The Travelers Companies, Inc., Q1 2009 Earnings Call, Apr-30-2009

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Conference Call Participants

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Matthew Heimermann

Michael Nannizzi

Paul Newsome

Presentation

Operator

Good morning, ladies and gentlemen. And welcome to the first quarter earnings review for Travelers. We ask that you hold all questions until the completion of the formal remarks. At which time, you may be given instructions for the question and answer session. At this time, I would like to turn the call over to Gabriella Nawi, Senior Vice President of Investor Relations. Ms Nawi, you may begin.

Gabriella Nawi

Thank you, Lindsey. Good morning, and welcome to the Traveler's discussion of our 2009 results. Hopefully, all of you seen our press release, financial supplements, and webcast presentation released earlier morning. All of these materials can be found on our web site at www.travelers.com under the Investors section.

With me today is Jay Fishman, Chairman and Chief Executive Officer; Jay Benet, Chief Financial Officer; Brian MacLean, President and Chief Operating Officer; Alan Schnitzer Head of our Financial, Professional & International Insurance Business; Joe Lacher, Head of our Personal and Select Businesses as well as other business members of Senior Management.

We will discuss the financial results of our business and the current market environment. Refer to the webcast presentation as we go through prepared remarks and then we will open it up for questions.

Before I turn it over to Jay, I'd like to draw your attention to the following on page one of the webcast. Our presentation today includes certain forward looking information which is found in Private Securities Litigation Reform Act of 1995. All statements other than certain historical facts may be forward looking statements. Including our earning time maybe forward-looking and we may make other forward-looking statement that accompanies results of operation, financial condition and liquidity, the sufficiency of the company's reserve and other topics.

The company cautions investors that any forward looking statement involves risk and uncertainties and is not a guaranty of future performance. Actual results may differ materially from our current expectations 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 files with the SEC.

We do not undertake any obligations to update forward-looking statements. Also, in response or remarks to questions, we may mention Travelers' operating incomes, which we view as a measure of profits and other measure that may be non-GAAP financial measures. Reconciliations are included in our recent earnings press release, financial supplements, and other materials that are available in the Investor section on our website at travelers.com. With that, we're all set. And I'll turn it over to Jay.

Jay Fishman

Thank you, [Gaby]. Good morning, everyone, and thank you for joining us today. In light of the overall environment and as it relates to investment performance, recalling that the SMP 500 index traded $6.66 shortly before the end of the first quarter. Our results this quarter were again, quite solid and our financial performance speak for itself in our release. Our management teams can speak to some of the detail in our businesses. And I'll just like to take a moment or two and give a broad perspective on our business trends.

From an underwriting perspective, business insurance continues to gain momentum. First quarter data continues to show an improving price trend. And we've also seen a continuation of the opportunity we've had to quote on more new business, driven we believe, by a flight to quality. It is particularly noteworthy that in this quarter we have been more successful at converting the slow (inaudible) business. And Brian will speak to that important dynamic.

Exposure continues to decline. We suspect this as a direct result of the weakening economy. And we're appropriate on our part to discipline under riding given general economic conditions. Not withstanding several quarters now of improving rate trend, we are mindful of cost pressures that all businesses have so we will watch and wait information carefully quarter-by-quarter to see how it goes and refrain from making predictions.

On the personal lines front, during the quarter, we announced our effort to launch a direct to consumer initiative leveraging the Travelers' brand. There's been much work to get to this point. The development of Quantum, in addition to allowing us to offer a best in class product to independent agents was critical in giving us a product that can compete with the best direct riders.

In order to make quantum successful, we also needed to invest and develop acquaint capacity that could serve as a broad array to all our customers. Lastly the development of Quantum Home gives us a unique advantage in bringing a full product line directly to consumers. The direct to consumer initiative did increase our personal lines combined ratio in the quarter compared to last year and will continue to do so for a number of years.

None the less, we are confident in our ability to succeed. And we believe this is an important step in our personal line strategy. We will however, always be and remain independent Asian based company and our commitment to delivering the best product possible at the most compelling value to our agents as paramount in our minds. Joe will of course, speak more of about personal line results and its initiative.

Alan Schnitzer will speak about our financial professional and international segment. But I would share with you that the claim activity we are experiencing in our financial and professional lines as of waits to financial related matters is consistent with what we were expecting and what we shared with you last quarter. Consequently and positively, there is no change in our out look in that regard

In the investment arena, we continue to be pleased with our portfolio performance in this most difficult environment. Our long term fixed income portfolio produced with terms very much consistent with expectations that our alternative portfolio posted negative returns for the third consecutive quarter.

We are pleased that we have had a low level of impairments relative to our $72 dollar investment portfolio and we remain 94% fixed income invested with an average rate in the double A plus.

Well in the past, some might have thought our under lighting and investment philosophy to be conservative, we are pleased that the characterization seems now to have morph to prudent. As further evidence, Jay will be sharing with you an interesting analysis of our exposures related to a group of companies Moody's have identified as “bottom rung”. It's another example of thoughtful risk management in our organization.

Finally, given all the recent press reports on merger activity, including some mentioning us. Let me reiterate our philosophy on transactions. First, we will not comment on any specific situation. In addition, given our substantial experience, we believe we understand the risk inherent in an acquisition quite well.

