

Finally, I wanted to give you an update on our joint venture in Brazil that we announced in November. We continue to expect the transaction to close in the second quarter and remain excited about the opportunity this arrangement gives us to leverage our leading U.S. Surety franchise to enter the growing Brazilian market and to expand more broadly into PNC and to do so with the benefit of a local market leader.

Moving to Personal Insurance, we are pleased with our overall underwriting results, and we had another quarter of solid production with continued growth in both policies enforced and net written premium. From a financial perspective, reported cats and prior year development for the segment were favorable year-over-year. However, underwriting results were impacted by a significant amount of non-cat weather that affected the industry in the quarter. We remained pleased with the underlying profitability of the segment.

As with our Commercial Lines businesses, we manage Personal Insurance consistent with our financial strategy of delivering mid-teen return on equity over time. As such, we are committed to maintaining target profitability as we look to achieve our desired growth within these confines. To that end, we have been making some targeted but aggressive rate actions particularly in the homeowner space, which has been adversely impacted by weather trends in the last few years. We believe that our rate actions are well justified given these loss trends.

In summary, we feel terrific about the results this quarter. While we are still operating in a fluid and challenging market environment, we are clearly beginning to see some improvement and are cautiously but increasingly optimistic that this trend will continue. Both execution across all our business segments and how we are positioning going forward are very strong.

With that, let me turn it back to Jay Fishman for a closing comment.

Jay S. Fishman
Former Executive Chairman

Thanks, Brian. Just as I've said any number of times before, a lot of our own folks listening to this call, if not today, then they will over the next few days. It was a really busy first quarter for all our folks in claim, and obviously given the activity in April, it continues to be a busy time, and they are all out there hopping. I just want to let them know that we know that, and what they are going to do today and what they do every day really makes a difference for us.
And with that, let's open it up for questions.

Question and Answer

Operator

[Operator Instructions] And our first question comes from the line of Keith Walsh with Citi.

Keith F. Walsh
Citigroup Inc, Research Division

First question just on Business Insurance, the pricing that we're seeing here. I guess I was definitely surprised about pricing being up and your retention being up at the same time. Now could you just give us a little more color behind that? Was there some potentially pent-up pricing maybe from the recession or are you using -- is this expected frequency ticking up from a recovery that you're factoring into your pricing? Just maybe a little bit more color around that.

Jay S. Fishman
Former Executive Chairman

Let's tag team this a little. It certainly, Kevin (sic) [Keith], isn't driven by a concern about frequency or anything of that nature. I'd say if there's anything in the back of at least my mind, it's that, it's possible that this investment return environment may turn out to be longer rather than shorter. And as I've said on previous calls, when rates change pretty dramatically pretty quickly, we certainly didn't knee-jerk – have a knee-jerk reaction with respect to our pricing. That would obviously be disruptive to both agents and customers. And now that we're 18, 24 months into it, I think it's prudent that we be thoughtful of the possibility, mindful of the possibility that this could be longer rather than shorter. And so it is targeted, it's moderate, it's thoughtful. And I think that, that slide on Page 9 really speaks articulately to the issue, 2/3 of the accounts, we were successful in getting rate increases. And yet with retention, that stayed at historical levels, historically high levels. So I think it speaks to the value of the franchise. I think it speaks to the way in which the company is regarded by agents and customers. And I think you always have to remember -- there's a tendency of lots of folks to lump all of us together as one industry. We are a small and middle-market company. And if you get a point and a half of rate on $100,000 premium account, that's $1,500. And so, if we do this thoughtfully, and I think in a measured way, we are optimistic that we can be successful. And is there anything, Brian, that you would...

Brian W. MacLean
President and Chief Operating Officer

No, I think it's -- that's the message.

Keith F. Walsh
Citigroup Inc, Research Division

Okay. And then the second question would be, if you could speak to the RMS [Risk Management Solutions] model changes on inland wind that we're seeing out there. First of all, do you use RMS? And then secondly, if you could just talk to the changes in your PML in Florida, Texas and the mid-Atlantic from the model changes that we've seen?

Brian W. MacLean
President and Chief Operating Officer

Yes. So this is Brian. We absolutely use RMS. But we don't use it exclusively. We use every available model that you can think of that we're out there working with. So we work with a number of folks. I'm not going to be able to give you an answer as specific as what you asked for. It's a significant change to their model. It's a complicated process, and we've been heavily involved working with them for quite a while now. Some of the things that they're contemplating in the model, like inland exposures from the storm, we'd already been looking at pretty significantly. But there are a number of things that they are changing. And like I said, we're working with them. So it'll be later in the year before we're going to come out with anything definitive on -- as in well into the third quarter probably, before we come out with anything on what the model changes will actually mean.

