S&P Global
Market Intelligence

The Travelers Companies, Inc. NYSE:TRV

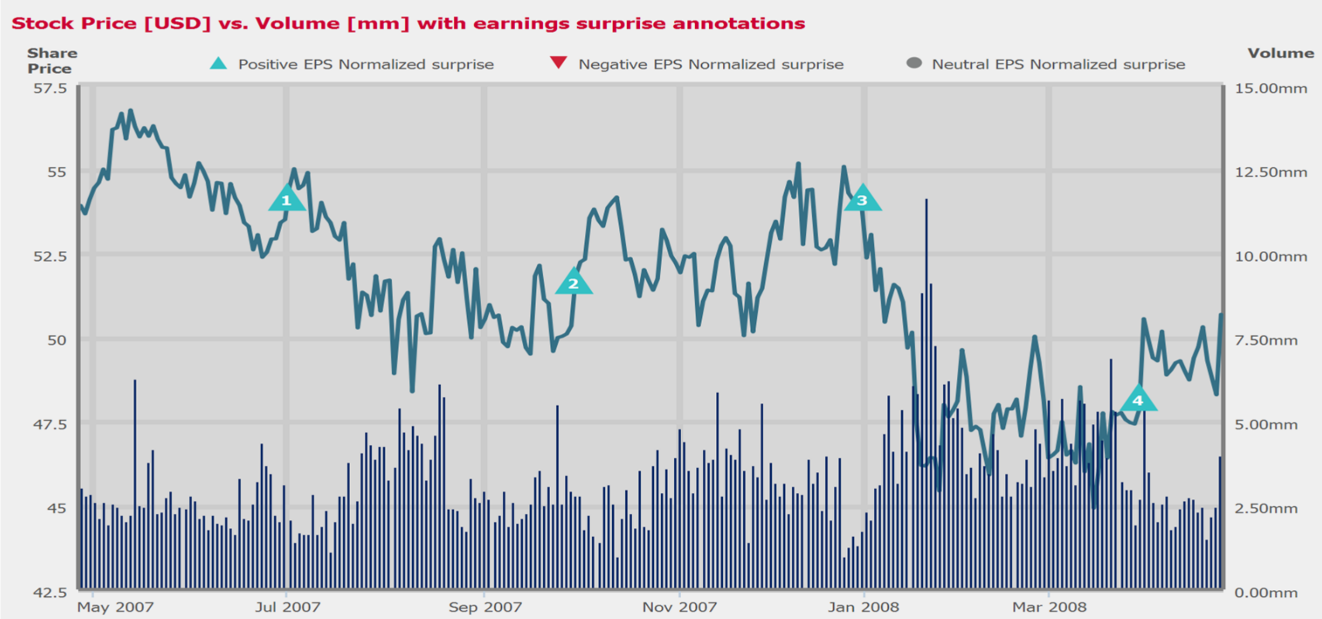
FQ2 2008 Earnings Call Transcripts

Wednesday, July 23, 2008 1:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ2 2008-			-FQ3 2008-	-FY 2008-	-FY 2009-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	1.45	1.50	3.45	1.40	5.99	5.96
Revenue	-	-	(2.19 %)	-	-	-
Revenue (mm)	5476.72	5357.00	-	5401.07	21620.32	21535.55

Currency: USD
Consensus as of Jul-23-2008 1:51 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ2 2007	1.49	1.73	16.11 %
FQ3 2007	1.49	1.81	21.48 %
FQ4 2007	1.60	1.63	1.88 %
FQ1 2008	1.54	1.61	4.55 %

Table of Contents

Call Participants

EXECUTIVES

Brian MacLean

Gabriella Nawi

Jay Benet

Jay Fishman

Joseph Lacher

ANALYSTS

Alain Karaoglan
Banc of America Securities

Bill

Brian Meredith
UBS

Ian Gutterman
Adage Capital

Jay Cohen
Merrill Lynch

Jay Gelb
Lehman Brothers

Josh Smith
TIAA Cref

Joshua Shanker
Citigroup

Matthew Heimermann
JP Morgan

Not Identified

Vinay Misquith
Credit Suisse

William Wilt
Morgan Stanley

Presentation

Operator

Good morning ladies and gentlemen and welcome to the second quarter earnings review for Travelers. (Operator Instructions)

At this time I'd like to turn the call over to Gabriella Nawi, Senior Vice President of Investor Relations.

Gabriella Nawi

Good morning and welcome to the Travelers discussion of the second quarter 2008 results. Hopefully all of you have seen our press release, financial supplement and web cast presentation released earlier this morning. All of these materials can be found on our web site at www.Travelers.com under the Investor section.

With me today is Jay Fishman, Chairman and CEO; Jay Benet, Chief Financial Officer; Brian McLean, President Operating Officer; Joseph Lacher, Head of our Personal and Select businesses, as well as other members of senior management.

They will discuss the financial results of our business and the current market environment. They will refer to the web cast presentation as they go through their prepared remarks and then we'll 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 web cast.

Our presentation today includes certain forward-looking information as defined in the Private Securities Litigation Reform Act of 1995. All statements other than statements of historical fact may be forward-looking statements. Specifically, our earnings guidance is forward-looking and we may make other forward-looking statements about the company's results of operations, financial condition and liquidity, the sufficiency of the company's reserves and other topics. The company cautions investors that any forward-looking statement involves risks and uncertainties and is not a guarantee of future performance.

Actual results may differ materially from our current expectation due to a variety of factors. These factors are described in our earnings press release and in our most recent 10-Q and 10-K filed with the Securities and Exchange Commission. We do not undertake any obligation to update forward-looking statements.

Also in our remarks or responses to questions we may mention Travelers operating income which we use as a measure of profit and other measures that may be non-GAAP financial measures. Reconciliation's are included in our recent earnings press release, financial supplements, and other materials that are available in the Investor section of our website, www.Travelers.com.

With that I'm going to turn it over to Jay.

Jay Fishman

Thank you Gabby and welcome to the team. It is good to have you here. Good morning everyone and thank you for joining us today. We are very pleased with our solid results this quarter with operating earnings of $918 million or $1.50 per diluted share, operating return on equity of 14.3% and a combined ratio of 89.3%.

Rather than focusing on specific results we posted this quarter which Jay, Brian and Joe will review with you in detail, this morning I'm going to take a few minutes to share our perspective on the current operating environment.

Reviewing our first six months the underlying business has shaped up about as we had expected. Our revenue strategies are paying off in each of our segments and we see that in our retention rates which remain very high. As we outlined in Investor Day our agents and brokers are embracing our products and that is reflected in the significant increase in deal flow to us in Business Insurance, primarily from

Travelers Express, our new small commercial platform and Industry Edge, our new middle market products.

In personal insurance as well our progress is evidenced by the success of Quantum Auto and Quantum Home. Nevertheless, our close rates are actually down as we have responded with discipline to the more competitive marketing business environment. We have tremendous tenure among our underwriters and we are pleased they have applied their knowledge learned during previous cycles by exercising such discipline in this market place.

