THE TRAVELERS COMPANIES, INC.
“Second Quarter 2014 Earnings Results”

July 22, 2014, 09:00 AM ET
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Chairman & Chief Executive Officer

Jay Benet
Vice Chairman & Chief Financial Officer

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OPERATOR: Good morning ladies and gentlemen, welcome to the Second Quarter Results Teleconference for Travelers. We ask that you hold all questions until the completion of formal remarks, at which time you will be given instructions for the question-and-answer session. As a reminder, this conference is being recorded on July 22nd, 2014.

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

GABRIELLA NAWI: Thank you. Good morning and welcome to Travelers' Discussion of our Second Quarter 2014 Results. Hopefully, you have seen our Press Release, Financial Supplement, and Webcast Presentation released earlier this morning. All of these materials can be found on our Website at www.travelers.com, under the Investor Section. Speaking today will be Jay Fishman, Chairman and CEO; Jay Benet, Vice Chairman and Chief Financial Officer; and Brian MacLean, President and Chief Operating Officer. They will discuss the financial results of our business and the current market environment. They will refer to the Webcast Presentation as they go through prepared remarks and then we will take questions.

Other members of Senior Management are also available for the question-and-answer period including Alan Schnitzer, Vice Chairman and Chief Executive Officer Business and International Insurance; and Doreen Spadorcia, Vice Chairman and Chief Executive Officer of Personal Insurance and Bond & financial Products. Before I turn it over to Jay, I would like to draw your attention to the explanatory note included at the end of the Webcast.

Our presentation today includes forward-looking statements. The Company cautions investors that any forward-looking statement involves risks and uncertainties and is not a guarantee of future performance. Actual results may differ materially from those projected in the forward-looking statements due to a variety of factors. These factors are described in our Earnings Press Release and in our most recent 10-Q and 10-K filed with the SEC. We do not undertake any obligation to update forward-looking statements. Also, in our remarks or responses to questions, we may mention some non-GAAP financial measures; reconciliations are included in our recent Earnings Press Release, Financial Supplement, and other materials available in the Investor Section on our Website.

Now, Jay Fishman.

JAY FISHMAN: Thank you, Gabby. Good morning everyone and thank you for joining us today. We're quite pleased with the strong results we posted this quarter, particularly given the magnitude of our catastrophe and non-catastrophe weather losses. Operating income was $673 million or $1.93 per share. Operating return on equity was 11.4% and we continue to make great progress in lifting our returns, largely in response to continuing variable interest rates and continuing volatile weather. Who would've thought that we'd be talking about a polar vortex in July and a 2.5% 10-year Treasury in 2014?

As demonstrated on Slide 4 of the Webcast comparing this quarter's earnings to last year, is more than accounted for by the tax and legal settlement gains of $122 million, recognized in last year's second quarter, as well as the difference in catastrophe losses, quarter-to-quarter.

The short story for each of our business segments is good. In Personal Insurance, we are really pleased with the marketplace response and production trends from the new Personal Auto Program, Quantum 2.0. While we need more time and data, the very early on loss indications are encouraging and consistent with our expectations.

Our Financial, Professional, and International Insurance segment produced record results with good results from both the Bond and Financial Products business, and the International business. In Business Insurance, we continue to generate strong returns as underlying underwriting margins on an earned basis continued to expand and written rate gains in the quarter approximated loss trend. Because there was so much interest in our assessment of the rate environment in Business Insurance, we're going to spend a few minutes on that this morning before I turn it over to Jay.

At our recent Investor Day, we were struck by the fact that one analyst asked a question about rate which started off by saying, that he knew we didn't like talking about aggregate rate indicators. That's just not so, but the critical caveats in discussing the headline rate are that first, we do not manage rate in the aggregate. We manage it account-by-account or class-by-class and the actions that we take ultimately add up to a single number. This granularity is evidenced on Slide 15 of the Webcast, which we've shared with you before. The Slide is the distribution by rate gain of our Commercial Accounts business for the second quarter of 2014, and Brian will talk more about this analysis later.

Second, we believe that there can be an incorrect assessment of the competitive environment, based upon the direction of the headline number. Let me say again what I've said many times before, we are a return-driven organization. We have talked with you before and have shared with you data which demonstrates that the success we are having in improving returns, is based upon achieving rate gains on our poor performing business, and maximizing retention on our best performing business. We've also said before, if we are successful, the headline rate gain will inevitably decline over time.

There is a conventional reaction amongst many industry observers that this decline reflects, as many would put it, a more competitive environment. We just don't see it that way given our ability to continue to achieve strong levels of retention at increasing returns, approaching our targets. If we have an account where we've been successful at increasing returns over time and that account has now reached an appropriate level of profitability, it would be unwise of us to attempt to continue to increase rates significantly on that account and risk the relationship with the agent and customer.

Consequently, we just caution everyone from reacting to the decline in the headline number as an indication that the environment generally has become meaningfully and broadly more competitive. At least for us, the environment has become more rate adequate and we are executing account-by-account, class-by-class, accordingly. So now, after three plus years of actions resulting in improved returns and profitability, the question is where from here? We've been reluctant to use the phrase "soft landing" because we believe that the phrase is often mischaracterized to mean that somehow we have finished attempting to improve the performance of our portfolio.

Nothing can be further from the truth. We remain concerned that the weather volatility remains problematic and we are not convinced that each of our catastrophe exposed property accounts is priced to reflect that volatility. In addition, not every line or every class of business is performing at the same level. For example, we are not satisfied with the returns on our Commercial Auto Book, particularly in Select, and we will continue to analyze that portfolio and take the actions necessary to improve it. So, we have more work to do, but there are lots of accounts that after years of successful rate and underwriting actions are now at return levels that are consistent with our return threshold, and our expression of a "soft landing" relates to that portion of the Book where we have achieved so much.

We don't see anything in the marketplace that suggests that we are at a precipice or that the increased churning of accounts or significant across the board rate declines are imminent. Of course, we could be wrong about this, we know we operate in a fragmented marketplace with lots of competition, but we can only share with you our strategy. From our view, it's more of the same and as we shared with you at Investor Day, we're going to relentlessly leverage competitive advantages that should allow us to out-select and out-price our competition. We expect to produce earnings and capital substantially in excess of what we need to support our business and we will continue to return that excess capital to shareholders.