Our financial objective is to deliver in mid-teens turn on equity over time to our shareholders. As a result, we would only gauge a new transactions, which given all the risk inherent in the M&A environment, we fundamentally believe makes that mission more achievable. And with that, let me turn it over to Jay

Jay Benet

Thanks, Jay. Our investment portfolio, our reserves, our capital, and all liquidity remain in very good shape. As we have said over many quarters, operating company capital remain at or above all of our target levels. Our debts to total capital ratio actually decreases to 18.9%, which is below our 20% target, the midpoint of a 15% to 25% range that derives from our double A ratings.

Holding company liquidity increased over $2.5 billion, which is approximately $1.5 billion higher than our target of one year's worth of interest and dividends. And this is after using existing funds to retire a $141 million of debt that matured in the quarter.

We have negligible amounts of debts maturing through 2011 and still do not rely on the commercial paper markets. Book value per share of $45.12 inclusive of a net unrealized investment gain of $543 million after tax increased 5% during the quarter while book value per share ex-FAS 115 of $44.19 also increased by 2%. And we closed the quarter with approximately $26 billion of common equity.

We updated the list on page 5 that shows areas of market disruptions and their impact or lack there of on Travelers. We have added valuations of preferred and hybrid security issued by global financial institutions so the list this quarter of which we current hold only $56 million after having taken impairments of $55 million in the current quarter. Overall, we continue to be unaffected in any significant way from these areas of market disruptions.

We continue to look for and evaluate any information that could suggest investment valuation reps. Moody's has recently issued a publication entitled, Bottom Rang in which they provided 283 speculative grade non-financial US issuers with high default risk. We hold investments in only 14 of these names with an aggregate book value of only $26 million and a total market value of $23 million.

Our bond business also reviewed its exposure to the entities on this list. Our commercial and construction surety business have aggregate expose limits to the identified as it is, net of reinsurance and collateral of approximately $270 million. If in a worst case and of course, unrealistic scenario, every account had a full limit loss or after tax exposure would be about $175 million. And as a result of discipline underwriting practices, we believe our actual exposure to loses on these accounts is actually negligible.

Our high quality $72 billion investment portfolio, which remains well diversified across industries, investment types, and individual issuers, ended the first quarter with an $803 million free tax unrealized gain. Fixed income investments continued to comprise 94% of the total investment portfolio with a double A plus rating at a 4.2 duration. And the loan investment grade investment comprised only 2% of the fixed income portfolio.

We continue to apply very rigorous processes to identify investments for which write down should be made. During the first quarter, we have recorded net realize investment loses of $137 million after tax, including impairments of $120 million after tax, comparable to the fourth quarter of 2008 and representing a very small percentage of both our investment portfolio and our capital.

The information that appears on page seven is based on a schedule that it will appear in our form 10-Q showing unrealized losses on investments, which estimated fear value of less than 80% of amortized cost. This amount has decreased from the fourth quarter of 2008 and now stands at $673 million to enlarge parts of the impairment taken on the quarter. While still a small fraction of both total investments and share holders equity, we do closely monitor these investments for these are the most likely source of future impairments.

I'd also like to make one of the important observations that is reflective of the discipline and rigor of our investment impairment process. We have no investments for which fair value is less than 80% of cost for more than 12 months and those were in the of 6 to 12 month category adds up to less than a $100 million.

Finally I would point to pages 23 through 26 of the webcast, the appendix in which we provide supplementary information about our commercial package securities and the composition of our private equity hedge fund and real estate portfolios.

Shown on page eight are operating income of $799 million declined 21% from the prior quarter primarily due to a $176 million after tax reduction and net investment income, which I will discuss further in a minute. Margin compression that we had anticipated in our plan based upon recent pricing and lost cost trends and lower net favorable prior year reserved development, all partially offset by a $40 million reduction on our estimate of Texas Windstorm assessments related to Hurricane Ike, and $69 million in tax benefits resulting from the favorable resolution of various tax matters. Net losses were fairly comparable quarter-to-quarter.

Net tax and net favorable prior year development, our GAAP combined ratio is 93.9%. And after adjustment for the change in the (inaudible) estimate, which was worth 1.two points, it was 95.1. So we remain pleased with the underlying profitability of our businesses.

First quarter net investment income of $474 million after tax, or which is shown on page nine, was down significantly from the first quarter of 2008, but up slightly from the most recent quarter. The long term fixed income portfolio's after tax yield was 3.7%, consistent with prior periods. Although the short term portfolio yielded only 40 basis points due to the very low interest - interest rate environment for short term investments.

The non-fixed income portfolio yielded a negative 11.1% as private equity real estate partnerships and hedge fund valuation continued to be challenged by financial market conditions. And consistent with our practice, we updated as best we could our non-fixed income returns through March 31 despite the usual time lag in which investment managers report results.

Page ten of the webcast shows the three major contributors to our operating return on equity fixed income NII plus interest on corporate debt, what we refer to as the passage of time component, contributed 8.two points in the current quarter, down slightly from prior years due to the lower short term interest rates. Non-fixed income NII, our much smaller contributor to operating ROE, or one that varies from period to period, contributed a negative 1.7 points in the current quarter. And underwriting income contributed 5.9 points.

Cumulatively from January 2005, we produced an average annual operating ROE of approximately 14.4%, consistent with our stated longer term goal of mid-teens ROE.