Keith F. Walsh
Citigroup Inc, Research Division

So would we expect changes in your -- the way you think about capital heading into next year then? January of next year or late in the year is what you're referring to?

Brian W. MacLean
President and Chief Operating Officer

What we've got to look at, obviously, is as we sort through all the changes in the model, we've got to look at what that does to our expectation of losses. As I said, it's not the only model we use. So we're going to take that output. We're going to look at the other models. We're to look at all of our internal data, and we're going to assess where that is. As it moves, we can figure the conjecture on a bunch of different possibilities of what that could mean.

Jay Steven Benet
Vice Chairman and Chief Financial Officer

As it relates specifically to capital, we will be evaluating what we think the model has done to our exposure base. So our exposure base doesn't change the models. Measurement of it changes perhaps. But ultimately, we'll be in discussions as I'm sure all of our counterparts will be with rating agencies and see what rating agencies think of the new models. And we start in all of our capital planning with -- as we've said, many, many times before, having operating company capital levels at the AA levels. So we'll just continue to do that process.

Operator

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

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Could you give a little bit more color on the action at Lloyds and kind of what you're expecting from that business for the rest of the year? And I just have one follow-up.

Alan David Schnitzer
Chairman of the Board & CEO

Sure, Mike, it's Alan Schnitzer. When you look at our experience over the recent years, we've just had more really severity and volatility out of that business than we'd really like. And so we've taken a step back just to reassess risk and reward, and obviously, we're starting on the risk side and taking some exposures down as we think about that and making sure that we're taking all the analytics and thought processes that we have in the U.S. and driving it into those businesses as well. So, we started this analysis in 2009. We worked through that, and slowly, we've been increasing the implementation. And we'll be working through it for a couple of more quarters and starting to look more at the opportunity side as we start to put some of the analytics and thought process in place. And when you look at the decrease in written premium anyway, in the international, if that's what you're looking at, you're only about -- a third of that relates to what we're doing on the Lloyd's book. There's another -- about a third that relates to some timing, some accounts that were 18 months when written and will be available for renewal later in the year. There's a little bit of reinsurance, reinstatement premium, and we've got the termination of the distribution arrangement in Ireland, which will continue for the rest of this year to run through the top line, although that piece won't have a significant impact on profitability.

Jay S. Fishman
Former Executive Chairman

Let me just jump in. I think Alan just because he's leading this effort, tends to kind of understate it a little bit. We've talked for years about the nature of analytical skill and our ability to evaluate risk and reward. In the U.S. and all of our operations here, that skill base was not nearly at the same level in our International business broadly. But I think it was particularly true in Lloyd's, although maybe not, maybe it was more balanced than that. And the effort that Alan has been doing is to bring the same level of analytics, as well as the same level of interpretation of those analytics to the business that we do in our international operations. And so ultimately, it'll turn out, at least initially, to be somewhat smaller. I think it will give us an awfully good platform to move ahead and to build the business with the sense of confidence, the same sense of confidence that we have here in the U.S. So it's very much a voluntary effort designed to bring that risk and reward profile in line with what we do here in the U.S.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Great. And then I have one question in commercial accounts. I noticed in your -- the Q you talked about margins being slightly narrower for the rest of the year in Business Insurance I believe and referencing kind of Brian's point of loss trend outpacing pricing. And then, obviously in the first quarter, you saw a big increase in commercial accounts. I'm just trying to reconcile those trends and make sure I understand on the thought process behind the outlook and then the increase in exposures in the quarter.

Jay S. Fishman
Former Executive Chairman

I think, again, Brian and I will tag team this. First, always keep in mind that our P&L, our GAAP financial statements, are based upon earned premium. And as a consequence, they reflect more of the rate dynamics of the past 12 months than they do the past quarter. You book it -- if it’s a 12-month policy, you book it for 12 months and you amortize it in. And so the rate picture that we're providing this morning is in the written premium arena, which obviously, will affect earned premiums down the road. And what really you're seeing here, at least in the GAAP statement, is that -- and what we anticipated, which is that the earned price, the earned rate that's reflected in earned premium, we expected that to be less than what we were contemplating for embedded loss trend for loss reserving purposes. So as a consequence, we were anticipating a modest margin contraction in Business Insurance. And we are seeing very much that, and it was actually reasonably predictable at the time. So that's the earned piece with respect to written, and there was a...