In short, nothing new and no shift. We feel very well positioned to continue our mission of creating superior shareholder value. With that, let me turn it over to Jay.

JAY BENET: Thanks, Jay. Let me start by saying that we were very pleased with our results this quarter, particularly taking weather into account. Our investment results continue to be very solid, driven by private equity returns as were our underlying underwriting results.

Within underwriting, earned rate increases continue to exceed loss cost trends in each of our business segments, although the benefit to earnings into our loss ratio was partially offset by higher non-Cat weather related losses this quarter versus the prior year quarter. Underwriting also benefited from net favorable prior year reserve development of $183 million pre-tax, down slightly from the prior year quarter, and was negatively impacted by cat losses of 436 million pre-tax, up 96 million from the prior year quarter.

We provided two analyses in the Webcast this quarter to help you better understand the relationship of operating income to both the prior year quarter and to analyst estimates. Jay already discussed the first analysis shown on Page 4 of the Webcast, which provides insight as to why operating income decreased from the prior year quarter. The second analysis, shown on Page 5 of the Webcast, provides insight as to why operating income was less than the consensus estimate. The Cat Loss estimates contained within the consensus estimate was significantly lower than our actual Cat Losses. We hope this type of analysis is helpful to you.

Each of our business segments, once again, experienced net favorable prior year reserve development. In BI, net favorable development of $25 million was driven by better than expected loss experience in general liability excess coverages for accident years 2008 through 2012, resulting from a more favorable legal and judicial environment than we had expected. This was partially offset by an $87 million increase to our environmental reserves. Net favorable reserve development of 146 million in FP&II, primarily resulted from better than expected results in Contract Surety within Bond and Financial Products. While in PI, net favorable development of $12 million was primarily driven by better than expected loss experienced in Home Owners and other for non-Cat weather related losses in the 2013 accident year.

Year-to-date, on a combined stat basis for all of our US subs: Only accident year 2004 and prior, developed unfavorably by a very modest amount, $73 million due to the strengthening of environmental reserves. All other accident years, 2005 through 2013, developed favorably. We've included an overview of our Cat Reinsurance Coverage on Page 22 of the Webcast which has been structured in a way that is generally consistent with the prior year. Effective July 1, we renewed our Gen Cat treaty keeping both the attachment point and the dollar amount of Recovered Losses the same as last year, Recovered Losses of up to $400 million within the $1.5 billion to $2.25 billion layer.

Also, effective July 1, we renewed our Northeast Gen Cat Treaty with the same $2.25 billion attachment point as last year, but with an increased dollar amount of Recovered Losses, up to $850 million this year, as compared to $600 million last year. Given the current Reinsurance marketplace, both renewals were accomplished at lower rates on line and with improved terms and conditions including amending the loss occurrence definition so that all wind losses have a duration of 168 hours rather than 96 hours.

For a more complete description of our Cat Reinsurance Coverage including a description of our two Long Point Re III Cat Bonds, our Gen Cat Aggregate Excess-of-Loss Treaty that covers an accumulation of certain property losses arising from multiple occurrences, our Earthquake coverage and our International Coverage, is included in our second quarter 10-Q which we filed earlier today, as well as in our 10-K.

We continue to generate much more capital than is needed to support our businesses, allowing us to return $1.065 billion of excess capital to our shareholders this quarter. We paid dividends of 190 million and repurchased $875 million of our common shares under our publicly announced share repurchase program consistent with our on-going capital management strategy.

Operating cash flow remains strong at a little over $600 million and we ended the quarter with over $1.8 billion of holding company liquidity.

All of our capital ratios exceeded our target levels and we ended the quarter with a debt-to-total capital ratio of 21.3%, well within our target range. Net unrealized investment gains rose to approximately 3.1 billion pre-tax or 2 billion after-tax, up from 2 billion and $1.3 billion, respectively, at the beginning of the year due to lower interest rates. Book-value per share per share of $75.32 was 13% higher than a year-ago and over 7% higher than at the beginning of the year.

One final note, as you know, we're revising our business segments and related disclosures to reflect the Management changes that were announced on June 10th, and that became effective on July 1. Accordingly, we will report third quarter results using the new segment structure. We are currently in the process of restating our 2013 Form 10-K, our Second Quarter 2014 Form 10-Q, and our Financial Supplements for the period contained therein, to reflect the new segment structure and we expect to make these restated documents available to you in early September.

So, with that, let me turn things over to Brian.

BRIAN MACLEAN: Thanks Jay. In Business Insurance, second quarter operating income was 409 million and the combined ratio was 99%. The underlying combined ratio which excludes the impact of Cats and prior year reserve development was 92.1% for the quarter, an improvement of a full percentage point year-over-year and 90.1% for the first half of 2014, an improvement of 2.5 points over the first half of 2013. The point of improvement in the quarter was driven by about two points of earned rate in excess-of-loss trend, partially offset by about a point of non-Cat weather losses. So, despite the significant impact of weather; solid profitability in the quarter.

Turning to production trends, beginning on Page 11: Retention of 81% was strong and slightly higher than recent periods. New business volume of 486 million was 8% higher quarter-over-quarter, while renewal premium change is down somewhat from recent periods at about 6%. The 6% included pure rate increases of about 4% which was about a point lower than last quarter. As has been the case for the last 13 quarters, all major lines of business had positive rate change with the largest change this quarter coming in Commercial Auto. Not surprisingly, Auto was the line of business with the lowest return and accordingly, the greatest rate need.

Loss trend for the segment continued to run at about 4%, so on an aggregate written basis, rate gains approximated our current view of loss trend. We believe the production results, both in the aggregate and by line of business are appropriate given our view of product returns, but as Jay mentioned in his comments, we don't manage the business at an aggregate or total line level. We execute account-by-account or class-by-class and this is demonstrated on Slide 15 which displays the distribution of renewal rate changes for Commercial Accounts in the second quarter.

As you can see from the Slide, most accounts received a single-digit rate increase, but there were numerous accounts that got a rate increase greater than 10% or got some level of rate decrease. There are also some general trends in the portfolio: Recently, larger accounts have lower average rate changes and has been the case for several quarters, Commercial Auto accounts have higher average rate changes. As always, individual account loss experience matters.

But the real take away from this slide is that the aggregate rate number is simply an average of thousands of individual account actions, and accordingly, success in this business is not about achieving a higher aggregate rate number, it's about doing the right things for the right account, and generating an appropriate return over time.

