TRAVELERS

The Travelers Companies, Inc.

Third Quarter 2017 Results Conference Call

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CORPORATE PARTICIPANTS

Gabriella Nawi – *Senior Vice President, Investor Relations*

Alan Schnitzer – *Chairman, Chief Executive Officer*

Jay Benet – *Vice Chairman, Chief Financial Officer*

Brian MacLean – *President, Chief Operating Officer*

Michael Klein – *President, Personal Insurance*

PRESENTATION

Operator
Good morning, ladies and gentlemen. Welcome to the Third Quarter Results Teleconference for Travelers. We ask that you hold all questions until completion of formal remarks, at which time you'll be given instruction for the question and answer session. As a reminder, this conference is recorded on October 19, 2017.

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. Good morning and welcome to Travelers' discussion of our third quarter 2017 results. Hopefully, all of you have seen our press release, financial supplements, 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, Chairman and CEO; Jay Benet, Chief Financial Officer; and Brian MacLean, Chief Operating Officer. They will discuss the financial results of our business and the current market environment. They will refer to the webcast presentation as they go through prepared remarks, and then we will take questions. In addition, other members of senior management are in the room including Bill Heyman, Chief Investment Officer; Michael Klein, President of Personal Insurance; Tom Kunkel, President of Bond & Specialty Insurance, and Greg Toczydlowski, President of Business Insurance.

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 expressed or implied in forward-looking statements due to a variety of factors. These factors are described in our earnings press release and in our most recent 10-Q and 10-K filed with the SEC. We do not undertake any obligation to update forward-looking statements. Also, in our remarks or responses to questions we may mention some non-GAAP financial measures. Reconciliations are included in our recent earnings press release, financial supplement, and other materials available in the Investor section on our website, travelers.com.

And now, Alan Schnitzer.

Alan Schnitzer
Thank you, Gabi. Good morning, everyone, and thank you for joining us today. This morning we reported third quarter net income of $293 million or $1.05 per diluted share, and core income of $253 million or $0.91 per diluted share. The fact that we made a considerable profit in one of the costliest hurricane seasons on record demonstrates the earning power of our franchise which is built on the strong foundation of underwriting and investment expertise. This is reflected in our manageable catastrophe losses, underlying underwriting gain of $292 million, and after tax net investment income of $457 million.

Our catastrophe losses were well within what we would expect from the events in the quarter. Balancing risk and reward to generate leading results over time is in our DNA. While that's evident in our results this quarter, our underwriting discipline would have been even more evident if Hurricane Irma had taken the track through Miami and up the East Coast of Florida, which was projected just 48 hours before landfall. Notwithstanding ten years of relatively moderate Atlantic storm activity, our investors should know that we were well-positioned for the very real possibility of a $150 billion industry event. That's not to say that we'll never have a substantial or even an outsized loss from an event, it's just to say that balancing risk and reward is always front and center for us.

Our catastrophe underwriting also incorporates lessons learned over the years from events like Hurricane Katrina and Superstorm Sandy. Those lessons are reflected in our disciplined approach to terms and conditions which make outcomes more predictable; risk control initiatives, which make a difference in risk mitigation, selection, and pricing; and, proprietary flood underwriting down to the address level.

Our experience with the storms this quarter also reaffirms the competitive advantage in our claim model in terms of the value it delivers to our customers and agents, and for our shareholders. Through military-like logistics capabilities and a sophisticated cross-training strategy, we had the capacity to conduct, and we did conduct, virtually 100% of our claim inspections for Hurricanes Harvey, Irma, and Maria with Travelers employees. That would have been the case even if Irma had taken that East Coast of Florida track, and even in that scenario our flexible model would have given us capacity to spare.

As compared to an independent adjuster, we're confident that a highly-trained and committed Travelers claim professional produces a better experience for our customers and a much more efficient outcome for us. To that point, we were successful this hurricane season in meeting our objective of having the vast majority of our property claims closed within 30 days of the event.

Our response to the storms also included our largest deployment of our drone fleet to date. We conducted more than 1,000 inspections with drones which significantly accelerates the speed and reduces the cost of handling those claims, again, a better outcome for our customers and a more efficient outcome for us. We own and operate all of our drones and we're on track to have more than 650 drones in regular operation around the country by the middle of next year.

Moving beyond catastrophes, we are very pleased with the underlying performance of our businesses. In Business Insurance, the underlying combined ratio of 96.4 was solid, particularly in light of a high level of non-CAT fire-related losses. To a large degree, we believe it was normal period-to-period volatility.

Specialty Insurance produced another impressive quarter with an underlying combined ratio of 77.7. In Personal Insurance, the underlying results reflect loss trends within expectations, the continued success of the pricing and underwriting actions we began implementing in our Auto business a year ago, and the successful performance of our property business.

Notably, our consolidated expense ratio has improved 90 basis points year-to-date, the result of maintaining expense discipline while investing strategically. For example, in Personal Insurance, over the last few years we've invested in product and marketing initiatives, platform improvements, and distribution management resulting in significant net written premium growth.

In Business Insurance we're investing in technology and enhancing work flow to be a better partner for our agents and brokers, deliver compelling value for our customers, and improve our operating efficiency. We've made those investments on about flat G&A expense dollars. We're looking forward to sharing more about these initiatives with you at our Investor Day next month.

