



The Travelers Companies, Inc.
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PRESENTATION

Operator

Good morning, ladies and gentlemen. Welcome to the Fourth 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 January 21, 2016.

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

Gabriella Nawi

Thank you, Tina. Good morning, and welcome to Travelers' discussion of our 2015 Fourth Quarter and Full Year 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 Investor section.

Speaking today will be Alan Schnitzer, CEO; Jay Benet, Vice Chairman and Chief Financial Officer; Brian MacLean, President and Chief Operating Officer; and Doreen Spadorcia, Vice Chairman, Chief Executive Officer of Claim, Personal Insurance, and Bond & Specialty Insurance. They will discuss the financial results of our business, and the current market environment. They will refer to the webcast presentation as they go through prepared remarks, and then we'll take questions.

In addition, Jay Fishman and other members of the senior management team are also in the room.

Before I turn it over to Alan, I would like to draw your attention to the explanatory note included at the end of the webcast. Our presentation today includes forward-looking statements. 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 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 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 Investor section on our website.

And now Alan Schnitzer.

Alan Schnitzer

Thank you, Gabi. Good morning, everyone, and thank you for joining us today.

We're very pleased to finish 2015 with another strong quarter. As I'm sure you've seen, we reported operating income of \$886 million, or \$2.90 per share, and operating return on equity of 15.8%. That caps off another terrific year with operating income of just over \$3.4 billion, operating income per diluted share of a record high \$10.87, and operating return on equity of 15.2%.

Our underwriting results across the board remained strong as you can see from our combined ratio of 86.6% for the quarter and 88.3% for the year. In Domestic Business Insurance, consistent with our



marketplace objectives, we achieved a record level of retention in the quarter with positive renewal rate change. In Bond and Specialty Insurance, we generated an all-time best underlying combined ratio of 80.1% for the year. Broadly speaking, the market dynamics in the commercial insurance marketplace continue to be remarkably stable.

In Personal Lines, Quantum Auto 2.0 continues to meet our expectations. In Agency Auto, we had year-over-year policy in force growth of 8% in the fourth quarter, and as you can see in the webcast, that's the sixth consecutive sequential quarter of increasing PIF count. Those of you who have been following our Agency Auto story know what a success it has been. We're also pleased to be seeing an impact from the success of Quantum Auto 2.0 on our Homeowners business, and you'll hear more about that from Doreen.

Jay Benet will have more to say about our current investment results, but I'll just note that we have delivered pretty exceptional returns on equity for quite some time notwithstanding all the headwinds in the investment arena; historically low interest rates, the decline in energy prices and volatility in the equity markets just as examples from this quarter. This speaks volumes about our ability to select and price underwriting risk and the strength of our insurance franchises.

Just as a data point, our after-tax net investment income is about a billion dollars lower in 2015 as compared to its high in 2007. On the other hand, our after-tax underlying underwriting margin is about a billion dollars higher in 2015 than it was at its low in 2011. Particularly to the extent that fixed income yields remain low, and that seems like the outlook for at least some time, and with capital finding its way into the largest end of this business, expertise in generating underwriting returns and having strong franchises in the small and middle marketplaces with meaningful barriers to entry will really matter.

Turning to capital management, consistent with our ongoing capital management strategy, we returned nearly \$1.2 billion of capital to our shareholders in the quarter and nearly \$4 billion during the year. The long-time, consistent strength of our results sits behind our capital management strategy. Just as we have for nearly a decade, we will continue to right size capital and invest thoughtfully in the business. Thanks to that strategy, we have now returned close to \$35 billion of capital to shareholders since the middle of 2006 when we started our share repurchase program.

Let me take just a minute to comment on the leadership transition. What I suspect many of you want to hear from me is, where do we go from here? As I've explained to our leadership team, our challenge is this: To take today's summit and make it tomorrow's base camp.

I'm confident that we already have the right strategy in place to do that, and we've got the right team to execute it. We've been executing it, we understand it and it has been remarkably successful. It's this team's strategy.

Delivering superior returns over time will continue to be our North Star. We'll do that by investing in and leveraging our competitive advantages, delivering industry-leading products and services, and making sure this is a great place to work for the best talent in this industry. That's not to say that we won't challenge ourselves constantly to make sure that both the strategy and the way we're executing on it remains relevant. It's critical that we reassess all the time, and we will continue to be a leader in evolving and innovating, particularly given the potential for change around us.

Among other things, we'll continue to refine our data and analytics to make sure that we lead in risk selection and pricing. We'll continue to innovate on the product side and in our claim and risk control organizations to make sure that we're delivering at the forefront for our agents, brokers and customers;

and we'll continue to build on our leading position with our distribution partners to make sure that we're a partner of choice for them.

We've always understood the value of size and scale, and we're well positioned in that regard. Just as in the past, we'll seek opportunities to grow thoughtfully and in ways to contribute to shareholder value; and, as always, we'll manage our expenses thoughtfully. All of that is business as usual for us. Our confidence in our strategy and our track record in executing on it give us confidence in our ability to continue to deliver for our shareholders.

And with that, I'll turn it over to Jay Benet.

Jay Benet

Thanks, Alan. As Alan mentioned, we were very pleased with our results this quarter: Net income per diluted share of \$2.83, operating income per diluted share of \$2.90, and an operating ROE of 15.8%.

These results were driven by the continuation of our very strong current accident year underwriting performance as evidenced by an underlying combined ratio of 90.7% despite relatively high non-cat weather related losses in the quarter. Net favorable prior year reserve development was very strong at \$292 million pre-tax and cat losses were relatively modest at \$46 million pre-tax.

That said, as shown on page four of the webcast, current quarter results were lower than our very strong fourth quarter 2014 results mostly due to the impact of low interest rates and private equity returns on net investment income, and an even higher amount of net favorable prior year reserve development in the prior year quarter. Underlying underwriting margins were pretty much the same in both quarters.

