



The Travelers Companies, Inc.

Second Quarter 2019 Results Conference Call

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CORPORATE PARTICIPANTS

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PRESENTATION

Operator

Good morning, ladies and gentlemen. Welcome to the Second Quarter 2019 Results Teleconference for Travelers. We ask that you hold all questions until the completion of formal remarks, at which time you'll be given instructions for the question-and-answer session. As a reminder, this conference is being recorded on July 23, 2019.

At this time, I'd like to turn the conference over to Ms. Abbe Goldstein, Senior Vice President of Investor Relations. Ms. Goldstein, you may begin.

Abbe Goldstein

Thank you so much, and good morning. Welcome to Travelers discussion of our second quarter 2019 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 travelers.com under the Investors section.

Speaking today will be Alan Schnitzer, Chairman and CEO; Dan Frey, Chief Financial Officer; and our three segment presidents, Greg Toczydlowski of Business Insurance; Tom Kunkel of Bond & Specialty Insurance; and Michael Klein of Personal 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 will take your questions.

Before I turn the call over to Alan, I would like to draw your attention to the explanatory note included at the end of our webcast presentation. 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 expressed or implied in the forward-looking statements due to a variety of factors. These factors are described under forward-looking statements in our earnings press release and 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 investors section on our website. And now, I'd like to turn the call over to Alan Schnitzer.

Alan Schnitzer

Thank you, Abbe. Good morning, everyone, and thank you for joining us today. The overall results for the quarter were solid, benefiting from the continued successful execution of our strategic agenda. We said for years that the primary measure we use for managing the business is return on equity and we've also said that any strategy to deliver leading return on equity over time requires a strategy to grow over time. To that end, a few years ago, we laid out a strategy to achieve profitable growth in the context of the forces of change we've previously identified as impacting our industry. We established key innovation priorities and invested in capabilities consistent with those priorities. The successful execution of that strategy has contributed to growth over the past several years and contributed to the growth in earnings this quarter. Earned premiums were up 4 percent to almost \$7 billion, adding meaningfully to underwriting income in the quarter.

We've also shared that improving productivity and efficiency is a priority and efforts we've been undertaking for some time to leverage technology investments and workflow enhancements are paying off. Again, this quarter and year-to-date, we've grown the top line and managed general and administrative expenses to about flat, while continuing to make important investments in the business. All of that, together with strong performance from our investment portfolio, contributed to core income of \$537 million, a 9 percent increase over the prior year quarter and core income per diluted share of \$2.02, a 12 percent increase over the prior year. Core return on equity was 9.2 percent.

In terms of underwriting margins, this quarter, we delivered a solid all-in combined ratio of 98.4 percent. As a reminder, our expected weather losses are seasonally highest in the second quarter. But, as you can see on page four of the webcast, the underlying combined ratio was up 1.3 points over the prior year quarter. There were a number of favorable items impacting the underlying results, including a lower level of large losses and improved expense leverage. But, I'd like to highlight and put in context two items contributing to the increase; non-catastrophe weather losses and some continued deterioration of trends in the tort environment.

I'll start with the weather, which, of the two, had the larger impact. For the quarter, total weather losses in the aggregate, cat and non-cat, were well within a range of what we would consider normal. But, breaking that down, catastrophe losses were favorable, while non-cat weather losses were worse than what we would consider a normal level for the second quarter. That resulted in a nearly two point increase in the underlying combined ratio compared to the prior year quarter. Again, all-in weather losses weren't far off what we planned for, so we consider this bucketing.

In terms of the tort environment, the trends we discussed in the fourth quarter of last year impacting bodily injury severity in commercial auto have developed a little worse than we expected in the commercial auto line. And while we anticipated those trends extending into the other liability coverages, they extended into the primary and excess coverages of the general liability line somewhat more than we anticipated. That drove the adjustment this quarter. On the whole and looking back over the last three quarters, the issues continued to be most heavily associated with commercial auto related losses, manifesting in two places, in the commercial auto line, as you would expect, and also in excess coverages of the general liability line, where the underlying losses are auto related.

The run rate earnings impact of this updated view of the tort environment is a little less than \$20 million per quarter after tax. The current quarter underlying result also included a catch up of about the same amount from development of the first quarter. The aggregate impact of the first and second quarter adjustments added around two-thirds of a point to the consolidated underlying combined ratio, which amounts to about 14 cents per share. Also, I'll note that unlike commercial auto where the returns are still clearly inadequate, the returns in the general liability line, both primary and excess, are much healthier for us.

Turning to the top line. Production was once again excellent in the quarter. We grew net written premiums by 4 percent to a record \$7.5 billion. Our premium growth reflects high levels of retention and positive renewal premium change broadly across the portfolio. As I pointed out before, that speaks to the high quality of the business we're putting on the books. We're growing our new and renewal business with confidence in terms of accounts, geographies, and industries that we know well.

In business insurance, we achieved renewal premium change of 6.7 percent, including renewal rate change of 3.6 percent. In both cases, the highest levels in five years, while maintaining historically high levels of retention. We increased renewal rate change and renewal premium change both year-over-year and sequentially in each of our product lines other than workers' compensation. In our leading bond & specialty business, we once again achieved strong production in both our management liability and surety businesses, with record levels of retention and new business in domestic management liability.

In personal insurance, higher net written premiums benefited from renewal premium increases in both our agency automobile and agency home businesses and an all-time high for domestic new business. We have momentum in all of our businesses. And in an environment of persistently low interest rates, ongoing uncertainty surrounding weather-related losses and continuing challenges in the tort environment, we will continue to leverage the power of our franchise to meet our return objectives, including by continuing to selectively and thoughtfully seek price and improve terms and conditions. You'll hear more shortly from Greg, Tom, and Michael about our segment results.