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

Brian MacLean

Thanks, Jay. Turning to slide 11, the business insurance operating earnings of $547 million was down 20% from last year, primarily due to the drop in investment income. The underwriting results had a lot of moving pieces, but in the aggregate, a pretty good story.

Net favorable prior year reserve development, although lower than last year, was still considerable at $118 million after tax, and Cap losses were light. Net of these items, our combined ratio improved half a point. We reduced the estimate of our Texas Windpool assessment from Hurricane Ike, lowering our expense ratio nearly one point, and large losses, which were running heavy in first quarter 2008, returned to planned level. Absent all these impacts, the rate and loss trends in business insurance resulted in about two points of margin compression, which was consistent with our expectations.

I'll talk about the rate trends as I go through the top line. On the left side, frequency trends are relatively flat and loss inflation remains benign in the low single-digits. We are watching for the impact of a more challenging economic environment on our loss activity, and to date, there hasn’t been anything of significance. So we feel good about the bottom line story, but just as good about the top line.

Turning to production, net written premium increased 2% in the first quarter of 2008. As we have reported last quarter, the economic slowdown has negatively impacted those businesses in the construction, constructing fields, as well as large property accounts. However, in spite of the broad economic contraction, many of our businesses are indeed experiencing premium growth. We are pleased with the overall production results, which underscore our ability to find opportunities in difficult conditions.

As shown on slide 12, retention remains high across all our domestic commercial businesses, uniformly exceeding first quarter of last year, and at or higher than the fourth quarter. In the face of significant instability in the marketplace, these results reflect customers' flight quality and are an important component of our continuing success.

The renewal price change data indicates that prices on these renewed accounts are relatively stable. And in general, show an improving trend. Slide 13 takes the price change data and splits it into its two primary components, the renewal rate, and exposure change. The trend shows rate change has been moving up. And then in the aggregate, it's now approaching zero. At the same time, exposure change has been dropping. And in most of our businesses, has turned negative. This of course, is a reflection of the contracting economy.

On slide 14, we display our new business results, and this is an area where our story has began to shift very positively over the recent quarter. In the aggregate, new business dollars are up 1% from the first quarter of 2008. This is the first quarter-over-quarter increase in new business in over two years. And a significant improvement from the down 7% to 8% we were experiencing early last year. The improvement is being driven by two factors.

First, and clear from the numbers on this slide, our new products and platform roll out in select is having a strong impact. With new business, dollar's up 20% from first quarter of '08. The second is less obvious from this slide. And that is that throughout the quarter, we have seen an improvement in the quality of deal submissions in our middle market businesses. For over a year now, we have had consistent new business methods in business insurance. That is, very strong submission for the flow of new business opportunity, barely constant quote ratios, and slightly declining hit ratios.

We were comfortable that although this resulted in less quarter-over-quarter new business dollars, we were getting more opportunities in maintaining our underwriting standards in tough market conditions. So what's changed? For across a broad array of our new market businesses, these trends have improved with not only greater submission flow, but more importantly, improvement in the quality of that flow. We are now seeing more of our competitors' premier accounts, those $250,000 to $1 million accounts that are stable, well-managed businesses for a conscious diverged management and value quality partners.

Slide 15 shows the amount of new business we are writing in commercial accounts and other business insurance as a percentage of our expiring banks for the last five quarters, as well as month by month in the current quarter. The reason we show the new businesses as a percentage of the expiring date take the impact of seasonality out of the numbers. You can see that in both February and March, we sought significant increase in our new business writings. We usually don't focus too much on monthly data. But here, we think the trends in the last two months speak into a real new business opportunity for us and is worth some emphasis and explanation.

First, I want to emphasize that we feel very good about the profitability of the business. We have lots of metrics around pricing. And our increased writings are hitting target return levels for new business. Second, the increase is not accidental. It is a result of the very conscious strategy to expand product offerings, better rewind our capability, and more proactively seek opportunities in the market. We've been talking to you about this for several years, and we believe market conditions are now such that we can see some real benefit.

Third, the flight quality is very much agent broker driven. Although somewhat anecdotal, it is clear to us that agents are focused on ensuring that their customers, especially their best quality accounts, are very high-quality markets like Travelers. And this dynamic has been much more noticeable in the recent months. Fourth, the improvement in the rate environment has been an obvious enabler to these results.

And lastly, our success is being driven by our confidence in our people on the point of sales. Unlike many of our competitors, we are not on our heels. We are well positioned and looking for ways to invest and drive opportunities. Our frontline staff is fully focused on the marketplace and is energized by our collective success.

So we're not going to predict where the market will go, but we are encouraged by the quarter's results. Although exposures are contracting, the rate trends are improving and the flight to quality is impacting both the amount and quality of our opportunities. The result is that the business insurance segment produced an improved top line and continued solid market. Given the broad economic contractions, we are very pleased with these results.

With that, let me turn you over to Alan Schnitzer for the financial, professional & international results.

Alan Schnitzer

Thanks, Brian. Turning to slide 16, in the financial, professional & international insurance segment, operating income was $148 million for the quarter as compared to $208 million in the prior year. The adjusted combined ratio for the quarter was 91.6%, up 2.8 points from the first quarter of last year. This was primarily driven by a small number of large losses in our international business. These losses were consistent with our expectations, but higher than they were in the first quarter of 2008.

