S&P Capital IQ

CONTENTS

The Travelers Companies, Inc. NYSE:TRV

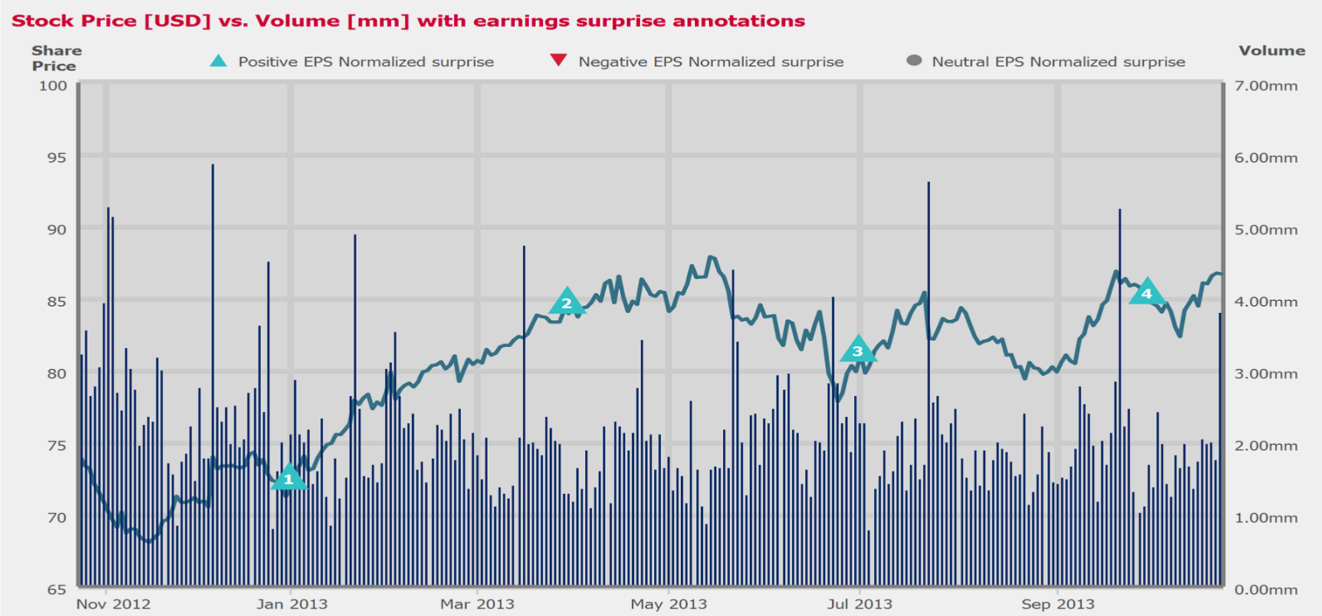
FQ4 2013 Earnings Call Transcripts

Tuesday, January 21, 2014 2:00 PM GMT

S&P Capital IQ Estimates

	-FQ4 2013-			-FQ1 2014-	-FY 2013-		
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	ACTUAL	
EPS Normalized	2.16	2.68	24.07	2.19	8.95	9.46	
Revenue (mm)	5657.21	5851.00	3.43	5625.25	22446.11	22637.00	

Currency: USD
Consensus as of Jan-21-2014 1:47 PM GMT



- EPS NORMALIZED -	CONSENSUS	ACTUAL	SURPRISE
FQ4 2012	0.12	0.72	1 500.00 %
FQ1 2013	2.03	2.31	2 13.79 %
FQ2 2013	1.60	2.13	3 33.12 %
FQ3 2013	2.06	2.35	4 14.08 %

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Call Participants

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Chairman of the Board & CEO

Brian W. MacLean
President and Chief Operating Officer

Gabriella Nawi
Senior Vice President of Investor Relations

Jay S. Fishman
Former Executive Chairman

Jay Steven Benet
Vice Chairman and Chief Financial Officer

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Presentation

Operator

Ladies and gentlemen, good morning. Welcome to the Fourth Quarter Results Teleconference for Travelers. [Operator Instructions] As a reminder, this conference is being recorded, January 21, 2014.

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

Gabriella Nawi
Senior Vice President of Investor Relations

Thank you, Lina. Good morning, and welcome to Travelers' discussion of our fourth quarter and full year 2013 results. Hopefully, all of you have seen our press release, financial supplement and webcast presentation released earlier this morning. All of these materials can be found on our website at www.travelers.com under the Investors section.

Speaking today will be Jay Fishman, Chairman and CEO; Jay Benet, Vice Chairman and Chief Financial Officer; and Brian MacLean, President and Chief Operating Officer. Other members of senior management are also available for the question-and-answer period. They will discuss the financial results of our business and the current market environment. They will refer to the webcast presentation as they go through prepared remarks, and then we will open it for questions.

Before I turn it over to Jay, I'd like to draw your attention to the explanatory note included at the end of the webcast. Our presentation today includes forward-looking statements. The company cautions investors that any forward-looking statement involves risks and uncertainties and is not a guarantee of future performance. Actual results may differ materially from those projected in the forward-looking statements due to a variety of factors. These factors are described in our earnings press release and in our most recent 10-Q and 10-K filed with the SEC. We do not undertake any obligation to update forward-looking statements.

Also, in our remarks or responses to questions, we may mention some non-GAAP financial measures. Reconciliations are included in our recent earnings press release, financial supplement and other materials that are available in the Investors section on our website.

And now, Jay Fishman.

Jay S. Fishman
Former Executive Chairman

Thank you, Gabby. Good morning, everyone, and thank you for joining us today. This morning, we're very pleased to report a terrific fourth quarter to conclude a very impressive 2013. We posted full year operating income of $3.6 billion, coming from dramatic improvements in our underlying underwriting margins over the past 2 years, continued contributions from prior year reserve development, as well as more modest level of catastrophe losses than we've experienced in recent years.

These operating results, combined with our strategy of returning excess capital to shareholders, led to record earnings per diluted share of $9.46 and an operating return on equity of 15.5%. For the fourth quarter, we generated $981 million in operating income, producing operating earnings per share -- per diluted share of $2.68 and an operating return on equity of nearly 17%. I don't think we could be more pleased than we are with these results, particularly given the challenges that our industry has been facing over the last several years including, historically, low interest rates and more volatile weather patterns.

These 1-year results should not be viewed in isolation, but rather as part of the journey we've been on since 2010, when we articulated a clear strategy of thoughtfully and appropriately increasing the profitability for our products, particularly for those that were not meeting profitability thresholds. While improved rate, terms and conditions were our tactics, our strategy was, is and will remain all about

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producing superior returns. The returns of our products had deteriorated over a number of years from declining pricing, and the return deterioration was exacerbated after the financial crisis, when interest rates fell to historic lows.