So, in this context, our fundamental approach is unchanged and the results continue to be encouraging. Simply put, we are retaining a very high percentage of our best performing accounts, at relatively modest rate increases. While on our poorer performing business, we continue to get rate increases significantly above loss trend with lower retention. We are comfortable moving away from business where returns remain well below target levels, and as always, we actively look for new business opportunities with appropriate returns. We continue to be very comfortable with how our organization is executing at the granular level, and accordingly, feel very good about the results.

In the Financial, Professional and International segment, we had record operating income of 254 million which was 65% higher than the prior year quarter. The increase was driven by higher levels of favorable prior year reserve development, improved underlying underwriting margins, lower catastrophe losses, and the inclusion of the Dominion. The underlying combined ratio for the quarter was a very strong 89.2, a slight improvement from the prior year. The improvement was due to the 2014 exit from a Management Liability Excess-of-Loss Reinsurance Treaty, along with earned rate increases in excess of loss cost trends across the segment, largely offset by the impact of the Dominion.

Net written premium was up 38% in the quarter compared to the prior year due to the inclusion of Dominion. In the Management Liability business within Bond and Financial Products, retention of 84% and new business of 37 million were both consistent with recent periods and prior year, while renewal premium change of about 4% was down somewhat from recent periods. In International, retention remains strong at 80% while renewal premium change improved to 3%, and new business was up year-over-year due to the impact of Dominion. So, overall a great quarter for the segment.

In our Personal Insurance business: Operating income of $75 million for the quarter was down 47% compared to the second quarter of 2013, driven by lower net favorable prior year reserve development in Homeowners, along with higher levels of catastrophe related losses in both Auto and Home. The underlying combined ratio for the quarter was 89.8, a slight improvement over the second quarter of 2013, with lower underwriting expenses and rate increases and excess-of-loss trends, largely offset by higher non-Cat weather related losses.

Looking specifically at Auto on the production side: Retention remains strong at 82%, renewal premium change was about 6% while new business volume of 139 million was, once again, up significantly versus recent periods due to the roll-out of Quantum Auto 2.0. We continue to be very pleased with the early results for Quantum Auto 2.0. The product is now live in 31 states and those states represent about 85% of our countrywide Auto new business production. In the states where we've launched the product, we've seen quoted policies increase more than 10% while the number of policies issued has more than doubled from prelaunch levels.

In addition, we continue to make progress on the expense initiatives announced a year-ago, that are fundamental to our ability to make our Auto product more price competitive. To-date, we've executed on initiatives responsible for about

75% of the 140 million run-rate savings target and we remain on track to achieve the full run-rate saves by the end of the year, in-line with our original expectations.

Turning to Auto profitability: The underlying combined ratio of 96.2 for the quarter was a slight improvement compared to the second quarter of 2013, with earned rate increases more than offsetting loss trend and the impact of higher mix of new business versus renewal business volumes. Our current view of Auto loss cost trend remains at about 4% with no significant change in the underlying texture from previous quarters.

Looking at Homeowners: Production was strong in the quarter with renewal premium change of about 8% while retention remained at 84%. New business volume of 85 million was up from the prior year quarter and recent periods, due in part to account rounding on our Auto new business. From a profitability perspective, the underlying combined ratio of 81.5 was in-line with the second quarter of 2013 with earned rate increases in excess of loss trend and lower expenses, offset by non-Cat weather related losses. So, overall in Personal Insurance, we saw strong profitability and an improving production picture.

With that, let me turn it back over to Gabby.

GABRIELLA NAWI: Sorry, there's an addition from Jay Benet.

JAY BENET: Yes. Thanks Gabby. Before we open for questions, I did want to mention one additional item. We'd be remiss if we did not say how pleased we were to have been recognized as an A++ Company by AM Best this past May. So, we just thought we would end with that and we'd be happy to take your questions now.

GABRIELLA NAWI: Kelly, we are ready for the question-and-answer portion. May I ask that you all limit yourselves to one question and one follow-up, please. Thank you.

OPERATOR: Thank you. Ladies and gentleman, if you would like to register a question, please press the one, followed by the four, on your telephone. You will hear a three-tone prompt to acknowledge your request. If your question has been answered and you would like to withdraw your registration, please press the one, followed by the three. If you are using a speakerphone, please lift your handset before entering your request. One moment for the first question.

Our first question comes from Brian Meredith with UBS. Please proceed with your question.

BRIAN MEREDITH: Yes, thanks. A couple of quick questions here for you. First of all, Jay, just curious, if I look at the Business Insurance and you kind of strip out the reserve releases and you kind of normalize for Cat Losses, I kind of come up with about a 12% underlying return on equity for the business. I guess, my first question is, is that right and is that about where you're kind of targeting, given the current interest rate environment?

JAY FISHMAN: I'll answer the second part of it, I'll let Jay fuss with—I'll let Jay Benet fuss with because he does the math in his head. You know, we've been saying for some time that our stated target of achieving a mid-teens return on equity over time was simply really not achievable in this interest rate environment. But, we were going to keep it, keep it as a statement, as an aspirational goal, but also because so many of our systems and our culture are geared around it.

Having said that, we've chosen to avoid the notion of an artificial ceiling on what rate adequacy or return adequacy is on an individual line or an individual business. Some of that is driven by competitive dynamics; what is the rest of the marketplace doing? Some of it is based upon capacity. So, you know, it feels, I mean obviously, at a 2.5% 10-year treasury, a 12% number feels pretty good, but that doesn't mean that we're going to not take the actions on an account-by-account or on a class-by-class basis that would continue to lift it, if it's possible.

So, that's really our honest assessment of it; feels pretty good to us, but maybe there's more and we're certainly going to try. But that, again, is a specific comment more than it is an aggregate rate number; so important that we always keep that in mind. We price individual accounts; we don't price a portfolio.

BRIAN MEREDITH: But, if you're pricing right now in-line with trend, doesn't that kind of mean you're assuming that returns are adequate?

JAY FISHMAN: I'm sorry, Brian, try me again?

BRIAN MEREDITH: You said you're pricing, you're pricing your Business Insurance in-line with loss trend, right?

JAY FISHMAN: Oh, no, no, no. What Brian said was that our best accounts are getting modest loss trend, I believe. I'm trying to go back to his comments and that our poorer performing accounts, whatever that means in that framework after three years of rate increases, but there are always poor performing accounts. But, the poorer performing accounts are getting significantly more rate increase at lower retention.