Fixed income NII of \$422 million after tax was down \$31 million from the prior year quarter principally due to what we've been saying for many years: Securities that had higher book yields have run off during the past 12 months and have been replaced with securities having lower yields due to the current low interest rate environment. Another contributing factor to lower fixed income NII was the modest reduction in average investments that resulted in part from the company's \$579 million first quarter 2015 payment to settle the asbestos direct action litigation. Looking forward, based on the current interest rate environment, we would expect that the impact of lower reinvestment yields and a lower level of fixed maturity investments could in 2016 result in approximately \$20 to \$25 million of lower after-tax NII on a quarterly basis when compared to the corresponding periods of 2015.

Non-fixed income NII of \$25 million after tax was down \$42 million from the prior year quarter primarily due to lower private equity returns. Private equities essentially broke even this quarter as compared to earning \$30 million after-tax in the prior year quarter due to lower valuations for energy-related investments.

Each of our business segments continue to benefit from net favorable prior year reserve development. In Business and International Insurance, net favorable development of \$176 million pre-tax primarily resulted from better than expected loss experience in workers' comp for accident years 2006 and prior and accident year 2014; in general liability for both primary and excess coverages for accident years 2012 and prior, and in the company's operations in Canada.

In Bond & Specialty Insurance, net favorable development of \$80 million pre-tax primarily resulted from better than expected loss experienced in fidelity and surety for accident years 2012 through 2014. And in Personal Insurance, net favorable development of \$36 million pre-tax primarily resulted from better than expected loss experience in Auto liability for accident years 2013 and 2014 and in Homeowners and Other liability for accident year 2014.

As I've done in the past, I'd also like to provide you with some insight into what our combined 2015 Schedule P is expected to show when it is filed on May 1.

On a combined stat basis for all of our US subs, all accident years in the aggregate across all product lines are expected to develop favorably, and all but one product line on Schedule P are expected to develop either favorably or show very modest or de minimis unfavorable development. The product line that is expected to develop unfavorably, by approximately \$50 million pre-tax, is products liability-occurrence, but another product line, other liability-occurrence, will have an offsetting amount of favorable development as we've refined our allocation of IBNR between these two components of general liability based upon how losses, such as those related to construction defect, have been developing by coverage type.

In total, our general liability reserves were not affected by this action. Returning to GAAP, for the year, we had net favorable development of \$941 million pre-tax with approximately \$840 million coming from our US ops and a little over \$100 million coming from our Canadian and UK operations.

There are two additional topics I'd like to update you on. As shown on page 21 of the webcast, we renewed our corporate cat aggregate XOL treaty effective January 1. The treaty provides coverage for both single cat events and an accumulation of losses from multiple cat events with similar terms as in the prior year but at a lower cost.

The treaty continues to provide \$1.5 billion of coverage, part of \$2 billion excess of \$3 billion after a \$100 million deductible per occurrence. It keeps the same broad peril and geographic coverage and the same positioning of the coverage layer, providing a significant buffer between earnings and capital. The treaty has a single limit with no reinstatement provisions. And please note that the total cost of this treaty and therefore the reduction in cost are quite small in relation to our operating income.

The second topic relates to the recent drop in oil prices. Page 22 of the webcast contains updated information showing the magnitude of our investments in below investment grade energy bonds and energy related equities. And as you can see, the sum of these investments is relatively small and the exposure quite manageable.

Operating cash flows remained strong, \$760 million in the fourth quarter after making a \$100 million discretionary contribution to our qualified pension plan, bringing total operating cash flows to over \$3.4 billion for the year. We continue to generate much more capital than we need to support our businesses and, consistent with our ongoing capital management strategy as you heard from Alan, we returned almost \$1.2 billion of excess capital to our shareholders this quarter through dividends of \$183 million and common share repurchases of a little over \$1 billion. For the full year, we returned almost \$4 billion of excess capital to our shareholders through dividends of \$744 million and common share repurchases of over \$3.2 billion.

Holding company liquidity ended the year at \$1.6 billion, well above our target level, and our debt-to-total capital ratio, which was 23% at the beginning of the quarter, slightly elevated due to our having issued \$400 million of debt in the third quarter to pre-fund a \$400 million of debt that was maturing in the fourth quarter, has come back down to 22.1%, well within its target range with the retirement of that debt. Net unrealized investment gains were almost \$2 billion pre-tax, or \$1.3 billion after-tax, which was down from \$3 billion and \$2 billion, respectively at the beginning of the year due to an increase in interest rates and spreads.

Book value per share of \$79.75 grew 3% from the beginning of the year and, importantly, adjusted book value per share of \$75.39, which eliminates the after-tax impact of net unrealized investment gains, grew by 6% during this year.

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

Brian MacLean

Thanks Jay. Business and International Insurance results for both the fourth quarter and the full year were strong. We continued to generate excellent returns, with a full year combined ratio of 92.1%, and our retention throughout the year was very strong and reached a record level this quarter in our domestic business.

Pricing trends remained relatively consistent with renewal rate change still slightly positive at the end of the year while new business volume in our domestic business saw a modest increase.

Turning to the quarter's financial results, operating income was \$566 million with a very strong combined ratio of 89.6%. The underlying combined ratio, which excludes the impact of cats and prior year reserve development, was 94.4%, up a half a point compared to the fourth quarter of 2014 primarily due to a higher level of non-cat weather-related losses.

Looking at the top line, net written premiums for the quarter were down about 1.5 points compared to the fourth quarter of 2014, with Domestic Business Insurance premiums up about a point.

In Domestic Business Insurance, we remain pleased with the continued execution of our pricing strategy. As we've been saying for some time, given the attractive returns that we are generating in this business, our focus continues to be on retention. And accordingly, we are very pleased that retention improved to a record 85% in the quarter. Renewal premium change came in at 2.4 points while renewal rate change remained positive, but down slightly versus the third quarter. New business of \$476 million was up compared to both the prior year and the third quarter.