To sum it up, our performance this quarter and year-to-date reflect both the successful execution of our long-term strategy and our relentless execution in the marketplace every day. With leading data and analytics in the hands of our frontline underwriters, the best talent in the industry, and deep relationships with our agents and brokers, we remain well positioned to continue to deliver shareholder value over time. And with that I'll turn it over to Dan.

Dan Frey

Thank you, Alan. Core income for the second quarter was \$537 million, up 9 percent from \$494 million in the prior year quarter and core ROE was 9.2 percent, up from 8.7 percent. Earnings per share and core earnings per share were up 9 percent and 12 percent, respectively. Our second quarter results include \$367 million of pretax catastrophe losses, down from \$488 million in last year's quarter, but the lower level of cat losses was more than offset by higher levels of non-cat weather. As we have previously disclosed, our definition of catastrophes is limited to industry events where our losses exceed a specified dollar amount, generally around \$20 million.

In the second quarter, a larger portion of the weather losses we experienced fell below our cat threshold and thus adversely impacted our underlying combined ratio. But, again, as you heard from Alan, overall weather results, cat and non-cat combined, were well within the range of what we would expect.

In terms of weather expectations, during our fourth quarter earnings call, we explained that our expectations for cat losses for 2019 would trend up for two reasons. One is that we've seen growth in our premium volume and the overall exposure level in the business. Two is that we're placing a little more weight on recent periods and that results in a bit of an uptick in terms of our view of normal cat load per dollar of premium. Add in the seasonality of our cat losses and our second quarter total weather results were no surprise.

Pretax underlying underwriting gain, which excludes the impacts of cats and prior year reserve development, decreased by 19 percent. Higher non-cat weather-related losses adversely impacted the underlying combined ratio of 94.9 percent by nearly two points compared to the prior year quarter. Also, and to a lesser degree, the change in the underlying combined ratio was impacted by several favorable items, including lower large losses and improved expense leverage, partially offset by a modest impact from the continuing challenges in the tort

environment as Alan mentioned. Net favorable prior year reserve development in the second quarter was \$123 million pretax, down from \$186 million in the prior year quarter.

In business insurance, net favorable PYD was \$71 million. In terms of highlights, the net favorability resulted primarily from better-than-expected performance in workers' comp, which improved by about \$275 million. Partially offsetting the favorability in workers' comp is unfavorable development of approximately \$125 million in general liability for both primary and excess coverages and commercial auto. This represents the estimated impact of the continuing challenges in the tort environment that drove the nearly \$20 million of after-tax run rate increase in the current quarter's underlying losses.

Second quarter PYD in business insurance also included a \$60 million increase to environmental reserves for accident years prior to 2010. As a follow-up to last quarter, second quarter PYD also included a modest impact, resulting from a handful of additional states, extending the statute of limitations for molestation claims. The impact on our book from these legislative changes in the second quarter was much smaller than the first quarter impact from the adoption of similar legislation in New York.

In bond and specialty insurance, net favorable PYD of \$39 million was driven by domestic management liability. In personal insurance, net favorable PYD of \$13 million was driven by favorability in our domestic businesses. Last week, the UK updated the Ogden rate, which is the discount rate applied to lump sum bodily injury payouts. The rate change was modest, and as a result we expect to book only a small benefit in the third quarter.

Net investment income increased by 8 percent from the prior year quarter to \$548 million after tax as higher fixed income returns were complemented by higher returns in our non-fixed income portfolio. Fixed income NII increased by \$25 million after tax, due to the higher-average yield on invested assets and an increase in the amount of average invested assets. Higher returns in the private equity portfolio reflected the broader market recovery. Looking forward, with interest rate expectations now lower than they were three months ago, we have updated our outlook and now expect after-tax fixed income NII for the remainder of 2019 to increase by approximately 10 to \$15 million per quarter compared to the same period a year ago.

As we discussed on our earnings calls for the last two quarters, we added a new catastrophe reinsurance treaty for 2019, providing coverage for PCS-designated events for which we incur \$5 million or more in losses, above an aggregate retention of \$1.3 billion. While the impact on written premiums was reflected entirely in the first quarter, the new treaty impacts all four quarters on an earned basis. For the second quarter, the impact of the treaty increased our consolidated underlying combined ratio by about a half a point as expected. Through June 30th, we've accumulated a little less than \$800 million towards the \$1.3 billion retention. As you think about the elevated non-cat weather this quarter, it's important to keep in mind that much of that weather activity was from non-PCS events that did not count towards the treaty.

On the topic of reinsurance, I'll direct your attention to page 20 of the webcast and provide an update on our catastrophe reinsurance program. The structure of our cat reinsurance treaty is generally consistent with the prior year. We renewed our Northeast Cat Treaty effective July 1st with substantially similar terms and flat pricing. Our cat bond Long Point Re III is in the second year of its four-year term. And in the annual reset for the 2019 hurricane season, the attachment point was adjusted from \$1.9 billion to \$1.79 billion, while the total cost of the program was flat year-over-year. A more complete description of our cat reinsurance coverage, which also includes a description of our gen cat, aggregate XOL treaty that covers an accumulation of

certain property losses arising from multiple occurrences is included in our 10-Q, which we filed earlier today and in our 2018 10-K.

Turning to capital management. Operating cash flows for the quarter of \$1.2 billion were again very strong. All our capital ratios were at or better-than-target levels and we ended the quarter with holding company liquidity of approximately \$1.5 billion. Net unrealized investment gains increased from \$1 billion after tax as of March 31st to \$1.9 billion after tax as of June 30th due to the decrease in interest rates during the quarter.

Adjusted book value per share, which excludes net unrealized investment gains and losses, was \$90.05 at June 30th, 3 percent higher than at year-end and 6 percent higher than the end of the second quarter last year. We returned nearly \$600 million of excess capital to our shareholders this quarter, comprising share repurchases of \$376 million and dividends of \$217 million. On a year-to-date basis, we have returned over \$1.2 billion to shareholders.