Turning to the top line, we were very pleased with the success of our marketplace strategies, which resulted in 4% net written premium growth to a record $6.7 billion. Across our commercial businesses we continue to be successful in achieving historically high retention rates, positive renewal premium change, and an increase in new business.

In business units accounting for around two-thirds of our Business Insurance premium, pure rate change in the quarter was higher both year-over-year and sequentially. In our personal auto business, our execution was spot-on plan and we were, again, pleased to see continued momentum in our industry-leading homeowners business.

There's been no lack of speculation around the outlook for pricing in the wake of an unprecedented hurricane season, which still has six weeks to go, and in the midst of an ongoing, unprecedented wildfire season in California. Big events impact pricing when a material amount of industry surplus is eroded and/or when the events change the market's view of risk. It's not hard to make the argument that we've experienced both, by some estimates 10% or more of industry surplus and counting.

The first time more than one category 4 hurricane has made landfall on the US mainland in one season. As devastating as it was, a very close call with Irma, and in the fourth quarter, forest fires that are burning not in forest, but in subdivisions, and that's not to mention two earthquakes in Mexico and a cyber-event impacting more than 140 million US consumers.

While those events have understandably captured everyone's attention, that's only part of the story. Interest rates remain at historically low levels. Loss trend has outpaced rate and exposure for a few years now to a degree that many others in the industry are probably not earning their cost of capital, and insured losses from PCS CAT events in each of the last four quarters have exceeded the ten-year average for that quarter. I can't predict what the market is going to do, but I will share with you what we're planning to do.

As a component of our strategy to manage all the levers available to us to meet our return objectives, for more than a year now we've been discussing our efforts to improve renewal rate change, and for more than a year now we've been making incremental but steady progress. The circumstances I've just described strengthen our resolve. We'll seek rate thoughtfully and in close coordination with our distribution partners, and in that regard, we believe our customers are well-served by a stable and predictable market that keeps pace with inflation as opposed to the higher pricing swings of the past.

Two final comments before I pass the microphone to Jay. First, I want to add my voice in support of the corporate tax reform efforts in Washington. As a country, addressing the corporate tax rate is important for enabling US businesses to compete more effectively at home and abroad against our foreign counterparts. Beyond just the tax rate we were particularly pleased to see that the big six framework for tax reform promotes leveling the playing field between US and foreign companies. In addition to contributing to the country's tax base it's important in addressing the decades-long streak of the US-based insurance companies losing US market share and American jobs to offshore companies, case in point, a $2.5 billion transaction announced just yesterday.

Finally, I'd like to thank our claim organization for an extraordinary effort over these past few months. They've certainly risen to the occasion. It's an understatement to say that events like Harvey, Irma, and Maria, and others that have been in the news, are devastating and our thoughts and prayers are with all those who have been impacted. Events like those serve as reminders that in the end, we sell a promise. We work hard to make sure that our agents and brokers are proud to sell that promise and that at every opportunity we demonstrate the value of that promise to our customers who buy it.

With that, let me turn it over to Jay.

Jay Benet
Thanks, Alan. Core income was $253 million, down from $701 million in the prior year quarter, and core ROE was 4.5%, down from 12.5%. As in the first half of the year, these reductions in core income and core ROE were not driven by fundamental changes in our underlying performance, rather they were reflective of the high level of CAT activity this quarter.

Beginning with underwriting results, our underlying underwriting gain remains strong as evidenced by our 92.8% underlying combined ratio which was 0.7 points higher than the prior year quarter. This slight increase was primarily due to a relatively high level of non-CAT fire-related losses in Business Insurance this quarter.

Catastrophe losses were $455 million after tax, compared to only $58 million in the prior year quarter. This increase of $397 million was driven by estimated losses from Hurricane Harvey of $319 million pre-tax or $207 million after tax, Hurricane Irma of $242 million pre-tax or $157 million after tax, and Hurricane Maria of $82 million pre-tax or $54 million after tax.

Net favorable prior year reserve development, which I'll discuss in more detail shortly, was $10 million after tax, down from $27 million in the prior year quarter. Net investment income of $457 million after tax continued to be strong, although down $15 million from the prior year quarter. Fixed income NII, as anticipated, was lower by $20 million after tax due to the continued low interest rate environment, while non-fixed income NII increased by $5 million after tax due to the strong private equity returns.

Interestingly, when we look at the long-term bonds we hold that are maturing through the end of next year, along with growth in the size of our fixed-income portfolio and higher short-term interest rates, our outlook for after tax fixed-income NII during the remainder of 2017 and into 2018 is only slightly lower, $10 million or less quarter-over-quarter as compared to the corresponding quarters in 2016 and 2017, an improvement from what we've been experiencing in recent years.

Consolidated net favorable prior year reserve development was $15 million pre-tax compared to $39 million in the prior year quarter. Business Insurance's net favorable reserve development was $9 million pre-tax compared to $4 million in the prior year quarter including an increase to asbestos reserves of $225 million pre-tax, the same amount as in the prior year quarter. Excluding the asbestos reserve increase, BI's net favorable reserve development was $234 million pre-tax primarily driven by better than expected loss experience in domestic workers' comp and GL partially offset by higher than expected loss experience in domestic commercial auto.