To a lesser extent, a mixed change as a result of lower construction surety bonds also impacted the combined ratio. Adjusting to the impact of changes in foreign exchange rates, net written premiums declined 6%. In bond and financial products, the decreased net written premium is primarily due to lower volumes in the surety business. In the international business, the decrease resulted from changes in foreign exchange rate as well as the timing of reinsurance treaties in 2009 versus 2008.

Turning to slide 17, in our management liability business in the quarter, retention remains high and consistent with the past four quarters. Renewal price change was positive at 2%, reflecting positive rate, partially offset by decrease in exposure. New business was a little lower than in the prior year, driven by declines in new business in both financial institutions and private non-profit, largely due to disciplined underwriting. This decrease was partially offset by an increase in our public company liability business, primarily due to flight to quality.

In the international business, retention was at 78% in the quarter, in line with recent quarters and down 4 points year-over-year, primarily due to intentional underwriting actions. Renewal price change was flat as slightly positive rate was offset by decreased exposure. Adjusting for the impact of changes in foreign exchange rates, new business was ahead of the prior year.

In our fourth quarter earnings call, we updated you on the impact of the financial market disruption on our management liability business. As we told you, we continue to monitor that analysis on a monthly basis, and our conclusions remain the same. Due to a well diversified portfolio, and disciplined management of the exposures, we expect that the management liability business will continue to be profitable in 2009.

With that, let me turn it over to Joe for discussion on personal insurance.

Joe Lacher

Thanks, Allan. Personal insurance had a good quarter, solid earning and top line growth. Despite some adverse weather and the challenging auto marketplace, the business continues to demonstrate sound results. Something I'm especially pleased with given these difficult economic times. Our personal insurance business continues to benefit from a balanced mix of auto and property business.

When you turn to page 18, you can see the first quarter has strong combined ratio of 93% and a 3% growth in net written premiums. And for the first quarter of 2008, operating income is down $27 million driven primarily by lower levels of net investment income, and increase in weather-related losses, and reduced underwriting margins related to pricing, lost cost trends and mix changes, partially offset by net payable prior year development, and our previously discussed reduction in the two-year assessments.

Before getting into product specific results, I'd like to share some details on our exciting direct to consumer initiative. As Jay mentioned earlier, during the quarter, we announced our intention to expand, strengthen and broadly deploy our capabilities to market directly to consumers. Travelers is a leading independent agency company and is committed to enhancing our leadership position with agents. While we believe that the independent agency channel is and will remain vibrant, we also recognize that a growing population of consumers is choosing to purchase auto insurance directly. With our execution strength and by being respectful to valued independent agents deliver, we're confident we can successfully distribute through both channels simultaneously.

Successful introduction of our quantum product and the investment in our claim infrastructure has enabled us to competitively serve a broad cross-section of consumers. We have experience in distributing products outside of the independent agency channels to our robust affinity business. We have been expanding our existing capabilities and increasing our activities to market insurance directly to consumers. We've already successfully expanded our web capabilities in advertising. And in the second quarter, we will expand our marketing with a multimedia campaign, including television advertising.

We recognize that results to the direct-to-consumer initiative will have an impact on our combined ratio for a number of years. For the full year 2009, we'd expected to have a combined ratio impact of 2.5 points for auto, and one point for homeowner and other. We believe this initiative will better position us to profitably grow our business and is well worth the investment. We're excited about both our prospects and our early progress. Looking specifically at our auto results, our combined ratio for the quarter was 102% or 3 points higher than the first quarter of 2008.

As you can see on page 19, this increase was driven by two points from the results of our direct-to-consumer initiative, and by an additional two points from net unfavorable prior year car (inaudible) reserve development related to New Jersey PIPP and modeling industries. The New Jersey results were driven by a difficult PIPP environment, exacerbated by the fact that we had a number of operational missteps in recognizing and responding to the local environment's emerging trends.

We believe that we've identified those underlying issues, reset our organization, and are executing the steps necessary to fix these issues. Excluding the impact of our direct-to-consumer initiative, our full year 2009 guidance assumes an auto combined ratio in the high 90's. As I mentioned earlier, the direct to consumer initiatives expect to impact the auto combined ratio by 2.5 points for the full year. For those of you who wonder how we foresee a 98 combined ratio, it would mean our return threshold, albeit at the low end of the range.

Looking at our auto production results on page 20, retention was 82%, (inaudible) grew 1% over the first quarter of 2008, and renewal price change increased to 5% reflecting proactive rate filing activity. We are seeing a decrease in new business volumes and looking at policies in four state in our statistical supplements, you can see the sequential quarter policies and force decline.

We believe that in these challenging economic times, more consumers are demonstrating increased sensitivity to auto premiums. Similar to previous quarters, we experienced auto loss trends declining slightly, severity trend was slightly increasing, was offset by moderately decreased frequency.

Turning to property results, we produced an excellent combined ratio of 83%, which is two points lower than first quarter of 2008. Production results for the quarter were strong, but policies enforce growth consistent 3%, retention stable at 86% and renewal price change plus 6%. We remain pleased that continuing growth of the Quantum Home products, and its ability to drive profitable new business despite very challenging economic conditions.