In addition, it was apparent that weather patterns, at least in recent periods, had become more volatile. With the philosophy of not reaching for yield in our investment portfolio beyond where the risk return balance is appropriate, our strategy was to improve the price and, where appropriate, the terms and conditions of products that we sell so as to improve the returns on an account-by-account or class-by-class basis, with the additional goal of not disrupting our agent's business or the relationship with our insureds. The results since then have been nothing short of remarkable.

As Slide #4 indicates, underlying underwriting gain in 2013 was almost triple the amount it was in 2011 and demonstrates that we have way more than offset the decline in net investment income resulting from lower investment rates. Second, the impact on product returns, which is what drives us, has been impressive. Slide #5 in the webcast shows a summary analysis of our expected economic product returns and demonstrates that the impact on these returns has been consequential. On the slide, we show our analysis of expected economic product returns on a written business for 2 periods, the outlook for Q1 2013 as of that time and the outlook for Q1 2014.

The numbers noted in red indicate the percentage of our aggregate premium from products where the expected economic return on capital allocated to those products is less than 10%. The numbers in black indicate the percentage of our aggregate premiums where expected product returns are in the range of 10% to 20%. And the numbers in blue indicate the percentage of our premiums where expected product returns exceed 20%. The progress, we believe, is quite remarkable. I should note that this analysis does not directly correspond to a GAAP return, and I encourage you to read the important explanatory notes on Slide #6.

The significance of this analysis is that the very granular data we review played an important part of our pricing strategy and tactics and it is a critical element of our senior management analysis and review. We all spent a lot of time with it, and it is one of the most important tools. We have been on an analytical journey for a long time and have worked diligently on developing this analysis, and it allows us to be quite surgical in our marketplace strategy.

The conclusion to be drawn from the summary analysis is that we've made tremendous progress in driving our returns closer to our long-term targets. However, closer to is not good enough. For those who will consider that this analysis suggests we are finished trying to improve returns, that is just categorically wrong. We will continue to take pricing actions on an account-by-account or class-by-class basis for those accounts or classes of business that continue to be in the poorer performing segments of our portfolio. While after 3 years of pricing actions, considerably more of the portfolio has moved from poorer performing to better performing classes, there is still enough business in the poorer performing classes so that successful pricing actions should continue to result in improved returns.

Even for our better performing accounts, we will see great -- equal to or greater than loss trend when appropriate. We remain optimistic that we will be able to continue to execute this strategy successfully. Brian will speak more about rate and will provide some perspective on looking at the data on a segmented basis. And while we can't predict the future, the recent data as well as the most recent anecdotal observations from the field give us confidence that we will be able to continue to execute successfully.

We have also been helped in pursuing higher returns by somewhat increased interest rates, and Jay Benet will speak more to that. While we are not explicitly contemplating further meaningful increases in the near-term, in interest rates, that is, we do believe that interest rates will eventually rise from here and will provide further lift to returns.

We have commented before that we believe that many industry observers are putting inappropriate significance on the absolute number of rate gain, particularly the headline number that is so often quoted. While the number is interesting, it is not nearly as revealing as many believe, as the rate and retention in a much more granular basis holds the real key to success. It's also worth noting again that we are return-

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focused, and as long as our risk profile is appropriate, whether in underwriting risk selection or investment selection, we are agnostic about where product returns come from.

Our goal remains a simple one, top-tier profitability, and if we generate more capital than is necessary to support our business, returning that capital to our shareholders so as to right size our capital base. To that point, since we started buying back our shares in the middle of 2006, we have returned almost $27 billion to shareholders through share repurchases and dividends, an amount which is now approaching the market capitalization of the company when we embarked on our active capital management program. The strategy has worked elegantly by producing superior returns, and we remain committed to it.

With that, let me turn it over to Jay.

Jay Steven Benet
Vice Chairman and Chief Financial Officer

Thanks, Jay. By any measure, our fourth quarter results: record net income per diluted share of $2.70, record operating income per diluted share of $2.68, operating ROE of 16.8% and a GAAP combined ratio of 87.7%, were very strong. As has been the case all year, these strong results were built upon very solid investment and underwriting performance. Within the investment world, the recent rise in interest rates has lessened the headwinds that we and our industry have been facing due to historically low interest rates.

Slide 10 shows how average after-tax yields have increased for the long-term fixed income securities that we actually purchased during each quarter of 2013. For taxable, that increase was approximately 45 basis points from the fourth quarter of last year, while for tax-exempt, the increase was 105 basis points.

As we've done periodically, we've included in the appendix to this webcast the schedule showing our current expectations for maturities and calls of our long-term fixed income investments projected over the next 3 years, along with the expected impact on net investment income if reinvestment rates generally remain where they are today. All things being equal, while we still expect that fixed income, net investment income will decrease in the next 3 years, that decrease will be smaller than what we previously expected.

Turning to underwriting. We continue to earn rate increase in excess of loss trends in each of our business segments. This drove 130 basis point improvement in our underlying combined ratio in BI as compared to the prior-year quarter, although in PI and in FPII, the benefits from earned rate increases exceeding loss cost trends were more than offset by normal quarterly fluctuations in non-cat weather, fire-related losses and what we define as large loss activity.

Pre-tax cat losses were $53 million in the quarter, down dramatically from last year's fourth quarter, which included Storm Sandy, and pre-tax net favorable prior year reserve development remains strong at $259 million. As has been the case throughout the year, each of our business segments contributed to the favorable reserve development, which was driven by BI's general liability product line for accident years 2006 through 2012, FPII's Surety business for accident years 2006 through 2010 and by PI's Homeowners & Other business for both cat losses related to accident year 2012 and liability losses for accident years 2009 through 2012.

As I've done in the past, I'd also like to share with you a preliminary view of what our combined 2013 Schedule P is expected to look like when it is filed on May 1. On a combined product basis, all accident years, other than accident year 2012, developed favorably and the unfavorable development for 2012 is truly de minimis.

Looking at the data on a product line rather than on an accident year basis, our major product lines developed favorably across all accident years, except for relatively small unfavorable development in Auto liability and CMP.

Commercial and Personal Auto liability developed unfavorably by a little over $30 million and $20 million pre-tax, respectively, each having a reserve base of approximately $2 billion, driven mostly by the

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2012 accident year, while CMP developed unfavorably by about $60 million pre-tax on a reserve base of approximately $3 billion, and that was spread out over several recent accident years.