So far this year rate and underwriting loss trends are generally developing as we had expected they would with some variances about which Brian will speak later. Net investment income is down as short rates declined much more than we had originally anticipated they would and returns on non-fixed income investments, while positive, remain significantly lower than last year. We continue to be extremely pleased with our asset portfolio. We are gratified that Moody's upgraded our debt and insurance financial strength ratings during the second quarter while so many other companies are being pressured to raise capital. Travelers remains very strong with a superior balance sheet and significant liquidity.

When we look out to the rest of the year we are aware of the current economic environment and the potential for an interesting combination of continued low interest rates, a lower growth economy but higher inflation. We are looking at a macroeconomic environment which has changed significantly over the last six months and we are certainly taking that environment into account in terms of how we go to market.

Let me be clear, we have not yet seen evidence of any real spike in inflation in our loss trend data. Finally, we have been disciplined with regard to the left side of our balance sheet as we have with the right side. Bill Heyman and his folks have done a terrific job in thinking about risks and in making sure that our risks and return equation is disciplined and thoughtful. As a result so far we have been able to avoid all of the missteps that plague so many other financial service companies.

We have managed our business with long-term returns and profitability in mind and this philosophy has served us particularly well. So tying it all together we remain committed to our long-term financial objectives and I believe the franchise is well positioned to achieve them. History would suggest that our confidence is well placed. Since January of 2005 we have achieved an average return on equity of 15.3% after $1.9 billion in after tax catastrophe losses including the largest U.S. catastrophe on record as well as an increasingly competitive pricing environment in much of our business dating back to 2005.

Our underwriting results over time are a real indication of our underwriting experience, skill and discipline. So we look forward to our goal of mid teens ROE over time, it is based on what the businesses have achieved, how we underwrite and how we manage our capital.

With that let me turn it over to Jay.

Jay Benet

Thanks Jay. Let me begin by going through some of the highlights during the quarter as shown on page 3 of the web cast. As Jay mentioned, second quarter 2008 operating income was $918 million or $1.50 per diluted share producing an operating return on equity of 14.3%. Our weighted average diluted share count declined to 611 million shares as we continued to generate capital in excess of our growth needs and used $750 million of that excess capital to repurchase 15.3 million of our common shares in the current quarter.

Despite dividends and share repurchases of $4.1 billion in the last twelve months, adjusted book value per share grew by 12% in the past year and 3% in the current quarter. Later Brian and Joe will discuss the drivers behind the slight decrease in net written premiums so let me end my comments on this page by noting how pleased we are that we received the ratings upgrade from Moody's this quarter.

Page 4 of the web cast shows the components of operating return on equity as we first displayed them at our May 2008 Investor Day conference. Fixed income net invested income less interest expense remained the major driver of year-to-date operating ROE. This passage of time component produced an 8.8% return in the current period, down slightly from the prior two years due to lower short-term interest rates.

A much smaller contributor to operating ROE both historically and year-to-date is non-fixed income investment income which produced a positive return of 0.3%, down as expected due to current market conditions.

Underwriting income continued to provide a very strong return of 5.8% year-to-date driven by healthy underlying underwriting margins along with net favorable prior year development and despite a very high weather related losses.

As the data on page 5 indicates both CATs and net favorable prior year reserve development played a meaningful role in our results. CAT losses which were concentrated in the business and personal insurance segments resulted from the unusually large number of severe weather events that occurred during the quarter including tornados, hail storms and floods in various regions of the United States. CAT losses net of reinsurance added 6.6 points to our GAAP combined ratio this quarter.

Net favorable prior year reserve development resulting from better than expected loss experiences in each of our business segments reduced our second quarter GAAP combined ratio by 9.8 points. As this slide indicates our GAAP combined ratio when adjusted for CAT net favorable prior year reserve development and last year's timing impact for the change to the fixed value based agent compensation program increased by 2 points. This increase, which was less than the 2.4 increase in this year's first quarter, was generally consistent with our underlying expectations for pricing and loss cost trends and also included the impact of a small increase in the number of large property losses that Brian will discuss later.

Page 6 provides further information about our net favorable prior year reserve development in the quarter. Development was concentrated in our commercial businesses for accident years 2004-2007 primarily related to liability lines and was net of an $85 million increase in environmental reserves.

There are many factors that have contributed to our favorable reserve development in recent quarters. Some we can control and others we cannot. Within our control are processes that help to detect unfavorable trends that could lead to unfavorable development such as having the analytical tools, management information and culture to maintain strict underwriting discipline at all times while maintaining thoughtful and responsible reserve methodologies that constantly look back to underwriting and claims experience.

Also within our control are initiatives that can actually give rise to favorable reserve development such as the claims initiatives we introduced in recent years that reduced actual claim costs from claim costs assumed in reserving that had been based upon historical settlement values. These claim initiatives have included faster settlement of auto claims and the use of managed care techniques for Worker's comp claims and others.

Factors that are not within our control include improvements in the legal and judicial environment including torte reform. All of these factors have continued to play a role in the favorable development of our prior year reserves and in many cases translate into improved estimates and profitability in current year business.

Before turning the microphone over to Brian I did want to provide an update to certain information we last provided to you over a year ago at our May 2007 Investor Day Conference. Since that time we have been actively managing our CAT risks by reducing our hurricane exposure in coastal areas in the southeast and changing our reinsurance coverage to reduce hail risks and related capital charges particularly as they relate to northeast winds. Our focus has been on reducing exposure to highly severe, extremely low frequency events.

As can be seen on Page 7, our estimated probable maximum loss for a single hurricane at the 1 in 100 level net of reinsurance and after tax has been reduced to $1.4 billion or 5% of common equity. A single hurricane at the 1 in 250 level also net of reinsurance and after tax has been reduced to $2.2 billion or 9% of common equity. I should point out that these estimates correlate to extremely large industry events much larger than say a Katrina.

Our P&L estimates are based upon assumptions outlined on Page 2 of the Appendix to this web cast presentation and factor in the July 1, 2008 CAT reinsurance renewals that are incorporated into the chart provided on Pages 20 and 21 in the Appendix. The only significant change to our CAT reinsurance program and this year's July 1 renewal was the addition of another $250 million of northeast only coverage which brought our northeast CAT treaty up to $500 million and when combined with our $500 million CAT bound brought our total northeast coverage up to $1 billion, all excess of $2.25 billion.

The cost of our national CAT treaty was $77 million for the coverage period July 1, 2008 through July 30, 2009, down from $100 million for the prior year period. I should also point out this information regarding P&L is based upon output from analytical modeling related to probability and potential losses which are inherently unpredictable and that actual CAT losses could be materially greater than indicated. I urge you to read Page 23 of the Appendix of this web cast and with that let me turn things over to Brian.

