S&P Global
Market Intelligence

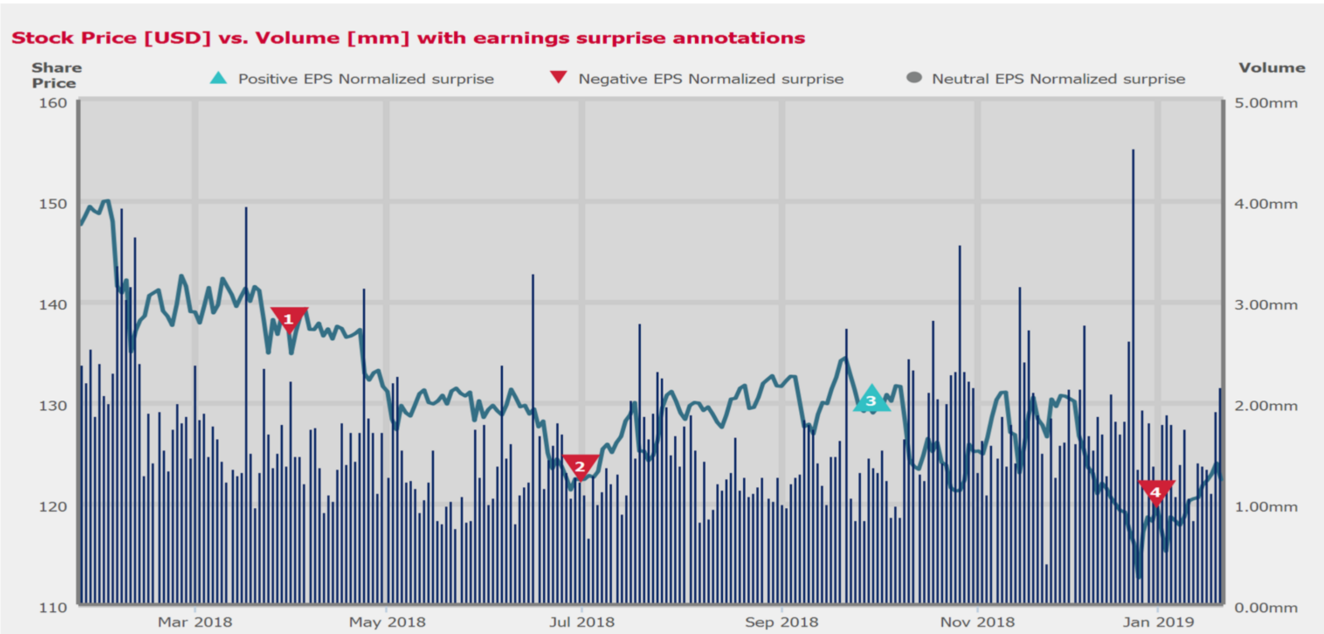
The Travelers Companies, Inc. NYSE:TRV
FQ4 2018 Earnings Call Transcripts

Tuesday, January 22, 2019 2:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ4 2018-			-FQ1 2019-	-FY 2018-		
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	ACTUAL	
EPS Normalized	2.20	2.13	▲(3.18 %)	2.88	9.06	8.94	
Revenue (mm)	6923.74	6945.00	▲0.31	6936.78	27041.24	27059.00	

Currency: USD
Consensus as of Jan-22-2019 1:36 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ1 2018	2.68	2.46	▼1 (8.21 %)
FQ2 2018	2.39	1.81	▼2 (24.27 %)
FQ3 2018	2.26	2.54	▲3 12.39 %
FQ4 2018	2.20	2.13	▼4 (3.18 %)

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EXECUTIVES

Abbe F. Goldstein
Senior Vice President of Investor Relations

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Chairman & CEO

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Executive VP & CFO

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Executive VP & President of Business Insurance

Michael F. Klein
EVP, President of Personal Insurance and Head of Enterprise Business Intelligence & Analytics

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Meyer Shields
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Presentation

Operator

Good morning, ladies and gentlemen. Welcome to the Fourth Quarter Results Teleconference for Travelers. [Operator Instructions] As a reminder, this conference is being recorded on January 22, 2019.

At this time, I would like to turn the conference over to Ms. Abbe Goldstein, Senior Vice President of Investor Relations. Ms. Goldstein, you may begin.

Abbe F. Goldstein
Senior Vice President of Investor Relations

Thank you. Good morning, and welcome to Travelers' discussion of our fourth quarter 2018 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 travelers.com under the Investors section.

Speaking today will be Alan Schnitzer, Chairman and CEO; Dan Frey, CFO; and our 3 segment presidents: Greg Toczydlowski of Business Insurance; Tom Kunkel of Bond & Specialty Insurance, who is joining us remotely this morning; and Michael Klein of Personal Insurance. 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 take questions. Before I turn the call over to Alan, 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, including as it relates to our discussion of our outlook. The company cautions investors that any forward-looking statement involves risk and uncertainties and is not a guarantee of future performance. Actual results may differ materially from those expressed or implied in the forward-looking statements due to a variety of factors. These factors are described under forward-looking statements in our earnings press release and 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 available in the Investors section on our website.

And now I'd like to turn the call over to Alan Schnitzer.

Alan David Schnitzer
Chairman & CEO

Thank you, Abbe. Good morning, everyone, and thank you for joining us today. As we look back on 2018, we're pleased that we improved returns, grew our business and delivered strong underlying underwriting profitability and investment results, while returning significant excess capital to shareholders and taking great care of our customers. Our results benefited from ongoing strategic initiatives geared toward creating top line opportunities and improving productivity and efficiency. Of course, our results were also impacted by a high level of catastrophe losses. Fourth quarter net income of $621 million or $2.32 per diluted share generated a return on equity of 10.9%. Core income was $571 million or $2.13 per diluted share and core return on equity was 10%. Net and core income were both impacted by almost $500 million of after-tax cat losses. Our full year core income increased by 19% to $2.4 billion, generating core return on equity of 10.7%. The fact that we were able to generate this level of profit and profitability with $1.4 billion in after-tax cat losses speaks to the earnings power of our franchise. Our consolidated underlying combined ratio for the fourth quarter improved to 91.1%, lowest level since the first quarter of 2016, even after the impact on the quarter of a full years worth of higher loss estimates in the Commercial Auto line driven by bodily injury severity. Commercial Auto has been a challenge for the industry and for us for some time and our most recent data reflects further deterioration. Greg will address in more detail what we've seen and how we're responding.