Looking at each of our individual Domestic businesses beginning with Select, rate and renewal premium change were in line with recent quarters while retention remained strong at 82%, demonstrating continued stability in this segment of the market.

In the middle market, we achieved record retention of 88%. Overall rate change was about flat and reflected a decline of about a point from the third quarter. As we've always said, the execution below the headline numbers is what matters, and we continue to feel great about the granular results.

Retention for our best performing business was just over 90% with an average rate decline of less than 2% on those accounts while for our poorer performing business we continued to get rate in excess of loss trend. In terms of exposure, the quarter's result includes a drag of about a point from our oil and gas business, resulting from reduced economic activity due to lower energy prices. Just as a reference point, our oil and gas business makes up only about 3% of domestic Business Insurance written premium. Middle market new business of \$254 million was up from the third quarter, and in line with the prior year.

In Other Business Insurance, retention was strong at 80%. Renewal rate change was about flat even after being negatively impacted by our National Property business. As I mentioned last quarter, although National Property is seeing the largest rate declines of any business in our portfolio, we are pleased with the overall performance of this business. Returns and retention remain strong, and pricing trends are stable. Excluding National Property, renewal rate change for Other Business Insurance remains positive and was relatively stable with the third quarter.

Turning to International, net written premiums were down about 16% for the quarter and 14% for the full year primarily due to the adverse impact of foreign exchange rates. Excluding the impact of foreign exchange, net written premiums for the fourth quarter were down about 6% largely driven by declines in retention in Canada and to a lesser extent at Lloyds.

International retention was down in the quarter to 79%, however renewal premium change was slightly positive, and new business for the quarter was very strong at \$80 million, up 18% year-over-year.

In Canada, a competitive renewal environment adversely impacted retention across our book. However, in June we launched Optima, our new strategic insurance platform in Canada for personal insurance. Optima was modeled after our US-based Quantum Auto 2.0 product. We're in the early days of the rollout, but are pleased with the initial response as we are seeing a significant increase in new business volume.

In Lloyds, we continue to see a challenging market resulting from global economic conditions, particularly in our Marine business. Offsetting this pressure are two new business products that we've recently launched focused on renewable energy and global construction, and early returns are encouraging.

So all in, for the segment it was a terrific 2015 with strong financial results in what we see as a remarkably stable environment, one where our competitive advantages really matter to our customers and agents

Before I turn it over to Doreen, I want to make one comment on our outlook for operating margins, which we include in our quarterly filings. Since our 10-K won't be filed for a few weeks, I would note that our 2016 underlying underwriting margin for the segment will be broadly consistent with 2015. This is subject to the usual caveats and forward looking statement disclaimers.

With that let me turn it over to Doreen.

Doreen Spadorcia

Thank you, Brian, and good morning, everyone.

Bond & Specialty Insurance finished 2015 with another quarter of exceptional financial results. Operating income for the quarter was \$162 million, down from the fourth quarter of 2014 due to lower net favorable prior year reserve development, but overall still a great result. The underlying combined ratio of 80.7% was 3.4 points better than the prior year quarter due primarily to two factors: A modest increase in the loss ratio in the prior year quarter that resulted from a re-estimation of the first three quarters of 2014 and secondly, the impact of certain customer-related intangible assets which became fully amortized during the second quarter of 2015.

Underlying underwriting results continue to run well within our long-term target ranges and, as Alan mentioned, the full year underlying combined ratio of 80.1% was an all-time best. We obviously don't think these results come by accident. We pride ourselves on maintaining the underwriting disciplines, aggressive management of risk and limits, strong account and agency relationships, analytics and claims management that drive these results. As we look ahead to 2016 for this segment, we expect underlying underwriting margin to remain broadly consistent with 2015.

As for top line, net written premiums in the aggregate were down 4% from the fourth quarter of 2014 primarily due to a decline in surety volume driven by lower bonding needs for our accounts particularly as compared to the strong production in the fourth quarter of 2014. Surety production can vary significantly quarter-over-quarter based on the number, size and timing of bonded construction projects

awarded to our customers. We have a strong portfolio of surety clients, and believe we remain well positioned to capitalize on increased bonding needs that might result from an improved economy.

Across our Management Liability businesses, retention remains strong at 85% while new business premium was up 17% from the fourth quarter of 2014. Renewal premium change trended down with lower rates being partially offset by an increase in other RPC, which includes changes in the size of insureds' exposures, limits written, attachment points and policy duration. The lower rate was as expected, and is consistent with the strong profitability of our portfolio.

So all in all, another great quarter closing a strong year for Bond & Specialty Insurance.

I'll turn now to Personal Insurance where we closed out the year with another quarter of exceptional underwriting results. For the segment, operating income for the quarter was \$222 million, and the underlying combined ratio was 86.2%. Great results, and as we move forward, the segment remains positioned to perform in line with our long-term return goals.

I'll touch on the quarterly results for Agency Auto and Agency Property in a moment, but first I'd like to share with you some thoughts on how we view the underlying health of these businesses.

First for Auto. I'll start by saying how pleased we are with the vibrancy of our Auto business. The market response from both agents and consumers to Quantum Auto 2.0 remains incredibly strong, and the portfolio is positioned to generate financial returns within our long-term target range.

In the Agency channel, we added 157 policies during 2015, an 8% increase from the end of 2014. As always, there remains competition in Auto, and we remain committed to keeping our products priced accordingly through disciplined expense management and superior pricing and underwriting segmentation. As we look ahead to 2016, we expect the Auto business to continue to grow in both policy count and premium volume although at a more moderated percentage than 2015 as the portfolio grows.

As for Agency Auto profitability, we've mentioned on several occasions that we are comfortable with where our margins are given the current market environment. That still remains the case today. The full year underlying Agency combined ratio of just under 97% was in line with our expectations for the year and a result we are pleased with. This combined ratio is somewhat higher than our long-term goal, driven particularly by the amount of new business that we've added over the past two years.