Brian MacLean

Thanks Jay. I'll begin by going over the production statistics for our commercial businesses and as you can see the results continue to be strong. Current market dynamics are obviously impacting our results but as our numbers indicate in the aggregate we are managing these market dynamics quite well.

Looking at the details on Slide 8 you can see that retentions remain at high levels across all the domestic, U.S. commercial businesses. These overall high retention levels reflect our ability to withstand market place pressure and execute on our strategy to keep profitable business and not sacrifice underwriting results.

In the international operations retention was down due to the intentional non-renewal of certain property business in Canada and auto business in Ireland and competitive market conditions impacting our Lloyd's business. Our business in the UK continued to have strong retention numbers.

The renewal price change which reflects both rate and exposure changes remains generally consistent with recent quarters. RPC in the Select business which represents about ¼ of the business insurance segment was still positive and consistent with the last two quarters. In the remaining domestic businesses the change in RPC was down modestly due primarily to declining exposure which reflects the broader economic environment. Underlying rate changes were consistent with last quarter.

The improvement in the international renewal price change was due to increased exposures primarily in Lloyd's. Again, our organization has done a great job of preserving our renewal book at appropriate price levels.

The new business dollars are shown on slide 9. In the aggregate they are essentially flat with the second quarter last year and last quarter. In the domestic businesses they were down slightly and in the international operations new business was up primarily due to Lloyd's. To get the real story you have to get beneath the written dollars and look at deal flow, quote ratios and hit ratios.

Overall flow of new business submissions was up in most all our businesses and in some businesses they were up dramatically. For example, in commercial accounts, our middle market franchise and construction which combined comprised about 25% of the premiums in the segment. Quotes year-to-date were up around 20% from 2007 and 50% from 2006. Our new product offerings, platform enhancements and strong position with agents and customers have continued to drive this heavy flow of opportunity.

We continue to feel good about the quality of the opportunities we are seeing. Accordingly we are quoting on much of this business and our quote ratio remains fairly consistent with historical trends. Unfortunately the pricing on new business continues to deteriorate and since we are being just as selective as we have always been our hit ratio, or the percentage of our quotes where we are winning, has been declining through 2007 and the first half of 2008. We believe that is evidence of our underwriting discipline.

We think the real story here is that we have built a franchise which is driving significantly more opportunities our way. In this more challenging pricing environment that has enabled us to maintain share where we seek to do so. More importantly it leaves us extremely well positioned for when the market conditions improve.

With respect to international the increase in new business over the prior-year quarter is driven by Lloyd's. As part of our strategy we have hired two underwriting teams, power and utilities and yachts that have generated over $50 million in the quarter. These are experienced teams that understand their markets.

Turning to the business segment financial results on Slide 10 you can see that net written premiums declined 4% quarter-over-quarter. The decline is due to the market pricing dynamics I just discussed and in these market conditions this feels like the right answer especially with retention levels remaining very strong.

On Slide 11 business insurance operating income was down 18% from the same quarter last year. The adjusted combined ratio on the page was 93.3 for the quarter, a two point deterioration from the second quarter last year. This decline reflects some compression of our core margin which is essentially in line with our expectation of benign loss trends and moderate price declines as well as a modest increase in the number of large property losses which I will discuss in a few minutes.

Our expense ratio after considering the timing impact of the agent compensation program is up about 9/10 of a point. 6/10 of this is the result of a reduction in national account fee income and the remainder is primarily from the decline in earned premiums.

So for the domestic U.S. business we feel great about how we are executing in some difficult market conditions. Business volumes and margins are down but modestly and given the market place we believe that is a very good result.

Turning to financial, professional and international insurance on Slide 12 the segment continued to produce positive results with operating income up 34% from the same quarter last year driven by the favorable prior year development. The adjusted combined ratio of 95.3 was also up 2 points in this segment from the second quarter of 2007 reflecting the same market conditions I just described in business insurance as well as the increase in large property losses.

It is probably worth noting right here that our increase in loss and LAE ratio in this segment is not the result of increased losses in our management liability business which includes our DNO portfolio or our surety business which includes our exposure to contractors in general and the central artery project in Boston in particular.

Financial, professional and international net written premiums of $985 million in the quarter was flat with the prior year. Bonded financial products premium quarter-over-quarter declined but was more than offset by net written premium growth in our international operations which benefited from the new business growth in the two units at Lloyd's also reflecting the favorable impact of exchange rates.

Now I want to take a minute to talk about the property large loss dynamic that I mentioned is running through both commercial segments. This increase in loss activity is being driven primarily by a modest increase in the number of large property losses in excess of $5 million net of reinsurance. We obviously anticipate some losses of this size but in the first half of 2008 the actual number of losses was above our normal expectations.

So to really quantify this for you we are talking about seven losses in business insurance and five in financial, professional and international. More importantly we manage our limits tightly with a maximum net retention of $15 million in business insurance and the UK and $5 million in our Canadian and Lloyd's operations. So in the aggregate it is not a large financial exposure but it is affecting our combined ratio comparisons in 2008.

The biggest issue is do we see this as a trend and if so is it from our underwriting. I can tell you for all large losses we scrutinize this very closely. We have examined all our large property losses. We have challenged ourselves and looked at all the data. The events run the gamut from the fire at Universal Studios to a large sugar plant explosion to a fire at a hotel under construction in Boston. We have not seen anything we can yet call a trend other than the obvious that many commercial losses are fire related.

So our assessment is this is not a result of our underwriting or pricing decisions but is an aberration. We are aware that industry-wide losses are also up and so we know that the issue is not unique to our results.

In summary, although it is certainly worth noting for the quarter and year-to-date results we don't see this as a trend but we are watching it very closely.

Stepping back to the larger picture overall our results in this quarter considering the softer insurance market place and the general economic conditions are very solid. We experienced strong levels of retention, modest price declines on our retained book, a significant flow of new submissions and our core margins are performing as expected.

With that let me turn it over to Joseph Lacher for the personal insurance results.

Joseph Lacher

Thanks Brian. Personal insurance results start on Page 13. Not surprisingly weather is a significant part of this segment's results for the quarter. Even against that backdrop, personal insurance produced strong results so the combined ratio of 97.3% and $122 million in operating earnings.

We have strong production results with increased new business and retention renewal pricing in year-over-year policy in force growth consistent with recent quarters. When comparing the quarter's profitability to the second quarter of 2007 earnings were down primarily driven by significant adverse CAT and non-CAT weather related losses, somewhat less favorable prior year reserve development and lower net investment income.

Excluding these items and the impact and the timing of the 2007 agent compensation program change the underlying combined ratio was in line with the prior year quarter. Looking specifically at our property results on Page 14 and in the statistical supplement, we can see the impact of adverse weather on the quarter. It is not news to any of you that the industry experience for the second quarter is projected to be one of the worst second quarters in a long time.

While our property results were impacted by nearly 19 points in catastrophes, we still reported an underwriting profit with a 96.5% combined ratio. At the same time we continued to grow our business. Policies in force increased 3%; retention remained stable at 86% with a renewal price change of +6%.