And with that, I'll turn the mic over to Greg for a discussion of business insurance.

Greg Toczydlowski

Thanks, Dan. Business insurance produced segment income of \$351 million for the quarter and a combined ratio of 101.1 percent. The combined ratio includes catastrophe losses, which were essentially in line with our expectations for the quarter. The underlying combined ratio of 97.4 percent was 0.9 points higher than the prior year quarter. There are several moving pieces underneath the 0.9 point year-over-year change, so we've added page nine to the webcast to illustrate the components. I'll start with the notable items that increased the underlying combined ratio year-over-year.

The most significant item was non-cat weather, which was higher than the prior year quarter by about a point. Next are two items that we've discussed with you previously. The first is the half point impact from lower earned premium due to the new cat treaty, and the second is the approximately half a point run rate impact related to the Q4 2018 re-estimation of commercial auto losses.

The last of the unfavorable adjustments relates to further deterioration of the trends related to the continuing challenges in the tort environment that drove the re-estimation of commercial auto losses in the fourth quarter as you heard from Alan. The most recent data showed loss experience that was somewhat higher than our revised expectations from the fourth quarter. This included further modest deterioration in auto and extended into general liability for both primary and excess coverages to a higher degree than we had previously anticipated. For these adjustments, there is about a half a point of ongoing run rate impact and about a half a point of catch-up from the first quarter of 2019.

As for the favorable year-over-year items, first, we had about a point and a half from domestic large losses returning to a more normal level as we expected. And second, we had about a half a point driven by continued benefit from higher earned premium volumes and disciplined expense management. Importantly, we continue to achieve this expense leverage, while investing in strategic initiatives that position us for the future.

Now to the top line. Net written premiums for the quarter were up 2 percent over the prior year driven by strong underlying production results. Partially offsetting the production results were some items that were generally timing in nature. For example, we changed the timing of one of

our reinsurance treaties from the first quarter to the second quarter. Adjusting for those items, the top line trends were in line with recent quarters.

In terms of domestic production, we achieved strong renewal premium change of 6.7 percent in the quarter, including renewal rate change of 3.6 percent, both their highest level in five years. The renewal rate change was up 1.3 points from the first quarter and more than 1.5 points from the second quarter of last year. This is a strong result, particularly given continued rate decreases in workers' comp. While the commercial auto and property lines continue to lead the way, our general liability, both primary and access, as well as C&P lines, also saw meaningful increases. Importantly, at the same time as we achieved these pricing increases remained historically high retention of 85 percent.

Last quarter, we said that in addition to price, we've also been focused on improving terms and conditions, particularly in our property coverages. In this quarter, terms and conditions, things like deductibles, sub-limits and insurance-to-value tightened further, contributing to rate adequacy. Even after our updated view of loss trend resulting from our re-estimation of losses in the auto and general liability lines, which increased our overall view of domestic loss trend by about half a point, we estimate that pricing that is rate plus the portion of exposure that acts like rate was in excess of loss trend on a written basis for the quarter. New business of \$531 million in total was essentially flat to a strong prior year quarter. We're very pleased with our production results and our continued granular and deliberate execution.

As you heard from Alan, given the low interest rate environment, continued uncertainty around weather-related losses, and some upward pressure from the tort environment, we'll continue to seek rate and use all the other available levers to meet our return objectives. As for the individual businesses, in select renewal premium change, the renewal rate change both ticked up from the first quarter, while retention remained strong at 82 percent.

New business was strong and comparable to the prior year quarter. We're pleased with the returns in this business and these production results reflect our strategic execution. In middle market, renewal premium change was 6.1 percent with renewal rate of 3.4 percent, up more than a point from the first quarter and 1.6 points from the second quarter of last year, while retention remained historically high at 87 percent.

New business premiums of \$275 million were down from a strong prior year quarter. For the most part, we attribute the new business dynamic to our underwriters prioritizing improving price, terms and conditions at renewal, and being disciplined in managing risk selection related to our exposure to the auto line. We're very comfortable with our execution. We continue to invest in our strategic capabilities and are confident that we're well positioned to profitably grow over time.

Page 18 of the webcast shows production statistics for our international markets across all three of Travelers' segments. Although, these statistics include more than business insurance, the overall trends are consistent with what we're seeing for the BI portion of international and reflect the rate risk selection, risk control, and other measures we continue to execute to improve profitability.

Lastly, I'd like to touch on our national property business, which had a notable increase in new business this quarter. In this space, we've been seeing more opportunities in the marketplace and we've been selectively writing some of that. Importantly, many are accounts that we've

quoted or written before, so we're familiar with them and we're writing them at prices and on terms and conditions that meet our discipline standards.

With that, I'll turn the call over to Tom.

Tom Kunkel

Thanks, Greg. Bond & specialty delivered another quarter of strong results. Segment income was \$174 million, a decrease of \$30 million due to a lower level of net favorable prior year development. The combined and underlying combined ratios were an excellent 74.9 percent and 81 percent, respectively. Net written premiums for the quarter were up a very strong 9 percent with solid growth across all businesses. Considering the high quality of our management liability portfolio, we are pleased that the domestic retention remained at a historically high 90 percent with renewal premium change higher at 4.2 percent.

New business for the quarter was a record \$65 million, up 20 percent from the prior year quarter. These results reflect a successful execution of our various marketing, product, and underwriting strategies to profitably grow these lines. Domestic surety net written premiums were up 4 percent over a very strong prior year quarter. Our existing portfolio remains well positioned to continue to provide leading returns over time and our competitive advantages allow us to thoughtfully and selectively add quality new accounts. So Bond & specialty results were strong and we feel terrific about our marketplace execution, competitive advantages, and our ability to continue to deliver excellent results.