For the full year, our record earned premium of more than $27 billion and productivity and efficiency initiatives contributed to an after-tax underlying underwriting gain of $1.5 billion, a highest in more than a decade. Our successful and consistent investment strategy also contributed to our results. After-tax net investment income was up 15% for the quarter and 12% for the year. The underwriting gain and investment income also reflected benefit of tax reform. These results, together with our strong balance sheet, enabled us to grow adjusted book value per share by 5% during the year after returning more than $2.1 billion of excess capital to shareholders consistent with our long-standing capital management strategy.

Turning to production, we remain very pleased with our performance in the market with each of our business segments contributing to a 4% increase in net written premium for the quarter. For the year, we grew net written premiums by 6% to a record $27.7 billion. Net written premiums in Business Insurance in the quarter increased by nearly $100 million or 3%, driven by historically high retention and positive renewal premium change. In our Middle Market business, retention reached a record fourth quarter high of 88%.

We completed the rollout of our business centers and our Commercial Accounts business during the year. All eligible renewals in new business are now flowing through these centers, freeing up our local underwriters to spend more time with our agent and broker partners. For the year, Commercial Accounts delivered its highest level of new business in more than a decade. Renewal premium change in Business Insurance including pure rate and exposure was nearly 5% in the quarter, up over 0.5 point compared to the same period last year and steady throughout 2018. We achieved positive renewal premium change in all lines.

In our Bond & Specialty business, net written premiums increased by 8% for the quarter with continued strong production in both our Management Liability and Surety businesses. In domestic Management Liability, we achieved record retention and new business for the full year. In Personal Insurance, net written premium growth in the quarter was strong at 5% with both our Agency Auto and Homeowners businesses contributing. Two years ago in 2016, we had a $4 billion book of Agency Auto business with some profitability challenges. Today, it's a $5 billion business that meets our return expectations. Thanks to impressive execution by the team and an improved environment, we got there ahead of schedule. We'll hear more shortly from Greg, Tom and Michael about our segment results.

To wrap it up, despite another year of elevated catastrophe losses, we achieved an 11% return on equity. That speaks to excellent underwriting execution and management of risk and reward across a diverse portfolio of businesses, our successful investment strategy and our active approach to capital management. It also speaks to the dedication and commitment of our 30,000 employees. With a talented team, competitive advantages that set us apart and an ambitious innovation agenda, along with a very high respect for our shareholders capital, we remain very well positioned to continue to deliver leading results and meaningful shareholder value over time. And with that, I am pleased to turn the call over to Dan.

Daniel Stephen Frey
Executive VP & CFO

Thank you, Alan. Core income for the fourth quarter was $571 million, down from $633 million in the prior year quarter, and core ROE was 10% down from 11.1%. The decrease in both measures from last year's fourth quarter resulted primarily from a higher level of catastrophe losses and a lower level of favorable prior year reserve development. Underlying results were strong as the consolidated underlying combined ratio of 91.1%, which excludes the impacts of cats and PYD, improved by 1.3 points from the prior year quarter.

Recall that last year's fourth quarter underlying combined ratio was elevated by about 0.5 as a result of tax planning actions taken at that time. Our fourth quarter results include $610 million of pretax cat losses, driven by $453 million from the California wildfires in November and $158 million from Hurricane Michael in October. Last year's fourth quarter cat losses of $499 million included favorable development of $157 million primarily related to the hurricanes from the third quarter of 2017. PYD in the current quarter, for which I'll provide more detail shortly, was net favorable $167 million pretax down, from $293 million in the prior year quarter. Our pretax underlying underwriting gain of $578 million improved by 22% from $472 million in the prior year quarter as increases in both Bond & Specialty and Personal Insurance were partially offset by a decrease in Business Insurance, which Greg will address in his comments.

Pretax net investment income increased by 5% from the prior year quarter to $630 million as increases in fixed income were partially offset by lower pretax returns in our nonfixed income portfolio compared to very strong performance in the prior year quarter. Fixed income results benefited from the more favorable interest rate environment and an increase in average invested assets resulting from continued growth in net written premiums. After-tax NII increased by 15% to $535 million benefiting from the lower U.S. corporate income tax rate.

After-tax fixed income NII in the fourth quarter increased by $65 million compared to the fourth quarter of 2017, and we expect that 2019 fixed income NII will increase by approximately $20 million to $25 million per quarter compared to the corresponding period of 2018 as we project that both the average level of invested assets and the average yield on the portfolio will be higher. All 3 segments experienced net favorable prior year reserve development in the fourth quarter. In Personal Insurance, recent accident years performed better than expected in the auto book. In Bond & Specialty, we experienced better-than-expected loss development in the Management Liability book. In Business Insurance, net favorable PYD of $48 million pretax was driven by better-than-expected loss experience in domestic workers comp, which was largely offset by unfavorable development in Commercial Auto and to a lesser extent General Liability. Commercial Auto unfavorable PYD in the quarter was $155 million pretax resulting from elevated severity in recent accident years.

In General Liability, where the returns remain attractive, unfavorable PYD in the quarter reflected changes across several accident years in business units. There is no broad theme, but the largest impact related to a small number of claims from older years in our run-off book. For the full year, despite the adverse changes in Commercial Auto and the third quarters asbestos charge, net favorable prior year reserve development was $517 million pretax. When our combined 2018 Schedule P is filed early in the second quarter, we expected to show that excluding asbestos, environmental, all accident years across all product lines in the aggregate and all product lines across all accident years in the aggregate developed favorably or had minor unfavorable development except for Commercial Auto and as a result of the change in Commercial Auto accident year 2017.