As has been the case in recent years, the asbestos reserve increase, which related to a broad number of policy holders, was driven by higher estimates for projected settlement and defense costs for mesothelioma claims than we had previously assumed. Notwithstanding these higher cost estimates, the underlying asbestos environment remains essentially unchanged from recent periods as compared to our expectation that the environment would improve. As you may recall, the current asbestos environment, which has continued to result in periodic reserve strengthening for us and the industry, is still much improved from the high-severity environment of 10 to 15 years ago when risks from pre-packaged bankruptcies, direct actions filed against insurers, and products/non-products coverage litigation, among others, led to very expensive settlement activity and a high degree of uncertainty in terms of the outlook.

The asbestos environment in more recent years has been frequency driven, the result of people developing mesothelioma and, unfortunately, dying soon thereafter. Interestingly, the most recent data from the Center for Disease Control, which we've included on Page 19 of the webcast, shows deaths from mesothelioma in 2015, the most recent data available, was 7.5% lower than in 2014, and importantly, the age distribution of these deaths has shifted towards higher age groups possibly due to more people who worked with asbestos prior to the mid to late-70s, the high usage years, "living into the disease."

What that means is that recent medical advances that have successfully treated a variety of other deadly diseases, seem to have enabled more people in this highly-exposed cohort to live well into their 70s and 80s and then develop and die from mesothelioma. As nature takes its course, this high-risk cohort will get smaller over time and, accordingly, we continue to expect the currently high-frequency claim environment to improve over time.

Bonds & Specialties, net favorable development was $6 million pre-tax compared to $46 million in the prior year quarter, while Personal Insurance had no reserve development compared to $11 million of unfavorable development in the prior year quarter.

Excluding A&E, year-to-date, on a combined stat Schedule P basis for all of our subsidiaries, all accident years across all product lines in the aggregate developed favorably and other than some modest reserve strengthening for commercial auto, all product lines across all accident years in the aggregate developed favorably or had de minimis unfavorable development.

Operating cash flows of over $1.6 billion was very strong and we ended the quarter with holding company liquidity of almost $2 billion, up from $1.7 billion at the beginning of the year. This higher-than-normal level of holding company liquidity provides funding for our $450 million of senior notes that mature in December. All of our capital ratios were at or better than target levels. Net unrealized gains were $1.5 billion pre-tax or $1 billion after tax, up from $1.1 billion and $0.7 billion respectively at the beginning of the year while book value per share of $86.73 and adjusted book value per share of $83.06 increased over 4% and 3% respectively from the beginning of the year.

Despite the high level of CAT losses, we returned $528 million of capital to our shareholders this quarter though dividends of $200 million and share repurchases of $328 million, bringing total capital return to shareholders to $1.68 billion year-to-date. As we've stated for many years and repeated in this quarter's 10-Q, the timing and actual number of shares we will purchase in the future will depend on earnings, among a variety of other factors. So, consistent with our ongoing capital management strategy we're keeping our eyes on the California wildfires, which we expect will be a significant CAT for us as we evaluate share repurchase activity for the fourth quarter.

With that, let me turn the microphone over to Brian.

Brian MacLean
Thanks, Jay. Starting with this quarter's results in Business Insurance, segment income of $105 million and the combined ratio of 109.8% were both impacted by the significant catastrophe events in the quarter. The underlying combined ratio of 96.4% was 2.3 points higher than the third quarter of 2016 with the underlying loss ratio increasing 3.4 points. The quarterly loss ratio was impacted by an unusually high number of large non-CAT property, primarily fire losses, and so the year-to-date results are a better indication of how the business is preforming.

On the year-to-date basis, the underlying loss ratio is up 1.7 points, 70 basis points of which is due to the large loss volatility I just mentioned, with the remaining about a point driven by loss trends in excessive earned pricing.

For the quarter, the underlying expense ratio decreased 1.1 points year-over-year. As with the loss ratio, there are normal fluctuations impacting the quarterly comparison. The year-to-date decline of about a half a point is a better indication of our current run rate with the decline driven by both growing earned premium and slightly lower G&A expense dollars.

Net written premiums of $3.4 billion for the quarter were up more than a point year-over-year with domestic net written premiums up about 2% driven by strong production results in Middle Market. International net written premiums were down 3% driven by re-insurance reinstatement premiums related to the CATs that occurred in the quarter, excluding the impact of reinstatements international was up 1%.

Turning to domestic production, we were pleased that retention for the quarter of 85% remained at a historically high level. Renewal premium change was strong at about 3 points in the quarter, with rate change that was up slightly from last quarter and up a half a point from a year ago. New business of $434 million was up 6% versus the prior year.

Looking at the individual businesses I'll begin with Select where production statistics remain strong with retention for the quarter of 83%, renewal premium change was nearly 5 points, while new business premiums of $98 million were up 4% year-over-year. In Middle Market, our results reflect consistent performance in the marketplace as demonstrated by another quarter of strong retention at 87%. Renewal premium change of 3 points was down slightly from the second quarter due to lower exposure growth while rate increases of nearly a point were up year-over-year and in line with the second quarter.

New business of $267 million was up 12% versus the prior year quarter. We attribute a large portion of this to great execution in the market by our field organization, particularly as it relates to larger accounts in industry segments that we like. We're also encouraged by how our investments in technology are enabling our underwriters to be more active in the market. We'll talk more about that at our upcoming Investor Day.

So, all in a quarter of that was significantly impacted by the weather and we were pleased with our execution in the marketplace. Our fundamental marketplace strategy remains unchanged. We seek to retain our best performing business while thoughtfully managing the profitability of the book. Importantly, the market and environmental circumstances that Alan outlined earlier further support our ability to successfully execute on this strategy.