And now, I'll turn it over to Michael to discuss personal insurance.

Michael Klein

Thanks, Tom, and good morning, everyone. Personal insurance grew income, revenue, and policies in force in the second quarter with improved performance in both auto and home. Segment income for the second quarter of 2019 increased \$105 million relative to the second quarter of 2018. Our combined ratio for the quarter was 100.2 percent, an improvement of 4.7 points over the prior year quarter, driven primarily by catastrophe levels that were nearly seven points below last year.

The underlying combined ratio of 94.6 percent was up two points from the prior year quarter, driven by an increase in non-catastrophe weather losses and the impact on earned premiums related to the new Catastrophe Reinsurance Treaty, partially offset by earned pricing net exceeded loss trend in agency automobile, and a lower underwriting expense ratio. Weather losses in the aggregate were better than the prior year quarter and we're pleased with the overall results. Recall that the second quarter is our seasonally highest quarter in terms of expected weather losses.

Turning to the top line, net written premiums for the quarter grew 6 percent with agency homeowners & other leading the way with growth of 11 percent. Personal insurance had strong retention in renewal premium change and record new--domestic new business for the quarter. Agency automobile, once again, delivered strong results with a combined ratio of 94 percent for the quarter, a 1.4 point improvement from the prior year period. The quarter benefited from a lower underlying combined ratio and lower catastrophe losses, partially offset by lower net favorable prior year reserve development. The underlying combined ratio continued to benefit from earned pricing that exceeded loss trend, including continued favorable frequency trends.

In Agency homeowners & other, the second quarter combined ratio was 104.5 percent, 9.1 points lower than the prior quarter due to lower catastrophe losses and higher net favorable prior year reserve development, partially offset by a higher underlying combined ratio. Higher non-catastrophe weather losses were the main driver of the 7.7 point increase in the underlying combined ratio to 92.9 percent as compared to the prior year quarter. While weather in total was favorable relative to the prior year quarter, a significant component of the weather activity came from non-PCS events this quarter in addition to PCS events that did not meet our catastrophe threshold.

Turning to quarterly production. Agency automobile retention remained solid at 84 percent with renewal premium change of 4.6 percent and a modest increase in new business from the prior year quarter. We remain focused on actions to grow this book at returns that continue to meet our objectives.

Agency homeowners & other delivered another strong quarter. We achieved renewal premium change of 6.7 percent, up 1.4 points from the first quarter, and up three points from the second quarter of last year with retention remaining strong at 86 percent. The pricing we achieved reflects actions we're taking to address the higher loss activity that we and the industry have experienced in recent periods. New business was up 26 percent, driven by our successful rollout of Quantum Home 2.0. QH2 continues to be well received and is performing as expected, driven by sophisticated pricing segmentation and the ability for agents and customers to easily tailor the product to meet their needs.

During the quarter, we continue to make investments in the business. For example, we rolled out QH2.0 in three more states and the District of Columbia and QH2 is now available in 28 states. We remain on track to complete the rollout in most of the remaining states later this year. In addition, we announced several new initiatives. First, we've partnered with American Forests, the oldest National Conservation Organization in the US to plant up to a million trees in connection with our initiative to encourage more customers to enroll in paperless billing, resulting in more efficiency for us, a better experience for them, all while benefiting the environment.

Second, we are working with Wildfire Defense Systems to help provide loss prevention services in California that supplement local firefighters and other first responders in the event of a wildfire. This new service gives California policyholders an added layer of wildfire protection at no additional premium. It is also an additional tool to help us manage our exposure. These are the latest examples of initiatives that continue to position us well to deliver value in the eyes of the customer and to grow profitably while investing in the business.

Now, I'll turn the call back over to Abbe.

Abbe Goldstein

Thanks, Michael. And thank you. We're ready to begin Q&A.

QUESTION AND ANSWER

Operator

If you would like to ask a question at this time, please press star, followed by the number one on your telephone keypad. Your first question comes from Jay Gelb from Barclays. Your line is open.

Jay Gelb

Thanks and good morning. I'm sure people are going to have a fair amount of questions on the underlying combined ratio shift in 2Q year over year. I really think you explained it well in terms of the impact of non-cat weather and the tort environment deteriorating.

I'm wondering, given the pace of price improvement, do you think at some point over the course of the rest of 2019 or 2020, we could see underlying margin improvement, given how those trends are unfolding?

Alan Schnitzer

You know Jay, we give you an outlook for the underlying underwriting margin in the outlook section of the 10Q and we do it by segment. So, you can see there what it is that we're thinking going forward.

In particular, in BI, where we're calling for continued improvement, really it's three things. It's non-cat weather. It's--we would expect improved results in International. And, in the fourth quarter of last year, you've got the timing impact of the fourth quarter auto adjustments.

But, there's a lot of levers we have to pull to manage overall margins and profitability, including price terms and conditions and we're working on all those things relentlessly in the market every day. That'll impact premium we put on the books and that also will earn in over time.

Jay Gelb

All right, that's helpful. Thanks. All right, so expectations of continued improvement. And, then I was wondering if you might have the rate impact or the rate benefit in domestic business insurance excluding what I would imagine is a drag from worker's comp.

Alan Schnitzer

Yeah Jay, worker's comp continued to be negative in the quarter. And, we have given that, as a separate statistic from time to time. We do it when we think it's relevant and we need to do it to clarify one thing or another

But, there's some competitive sensitivity there and we don't intend to continue to update that number and probably would prefer not to give it to you now. But, clearly, the numbers that you see for rate and RPC and BI would be higher, but for worker's comp, which is negative.

Jay Gelb

That's helpful. Thanks very much.

Alan Schnitzer

Thank you, Jay.

Operator

Your next question comes from Mike Phillips with Morgan Stanley. Your line is open.