Page 19 of the webcast provides information about our January 1 cat treaty renewal. Our corporate cat aggregate XOL treaty renewed on terms in line with the expiring treaty and continues to provide coverage for both single cat events and the aggregation of losses from multiple cat events. As you all know, the industry has experienced an elevated level of catastrophe losses in recent years. In response, we have updated our actuarial model to reflect the actual results of recent years and to give more weight to recent years when determining our view of normal expectations. As a result, we have recognized a somewhat higher level of expected losses on our pricing and underwriting models. In further recognition of recent weather activity and ongoing uncertainty, for 2019, we have also added a new catastrophe aggregate XOL treaty as described on Slide 19. This treaty addresses qualifying PCS-designated events in North America, for which we incurred losses of $5 million or more, providing aggregate coverage of $430 million part of $500 million of losses above an aggregate retention of $1.3 billion. Hurricane and earthquake events have a $250 million per occurrence cap. We believe this new treaty provides a reasonable level of protection at an appropriate price. In terms of the accounting, there will be an impact on the underlying combined ratio in 2019 due to the effect of ceded premiums on total net earned premiums.

Since the majority of any loss recoveries from this treaty will likely benefit our net catastrophe losses, which are excluded from underlying results, we expect about 0.5 point impact on the full year underlying combined ratio but a minimal impact on the full year total combined ratio. Because the attachment point is $1.3 billion, we also expect that any recoveries would likely be recorded in the second half of the year, and accordingly, the impact on the combined ratio will likely be more pronounced in the early part of 2019. Of course, the actual effect on our total combined ratio for 2019 will be impacted by the level of PCS events we experience.

Turning to capital management. Operating cash flows for the quarter of $948 million were again very strong, all our capital ratios were at or better than target levels and we ended the quarter with holding company liquidity of approximately $1.4 billion. Interest rates decreased modestly during the fourth quarter, and accordingly, our net unrealized investment loss narrowed from $447 million after-tax as of September 30 to $113 million after-tax at year-end. Adjusted book value per share, which excludes unrealized investment gains and losses was $87.27 at year-end, 5% higher than at the beginning of the year. We returned $375 million of capital to our shareholders this quarter comprising share repurchases of $170 million and dividends of $205 million. For the year, we returned more than $2.1 billion of capital to our shareholders through dividends and share repurchases. Consistent with our capital management strategy, that level of return capital takes into consideration a variety of factors. For example, the increased level of capital in support of the nearly $2.8 billion of premium growth we have generated over the last 2 years, the amount of earnings and contributions to the pension plan and you will recall that we made a $200 million contribution in September for tax planning purposes. And with that, I'll turn the microphone over to Greg for discussion of Business Insurance.

Gregory Cheshire Toczydlowski
Executive VP & President of Business Insurance

Thanks, Dan. For the fourth quarter, Business Insurance produced $391 million of segment income, down from $637 million in the prior year quarter, bringing the full year total to $1.64 billion, a 2% increase over 2017.

Earnings for both the quarter and the year included the relatively high levels of catastrophe losses, that Alan and Dan mentioned, as was the case in 2017. Earnings for both the quarter and the year were positively impacted by strong profitability in Workers' Comp, our biggest product line, as well as higher overall business volumes that resulted from recent earned premium growth and increased operating leverage that has reduced our expense ratio. Earnings were negatively impacted by a fourth quarter after-tax charge of about $195 million or about $245 million on a pretax basis related to higher Commercial Auto bodily injury loss activity.

Of that amount, about $155 million pretax reduced net favorable prior year reserve development. The remaining $90 million pretax represents the impact to the 2018 accident year and incorporates reestimations for the first 3 quarters of the year. The corresponding combined ratio impacts were approximately 6.5 points on the segment combined ratio for the quarter and a little more than 1.5 points on the segment combined ratio for the year. The impacts on the underlying combined ratio from the adverse auto adjustments were approximately 2.5 points for the quarter and a little more than 0.5 point for the full year.

As we've discussed with you, in the recent years, we've re-acted the higher Commercial Auto losses at different portions of our Commercial Auto book through various pricing, underwriting and reserving actions. But during the recent quarter, data emerged that changed our view of the overall loss environment broadly across our Commercial Auto book. We saw a more of an increase in the rate of attorney involvement than we had anticipated, and a lengthening in the claim development pattern. As a consequence, we are experiencing a higher level of bodily injury severity than we anticipated.

Because we believe the factors we're experiencing are environmental, our primary plan of action going forward will be to push for more rate. As we mentioned in the past, the auto line is where we've been getting the most rate over the last couple of years, but we need more of that. It is important to remember that auto was typically part of an account solution for our Business Insurance customers. We generally provide them with some combination of worker's comp, property, general liability and/or other coverages. Accordingly, we will use our extensive data and analytics capabilities on an account-by-account basis to improve auto profitability as aligned and as part of the overall profitability of our product portfolio.

Turning back to the segment results, the underlying combined ratio of 95.4% for the quarter was 1.5 points higher than the prior year. The loss ratio was about 3 points higher than last year, driven by the 2.5 points from auto. The remaining 0.5 point is due to higher nonweather loss activity in our international businesses with the largest contributor to that coming from Lloyd's, partially offset by favorable variability in domestic loss activity. The expense ratio for the quarter improved by 1.5 points with about half of that improvement coming from lower expense dollars and the other half coming from higher premium volumes.

As always, there are fluctuations in expenses from quarter-to-quarter so we point you to the full year expense ratio as a better indication of our run rate. All-in for the year, a 95.7% underlying combined ratio, which included large losses, which ran about 1 point over what we would have viewed as a more normal level.

Turning to top line in production, net written premium growth for the quarter was 3% bringing the full year total to $15 billion, almost $700 million or 5% higher than in 2017. We're pleased with our continued progress with our strategic initiatives, and we remain encouraged with the feedback from our agent and broker partners that we're focused on the right priorities. In terms of domestic production, we achieved strong renewal premium change of 4.8% in the quarter with renewal rate change of 1.6% while retention remained high at 85%, a reflection of the quality of our book. New business of $488 million was up 3% from a year ago. We're pleased with these production results and continue to operate at a granular level of executing in our marketplace strategy to meet our return objectives with a thoughtful balance towards retaining our best business, improving pricing where it's needed and pursuing attractive new business opportunities.