Brian W. MacLean
President and Chief Operating Officer

Just to restate some of the metrics and without being overly precise, but we've been pretty transparent. In the first quarter -- our last quarter, our view on what we were seeing across our Business Insurance market from a loss side was relatively flat frequency and lower single digits inflation on the severity side, and that has not changed. You can see where our premium change numbers were, and you can kind of make whatever estimate you want on where you think premiums changes are going to go for the rest of the year and see when you think those lines might be crossing on a written basis. But we still got a little bit of contraction going. So I don't know of those pieces add up for you.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Got it. And then just – workers’ comp it looked like was a big driver. It looks like just from the math, that most of that -- the change in commercial accounts was workers comp. I guess first question, is that right? And if you could just talk specifically about the decision to pursue more business there and kind of what that means?

Brian W. MacLean
President and Chief Operating Officer

Yes. This is Brian again. On the comp side, that is the line across Business Insurance that's growing the most. It's also the line across Business Insurance where we're getting the most price improvement. And

I'd say in every line within Business Insurance this quarter, we got from price improvement. But comp was definitely at the front end. Comp's a line that's gotten a lot of lot of publicity. If you look at our results over the last 10-plus years now, we've run a pretty significant favorable delta to the industry on a loss and combined ratio side. So we feel great about our selection in there. We feel great about our risk control capabilities and the claim capability that we have. And so, it is a line that we feel good about, but very, very select though.

Jay S. Fishman
Former Executive Chairman

Spend 30 seconds on the National Account business and the ability to export that skill.

Brian W. MacLean
President and Chief Operating Officer

Yes, I mean, we've got a very large account comp business, which is primarily loss responsive, as in taking credit risk, not underwriting risk. And that has enabled us, over the last 20 years, really, the scale of that, has enabled us to build claim and risk control capabilities and pricing selection tools, which we would not have been able to afford to build had we just had the guaranteed cost book that we've had over the years. So we think we've got a real scale and data advantage here and a technology and tools advantage that make a big difference in the marketplace. So we feel good about our comp book.

Jay S. Fishman
Former Executive Chairman

An example of that is out in the claim organization. You'll actually see nurses sitting side-by-side with claim handlers managing claim. I don't know, what do we have, close to $2.5 billion, $3 billion of claims under management in our National Account business? That provides two things. Brian got it exactly right: an expertise that we can export into the smaller guaranteed cost segments and also a scale because comp is fundamentally a state-by-state business. There are -- and you've really going to get very focused and very narrow in your analysis of it. So the combination of the scale, the expertise that exists predominantly in that National Accounts business is a real competitive advantage.

Operator

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

Jay H. Gelb
Barclays PLC, Research Division

Two questions for you. First, kind of following up on the last question, can you talk about the potential for loss frequency to start to increase a bit as the economy recovers? I know that's kind of a broad issue but focus more on commercial, I guess as well as personal. And then, second issue, do you anticipate Travelers' reinsurance costs could rise, and if that were to happen, would Travelers buy less coverage?

Brian W. MacLean
President and Chief Operating Officer

On the loss frequency side, Jay -- yes, clearly as we talked about on the other side of the coin, as the economy contracted, it actually creates a favorable dynamic within the comp world in that most businesses lay off the least experienced workers first and safety gets a little bit better and you're running fewer shifts and all that kind of stuff. If the economy really started to heat up, we would see some of that. We looked very closely, we haven't seen anything yet, and although the movement has been positive, it hasn't been that dramatic that we think it has changed those dimensions. Similarly, as you said, within all the lines, including personal lines, we're looking for any indications that economic growth is going to push frequency up, which it naturally will. I think the bottom line is the same across all our businesses. We're looking really hard, we haven't seen anything yet, and we think it's the magnitude of the pickup in economic activity hasn't been enough to drive that yet. But it's a great question and one that we'll be watching closely.

Jay H. Gelb
Barclays PLC, Research Division

The reinsurance?