Mike Phillips

Thanks. Good morning. Two questions. First on a personal insight agency auto. So, you saw pretty decent experience from many of your core margins. If I'm reading correctly, it sounds like your outlook calls for consistent levels of profitability into 2020.

So, I guess could you talk about what you're seeing on the competitive environment? It sounds like it might be more competitive now than it was last year and it sounds like if you're looking for consistent levels of profitability, you're not concerned then with any rising and physical damage severity impact in your margins there.

Michael Klein

Sure, Mike. This is Michael Klein. I would say on the competitive environment, we've talked about it the last couple of quarters. We certainly see, as you can also find, a moderation in rate increases being filed by our competitors. I think broadly speaking, it's in pattern with the methods that we've been sending that we're moderating rate in response to the improved profitability. And, I think we're working to be in step with the marketplace there.

In terms of loss trend, we do continue to see upward pressure on severity in personal auto more than offset over the last couple of quarters with improvements in frequency. I think what we're working to do is to balance our pricing with the long term view of trend over time and the outlook reflects the fact that we think we can do that and shift to a little bit more growth in auto at attractive margins. So, that's our--that's the view on our outlook.

The one exception, inside the outlook, you'll note that we talk about the fourth quarter in particular and so I'll just remind you of that as you look at the fourth quarter of 2019 and in comparison to 2018. There's a challenging year over year comparison there because we had both very strong quarter in terms of profitability in the quarter and in the fourth quarter of '18, we recognized some of the favorable loss trend that we had been seeing throughout '18. So, there was a good guy catch-up in the fourth quarter of 2018.

So, broadly consistent with the exception of the fourth quarter, which is really just the year over year comparison challenge.

Mike Phillips

Okay, great. Thank you, Michael, for the details there. Switching over to then to worker's comp, you mentioned this time, reserve development was from multiple accident years. I guess one, was there anything from accident year '18? Anything from the first quarter of '19 in that?

And, then I guess secondly, on comp, some competitors were talking about changing and loss trends may be slightly getting worse and California recently came out with some uptick in severity in California. So, I guess at what point do you become concerned on pretty substantial margin pressure in that line?

Dan Frey

So Mike, it's Dan Frey. I'll take at least the first part of it on PYD. So, to clarify, right, so there wouldn't be anything in PYD from the first quarter of '19. We'd count that as current year and then we would have called it out if there was a significant catch-up there.

With the long tail nature of worker's comp, the majority of our prior year reserves development is going to have come from years prior to 2018, just because you have a better chance to see how those are seasoning. But, there is a small piece from 2018 as we see the favorability in some of the older years continue to bid into 2018.

Alan Schnitzer

Mike, it's Alan. On the loss trend in worker's comp, I'd say broadly speaking, it continues to behave well.

Mike Phillips

Okay. Thank you very much.

Alan Schnitzer

Thank you.

Operator

Your next question comes from the Mike Zaremski with Credit Suisse. Your line is open.

Mike Zaremski

Hey, good morning. A couple questions. First, probably for Greg, in your prepared commentary, I believe you said in addition to price, you're getting tightened terms and conditions. If that's correct, I just wanted to clarify whether your disclosure of pricing changes is taking into account the terms and conditions tightening as well?

Greg Toczydlowski

Yeah, terms and conditions is all net inside our book of business yield. But, when we talk about terms and conditions, we're predominantly seeing that on the larger portion of the property segment. So, think insured to value, think deductibles, all peril deductibles, sub limits. So, that's where we're seeing some of those terms and conditions improvement.

So, as we make those changes on the renewal book, that certainly has an impact from a favorable point of view, from a loss cost net on the book of business.

Alan Schnitzer

Mike, are you asking whether that's sort of somehow adjusted in the rate number? Is that your question?

Mike Zaremski

Yeah, if it's mathematically taken into account within the disclosure in rate.

Alan Schnitzer

It's not math--I mean, the rate number is a pretty pure just price calculation, although to some extent, it could show up on the exposure side, right? So, if deductibles went up, for example, that would be a negative for exposure, but it would not factor into the pure rate calculation.

Mike Zaremski

Okay, that's helpful. I may follow up. And, lastly on tort inflation, would you say it's gaining momentum in terms of the inflation rate? And, do you think there are any underlying causes? I believe litigation finance, there's a bunch of--there's a couple public firms and there's been a lot of capital races there over the last couple of years and it's kind of gaining momentum. And, then asset class, maybe that's one of the underlying drivers. If you have any thoughts there, that'd be helpful. Thanks.

Alan Schnitzer

Yeah. So, it's--so what we're describing is the result of squaring triangles and coming up with numbers and then looking for culpable factors in the environment. So, there's a fair amount of estimation here and it's not--there's no math formula that gets us to the answer to that question necessarily.

But, I would say broadly, what we're reflecting in our numbers, we would describe is as a more active and more aggressive plaintiff's bar. Now, litigation finances, sort of its own topic and we certainly read about that. We can see numbers on that. We know more money is being raised for that as an asset class. We don't dismiss that as a factor.

I will tell you that that is one aspect that, at least now--this could change. But, at least now, we're not seeing that as a particularly significant driver in what we're referring to as changing the tort environment.

That could come--I mean, we're--we see the funds being raised for that and so--and by the way, to the extent we see that and anticipate it, that would get reflected in our loss picks as well. But, we're not seeing that as a standout issue.

Mike Zaremski

Thank you.

Operator

Your next question comes from Elyse Greenspan with Wells Fargo. Your line is open.

Elyse Greenspan

Hi, good morning. My first question, going back to the commercial auto and GL picks that went up in the quarter, I guess what I'm trying to tie together, is A, the increase that you guys saw there, and then also the commensurate increase in rate. So, do you--can you kind of try to bucket, I guess, how much of the rate was driven in your view off of just this higher loss trend environment, because when we think about going forward, it does sound like you guys are a bit more positive on pricing and reflecting relative to loss trend in terms of just thinking about your outlook? But, if trend keeps going up, that's going to obviously offset that rate versus trend phenomena.