We remain pleased with the continuing growth of the Quantum Home product and its ability to increase new business volume despite competitive market conditions. Quantum Home policies now represent a little over 10% of our policies in force.

Shifting to auto, our combined ratio for the quarter was 97.9%. Catastrophes negatively impacted that combined by 1.5 points in the quarter. We are pleased with our production results in the current market conditions. New business volume was up over 12% versus the prior year quarter and is at the highest levels we have experienced since the first half of 2006 and the roll out of Quantum Auto.

Policies in force grew 3% over the prior year quarter and at the same time our renewal price change was at +2% with retentions consistent with prior quarters. We continue to make investments in our business, infrastructure and distribution capabilities to fuel our long-term profitable growth. These investments continue to impact our results.

Our ongoing agency appointment strategy is one example. As an anecdotal illustration one of our regions reported in their last internal operating review that over 20% of their new business volume this year came from agents appointed within the last 18 months. They continue to deploy a systematic, segmented distribution and management process that is yielding growth opportunities without the need to be imprudently competitive on pricing.

Turning to page 15 I would like to touch on loss inflation in the auto line. Excluding the anticipated impacts from the broader risk profile of Quantum, we saw loss inflation in the quarter to be essentially flat. Frequency trends were down just slightly. We experienced total severity trends up just slightly. Similar to recent quarters we saw damage related severity increasing in the low single-digits and bodily injury severity slightly decreasing.

We believe this is a big deal. These numbers are not loose impressions but rather are based on actual experience. As we have previously discussed our bodily injury results appear out of pattern and better than what a number of our competitors have reported. We believe this is a direct result of our claim initiatives which leverage the strength and breadth of our multi-line claim organization. This continues to be a leveragable competitive advantage for us.

While the market place remains competitive we are seeing increasing signs of firming particularly in the auto line. We are continuing to monitor these, monitor loss trends and profitability and market place conditions as well as the change in economic climate. We adjust our tactics going forward. We remain pleased with the businesses' underlying performance and look forward to building on that success.

With that I will turn it back over to Jay.

Jay Benet

Thanks Joe. Net investment income for the quarter is shown on Page 16 with $624 million after tax or $134 million lower than the prior year quarter. Fixed income related NII was down only $7 million from the prior year quarter and was impacted by the lower shorter term interest rates. The major variance between the two periods occurred due to non-fixed income returns which remain positive well below the prior year period level as we had expected.

This level of non-fixed income related NII resulted from lower real estate and private equity partnership gains due to low transaction volume given current market conditions. Overall our after-tax yield was 3.4% for the quarter.

Turning to Page 17, our investment portfolio and our balance sheet continue to be in terrific shape as we continue to avoid the issues that others have had to deal with. We ended the quarter with almost $26 billion of common equity X FAS115 and book value per share X FAS115 of $43.45, up 3% in the current quarter and up 12% from a year ago. All this after $3.4 billion of share repurchases and $730 million of common stock dividends during the past twelve months.

Our capital remains at or above all of our target levels and we continue to generate significant amounts of excess capital and liquidity. Our debt to total cap ratio was 19.7% at the end of the quarter compared to our 20% target and holding company liquidity was $2.2 billion or twice our target of one year's worth of interest and dividends.

Page 18 provides updated information concerning our guidance for full-year 2008. We continue to expect fully diluted operating income per share of $5.55 to $5.85 which translates into an operating return on equity of approximately 13-14%. Our guidance incorporates our results for the first half of the year and assumes the continuation of lower short-term interest rates and the more challenging environment we experienced in the first half for non-fixed income investment returns.

Our guidance now assumes full-year CAT losses of $785 million pre-tax or $510 million after tax or $0.84 per share after tax which has been adjusted for actual CAT losses in the first half of the year. No further prior year reserve development either favorable or unfavorable. No significant change in average invested assets X FAS115 and after approximately $2.7 billion of share repurchases for the full year and our revised weighted average share count of approximately 610 million shares after share repurchases and employee equity rewards.

Before we take questions I'd like to turn it back to Brian who has a clarification.

Brian MacLean

One quick correction. When I was talking about the business insurance new business glove what I should have said was submissions from agents of deals was up 20% from 2007 and 50% from 2006 in our middle market and construction businesses. I think I incorrectly used the word quotes there.

So our quote activity is obviously up but not that dramatically.

Jay Benet
With that why don't we open it up for questions?

Question and Answer

Operator

(Operator Instructions) We'll take our first question from Jay Gelb - Lehman Brothers.

Jay Gelb
Lehman Brothers

I was hoping you could touch on a couple of points. First on the auto frequency trend can you outline to what extent you think that is driven by higher gas prices and consumers driving less and the sustainability there? Also with the combined ratio in auto in the high 90's do you feel you need to be taking more rate? The second issue I wanted to touch on is I don't know if you can quantify the fully impact of the non-CAT weather in the large property losses in the quarter and finally Jay if you could touch on your appetite for M&A at this point?

Joseph Lacher

On the auto frequency piece Jay we have seen all the reports on fewer miles driven per vehicle and lots of speculation on gas prices. My answer is going to be equal speculation at this point unencumbered by fact. It looks like it to us. There is no real way to tell. That seems to be the most logical conclusion. We are not making the assumption it is sustainable and will continue to drop over the long-term. Given where we are right now that is not the basic assumption we are making going forward. We are obviously constantly watching it and we'll see what happens but we are not assuming sustainability in terms of how we are going to navigate the business.

Relative to the pricing dynamic, we shoot for a mid-teens ROE. I'm not going to comment on specific pricing strategies of how we are working through it. We are obviously in the upper end of a tolerable combined ratio and we are obviously seeing the market place conditions we talked about and we'll factor all of that into our pricing though process.

Jay Fishman

The one observation I can give Jay is we were updating the grid that we shared with you previously at Investor Day for targeted product returns. The combined ratio in auto that we generated in the quarter and I think in the six months, let's check that but I believe it is true, the returns had an X for the auto business it would still be in that box that meets our targeted threshold of returns. So at these levels even given this interest rate environment because we are factoring that into our analysis the auto business continues to produce our targeted return in that 13-18% range we disclosed previously.

Joseph Lacher

At a 97.9 I pointed out we have got a point and a half impact on catastrophes running through that number. You don't typically see that running through auto numbers and you can track our CAT on auto back for awhile. That is somewhat atypical. We are okay with where it is.

Jay Fishman

The response to the merger and acquisition question is the same as it would have been if you were asking three months ago. There is nothing in particular that has changed. We think we have the tools and the requisite skills to grow our business organically and that is clearly our focus. Any transaction we would even consider we would do so only in the mindset that we would be convinced conclusively it would add to shareholder value and that kind of analysis would always incorporate the risk associated with any transaction and I have articulated before balance sheet risks and capital risks and people risks and systems risks and it is high. We have done enough of them to know how high those risks are.