I'll now turn to Bond & Specialty Insurance where segment income for the quarter was strong at $136 million, though down somewhat from the prior year quarter due to a lower level of net favorable prior year reserve development. The underlying combined ratio improved nearly a point from the prior year quarter to under 78%. As to the top line, net written premiums for the quarter were up 2% reflecting growth in both our domestic management liability and international businesses, with the international growth driven by strong production in both our Canadian surety and UK management liability businesses.

Turning to production in our domestic management liability businesses we continue to execute our strategy of growing our profitable portfolio by retaining our best performing accounts and writing new business in return adequate product segments. So, we couldn't be more pleased that retention came in at a record high of 89% for the quarter, the fourth consecutive quarter of 88% or better, while new business was up slightly from the third quarter of last year.

Renewal premium change of 3.5 points was up slightly from the second quarter due to a modest increase in exposure growth. So, Bond & Specialty results remain terrific and we continue to feel great about the segment's performance and our market positions.

Turing to Personal Insurance, net written premiums for the segment grew 9% in the quarter with more than half of that growth coming from higher pricing. Despite 8.7 points of catastrophe losses in the quarter, Personal Insurance generated $77 million of segment income with a third quarter combined ratio of 99.7%. The underlying combined ratio of 91% improved about 1.5 points year-over-year. The domestic Agency Auto combined ratio for the quarter was 106% and included 7.2 points of CAT losses, far above our normal third quarter auto CAT load expectation of about a half a point.

Compared to the third quarter of 2016, the underlying combined ratio is down 2.3 points. As you can see on Page 15 of the webcast, 1.3 points of the decrease is due to continued improvement in the expense ratio as we leverage a consistent level of operating expenses over a larger premium base. The remaining point of decrease is primarily due to the fact that the third quarter of 2016 loss ratio included the year-to-date impact of the bodily injury severity re-estimation.

As we discussed in previous calls, in response to higher bodily injury loss levels, we are taking actions to improve profitability most notably by improving the pricing of the book. As a result, renewal premium change increased from 7.9% in the second quarter to 9.5% in the third quarter, reaching 10.5% for the month of September. We expect that renewal premium change will remain in double-digits for the fourth quarter, and as we told you previously, by year end we will have obtained enough rate on a written basis to address the elevated bodily injury loss levels.

Retention declined modestly in the quarter, as expected, but remains strong by historical standards even as we implement meaningful price increases through the book. PIF growth has decelerated, but remains positive driven by lower levels of new business. Importantly, we remain on track to achieving the goals we laid out for the auto book back in January.

Turning to Agency Homeowners and Other, the combined ratio of 90.3% for the quarter reflects 12.2 points of CAT losses. The underlying combined ratio of 78.1% was in line with the third quarter of 2016 as net trend was offset by the impact of volume on the expense ratio. Homeowners net written premiums increased 5% in the quarter, somewhat accelerating the momentum we had experienced in recent quarters.

As a reminder, we have made a concerted effort to generate growth in this profitable line even as we moderate the growth in auto. Process and technology improvements have made it easier for agents and brokers to do business with us and we have focused on adding more property-oriented distribution partners and increasing our average number of policies per customer. Overall, in Personal Insurance, setting aside the significant impact of catastrophe losses in the quarter, both the Agency Auto and Homeowners results were in line with our expectations and both lines continue to make good progress towards the goals we laid out at the end of last year.

So, stepping back and looking across the franchise, while the headline for the quarter is obviously the CAT, we feel very good about our underlying results. Considering our significant competitive advantages, the investments that we're making to extend them and to develop additional advantages, and our ability to execute, we believe each of our businesses is positioned for continued success.

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

Gabriella Nawi

Thank you. We're now ready to open it up to Q&A. And, if I can ask you to limit yourselves to one question and one follow-up. Thank you.

QUESTIONS AND ANSWERS

Operator
Thank you. Ladies and gentlemen, we'll now proceed to the question and answer session. If you would like to register for a question, press the one followed by the four on your telephone. You'll hear a three-tone prompt to acknowledge your request. If your question has been answered and you'd like to withdraw your registration, 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 the first question.

Our first question comes from the line of Kai Pan from Morgan Stanley. Please proceed.

Kai Pan
Thank you and good morning. My first question is on the outlook for the core combined ratio for the Business Insurance segment. In your 10-Q you said broadly consistent into 2018. Could you walk us through the components of it in terms of your core loss ratio deterioration and also potential normalization of non-CAT losses as well as the improvements in expense ratio? And, does your forecast include a property and casualty better pricing outlook?

Alan Schnitzer
Kai, good morning. It's Alan. Thanks for the question. Let me start with it. We're going to try not to, in the outlook, try to break this down between the components of loss and expense. We give you a sense, as best we can, looking at our crystal ball which is never perfect and the world is never going to turn out exactly as we thought, but we try to give you as good a sense as we can on the overall profitability by segment.

In terms of the rate, in particular, you can see the written rate that we've been getting and, obviously, you can see, for example, in BI quarter-over-quarter, and so that will, of course, earn in and that will be a component of what gets reflected in our outlook, as will the impact of the expense ratio that you see in the nine months. But, we're going to try not to break it down between the loss and expense ratio component.