Of note, workers' comp developed favorably by approximately $85 million pre-tax on a reserve base of approximately $14 billion, even after the $42 million pre-tax charge precipitated by legislation in New York related to the New York Fund for reopened cases for workers' comp that we disclosed in the first quarter and some very minor strengthening of about $60 million pre-tax for a few recent accident years.

We continue to generate capital well in excess of what is needed to support our business and, consistent with our strategy, we've continued to return very significant amounts of capital to our shareholders. Operating cash flows were in excess of $900 million this quarter, bringing total operating cash flows to over $3.8 billion for the year. We ended the quarter with holding company liquidity of almost $1.6 billion after returning almost $1.2 billion of excess capital to our shareholders this quarter through dividends of $182 million and common share repurchases of $1 billion.

And for the full year, we returned over $3.1 billion of excess capital to our shareholders through dividends of $734 million and common share repurchases of $2.4 billion. All of our capital ratios remained at or better than their target levels. Our debt-to-total cap ratio of 21.3 was well within its target range during the quarter. Book value per share increased 3%, and adjusted book value per share, which excludes net unrealized investment gains and losses, increased 4%.

For the full year, book value per share increased 4% and adjusted book value per share increased 12%. The difference between unadjusted and adjusted growth rates was driven by the impact that the recent rise in interest rates have on net unrealized investment gains. Those net unrealized investment gains were approximately $1.3 billion after-tax at the end of the year, as compared to $3.1 billion at the beginning of the year.

So with that, Brian is now going to provide some further insight into our operating results.

Brian W. MacLean
President and Chief Operating Officer

Thanks, Jay. I'll begin with Business Insurance, which had a very strong fourth quarter, with operating income of $634 million and a combined ratio of 88.9. The underlying combined ratio, which excludes the impact of cats and prior year development, was 91.5 for the quarter, an improvement of more than 1 point year-over-year, and 92.2 for the full year, an improvement of about 2.5 points over full year 2012. As always, there were a lot of moving pieces in the combined ratios.

In 2013, large losses were slightly higher, expense items were a net positive and mix changes were a net negative. Excluding these items, the pure margin expansion, that is the impact of rate increases in excess of loss trend, was 2.5 points in the quarter and 2.7 points for the full year.

Turning to the top line, we posted record-high net written premium volume for the full year of $12.2 billion. Looking at the production trends underlying the premium volume on Page 13, retention was up slightly from recent periods at 80% while renewal premium change was in line with recent periods at about 8%. The 8% included pure rate increases of about 6%, down about 1 point from the last few quarters. The rate increases continue to be broad-based and were led by Commercial Auto. New business volume in the quarter was $435 million, and for the full year, new business was over $1.8 billion.

Loss trend continued to run at about 4% for this segment, so on a written basis, rate gains continued to be significantly above our current view of loss trend. The aggregate production results were strong, but as Jay emphasized in his opening, our focus has always been on returns. And to understand the impact of rate and retention on returns, you have to examine the detail behind how we got to the aggregate results. We've talked before about how we measure our business returns on a very granular basis. By business, by line, by territory, in smaller accounts, by class and in middle and large accounts down to the individual account level.

Looking at this data for full year 2013 and the fourth quarter, we're very pleased with our execution. Specifically, retention in our better performing business was very strong, with reasonable rate increases.

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But our real opportunity is to get significant improvement on our poorer performing accounts. For example, think of the below 10% ROE section on the chart Jay showed on Page 5. Obviously, we're not going to share with the public the full granular detail at all the levels that we manage the business. But we did want to give some insight into our performance, specifically for those poorer performing business.

Slide 17 shows the renewal rate change over the last 8 quarters for the poorer performing segmentation bands in our middle-market business, about 20% of our total middle-market premium. And middle-market here includes commercial accounts, construction, technology and our public sector business. Intentionally, we didn't give you specific rate numbers, but they're all well into the double digits. So you can see clearly from this slide that over the last 2 years, we've been able to consistently get meaningful rate increases on the portfolio for poorer performing accounts.

Although the rate changes move slightly quarter to quarter, in our view, there doesn't appear to be a clear trend which would signal any real movement in the marketplace. For example, we believe that the fourth quarter 2013 decline in rate and increase in retention is more a function of our execution than a change in the marketplace. And accordingly, we see an opportunity to improve pricing in this book of business in the coming quarters. So the main thing that this data tells us is that, at least through the end of 2013, for the lower returning businesses in our portfolio, our ability to take appropriate pricing and underwriting actions to improve performance in those accounts has not changed significantly in the last 2 years.

Not all the segmentation bands have this level of consistency in rate change. But in each band, pricing gains continued to exceed the expected increase in loss cost and we continue to make progress in the accounts with the greatest opportunity to improve returns. The data underneath this graph, along with the other granular analytics we use to manage the business, gives us confidence that throughout 2013, our underwriters continue to execute well on our strategy, making the right targeted decisions, class by class, account by account.

As we continue to execute on our strategy of improving returns, if we are successful, the aggregate headline rate will come down over time. The key for us, however, is not the headline number, but instead will always be why our rate and retention numbers are changing regardless of direction and whether these changes are consistent with our goal of generating mid-teens return on equity over time.

Turning to our Financial, Professional and International business. Operating income of $171 million for the quarter was up 31% over the prior-year quarter. This increase was driven by a lower level of cat activity in the current quarter, as well as higher levels of favorable prior year reserve development. The underlying GAAP combined ratio of 94.7 deteriorated 3.2 points over the prior-year quarter due to a higher underlying loss ratio, reflecting a higher level of large losses and non-cat weather-related losses for international, as well as the Dominion acquisition, partially offset by earned rate increases that exceeded loss cost trends.

The increase in the underlying loss ratio was partially offset by a lower expense ratio reflecting the inclusion of the Dominion. Net written premiums were up 29% in the fourth quarter of 2013, driven primarily by the inclusion of the Dominion for 2 months. Management liability premium increased as a result of our decision to discontinue the excess of loss reinsurance treaty for this business.

In our Personal Insurance business, operating income was $237 million for the quarter and $838 million for the full year, an almost fourfold increase over full year 2012. A very strong result driven in part by lower catastrophe losses, but also reflective of improvement in our underlying Auto and Homeowner results.

The underlying combined ratio for the quarter was 88.8, up about 2 points over 2012, due to unusually favorable fire and non-cat weather losses in 2012. On a full year basis, the underlying combined ratio of 88.3 improved 2.5 points over 2012 due to pure margin expansion.