Quantum Auto 2.0 is priced to our long-term target returns, but as you all know, the relatively higher combined ratio of new business improves over time. As we look into 2016, the significant volume of new business we've added will drive a slightly higher calendar year combined ratio compared to 2015. So far, the profitability of Quantum Auto 2.0 is maturing in line with our expectations. With this return profile, we continue to seek more new business as it should be accretive to long-term returns.

On Homeowners, the financial returns generated in the last couple of years have been exceptional and well within our target range. As you recall, we made significant improvements in the risk profile of this business over the last few years, including changes in deductibles, other terms & conditions and tightened underwriting guidelines. Of course, this is a more volatile business that will always have a weather dynamic to it. The weather in the last couple of years has been somewhat lower than our models suggested, but we know that won't always be the case.

As we look ahead to 2016 with respect to profitability, we do expect underlying underwriting margins in Agency Homeowners & Other to be lower than 2015, reflecting more normalized levels of loss activity. As Alan mentioned, we're also very pleased with the improvements we've seen in Homeowners production. This is attributable in part to account rounding along with making some localized pricing

and process adjustments, and certainly, the turnaround benefited from the momentum and agent engagement from the rollout of Quantum Auto 2.0. At this point, the business has leveled off from a policies in-force perspective, and we expect modest growth in 2016.

Now, I'll just highlight a couple of things specific to the quarter.

Looking at Agency Auto, new business premium was up 32% and net written premium was up 12% from fourth quarter 2014 levels, and we've added 51,000 policies during the quarter. The combined ratio for the quarter was 98.1%, and included over two points of favorable prior year reserve development. The underlying combined ratio was 100.2%, up from the prior year due predominantly to adverse weather in this year's quarter and the benefit in the prior year quarter of a 2.5 point favorable re-estimation of losses related to the first three quarters of 2014.

As for loss trend in Auto, our view of normalized frequency and severity remains consistent with recent quarters at around 3% in aggregate. There continues to be a lot of discussion about trend, particularly increasing frequency. From our vantage point, while we may observe normal fluctuations in any particular period due to things like weather, we see a stable and unchanged long-term frequency trend. As always, we continue to monitor external information and our own data closely using our extensive analytical capabilities.

Turning to Agency Homeowners & Other for the quarter, we once again had strong financial results despite relatively active weather in the month of December. The underlying combined ratio of 69.5% was slightly higher than the exceptionally favorable prior year quarter. As for production, new business premiums were up 27% from the prior year quarter, and continue to trend favorably while retention remains strong at 85%. Policies in force were up slightly both sequentially from last quarter and from the fourth quarter of 2014.

So to sum up Personal Insurance, we're exceptionally proud of the year we had and look forward to more of the same in 2016.

With that, I'll turn the call back to Gabi.

Gabriella Nawi

Great. Thank you, Doreen. Tina, we're now ready for the Q&A portion of the call. If I can please ask you all to please limit yourself to one question and one follow-up. Thank you very much. Tina, go ahead please.

QUESTIONS AND ANSWERS

Operator

Thank you. Ladies and gentlemen, if you would like to register a question, or a comment, please press the one followed 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're using a speakerphone, please lift your handset before entering your request. One moment, please, for our first question.

Thank you. Our first question comes from Jay Gelb of Barclays. Please go ahead.

Jay Gelb

Thank you, and good morning. The first question I had was on the potential for share buyback. Alan, any change in view in terms of deploying well in excess of annual earnings and share buybacks? [Indiscernible] buybacks has gone down just slightly annually over the past couple of years. I'm

thinking we might see that trend in place for 2016-2017 as well.

Alan Schnitzer

Jay, good morning. Thanks for the question. No change in strategy or approach to share buybacks or capital management overall. And there's no intent, and there's never been an effort to deploy more than earnings, right? We've had excess capital in past year and we made that very clear that we were sort of adding that to our annual income to buy back stock. But we said, I don't know, a year or two ago that our level of buy backs would be tied to our level of income.

And so, we'll have a level of earnings. We'll do what we need to do with it, whether that's making pension contributions or investments in the business, and we'll take what's left and return that to shareholders. And there won't be a perfect correlation between earnings in a year and share buybacks in a year. There's some timing differences, but I think as we've said pretty consistently recently, share buybacks going forward will be tied to earnings.

Jay Gelb

Okay. And then on the investment income from the non-fixed income investments, it was clearly impacted by lower energy prices in 4Q and given the collapse in energy prices so far this year. I'm just trying to get a baseline of what you might expect for 2016. Is that \$25 million result probably going to head lower on a quarterly basis from what we saw in 4Q?

Jay Benet

Let me just clarify one thing on the \$25 mil. That relates to the fixed income portfolio, not the non-fixed income portfolio.

Bill Heyman

Jay, it's Bill Hyman. Obviously, this week is a hard week from which to extrapolate for the rest of the year. The [indiscernible] year-end reflected a price which was an oil price higher than the price which one observes[indiscernible] today, but not by as much as one might think. During the year, most funds wrote down their holdings and in some cases, after the write down, the price of petroleum rose, but nothing was written up again. So, we think a lot of these portfolios have been marked pretty hard.

That said, if we had to predict either way, there's probably a little downside left in the portfolio, but the portfolio isn't that big that the amount ought to be material in the aggregate.

Jay Gelb

Okay. That's helpful for a starting point and Jay, just to clarify, I was talking about the \$25 million of income in 4Q from the non-fixed income investment portfolio in terms of the [indiscernible]. I understand what you were saying in terms of lower yield. [Indiscernible] that much of a quarterly impact.

Jay Benet

I apologize for the confusion there.