Turning to the individual businesses, in Select renewal premium change and renewal rate ticked up a bit, while retention remained strong at 82%. New business was up 11% over the prior year quarter as we continue to leverage our investments in technology and workflow initiatives. In Middle Market, renewal premium change was 4.5% with renewal rate change consistent with last quarter at 1.5%, while retention remained historically high at 88%, as Alan said, a record for the fourth quarter. New business premiums of $281 million were down a bit from a strong level in the prior year quarter and our core Commercial Accounts business where business center initiatives are now fully rolled out, new business was up 17% for the quarter, while full year new business premiums of $561 million were at the highest level in over a decade. In this business, we're pleased that the business centers and our strategic investments are having the intended impact. Submission and quote activity are both up from the prior year creating attractive top line opportunities.

To sum up, we feel terrific about our execution in the marketplace and confident about how we're positioned going forward.

Before I turn the call over to Tom to talk about Bond & Specialty results, I want to comment on our outlook for RPC and the underlying combined ratio since we will not be filing our 10-K for a few weeks. We expect RPC will remain positive in 2019 and at the levels broadly consistent with 2018.

We expect the underlying combined ratio for the full year 2019 will be lower than in 2018, which assumes that large losses, primarily in the property line, return to lower and more normal levels. Underneath that full year outlook, we expect the underlying combined ratio improvements to come in the second through fourth quarters of the year. With that, I'll turn the call over to Tom.

Thomas M. Kunkel
Executive VP and President of Bond & Specialty Insurance

Thanks, Greg. Bond & Specialty delivered another quarter of strong returns and growth. Segment income of $220 million nearly doubled from the prior year quarter due primarily to a higher underlying underwriting income and a higher level of net favorable prior year development. The improvement in underlying income reflects the impact of a single Surety loss in the prior year quarter and higher business volumes. The underlying combined ratio was an excellent 78.1%.

Net written premiums for the quarter were up 8%, driven by strong growth in our Management Liability business and solid Surety production that was up slightly from the very strong prior year quarter. In our domestic Management Liability business, our focus continues to be on retaining our high-quality business and targeting rate where needed, while pursuing attractive new business opportunities. So we are pleased that retention remained very strong at 89% for the quarter with a renewal premium change of 3.9 points. New business of $53 million was up 8% from the prior year quarter. These results reflect our extensive competitive advantages and solid marketplace execution. We are a leading franchise in our specialty markets with long-term customer, agent and broker relationships across a national footprint. We've got exceptional talent and specialized industry expertise, extensive data and advanced analytics. And while we have leading platforms and robust products, we continue to invest in strategic product marketing and technology capabilities that will further extend our competitive advantages.

So Bond & Specialty results were excellent. We continue to feel great about our growth, returns and the opportunities that are strong market positions and competitive advantages present for the future.

In terms of our 2019 outlook, as compared to 2018, we expect RPC for our domestic Management Liability business to remain positive and broadly consistent, and for the segment, the underlying combined ratio to be broadly consistent. For Surety, we expect 2019 net written premium to be slightly higher than it was in 2018. Due to the inherent lumpiness in Surety production, going forward, we will no longer be including Surety net written premium in our outlook disclosure. And now, I'll turn it over to Michael to discuss Personal Insurance.

Michael F. Klein
EVP, President of Personal Insurance and Head of Enterprise Business Intelligence & Analytics

Thanks, Tom, and good morning, everyone. In Personal Insurance for the quarter, segment income was $32 million, an improvement of $82 million over the prior year quarter, and our combined ratio of 102.6% improved 6.1 points. The lower combined ratio was driven by improved auto results, lower catastrophes and higher net favorable prior year reserve development.

For the full year, segment income of $297 million and a combined ratio of 100.6% are also better than the prior year, driven by the same factors I referenced for the quarter. Net written premium growth for the fourth quarter and full year was 5% and 7% respectively. Our premium growth helped us achieve a 30 basis point improvement in our expense ratio for the full year.

Agency Automobile delivered another impressive quarter with a combined ratio of 95.3%, down 7.7 points from the prior year quarter, driven primarily by a lower underlying combined ratio. Underlying margins continue to improve due to earned pricing exceeding loss trend and frequency remaining better than expected. These factors also resulted in favorable full year loss adjustments in the quarter that further contributed to a better loss ratio than we would have expected. The quarter also benefited from higher net favorable prior year reserve development, partially offset by higher catastrophes. Recall that the prior year quarter included a benefit from the reestimation of catastrophes, including Hurricane Harvey.

Our full year combined ratio for Agency Automobile of 94.2% was 10 points better than the prior year and returns were well within targets on both an overall and an underlying basis. In light of these improvements, we continue to moderate renewal premium changes in this line as we seek to balance growth and profitability.

In Agency Homeowners and other, the fourth quarter combined ratio of 109.8% improved by more than 5 points despite 3 significant catastrophes, the Camp and Woolsey wildfires in California and Hurricane Michael. On an underlying basis, the combined ratio was 72.5% or 2.3 points higher than the prior year quarter, driven by continued elevation in nonweather-related losses, which we noted in the prior quarter. The full year combined ratio of 105.6% reflects a second consecutive year of very high catastrophe losses, which again accounted for approximately 24 points of the combined ratio. The full year 2018 underlying combined ratio was 81.6%, 4.5 points higher than 2017, driven by higher levels of non-catastrophe weather and nonweather loss activity. Consistent with comments we made earlier this year, given this recent catastrophe and a non-catastrophe loss experience, and our assumption that some of this elevated loss pressure will persist, we continue to implement granular pricing and underwriting actions to manage our exposure and improve results.

Turning to quarterly production, our Agency Automobile retention remained at a solid 84%, while renewal premium change of 6.3% continued to moderate consistent with our objectives and new business was up 2% from the prior year quarter. In Agency Homeowners and other, we remain pleased with our momentum. Renewal premium change was 3.9%, nearly 1 point higher than a year ago. In addition, we delivered 6% growth in policies in force, on strong retention of 86% and a 17% increase in new business.