Kai Pan
Okay. My follow-up question on the reserve side of it, there are actually two components to that. One is on asbestos you've been taking charge of about $200 million a year for many years that we know, so why don't you take a big charge upfront or are you considering reinsurance transaction? The commercial auto side, what's driven that, and do you take out the increase of your current year, accident year loss take on the commercial auto line as well? Thanks.

Alan Schnitzer
Let me start with the auto side, and then I'll ask Jay Benet to comment on the reserves. On the auto, we've been seeing and talking about some severity on the commercial auto side for some time, and we've been addressing it. We view this as a tweak to those reserves in prior year periods and think about a $40 billion reserve increase on a couple of $2 billion or $3 billion reserve base, billion, a couple of $2 billion, $3 billion reserve base. So we look at that and we don't overreact to it. It's just the normal process of every quarter we go through, and we look at our reserves and look at the trends and the cases we've got out there and true it up. It's not anything that has to any significant degree impacted our view of loss trend or what's happening in the current year period.

Jay, do you want to address the asbestos?

Jay Benet
Yes. As it relates to the asbestos like every other reserve we take our best shot looking at all the data we have available at points in time to evaluate what the reserve should be. As part of that we're making assumptions as to what the future looks like with regard to the level of activity that will take place in terms of meso deaths and also look at what kind of settlement costs or litigation costs we face and come up with, as I said, our best estimate. What's been taking place over the last several years as we said in our description of the environment is the environment really hasn't changed very much, but the assumptions we've made that possibly would lead to a falloff in the amount of activity just haven't borne out. So there's nothing about our reserve increase that reflects a dramatically changing environment.

We thought we'd add some color to it this quarter with regard to this page we added to the webcast as it relates to what's been taking place in the various cohorts associated with mesothelioma deaths. We'll see what happens in the future, but as it relates to making any change in process or whatever, we didn't think that was appropriate.

Alan Schnitzer
Kai, as it relates to the reinsurance, you asked that as well. We certainly try to evaluate as best we can from the outside every deal we see announced by others, and we're talking to the same people that are on the other side of those transactions evaluating them for us, so no lack of analysis on our end or looking into it. If we found a deal that we thought really made a difference from an economic perspective, we would certainly be interested in that. We certainly see transactions that provide some limited duration benefit in terms of the GAAP accounting, but when we look at it from an economic basis and you get down to the cash flows, we just haven't seen one yet that makes sense for us.

Operator
Great. Thank you, sir. Our next question comes from the line of Jay Gelb with Barclays. Please proceed.

Jay Gelb
Thanks and good morning. I was hoping to touch base on the Business Insurance outlook for commercial insurance pricing. Alan, I believe in your commentary you talked about seeking thoughtful rate increases in conjunction with your distribution partners and keeping pricing ahead of loss cost inflation. Given all the factors that we've seen driving up large losses in the current quarter and into 4Q, can you talk a little bit more in terms of the outlook there?

Alan Schnitzer
Yes. We've been saying for some time, Jay, that for over a year now as we look at our book and we look down the road out at the horizon that we're going to need to improve written rate to meet our return objectives as part of our overall strategy. And we've been doing that for some time, and you can see we've had some incremental but steady success in it. When we look at the factors, when we look at the weather we had in the third quarter, when we look at some of the other things going on in the world, that's what's captured everyone's attention. I actually don't think that's the bigger part of the story. I think the bigger part of the story are the underlying dynamics that are driving the overall margins and profitability in this business.

When we look at that and we look at the accounts that we have, we say it's time to move a little bit. We're not executing towards a headline number. We take all our accounts and we segment them very thoughtfully. For some time we've been getting rate in excess of loss trend on the accounts that are most return challenge for us. And we're getting to a point where our need-to-get rate is sort of extending up the continuum and that's reflected in the fact that this quarter we got rate on a higher percentage of our accounts that we did last quarter and the quarter before that, etc., and it's been our intention to lean into that. The events of this quarter and the overall circumstances that I described cause us to say we're going to lean into it a little bit more, and we feel a little bit more confident in our ability to achieve it.

Jay Gelb
Makes sense, thanks. Then my follow-up is on personal auto. The underlying combined ratio for auto was improved to around 99%. I believe last quarter the company was talking about a longer term target of 96% to 98% plus some tenure impact, clearly you're getting closer there. How soon before you think we can get into the range?

Michael Klein
Hi, Jay. This is Michael Klein from Personal Insurance. Thanks for the question. And first thanks for noticing that the underlying combined ratio was below 100 and actually improved year-on-year. That's actually the first time in a while that that's been the case. Anyhow, Brian gave the main drivers of the quarter-over-quarter change.

I think to your question what's the longer term outlook, we think really there are two or three really key questions there. One is when are we in terms of pricing—where are we in terms of pricing for the increased bodily injury loss estimates that we recognized in the back half of last year. The second is is tenure playing out the way we anticipated. Then the third really is at the core of your question, what's our outlook for personal auto profitability.

And I'll just take those three real quickly in turn. Brian did mention we'll have achieved enough rate on a written basis by the end of 2017 to cover the increased level of bodily injury losses. That's on a written basis. So on an earned basis we remain on track to have done that by the end of '18, which is consistent with that 18 to 24 month timeframe that we laid out at the beginning of the year.

