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Second Quarter 2015 Results
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CORPORATE PARTICIPANTS

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PRESENTATION

Operator

Good morning, ladies and gentlemen. Welcome to the Second Quarter Results teleconference for Travelers. We ask that you hold all your questions until the completion of formal remarks, at which time you will be given instructions for the question and answer session. As a reminder, this conference is being recorded, July 21, 2015.

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, Carlos. Good morning, and welcome to Travelers' discussion of our Second Quarter 2015 results.

Hopefully, all of you have seen our press release, financial supplement, and webcast presentation released earlier this morning. All of these materials can be found on our website at www.travelers.com under the Investor section.

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

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

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

And now, Jay Fishman.

Jay Fishman

Thank you, Gabi. Good morning, everyone, and thank you for joining us today. By now, you've seen our second quarter results and as you can see from the release, it was another strong quarter, contributing to a very strong first half of 2015. We reported operating income of \$806 million, and an operating return on equity of 14.2%, bringing our year-to-date results to \$1.6 billion in operating income, and a 14.3% operating return on equity.

We achieved these results through strong underwriting performance, and solid investment performance consistent with our expectations. Most importantly, our long-term average operating return on equity now stands at 13.4%, well in excess of our cost of capital. This quarter is another brick in the wall of

exceptional long-term performance.

For all of the recent market commentary about the industry, our experience remains business as usual. At the point of sale where business is actually conducted, that is one agent, one underwriter dealing with one account, things are very stable and just fine. In fact, the commercial insurance marketplace dynamics over the last six months have been remarkably consistent with what we believe would happen, and have been far different from the historical conventional wisdom.

We continue to believe that the amplitude of the cyclicalities that our industry will deal with is much less than would have been the case historically, and you can trace that comment back to our Investor Day in May of 2007. Of course while things can change, so far so good.

Anticipating that some of you are going to ask us about our take on the recent consolidation in the primary P&C industry, let me make a few observations. No primary P&C insurer has come together over the past two decades through acquisition activity more than we have. We're very good at it, and while we haven't announced any mega transactions in a number of years, our shareholders should expect that we are aware of the possibilities and that we are expert at evaluating them. That evaluation comes down to determining the best way to create shareholder value.

The return-driven strategy that we've been executing for nearly a decade now has been highly successful in creating shareholder value. Our total return to shareholders over virtually whatever period you want to pick is at the top of the heap.

So, when we evaluate M&A opportunities, which we do all the time, we evaluate them against that standard. As it relates to Chubb, when we consider the modest opportunity to improve the performance of an already high-performing company with some of the best people in the industry, the high degree of risk inherent in combining two successful but very different cultures and the significant impact on returns on equity from the combination of the premium we expected would be required, as well as all of the required purchase accounting adjustments, the return just didn't measure up. We have the luxury of a Plan A that sets a very high bar, a strategy that comes from having highly differentiated competitive advantages, and highly successful business franchises with industry-leading product breadth.

Again, we believe that our total return to shareholders over the recent past, as well as over the longer-term speaks for itself, and we are confident in our ability to continue to deliver superior returns. But, we do keep looking at M&A opportunities, and when we believe there is a transaction that contributes to creating shareholder value, we'll make every effort to complete it.

Other than addressing the potential market implications of the transaction, which Brian will do, I hope this addresses your questions on the topic. We really don't expect to comment further on that recently announced transaction. And with that, I'm going to turn the call over to Jay Benet.

Jay Benet

Thanks, Jay. As Jay said, we are very pleased with our second quarter results, operating income of \$806 million, up 20% from the prior year quarter, and operating return on equity of 14.2%. Current quarter operating income was driven by a very strong consolidated combined ratio of 90.8%, which was 4.3 points better than the prior year quarter due to strong underlying underwriting performance, continued net favorable prior year reserve development, and lower catastrophe losses, as well as the inclusion of a \$32 million benefit from the favorable resolution of prior year tax matters. Operating income was also driven by solid net investment income, consistent with our expectations, although lower than in the prior year quarter.

Brian, Alan and Doreen will talk more about underwriting results in a little while, so let me say a few words about NII. As was the case in the first quarter, current quarter net investment income is being compared to a very strong quarter last year. Fixed income NII of \$431 million after-taxes, down \$32 million from the prior year quarter, principally due to what we have been saying for many years: Securities that have higher book yields have run off during the past 12 months, and have been replaced with securities having lower yields due to the current interest rate environment.

Another contributing factor to lower fixed income NII was the modest reduction in average investments that resulted in part from the company's \$579 million first quarter 2015 payment to settle the asbestos direct action litigation.

Non-fixed income NII of \$79 million after-tax was down \$16 million from the prior year quarter due to lower returns for energy-related private equity investments. These investments produced negative NII of \$9 million after-tax this quarter, which was better than the negative NII of \$21 million in the first quarter as compared to positive NII of \$11 million after-tax in the prior year quarter.