Jay Gelb

That's okay. No problem. So, Bill, you're saying that \$25 million after-tax we saw in the 4Q shouldn't be that impacted by lower energy prices even so far—

Bill Heyman

No. I couldn't put a number on it, especially after the first part of this month, but I'm simply saying that everyone assumes that there's a lot of downside based on prices as they are today and there might be

less downside than it appears simply because of the way in which funds marked their holdings in 2015.

Jay Gelb

Thank you.

Gabriella Nawi

Great. Thank you. Tina, next question please.

Operator

Thank you. Our next question comes from Randy Binner of FBR and Co. Please go ahead.

Randy Binner

Yeah, thanks. I think you touched on this in the opening commentary, but from my perspective, the headline pricing number you provide in the slide deck, the plus 0.6% was better than expected. And I guess I'm interested in your perspective on if you think Travelers is unique here. A lot of the headline surveys that we look at in the industry for commercial lines are moving significantly negative across the board. So, I just want to get your perspective on if you think Travelers is unique here and how kind of much discipline, I guess, you think your competitors are holding against a softer market.

Alan Schnitzer

Yeah, Randy, good morning. It's Alan. You said it was a surprise. It wasn't necessarily a surprise to us. It may have been a surprise to you or others. But, relative to the surveys, what we can tell you is we're showing you real data and I think what we've always seen is surveys tend to be anecdotally based and tend to maybe over emphasize some volatility either up or down because maybe the people responding to the surveys are thinking about their last transaction, or the transaction that's in their mind.

So, there's really nothing about this that surprises us, and we've been saying for a while that we expect the amplitude of the market to moderate. This appears to have moderated, and I think the fact that we can achieve what we did is, I think, a function of two things. One, our data and analytics, our expertise, our ability to execute at a very, very granular level, and a marketplace that we would describe as remarkably stable and at the moment rational.

Randy Binner

Just a quick follow-up; are there any lines that are really helping that figure, meaning is workers' comp still kind of the best from a pricing perspective where some other casualty lines might be moving negative?

Brian MacLean

No. This is Brian. It's still a pretty tight band to be honest with you across all the lines. So, nothing is dramatically out of pattern, up or down. As we commented, and Alan touched on in his comments and I in mine, it's more larger accounts feeling more pressure than medium and smaller accounts. As we said, National Property is the space where we're seeing more significant rate declines than others.

So, I think it's more an account size than a line of business volatility, or variability.

Randy Binner

That's great. Thank you.

Operator

Thank you. Our next question comes from Michael Nannizzi of Goldman Sachs. Please go ahead.

Michael Nannizzi

Thanks so much. I guess, Doreen, maybe a little bit more on the Auto side. Have you seen any impact from the rise in miles driven in your Auto book just given the fact that your growth has sort of come alongside that rise in miles driven?

Doreen Spadorcia

So, let me just talk a little bit about miles driven. The data shows that probably year-to-date the miles driven are up about 2.5% per capita. And there's still a lot of debate about whether that makes a difference if it's a long trip, a short trip; whether there's unemployment, whether you have safety features in your vehicles. And so, we watch that closely, but our long-term trend of 3% anticipates that. And we really haven't seen anything that that particular item is causing us to view frequency differently today.

Brian MacLean

And just to be crystal clear, the 3% is total trend.

Doreen Spadorcia

Yes, total trend.

Brian MacLean

With frequency being a small fraction of that.

Doreen Spadorcia

Right.

Michael Nannizzi

Got it. Thanks. I guess in middle market, I mean with retention up in the high 80s, I mean is that something that you could see that maybe coming down, or would you be comfortable with that at a lower level if you saw an opportunity to find some more rate increase opportunities? It just seems that high 80s, if pricing is flat and the results are pretty good. I mean is that an area where you could look to push for some more rate at some point?

Brian MacLean

This is Brian, again. That is a constant balancing act in our organization every day. I will tell you that overall, our core middle market business from a return perspective is in a very healthy spot. As I said in the comments, when we look at our better performing business, which is not a tiny part of the portfolio, our very well-performing business, we're at retentions north of 90 with pretty modest pricing increases. We'd obviously love to renew it in the 90s with different price increases, but retaining that business is a real priority because it is returning very, very well.

With that said, we're always looking for opportunities to see where we can balance the rate and retention trade off.

Jay Benet

Yeah, I would add to that. Even though that's not the headline number, that continues to be a headline number and the execution below that number is very, very granular. So, we're not managing that headline number. We're managing every single account.

Michael Nannizzi

Great. And just real quick; Bill, do you guys disclose—I definitely appreciate the disclosure on the energy portfolio. Do you guys disclose anywhere the Bbb- category of energy exposure as well, just

that sort of next rating level up?

Bill Heyman

Well, I can tell you that the investment grade portfolio has an average rating of single A and the high yield portfolio, which is 23 credits with book value of \$162 million, has an average rating of Bb-, which given the size ought to give you what you need.

Michael Nannizzi

Got it. Thank you.

Operator

Thank you. Our next question comes from Josh Stirling of Sanford Bernstein. Please go ahead.

Josh Stirling

Hi, good morning, Alan and I was just thinking, may you live in interesting times. You've had good fortune here to become CEO at the time the industry structure is changing very rapidly. I mean obviously over the past six months, we've seen ACE and Chubb merge. It creates a very large and powerful competitor. And on the other hand, over at AIG there's presumably going to be lots of opportunities for everyone in the industry.

As you've thought from Travelers' perspective how the environment is evolving, how are you guys going to sort of tackle these new challenges and opportunities, and what should we do to see Travelers take advantage of all this change in the market?

Alan Schnitzer

Yeah, good morning, Josh. So, I guess what I would share with you is that we are very aware and deeply engaged in all of those things. So, whether that's what's going on with any of our competitors, or what's going on with technology or big data, or driverless cars, consolidation among distribution, you could go on and on. I think what I would share with you is we're very aware and deeply engaged.