BRIAN MACLEAN: So, another way to say that Brian is, this quarter the way the arithmetic worked out is rate that we got on the entire portfolio approximated the aggregate loss trend. But, that could be very different and we could be thrilled with the result or unhappy with the result, either direction depending on how we get there.

JAY FISHMAN: I think the other part of that, that really is important, is that we wouldn't contemplate that we can improve our profitability by getting meaningful rate increases on our best performing business. Our focus there is to do our best to offset trend and to maximize retention. Our improvement in profitability is going to come from identifying those segments that underperform and continuing to make real progress there.

I recall in last quarter, we actually put up a Slide which showed the rate gain in our fifth segment in Commercial accounts, I think. I can't remember if it was Commercial or Middle Market, but compared the number of accounts and the rate gain to the previous year's quarter. The rate gain in that fifth bucket was 21%, I think, last year and 20% this year, was the rate gain. That's where the improvement in profitability is going to come from, not just from that fifth class, but that's the example here. It's going to be identifying those segments that continue to underperform and continue to drive them.

BRIAN MEREDITH: Great, thanks.

JAY BENET: The other thing I would add, before I'll address your first question is that we have this internal discussion about margin improvement and you have to look at it, in terms of what you're talking about. Are you talking about combined ratio or are you talking about dollars? When you talk about combined ratio, you know, if you do the arithmetic, if you're covering loss trend and I'll just make up some numbers. You know, let's say you have a 60% loss ratio, obviously premiums worth a 100%, if you're covering loss trend, that's 4% with rate increases, you know, you're multiplying the denominator and the numerator by, you know, the same number and you come up with the same combined ratio at the end of it 60%--I'm sorry, loss ratio, 60% in this case. What you lose track of in that are the dollars because you're applying a 4% increase to a hundred and another 4% increase to 60% of that. So, you're actually increasing the dollars of margin and increasing profitability therefore, even when you're covering loss trend.

So, I just say that for all of you to keep in mind, that you got to look at it as to what question are you really asking. Is combined ratio changing or dollars of margin changing? Getting back to the first question about, you know, the overall returns. We do an analysis of, you know, our quarters, our year-to-dates and you know, if I look at the year-to-date operating return on equity, which was 14.6%, yes there is prior year development in there. You know, prior year developments to us counts because a lot of it relates to recent periods where we've seen, you know, trends different than what we had expected and they've been favorable.

So, you know, in any given period, you can adjust for it, but you know, if you look at the 14.6 and back-out the amount of PYD and divide by the average equity, you'll come up with something that looks like a, you know, a proxy for an accident year, this year. So, you know, that's a way of looking at it, but you know, as Jay said, we look at these returns over time, and you know, we try to manage as close as we can to that mid-teens goal.

OPERATOR: Our next question comes from Paul Newsome with Sandler O'Neill. Please proceed with your question.

PAUL NEWSOME: Good morning. I was hoping you could maybe revisit the topical issue, the connections between the insurance market and the primary market, particularly in the large account basis and just given the fact that we've seen a lot of rate decline at every insurance. You know, how should we think about that affecting your businesses as the competitive environment changes there quite a bit?

JAY FISHMAN: You know, Paul, it's Jay Fishman. I think we'll all pitch in a little on that. First, I'd just observe that broadly speaking, we are really not a large account writer, I suspect in the context of the question that you're asking. We are a small commercial and middle market account company. We do large accounts on a fee-for-service basis that are largely independent of the Reinsurance decision, and we obviously do some National Property business, we certainly do that for large accounts.

Anecdotally, although some evidence to this I think exists, the layered national property business and my recollection—we did this last quarter, I think is less than 5% of our premium business overall. But, the layered large account property business is a much more price sensitive, price driven marketplace, more challenging than it was before. Now, there are returns in that segment that are awfully attractive and so you've got to balance out the notion of competitive dynamics within the overall returns, but nonetheless, I think you're seeing, we think you're seeing some of the changes in the new capital formation. Whether it's Reinsurance, by the way, or excess and surplus, bumping into that layered national property account business.

I would say on a primary side, for us, that's probably where the impact is most significant. I'm trying to see if anybody else here has a different, a different view. We are, we're really not, I mean our Treaty Reinsurance is, for a Company of our size, relatively modest, and so we've got wither savings opportunities; they're nice, but they're not going to move the needle very much, or we can change the way in which we purchase; we can buy more for the same dollars or less for even fewer dollars, but on the margin, it doesn't change anything.

I've been asked a few times whether in this is an opportunity for us and I suspect that what people are thinking is; does the calculus behind primary exposure change? Would you be willing to do either different classes of business or more business, particularly in catastrophe exposed areas, and rely more on Reinsurance to produce a net acceptable return? So far, the answer for us is no. We worry a lot about the mismatch of business; we worry a lot about relying on Reinsurance as a strategic solution rather than as a risk balancing factor, if you like, and the notion of expanding our liability base and relying on Reinsurance contract to bail us out. Where we're not sure if that Reinsurance capacity really sticks; is it permanent? Is it really there for the long-haul? It's just not clear to us yet.

So, for us the answer is that the impact of all of this is not yet very much. We spend, not an insignificant amount of time talking about it and thinking about ways in which it could impact us, but so far, I think you're hard pressed other than in that layered National Property business to find an area where it's really having an impact. I don't know, Brian, do you have anything?

BRIAN MACLEAN: No, I think it's, yes I think you got it.

PAUL NEWSOME: Then a second question.

JAY BENET: Somewhere at 6%.

JAY FISHMAN: I'm corrected, 6% of our premium on a net basis.

PAUL NEWSOME: Yes. You know, maybe another fundamental question here. You've obviously talked a lot about how focusing on that renewal rate number in Commercial Insurance is not necessarily the best measure of what your assessment of the competitive environment. You know, what's the alternative for us to look at that also illustrates?

JAY FISHMAN: That's actually a great question and I think you asked it, actually in exactly the right way. It's not that the number doesn't have arithmetic meaning, we acknowledge it does, but the tendency to perceive it as a competitive indicator, we just don't see that. We've always said and have for many years that retention is going to be the leading indicator of a changing competitive environment. I'll go back to the last, really difficult pricing environment that we had which was, you know, back into the '90s. You'll see retention rates in Middle market drop down into the high '60s and it—that really defined what was going on.