As I mentioned, earnings continued to benefit from net favorable prior year reserve development, which amounted to \$207 million pretax this quarter, up \$24 million from the prior year quarter. In Business and International Insurance, net favorable development of \$103 million pretax resulted from better than expected loss experience in several different product lines, including workers' comp for accident years 2006 and prior; GL for 2008 through 2013; Lloyd's in Canada, and property in both CMP and the property product line for more recent accident years, partially offset by a \$47 million after-tax, or \$72 million pretax increase to environmental reserves.

In Bond & Specialty Insurance, net favorable development of \$40 million pretax resulted from better than expected loss experience in contract surety for 2010 through 2013. In Personal Insurance, net favorable development of \$64 million pretax resulted from better than expected loss experience in homeowners and other liability for 2011 through 2014, and for non-cat weather-related losses for 2014, as well as better than expected loss experience in auto liability for 2012 through 2014.

On a combined stat basis for all of our US sub, there were no accident years, or product lines that had any meaningful unfavorable development this quarter or year to date.

Second quarter operating cash flows were also strong at \$676 million, up \$51 million from the prior year quarter, while holding company liquidity ended the quarter at over \$1.7 billion, and all of our capital ratios remained at or better than their target levels. Net unrealized investment gains were approximately \$2.1 billion pretax, or \$1.4 billion after-tax, down from \$3 billion and \$2 billion respectively at the beginning of the year due to the recent rise in interest rates, causing book value per share of \$77.51 to grow by only one-percent from the beginning of the year.

Importantly, adjusted book value per share of \$73.09, which eliminates the impact of unrealized investment gains, grew by 3% during this time period. We continued to generate much more capital than we needed to support our businesses and consistent with our ongoing capital management strategy, we returned almost one billion dollars of excess capital to our shareholders this quarter through dividends of \$194 million and common shares repurchases of \$801 million, bringing total capital returned to shareholders to almost \$1.85 billion year-to-date.

Before turning the microphone over to Brian, there's one more topic I'd like to cover, our cat reinsurance coverage. As you may recall, effective January 1 of this year, we significantly increased the attachment point of our gen cat reinsurance by replacing our previous gen cat treaties, the \$400 million cat aggregate excess-of-loss treaty, which expired as scheduled on Dec 31, and the \$400

million gen cat treaty, which our reinsurers agreed to terminate early as of that date, with a new aggregate XOL treaty that provides coverage for both single events and accumulation of losses from multiple events - \$1.5 billion of coverage, part of \$2 billion excess of \$3 billion after a \$100 million deductible per occurrence. By doing this, we retain the same broad peril and geographic coverage as the former gen cat and XOL treaties, while positioning the coverage layer to provide a significant buffer between earnings and capital.

During the second quarter, we repositioned our northeast specific cat coverage, lowering its attachment point from about \$2 billion while maintaining its maximum recovery. Our current combination of two northeast cat bonds and the new northeast gen cat reinsurance treaty attaches at \$1.058 billion of covered losses, and provides \$1.4 billion of coverage thru \$3.1 billion, the point at which the gen cat aggregate XOL treaty takes over. Taken collectively, we increased our potential reinsurance recoveries and repositioned the attachment points to more closely align with the risks in our business while spending essentially the same amount. A more complete description of our cat reinsurance coverage, including a description of new earthquake and international coverages, is included in our second quarter 10-Q, which we filed earlier today, as well as in our 2014 10-K.

So with that, now let me turn the mic over to Brian who's going to speak about underwriting results.

Brian MacLean

Thank you, Jay. Alan and Doreen will go over the segment details, but before they do I want to make a few comments about the macro environment.

Echoing Jay's comments, we're certainly very pleased with our results, both in the quarter and for the first half of 2015. We're at a 90% combined ratio year-to-date, very strong retention, stable renewal increases and no major surprises in our loss trend. In fact, results like this are what we spend our careers hoping to achieve, and here we are. But importantly, we didn't get here by accident. We did it with relentless and consistent execution on our strategies, and by investing in and developing a broad breadth of products and services, and other meaningful, sustainable competitive advantages in the markets we serve.

But while we feel great and want to talk about how well we're positioned, I suspect many of you are also interested in our thoughts on the impact that the Ace/Chubb transaction may have on the marketplace. So, let me share a few thoughts on that.

First, we already compete against these two companies, more so Chubb than Ace given our business and geographic focus, and we don't anticipate a lot of difference in competing against them as a single entity. Any company that is large enough can disrupt the market if it's willing to accept meaningfully lower returns over time. But, both Ace and Chubb were probably large enough to have done that before the transaction, so we don't see that risk being any different going forward.