Quantum Home policies now represent more than 13% of our policies enforced. Our property business remains the great strength of our personal insurance franchise and one that we will continue to leverage. While the marketplace remains competitive, we are seeing increasing times at priming in the auto line. We are continuing to monitor lost trends, profitability, and marketplace conditions as well as the changing economic environment as we adjust our tactics going forward. We remain pleased with our overall results and look forward to building on that success.

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

Jay Benet

Thanks, Joe. Page 21 sets forth our annual guidance for 2009 along with certain supporting information. We continue to project fully diluted operating income per share in the range of $4.50 to $4.90, which in round numbers should translate into an operating return on equity of approximately 10% to 11%. Based upon the limited visibility we have of the investment environment today, we will guide you through the lower half of this range.

Our guidance assumes full year cat losses of $360 million after tax, or $0.62 per diluted share. No additional prior year reserve development either favorable or unfavorable. No significant changes in private equity in hedge fund valuations for the remainder of the year as we are assuming unchanged capital market conditions. Lower real estate partnership valuations due to a continuing downward trend in commercial real estate values, share repurchase of $750 million, taking into account potential investment opportunities, for which returns more properly reflect risk and the uncertain economic conditions at all businesses space, rather than a shift in our capital management strategy. Also, no significant change in average invested assets EX-FAS 115 and a weighted average diluted share cap of approximately 585 million shares.

With that, let me turn it over to Jay.

Jay Fishman

Thanks, Jay. Just a quick closing comment before I turn it back to Gabby to take the questions. We are obviously a very fact-based organization, and we tend to report on statistics very heavily. But I'd like to make an observation that's somewhat anecdotal and really reflects much of what Brian and Joe and Alan have been speaking about for the last half hour. There is a sense of enthusiasm and confidence, and a real upbeat feel in our field organization that is really quite remarkable. It is palpable. And the combination of the dynamics in the industry and in our business, meeting up with that sense of confidence in the field, just gives us a real upbeat sense of where this organization can head over the near term. Can't give you a specific, there's no emotion meter that we can measure. But when you sit with any of our field folks, you'll see it, and you'll feel it, and understand it.

With that, Gabby, let's take some questions.

Questions and Answers

Gabby Nawi

Right. Just so you all now, there are no conflicting calls today so we're prepared to stay on and answer whatever questions you have. And with, Lisa, you can open up the questions, although I ask that you limit it to two, if possible. Thank you.

Operator

(Operator instructions) And our first question will come from the line of Matthew Heimermann with J.P. Morgan. Please proceed.

Matthew Heimermann

Hi. Good morning, everybody. First, I'll try to make it good. With the direct strategy, can you talk a little bit about - and I think you've mentioned this in your comments. But how much of the direct market you feel like your product will address on day one? And also whether or not, I know you talked about platform in Quantum and all these other - in claims that play a role and you being ready to roll out. But is there also now a significant shift in preferred customer shopping directly as well?

Joe Lacher

Two good questions, Matt. I'll try to hit them separately. Our quantum product has the capacity to address a very broad cross-section of the marketplace. We don't target the real need of the standard marketplace. But it does have the ability to hit the broad cross-section. What you'll see more early though is more a function of brand as we use the Travelers brand and we think about its positioning, we will send our targeting market there. So there's a need of that brand's appeal, which will be a little bit more towards a preferred end. And it will have a little bit of a recognition of folks who are buying the value proposition that is isn't cheap. It's buying quality.

So that target will not hit the full range of what folks think about in the direct marketplace and will expand from there. It's a plausible way to enter the marketplace, expand our capabilities, build out our experience, and do a leveraging of our position of strength. It will also leverage our homeowners' capacity, which we really do believe is a unique competitive advantage that we have. And we'll recognize consumers who are trying to think about the full breadth of their risk. (inaudible) I'm sorry.

Matthew Heimermann

I'm sorry, go ahead.

Joe Lacher

Regarding your second question on shopping behavior, we're seeing increases in shopping behavior. I wouldn't describe the preferred or highly preferred market moving to level that we typically see in our standard market. I do think you're seeing increases, albeit from - in those actually are from a lower starting point. But there is a general economic environment for people who are a little more sensitive to their expenditures and they're probing and asking questions. They're thinking about exposures. They're thinking about how to impact net premium and they're more sensitive to rate increases. We haven't seen - it's not like we've see in a huge percentage of our book calling and checking things, but we have seen increases in call activities and inquiries.

Matthew Heimermann

That's helpful. With respect to the homeowners' product, is it - obviously, well I would guess there would be a package discount for people buying book. But should we think about homeowners as being a driver of the auto or the auto pulling the homeowners? That makes sense?

Joe Lacher

I think it does. And let me - you tell me when I answer if I got your point. In all likelihood, in our marketing, we would be auto and we will closely bring in any sales process system and the marketing ability to cover all of your needs, and exactly have those products integrate and work together. We do offer discounts when you buy those in auto and a home, and a discount to the auto, and a discount to the home. We offer that today. So that's running trough our pricing returning to our results. We will highlight those items, and we will likely draw out the things that help them interact together a little bit more. I think we'll lead with the auto. I think the benefit of having them together will cause both of them to improve both of their production results.

Jay Fishman

And Matt, I would just add from experience, watching Joe and his management team develop Quantum Auto and Quantum Home, this is really an exceptional group of test and learn. All of the things that we've done in this venture have been slow, methodical test and learn. And one of the things that we're going to do as we move forward here is try any number of different marketing concepts and see which pulls harder. And we don't necessarily know the answer. And frankly, we're going to be doing some things that other people either can't or don't do because they don't have the product. But in these early days, Joe is exactly right. We are going to lead with the Auto product. But don't be surprised if you're watching a commercial in a state and see a pull for Hme because we're going to be testing to see how it does.