There was tremendous churn in the marketplace. It didn't happen overnight, but retention rates declined and that followed, that led if you will, the overall rate dynamic. Now, we haven't seen that yet. We haven't seen it; we haven't seen it on the way up. We haven't seen it; we're still on the way up, although we're at slower rates. We just haven't seen a drop in retention, and we've said for a long time that we think that that's the principal indicator.

Now, we also, to provide whatever anecdotal observation we can, we often have provided you with commentary about what we're hearing from the field. Now, you have to take that with a bit of a grain of salt because it doesn't mean it's right, but they are observations from people in the field dealing with individual accounts every day. Our comments remain that there's nothing that we're hearing from our folks that would cause us to think that we're at a precipice or broadly or more meaningfully competitive environment. But, I watch retention and that's what I look at and when I see a drop in that, that's when it's time to begin to understand what's going on in that local environment.

OPERATOR: Our next question comes from the line of Kai Pan with Morgan Stanley. Please proceed with your question.

KAI PAN: Good morning, thank you so much for taking my call. My question is regarding to the segmentation changes and Management changes recently. Could you comment a little bit more on that?

JAY FISHMAN: I don't know that we have much more to say. We put out a press release, that's part of Management's responsibility. Our responsibility here is to make sure that the younger talent in the organization gets additional exposure and exposure internally, exposure externally, and position the Company for continuity and just felt to us like a very ordinary and appropriate thing to do. The realignment was to a great extent driven by reporting relationships within those changes. So, much more about the people than about any particular realignment about the business.

KAI PAN: Great. Just to follow on that, and Jay, you've done a wonderful job for the Company and the shareholders. Is this the reason Management change is part of the evolution about how the Board thinks about a succession plan?

JAY FISHMAN: Yes. Well, I would never speak for the Board, and so, we think we have a responsibility to develop talent and present to the Board, as solid a Management team as we're capable of doing. We're going to be a Management team that's going to step up to that responsibility and not side-step it. The depth of the folks in this place, around here, it never fails to amaze me. The talent that's here is just remarkable, and my job, particularly, is to make sure that those people get additional responsibility and additional exposure.

When that time comes, that it's very natural. There's nothing upsetting to the organization internally, there's nothing upsetting to the constituents externally. It's as it should be and that's really my goal is for when this, I mean you know, I'll be 62 in November; Brian, I think is going to be 62 later this year; I think Jay Benet is, he'll be 62 in August. So, we all reckon we're not Methuselah here, we're mere mortals and our time will come and our job is to develop that next generation and present them, and just have it not be a big deal.

GABRIELLA NAWI: Thank you. Next question, please.

OPERATOR: Our next question comes from Amit Kumar with Macquarie. Please proceed with your question.

AMIT KUMAR: Thanks and I'm not 62 yet, so just wanted to get that out.

JAY FISHMAN: By the way, Bill Heyman is actually feeling left out. He's only 52, so for the record.

AMIT KUMAR: That was good to know. Just two quick follow-up questions. The first is, I guess it was Brian's question and you answered that. Jay you said retentions, you haven't seen it on its way up and I'm trying to sort of think about those, and you're right we should focus on retentions and rate adequacy. If so many lines are at rate adequacy, shouldn't that eventually start translating into better retentions and eventual growth in premiums?

JAY FISHMAN: Well, complicated question. I think that retention, something Chuck Clark taught me many years ago, the real emotional content behind retention is agent-comfortable, market-comfortable, customer-comfortable. A terrific set of circumstances where everybody feels good and fair and equitable in the relationship and that will encourage accounts to stay where they are. That's a really good thing. It's good for the accounts, by the way, we think tenure matters. We think it's an advantage, it's good for the agents, they can attend to things they need to attend to and obviously, it's good for the carriers that have the business.

So, the retention dynamic is, I think, really a reflection of the level of comfort of all of the parties to the transaction and that's really good. That's a good thing. The dynamic of growth is a more challenging one. There's no green light that goes on that says, ah-hah, now we're interested in growing. We're always interested in doing more business, always, and when we can bring on new accounts and we've demonstrated this in Slides in years gone by, recognizing that there is a, the internal expression is a new business penalty, but recognizing that there's a new business penalty associated with it. If we can see a pathway to bringing on new accounts and over time managing them to acceptable returns, we're going to go ahead and do that. There's nothing different about that this month then there was last month. It's not as if we weren't booking new business a year-ago, when rates weren't as attractive as they are now. We were as aggressive as we could be, and if anything, you know, I would say that our—if we had any disappointment, is that we weren't actually doing more not withstanding our encouragement. The thing to recognize is that, and again, I've said this before, I apologize for saying this so many times. I don't want to sound as though we believe this because this quarter, this is what we said. You're not going to grow your Book by marginally changing your price attitude at the point-of-sale.

First of all, we don't have a price list. We don't have a price list. It's an individual underwriter sitting down with an agent, talking about an individual account. So, it's not as if we can say lower prices by 3% or 4%; it just isn't that precise. So, the way you grow is by perceiving opportunity typically by risk selection, either categories of risk, lines of business geographies that you weren't in before that now for any number of reasons, you perceive opportunity for us. Canada, terrific opportunity; Brazil, a terrific opportunity. We showed at Investor Day, we've grown our Middle Markets business, my recollection is by 50% over eight or nine years from 2.1 billion to 3.2 billion in premiums.

Now, at the same time, our Construction Surety business has shrunk pretty dramatically as a result of the environment we're in. So, you have to be, we're not one market, we're 50 markets and you have to be nimble enough to see the opportunities where they are and pursue them aggressively. But, also be cautious enough to understand the risks presented in a changing set of circumstances and dial it back. So, we've been growing in the lines of business here significantly and either because circumstance change or we made mistakes in some markets and we did, we've shrunk others. So, it's all a net, but it is in that granular dynamic.

AMIT KUMAR: All right and I apologize for the fire alarm. Just very quickly, is there a portion of your book which can be potentially structured into a sidecar or alternative capital provider? Thanks.

JAY FISHMAN: I'm reluctant to give a quick answer on something that we haven't really thought about it, we haven't spent time contemplating it. I actually thought where you were heading was a portfolio transfer transaction which we always think about, but I haven't thought about the sidecar dynamic and I'd be reluctant to answer on-the-fly.