Looking specifically at Auto production, retention was strong at 81%, renewal premium change was 7% and new business volume was up versus recent periods, while net written premium was down year-over-year.

The increase in new business volume was primarily the result of the rollout of our new product, Quantum 2.0. By the end of 2013, we had launched the product in 18 states, and while we are still in the early

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days of the rollout, we are pleased with our execution so far. To date, in these states, we are achieving the competitive position that we had modeled, both broadly in the marketplace and specifically in the comparative raters.

In addition, in these states, our agents have embraced the benefits of the new cost structure and product features.

Turning to Auto profitability. The underlying combined ratio was 102.2 for the quarter, an improvement of 3.5 points, and 97.6 for the full year, an improvement of 1.6 points. Earned rate in excess of loss trend contributed about 2 points of improvement for the quarter and about 2.5 points for the full year.

Our current view of Auto loss cost trend is about 4%, mix adjusted frequency continued to be benign, while severity trend remains stable at a slightly elevated level. Specifically, bodily injury severity trend this quarter remained in line with what we've seen over the past few quarters.

Turning to Homeowners. Production was strong in the quarter with renewal premium change of 10%, while retention ticked up to 84% and new business volume was up from the prior-year quarter. From a profitability perspective, our full year Agency Homeowners combined ratio was 77%, both on a reported and underlying basis. This outstanding result reflects the long-term strength of this franchise and the impact of the rate and underwriting actions we have taken in the marketplace over the last 2 years. We feel very good about our Homeowners results and the marketplace position of this business.

With that, let me turn it over to Gabby.

Gabriella Nawi
Senior Vice President of Investor Relations
Lina, we will now like to open up for question-and-answer. [Operator Instructions] Lina?

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Question and Answer

Operator

[Operator Instructions] Your first question comes from the line of Randy Binner with FBR.

Randolph Binner
FBR Capital Markets & Co., Research Division

I have one on investment income. It ran higher in our model even counting the real estate and private equity partnerships, and you've made an illustration of kind of higher investment yield you've been getting. So I guess the question is were there any other one-timers in the net investment income line this quarter, like prepayments, et cetera, or was this a reflection of what the kind of underlying higher rate environment is helping with?

William H. Heyman
Vice Chairman and Chief Investment Officer

It's Bill Heyman. There were no one-timers in the fixed income portfolio.

Randolph Binner
FBR Capital Markets & Co., Research Division

And where are you seeing -- I guess, where is the sweet spot of where you are investing now, I guess from a rating and new money yield perspective?

William H. Heyman
Vice Chairman and Chief Investment Officer

I think probably the municipal market. If you look at the differential spreads between book yields expiring and new money, it's closest in municipal. In fact, for a time in the fourth quarter, we were investing even yield with what was expiring, that's fallen off a bit. Generalizing, in order of attractiveness, municipals, corporates, mortgages.

Randolph Binner
FBR Capital Markets & Co., Research Division

And the quick follow-up there, is that -- was that attractiveness in the muni market a function of people's expectations of a potential Puerto Rican sovereign default, and is that something that's affecting how you look at the market, and do you guys have exposure there?

William H. Heyman
Vice Chairman and Chief Investment Officer

Well, in order, it's not really affecting how we look at the market. As far as our exposure, I could go through it in some detail. I wouldn't say it's material. We haven't purchased a Puerto Rican obligation in 12 years and as a legacy portfolio, most is short-term insured or both. But I think Puerto Rico probably did affect the market as a whole. And frankly, speaking selfishly, anything that cheapens the market is good news for us.

Operator

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

Michael Zaremski
Crédit Suisse AG, Research Division

A question on the capital management outlook for 2014. If I do the quick math on 2013, add up dividends, share repurchase and then I guess M&A funded with cash, it equals about 105% of operating

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earnings. Should we think about that payout ratio level continuing in 2014 or maybe we should expect a slowdown, I see that exposure growth does seem to be picking up a little bit?

Jay Steven Benet
Vice Chairman and Chief Financial Officer

This is Jay Benet. I think in terms of looking forward as it relates to capital management, the absolute level of capital that's needed to fund growth in the business is relatively small. So what we've said in the past is to look at operating earnings as a rough base as to what might be available for capital management activities like share repurchases, subject to what needs to take place with regard to, as we just said, funding the growth of the business, possibly making a contribution to the pension plan.

Although I will say our pension plan at the end of the year was overfunded at this point in time. So that doesn't require, in our view, much in a way of funding next year. But it's always subject to all the things that might take place in terms of how the world will change next year. But operating earnings would be the base to look at.

Michael Zaremski
Crédit Suisse AG, Research Division

Okay, that's helpful. And lastly, a follow-up. So higher levels of non-cat large and non-cat weather losses appear to have materially impacted 2 of the main segments. I know this is tough to do, but can you help us think about the dynamics like, for example, were the losses a couple of points above historical levels or were they just much higher than prior levels which were very benign?

Brian W. MacLean
President and Chief Operating Officer

So Mike, this is Brian. For starters, in PI, which I think had the biggest swing, the real driver there was how low the fourth quarter was in non-cat weather in 2012. And so this year was more consistent with kind of a normal run rate level of a non-cat weather. In BI, it was relatively consistent. And in FPII, Alan?

Alan David Schnitzer
Chairman of the Board & CEO

Mike, it's Alan Schnitzer. In FPII, the small weather and the large losses compared to a very favorable result in the prior year. So that's really driving the difference.

Operator

And our next question comes from the line of Amit Kumar with Macquarie Capital U.S.A.

Amit Kumar
Macquarie Research

My first question relates to the new slide, Slide #5, and again, this is extremely helpful, the Slide 5 and Slide 17. What I was wondering is, using that Slide 5 as a backdrop, could you sort of help us understand what might be the range of earned rates in those different buckets?

Jay Steven Benet
Vice Chairman and Chief Financial Officer

What might be the range of earned rates in those buckets? Yes -- no, I understand. I'm trying to -- I wouldn't know how to answer that actually, because it's aggregated by product, by business.

Gabriella Nawi
Senior Vice President of Investor Relations

This is Gabby. That is -- those are returns on capital, so obviously, it's underlying margin and the investment component on those cash flows.

Amit Kumar

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Macquarie Research

What I was trying to understand is...