Jay S. Fishman
Former Executive Chairman

Bill just handed me a note. I think a better estimate of the claim -- I said $2.5 billion to $3 billion of claims under management. $2 billion to $2.5 billion is a better estimate for claims under management in national accounts. A combination of loss response and that which we have, well, due to [ph] service and guaranteed costs -- not guaranteed costs, loss responsive [ph]. We don't actually buy all that much catastrophe coverage broadly speaking. We have $1 billion retention. In the next $1.25 billion, our recovery, and this is round numbers, is about $500 million or so. And that's obviously a pretax number. So at a $2.25 billion loss, we have a $500 million recovery, pretax. We paid whatever we paid for the coverage, on a net recovery basis, in the first event, then you got to pay the reinstatement premium, you actually have modest recovery in that first event. It's really a second event reinsurance program, and we don't actually buy much, except the only area where it's important to us is in the Northeast. We actually have obviously the cat bond, and we have a separate Northeast wind cover that's meaningful given our exposures. And we wouldn't expect -- I don't know how to respond to the Northeast and the bond issue longer term, but in the context of the standard reinsurance market, we wouldn't expect a significant increase in dollars because what we pay for the policy is actually is not all that much. So even if it goes up some, it's not going to be a meaningful change in dollars.

Jay H. Gelb
Barclays PLC, Research Division

So do you anticipate -- I mean, there's a lot of controversy right now in terms of whether all the significant catastrophe losses in Asia-Pacific are going to sort of bleed over to the U.S.? What are your thoughts there?

Jay S. Fishman
Former Executive Chairman

I think you should ask the reinsurers. I have no idea.

Operator

And our next question is from Matthew Heimermann with JPMorgan.

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

Not to make this all about workers’ comp, but I was just curious on the non-guaranteed cost side, with the economy picking up, and presumably, that would mean that the Dallas is under management probably go up too. Is the outlook for the C [ph] income you generate on the business potentially going to get better over the next couple of years?

Brian W. MacLean
President and Chief Operating Officer

The short answer, Matt, is yes. We're all anxious and watch the economy and what it actually does, but we're seeing a little bit of a lift, and we would expect that to continue.

Jay S. Fishman
Former Executive Chairman

It's actually interesting the -- I think this is what I'm about to say is correct. The private market workers’ compensation premium was $38 billion in 2007. The estimate for 2010, once all the data is in, is $28 billion. 10 on 38 obviously, almost 25% reduction driven by the combination of lower employment and some decline in rate. So, the change in workers’ comp in the market broadly speaking has been really quite significant, and it will be interesting to see to the extent that employment begins to recover to what extent that $28 billion begins to lift back up in the direction of that historical high.

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

Just on the -- specifically on the Management Liability piece when I was looking at the presentation in terms of the rate change there, that was one that stood out relative to a lot of the channel checks and market commentaries being a bit different, because most competitors, I think, are describing that as more competitive and rates moving down 5% to 10%. I know some people are minimizing rate declines by changing kind of the position that they have on contracts. So could you just maybe give a little bit more color on that book specifically in terms of just the rate and maybe it's a product issue, too, but...

Alan David Schnitzer
Chairman of the Board & CEO

Sure, it's Alan Schnitzer. It's tough to answer those questions because people think about Management Liability broadly again as one thing, and it's really not. We've got different business units, so what we see in financial institutions behaves differently than what we see in public company liability versus what we see in private nonprofit. DNO is different than ENO is different than employee practices liability. So it's really hard to answer that on a portfolio basis. If I think about what's impacting us, the majority of our premium there is in our private nonprofit book, so the smaller account. And the rate dynamic there has been different and I'd say less significant than what we've seen in the larger account side. So that's probably the distinction I would make on rate.

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

Okay. And then how about on the FI and the public commercial DNO side? Can you just give a little commentary to what you're seeing there?

Alan David Schnitzer
Chairman of the Board & CEO

Sure. I'm not sure if you're -- if this is about -- if you’re talking about rate of the loss side, but on the rate side...

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

More on the rate side.

Alan David Schnitzer
Chairman of the Board & CEO

On the rate side, I think that as you get in larger account sizes, almost regardless of the industry or the product line. The larger account sizes are -- the rate environment is more competitive. So I think the same would apply in public company liability and FI as compared to, say, at private non-profit book.

Operator

And our next question is from the line of Josh Shanker with Deutsche Bank.

Joshua David Shanker
Deutsche Bank AG, Research Division

Looking at the resolution of prior tax matters, the one-time tax item? It's consolidated under the underwriting gain, I guess the way you define it. Can you sort of walk through a little bit how that hits the P&L?