Turning to our outlook for full year 2019, we expect renewal premium changes for Agency Automobile to be positive but lower compared to 2018, while renewal premium changes for Agency Homeowners and other should be positive and higher compared to 2018. We expect the underlying combined ratio to be broadly consistent in Agency Automobile, Agency Homeowners and other and for the Personal Insurance segment compared to 2018.

This underlying combined ratio outlook includes the impact of the catastrophe aggregate reinsurance treaty that Dan mentioned earlier. In the outlook section of our 10-K, we'll provide some quarterly texture underneath our full year underlying combined ratio expectations as quarter-to-quarter comparisons will likely vary throughout the year. All-in for this segment, in light of the improved results in auto, and the actions we are undertaking in homeowners, we are pleased with our position and with the opportunity to profitably grow the business while continuing to invest in new capabilities and explore innovative opportunities in an ever-changing marketplace. With that, I'll turn the call back over to Abbe.

Abbe F. Goldstein
Senior Vice President of Investor Relations
Thank you, Michael. And with that, we're ready to open up for Q&A.

Question and Answer

Operator

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

Jay H. Gelb
Barclays Bank PLC, Research Division

First I wanted to touch base on the California wildfires. Can you give us some more perspective on how you compare your 2018 exposure to 2017? And whether you feel there's some type of public policy solution that needs to be addressed here given the annual major exposure for the industry?

Alan David Schnitzer
Chairman & CEO

Michael, you want to start?

Michael F. Klein
EVP, President of Personal Insurance and Head of Enterprise Business Intelligence & Analytics

Yes, I'll start with just sort of the view of the exposure and Jay maybe give you a little bit of a view into a little more detail underneath what we'd mean when we talk about granular underwriting of pricing actions in response. So as we look at the California wildfires, clearly, 2 significant years in a row of losses. I think the discussion and the debate about the environment is pretty broad and pretty public. In terms of our response, we look at a handful of things. First, we look at our underwriting appetite and our view on terms and conditions in the marketplace, and we have taken actions. We had already taken action in 2017 to begin to restrict our new business underwriting appetite. We've implemented further actions that will take effect later on this quarter in 2018 to further restrict that new business underwriting appetite and also to instill new business underwriting procedures, for example, further inspections around the defensible space, as an example, that will, again, sort of tighten our new business underwriting appetite. We've also discussed with the Department of Insurance in California and begun to implement some nonrenewal action in the State of California to address some of the more significant wildfire exposures in the portfolio. And we're also in discussions with the department about a filing to increase prices for homeowners in California. So that gives you a little bit of texture underneath our response to wildfires in particular in the homeowners book.

Jay H. Gelb
Barclays Bank PLC, Research Division

It's helpful. My second question was on the pace of share buybacks in the quarter. So if I look back over the past 6 quarters, the average quarterly buyback is around $385 million, which was much higher than the $170 million in the fourth quarter. So I'm just trying to figure out if fourth quarter lower pace of buybacks was due to the elevated cat losses? Or if there's some other factor going on we should take into account when we project buybacks in the years ahead?

Daniel Stephen Frey
Executive VP & CFO

Yes, Jay, it's Dan, I'll take that. So really no change in our underlying philosophy. It's a consistent approach to capital management and to look at any one quarter's worth of buybacks is probably a difficult way to look at it, we think about it more over time. As you would -- as you suggested, and it would be true, in the fourth quarter, given the magnitude and the uncertainty related to the California wildfires, we did pull back a little bit on the level of share repurchase. But if you look at 2018 as a whole, we generated $2.4 billion of core income. We returned a little bit more than $2.1 billion through dividends and share buybacks, and remember, we made an additional $200 million contribution in the pension plan at the end of the third quarter. So really, no change there. We're going to look at what level of capital we think we need to support the business, our projected levels of earnings going forward and the cash needs that we have for things like the pension plan and react accordingly. So what we buyback in shares is going to be an outcome of those things not really an objective in and of itself.

Operator

Our next question comes from the line of Elyse Greenspan from Wells Fargo.

Elyse Beth Greenspan
Wells Fargo Securities, LLC, Research Division

My first question just going to the business insurance the underlying margin outlook for 2019. So if I go through some of your prepared remarks, you guys pointed to about 1 point of above normal level of large losses in '18 with an offset partially there from that coming back of the additional aggregate reinsurance coverage that you guys are purchasing. Now I know that's 50 basis points overall, I'm not sure if you can go into the specific details within business insurance as we think about the margin improvement this coming year. And then as you set the margin outlook, are you guys assuming Commercial Auto gets better or worse when compared to how you guys ended up booking that business in accident year 2018?

Alan David Schnitzer
Chairman & CEO

Elyse, it's Alan. So let me start, and Greg you can jump in. So we try not to get too quantitative on these outlooks. We try to keep it qualitative. There is a lot of estimates, a lot of a judgements and a lot of thing from -- things from period to period that are going to cause volatility. So we -- we've tried to give you a order of magnitude and direction. Having said that, Greg did point out the essentially 1 point of property large losses that we would expect to return to more normal level. We do expect to address Commercial Auto over time, but a significant improvement in that is not otherwise reflected in the outlook for margins. And the overall impact of the new cat treaty on the BI underlying is relatively small. So I think, in broad strokes, that gives you sort of the way to think about the underlying outlook.

Elyse Beth Greenspan
Wells Fargo Securities, LLC, Research Division

Okay. Great. And then my second question, in terms of thinking about the pricing outlook, you guys pointed to fairly stable renewal premium change this -- in 2019. So when you think about price versus exposure, can you give us a little bit of color of how you are seeing, potentially, picking up seeing in a different components? And then in the fourth quarter, now that's only kind of annualized really the uptick in rates that we saw in 2017 following on the record cat losses, but did you see anything different in the market as we started to annualize some of that price that will lead you to think maybe the push for price would go one way or the other in 2019?

Alan David Schnitzer
Chairman & CEO

Between the cat activity, Elyse, and the 1/1 reinsurance renewals, we'll all see together over time how that pricing plays out. We're not going to get anymore granular on the outlook than what we have in the outlook section. That will be in the 10-K and that Greg shared. Overall, I would say that about 5 points of rate changes -- price changes is pretty good change. If you look back at just the history of price change in BI, a plus 5 would be in that historical context pretty good. And we've seen relatively stable allocation of that between exposure and rate. And so we feel pretty good about that overall.