As we see all of those things, and others—those, by the way, weren't meant to be necessarily in order, what's top of my mind; just what came to my mind. But, as we think of everything that's got the potential to change in this marketplace, nothing is going to change overnight. These are things that are all going to evolve and develop over time. And what we've got great confidence in is our positioning to manage all of them. So, we think we can understand and manage.

We've got the talent. We've got the resources. We've got a deep understanding of risk and reward, and the quality of our underlying business, the results you see this quarter and this year, we've got no distractions.

So, we are starting from a really good point as we think about and engage on all of those issues. And without taking it one-by-one, for the most part and maybe all in, we see more opportunity than we do risk. But, we're certainly examining them from both sides, making sure that where there is opportunity we're positioning ourselves to be able to leverage it and where there's risk that we're making sure we do everything we need to do to mitigate it.

Josh Stirling

That's helpful. I wonder if we could maybe just switch gears a little bit. You mentioned risk. Could you give us a little bit of a, maybe either Alan or Brian or whoever is appropriate, a little bit of help of understanding what the liability side exposure is, maybe not Travelers per se but just generally for the industry, from a meltdown in the commodities and energy patch would be?

I mean presumably, we might see a bunch of bankruptcies. There's a lot of different product lines that everybody in the industry sells into companies. I remember a decade or so ago, Chubb really surprised people when they got hurt in an energy surety deal with Enron and obviously got DNO exposures and maybe workers comp severity. So, I'm sure you guys are playing defense here. I'm wondering if you can help us sort of think through how you and your underwriters are thinking about potential exposures if that part of the world keeps getting hurt.

Alan Schnitzer

I'll start and then I'll look at either Brian or Doreen and invite them to jump in. I'll say you sort of hit it. We think about the loss side of that equation all the time and whether it's going through our management liability book, or our surety book, making sure that we understand what our exposures are. And I'll say that we look at these things—we don't wait for there to be something significant in the marketplace to look at it. We're looking at it all the time and as far out as we can.

So, we're managing our nets. We're looking at on the surety side what kind of collateral we have, for instance, on some of these accounts. We exit accounts when we need to exit accounts, but we've got a really good track record I think in all of those businesses.

So, just on the management liability side, for example, we're much more heavily weighted on the private non-profit side as opposed to the large public DNO. And so, this is what we do every day is manage risk and think about risk and reward. Doreen, Brian?

Doreen Spadorcia

Thank you, Alan. The only thing I'd add to that is that when we see any potential issue, we run that through our entire book of business, not just what that class of business is. So, we look at all the consequential effects that that may have on related industries.

And so, for example, in writing banks, we look at the level of their portfolios that are exposed not just to oil and gas, but to any one thing in particular. So obviously, surety, watching credit, and looking at collateral, other management liability areas; looking at concentrations, but this isn't unique to us. We always take an issue and run it through the entire book and look at any consequences that might come from that.

Josh Stirling

Okay. Well, thank you. I appreciate it. Good luck.

Alan Schnitzer

Thank you.

Gabriella Nawi

Thank you. Next question please.

Operator

Thank you. Our next question comes from Ryan Tunis of Credit Suisse. Please go ahead.

Ryan Tunis

Hey, thanks. Good morning. I think my first question is for Brian, and I think he mentioned in his prepared remarks that in middle market I think the better accounts—you were renewing, I think, with a modest rate decline, a decline, but it sounded like it was only modest. I guess I'm just curious; how is the conversation changing with those better accounts now versus maybe a year ago? Right now, like I

said, it sounds like it's maybe a modest decline. I mean is that kind of what everyone's kind of looking for, still modest, or how is that conversation evolving?

Brian MacLean

Yeah. It's pretty much as you're saying and as you would expect based on the data. A couple of years ago, almost every conversation was starting with some form of price increase, even for the best accounts because everybody saw where the trends were and that is gradually mitigated over time. But, even with those better accounts, the conversation starts somewhere with trying to renew it at a modest decline or flat. Obviously, if the average is less than 2%, there are still some that are positive.

The thing that we're doing probably a little different than we were a year or two ago is we're really trying to get out as early as possible; frequently at least three if not six months ahead of time, have conversations with the broker and the account. I think we do have a strong franchise with a valued product and valued services and fortunately, most of those companies start by wanting to stay with us.

And then I think the other key point is really being able to have the data and analytics where our front line people can see and really segment their portfolio and in the middle market account-by-account looking at how they're performing. And when there are issues either in that account, in that line, or in that class of business, being able to have an informed conversation with the broker about what those are and why we're trying to do what we're doing on the account really, really makes a difference.

So, I'd say the big change is getting out early and having a kind of granular conversation on the performance of that line and that business.

Ryan Tunis

Got it, okay. And then my follow-up was actually a follow-up to Jay's question on capital return and excessive operating income.

I guess since the start of 2014, we see like your premiums surplus ratio has drifted up from about 1.0 to 1.2. Leverage has been relatively flat. You've said over the past couple of years you've had access; you've been able to deploy. I mean how do we think about that level of excess just because on those metrics it does seem like whatever excess you did have you have sort of used to a certain extent. I mean are those metrics even relevant?

Jay Benet

This is Jay Benet. The premium-to-surplus ratio I would view as not being relevant at all. I mean that was a ratio that was used at a time when rating agencies and regulators didn't have the sophisticated models they have today.

So, as I've said on previous calls, we deal with each one of the models, whether it's our internal models, the regulatory models, or the rating agency models to come to a place where given the profile of our business as it relates to each quarter, what is the capital that we think we need in the operating entities that we manage to support a Aa rating and support a solid Aa rating, not one where if the wind blows, we're worried about our ratings going down. So, that's always the starting point.

Given the size of our book, it doesn't change very much from quarter-to-quarter. But what does change is the profitability in each quarter. So, there are some quarters where the profitability, whether it's for favorable development or some other things that take place, is higher than our expectations keeping in mind that we have a flow of monies out of the operating companies up to the holding company each quarter based on expectations. So, to the extent we earn more, we bring some more up probably a little later than that.