Jay Steven Benet
Vice Chairman and Chief Financial Officer

This is Jay Benet. It is weighted by the premium volumes associated with each one of the businesses. So I think it's a proxy. You could probably look at those weightings as, rough justice, approximately what the earned premiums are. But keep in mind, what Jay said earlier, this is an economic product yield going forward, what the returns are going to look like. This is not a GAAP yield. That's why we're having trouble answering your question. So let me, as a proxy, you can kind of divide the earned premium.

Brian W. MacLean
President and Chief Operating Officer

Amit, this is Brian. Let me go back, I think -- go back to my comments in the webcast. And you can kind of translate the ROE slide roughly into the poorer performing businesses, obviously, the bottom of the ROE chart and vice versa. And as I said, for the poorer performing accounts, obviously, we've got some that are still well into the 20s, but think solid double-digit rate increases.

Now I'm talking written, and you mentioned earned. So I'd have to think through how everything's get earned in. And although there, over the last couple of years, there hasn't been a great volatility. In the better performing businesses, as I've said in the comments, we're still getting rate increases on a written basis that exceed our loss cost growth. So you can kind of approximate what that would be, about the 4 percentage, 3 percentage range. But we -- and then there are other things in between.

Jay S. Fishman
Former Executive Chairman

I think this will be our last comment on it, because it's an unusual question. The analysis is our best estimate of the economic capital returns of the products being sold, I'll say, today, but think about it over the next quarter. And so there really isn't much of a rate assumption in terms of change in written rate. It is largely an earned rate embedded in what has already been written and will be earned in the quarter. But it's looking at the returns on a fully discounted basis. And so we're discounting that projected investment income. It is an economic return concept based on allocated capital. But it is, as of today, as of the next 3 months, that's why we say for the quarter.

Amit Kumar
Macquarie Research

No, actually, that color is extremely helpful. But the only other question I have is that of a quick follow-up on the opening comments regarding the modest adverse development in Workers' Compensation. I'm trying to sort of reconcile the $85 million modest development with the growth in that line if I look on -- at page, the level of the supplement, and then the loss cost trends, can be -- can you sort of talk about how do you think about the returns in Workers' Compensation line? And maybe address that development a bit more?

Jay Steven Benet
Vice Chairman and Chief Financial Officer

What -- this is Jay Benet. Let me talk about the development for a second. First of all, I do want to correct one thing. Worker's Comp developed favorably this year. It didn't develop unfavorably. What you heard us talk about before is that we have a very, very granular by-business line approach to calculating and evaluating our reserves.

So when one of our business units -- and these can be very relatively small business units, says they're seeing a trend, and maybe the trend is they have a few losses that went tabular, that were more than what they expect and, therefore, they feel they should be strengthening their reserves in that business line. That will bubble up through the reserves setting process, so I can't stress enough that when we're

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talking about a modest increase, it's against a reserve base or -- I'm sorry, a premium base of $3.5 billion in any given year.

So I think it's more a function of our businesses looking at things that are taking place, not putting news in a drawer, hoping that it goes away, but just reacting to whatever they currently see. It's not an indication that if you have a negative development in 1 quarter, you're going to get more development of a negative type in the next quarter. It is just the normal variations that we see going forward, and the quarterly reserve settling process. And as I've said, overall, Worker's Comp. developed favorably. And we can see the same thing in all of our lines and in same kind of variation.

Brian W. MacLean
President and Chief Operating Officer

So just -- and so I'll give you a couple of comments, this is Brian, on the -- from a business perspective how we're feeling about comp. And first of all, I'd say if you're looking at net written premium, the growth in net written premium is because of pricing, primarily rate. So that's been driving the growth there, not necessarily account growth. I'd also say, we understand comps very well. We understand this -- its challenges and its volatility. For the last 2-plus years, it's gotten the strongest rate increases across our portfolio. And I think we've got real competitive advantages there. So it's a state-by-state industry, class-by-class gain, and there are clearly some states and some classes that still need rate improvement, but in the aggregate, we feel very good about the returns.

Jay S. Fishman
Former Executive Chairman

I am -- Hi, it's jay Fishman. I misspoke on a comment about that Slide 5. Let me just correct it. I -- I'm told I said it's earned rate. It's not. That's a written rate analysis. It's the price, the rate at which the product is being written today. And so, again, just to correct the record on that.

Operator

And our next question comes from the line of Michael Nannizzi from Goldman Sachs.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

So I do have a question on Dominion. I don't know if it could be possible to know kind of what the underlying was for Dominion in the fourth quarter, I mean what FP&II would've looked like x that. And if you could just talk about the rate -- the actions that you're taking in that book, and whether there are any constraints from a regulatory or other perspective that could impact your ability or will -- that will allow you to push for rates that you need to improve that business?

Alan David Schnitzer
Chairman of the Board & CEO

Sure. It's Alan Schnitzer. Let me try to take that. In the quarter, actually, the Dominion was all in neutral. It was adverse to the loss ratio, but favorable to the expense ratio, so that sort of netted out. But that was really the result of a couple of, I'll say, unusual things related to the transaction and just as an example, purchase accounting. So I think the way to think about that going forward is, for next year we expect the Dominion to have about a 2-point adverse impact on the overall FP&II combined ratio.

Now I'll also say that we expect that to be offset by some other things going on in the segment, so the way to think about the segment for next year is for 2013, we had an underlying combined of about 92, and we're expecting that to be broadly consistent in 2014, so just to put the Dominion in perspective. Certainly, there are -- we're harder at work on that business and trying to bring all the Travelers sophistication and know-how, and working with our FP&II and BI colleagues here in our U.S. based business to try to bring all the Travelers benefits to that business.

When you talk about regulatory constraints, you're probably referring to Ontario Auto. That's a fluid situation and, obviously, the regulators in Ontario were looking for some significant rate cuts. But we're

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also hopeful that, that will be combined with some commensurate reductions in loss cost. So it remains to be seen what the impact would be on the overall margins. But we are quite confident that even though we'll have that 2-point impact in 2014, that all the work that we will bring to that book over time will improve that result, and clearly, we'll evaluate that transaction as it impacts our ROEs for our international business over time, and we remain as optimistic about that today, as we did when we announced the transaction.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Great. Thanks. And then, I guess, on that front, I mean, did you expect -- anything we can glean from what you expect for on a top line perspective, in terms of how much of the book you expect to keep versus part of the business that may go as a result of the rate gain or the rate action that you take?

Alan David Schnitzer
Chairman of the Board & CEO

It's right. I understand the question. I think given the size of the transaction and its significance to the segment in the overall business, we're not going to -- we're going to stay away from that level of detail. But I'll try to give you the combined ratio impacts to help you with the modeling as you think about it for next year, but I think, what we're trying to stay away from that level of detail on that side of business.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Great. And then just 1 if I could on the -- on BI. I know that non-cat weather has created some noise in terms of the evaluating the year-over-years over the last couple of quarters. How should we think about the starting point for margins next year when we're comparing to this year, either fourth quarter or for the full year, as we think about the rate actions on a written basis earnings through?