Operator

Our next question comes from the line of Mike Zaremski from Crédit Suisse.

Michael David Zaremski
Crédit Suisse AG, Research Division

First question in regards to the expense ratio on improvement story. Would you say this is -- this will be -- is this in its early innings and could this be kind of a multiyear trend? It seems to have picked up in the second half of the year in terms of the improvement.

Alan David Schnitzer
Chairman & CEO

Well, what's definitely ongoing for us is the thoughtful and disciplined management of productivity and efficiency as a strategic effort and that goes across the entire company, everything we do. So I -- you will see more activity from us in that regard. In terms of how it's going to come through in the numbers, you may or may not see that in the expense ratio. We've been saying for a while that our objective here is to create incremental operating leverage, and we think that's very helpful to us. But really in the sense that it gives us a lot of flexibility. We can let that fall to the bottom line in the form of a lower expense ratio, we can take those savings and reinvest it into important strategic initiatives or we can decide to put it in the price without compromising our return objectives. So it's definitely an ongoing objective for us across the company. I think Greg gave you a sense of what a run rate is for BI, and I don't know, you want to, Dan?

Daniel Stephen Frey
Executive VP & CFO

Yes, and for the enterprise, I'd say, similarly. If you look at the full year expense ratio, that's a pretty good indication of where we are probably heading going forward. It has improved quite a bit over the last couple of years. I think, we've reached a level that we're more happy with. As Alan said, we'll continue to focus on productivity and efficiency, but I wouldn't expect to see a continued level of dramatic decrease in the expense ratio from the levels we're at now.

Michael David Zaremski
Crédit Suisse AG, Research Division

Okay. Great. And my last follow-up question is in regards to workers' comp where margins remain healthy. If we think about work comp pricing, is that expected to become more or less of a headwind as 2019 progresses? And then maybe you can also update us on loss cost trends in comp.

Alan David Schnitzer
Chairman & CEO

Yes, workers' comp, it's been under some pricing pressure, but completely rational given where the profitability of the line has been. We're not going to break out pricing outlook by line. We give it to you for the segment, but the profitability continues to be good, and generally speaking, we would expect continued pressure in the compline. We've got no change in commentary on workers' comp loss trend from what we shared with you last quarter, which is to say that we -- frequency and severity are -- those are selections, those are picks for us that go into loss ratios. And then data comes in overtime and you look at reported activity over time and you compare that to what your selections are and decide if there is anything you're seeing that requires you to move off that. And as we shared last quarter, and we would reiterate again, we're not seeing anything in the data that causes us to move off our loss picks.

Operator

Our next question comes from the line of Kai Pan from Morgan Stanley.

Kai Pan
Morgan Stanley, Research Division

My first question on the new aggregate reinsurance program. So how much your cat loss would be in 2017 to 2018 if this program is applied retroactively?

Daniel Stephen Frey
Executive VP & CFO

Yes, Kai, so we looked at modeling, what things would look like going back a number of years and, in particular, over the last 2 years, probably not surprisingly given the elevated level of cash we would've seen a full recovery under the treaty in each of the last 2 years.

Kai Pan
Morgan Stanley, Research Division

Is that sort of safe to assume your core loss ratio would be 50 basis points higher given the new aggregate cover, but your normalized cat loss would be 50 basis point lower going forward?

Daniel Stephen Frey
Executive VP & CFO

Yes, I wouldn't say that's an exact offset. I think if you go back to my comments, it's definitely about 0.5 point on the underlying combined ratio with the mitigating factor on the overall normal cat expectation to get us back to pretty de minimis impact on the combined ratio all in, if we had a normal year of cats which, as you know in the last 7 years, we haven't.

Kai Pan
Morgan Stanley, Research Division

Okay. In other words, if a cat, we see it come in lighter than your normal, you actually -- the loss combined ratio would be worse than in the normal year?

Daniel Stephen Frey
Executive VP & CFO

The combined ratio would be worse because we had exceeded away premiums and had no recovery, correct.

Kai Pan
Morgan Stanley, Research Division

Okay. Great. My second question on personal lines side. And your prior guidance for 2019 was improvements in underlying margin in both homeowners as well as auto book. Michael just gave guidance for -- new guidance 2019 pretty much consistent with 2018. Is that because 2018 actually improved better than you were previous expected? Or you are reinvesting the business for growth?

Michael F. Klein
EVP, President of Personal Insurance and Head of Enterprise Business Intelligence & Analytics

Sure, Kai, it's Michael. I think it's -- so it's actually a little bit of both, right? If you think about auto, auto came in better than we expected and so a broadly consistent outlook just reflects the update of the actual results compared to the outlook. On the property side, it's a little bit of a change in the outlook. Again, we've been talking about catastrophes and non-catastrophe weather and non-weather loss experience and talking about the fact that we continue to put more weight on more recent periods as Dan mentioned. And so the broadly consistent outlook for our property is partly a reflection of that as well as the impact of the accounting of the new cat ag treaty, which as Dan just talked about is a drag on underlying and, in particular, impacts the property line. So those are kind of the pieces.

Operator

Our next question comes from the line of Amit Kumar from Buckingham Research.

Amit Kumar
The Buckingham Research Group Incorporated

Maybe just a couple of quick questions for Michael Klein. Number 1, if you go back, I guess, to Alan's opening remarks, it seems like a lot of the work which was needed in personal auto has been done, and I think here the comment was that we got there ahead of expectations. Maybe just update us on the loss cost trend environment out there? And maybe the trajectory of rate filings?

Michael F. Klein
EVP, President of Personal Insurance and Head of Enterprise Business Intelligence & Analytics

Sure, Amit. So I think loss cost trend fairly consistent with what we've talked about, right? We see continued severity trend particularly in collision and physical damage, increased cost to repair vehicles, and again, many of those dynamics we see as being relatively consistent with what we would've talked about a quarter ago. There's been some commentary about a little bit less pressure on bodily injury loss cost trend in the environment. Again, I think when you put it all together and combine it with our view on frequency, I would say it's consistent with Alan's comments earlier of we have a pick, we observe results and we sort of see most of that as variation around the loss cost trend we've estimated and so don't see a significant change in our loss trend outlook there. In terms of outlook for price change going forward, again, our RPC outlook for auto is that RPC will remain positive, but be lower in 2019 than it was in 2018.