Second, we have great long-term and trusted relationships with our important broker and agent partners, and we don't see that being disrupted. We remain a leading independent agency commercial insurer in our principal market, the United States, and in Personal Lines, we are the leading independent agency market in the homeowners business, and we don't generally compete in the high-end home product, which is Chubb's primary Personal Line focus.

Third, having completed a number of large-scale transactions ourselves, we know that there inevitably will be disruption and dislocation of people and business. This will likely create near- and medium-term opportunities, and it's possible we will benefit from these. Obviously, only time will tell what the long-term impact may be. But as I said before, we feel great about Travelers. We remain very pleased with

how our business is performing and more importantly, how well we are positioned for opportunities in this marketplace going forward.

Before I turn the call over to Alan, I'm sure that many of you have seen that recently we made some senior level organizational changes, and I want to recognize a few of those folks on their new responsibility. Greg Toczydlowski, who's done a fabulous job managing our Personal Insurance business, is moving over to Business Insurance to oversee our Small Commercial operation, as well as take on responsibilities for technology, operations and business platform across all of Business Insurance.

Michael Klein, who had been managing our Middle Market Commercial business, will take Greg's spot in Personal. Michael has had a broad range of experiences in his 25-plus years with the company, and his management skills, knowledge of analytics and our products make him perfectly suited to run the Personal business.

Mark Schmittlein, who for the last 12 years has led our efforts in Small Commercial business, will take on the role of coordinating our cyber insurance efforts across our business. We see cyber coverage as an important an important opportunity in the marketplace.

Scott Higgins will assume leadership for our Middle Market Commercial business, and Behram Dinshaw has been appointed Chief Operating Officer, Personal Insurance.

We're thrilled that we have this depth of management talent and the collaborative culture in which great people can thrive. After all, in this industry, when we talk about competitive advantages, we start with talent and culture, and to succeed, you need both of them.

With that let me turn it over to Alan to cover the Business Insurance and International Segment.

Alan Schnitzer

Thank you, Brian and good morning. We delivered another quarter of strong performance in Business and International Insurance with operating income of \$543 million. Our underlying combined ratio was relatively consistent with the prior year quarter at 93.1%, reflecting attractive and stable product returns.

In terms of the top line, net written premiums decreased by a little over one percent from the prior year quarter. This was driven by our International business, where net written premiums were down 15% primarily as a result of the adverse impact of foreign exchange. Domestic business insurance net written premiums were up about a point and a half.

In terms of our domestic production results, as Jay said, we remain pleased with the stability of the market, as evidenced by historically high retention and positive rate change. We've commented for some time now that as pricing has improved, more of our portfolio is generating attractive returns, and our objective has been to retain more of that business. We've now posted a very strong 84% retention for two consecutive quarters.

As you can see on Slide 9, excluding the impact of our large account property business, which I'll get back to in a minute, positive renewal rate change in Domestic BI was unchanged from the first quarter. Our ability to deliver these results comes from the excellent execution by our field organization of our very granular, account-by-account and class-by-class strategy.

Turning to Slide 10 in the webcast, in Select, retention hit a 6-year high, while renewal premium change moderated only slightly. In Middle Market, we posted very strong retention and steady sequential

renewal premium change. Notably, within renewal premium change, renewal rate change has been remarkably steady over the past five months. In terms of retention, we're retaining around 90% of our best performing business, while achieving renewal rate gains in excess of loss trend on our worst performing business. New Business in Middle Market was down year-over-year. While we like the marketplace stability, one consequence of a stable market is that submission flow is down somewhat.

In Other Domestic Business Insurance, while renewal rate change turned negative this quarter, as you can see on Slide 12 of the webcast, the decrease is driven by National Property, our large account property business. Excluding the impact of National Property, renewal rate change in Other Domestic BI would have been a positive 1.9%. To put it in context, National Property accounts for about 25% of the net written premium in Other Domestic BI, but only about 5% of the net written premium in the segment. Even with the rate change in National Property, current pricing levels and returns in that business are attractive, and accordingly we have successfully driven retention to near record levels.

In our International business, retention continues to be strong and steady at 82%, while renewal premium change of 1.5% was consistent with last quarter. New business is down over the prior year quarter, primarily as a result of disciplined underwriting in a competitive environment in Lloyd's, and the impact of foreign exchange rates.

To sum it up, we're pleased with the stability in the marketplace and the results we delivered in the quarter, and with the depth and breadth of our talent, particularly in the field, our deep analytical capabilities and our market leading products and services, we're well positioned to continue to deliver superior results.

And with that, let me turn it over to Doreen.

Doreen Spadorica

Thank you, Alan and good morning everyone. Bond & Specialty Insurance had another strong quarter with exceptional financial returns. For the quarter, operating income was \$151 million, a reduction from the second quarter of 2014, driven by a lower level of net favorable prior year reserve development, partially offset by a favorable resolution of prior year tax matters. Underlying underwriting results remain very strong and well within our targets.