Alan David Schnitzer
Chairman of the Board & CEO

So first of all, I'd -- you meant Business Insurance there, right?

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Business -- I'm sorry, Business Insurance.

Alan David Schnitzer
Chairman of the Board & CEO

Yes. I think, well, because in Business Insurance, there really wasn't much of an impact of non-cat weather. Last couple of years were very comfortable. It wasn't exactly the same number, but around it. There wasn't -- when you look at the full year 2013 in Business Insurance, there was a little bit of movement in large losses and mix change. But nothing really material. So that's probably a pretty decent benchmark of run rate, combined ratio or loss ratio. And then you can see our written rate numbers and how they're going to earn in overtime. So I think you can -- as we said, loss trends holding at about 4%. So I think you can kind of do that arithmetic. There isn't a lot of unusual stuff that's really distorting that number this quarter.

Operator

And our next question comes from the line of Vinay Misquith with Evercore.

Vinay Gerard Misquith
Evercore ISI, Research Division

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So the first question was just a clarification on the Dominion acquisition. I believe it was mentioned that the acquisition would have a 2-point negative impact on '14 combined ratio. But I still thought that you said that the combined ratio will be flat '14 versus '13?

Brian W. MacLean
President and Chief Operating Officer

Yes. That's right. And that's because while the Dominion transaction on itself has about a 2-point adverse impact, there will be other things that we expect to offset that. For example, a change in the reinsurance program in our management liability business, and as earned rate continues -- as written rate from that prior year and this year continues to earn in at a higher level than loss cost, so that margin improvement, together with the reinsurance program, on a segment basis we're talking about, should be about -- on an underlying basis x cats and PYD.

Vinay Gerard Misquith
Evercore ISI, Research Division

Sure. That's helpful. Okay. And then just looking at the Business Insurance segment. I'm looking at it for this quarter -- that's the fourth quarter. I'm looking at it on an accident year loss ratio x cats. It seems that, that number was relatively flat at about 61.2% this quarter versus the year ago quarter. Just curious, given the rate increases, I would have expected a 3-point improvement year-over-year.

Brian W. MacLean
President and Chief Operating Officer

Yes. So in the quarter, there were some moving pieces, and there's always a little bit of weather and a little bit of large losses and a little bit of mix and are you talking this loss ratio, so expenses aren't impacting it. We saw about a 2.5 point, when we net through all of that stuff, the -- what we think of is kind of pure margin, the rate, x earned rate, x net to the loss cost trend was about 2.5 points in the quarter, down a little bit, it was about 2.7 points in the full year.

Jay Steven Benet
Vice Chairman and Chief Financial Officer

Yes. One of the other things that's always going to impact the year-over-year, quarter-over-quarter look at the loss ratios, in particular would be mix changes in the business, which -- what products are of higher percentage 1 year versus the next, how much loss sensitive business there is relative to guaranteed cost, so I mean that's also impacting some of the quarterly variations that you're seeing.

Vinay Gerard Misquith
Evercore ISI, Research Division

Okay. That's helpful. And just one last question on pricing. I just wanted to get a clarification that you mentioned that the slowdown in rate is not because of market conditions, but more the actions that Travelers is taking and more of your businesses adequately priced. I just want to get a clarification on that?

Brian W. MacLean
President and Chief Operating Officer

So several comments there. I mean, clearly, in the poor performing business, we feel very good that our ability to get price improvements, terms and conditions, whatever we need to approve the account is pretty consistent with where it has been in the last couple of years. So there, we don't see a lot of -- a lot of market movement.

Jay S. Fishman
Former Executive Chairman

And this Jay. To the point that Brian made in his comments, what you'll see in the fourth quarter on that graph is a slight deterioration in rate and an increase in retention in those poor performing classes. So the comments about our own actions is that we would look back on that and say we didn't execute to

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allow retention to go up and rate to go a tiny bit down, a little bit down, in the poor performing classes. Not perfect, not perfect. It would have been better if we had achieved flat retention and rate have moved differently there. So Brian's comment was more specific to the management of those poor performing classes.

The question that I always ask when we're talking about marketplace competitiveness is, do our field underwriters think that if an account in a particular class came up for renewal today versus 1 year ago or 2 years ago, would the opportunity for rate improvement be viewed differently by a field underwriter today than it would have then? And I've asked the question many times in a lot of ways, and the answer that I get routinely is, in the poorer performing classes, no, no difference at all.

In the best performing classes, perhaps a little more difficult. Perhaps a little more difficult is quite literally the words that we hear. As we looked at the numbers, our rate gains, even in the best-performing classes, more than offset loss costs. And so that continues to be pretty good. The point about the headline number is that as business moves from poor performing classes to the better performing classes, by definition, the headline number is going to go down.

And it would be, I think, inappropriate to make a direct conclusion that, that number going down, therefore means that rate opportunity has peaked. What you're seeing much more is a change of mix within the classes than the ability to get a rate improvement in a particular class. And lastly, Brian mentioned that the poor-performing classes, that graph that's in the materials still represents about 20% of our...

Brian W. MacLean
President and Chief Operating Officer

Middle-market.

Jay S. Fishman
Former Executive Chairman

Middle-market business. So there's not -- it still represents a meaningful portion on which to improve rate. Now, I wish the answer for rate peaking or not peaking was a lot easier to say than that. It's just not. It's a complicated business with a lot of moving parts, different business, different lines, and after 3 years, different levels of profitability. But that's the most fulsome response I think that we can provide.

Operator

And our next question comes from the line of Greg Locraft with Morgan Stanley.

Gabriella Nawi
Senior Vice President of Investor Relations

Next question then.

Operator

And our next question comes from the line of Josh Stirling with Sanford Bernstein.

Josh Stirling
Sanford C. Bernstein & Co., LLC., Research Division

And 2 good new slides this quarter, and I guess just trying to synthesize them. The point you're keen to -- seem to be making is that the mix of accounts sort of how much you need is, you're taking, is stable, but as accounts naturally improve, they're sort of fewer, fewer on which you need to take weight. I guess if we could, just to belabor the point then -- just to set expectations for headline run rates, though.