I think if you go back over time and you go past two years ago to an earlier period and start adding up the earnings versus the share repurchases, you see that there's a very, very strong correlation to that. So, I wouldn't read into anything that says one year we've done a little more than earnings; another year we did less. It's really just, as Alan said earlier, the timing.

And now if the premium-to-surplus ratio goes up a little bit, I'd kind of ignore that. What I'd look at is in our supplement, we talked about specifically on a quarterly basis what the stat surplus is, and I think you can see that that moves around probably in a pretty narrow band.

Ryan Tunis

Okay. Understood, thanks.

Gabriella Nawi

Great. Next question please.

Operator

Thank you. Our next question comes from Vinay Misquith of Sterne Agee. Please go ahead.

Vinay Misquith

Hi, good morning. Just a question on loss cost trend, and the pricing roughly flat. I'm curious how we are managing to leave margins flat in '16 versus '15.

Brian MacLean

Yeah. So, this is Brian, and speaking for the BII segment, you start with the kind of simple arithmetic of the earned premium. And again, it's not just rate. It's price, which includes exposure change and does offset some trend. So, when we look at the arithmetic of earned rate versus loss trend, we come up with a very modest, about a half point of loss ratio compression into 2016. And that, of course, is based on our assumption of loss trend, which is, as we've said, running right now at about 4% and looking at a relatively stable orderly marketplace.

And then that's offset by a variety of other factors you can think of - weather, large losses, mix change, underwriting actions, etc. But, the real starting point is that that compression from the rate loss trend dynamic, price loss trend dynamic is a pretty modest number in how we're looking at it.

Jay Benet

And I think that distinction between price and rate is important because as we've said in the past, there's a meaningful component of exposure that from a profitability perspective behaves like rate. And so, what we really see in that true margin deterioration is we see going forward—as Brian said, it's very small and probably within the margin of error of all the other things that impact margin.

Vinay Misquith

Ah, sure. Fair enough. The second question is on the pace of future rate increases. You mentioned that on best performing accounts, you have decreases of less than 2%. I'm curious what proportion of the accounts now are well-performing? So, should we see sort of further pressure on pricing this year because more of the accounts are better performing?

Brian MacLean

Yeah. I think there's a level of granularity and precision here that for competitive reasons I'm not going to overly segment the portfolio.

I think the backdrop to this is really the view of do we think the industry is going to continue to fundamentally be focused on the returns in the product, and we think that's the right way to be thinking about the business, and we're optimistic that the majority of the marketplace is actually looking at that.

So, the healthier the business, the more pressure there should be on pricing. But in the aggregate, we're pretty comfortable that we should be able to generate appropriate pricing to maintain reasonable returns. And then you can come up with any variation on the theme you want off of that and be as bullish or as bearish as you want.

Vinay Misquith

Fair enough. Thank you.

Brian MacLean

Okay.

Alan Schnitzer

Thank you.

Operator

Thank you. Our next question comes from Charles Sebaski of BMO Capital Markets. Please go ahead.

Charles Sebaski

Good morning. Thank you. I have a couple of questions, I guess, on the personal lines business. I guess the first on the personal auto growth and the success you've had from Quantum. Is that coming from stand-alone auto policies? I guess I'm trying to just understand that you've got a sweet spot. It seems to be on packaged multi-policy programs. You have auto growth while homeowners is flat. I'm just kind of wondering how you're working in the auto growth relative to your kind of package program.

Doreen Spadorcia

Good morning. This is Doreen. We've actually seen success in both, and I think this was some of what Alan and I referred to in our earlier comments.

Clearly, our auto product was competitive in agents' office and also in the direct channel. And in many cases, what that did because we're an account-focused company that allowed us then to bring the home with it. So, we've stand-alone auto come in. We've seen more opportunities for cross-selling, and I don't think it's anything small given Quantum Auto 2.0 that we've been able to actually increase and stop the shrinkage in homeowners.

We've also put some processes in place that have been very helpful where it prefills certain information so that if someone is looking at an auto quote, it'll prefill for home. So, we like the account business. We continue to look for that, but given where the returns are and where we're going with auto, we're pleased with that as well.

Charles Sebaski

Okay. I guess finally, just a follow-up to a comment that you guys made in the Business Insurance regarding the exposure drag and the oil and gas exposure. I think you said that oil and gas accounted for a one point exposure drag, but that oil and gas only accounted for 3% of the book, or is that 3% of the exposure? I guess I was trying to understand how 3% could account for a one point drag.

Brian MacLean

Yes, the 3% is a premium number, but the exposure, as you can imagine, was down pretty significantly. So, when you combine the 3% against a pretty big exposure delta in oil and gas, that drove the one-percent.

Gabriella Nawi

And the 3% is to total domestic business insurance, not to middle market [indiscernible] premiums.

Brian MacLean

Yeah, and that's a good point and maybe we shouldn't have mixed those two numbers. The 1% drag was on the middle market exposure change. The 3% was on total domestic BI. So, if we did that arithmetic quickly—

Fred Donner

The 3% is the premium. The 1% is on the charge and the exposure.

Brian MacLean

And it's both middle market?

Fred Donner

The 1% exposure drag is a middle market exposure.

Brian MacLean

Yeah.

Fred Donner

3% is quantifying the percentage of the premiums of our oil and gas business on the total Business Insurance—

Brian MacLean

Right. Right. So, the premium on just middle market would be a higher number.

Charles Sebaski

Okay. So, that makes sense how you could have—the math just didn't seem to work. I appreciate the clarity.

Brian MacLean

Yeah.

Gabriella Nawi

Great, and this will be our last and final question please.

Operator

Thank you. Our next question comes from Kai Pan of Morgan Stanley. Please go ahead.