The answer with respect to the M&A environment is it is no different than it would have been in the first quarter.

Joseph Lacher

On the property loss thing Jay we are not disclosing a discrete number but I gave you a lot of information there. If you want to do the arithmetic the first six months and say about a dozen losses and I gave you the limits. They weren't all limit losses but you can come up with a number. I think the conclusion there is that it is causing a little blip in the first two quarters. The bigger issue as I mentioned in my comments is what does it mean for going forward and we are looking at that just like everybody else in the industry.

Jay Fishman

I will make an observation. Brian did actually articulate three of the losses. Two of the other ones were aircraft actually. So it is all over the lot. It is just not specific.

Let me correct that response, I'm sorry. The airline events that I was just making reference to actually fall below the threshold that Brian identified as large property losses. I misspoke and I apologize.

Operator

The next question comes from the line of William Wilt - Morgan Stanley.

William Wilt
Morgan Stanley

First a general question. Jay I heard you remarks at the outset on inflation. You seemed to recap that it is on the radar screen but not yet showing up on the loss cause trends you are analyzing. At least not in an outsized way. I guess one confirming that is the right characterization. Two, what types of inflation are highest on your radar screen?

Jay Fishman

Your characterization is actually right on. I think all of us are aware of the inflation risks predominately from what we have been reading in the financial press, watching oil now albeit at $126 per barrel rather than $140. The sort of attention that has been given to it. What I think that people would anecdotally think is perhaps we have seen it in construction materials already. We have certainly read about increases of prices in cement and increasing prices in building materials generally. Interestingly enough it hasn't yet evidenced itself in any substantive, serious way in our loss trend data. Notwithstanding under the anecdotal observations. But given the fact we incorporate estimated inflation as we price our product and reserve our product it would be foolish of us not to have it higher on the radar screen than perhaps it might have been six months ago. We have, the industry has benefited from a long standing period of benign inflation and I think that has to some extent offset some of the pricing pressure that has been around for a couple of years. If in fact that inflation dynamic changes it is obviously something we need to begin to think about in the context of our pricing strategies. That is I think why we identified it as an item of concern and it belongs on the radar screen for any responsible management team.

Brian MacLean

When you look at the hierarchy of concern the other one that would be high on the list is medical inflation flow through. Obviously our Workers Comp and many of our liability claims so we watch medical inflation very closely.

William Wilt
Morgan Stanley

Thank you for that. The same characterization holds true there? It is on the radar screen but no apparent change?

Brian MacLean

Correct. We are always seeing minor ups and downs but nothing systemic.

Jay Fishman

I want to comment though because it is obviously information that is available on the Workers Compensation…

Brian MacLean

For example comp was aligned where we actually had a little bit of unfavorable development in the quarter. That was due to seeing both pharmaceutical costs and long term care costs inflated higher than what we thought. It actually helps to break the comp disclosure down by year, which I don't think we do publicly. The more recent accident years, I think 2005, 2006 and 2007 I think were still developing favorably and it would be 2004 and prior that were net negative. That was an example of seeing some relatively minor but of course you know inflationary…

Jay Fishman

Jay spoke about it earlier. What you are hearing on this call is actually an example of the feedback that exists between the claims department, loss analysis right back in the underwriting. It is incorporating what we are seeing on the front line back on the claims side back into our underwriting analysis. You hope it keeps us a step ahead of the game.

William Wilt
Morgan Stanley

Jay you have talked quite a bit before about the evolution of the pricing cycle and suggested that folks should keep a close eye on retention ratios and the new business penalty. I guess I'm looking for an update to that discussion. Retention ratios hanging in there. Has the new business penalty shrunk? Is that part of the reason perhaps that retention ratios are remaining stable?

Jay Fishman

No, I don't think so. That is the short answer. First of all I characterize the retention ratios as actually worth hanging in there. I think actually [inaudible] in a sense there. They are different. This is a different cycle certainly than anybody sitting around this table has ever experienced before. This long into a pricing deterioration, albeit a modest one where retentions have stayed at the levels they are and continue to look just very, very solid. If anything in the second quarter and this is more anecdotal than it is factual because it is hard to track it quite that currently, our sense was that the market for new business actually became somewhat more heated and the little bit of data I can offer that is interesting, Brian ran through the points so quickly I think it gets lost. A number of actual field quote submissions that we are seeing is up in many of our businesses and they are up dramatically. We want to talk about competitive advantages. If you never get a deal on a house if you never bid on it.

As Brian talked about a 50% increase in field quote submissions and the sum of middle market construction in the last three years, two years, really it is quite amazing. The quote ratio, the number of times we quote, has largely stayed flat but the hit ratio is actually down. The number of times we are succeeding is actually down and we take that as kind of a leading indicator on the nature of the competitive market for new business. Based upon that data we would conclude that the second quarter was somewhat more heated for new business. Not less.

I do understand you analysts say well how do you figure retentions are staying as high as they are and I guess the same question that has been out there for awhile. This is an interesting market. It is a new business market that has a certain aggressiveness to it and a retention market that has a surprising amount of stability to it. Beyond that I…

Not Identified

The other point I'd make and maybe a little bit given some credit here, I don't think there are a lot of competitors that talk about deal flow numbers so it is not something you can see easily. Given…I doubt that many of them would be talking about a lot more deal flow right now. I think part of it honestly does speak to our position in the market place in both our ability to retain our accounts and our ability to attract significantly more deal flow in an economic environment where I don't think there is a lot more deal flow out there in the aggregate. This speaks somewhat to our franchise and what we have been doing.

Operator

The next question comes from the line of Joshua Shanker - Citigroup.

Joshua Shanker
Citigroup

My first question regards the environmental reserve addition. What are you seeing in environmental that led you to this modest reserve addition overall?

Jay Benet

There is not a lot going on. What we saw in the data we had as it relates to pending policy holders so it is not driven by new stuff coming in. We did see some upward development in the expense costs and settlement values so we reflected that in this quarter.

Joshua Shanker
Citigroup

Refresh us. Have there been any trends there or is this a one-off in terms of where we have seen the previous quarters?

Jay Benet

I wouldn't say there has been any trend. Each year and each quarter we go through and evaluate what has taken place. Sometimes it takes a little longer for information to develop for us to act on it. We do, as you said, recognize the fairly modest increase to the reserves and it is just indicative of us always staying on top of what is taking place in our reserves and making sure our balance sheet is as current as can be.

Joshua Shanker
Citigroup

You mentioned 2004-2007 years particularly in liability have been showing some favorable development. Particularly that 2007 year, what kind of data are you getting and is that the minority of the impact or are you seeing that 2007 is really turning into a year where you might see some profit?