Amit Kumar
The Buckingham Research Group Incorporated

That's helpful. The only other question I had was on the press release on Lyft. And I think Lyft has $1.4 million or so drivers. And I was curious if you could maybe just broadly talk about this opportunity. How we as outsiders should sort of handicap this going forward?

Alan David Schnitzer
Chairman & CEO

Yes, Amit, on Lyft, we think it's an exciting opportunity for us to participate in a changing economy. It's a service offering for them. We wouldn't expect from an economic perspective for it to meaningfully moved the numbers in the near term. But it's a great partner, and we're excited to work with them and excited to bring our leading claim capabilities to benefit for them.

Amit Kumar
The Buckingham Research Group Incorporated

And any thoughts on expanding into other TNCs down the road?

Alan David Schnitzer
Chairman & CEO

I don't -- we don't have anything to announce at the moment. We're always thinking about whether there are opportunities for us to participate in an evolving economy, and we'll continue to do that as we think about innovation and what insurance means in a changing world.

Operator

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

Brian Robert Meredith
UBS Investment Bank, Research Division

A couple of quick questions here for you. First, just going back to the cat loads or the cat treaty that Kai was talking about. Is there simple way to think about this kind of going forward so we kind of assume a $1.3 billion cat load for you guys? Is that kind of a good way to think about it?

Daniel Stephen Frey
Executive VP & CFO

Brian, it's Dan. So yes, I'll say we don't give earnings guidance and so we won't give guidance on the specific pieces of the components that go into earnings. You could see historically, we'll disclose from time to time in the proxy what our expected level of catastrophes had been on sort of a backwards looking basis. You should take that number and probably think about it trending up over time for 2 reasons. One is, we've seen growth in the premium volume and the overall exposure level on the business; and two, as was mentioned in my comments, a little bit more weight on recent periods that gives us a bit of an uptick in terms of our view of each dollar of those premiums that would need to go into cat. But I'm going to avoid giving a specific number.

Brian Robert Meredith
UBS Investment Bank, Research Division

Got you. Great. And then my second question, I'm just curious, you guys have had really good strong growth, new business growth in your select business, Small Commercial. I'm just curious, does that have any pressure on your underlying loss ratios when you are seeing that type of new business growth?

Gregory Cheshire Toczydlowski
Executive VP & President of Business Insurance

Hay, Brian, this is Greg. In the select business, you can see the 11% new business growth year-over-year. Really, we feel terrific about that growth. We've been spending quite a bit of investment in the technology in the workflow and the product management across all of the select business. You can see that the quality of the book looks really good, with really strong retentions in the 82%, 83% range. So we haven't seen any meaningful deterioration in the underlying based on that new business.

Brian Robert Meredith
UBS Investment Bank, Research Division

Great. So it's really -- there's really like an auto you'll see that 10-year impact, you don't get that in the Small Commercial?

Gregory Cheshire Toczydlowski
Executive VP & President of Business Insurance

Not as much just because you have the comp, you have the property, the GL in the auto in addition to it, yes.

Operator

Our next question comes from the line of Ryan Tunis from Autonomous.

Ryan James Tunis
Autonomous Research LLP

First question is for Alan. Looking at the 95.7% underlying combined ratio in Business Insurance. We factor in some elevated large loss activity, but then you throw in kind of a normal cat load in 3 to 3.5 point range. It feels like we're running at a normalized level here at like 98%, which is only a 2% underwriting margin. That doesn't feel like a double-digit ROE. I'm curious, if there is a level on the combined ratio where you'd be looking to kind of hold the line? If there is a place you should be thinking about? Will you give a little bit of more sense of urgency around rate increases?

Alan David Schnitzer
Chairman & CEO

Ryan, I'm not going to get into calculating those returns with you. But I -- and clearly, there's been some headwinds in pockets of BI, right? We've talked about the Commercial Auto, we've talked about the large losses. We've -- Greg mentioned today some of the pressure outside United States and the largest piece of that comes from Lloyd. So there are some aspects of that in which we would expect improvement over time. And we continue to get the 5 points of rate. So there are margin opportunities outside of the pure-rate trend dynamic. Again, the BI large loss is outside the U.S., Commercial Auto, the fixed income NII helps us as those rates are where they are and the bond portfolio turns over. Again, you've heard us talk about expense leverage that's been pretty good. And just in terms of earnings dollars, the volume helps as well. So we're not feeling badly at all about where the returns are on underlying basis and where they're trending. And if you take a step back and look at the whole company, Ryan, and you can do this math as well as we do, but if you take out prior year development and you put in whatever you think is normal for cats, you get a return that's somewhere in the low double digits. And given where the 10-year treasury is today, again, that doesn't feel altogether bad to us, particularly with some opportunities we would see going forward. And one of the benefits of having a company this size is you got a diversified portfolio of businesses. So we always feel a sense of urgency around here. There is no question about that. We are at the heart of who we are optimizers and if everything's not perfect, we're going to work with a sense of urgency to optimize it. But there is no sense at all here that there are problems.

Gregory Cheshire Toczydlowski
Executive VP & President of Business Insurance

Ryan, one thing I would add, this is Greg, is when you do that math, keep in mind that we do have different combined ratio targets depending on what the net investment income has generated based on those product lines. So think Workers Comp where we have the largest weight, where we could run a higher combined ratio relative to a shorter tail line like Property. So I'd just ask you to keep that in mind also when you do that math.

Ryan James Tunis
Autonomous Research LLP

Understood. And then my follow-up is, I get the Commercial Auto, the increased litigiousness, more lawyer involvement. But what's not completely clear to me is why that wouldn't translate to some elevated trend in the other liability lines. I'm just curious what gives you guys comfort to do things you're seeing in auto or auto-specific, and we shouldn't be seeing more broadly in general liability?