Kai Pan

Thank you for fitting me in. First question is on reserve releases. It looks like workers' comp you have releases in 2014 accident year. I'm just curious why the early release rather than for this normally long-tail line of business. And could you talk also in general with loss cost trend by major lines, and how that compare with your 4% assumption in overall loss cost trend?

Jay Benet

This is Jay Benet. Just in terms of the reserve release, when you're dealing with a long-tail line, you have two components to how you're going to look at the reserves. One is what has developed in terms of the loss activity, and you're absolutely right. In a short period of time, you're not going to really see a great deal of activity.

On the other hand, what you've done is you've established a starting point for what you think the loss activity is going to be, and we refer to that as the loss pick [ph]. So, just imagine on January 1, you're trying to predict what the loss is going to be for the entire period of time that those workers' comp policies will be out there, and come up with a loss pick.

In the example I'm going to use is I'm just making up a number. Let's say it's 60% based on what you've seen historically, and looking at the historical data then for earlier accident years and evaluating that against that initial loss pick that you had for a current year. And there are times when you see loss activity in prior years that you say, "That really has no bearing whatsoever on how I thought about the starting point for the current year," and then there are times when you look at it and you say, "No, actually, this really does change the bar for the starting point."

So usually, on a long-tail line of business, when you see us do what we've done here, it's based on what we refer to as base year movement, looking at the history and just saying that the initial loss pick was a little on the high side.

Brian MacLean

I was just going to say, this is Brian, just to respond to your—trend by line in Business Insurance is actually a pretty tight band ranging from the high 3s to the high 4s, but an average trend of right around 4%. So, nothing really out of pattern by line.

Kai Pan

Great. Well, thanks so much. My follow-up question is for Alan. Now you are seven weeks on the new role. So, I just wonder; what's your top priority these days, and what are you most—you think you have the right strategy in place now, but what are you focusing on?

Alan Schnitzer

Sure. Thanks for the question, Kai. So, I've had experience managing essentially all of our commercial businesses and our business outside the US. What I haven't had experience with is the Personal Lines basis, or on a relative basis not as much, Personal Lines business and some of our functions like claim and IT and ops and things like that, risk control. So, I'm trying to spend a lot of time in those businesses and areas that I haven't had the experience with, trying to spend a lot of time on the road, out in the field with distribution and our employees in the field, which has always been a priority of mind.

And I guess beyond that, in my comments, I said one of the things that we're going to do is continue to evolve and innovate. And reassessing is something that we've always done and Jay Fishman has always led that initiative. And so, I have taken that over from Jay. And just like Jay didn't do it alone, Jay did with a group, I'll continue to lead the group in making sure that we're assessing what's going on in the marketplace and we're evolving and innovating.

So, I would say that makes up sort of the way I'm allocating my time.

Kai Pan

Great. Well, thank you so much for all the answers.

Alan Schnitzer

Thank you.

CONCLUSION

Gabriella Nawi

Great. Thank you very much for joining, and as always, we are available in Investor Relations if you have any follow-up questions.

Forward-Looking Statements and Non-GAAP Financial Measures:

This transcript contains certain “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995. All statements, other than statements of historical facts, may be forward-looking statements. Words such as “may,” “will,” “should,” “likely,” “anticipates,” “expects,” “intends,” “plans,” “projects,” “believes,” “estimates” and similar expressions are used to identify these forward-looking statements. Examples of our forward-looking statements include statements relating to our future financial condition and operating results, our share repurchase plans, potential margins, potential returns, the sufficiency of our reserves and our strategic initiatives.

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Some of the factors that could cause actual results to differ include, but are not limited to, the following:

- Catastrophe losses;
- Financial market disruption or economic downturn;
- Changes to our claims and claim adjustment expense reserves;
- The performance of our investment portfolio;
- Asbestos and environmental claims and related litigation;
- Mass tort claims;
- Emerging claim and coverage issues;
- Competition, including the impact of competition on our strategic initiatives and new products;
- The collectability and availability of reinsurance coverage;
- Credit risk we face in insurance operations and investment activities, including under reinsurance or structured settlements;
- The federal, state and international regulatory environment;
- A downgrade in our claims-paying or financial strength ratings;
- The inability of our insurance subsidiaries to pay dividends to our holding company in sufficient amounts;
- Disruptions to our relationships with our independent agents and brokers;
- Risks associated with developing new products, including in Personal Insurance, or expanding in targeted markets;
- Other changes in tax laws that adversely impact our investment portfolio or operating results;
- Risks associated with our use of pricing and capital models;
- Limits to the effectiveness of our information technology systems;
- Difficulties with our technology, data security and/or outsourcing relationships;
- Risks associated with our business outside of the United States, including regulatory risks;
- Risks associated with acquisitions, and integration of acquired businesses;
- Changes to existing accounting standards;
- Limits to the effectiveness of our compliance controls;
- Our ability to hire and retain qualified employees;
- Company may be unable to protect and enforce its own intellectual property or may be subject to claims infringing on intellectual property of others;
- Losses of or restrictions placed on the use of credit scoring or other underwriting criteria in the pricing and underwriting of insurance products;
- Factors impacting the operation of our repurchase plans; and
- The company may not achieve the anticipated benefits of its transactions, its new products or its strategic initiatives or complete a transaction that is subject to closing conditions.

For a more detailed discussion of these factors, see the information under “Risk Factors” and “Management’s Discussion and Analysis of Financial Condition and Results of Operations” in our most recent Form 10-K and Form 10-Q filed with the Securities and Exchange Commission. Our forward-looking statements speak only as of the date of the earnings conference call or as of the date they are made, and we undertake no obligation to update those statements.

In this transcript, we may refer to some non-GAAP financial measures. For a reconciliation of these measures to the most comparable GAAP measures and a glossary of financial measures, we refer you to the press release and financial supplement that we have made available in connection with this transcript as well as our most recent periodic filings with the SEC. See the “For Investors” section at Travelers.com.