Alan Schnitzer

Yeah. So, Elyse, we do give you some perspective on outlook for RPC in the outlook section of the 10Q. And certainly, everything we know about loss trend goes into our pricing models and our view of great adequacy and review of what rate we need to get to achieve our return objectives.

You know, I will say that does come in on a lag basis. We've got to see it. We've got to put it through in our models to the extent there are regulatory filings. There's a process there. Then, you've got to put it on the books. It's got to earn in. So, there is a lag between the recognition of these trends and the time price goes into the market and gets put on the book.

So, that's a long way of saying that commercial auto was at an inadequate return before we saw some of these trends. It just got worse. And I think, to a large degree, the pricing that we're seeing now is reflective of longer term trends in commercial auto. Although, some of what we're seeing in the quarter would be reflective of recent trends.

Elyse Greenspan

Okay. And then, my second question--so, you guys said the increase picks are about \$20 million going forward. That's about 50 basis points within business insurance. I know there's two buckets, one being commercial auto, and then, one being the GL portion. But, you guys did increase your commercial auto picks two quarters ago in the fourth quarter. So, I'm just trying to get a sense--the conservatism that you guys have now that this has been addressed and maybe

instead of half a point, it's not one point that you chose to increase to through your last pick in the current quarter.

Alan Schnitzer

Elyse, our objective isn't to miss it high or low. Our objective is always to get it right. We're trying to come up with an estimate of losses. We price the product based on an estimate of losses and the interest rate curve. And so, our objective is always to get the right price. And so, we wade through a lot of data. We've got terrific actuaries and experts that help us think through this. We've got management input on top of that. And our objective is just to get it right. So, can we tell you boy we swung a big stick at it and we're done, this is it? No, we can't. But, we can tell you that, based on everything we see in the data and based on our experience, we think we've got the picks in the right place.

Elise Greenspan

Okay. Thank you very much.

Alan Schnitzer

Thank you.

Operator

Your next question comes from Bijan Moazami with Compass Point Research. Your line is open.

Bijan Moazami

Good morning, everyone. Thank you for taking my question. I guess I want to understand a little bit more what's going on in the commercial auto business. In particular, you guys picked up a fair amount of premium volume this year and last year. Was it all rate, or was it something else? And this big pick up in BI severities that broad based, or is it related to a subjection of the commercial auto, or is it geographically located?

Greg Toczydlowski

Hi. This is Greg. Commercial auto, as you can see, in the quarter, we had an eight percent change in net written premium and a predominant dynamic underneath that is broad RPC across the portfolio. We're clearly seeing the commercial auto challenges that we believe the industry is also. So, it really isn't a segment of the book. It's a broad dynamic and hence the reason why we've been achieving RPC so broadly across it.

Bijan Moazami

Thank you. And then, regarding your \$6 million reserve charge for environmental liability--I assume this is all pre-1986 and what's going on there.

Dan Frey

Hey, it's Dan. I'm not sure if it goes all back as far as pre-'86. It's certainly in the accident years older than '09. It's really a continuation of what we have seen in environmental over the last several years. We do see an improving environment in terms of the number of claims that come in. Because it is old, we do expect it to run off. The reaction here in this quarter is simply that things have not improved quite to the degree that we would have anticipated in our prior pick. So, you're right to think about this as mostly very old stuff. You're right to think about it as generally improving over time in terms of the volume of these things slowing down. It just hasn't slowed quite to the degree that we had previously expected.

Bijan Moazami

Thank you.

Operator

Your next question comes from Ryan Tunis with Autonomous Research. Your line is open.

Ryan Tunis

Hey, thanks. Good morning. My first question, I guess, is just on the renewal rate numbers sequentially. I'm trying to get a feel for maybe how much that increase just had to do with the mix of the premium that you wrote in this second quarter versus the first because I noticed that there was less workers' comp where you're obviously not getting rate, but there was a lot more property where I'm guessing the rate is better than the three six. So, is there any way to kind of tease out the impact of just control for mix in that three six versus the--or the 130 basis point increase sequentially?

Greg Toczydlowski

Yeah. Ryan, this is Greg again. Comp wasn't off materially, and obviously every month we pride ourselves in our pricing to the local execution, very granular partnership with our distributions. So, it depends on the accounts that are coming up, the loss experience that's associated with them. And we do our best in partnering with them. But, can't really say that there was a comp dynamic driving that. It was really the exposures that came up for renewal.

Ryan Tunis

And the exposure increases in workers' comp--is it fair to kind of use the exposure increase for all of BI as a good barometer of what you're seeing in comp too?

Alan Schnitzer

No, not necessarily. And we don't disclose comp at that level. But, not necessarily. But, Ryan, I'm looking over the data. My instinct is that there's not a big mix factor driving the overall rate change.

Ryan Tunis

Okay. That's helpful. And then, my follow up was hitting on interest rates. First, I'm curious what the new money yield is today for the company. And then, second of all, just thinking about buy backs versus what the stock's trading--I haven't seen it trade at this price to book valuation in quite some time. And I know, Alan, you've always talked about structural returns in this business being linked, to a certain extent, to wherever interest rates are. I guess we're back to very low levels of interest rates. So, I'm curious, looking into the back half of the year, has your appetite for buy backs changed at all?

Alan Schnitzer

Yeah, Ryan. Let me start with the buy back. And then, I'll see if Bill wants to comment on the new money yields. But, in terms of buy backs, our first objective for every dollar of capital that we generate is to invest it back in the business when we think we can do that and generate a return for it. And when we can't, we're going to give it back to investors. And our alternative is to put that into a big * portfolio, and we don't think that's what our investors expect us to do.