Jay Benet

That is a great question. When we talk about where the reserve development is taking place and obviously it gets highlighted in particular years. But it also goes back to something that is inherent in the reserving process. That being that when you start analyzing 2004, 2004 provides you information as to not just 2004 but the starting points then for 2005, 2006 and 2007. So each one of the analogies kind of rolls into the next. When we talk about adjusting 2007 it is not an adjustment based on just current long-tail information coming in at a rate that is lower than what we expected. That is not the primary driver. The more current of the years is driven more by the roll over effect of what is taking place from the prior years.

Joshua Shanker
Citigroup

Finally, and I'm being as nonspecific as possible and really intend to be, but in the events you were to make an acquisition what sort of financial metrics in terms of pay back or in terms of what it has to be in terms of being accretive to Travelers, what do you have to see early on and what do you have to see over a 3-5 year period to justify it in your mind?

Jay Fishman

I'm not sure I really know how to kind of answer that question other than to say which is the same thing I have been saying…we would have to be convinced that a transaction would add to shareholder value. I think the way you analyze that is based upon the specific circumstances of the time. Every transaction I have ever been involved in has always stood on its own analytically. Every one added something different from another. So the way in which you approach thinking about what it did for your franchise the transaction simply adds volume, you bring in geographically and you kind of analyze one way. A transaction that helps you get through a strategic imitative that might be important you might have a longer view of. So I don't know really how to answer it other than to say anything we ever looked at would have to pass a high pressure test of creating shareholder value.

Operator

The next question comes from the line of Matthew Heimermann - JP Morgan.

Matthew Heimermann
JP Morgan

I guess my question is just the economy and its potential impact on exposures and the brokers have opined that I think of the smaller end of the market that is becoming an issue in their eyes. It doesn't look based on the premium trends that necessarily is indicative of what might be happening broadly speaking. I was wondering if you could just give some insights there?

Jay Fishman

First let's make sure we are talking about the same thing. When we talk about exposure we think about it as units of insurance. So if you are writing an account and they have one truck and they are growing their business and they add a second truck and they need more insurance that to us is a change in exposure. So if that is the concept…

Matthew Heimermann
JP Morgan

I guess it would be more broad than that. I guess it would be since exposure could be for Work Comp, payrolls, it could be autos…it could be that plus maybe discretionary decisions about how much coverage.

Not Identified

A lot of our products are rated on receipts, etc.

Jay Fishman

We are an industry that likes economic growth. The more economic growth there is the more stuff there is to insure. We are all for making new plants and hiring more people and adding to payrolls and when payrolls shrink and plants get closed and shuttered our economic engine turns the other way. In its simplest form and I can tell you what we have seen so far is we have exposure while positive in the quarter was nonetheless lower than what it had been. That is an early indicator of some slow down and that is what it is. I don't know for sure. It is too early to tell. But I would say again that exposure in the aggregate is positive in the quarter. It didn't shrink but it is down from where it was. We're going to watch that very carefully.

Again I'm not sure we can do much about it. We will write more Worker's Comp business when payrolls go up. We'll write more property insurance. As companies expand we'll do better and as company's contract we'll do worse.

Matthew Heimermann
JP Morgan

There has been a lot of M&A, and this isn't your outfit, there has been a lot of M&A that has happened, particularly smaller, regional companies. I guess does that help or hurt your strategy? I guess what I'm really getting at is I view one of your advantages as being kind of your pockets and your resources and your technology which creates an advantage. As some of these companies perhaps become part of bigger organizations do you worry about that eroding or given that some of these businesses are net new they still don't have the kind of scale you have?

Jay Fishman

I'd say first that give the stability of this organization, given its feel for stability we hope that we are the beneficiaries any time there is any dislocation in the market place. Any time there is a transaction where one company is combining with another any agents office there is always dislocation. Always. I think given our stability and the clarity of our underwriting profile in the near term we end up as a beneficiary of those things and so that is more of an aspirational statement but a belief more than I can show you and prove to you.

In the long-term there isn't anything that has happened in the last year or two years that cause us to feel at any competitive disadvantage or the advantages of the company have in any way been compromised or marginalized. I just don't believe that. The transactions have been largely related to relatively small companies with either relatively small geographic footprints or very narrow underwriting profiles. I just don't think it makes much of a difference.

I said before I didn't think that the two mutual transactions would particularly change the competitive market place much at all. I still believe that and I still think we are just very well positioned in the competitive arena. We are unusual in that we are a very big company but with a focus on small and middle market commercial business.

It is really a function of the history of the organization and how it came together. It has come together with a bunch of individual companies that all had that end of the market to focus. We love it.

One of the real advantages is the ability to bring expertise, platforms and Travelers Express has been nothing short of a home run. It really has been remarkable. And it takes real assets to be able to do it. It takes real wherewithal. If you are a little company with a little footprint you haven't got that much wherewithal to create a Travelers Express. So the real scale opportunities that come to us I think do because we are as solid as we are and yet we market to an end of the market that most competitors don't have that scale. It is an interesting place to be.

Operator

The next question comes from the line of Alain Karaoglan - Banc of America Securities.

Alain Karaoglan
Banc of America Securities

I have a couple of questions Jay. If I look at the current accident tier combined ratio it is around 92.5 and at 2.5 points of normalized catastrophes you'd be at around a 95 give or take a few which would suggest the return on equity based on slide 4 of around 12%. Is it time to focus…when would it be time to focus more intently on the expense ratio given that the pricing environment is continuing to be challenging, the opportunities and doing the best to get new business but top line isn't likely to grow significantly.

Jay Fishman

I think we focus on expenses all the time. It is always to focus on expenses. There is never a time not to. We don't focus candidly on the expense ratio as many analysts tend to look at. The reason is when you look at the success of this organization much of it has happened because of investments which drove an increase in the expense ratio and ultimately provided a more than offsetting benefit, significantly more than offsetting benefit, of a loss ratio. I would use all the claim work that Joe has talked about so effectively over the last couple of years. That takes real people and real systems and real spending to have happen. I would tell you that what we do every day is we think about the long-term returns that are available to us in the business and we make the investments we are going to make that we are convinced will add to that value equation and allow us to continue to hit the mid-teens ROE over time. That is the way we think about the business.

If an investment won't help us meet that goal we are not going to make it regardless of the environment we are in. If it does make it we are going to try like heck to make that investment regardless of the environment. There are going to be times where and we are not yet there, I think that is an important point, we are not yet at the point where it would be appropriate to start chipping away at the investment strategy of the organization. It has been very successful. It has got a great governance and diligence process around it and we are going to continue it. If in fact the market continues to deteriorate and two years from now we are having this conversation I think the bar gets raised and we look at it differently.

I would tell you that when you look at Travelers it is not at all like in the old days in the sense that it is not about cell phones anymore. It is not about clients in the office. We are an unbelievably expense conscious, expense focused organization and by that I mean no one wastes any money here. No one wastes money.

Ultimately what you are really talking about is the level of investment we made to build our business for the future and that gets rigorous analysis for the long-term.