Matthew Heimermann

All right. Thank you very much.

Operator

And our next question comes from the line of Josh Shanker with Citi. Please proceed.

Josh Shanker

Good morning, everyone. During the opening remarks where you said that you weren't going to talk about acquisitions. I won't even go there. You mentioned that the whole point was to get a mid-teens ROE. And we're not there right now. I realized there's some hope of the things are improving the marketplace. But if rates stay where they are right now when you don't get interest rate improvement, what is the forecast for ROE for the next couple of years? And how do we get that up?

Jay Benet

Our financial goal is actually a mid-teens return on equity over time. And those last two words are really extremely important, not only because of the cyclicality that our industry has experienced historically. Although there's been less cyclicality over the last several years. We've talked about that a lot. And perhaps those who have been involved in the industry for a long term recall. But obviously also because of the weather dynamic. We priced product to produce returns over a long period of time. Sometimes the wind blows, sometimes it doesn't.

Observations up from the - for the four-year period 2005 through 2008 is that we actually have a 14.5% after tax operating return on equity over that four-year period. So we're in a cycle, we're a combination of reasons. Obviously, the investment arena is more challenging at the moment. We are obviously focused on pricing, and we're going to see how the extent to which we can maintain that strategy. But we want the business for the long term. We priced our product for the long term. We make long term investment decisions. So we're not going to react in any particularly harsh way to drive returns up. We believe that the industry has the dynamics that enable the best companies to produce those mid-teens return on equity over time. And we think we're one of them. And we're on track to continue to do that.

Josh Shanker

Okay. Well let me try and attack from one other way, and then I'll give up. I think that the media might just have been looking for a quote, and they wound up picking on you in order to make their point. But the Travelers will be happy to participate in the PIPP - or PPIP as a buyer of securities and not as a seller. Maybe you're just being open-minded about that. But do you have thoughts about getting investment returns up over the next year? Is there less risk out there? Will you be at all opportunistic in this marketplace?

Jay Benet

First, in respect of the comment about the government program, we recalled about 32nd after the announcement of the program and before there were any materials about what it meant to be in the program and what the opportunities were or wouldn't be. And our response to that was perhaps not as elegant as it might have been, but we'll consider anything. We'll certainly consider looking at any program to the extent that there is an opportunity to produce - to produce returns. As it turns out, it doesn't look to us like it makes sense for us to participate in that program.

The comment about being as a seller was that we had no need to. Our investment portfolio was such was that there was no need to participate in it as a seller. For the moment, our investment profile remains as it has been. There isn't anything that we're doing with our cash flow today that's different from what we were doing six months or a year ago. We run the business for the long term. Yield in returns are perhaps returning to normalize long term levels. But I'll ask Bill. There isn't anything that we're doing different (inaudible).

Bill McLean

Hi. We have always attempted to benchmark risks as opposed to returns. We'd like to maintain a relatively constant level of risk in the portfolio and to get whatever the best return that is possible with that level of risk. And right now that return, of last year or so, has been lower than we liked. We think it might start to get a little higher. But we're using cash in much the same manner as we have. We're staying pretty high up the credit scale.

I think everybody can agree there has been the equivalent of 100-year flood. But the debate is whether the water is still receding or gently rising. We think it's still gently rising. We think that there's a lot of (inaudible) in the system that will have to be liquidated, equitized. And the consequences to get holders in that process maybe pretty severe and would determine if that is true of our securities as possible be subject to it. So we're concentrating on corporates and municipals with an average quality of AA or better.

Jay Benet

We don't change to - attempt to answer your question more specifically, we don't chase return. Page five of this webcast is what it is because we've had a long standing discipline of not chasing return. We don't chase it on the underwriting side, and we don't chase it on the investment side. One of the reasons that we actually stopped buying residential mortgage backed securities at the end of 2004 was that the difference between a Fannie Mae ten-year security obviously rated in AAA. And a then AAA residential mortgage backed security structure, without the implicit guarantee of the US government, the difference was 25 basis points. Well, anyone can say, "Gee, AAA is AAA, and those 25 basis points might be worth it." We tend not to reach for yields. So you're not going to see a dramatic shift in what we do, either on the insurance side or in the investment side.

Josh Shanker

Thank you for all the response. And good luck to you.

Jay Benet

Thank you.

Operator

And our next question will come from the line of Jay Gelb with Barclays Capital. Please proceed.

Jay Gelb

My question has to do with the pace of pricing improvement in commercial lines. We've heard some carriers be more robust in their view of what's going on currently in the rate environment and Travelers, and some brokers seem to be less optimistic. I’m trying to get a sense of why you think there’s so much disagreement about what’s going on currently in the pace of the rate of change on pricing.

Jay Fishman

Jay, I don’t -This is Jay Fishman, and I'll let Brian step in. I don’t actually think that there is much disagreement amongst different companies. The data is what it is. And we present the data with one of the two companies that actually present the data very clearly, as you can see it and understand it. I read everyone else’s reports, I don’t hear any inconsistencies. Where there is an inconsistency is there are some companies that are very comfortable declaring that we’re at a turn.