Should we as investors expect them to continue this sort of this slow downward trajectory into 2014 or -- 2013 was reasonably stable for most of the year after you guys sort of set a trajectory at the end of 2012. And I'm wondering, if you think it's going to look more like last year, or if the recent trend for the next -- for the past quarter or 2 is likely to persist, of pricing slowing as we work our way through the year?

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Jay S. Fishman
Former Executive Chairman

I think it's very difficult for us to project in the short term, because it's a function of which accounts in particular come up for renewal in a given quarter. So it's difficult to compare a third quarter to a fourth quarter or a fourth quarter to a first. They're not the same accounts. It's a different batch. So in the short-term, I'd -- we would struggle to answer that. We just don't have the insight that I think you all think that we do.

In the longer-term, if we continue to be successful, I would say with certainty the headline number will continue to go down. As accounts move into our best-performing business, our goal changes to the highest retention possible consistent with maintaining margin. That's very, very different than the philosophy in the poor performing accounts where lower retention, if we're unable to achieve meaningful rate gains, is just fine. Our goal is always to improve product returns. And once accounts get into a range that are consistent with the highest levels of profitability in our industry, we begin to move much more to retention.

And so if we're successful, my expectation is that our retention will slowly tick up over time, again, I'm not speaking about quarter-to-quarter because the mix will change, and that the headline rate number will continue to come down over time. If it doesn't, there's really something that we're executing that's not quite right. Now, again, quarter-to-quarter because the accounts themselves are different, not nearly as predictable, but as an overall trend, that's really is -- that's the way that we look to the business.

Josh Stirling
Sanford C. Bernstein & Co., LLC., Research Division

Great. So, if I ask if one kind of final question, growth. You guys are starting to get some results from Quantum, separately, it looks like in a commercial lines business, you might be seeing significant growth in the targeted risk section a bit. I'm interested in your thoughts of both in sort of success of Quantum and maybe more qualitatively what agents are really -- sort of what sort of feedback you're really getting from agents, as well as if there's anything that we should be inferring from sort of rising growth in a couple of your smaller Business Insurance lines?

Jay S. Fishman
Former Executive Chairman

It's Jay Fishman. I'll start with Quantum, and I'll ask Gregory Toczydlowski to chime in and provide perspective, and then I think we'll look to Brian for comments and Bill come in as well on Business Insurance. Our goal in Quantum, remember we shared with you that we had back tested it and had a view of how the product would be positioned in the comparative rating engines, our goal was to achieve a meaningful improvement in its positioning in those comparative raters. That doesn't mean a reduction in profitability because of cutting price, you got to absolutely remember that Quantum's premise is a lower cost, lower commissioned product and, therefore, could support the same returns at a lower price. That's the entire philosophy of it.

As of year-end, we were in 18 states. The -- we do know, were it's positioned in the comparative rater. We get the data. And its positioning so far is consistent with our back testing modeling. It is doing, from a comparative rating positioning, just what we had hoped it would. Now, no idea what competitor reaction will be perspectively, or what will happen. Our goal initially was to do the analysis thoughtfully and see that we have the product positioned in the comparative rating engine correctly, and the price was what we had contemplated it would be. In that regard, so far, so good.

It, obviously, you don't get -- we have an analysis, an assumption of loss content. We will find out as losses begin to develop, how good that is. We don't have a point of view, or view on that yet other than the analytics that we did when we developed Quantum 2.0. So we're not yet declaring victory that the underwriting margins coming from it will be consistent with what we modeled. We're hopeful. We will know more of that relatively soon, I suspect over the next, I don't know Greg, a couple few quarters we'll begin to have a view on the loss content. In terms of agent react -- why don't you, one of you go through the agent reaction, anything else you want about that.

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Jay Steven Benet
Vice Chairman and Chief Financial Officer

Yes. I think just as you said, the agent reaction has been very positive. We're 3 months in to the big wave that went out in October and we're actually not surprised on that. We have a lot of co-development with the agents that were right here in Hartford in helping us to design the structure, the features of it, and so we got a lot of feedback from them in helping build the product. And the 2-key metrics we're watching right now are we seeing an increase in flow, the amount of at bats or quotes and we are seeing that.

And then the actual success of our competitive position of those quotes that we're seeing a meaningful uptick there. So when we put both of those together, we're very encouraged and as Jay said, the loss experience will be the third leg of the stool, that we're not waiting for a full loss ratio to develop. We're spending a lot of time looking at surrogates or leading indicators, including the profile of the business. And again, we're encouraged on that. So across-the-board, we're going to continue rolling it out with the same level of discipline and we are very enthusiastic as we do that.

Brian W. MacLean
President and Chief Operating Officer

On the BI front, as Jay mentioned as, were about returns and as returns improve, we're going to be more interested in retaining more business and we feel good that we had record net written premium in BI. It is clearly being driven primarily by pricing actions. Independent of price, there are a lot of things that we're doing to leverage competitive advantages and various strategic initiatives to grow and we've got a lot of that. The thing that we won't be doing is trying to grow through playing a price game. So we're not going to run a sale in the hopes of increasing our market share at the expense of returns, so.

Jay S. Fishman
Former Executive Chairman

I think that's important. The questions that we get on many of these calls seem to center on the impact of pricing and growth. We do have a series of initiatives in our Business Insurance segment that are designed to produce growth, including in 1 case, more salespeople. And hopefully, it actually turns around and has an impact, but we will find out. Because we have a disciplined view of price, doesn't mean that we refuse to think of, or abdicate responsibility for finding growth opportunities that are there by product, by people, by expertise, by underwriting skill, and we remain committed to that. As a business that generates 20-odd-plus billion dollars of premium a year, it's a challenge to generate numbers that are consequential in the total. But it doesn't mean that are -- we don't have serious effort and work to try to find those opportunities. We do.

Operator

The next question comes from the line of Jay Cohen with Bank of America Merrill Lynch.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

On the explanatory notes, on the expected economic return table, you talked about $2.5 billion of statutory surplus that was not allocated in this analysis. Should we think of that as excess surplus? Or if not, why wasn't it allocated?

Jay Steven Benet
Vice Chairman and Chief Financial Officer

Jay, this is Jay Benet. First of all, there is some fluidity in what the statutory surplus balance is going to look like each quarter, because we have earnings and those earnings will get dividended up to the holding company. So that's part of it. But we also have, as you know, asbestos and environmental reserves and some other runoff businesses, so there's capital that supports that as well. So what we've done in this model is we've allocated all the capital that supports what we've referred to as The Business, to those -- to the products associated with the business. So we think it's a -- in that regard, a full allocation of the capital that we have for the businesses.