As between dividends and buybacks, we think buying large buybacks is the preferred solutions. It's less diluted to book value per share. And so, we're not trading in this stock. We're right sizing capital. And we'll continue to do that. Of course, we wouldn't be buying back stocks if we thought the stock was trading at above intrinsic value, and we don't. So, this really is--it's not

tactical. We're right sizing capital, and it's a strategy to deliver shareholder value. And we--over the last ten or 12 years, we get this question from time to time when--depending on where the stock is trading--and so this has come as a concern before or at least a question before, maybe not a concern.

And I would just point out, since '06, we've bought back something like \$35 billion worth of stock and at an average price per share of, I think, 66 or 67 bucks a share. So, we feel pretty good that we've bought stock back thoughtfully and in a way that's created shareholder value and no change in our philosophy. Bill, do you want to comment?

Bill Heyman

Ryan, in terms of new money yields, in the second quarter, the new money yield was between 3 and 3.25 percent. It ended the quarter towards the bottom of that range, and it's probably about there now. We think more in terms of the relationship between new money yields and maturing yields. And obviously, in the fourth quarter of last year, we were reinvesting at book yields comfortably above money running off. We were above--in this first quarter--but less so. But, obviously in the second quarter, we slipped below and rates at the lowest point in that cycle.

To measure the gap, and--on a daily basis, it's random. So, we do it over periods. We look at the curve and spreads. We look at what is running off. We look at the mix of assets we're buying, which also changes. And we also look at sales we're making in the market. And we do make some sales, especially in areas where the Tax Reform Act changed the profitably to certain products. I can tell you that the gap as we measure it is in excess of 50 basis points and can run higher than that.

Alan Schnitzer

And Ryan, the net effect of everything Bill just shared was in the outlook for NII that Dan shared with his prepared remarks and it's in the outlook section of the 10Q. So, that would all be reflected in that number.

Ryan Tunis

Thank you.

Alan Schnitzer

Thank you.

Operator

Your next question comes from Meyer Shields with KBW. Your line is open.

Meyer Shields

Good morning. Quick question, I guess, on the workers' compensation reserve release. It's not a perfect comparison. But, Schedule P showed \$625 million or so of releases in full year 2018 for workers' compensation. So, it seems like the pace is picking up, and I was wondering, was that because of more conservative loss picks or incrementally better observed loss trends?

Dan Frey

It's Dan. I wouldn't say more conservative loss picks. I would say we're simply doing what we always do, which is every quarter, we're going to go through all the data as it comes in relative to the expectations that we had in the previous set of picks. Clearly, we've moved, over time, favorably in prior year reserve development and workers' comp. We do take those things and reflect them, and our most recent views, what you see this quarter, is simply another quarter's

worth of data where things have come in more favorably than what we would have embedded in the prior pick. I don't think this is, in any way, the unwinding of some increasing conservatism in prior picks.

Meyer Shields

Okay. That's helpful. Thanks. And then, I guess this is for Michael. If we take out the personal auto and agency homeowners from total personal lines, it seems like the remainder, the direct to consumer and international actually saw about a 200 basis point in the core loss ratio in the year over year basis, excluding catastrophes and reserve development. Is that mix--is that international?

Michael Klein

So, we obviously disclosed the segment. We disclosed the components. And you're talking about the delta. And we sort of talked about this in past quarters. The international book, which is predominantly Ontario auto, but broadly Canada, has been underperforming. We're being impacted there by similar trends and experience that you've heard others in the industry talk about. We've got a game plan to work to improve that. But, it's a challenging environment. I will say, on a positive note, we've got a seven point rate increase approved by Ontario earlier this year. We have another rate increase on file with the regulators as we speak, and, through that and some distribution management and underwriting actions, we're working to improve the performance there. But, yeah, the delta there is really a drag, primarily from international.

Meyer Shields

Okay. Excellent. Thanks so much.

Operator

Your next question comes from Yaron Kinar with Goldman Sachs. Your line is open.

Yaron Kinar

Thank you. Good morning. Point to the rate improvement in the business insurance. So, I think you said that it's currently an excess of loss trends on a written basis. Considering the fact that loss trends have moved up over the last couple of quarters at least, I guess, what quarter was the inflection point in terms of achieving rate in excess of trends?

Alan Schnitzer

Yeah, Yaron, that's a hard one to pick here on the fly. We're talking about going back and looking at it. We've said for a few quarters that they were close, one way or the other, a couple quarters ago, when we said written was a little bit ahead of trend, it was. Now, based on our new view, it was probably a little bit behind trend. Exactly what quarter or date the inflection point, is hard to pick. There's a lot of estimation in all of it. We can tell you that, as you heard Greg say in his prepared remarks, where we are today. And it's not just rate. It's rate and exposure. Where we are today, even taking into account our updated view of loss trend, we feel like, on a written basis, we're expanding margins.

Yaron Kinar

Okay. That's helpful. And then, if I turn to homeowners, so the deterioration in the accident year loss ratio comes in the face of strong NPW growth and the quantum two product in home. Is the quantum part of it the growth strategy performing as expected and it's just a matter of severe non-cat weather that's kind of throw a wrinkle this quarter or--yeah, why don't I stop there?

Michael Klein

Sure. And this is Michael. I would say the short answer to your question is, yes, the quantum home two product is performing as expected. As we monitor the loss experience there and, in particular, the data that's most credible still at this early stage is frequency. But, the loss experience is performing as we expected in the product. And in this quarter, really, the miss on underlying is actually more than explained by the non-cat weather variance.

I will take a step back and just talk to you sort of broadly about homeowner's profitability and just remind everybody that we have been talking about a bit of pressure on underlying loss experience in property. Some of that wasn't related. Some of that non-weather water related. And while non-weather water wasn't a significant impact this quarter, it doesn't mean it's gone away. And so, that's behind my comments about continuing to drive for price change in homeowners in order to address some of those underlying profitability challenges. But, again, we think it's really weather related and a little bit of non-weather water related, less about the product itself.