Jay Steven Benet
Vice Chairman and Chief Financial Officer

In terms of the way we manage our expenses and income, we, as a rule, take all of the items and allocate to the various business segments. We don't have a large corporate component to our expense structure or our revenue structure, as you can see when you look through the information that we have in our 10-K and 10-Q. So, when we have things like tax matters that get settled, we go back to the segments that gave rise to them in the first place. And to the extent there's a tax benefit, it just goes right back to the segment. So that's what drives the earnings piece of it. As it relates to other elements of it like combined ratio, combined ratio is a pretax concept. So the tax benefit has absolutely no impact whatsoever on the combined ratio.

Joshua David Shanker
Deutsche Bank AG, Research Division

My apologies, I misunderstood that. Thank you for clarifying. The second question I have is I'm looking at the historical financials. I noticed in the past, some of the previous slide from prior conference calls have different numbers than the previous ones, in terms of -- is this audit premiums going back and revising the past slides?

Brian W. MacLean
President and Chief Operating Officer

Yes, you're talking about the production statistics that we might have on rate and renewal price change and exposure, right?

Joshua David Shanker
Deutsche Bank AG, Research Division

Yes.

Brian W. MacLean
President and Chief Operating Officer

Yes, so those numbers developed, just like -- not a dissimilar concept to loss numbers developing. So as we go through, we're looking at the monthly/quarterly production numbers. We're reporting the same numbers that we look at internally as to what we think is going on with the pricing and the retention and the renewal. But invariably, they were going to be accounts, for example, that we believe we thought at the close of the month we'd retained and we find out two weeks later that we actually did not. So those come out of the statistics. So the numbers do move.

Jay Steven Benet
Vice Chairman and Chief Financial Officer

And we do put a notation on the slides, as well as anywhere where we provide estimates associated with statistics that we use to run our business that these are, in part, actuarial estimates subject to change, and when they change, we restate the past.

Joshua David Shanker
Deutsche Bank AG, Research Division

Very good. And finally, one more question on workers comp. Is there anything, broadly speaking, you can talk to how these statistics look different excluding the workers comp?

Brian W. MacLean
President and Chief Operating Officer

No. We don't have them. I mean, we could calculate them obviously, but we don't disclose them, right.

Jay S. Fishman
Former Executive Chairman

We don't disclose at that level of granularity.

Gabriella Nawi

Senior Vice President of Investor Relations

[Operator Instructions]

Brian W. MacLean
President and Chief Operating Officer

I would reiterate what I said before, though, is that across Business Insurance, we had great improvement across all the lines of business. So it wasn't just comp, but comp had the greatest.

Operator

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

Gregory Locraft
Morgan Stanley, Research Division

My two questions are cap deployment and then the direct auto initiative. On cap deployment, I just wanted to clarify that the guidance was indeed increased from the last time you guys gave us your thoughts. Specifically, it was increased by the amount of reserved releases, as well as the after-tax impact of the tax scheme [ph]. Is that true?

Jay Steven Benet
Vice Chairman and Chief Financial Officer

Actually, I would say just the opposite. We entered the year with a view as to what our share buybacks were going to be. We gave you some insight in the first quarter -- in the fourth quarter press release -- I’m sorry, in the fourth quarter webcast as to how to think about that. It's very early in the year, and we're, at this point in time, not changing our view internally as to what the overall level of buybacks are going to be for the full year 2011.

Jay S. Fishman
Former Executive Chairman

It's worth going back a little bit because this is a little -- it's unusual and somewhat out of context. A year ago we said that we were going to stop giving earnings per share guidance in 2011. But we also said that we would provide meaningful insight into what we plan to do from the share buyback perspective because that's a number that we believed was really not determinable from the outside looking in. So the way that we did that, back at the first quarter was to say that at least for our own planning purposes, that we were assuming that the share buybacks would be our estimate of earnings plus $1.5 billion. And that, of course, allowed observers to make their own estimates. And so, while it's funny to be talking about guidance of an individual item that's not tied in some way to earnings guidance, what we are attempting to say is, notwithstanding the results in the first quarter, whatever they were, at least for our own purposes at the moment, we continue to assume the same dollar level that we did when we gave that information three months ago.

Gregory Locraft
Morgan Stanley, Research Division

Okay. But I guess from my perspective, we all have different estimates of what the after-tax op income will be. When we exit the year, whatever your after-tax op income is, plus $1.5 billion, is what the share buyback will be for 2011. Is that -- am I understanding it appropriately?