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Jay S. Fishman
Former Executive Chairman

And the majority that is not allocated is attributable to what we also would call these runoff businesses, meaning specifically asbestos, environmental and such.

Operator

And we have a question coming from the line of Brian Meredith with UBS.

Brian Robert Meredith
UBS Investment Bank, Research Division

A couple of quick ones here. First, can we chat a little bit about the Homeowners Insurance business? It looks like your underlying combined are in pretty good shape there. And I guess my question is, what point do you think you're going into pull back on some of the rate that you're getting in Homeowners, and maybe, to potentially look to grow that line of business? And could that help at all with some of the Auto insurance growth?

Brian W. MacLean
President and Chief Operating Officer

So, Brian, this is Brian MacLean. The -- clearly, the Homeowners combined on a -- on any basis you look at it, we feel very good. There's obviously been a huge story of weather volatility that we're still -- so there's still a decent number of places around the country that we are still taking some underwriting actions and looking at managing that. Broadly speaking, you can look at our rate filings and see that our rate there is tempering a bit.

But in the aggregate, still haven't a need. We do expect that we will get some lift through the Quantum product. We are very much an account-focused personal lines company. So we sell more combined Auto and Home than any of the other major competitors. And so we should be getting a lift as our Auto product moves out into the marketplace and get some of the traction that we were talking about before.

Jay S. Fishman
Former Executive Chairman

And I'd love Greg [ph] to comment on -- I'd just make an observation, we take it for granted. Our pricing, terms and conditions profile in Homeowners is not anecdotally driven. Right? It's not as if it's instinctive. We're basing it on the data and the information that we have.

Unknown Executive

Yes. And as Brian said, that really does have a local story underneath that. When you're following the perils across that product line. So as Brian said, based on some of the weather trends and the perils, we've got various strategies across the country right now.

Brian Robert Meredith
UBS Investment Bank, Research Division

Great. And then my second question just quickly here, on Business Insurance and FP&II, are you seeing any loosening at all in terms on [ph] conditions and from a competitive landscape out there, anything that we should be concerned about as investors?

Brian W. MacLean
President and Chief Operating Officer

Yes. In the aggregate, no. And that's something we're put [indiscernible] encouraged with, so we feel good about that.

Gabriella Nawi
Senior Vice President of Investor Relations

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And this will be our last question for today.

Operator

Our last question comes from the line of Jay Gelb with Barclays.

Jay H. Gelb
Barclays PLC, Research Division

I have 2 questions. The first is, so far in the first quarter, there's been some pretty severe freezing temperatures. I'm just wondering if that could lead to elevated non-cat weather from things like burst pipes in the first quarter.

Brian W. MacLean
President and Chief Operating Officer

I think, Jay, the honest answer is it's too soon to tell. But no question, when you get the severe temperature changes that you get, we get claim activity from that and we've seen some of that. We can't really assess the magnitude of it and forecast here in Northeast is another round in the next couple of days. So we will watch it. But -- and it's actually maybe less about the Northeast and more about when you get those severe temperatures in mid-Atlantic and down south, where you really start having some challenges. But there will be claim activity coming. There is claim activity coming out of it, but we don't -- we haven't scoped it.

Jay H. Gelb
Barclays PLC, Research Division

And the second one, on a broader issue, as the economy recovers, we're seeing the benefit of increased exposure growth, but I think there's also the looming issue of potential increase loss cost inflation, both on frequency and severity. So when you talk about is -- 4% for baseline loss cost inflation and Business Insurance, to what extent could we see that move up as the economy recovers?

Brian W. MacLean
President and Chief Operating Officer

So I think, again, this is Brian, Jay. Things we worry about all the time, we are seeing a little bit of exposure movement from a positive kind of GL and comp driven, which are good things. Nothing dramatic. But there's a little bit of movement there.

Jay S. Fishman
Former Executive Chairman

Good news.

Brian W. MacLean
President and Chief Operating Officer

It's quite positive news, right. And on the -- so supporting your comment about signs of some economic growth, we -- all I can tell you is we obsess over looking at every metric we can about what's going on in loss trend, and we continue to be encouraged that we're not seeing anything out of pattern, that probably the biggest thing that we look at that we've been talking about for years now is the Auto BI trend, bodily injury trends, and -- across all of our businesses. And that continues to run at elevated level, but it hasn't been getting worse in the last several quarters, so -- but we look at it closely.

Jay S. Fishman
Former Executive Chairman

And I think that it’s -- we still far fear to say, broadly speaking, I'm not speaking about the insurance industry now or us [ph], but broadly speaking, there remains not yet a meaningful change. In fact, but argue there isn't any change in actual inflation, at least by the traditional measures by which it's reported.

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We pay a lot of attention. We read everything we can. But it’s very much kind of an outlook question, and who the heck knows. I think it's the answer there.

Jay H. Gelb
Barclays PLC, Research Division

As long as overall economic inflation remains benign, should that be a pretty decent indicator on loss cost inflation if you boil it down?

Jay S. Fishman
Former Executive Chairman

I think we have -- I think the property-casualty industry has some specific areas where we have a little bit of, what I'd call, inflation concentration dynamics. So wage inflation as it relates to Workers' Comp, medical inflation as it relates to Workers' Comp. Tort inflation as it relates to general liability.

Building products as it relates to Homeowners and to some extent, Select. Like, we're not about food, we're not about energy, really, there are some pockets that are more relevant to our loss cost trends than the basket kind of dynamics that you'd pick up from traditional economics. So we rely pretty heavily on our own look, our own ability to look at the data, the actual data, the emerging data on those areas that affect us, and look, you can speculate on a lot of things.

You can speculate that perhaps medical inflation will actually continue to decline. I don't know, you could also speculate that it will go up. There certainly more than enough economists who share an equal number of views on that. The tort environment takes a long time to change. Things don't change so quickly in that regard.

So while it's always on our minds, because it's important for us, it's not something that, that's going -- I don't -- we don't think -- I don't think personally, in my point of view, that it will be something that will occur quickly, or be a great surprise when it occurs. It will begin to evidence itself slowly, and I hope that we'll see it and be able to react from a pricing standpoint with respect to it. Now I could always be wrong, it might not be the right assessment, but that's how we think about it.

Gabriella Nawi
Senior Vice President of Investor Relations

Thank you all for joining us today. As usual, myself and Andrew Hersom, and the Investor Relations department will be available for any follow-up questions. Thank you, and have a great day.

Operator
Thank you, ladies and gentlemen, that does conclude today's conference call. We thank you for your participation and ask that you to please disconnect your lines. Have a great day.

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