Yaron Kinar

Got it. Thank you very much.

Alan Schnitzer

Thank you.

Operator

Your next question comes from Amit Kumar with Buckingham Research. Your line is open.

Amit Kumar

Thanks, and good morning. Maybe two quick follow ups on the tort climate. The first question I have is--what should give us confidence that this, I guess, adverse trend line will not spread across other segments? Is it more so the inherent, I guess, nature of commercial auto, which leaves it open to the plaintiff bar chasing it, or what else is going on a bit more deeper basis?

Alan Schnitzer

Amit, I think we have said in prior quarters that we do see this thematically across liability lines. So, whether it's bodily injury severity in personal auto or whether it's the CMP product or--we have said we see it broadly. But, we've also said that there's--this is driven by commercial auto underlying dynamic. And the reason--and I think we went into this a little bit in the fourth quarter. But, the reason is there's a high degree of homogeneity to those losses, and so, in terms of the plaintiff's bar business model, there's just a lot of attractiveness to that as compared to other claims. A slip and fall, for example, where it's going to be highly dependent or anyway more dependent on facts and circumstances and it's a little bit more complicated to litigate.

But, again, as we've said in the past, we do see this thematically, and we are taking that into account in all of our loss picks. Just so far, it's been, for the most part, a commercial auto dynamic.

Amit Kumar

Alright. The second question, and my only question is, if you look at the past trend lines, and I think all of us have lived through adverse tort climate if your margin guidance--is the thought process that it stabilizes here, or are we at an inflection point, or--what should give us

confidence that this does not deteriorate or continue to deteriorate further and then sort of swing back? I mean, how do we think about the inflection point here on this plan? Thanks.

Alan Schnitzer

Amit, Greg did say, in his prepared remarks, that we did increase our loss picks for BI as a consequence of what we're hearing. So, we are--we think that the starting point was higher and the inflation rate from here is higher. As I said in my answer to a prior question, do we think we've taken care of all of this? We think so. Otherwise, we would have done something different. Having said that, we're not trying to be aggressive or conservative. We're trying to get it right. Our loss estimates, our viewed losses go into our pricing.

And so, it's important that we sharpen the pencil and put our very best estimate on it. And that's what we've done. And I think you can look back over some number of years in our business and our track record, and whether it's in commercial auto or whether it's in personal auto or other issues, this is insurance. Loss estimates and underlying loss dynamics are going to change. And all you can hope is that you've got the right data, the right analytics, the right experience, and the right expertise to see it and react to it. And we think, if you look back over time at our business, we've done a pretty good job of reacting to that. And this--it's unfortunate when it happens. But, that's the business we're in, and we think that we've done all the right things.

Amit Kumar

I got the answer I was looking for. Thank you so much, and good luck for the future.

Alan Schnitzer

Thanks, Amit

Operator

Your next question comes from the line of Brian Meredith with UBS. Your line is open.

Brian Meredith

Yeah, thanks. I'm just curious here, looking at the middle market--new business down year over year, little bit of deterioration or retention. Are you guys starting to dig in your heels little bit more right now, just on pricing and terms and conditions, maybe kind of like we started to see happen back in 2011, granted it doesn't seem like an extreme situation? But, is it--should we expect kind of new business to continue to kind of be more challenging here going forward, maybe retention start to deteriorate a little bit?

Greg Toczydlowski

Hey, Brian. This is Greg. First, when you do that math, you're looking down from a really strong period in the prior year. And we've shared with you, in the past, all the strategic initiatives we've been executing in the business, really, to free up our underwriters and give them more capacity to be active in the marketplace. The word active we'll use based on different environments in the business. Right now, active is really addressing what you said: making sure that we do have the right terms and conditions and, most importantly, the right adequate price on the product.

And so, our underwriters have been using a lot of that capacity right now to improve the margins on the business. And we think in terms of the book of business and your question on retention, we think it's a really high-quality book of business, and we do everything possible to work with

our distributors to try to keep those retention levels up there while improving the margins on the business also.

Alan Schnitzer

Brian, I'll just point out 2011 was a very different environment in terms of where we were and terms of rate adequacy and returns. So, difficult to draw a comparison. Every point in the cycle is different. I'm not sure there's a lot of comparison.

Brian Meredith

Got you. Got you. And then, second question, just quickly here. I know you guys aren't huge here. But, you do have an excess & Surplus lines or non-admitted carrier. Can you give us any differentiation between those two markets as far as what you're seeing happening in admitted versus non-admitted?

Greg Toczydlowski

Yeah. Brian, this is Greg, again. And we see some of the industry statistics also where it has been an uptick in some of the larger states from a non-admitted point of view. Just as a reminder, we have two areas where we write non-admitted business, one in our Northfield business, which is a less complex solution, a smaller business exposure. You can think of it that way. And then, we also use the non-admitted business across our property book of business. But, as you said, certainly not a real big part of our product strategy. And that's because we think we've got really modular and customized product offerings. And what we need to do to address terms and conditions in this market, our product portfolio has been able to do that. So, we've been comfortable with that portfolio mix.

Brian Meredith

Great. Thank you.

Operator

We have completed the allotted time for questions. I would now like to turn the call back to Abbe Goldstein for closing remarks.

Abbe Goldstein

Thanks, everyone, for joining us this morning. As always, if you have any follow ups, please feel free to get in touch with investor relations. And have a good day.

Operator

This concludes today's conference call. You may now disconnect.

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.

We caution investors that such statements are subject to risks and uncertainties, many of which are difficult to predict and generally beyond the company's control, that could cause actual results to differ materially from those expressed in, or implied by, such forward-looking statements.

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.