Jay S. Fishman
Former Executive Chairman

Well, the share buyback will be whatever it turns out to be, right? Whatever, and there's a lot of things between now and the end of the year that may, in fact, affect that one way or another. But for planning purposes, what we again tried to give you was at least some guidance, so that you'll be able to make those estimates for yourself. And I think -- not I think. What we're really saying to you is not to adjust to that number on a very granular quarter-by-quarter basis, if we think something has changed, we'll certainly let you know. But, it's not -- it just isn't quite as formulated as the notion of earnings plus $1.5 billion. We wanted to -- the reason we did that was we were intentionally stepping away from the process of giving earnings guidance. And so we were trying to be as transparent as we could in the circumstance and give you as much information as we could, to the extent that there are circumstances during the year that arise, good or bad, that cause us to think about that share buyback in some meaningfully different way, we will continue to give you the insight that we're capable of giving. Our advice here is not to overreact to your perception of the first quarter.

Gregory Locraft
Morgan Stanley, Research Division

Great. And then also on capital deployment, could you just address the dividend. The increase is a healthy increase. What is your dividend policy and how did you settle in on $0.41 a share as being the right number as opposed to something else?

Jay S. Fishman
Former Executive Chairman

Well, you know $0.40 could’ve been right also. It’s not -- again, it's hardly that precise. But our mindset has been to set a dividend level that reflects the fact that we're in a business that has great earnings volatility. We always recognize that the 1-in-1,000 event could happen this year. And it could happen twice this year. Just because it's 1-in-1,000 doesn't mean that it's 0. It's possible. So our goal is to evaluate our cash flows, recognizing that the share buyback has reduced the number of shares significantly overtime. Actually, I think in about half at this point, we're down to about half of the shares when we started. So we are able to increase the dividend I think thoughtfully, but always keep it at a level that even looking at the tail risks of our business, it would be unlikely -- I don't want to say 0 again. We’re not a 0 basis kind of company. But it would be unlikely to be in a position of having to make a change in that regard. So, and what we do is to the extent that there is additional capital above and beyond that, we obviously deploy it in the share buyback program. So that's the thinking. And it really, it doesn't -- it actually is not driven by a set payout ratio because our earnings can change meaningfully based upon natural events or otherwise. It's set at a level where we have a reasonable degree of confidence that in a lot of scenarios, that we would be in a position of being able to support a continuation of the dividend.

Gregory Locraft
Morgan Stanley, Research Division

And then just on the direct business, the direct auto initiative, it's obviously growing very -- it looks like it's up almost 50% year-over-year just premiums. There is a P&L drag as well. But just curious, your updated thoughts on that trajectory and where this potentially could go over time?

Jay S. Fishman
Former Executive Chairman

Greg and I will tag team this as well. When we set on this venture, we were very clear and transparent that this was long-term in nature. And we are not yet at that long-term level. We are still very much -- meaning we are still in the process of learning and learning enough to what we hope, ultimately, will put us in a position to be able to deploy the resources of this company in a thoughtful, substantive way and actually grow that business, hopefully, meaningfully. We don't yet know enough to do that. We don't know enough about the pricing of the product. We don't yet know enough about how to convert quotes into sales at a level that's likely to produce a long-term, profitable return. So our investment in this regard is as in effect as little as it can be, while still allowing us to learn as much as we're capable of learning. And that's a real trade-off that we decide every year. So it's still, I would say, at best -- it may not be the early days, it's later, it's certainly further on than that. You will see a change this year in our advertising program to be more of an “operators are standing by” type of advertising. For those of you who aren't old enough to remember what that means, it's really the decades-ago dynamic of call now. Call now, we're going to obviously not embrace the call-now dynamic, but you are going to see more of a drive to action-oriented advertising. And we'll see how responsive that is. I think you can talk about the digital world too, as long as we're at it.

Gregory Cheshire Toczydlowski
Executive Vice President and President of Business Insurance

Sure. This is Greg Toczydlowski. Just to echo Jay's comments, I'll start with the assessment. We're as encouraged today as when we started the investment around where the future value of that is. We've spent a lot of time, as Jay talked about, in the advertising arena, not only in creating and executing ads but trying to understand an attribute, the sales across all the mediums, the one that Jay just talked about was on the digital front. We're spending a lot of time inside that arena and really working the search optimization and display-type ads and building good capability there. And I certainly don't want to pick at your words, but there is a little bit of a bias in the industry that -- I think your words were "the direct auto initiative." If you look at the statistical supplement, you'll see -- do some quick math and over 40% of the PIF is in the property lines. And we really think that's where we -- we've a long-term strategic competitive advantage there with the breadth of our product and the strength of that property line. And I think consumers have seen that. So in the early days, we're very pleased what -- how we're building that capability and what the profile of the customers look like.