GABRIELLA NAWI: Great. Next question, please.

OPERATOR: Our next question comes from Michael Nannizzi with Goldman Sachs. Please proceed with your question.

MICHAEL NANNIZZI: Thank you. I have a question about Dominion. Actually, if I remember right, that was a business when you guys bought, it that was operating around a hundred combined and it looks like you've really turned that around very quickly. Just curious, kind of where is that business running now and maybe you can just talk a little bit about what actions you've taken in order to, kind of to get yourself to that place? Thanks.

ALAN SCHNITZER: Michael, it's Alan Schnitzer, I'll handle that.

MICHAEL NANNIZZI: Great.

ALAN SCHNITZER: I guess I would say, I would caution you from thinking that we turned it around that quickly. There's certainly a lot of integration work going on and we're still hard at work on that. So, the improvement you're seeing, my guess is you're looking at the results and seeing the combined ratio relative to what we guided you to and attributing that to Dominion. That's actually not correct. It's mostly a Reinsurance transaction and some large losses that were better than what we had in the 92. So, it's actually not coming from the Dominion.

MICHAEL NANNIZZI: I see.

ALAN SCHNITZER: To get to your, to get to your question what are we doing? We're doing all sorts of things you think a Company like us would be doing; we're working hard with Greg Toczydlowski in Personal Insurance and the whole Business Insurance team, to bring all the know-how and sophistication and data and analytics, some scale and synergy advantage. But, really just taking the know-how we have resident here at Travelers and exporting it to that platform, and we feel very good about the opportunity, as good as we did when we signed up the deal. But, I can't tell you that it's all been reflected in this quarter.

MICHAEL NANNIZZI: I see. So, the expense ratio benefit that we saw is primarily a result of the Reinsurance action you mentioned?

ALAN SCHNITZER: No, no. The expense benefit you saw does primarily come from the Dominion, but there is more than offsetting loss ratio deterioration from the Dominion. So, on a net basis, well, on an all-in basis, loss and expense ratio, Dominion's actually hurting, but it is helping on the expense ratio, pretty significantly. It's a loss ratio piece, we think that over time we'll be able to work through and bring to hurdle levels. Does that make sense?

GABRIELLA NAWI: Next question, please.

OPERATOR: Our next question comes from Jay Gelb with Barclays. Please proceed with your question.

JAY GELB: Thanks very much. For those that have been covering the Company and the industry for a long time, I think we all understand its spring storms, tends to be a heavy seasonal Cat quarter. I think it would be helpful for folks to get a perspective on what you would view a normalized annual Cat load to be. If I look back, over say the past dozen years, I think the average is between four and five combined ratio points. Is that a good starting point?

BRIAN MACLEAN: Jay, just for clarification, you're talking about in the second quarter?

JAY GELB: Correct. Well, no, I'm talking about for say, the full year. I think that gives a better perspective.

JAY FISHMAN: Yes. We've got something that's a proxy.

JAY BENET: Yes, actually, this is Jay Benet. Actually, if you go to the proxy, you know, there's a discussion about results, and in it we do talk about, you know, what the expectation was for Cats in the year versus where we ended up. My recollection is the number is about 550 after-tax dollars, in dollars, yes. So, we're just having somebody open up the proxy and make sure we're right about that.

JAY GELB: Okay, thank you. I can certainly take a look at that. On the next issue, it would be in terms of capital return. I'm wondering if we were to think about out-years, could Travelers ultimately be in a position where dividends plus share buy-backs could exceed annual operating earnings?

JAY FISHMAN: Not permanently. It can, obviously year-to-year and that's really a function of timing, but the only way it could actually exceed earnings permanently would be if we liquidated the Company. That's the only way to do it. So, you know, not permanently, no.

BRIAN MACLEAN: Jay, let me just jump back, this is Brian MacLean. You know, you started with we all know, kind of spring storms and volatility and clearly we do. But, when we look at our data of, particularly what's happened with spring weather, over the course of the last—well really, since 2008, it's dramatically higher than what you would have seen in the previous 20 years. To the extent of, you know, a 3X kind of number, and in fact, and that's not even counting the 2011 off the charts number that we had.

So, we've always known that we would have near-term, short-term volatility in our Cat numbers and everybody who follows the industry is used to looking at that. But, particularly for the second quarter tornado/hail activity, and how our product is used to deal with that, we really have done a lot of thinking about what's the long-term move to and whether we see continuing volatility in that number.

JAY FISHMAN: A good example, anecdotally, actually of the magnitude of the volatility; there was not too long ago we didn't think about catastrophe load in Auto, in Personal Auto. We do now and that's just a function of experience. So, we're reacting to the changing weather patterns, you know, kind of almost on a real-time basis. It's hard to answer the question at this point, of what a normal level is. That's why we've talked about it so much over the last few years as being a driver of not only rates, but underwriting in terms and conditions. It's just proving to be a challenge.

GABRIELLA NAWI: Great. Next question, please.

OPERATOR: Our next question comes from Vinay Misquith with Evercore. Please proceed with your question.

VINAY MISQUITH: Hi, good morning. First question, on the competitive environment. I think you've done a good job explaining that it's largely unchanged, but Jay, you mentioned that you think that there's likely going to be a soft landing. Just curious, sort of looking at this cycle versus the past; what's different and what gives you greater confidence that there is going to be a softer landing this time around?

JAY FISHMAN: Yes, Vinay and obviously, just because it's my opinion doesn't mean it's so. I need to start off with that. It's just one person's point of view. We've been talking for years now about the fact that our view was that the magnitude of the cyclicality in our business, we thought would be lower than historical experience, and it was driven by everything from much better data across the industry. I'll exclude myself, but I think much better management in the industry than was in the case 20 years ago. You look at capital deployment philosophies; it's different than it was 20 years ago.

I think Sarbanes-Oxley and the attention of audit committees and Boards to adequacy of reserves, to the level—the procedures and policies around reserve setting, has made them much more accurate. It's not that people were abusing it before, it's that there's a whole different level of attention and focus on those initial picks, what's driving them, what are the factors, the transparency that exists throughout the Governance Committee, external auditors, internal auditors, Boards; those are all things that will make the accounting and reserving process better. Never a guarantee. We're all talking about the future, but it will make it better and I think it has.