And they’ve been very bullish and very optimistic about the near term. The circumstances that we are in specifically, lend us -bring us to the conclusion that that’s not the most prudent thing to do. Economic environment’s still very difficult, exposures declining, cost pressures on every business. If anyone thinks that they’ve been in this specific circumstance before, they don’t understand the complexity of it. So what you’re hearing from us is we’re straight on declaring a turn. We’re going to report the data to you. And I’m going to ask Brian to comment again on the rate gains. But the only thing you’re hearing from us in the context of robustness is a willingness to make predictions without the benefit of a crystal ball.

Brian McLean

Yes. And I think, Jay, we’ve talked about it in the past and so with a lot of other people. There’s a difference between statements that are made by companies based on real data. And there’s a difference from anecdotal surveys. I would argue that the anecdotal surveys are always, by their nature, going to be heavily driven to new business or business that's actively in the marketplace, and that’s not true of each and every account.

Looking at the stuff we presented, I think that we feel very good about the momentum, especially in core middle market and broadly - very broadly speaking, the commercial - the net commercial businesses. And we’ve turn from a couple 3 to 4 points to negative on pure rate to something that’s pretty close to zero. The small commercial always moves a little slower on up and down. So, it’s moving a little slower up than some of those other markets, but we feel great about the margins in that business. And are pretty happy where we are in the direction we’re going.

Alan Schnitzer

And, Jay, that maybe - the underlying mix, maybe some of the discord that you hear, which is if you’re speaking to someone who’s representing a small agency business they’re going to be more strained as we look at our select numbers. And they didn’t go down nearly as much and it has yet to come up very much. And towards the middle market end, you see that if it declined, and now it’s moving up pretty -

Brian MacLean

And another dynamic that’s important here is all of these data is obviously the average of thousands of different accounts, which are all over the place. So one perspective, a year ago in our middle market business, broadly speaking, about one out of every four accounts we’re getting a price increase. And in today’s environment, about half of our accounts are getting a price increase. And obviously, the remainders go in the other direction. But it's a blending, we look at every account, especially in the individual and direct account stuff. We look at every account individually. And so, broad-versed comments are hard to come by.

Jay Gelb

My follow up - and thanks very much for that answer. My follow up has to do with the trends in pricing for new business. Can you talk about that, especially in the core market? Is it more aggressive for new business and renewal business on pricing?

Jay Benet

No more so than normal. It is always more aggressive pricing for new business and renewal business. We did talk clearly about our business in the data we have. We agonized over looking at what we believe the returns are on new business that we're writing. We compare it to renewal accounts. We try to adjust for mix and market, and everything you can imagine. We continue to feel pretty good that the business that we're seeing and the business we're writing is still hitting the returns that we would have for writing new accounts.

One of the comments I tried to get across is I feel that we, and I suspect not everybody, is seeing an improvement in the quality of the stuff that's out there in the market. And that's made us feel even better about our pricing. But new business is always competitive at one end of the spectrum, and it's been at one end of it for a while. But we feel good about what we're writing.

Jay Gelb

Thank you.

Operator

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

Paul Newsome

Good morning, and thank you for the call. Maybe a little history would be helpful for at least me. Once upon a time, Travelers actually tried to get a direct model going. And clearly, the existence of Quantum is a big difference between then and now. But maybe you could chat about how the process has really changed and why? I think at one point in time there was some pretty convincing arguments that it was not worth the while, where you obviously changed your mind. And can you just maybe compare and contrast the two periods?

Jay Benet

Sure. And I assume what you're talking about is some of the work we've done back in the mid to late 90s with our PFS cross-sell and the secure program that's under cross-sell with our Citibank credit card business?

Paul Newsome

Yes.

Jay Fishman

And what we had there - and I would just add to Joe's point, is that at that point, the company was a subsidiary of Citi Group that is Travelers. And the program that Joe was about to describe was a very structured program designed to take the Travelers' product and make it available to PFS agents. Quite different, just to contrast - quite different than what we are about to undertake now. But recognize, we were part of Citi Group at that point.

Jay Benet

Yes. Those were programmed again, as Jay described, very specifically not going to a broad consumer population, but leveraging existing populations and existing relationships and shoehorning that distribution platform into our product.

And at that time, the complexity of dealing with that shoehorning process and the less effective products that we had relative to Quantum today, those combined to perform - to produce results that were not great results. We had very much had a product that was tuned towards preferred - highly preferred costumers distributed through independent agents, and didn’t have the operational infrastructure to deal with the differences that came from this different distribution platform. What we have today is really different on almost every front.

The product is meaningfully more sophisticated. We’ve got the folks in-house that know how to deal with that and manage that product, and at the management information to handle it. We’ve rebuilt our claim organization and their ability to manage higher frequency cases with greater efficiency and to manage the severity on those programs. And so, we had the capacity to deliver that. And we’ve rebuilt a good chunk of our systems infrastructure to be able to deal with the other operational impact around us. So it’s almost a different company than it was ten years ago when we tried some of those efforts. So there’s not a lot - the same other than the fact that we’re still selling auto insurance.