Jay S. Fishman
Former Executive Chairman

We've also hired some two terrific leaders in the last year for that business: one out of Microsoft and one out of the direct industry, not insurance, but someone with real skill in building a direct response business. And so, these are all steps in the right direction to building what we hope will be a successful venture.

Operator

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

Lawrence David Greenberg
Janney Montgomery Scott LLC, Research Division

Know that most of the increase in your accident year ex-cat combined ratio for personal was non-cat weather. But you had said in the first quarter, excuse me, coming out of last year, that you expected personal lines premium – personal lines margins to be improving this year. And I mean, adjusted for the non-cat weather, I'm just curious whether you still feel that way?

Gregory Cheshire Toczydlowski
Executive Vice President and President of Business Insurance

Good morning, Larry, this is Greg Toczydlowski again. Yes, up to this quarter, we certainly did see relatively low loss cost trends, both frequency and severity. And we saw rate outpacing that. Clearly this quarter, we could see was in the weather lines, and then we really segment the data and look at a geography level and the coverage line, we could see it predominantly in the physical damage coverages. So when we looked -- that we're expecting normal weather patterns for the rest of the year, we still believe in that statement that our loss cost trends will be offset with slightly more rate.

Jay S. Fishman
Former Executive Chairman

Yes and I've just observed that God has His own plan for the weather. And while obviously that statement is always going to be measured relative to -- in particularly in the non-cat area where obviously, we're out of pattern here for the first three months anyway.

Lawrence David Greenberg
Janney Montgomery Scott LLC, Research Division

Sure. I appreciate that. And then second question, Brian, your comments on Surety competition, can you just elaborate a little bit? Is that just coming from the traditional players? Are you seeing any new capacity moving into that area?

Alan David Schnitzer
Chairman of the Board & CEO

Larry, it's Alan Schnitzer, I'll take that. I would say that we are continuing to see a lot of capacity and just a lot more bold activity on the part of previously existing capacity. I wouldn't say that it's necessarily new entrants into the marketplace, although there's always puts and takes on that as well.

Operator

And our next question is from Jay Cohen with Bank of America.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

I've got two questions. The first is in looking at the Select Account business, and you've had consistent renewal rate improvements there. I guess I'm assuming that a fair amount of this business gets renewed fairly automatically with some modest increases, and it's not too much of a push to get those increases. Is that oversimplifying it?

Brian W. MacLean
President and Chief Operating Officer

You know, slightly, but directionally, it's right. And we're obviously looking at that class by class, so it's not -- we talk about the individually underwritten stuff and deal by deal. I don't want to imply that this is just one big bucket. But we are looking at industry classes and kind of bucketing it that way. But directionally, Jay, you're right. A lot of it is automatically handled. On the express side, about 80% of that business goes through without being touched by a person. And there's obviously ability to drive a little bit of price through there that we've been successful with. And like you said, you can see the numbers on whatever that is, Page 11, that would reinforce that.

Jay S. Fishman
Former Executive Chairman

And the statistics I last looked at in Select was that 80% of the accounts have not had a loss in the last 3 years, and as a consequence, the loss experience for an individual account is not terribly relevant but the size of the book and the ability to determine the right price for the class is what the secret sauce is all about. And so that's what we're responding to there is the loss dynamics from a class perspective.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Got it. And then the other question. I forget exactly who used the word, but -- maybe it was Brian, when you were talking about rate increases, you suggested the environment was becoming more receptive. I think most of your discussion on the pure rate environment has been about your efforts to target selectively rates and getting the right price for the right risk, but are you seeing a reaction by your competitors to act in a more disciplined fashion? Obviously it'll vary a lot by a line of business and by size of account. But is there any underlying trend where that might be the case?

Jay S. Fishman
Former Executive Chairman

Brian and I, we're going to tag team this a little bit. We often get asked, who's stepping on the gas? There's lot of different ways to ask that question. And the anecdotal observation that we have to that is nobody. We just haven't seen competition -- we just haven't seen competition where we turn back and we scratch our head. Broadly speaking, you could always find an individual account or an individual transaction that doesn't make sense to one carrier versus another. But it's not as if we look broadly at the marketplace and we say, "Gee, we can't figure that strategy out." And it's been interesting because, again, I think the observers to the industry have perceived that there is someone like that. And I think -- I know there's actually been some commentary to that effect. We haven't seen -- we don't come to that conclusion. And I think it's evidenced in the retention rates that are universally strong amongst the best competitors. Now ours, I think, if you look at the real data, ours is probably the highest. But when you look at what we think of as the great middle market accounts, they're all historically at pretty solid levels relative to their own circumstances, and if there were someone who were really acting that way, carrier or carriers, we think you'd see more churns. This gets back to our view of the kind of the mythical cycle dynamics. I find it interesting that people talk about it being a soft environment. And it may be at the top line. If you look at our earnings per share last year, before tax, look at all the earnings that we generate earnings per share pretax. Last year was actually our best earnings-per-share year ever. And you can say yes, it was favorable development, or it was this or it was that, the negative is investment returns have been challenged, but it's been interesting to us that the observation of the challenging marketplace, and we acknowledge that with respect to the top line, really hasn't translated through the bottom line, so...