I think as a consequence of that, the feedback loop between claim performance and underwriters and pricing decisions is stunningly faster than it was 20 years ago. We actually are at the point, right now where we're booking weather dynamics virtually month-to-month. When I first started here, you were lucky if you had it in a quarter. That's the level of feedback that there was. So, the delay in understanding loss trend, factoring it back into reserving and changing pricing was much more attenuated than it is today; it's crisp. I listen to other companies and how they report; I don't think we're unique in that regard. I think, I listen to other companies and I'm impressed by what I hear and the nature of controls and procedures and thoughtfulness.

I think as a consequence, the magnitude—there will always be some cyclicality here, there's a cyclicality in every business, but I said, coming close to eight or nine years ago, I thought the amplitude on the way up, as well as the amplitude on the way down were going to be much more narrow. I think that was true, obviously, on the way up. We will now, we will now see how great I am on the way down. So, that's what I think and we'll find out. I think the leadership in this industry has come to understand that attempting to grow market share by marginally changing price and actually creating shareholder value from it, is impossible. I think about it all the time and I don't know how to do it and I'm not sure anybody else does, and so, we've all learned within our own cultures and our environment and our own strategies, how to manage our businesses to create shareholder value. That's what we're supposed to do.

VINAY MISQUITH: Sure, that's helpful. Thank you. Just as a quick follow-up on the Quantum 2.0. I think you said that the results were in-line with expectations. Just a little bit more color in that? You've had six months in, and so, what do you see in terms of loss trend versus your expectations? Thanks.

JAY FISHMAN: Yes. I'm going to turn it over to Greg in a second to talk about loss trend, but I would be remiss, if I didn't observe because I think he takes it for granted on this. We mentioned that the number of quoted policies is actually up 10%. That's one of the really wonderful surprises here. We thought, going into this, that we were being quoted everywhere because of the comparative rating process. It was not our going in expectation that by putting in a different model, that we would actually increase the number of quotes.

So, that's been—that 10% is a big number and what's impressive about that is the agent understanding and reaction of the Travelers product, of Quantum 2.0 as a legitimate competitive product and they're embracing it in their quoting process. So, that's our loss trend, but we've, to some extent, taken for granted internally, the increase in quotes, but it's a substantive plus.

GREG TOCZYDLOWSKI: Absolutely, and I think that echoes how we feel about loss performance. We're very encouraged, you know, when we saw that increase in quote flow that Jay talked about. Obviously, our focus then shifts right to our margin; how we're feeling about profitability of that business, given that we just launched our three largest states last month. We're not up on a one year anniversary. Obviously, we don't have a credible set of earned premium yet to declare victory.

But, our focus is really looking at long-term surrogates (ph) of profit right now including the mix of business, short-tail coverage's like the frequency and physical damages coverage's, and all of those things that we're looking at, they're right within expectations. So, we'll continue to aggressively measure the ultimate combined ratio, but all those proxies that we look at are within expectations. So, we're feeling as good about the quote flow that Jay talked about, that we are with the early loss indicators.

GABRIELLA NAWI: Before we go to the next question, Jay Benet has a correction.

JAY BENET: It's a comment more than a correction. We said we would, you know, give you the number from the proxy as it relates to, you know, the "normal Cat losses" and what we were remembering was actually from two years ago. The proxy from 2013 had 645 million as the after-tax cost associated with Cats. So, we had 550 before, and as I'm reflecting on that, the thing I'd want to share with you is really the fragility of these kinds of estimates. Because looking at, you know, the 550 going to 650; it's not a reflection of increased exposure. It's really a reflection of trying to refine year-over-year what these Cat estimates are, and it's not all that long ago, that you know, if you asked the same question and we would have said something like 350 million after-tax. Thinking back to those times, I would say our exposure base was actually quite a lot larger than that. So, this notion of normal…

JAY FISHMAN: Larger coastally, probably less inland.

JAY BENET: Yes.

JAY FISHMAN: But, the 10 years we built more inland exposure and less coastal.

JAY BENET: Yes. So, you know, while we're saying this is "normal", I just want to highlight the fragility of the estimates.

GABRIELLA NAWI: Great. Next question, please.

OPERATOR: Our next question comes from Randy Binner with FBR Capital Markets. Please proceed with your question.

RANDY BINNER: All right, thank you. I have a couple on reserves and it's in the Commercial area. You commented that better legal environment led to kind of '08 to '10, I'm sorry, '08 to '12 releases. Can we infer, just kind of from a normal claim closing pattern on General Liability, that you know, anything you'd get '08 and prior, in that area is kind of, you would have seen it by now?

JAY BENET: This is Jay Benet. When we're dealing with reserves, by definition we're dealing with incomplete information. So, we're looking at new information that's coming in every quarter and evaluating, you know, that with regard to whatever the assumptions have been. So, I wouldn't look any one of our reserves as being at, you know, finality. We're always looking at the flow of information and adjusting. You know, there are times when you see some things you're not sure whether you're going to react in full or in part to it. So, I think that's the best I can do to answer your question.

RANDY BINNER: Okay, yes. I mean, I'm just trying to get a sense of because there's some tail in GL, but it's not as long as like asbestos in environmental. So, I'm just trying to get a sense of if there really even is the potential for a lot more to come from '08 and prior?

JAY BENET: I mean, our reserves are always at best estimates, so you know, we don't really comment on whether they're going to change. We'll see what the data says, going-forward. There's always new information coming in.

JAY FISHMAN: I'll just make an observation, asbestos in environmental is a General Liability exposure. Now, the difference there is that, particularly in the asbestos arena, much of it came from the time when there were no policy aggregates; where they were per occurrence aggregates, at least on an admitted basis. I think we ended up with policy aggregates starting in the early '80s. So, that was, that pre-dated that, but you know, liability is a policy that lasts forever, you can always have things pop. You just never know.

GABRIELLA NAWI: All right. Next question, please.

OPERATOR: Our next question comes from Jay Cohen with Bank of America-Merrill Lynch. Please proceed with your question.

JAY COHEN: Thank you. Yes, I guess the question I had was on loss trend. You talk about a loss trend in Business Insurance of roughly around 4%, and I'm wondering, is that the number you price for or is that what you are observing because seemingly, what you've been pricing for, for the past five years, you've seen something less than that given the reserve releases. So, when you talk about that number, what exactly are you referring to?