Alain Karaoglan
Banc of America Securities

A follow-up to that, on the personal auto business for Joe the command ratio was 98.6 and 97.9 if you take away the CAT. Were reserve releases similar to what you had in the personal lines? That would suggest a combined ratio closer to 98.5. Any way to quantify what is the investment you are making? Why are you still comfortable that you are okay and we shouldn't worry more about it going forward?

Joseph Lacher

The reserve releases, we don't disclose those by line, were generally consistent but lower in the quarter than they had been for auto. But they have also been somewhat consistently running for some period of time inside of that line. When we look at the combined ratios and we look at the mid-teens ROE and the range we have put on them before we see the line running inside of that range. Admittedly at the less profitable end of that range but inside the range.

Jay Fishman

It is not hard in our business when you have the analytics to sit down and know exactly what combined ratio will translate to what return. It is not anecdotal. Joe has charts and the charts he has show here is the combined ratio. Here is the achievable return in that product. So we know it and we are watching it very, very carefully. There will come a time when you turn around and you go you know if you run the business for the long-term and we're going to make those hurdles and something has to change and we're going to take that into account as we think about our own pricing strategy.

So I think Joe said it right. I don't know that we are at the low end of the range of acceptable margin and acceptable return but we are certainly at the lower end but still well within that range that lets us meet those thresholds. If that changes we'll change our pricing strategy.

Joseph Lacher

What we experienced in the quarter was flat loss trend and a 2% positive RPC which isn't total gloom and doom.

Alain Karaoglan
Banc of America Securities

I promise that is the last question. Jay in terms of the question on M&A transactions you mentioned you will judge them all in terms of creating shareholder value. I assume that relates to your mid-teens return on equity on average over time that any transaction you would like it to achieve…that is how you would measure creating shareholder value from a financial point of view.

Jay Fishman

I think that is right. I think you have got it exactly right. If ultimately we can achieve mid-teens and we end up taking on a transaction and we end up going down to single digits we haven't achieved much have we? I do think you have to look at these things in the long-term and that goes again to what the capital demands of whatever you buy. It is a complex issue but I think you expressed it exactly right.

Operator

The next question comes from the line of Vinay Misquith - Credit Suisse.

Vinay Misquith
Credit Suisse

On the Worker's Compensation business we saw some small areas of development in the 2004 and prior years. Does that change your mind about your decision to increase your Worker's Compensation business in small accounts?

Jay Benet

No. We have talked a little bit about this in the past. We are a company that from a guaranteed cost perspective is relatively underrated in Worker's Comp but from an overall expertise in corporate capabilities and I'm speaking to our larger account comp servicing carrier capabilities we are a very experienced and knowledgeable comp company. We are pretty confident if not the best one of the absolute best claim engines in control and comp losses. We think we know the line very well. We have historically had a very cautious; some might say overly cautious view of guaranteed cost comp. We have been over the last couple of years very selectively moving forward and trying to look at areas both by account size, and so we have done more in the small account area and also by geography.

This isn't close to a one size fits all but we are taking a very selective look at comp and we continue to think there is opportunities. We went through a bunch of this at Investor Day. We talked about some of our claim capabilities there. I think that is worth referring back to. We still feel good about the line and the 2004 and prior stuff hasn't really changed our view.

Vinay Misquith
Credit Suisse

The second question is on personal auto. Joe mentioned that your [inaudible] claims are increasing less or maybe they are decreasing versus the prior years. Could you help us understand what specifically you are doing versus the other personal auto insurance that keeps your BI claims lower?

Joseph Lacher

I did say that our BI severity was decreasing, not increasing, which at least when we heard other folks talking about the last couple of quarters has been consistent with what other companies are seeing. I'll point you back a little bit to what we did in our recent Investor Day presentation because you can get a fair amount of slides and description longer than I can give you at the tail end of this call. We are taking advantage of the full breadth of our claims capability. Some of the managed care capabilities we have in our Workers Comp claim department to use nurses to triage medical claims from a BI perspective.

We are using our medical bill re-pricing capability for Workers Comp in the breadth of our networks to run medical bills through from an auto perspective. Those are capabilities that other players wouldn't have without the volume of medical losses that we have running through the entire organization.

Jay Fishman

One of the things, it is no secret but it is not necessarily visible from our financials, we are a very, very large and very successful fee for service Workers Compensation Claims handler for large international accounts. We don't write the guarantee costs, the first dollar insurance you think of, but we handle substantial amounts of claims for large companies being paid a fee for managing those claims on their behalf. There is a significant developed over literally decades of Workers Comp claim handling engine that exists in this organization with real first rate medical plan expertise. Handling medical losses that occur on the job site. That expertise is stretchable. It can be stretched from that Worker's Comp platform over into the auto bodily injury work and if you don't have that Worker's Comp engine behind you then you don't have the ability to do that.

That is a perfect example of where the size of the organization benefits us really at the point of claim. There is a real difference, a competitive difference.

Operator

The next question comes from the line of Ian Gutterman - Adage Capital.

Ian Gutterman
Adage Capital

I want to go back to the M&A topic and rather than dance around it I thought I'd try to ask a little bit more directly. Knowing your ability to comment may be limited but obviously there has been a lot of very public media reports about RBS and who is interested in that property. I guess what is surprising to me and the part I hope you can talk about is I can understand why you don't want to take a look at any big property on the market but when we see all these media reports that everyone else is dropping out and you are one of the final three left it implies you are relatively serious about it.

I guess what is confusing and what I hope you can address is from your past comments about M&A you have said that international is not a priority and I can't recall any time in the past you talking about being interested in getting into direct distribution. So it just seems that I can understand you wanting to look at deals that fit strategically. I guess I don't understand why more international and direct distribution whether it be RBS or some other company fit strategically with Travelers.

Jay Fishman

Ian it is a very thoughtful question. Let me go back I think to 2005 when it was reported on page A1 of the Wall Street Journal that we were in deep talks with Zurich Financial Services and sources close to the talks were reporting that the transaction was imminent. The only thing I can comment is we are not responsible for media reports. We are responsible for what we say and ultimately the reason we came out with our commentary on the Zurich transaction was that it was being viewed by everyone as though we had said something. It was being viewed as fact. In fact it was proving to be not in the interest of our shareholders not to say something. I felt responsible to do so.

I don't feel that sense of responsibility now. I think it is very counterproductive to building shareholder value to comment every time someone suggests that we are looking at something. We are going to look at some things. We're not going to look at others. As I said before I think thoughtful management always stays tuned to what is happening in the market place to try and stay knowledgeable about things. But I think you have to rest back on my earlier comments which is notwithstanding the history of the company and the fact that it was built by acquisition we are in a very different place now. We are in a very, very different strategically competitive place and the only time we would look at something seriously would be if we were absolutely convinced it would add to shareholder value.

So if you are questioning that something wouldn't create shareholder value I think you can make the assumption we have had ourselves the same question. I'd like to just leave it at that. I don't think I have anything more to say about any specific company or rumor.