With respect to tenure, just a couple comments. One, it's important to note that the reason we spiked that out initially was that it had an outsized impact on these kind of period-to-period comparisons due to the elevated levels of new business that we were writing. As we talked about the impact of tenure from one period to the next, the delta that it drives dissipates as new business levels return to normal and as the portfolio matures, which is what's begun to happen in 2017. So from this point forward, tenure becomes less of an anomaly quarter-over-quarter and is just one of many factors that you need to think about as you look at our results.

I think what's most important to takeaway this quarter as respect to personal auto is we have begun to turn the corner on profitability. Earned rate is exceeding loss trend and it's combining with underwriting and process changes, growth, and expense ratio reduction to drive that improving underlying profitability that you see. As noted in our outlook, we expect underlying profitability in Agency Auto to improve over the next four quarters relative to the comparable prior periods.

I would remind you given we're going into the fourth quarter that the fourth quarter is a relatively high combined ratio period from a seasonality perspective, so you have to factor that into your overall evaluation. But at the end of the day, we feel good about the progress we're making towards our target combined ratio and that progress will continue through 2018 and into 2019.

Jay Gelb
Thanks for the answers.

Operator

Thank you. Our next question comes from the line of Randy Binner with FBR. Please proceed.

Randy Binner
Good morning. Thanks. I had a question on the CAT losses coming in quite a bit lower particularly with Harvey kind of coming in below the previously guided range. What changed there so dramatically? Did it have to do with the number of total vehicles or your ability to close claims as you commented earlier in the call? Just trying to get a sense of what improved and how settled the claim activity there is on Harvey and the other hurricanes.

Alan Schnitzer
Randy, it's Alan. I'm starting and then maybe Jay will have something to add. The only reason that we gave a view on Harvey is because we were speaking at a conference that wasn't FD compliant and we wanted to talk about it at that conference, and so we made a disclosure about it. That was relatively near to the events, and so there was a relatively higher degree of uncertainty around our losses at that point. So the range we gave reflected what we thought and all the information and uncertainty we had at the time.

We've had a significant amount of time elapse from then to now. We've had the opportunity to inspect virtually all of our claims. As I said, the vast majority of our property claims are closed. Not that there's no uncertainty left, but we feel much better from a certainty perspective and are confident in the number we put up. So I would really say nothing dramatic changed, it was the passage of time that gave us more insight into the losses.

Randy Binner
Well, given that comfort, would buyback be able to resume maybe earlier than would have been the case if there was more demand surge or other aspects making the tail longer on the claims?

Alan Schnitzer
In terms of the storms in the third quarter, we ended the third quarter with our balance sheet in very strong shape. So there's nothing from the third quarter where we feel like we have to build back a capital deficit to any degree at all. So the fourth quarter will be business as usual in the sense that we'll look at what our earnings are expected to be and we'll consider buybacks accordingly.

As Jay said in his prepared remarks, the wildfires are out there. That's an ongoing event, that will be significant for us, and so we'll evaluate that and our fourth quarter outlook for earnings as we make decisions about buybacks.

Randy Binner
Thank you.

Alan Schnitzer
Thank you.

Operator
Thank you. Our next question comes from the line of Ryan Tunis with Credit Suisse. Please proceed.

Ryan Tunis
Thanks. Good morning. I just had a couple I think for Brian. I guess the first one is if you were to just look at accounts where there were 3Q property losses on the business insurance side or maybe those that didn't even have losses but were in loss-affected geographies, what's been the conversation I guess so far about with renewals? What's been the magnitude of rate increases or how have those

conversations gone? Thanks.

Brian MacLean
I missed a little bit of the beginning. You said accounts of 32 on the, oh 3Q. I'm sorry. I think some of the stuff is obvious. In the really CAT exposed areas the conversations are very clear. The perspective on the flood risk, the exposure to the wind, we were reminded once again of what those are, so there's more momentum there.

I think it's more of what Alan said in his opening, the overall environment of what we've been seeing in property. Two or three years ago we were saying that the line was in very healthy condition and although experiencing some price decreases, the largest price decreases we were seeing in the book a couple years ago, we thought it was a healthy line and we'd manage it. A couple years later that compounding has impacted the core profitability, so we're looking at that.

We're also seeing a little bit of inflation running through the book of business and that is in the labor and material side, a number that wouldn't even be big enough to warrant a comment other than the fact that we're beginning to see it. The line is already under some pressure and the potential for demand surge out of all the CAT activity is making that more dramatic. So a bunch of stuff going on in the line today, and we think there's an opportunity to improve the profitability there.

Ryan Tunis
Okay. I guess my follow-up was just thinking about just the potential for further favorable or unfavorable developments in these events, I noticed in the queue that the commercial property IB&R looked like it was up about $300 million quarter-over-quarter. I guess just as you think about the losses you reported, where do you see I guess the greatest potential for uncertainty from here on out? Thanks.

Jay Benet
Well, anytime you have large CATS you're settling claims quickly, but generally those claims that you're settling are the more straightforward ones. So when you look at the level of IBNR there remains a great deal of uncertainty associated with the CAT losses. We've taken our best shot based on all the information that we have available, and we can't predict whether that will actually be higher or lower than what this will ultimately come out to be. I think we have a good track record of being fairly good at these estimates, but there is a lot of IBNR at this point in time.

Ryan Tunis
Thank you for the answers.

Jay Benet
Thank you.

Operator
Thank you. Our next question comes from the line of Amit Kumar with Buckingham Research Group. Please proceed.