[Technical Difficulty]

Brian W. MacLean
President and Chief Operating Officer

Real quickly, Jay, at the beginning, as you teed it up, we tend to first and foremost look at our own information. So we look at the fact that as I said, throughout this quarter, and really through just about two straight quarters now, month by month, we've seen a little bit of improvement every month in pricing, and this month, we saw retention improved by 2 points, and we look at the combination of those, and it says we're not pushing too hard. We hear the rhetoric and the anecdotes just like you do. One of the things -- one of the reasons why we say we don't see the big amplitude in the cycle is that 5 years ago, certainly 10 years ago, in our offices, there would be all those anecdotes. Everyone would rattle off, “These are the two or three markets that are behaving crazy in the world today.” And we don't get that same level of noise out of our folks. But you're right. We look at our own information first, and we feel good about our data. So...

Operator

And our last question is from the line of Vinay Misquith with Crédit Suisse.

Vinay Gerard Misquith
Crédit Suisse AG, Research Division

Just to follow up on Jay's question before, has an improving economy helped you and your ability to take rates up?

Jay S. Fishman
Former Executive Chairman

I try hard to separate what we know from what we speculate. I know the data. I know the numbers. Exactly why we've been successful in that strategy would be speculative on our part. It was interesting and I -- you can look at the data, when the economy was deteriorating, going back now just 2 or 3 years ago, we were actually able to move rate in the right direction. Now I don't know that it ever got positive, but it, certainly as the time went on, became less negative. Now that was -- that would be contrary to what one would think. So I'm respectful of the complexity of our industry and the data that comes at us. I can only share with you that we've been -- it would be hard to overestimate the nature of engagement of the leadership in Business Insurance and Personal Insurance with the folks in the field about how to operate in this environment. So I can tell you that the direction has been specific with clarity, one would even argue intense. That doesn't mean intense pressure, but an intense involvement. And whether that's attributable to an improving economy or the value of the franchise, which is sort of the one that I personally endorse, but I’ll leave that to others to speculate more subsequently.

Vinay Gerard Misquith
Crédit Suisse AG, Research Division

Fair enough. And this is a follow-up to that. How do you see pricing versus loss cost trends for the future based on where you're pricing right now?

Jay S. Fishman
Former Executive Chairman

I assume you're talking about written because earned is what it is. And that's baked in to our -- and I say baked in, it's very, very predictable. But we haven't -- just to be -- and then I'm going to turn it over to Brian. We haven't actually done the arithmetic to sit here and say that if rate continues to improve at this level and loss trend doesn't turn, when written rate would exceed loss trends. So we just haven't done it yet. But we're -- this is encouraging. The last couple of quarters is encouraging. And you...

Brian W. MacLean
President and Chief Operating Officer

I go back and repeat the numbers I said before about frequency and severity, and then we're not making a projection of what we think rate’s going to be over the next however many quarters. But we are encouraged with the trends that we’ve seen in the last 5 or 6 months now, and you can do the arithmetic. And we watch the loss cost closely and so any of the variables could move.

Jay S. Fishman
Former Executive Chairman

And again, we've just been a company that has refrained from making predictions about rate. There are so many variables: the economy, energy prices. All sorts of things interact with this. And so we're real pleased with what we did in the first quarter, we're feeling -- as I said in the press release, cautiously but increasingly optimistic, and we'll keep our fingers crossed for the second quarter. That's kind of been -- not that it's about luck but that the environment continues to be supportive of the strategy that we're employing. Operator, thank you.

Operator

You're very welcome. We have no more questions at this time. I'll now turn the call back to you.

Gabriella Nawi
Senior Vice President of Investor Relations

Yes, thanks for joining. As always, Andrew Hersom and I are available in Investor Relations for any follow-up questions. Thank you, and have a good day.

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