Alan David Schnitzer
Chairman & CEO

Yes, so Ryan, we certainly watched that carefully and just to walk you to the lines and our thinking on it. So you've got GL -- think GL large for a second, excess umbrella, and I would put Management Liability in this group too. Already have very, very high levels of representation in those claims. So that's, again, already a high percentage, already pretty active there. On the smaller side, the GL small, we are seeing a little bit more of the attorney rep, but it doesn't seem to be quite as active as it is in the auto. And we just speculate that's probably not as attractive of business opportunity for the plaintiffs bar. You've got a much more varied portfolio of claims there, harder to make the case in many cases. So just -- it's just not as well hanging fruit at least for now. When you get into the really small, when you see the liability component of CMP, again, we have seen the pressure though, there -- this theme, in other words, does cross the liability lines, but to a lesser degree than we see in auto.

Operator

Our next question comes from the line of Meyer Shields from KBW.

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

Probably beating on a dead horse here but when you discuss the impact on the core loss ratio from the incremental treaty, that's completely separate from the 1 point elevated large success property losses. Do I have that right?

Michael F. Klein
EVP, President of Personal Insurance and Head of Enterprise Business Intelligence & Analytics

Yes, 2 totally separate topics.

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

Okay. And second, the 50 basis point increase that you mentioned, that's not compared to 2018, that's compared to what 2019 would be otherwise, is that fair?

Michael F. Klein
EVP, President of Personal Insurance and Head of Enterprise Business Intelligence & Analytics

It is compared to what 2019 would otherwise have been, correct.

Operator

Our next question comes from the line of Larry Greenberg from Janney Montgomery Scott.

Lawrence David Greenberg
Janney Montgomery Scott LLC, Research Division

Just on investment income, wondering if there is anything to say about non-fixed income in the first quarter given the volatility in equity markets and fixed income markets in the fourth quarter. And then, just given some of the spread widening that took place in the fourth quarter, have you done any asset reallocations given some of that volatility or what some might view as opportunity?

William Herbert Heyman
Vice Chairman & Chief Investment Officer

Larry, it's Bill Heyman. Let me take them in reverse order. With respect to the second question, we haven't really changed our strategy. We regard increase spreads as you say as opportunity assuming our credit judgment is good, which historically it has been. The -- as you know, the yield on the 10-year treasury dropped from 3.06% at the end of the quarter to about 2.69% at the end of the year. It's back up to about 2.75%. So that's been partly compensated forward by spread widening. So we're still pretty comfortable with what we're seeing out there. In returns of private equity, we occasionally make internal projections of what we think the portfolio will throw up, and we have been notoriously inaccurate. We're generally far too pessimistic. I agree that the developments in public equity markets in the fourth quarter taken alone wouldn't all grow well for 2019, but we've seen similar situations where developments like that have been followed by perfectly good years. So your guess is probably as good as ours.

Operator

We have time for one more question. Your next question will come from the line of Yaron Kinar from Goldman Sachs.

Yaron Joseph Kinar
Goldman Sachs Group Inc., Research Division

Just wanted to go back to Business Insurance and the underlying combined ratio there. So I think you said that you had about 1 percentage point of non-cat large losses in '18. I think that was roughly the same number that you had in '17. So if I look at the underlying combined ratio it seems like there was a little bit of deterioration year-over-year. Maybe even if I adjusted the Commercial Auto, it's flat to slightly worse. Can you maybe talk about what is driving that this year? And then what gives you the confidence that 2019s numbers would look better?

Gregory Cheshire Toczydlowski
Executive VP & President of Business Insurance

Yaron, this is Greg. Number 1 you're correct that we do our best job possible of trying to normalize our large losses and that's how we price and manage the business and we were over expectations in 2017 and as I disclosed in my prepared comments, we were also over our normal expectations for 2018 and that was roughly the 1 point. The difference in maybe a point to the full year underlying combined ratio where you can see an 80 basis points difference between the full year '17 and the full year '18. And again, in my prepared comments, I mentioned, auto driving a little bit more than 0.5 point there. The international business is also driving about a little more than 0.5 point and that's predominantly driven-based on the Lloyds' business. And then we had some, as I disclosed, some favorable expense activity that offset some of that. So those are all the pieces that get you there.

Yaron Joseph Kinar
Goldman Sachs Group Inc., Research Division

So if you expect the expense ratio to maybe not improve to the same magnitude in '19 and you still expect some improvement in '19 for the overall underlying combined ratio. Can you maybe talk about where that improvement would be coming from given the current loss terms?

Gregory Cheshire Toczydlowski
Executive VP & President of Business Insurance

It's basically that 1 point of large losses.

Yaron Joseph Kinar
Goldman Sachs Group Inc., Research Division

Okay. Okay. And then maybe a quick one on the prior year development. It sounds from the scripted comments that the slowdown in net prior year developments, favorable development was really driven by an increase in adverse development and not so much by maybe a decrease at gross favorable development. Is that fair?

Alan David Schnitzer
Chairman & CEO

Let me just start and I'll queue it. The question almost implied that there's a trend in prior year development. There is no trend in prior year development. Our obligation at the end of every quarter is to come up with management's best estimate and we do that. And then every quarter, we go through the process of reevaluating our reasons and making adjustments where we feel like we need to. So in any -- for any given period, the level of prior year development is just the net of those adjustments to best estimates.

Daniel Stephen Frey
Executive VP & CFO

Yes, I would echo that, which is why, I think, we're pretty careful to always characterize it as net favorable prior year reserve development or net unfavorable prior year reserve development because they're our business lines and accident years that go both ways. And if you step back and look at the full year, a little more than $0.5 billion of pretax net favorable prior year reserve development, not that big in the scheme of the balance sheet. If you look at the right side of the balance sheet, you are seeing loss and loss adjustment expense reserves of around $50 billion. So we're pretty good at estimating losses, but every quarter, we're going to update and refine them.

Operator

I'll now turn the call back over to Ms. Goldstein for closing remarks.

Abbe F. Goldstein
Senior Vice President of Investor Relations

Thank you all for joining us today, and as always, if you have any follow-up questions, please reach out to us in Investor Relations. And have a good day, thanks.

Operator
This concludes today's conference call. You may now disconnect.