Jay Fishman

Yes. I’ll make two observations. One is that, it really wasn’t a direct sale, it was sale through a captive agent. PFS had a group of captive agents and they were selling the products. So it was not really direct to consumer, this is - that's quite different. Two, that effort, the captive agent program, was not successful. And one of the terrific things about lack of success is what you learn from it. And so the learnings from that experience are substantial, and in fact formed the basis for much of the operational and tactical thinking that Joe and his group had done and positioned this one to be successful. A good question, but a very, very different program.

Jay Benet

A lot of what we’ve done in the last six or seven years has been tuning those items. And what we really have, as the opportunity here, is we have not spent a lot of time in marketing direct to consumers. And that’s the learning you’re going to see us working on right now. And the core build-out that we have left of the initiative is how to be more effective marketers with the program.

Brian McLean

And that's, I guess as Jay has mentioned before, way to see our test and learn.

Paul Newsome

Good. Are you going to have different prices in product tweaks for direct versus agency?

Jay Benet

No. Right now we’ve got one product, one pricing platform. And we’re going to leverage that and use that in both environments.

Paul Newsome

Great. Thank you very much.

Operator

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

Larry Greenberg

Thank you, and good morning. Can you quantify what the non-Cat weather was in the quarter?

Jay Benet

The bulk of it was personal line related. And it was just an increase in the general weather activity, things that didn’t classify as Cat, by our definition of Cat, whether it was with storm activity, basic thunderstorm activity, hail, tornadoes. I’m looking for the number as we’re - as I’m answering it.

Larry Greenberg

Keep talking.

Jay Benet

Just let me - give us a minute to find the exact number, Larry.

Jay Benet

On the business insurance side, it was a modest positive. The negative bearings was on the personal side.

Larry Greenberg

Okay. Great. And then just numbers or accounting question, the Texas Windstorm, that’s accounted for in the expense ratio as opposed to the loss ratio? And then secondly, on the discussion on the direct consumer, the press release described the impact as the results, not the investment in it. So going forward, when we see what the impact is, is that going to include those underwriting results and the investment in the new program?

Jay Benet

We try to hit all of those and assuming reverse orders. It is describing the results, which includes the underwriting and the expense, and everything around it. It's a total view there. And that's what we intend to talk about to get a more wholesome disclosure.

Jay Fishman

And through that point, in the early period, Larry, of the program, we will have underwriting losses like we in the (inaudible) experienced in the direct channel is that you test and learn. And that test and learn experience will (inaudible) itself. We believe those underwriting losses in the direct channel. And so we intend to continue to give disclosure and clarity throughout its entirety.

Larry Greenberg

Okay. Just on that point, do you have an expected breakeven period?

Jay Benet

You know the complexity underneath this. There's breakeven on an economic basis, and there is breakeven on a reported basis. You will be - it'll be several years before we get to that number, and we're not - (inaudible) disclosing that projection. It will hit economic breakeven, obviously, before it hips a GAAP reporting breakeven.

Larry Greenberg

Okay. That's fair. Thanks.

Jay Fishman

This is Jay, Larry. Just in terms of a small weather impact, for round numbers on an after tax basis, it looks like it's about $20 million if you look at it on period-over-period basis. So that would be the delta.

And relative to your accounting question with regard to assessments, you are right. The accounting that we do is to take assessments like (inaudible), and put them through the expense line because there will be recoveries in the future associated with taxes, licenses, and fee accounting. So that's where it all is.

Larry Greenberg

Great. Thank you.

Operator

(Operator instructions) And our next question will come from the line of Michael Nannizzi with Oppenheimer. Please proceed.

Michael Nannizzi

Thanks a lot. A couple of quick questions, one, would it be possible to break down the change in unrealized just by a couple of the large categories, maybe your non-agency mortgage backs, the corporate debts, and maybe offsets in some of the other asset categories. And I just have one follow up. Thank you.

Jay Fishman

In terms of - we could -

Michael Nannizzi

In broad strokes. I just want to understand where - I mean where did a lot of the mark come, in one group or in another; just to understand how the quarters stack up?

Jay Fishman

The primary change in unrealized came about because of the Munich portfolio. If you looked at the marks on the Munich portfolio as of the end of the year, they were different than where they were now. I think that would be the primary driver of the change.

Jay Benet

And the VAT, it was largely an improvement in the ratio of yield, the Treasury yield. Because as you remember, the ten-year backed up from $2.21 to $2.66 in the first quarter.

Michael Nannizzi

All right. Great. And then, as far as the Select business and on the business side, was there any segment that benefited from improved penetration there over any other, any of the main line GL, comp, or any of those other recording segments?

Jay Benet

Yes. In Select, we've seen - all of our lines of business experienced productivity, increase in sales and growth. Our comp business, particularly relative to, say, a year ago or three years ago, has seen probably the most significant amount of growth.

Jay Fishman

And they are as a result of a very intentional strategy.

Jay Benet

It's a very intentional strategy to bring our Travelers Express operational model and pricing model and capabilities there. We feel very good about the underlying margins, and track them in a whole variety of different ways very specifically. So we feel good about that underlying growth.

Michael Nannizzi

Right. And is the profile - the new - that new comp business or is it any different than the profile of the existing book of business that you have? Or just more penetration into the same margin?

Jay Benet

Particularly on the Travelers Express side, it is consistent or better than the profile book of business that we have.

Michael Nannizzi

Thank you very much.

Operator

Ladies and gentlemen, this concludes your presentation for today. You may now disconnect. Thank you for joining us.