JAY BENET: You know, our actuaries, our finance folks, our business folks are always looking at, you know, what they think frequency and severity is going to be, and you know, building in various assumptions. They take into account, you know, what recent trends have been. You know, there's always the question of gee, if you've seen—I'll, you know, make up an example. If you've seen recent inflation running at 1% or whatever, what does that mean going-forward? Is it going to continue at 1% or is it going to get better? Is it going to get worse?

So, at a very granular level, we're making assumptions every day in pricing and reserving, as to what the future has in-store based on current events and past trends. You know, when you look at the kind of environment that we're faced with today, you know, looking at very tame inflation, but some of the factors at work as to creating uncertainty as to what those inflation rates are going to be, going-forward, you know, you have to take that into account, and ultimately that, along with every other assumption comes down to a series of numbers for frequency and severity.

You know, things have been running pretty moderately, but when we say there's a 4% trend factor and you go back in time, I think you're absolutely right in saying, well maybe it was actually a little less severe than we had expected. So, we have favorable development, but you know, going-forward, you have to make a determination as to whether that's going to continue or whether the world is going to change.

BRIAN MACLEAN: Right. So, specifically Jay, when we say this quarter a 4% loss trend, we're talking about both what we're seeing as trend in the current year and what we're pricing for, and obviously that's an aggregate number. So, it's all over the place by different lines. As we have prior year development, we're looking at why we had that development and does that change our outlook of what the current year should be.

So, an example of one which usually wouldn't, would be if we had favorable development on prior year Cats, we'd probably say that doesn't fundamentally—unless they were dramatic, wouldn't fundamentally change our view of Cats this year. There are other things that you could obviously say would change it. So, the base year does move, but its—

JAY FISHMAN: You know, and the most volatile part of it is non-Cat weather. Our loss trend numbers make an assumption about non-Cat weather and that's obviously, at least I think, the most unpredictable part of that loss trend dynamic. It is one of the reasons why you're hearing us relentlessly talk about offset by favorable non-Cat weather or offset by adverse non-Cat weather. It's just, who knows.

JAY COHEN: Yes, and on that topic; you had talked about non-Cat weather relative to a year-ago being worse. Can you speak to non-Cat weather relative to a normal second quarter? Was this worse than you might have expected normally? Instead of just compared to last year versus a normal expectation?

BRIAN MACLEAN: So, I'll take that and it's a little different BI to PI. So, in Personal Insurance we would say this quarter was, the non-Cat weather was about normal; it was a couple points worse than last year which was abnormally low. In BI, this quarter non-Cat weather was a little bit high. So, about, you know, a point unfavorable to both last year which was kind of normal, and what we would've expected this year.

The difference there is, you know, especially when you get into tornado/hail, the impacts in the Commercial business can be really random and volatile. Personal Lines, you know, you have a storm and it hits a neighborhood and we can kind of see the claims. In Business Insurance, you can hit our risk or not hit our risk and it could dramatically change the numbers. So, that's the perspective relative to kind of normal. PI about normal this quarter; BI a little bit worse than normal.

GABRIELLA NAWI: Great, and this will be our last and final question.

OPERATOR: Our last question comes from Josh Stirling with Bernstein. Please proceed with your question.

JOSH STIRLING: Hi. You guys are kind for fitting me in, thank you. So, we talked a lot about reserves. I was wondering if you could give us some color. I know it's a best estimate, but there's a range of different approaches across the industry. Some companies consistently target something like a zero favorable development target; some consistently target a much larger number. You guys, just from observation, seem to be sort of in the middle of the range, but as everybody's thinking about earnings over the next few years, pricing slowing, you know, I think you're guiding—guiding, in your Outlook section; you talk about how underwriting margins in the underlying base seem to be slowing and stabilizing. I'm wondering what we should be expecting? You guys, you know, truly would like to be sort of a normal level of favorable development when you think about sort of what your philosophy really through the cycle, ought to look like? It would be very helpful for us.

JAY FISHMAN: Looking at each other, Jay and I are. My own view is that our goal is to get it right. If we could pick the right number and first of all, that's our responsibility, our obligation is record best estimates. So, that's what we do. We attempt to record best estimate and the accounting rules are critical, they're a really big deal. But, it's also how you price and how you think about the returns in your business and where you perceive risk versus reward. So, the importance of making it our best estimate is just critical. We'd struggle to figure out how to manage the business if we were recording something other than that because we price to that loss ratio, we price to that trend, we price to that yield curve; it's just critical for us.

So, I'm sure Jay and I, I'd say this, but I'll look at him, would give you the same answer which is our expectation sitting here today is that there won't be any development. We think we've got it right. It doesn't mean that we don't have issues that we're watching and aware of, and you all ask us often about emerging trends in claims and we keep track of all that. But, our goal is get it right. So, the notion of a question about a normal level of reserve development just doesn't resonate with us. We don't think of it that way. We don't think there is a normal level of reserve development.

JAY BENET: I fully agree with that. It's always about best estimate. It's always about getting it right, and you know, I just echo what Jay says.

JOSH STIRLING: So, that's fine and thank you. I'm going to just ask a question then. This quarter seemed to slow a bit, the competition was, I think you talked about just some good guys and bad guys. FPII was obviously good news and then there was some environmental. You know, is there anything that we can infer from the recent—from the sort of the lower BI favorable development and the, you know, the lower Personal Line's favorable development, that we should look at as sort of as a forward-leading indicator? Or is that, or is the process still the same? Should we just sort of, you know, look back over the average and make our own conclusions?

JAY BENET: Well, we try to give you as much information as we can with regard to what the drivers of favorable development are, you know. So, in the case of PI, if you think about the first quarter; a lot of it dealt with weather related losses, both Cat and non-Cat. We had some additional non-Cat weather, you know, related losses that turned out to be more favorable. You know, in Business Insurance, you just mentioned the level of favorable development was, you know, 25, but that was after the environmental.

So, I think if you just look at the numbers, you've got a storyline that over the last many years has provided insight as to what are the drivers of it. We'll see, you know, just how those, how those drivers or others manifest themselves, you know, moving forward. But, you know, I don't think there's more that we have to offer as it relates to that. We try to be pretty transparent, very transparent on it.

GABRIELLA NAWI: Very good. That will conclude our call for today. Thank you very much for joining us and as always, Andrew Hersom and I and Investor Relations will be available for any follow-up questions. Thank you.