Operator

The next question comes from the line of Jay Cohen - Merrill Lynch.

Jay Cohen
Merrill Lynch

Jay your stock has been hovering around or even slightly below your book value per share. I guess theoretically what the market is saying is either they don't believe your book value per share which frankly given the reserves that you have seen and given the cleanliness of your asset portfolio doesn't seem to be a big concern or the second issue is your ROE is relatively quickly going down to your cost of equity capital, 9-10%. I guess I wanted to focus on that. What kind of environment would you have to see for your ROE to go from where they are now down to that level and what do you think the chances of that sort of environment are of emerging in the next 2 years?

Jay Fishman

There is actually a slide in Jay Benet's presentation that actually answers that question. If you take a look on page 4 so far for this year we have earned a 9.1% return on equity from our investment portfolio in an environment of short rates. We can circle the short rates on that slide because they are actually half of what they were a year ago. 1.7 short rates versus 3.8 a year ago. We're talking about a 200 basis point drop in short rates in that period of time.

So we had a 9.1% return on equity just from the investment portfolio which means that the answer to the question is 100% combined ratio would have produced a 9.1% return on equity in this quarter and you see the numbers. How far are we away from 100% combined ratio? If rates continue to go down 3-5% we will eventually get there but we are a long way from 100 now.

That is why four is there, to show there is a sustainable level of return on equity in our business just embedded in the left side of the balance sheet and it is pretty powerful. I think that people tend to forget that and so that's why we present it that way.

Operator

The next question comes from the line of Brian Meredith - UBS.

Brian Meredith
UBS

You commented that pricing continues to be pretty competitive here. I was wondering if you could get a bit more granular and say what lines of business right now are you worried about or actively pulling away from versus what lines of business you think are attractive. Then can you provide some comments on what is happening in terms and conditions?

Brian MacLean

Consistent with what we have said in the past and I think what a lot of other folks say from account size perspective maybe most importantly the larger the account the more pressure, not to say there isn't pricing pressure everywhere. But clearly smaller accounts a lot less than larger accounts. You can see that a little bit with the fact that in small commercial we are still seeing total price change a little positive and underneath that total rate change would be slightly negative but very consistent. From a line of business perspective I would say large property stuff is under pressure and something we are looking at although the large loss dynamic I talked about especially being industry wide is beginning to have a lot of folks rethink that. So that might be one that we see some signs of actually the softening mitigating a little bit.

Nothing dramatic other than that within the lines. It is much more of account size.

Jay Fishman

The other thing I was thinking about with some extent to size is if we had to pick one and we are obviously very large but the excess casualty business, the umbrella business, is one that has been subject to not an insignificant amount of price deterioration.

Brian MacLean

Even in that business you use the words pulling away from. We are not pulling away from that market but it is one where more accounts than not we see some pressure there.

Jay Fishman

It really comes back to looking at the retention rates. We are not in effect pulling back from anything in our business. It would show up in the retentions if we were in a serious way. I think the relevant question is in the new business environment what is going on and you can look at the new business numbers and get a pretty good feel for it I think of what it is and how we are reacting to it.

Brian Meredith
UBS

Are trends and conditions loosening at all?

Brian MacLean

Not dramatically. There is always some movement as markets move. On our book I would say not dramatically and I would probably have the same comment. The bigger the account the more pressure.

Jay Fishman

If you think about it though, as we describe it, there is only a few businesses we are in where terms and conditions play. Small commercial is one. You really wouldn't talk about as the question is being asked in terms of conditions. You would think about it actual property. You would think about it in some of those lines; the individually negotiated if you like accounts. The smaller you get the less it becomes a substantive discussion. Is that fair?

Brian MacLean

[Products].

Brian Meredith
UBS

One last question for Joe. On the TD severity that you said was up modestly what would you attribute that to and would you expect the impact of raw material prices rising here may put some pressure on that severity here going forward?

Joseph Lacher

I think it is just generally what is in there already. It is the normal inflation in costs whether it is parts or labor rates or the like. You get some level of model symbol drip that is running through the physical damage severity which is the newer cars tend to have a higher value and there is a different repair cost there. It is that and we would expect that trend would generally continue.

Jay Fishman

From a macroeconomic level there hasn't been any meaningful wage push inflation yet. That doesn't mean there won't be but you can actually look at Bureau of Labor Statistics data and you'll see there really is no significant wage push. That is one of the things we will keep watching as a leading indicator.

Operator

Your last question will come from the line of Josh Smith - TIAA Cref.

Josh Smith
TIAA Cref

On the investment portfolio no one would argue that you don't have one of the cleanest ones out there. I'm just curious how you feel about the turmoil that is surrounding the GSE's and how that may affect your securitized leader at the more senior levels and secondarily with the two mono lines being put on watch for downgrade by Moody's…I noticed that your AAA's have dropped sequentially during the quarter. I imagine that is because of downgrades of the mono lines in your Moody book. If you could talk about how if any deal went to AA how that would impact your credit quality?

Jay Fishman

Josh we gave an analysis last quarter where we took the entire municipal fund portfolio and it is on the web, you can see it, where we actually gave the ratings, underlined the securities x the wrap and there is an analysis there and that hasn't changed any significant way. The portfolio would change from a rating perspective modestly if…

Josh Smith
TIAA Cref

I just noticed 10% went from AAA to AA and I thought it might have been due to mono lines losing the rating.

Bill

Let's go back and take the questions in order if we could. In a way we look at the GSE's not unlike municipals. The mortgage backed securities can be viewed as mortgage backs in which the residual is insured by the GSE. In terms of straight obligations of the GSE's our total for both is a mere $19 million which could be characterized as nothing more than a place holder. We look at them as financial institutions which have always been much more leveraged than the big money center banks and are treated accordingly.

With respect to our mortgage banks we look at them on the strength of the underlying mortgages and try not to attribute too much value to the guarantee of the U.S. government if there is one or the guarantee by the GSE of the pools. The underlying mortgages and underlying mortgage banks are in terms of age and seasoning we think pretty secure so we feel pretty good about them.

Skipping to the municipals I think one has to remember that the principle concern with the mono lines is less with their insuring municipal bonds which had very low full rates to begin with than with their insuring of structured products and with respect to those products when the insurance falls away there is much greater concern. With respect to municipal bonds again I think one has to remember that the rating scales are very different.

AA, maybe even less than AA municipal defaults with the same frequency as an AAA corporate. You have probably read the newspaper of Congressional testimony by municipal treasurers asking or demanding the rating scales be adjusted. We have always felt very secure about the credit of the municipal portfolio even in the absence of insurance and we have never owned a security where we felt we needed the insurance. Our view has been valuable if the County treasurer absconds with some money but in a period of financial stress the insurers are likely to have as much stress as the insurance and that is what we are seeing. So I hope that is responsive.

Jay Fishman

I think that closes us up. Gabby?

Gabriella Nawi

Thank you very much and any further questions see either myself or Mike Connolly in Investor Relations.