Amit Kumar
Thanks and good morning. Two questions if I might. The first question goes back to the discussion on pricing. If I were to take that comment and sort of flip it towards the reinsurance side, how do you expect those discussions with the reinsurers to go? Do you expect to sort of hold the line on pricing based on your outlook or just maybe help us understand that equation a bit better?

Alan Schnitzer
I don't think we have a lot insight to give you on that. Obviously we'll be thinking about it over the coming weeks and months. I guess one reason we're not particularly preoccupied by this, we don't buy all that much reinsurance. We're a gross line underwriter. We like our underwriting, and so we don't buy that much. So on a relative basis we're less impacted by that.

I would hope that our thoughtful underwriting, as it was demonstrated in these storms, would factor into whatever pricing we negotiate when it comes up but it's just not something we spend a lot of time wringing our hands over.

Amit Kumar
Got it. That's a fair comment. Switching back to the discussion on Business Insurance, if you look at the mix of BI, 50% of the book is comp, international, and GL. Do you think these CAT losses give you ability to enforce some incremental rate action in the non-CAT impacted lines, or do you think that piece somewhat gets relegated to the exposed lines at this juncture?

Alan Schnitzer
Amit, you've got commercial auto on one end of the spectrum. You've got workers; comp on the other end of the spectrum and everything else sort of falls in the middle in terms of where it is in terms of rate adequacy. What I would tell you, though, and one of the reasons why in my prepared remarks I was so deliberate about talking not just about the storms that captured everyone's attention but about the other underlying factors in the business is those are real. Things like where interest rates are, things like what weather has done. We have pricing and loss trends over several years that impacts all the lines.

So we view—our pricing objectives I should say go beyond the property line, really extend across all our lines and all our geographies. So we're not thinking of this as property related or coastal related. We're thinking about it much more broadly.

Amit Kumar
I see your point. Thank you for the answers. Good luck for the future.

Alan Schnitzer
Thank you.

Operator
Thank you. Our next question comes from the line of Elyse Greenspan with Wells Fargo. Please proceed with your question.

Elyse Greenspan
Hi. Good morning. My first question, I'm just trying to get a feel as we think about flood risk here obviously a big component of the Harvey loss. How much of flood-related risk came through your commercial line exposure? As you think about going forward, is there an opportunity both on the commercial line side and then also maybe depending upon what happens with the National Flood Program to potentially write more flood risk both within your commercial and personal lines businesses?

Alan Schnitzer
Elyse, it's Alan. I'll start and then see if Brian's got anything to add, but Harvey was by in large a flooding event for us. As it turns out our underwriting held up and we feel good about it. We have a pretty good market share in the state, and our losses we think are reflective of the fact that we do have proprietary address by address flood underwriting that really stood up to it, and so we feel good about

it. Whether there's incremental opportunity, after every one of these big events we take a step back and we think about how we feel about our exposures and how we feel about opportunity and what the lessons learned are from that event and how we apply those to exposure elsewhere.

So we will be going through a post mortem process and assessing how we feel about our coastal flood exposure. We may look at that and say boy we could take on a little bit more. We may look at it and say we're just right, or we may look at it and say we'd like a little bit less. We're in that process but it could be we find more opportunity there.

On the personal line side, I think that's a much more complicated question and you get into the NFIP. It's really hard to compete with the government program that prices at the discount that it does. And as long as there's that program out there pricing at the discount to actuarial sound rates, it's not going to be an opportunity for us or anybody.

Elyse Greenspan
Okay. Then my second question, I know earlier in the call you guys did mention that the California fires would be a significant loss. How do we think through the losses there and the potential business interruption claims from some of the wineries that are obviously very significantly impacted from this event? Any color you can just give there? Thank you.

Alan Schnitzer
Yes. We're as interested in it as you are. I would say it's early, the event is ongoing, and it's hard for us to give a sense right now. I'm not sure what else to add there.

Elyse Greenspan
Okay. Thank you very much.

Alan Schnitzer
Thank you.

Operator
Thank you. Our next question comes from the line of Jay Cohen with Bank of America Merrill Lynch. Please proceed.

Jay Cohen
Thank you. Most of my questions have been answered. Just one quick follow-up, the elevated fire losses on the Business Insurance segment, can you talk about or quantify what the impact was in the quarter on the loss ratio?

Alan Schnitzer
Yes. In the quarter, Jay, I think around two points.

Jay Cohen
Got it. That's really helpful, Alan. Thank you.

Alan Schnitzer
Maybe a tick higher but two to two and a half, something like that.

Jay Cohen
Got it. Thanks.

Operator
Thank you. Our next question comes from the line of Sarah DeWitt with J.P. Morgan. Please proceed.

Sarah DeWitt
Hi. Good morning. Just following up on the pricing discussion, when you talk about pushing prices to keep pace with loss trends, should we interpret that as business insurance renewal rates should move closer to about 2% versus the 1% right now?

Alan Schnitzer
First, good morning, Sarah. Thanks for the question. I think that's a broader brush than we think about it. I think what you should takeaway is more than the one you see now. We talk about loss trend being four, and we'd like to get to a point where we have rate and the component of exposure that behaves like rate offsetting inflation and maybe even improving from there.

The other thing I would tell you is we're intent on doing this in a way that is thoughtful and controlled and in close partnership with our agents and brokers and do it in a way that isn't disruptive to our customers. We think that's actually a much better model for them. So this isn't anything we need to achieve tomorrow or next week or all in one fell swoop next quarter. This is going to be a gradual process over time.

Sarah DeWitt
Sure. Great. That makes sense. Then just when you say the loss trend being four, is that what you're actually realizing right now, or is that what you're booking your reserves out looking at a longer-term trend? But I thought maybe more recently it's been coming in lower than that.

Alan Schnitzer
Yes. The four is a broad number and it covers our whole Business Insurance premium base, so obviously there's variation among the products and businesses within that. The fact that we've had as much PYD as we've had over recent years suggests that it's coming lower than that. We don't in terms of our pricing expect that that's going to continue forever. We expect that over time loss trend is going to return to a longer-term average. So our longer-term outlook continues to be four, but again that's a very broad observation.

Sarah DeWitt
Sure. Thanks for the answers.

Alan Schnitzer
Thank you.

Operator
Thank you. Our next question comes from the line of Meyer Shields from KBW. Please proceed.

Meyer Shields
Thanks. Good morning. How does the fact that people are living into the asbestos-related diseases impact your thinking about permanent injuries on the workers' compensation side?

Alan Schnitzer
Say it again, Meyer.

Meyer Shields
Okay. On the asbestos side one of the factors driving the adverse reserve development is the fact that

people are living longer so asbestos-related diseases are manifesting themselves or there are claims associated with that. I'm wondering if people are living longer, how's that impacting workers' compensation reserving?

Brian MacLean
This is Brian. I'll take a shot. So obviously we are factoring in to everything we look at in workers' comp and permanent injuries, lifetime injuries. We're looking at the actuarial life expectancies and given the injuries that the workers have what is their life span. No question that advances in medicine in general have extended that period over time. I think it's a lot of the same information, but that's been embedded in our numbers forever really. We've always looked at it that way. So I don't think there's anything fundamentally new there.

Meyer Shields
Okay. Then one small question I guess. Within BI there's a $21 million expense for non-insurance G&A. I was wondering if you could talk to about that. What's going on there, what that is?

Jay Benet
What you're seeing, we closed the acquisition of Simply Business this quarter. So what you're going to start seeing is the G&A expense is going to be influenced by what's taking place with regard to their expense base. And from the other side of the coin, the other revenue line, is where their revenue numbers are getting consolidated so that will just work its way through our consolidated results going forward.

Meyer Shields
Okay. Is this a good run rate, the $21 million of expenses?

Jay Benet
Well we closed on the acquisition in August, so it's not quite a full quarter.

Meyer Shields
Okay.

Alan Schnitzer
I'm also not sure that on such a small component that we're necessarily going to give a perspective on a run rate expense for a strategic initiative like that. It's all factored into our outlook in margins for the segment.

Jay Benet
There's also costs associated with the acquisition itself that are flowing through that. So I wouldn't look at it at this point as a run rate. You can develop it over time. I think ultimately what you'll see is if you look at what's taking place with regard to revenues versus expenses in total it's not a big delta.

Meyer Shields
Okay. Perfect. Thanks so much.

Alan Schnitzer
Thank you.

Gabriella Nawi
This will be our last question please.

Operator
Thank you. This question comes from the line of Brian Meredith from UBS. Please proceed.

Brian Meredith
Yes. Thank you. The first question I think for Michael, on the personal auto business, is there a way to kind of dissect it where you can give us a perspective of how much the improved frequency the industry is seeing that is benefitting you versus what's happening with tenure and some of the underwriting initiatives that's happening?

Michael Klein
Sure, Brian. I would say as respect to the industry trending information we've seen the second quarter ISO Fast-Track data, taken a look at it, I would make I think the same comment we typically make about that data which is it's paid data, it's an interesting data point, it's certainly not complete. But as we look at the ISO Fast-Track data, we look at our own trend experience, we think those results are relatively consistent with what we're seeing.

As I mentioned in the earlier question, sort of dissecting the components, and I think I mentioned this, as you think about all the dimensions underneath the underlying combined ratio there's not really any significant change in any of them this quarter.

Brian Meredith
Okay. Great. Then my second question, just curious you mentioned the cyber loss obviously with Equifax upfront and there's been some others. Any change in your view of the cyber business here as a result of what's going on? What does the market look like right now for cyber? Is that becoming a more attractive growth area at this point?

Alan Schnitzer
Yes. Stepping back I would say that there's an increasing awareness and consciousness in the mind of the risk manager and whether that's a job description for somebody in a big company or a proprietor in a small business. I think there's a greater sense of the need for the product, and we think that's a healthy thing. We think to a degree that we'll be there to help solve that problem.

Having said that, we are extraordinarily mindful that it's an emerging risk and there's a lot about we know, and there's a lot about it we don't know. And that gets factored into the way we think about the industries we want to write in, the individual risks we want to write, the lines we put out, the reinsurance programs that we have. And so we do think it will continue to be a growing opportunity, and we will be continue to be cautious in the way we approach it.

Brian Meredith
Great. Thank you.

Alan Schnitzer
Thank you.

CONCLUSION

Gabriella Nawi
Very good. Thank you very much for joining us today. Also we look forward to seeing a number of you at our Investor Day on November 13th. Thank you very much, and have a good day.

Operator

Thank you. Ladies and gentlemen, that does conclude the conference call for today. We thank you all for your participation and ask that you please disconnect your lines. Thank you once again. Have a great day.

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.