As for top line, net written premiums were generally flat to 2014. Across our Management Liability businesses, retention and new business premiums picked up modestly, while renewal premium change was down slightly; so, great results for this segment.

I'll turn now to Personal Insurance where we also had another terrific quarter with strong underwriting results in both Agency Auto and Agency Homeowners & Other. For the segment, operating income for the quarter was \$174 million, up significantly from the second quarter of 2014 due primarily to lower cat and non-cat weather, and higher net favorable prior year reserve development. The underlying combined ratio improved by more than a point from the prior year quarter driven by favorable non-cat weather. We continue to feel great about the margins in this segment.

Looking at Agency Auto, we once again delivered strong top and bottom line results for the quarter, and continue to be very pleased with the performance of this business. The 96.5% combined ratio for the quarter included 2.5 points of favorable prior year reserve development, which was driven by better than expected severity in bodily injury. The underlying combined ratio of 96.9% continues to run in a range we're comfortable with given current market conditions. This result was up modestly from the prior year quarter due to a variety of small items including non-cat weather, which, although materially

favorable for Homeowners, was slightly adverse year-over-year for Auto. Our loss trends remain consistent with recent quarters.

Production results also continued to be strong, driven by Quantum Auto 2.0 where we are now coming up on 2 years since the start of the roll-out. New business premium was 37% higher than the second quarter of 2014, and we continued to grow policies in-force, which increased more than 35,000 during the quarter. Net written premiums increased 7% from the prior year quarter. So by all measures, great results for Auto for the quarter.

Turning to Agency Homeowners & Other, we once again delivered strong financial results with an underlying combined ratio of 77.5%, a four point improvement from the prior year quarter driven by relatively benign non-cat weather. Margins in this business remain well within our return expectations.

As for Agency Homeowners production, we're very pleased with the progress we're making. New business premiums were up 33% from the prior year quarter and continue to trend favorably while retention remains strong. Policies in-force have leveled off, and net written premiums are essentially flat from the prior year; so, the book has stabilized. As we said in prior quarters, this is an area of high focus for growth, and we're encouraged with the positive results we're seeing. So to sum up Personal Insurance, another great quarter.

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

Gabriella Nawi

Thank you. We'll now take questions please. Before we start, can I remind you all to please limit yourself to one question and one follow-up. Thank you. Carlos, go ahead.

QUESTIONS AND ANSWERS

Operator

Thank you so much. Ladies and gentlemen, to queue up for a question, please press the one followed by the four on your telephone. You will hear a three tone prompt to acknowledge your request. If your question has been answered and you would like to withdraw your registration, please press the one followed by the three. If you're using a speakerphone, please lift your handset before entering your request.

Our first question comes from the line of Randy Binner with FBR Capital Markets. Please go ahead.

Randy Binner

Hey, great. Thank you very much. So, Travelers has followed kind of a moderation in price decrease as we've seen across commercial lines. And so, I was wondering if we could go a little more into detail and what you're seeing out there, what's causing that headline pricing number to moderate more as it approaches the zero level.

Alan Schnitzer

Randy, it's Alan Schnitzer. I'll take that. You guys focus on the headline rate number a lot more than we do. We're looking at this on an account-by-account basis, and it'll build up to whatever it builds up to. And at least in our performance, I think what you see is as more of our business is reaching rate adequacy, our objective is to keep that business, not to continue to necessarily get price on it. So, it really is a function of more of that business going over four years of rate increases to rate adequate for us. What you see in the headline number is just an aggregation of all those individual transactions.

Randy Binner

I know we focus on the number, but it's important for us. Is there kind of more consistency, or more rational behavior in the environment? Is there less— I mean Travelers is a big company and there's a lot going on, like Property for instance. But, is there kind of less bad behavior out there in the most recent quarter compared to maybe what we saw later last year?

Alan Schnitzer

Yeah. So, Randy, I didn't mean to suggest that the number is not important. I'm just suggesting we focus on it differently than you do because we're executing really on a very, very granular basis, and we're looking at it one account at a time. But to get back to your other question, I think when we talk about the market among themselves and we talk to our field organization, we would say that by and large it does appear to be a pretty rational marketplace, and it appears that there's a real return focus in the industry.

Jay Fishman

This is Jay Fishman. I think that's absolutely right, and Brian spoke about it as well. Any one company, if it's large enough, and is willing to accept subpar returns over time can affect the marketplace from a pricing perspective. That's not been the case. It's not been the case for a long time.

Now, why that is; I actually think a lot of it is data and analytics and the fact that people actually understand their returns better than they did ten years ago. No one would openly knowingly say, "Well, I'm pricing this to produce subpar returns." I think that happened to some extent accidentally, not intentionally.

And so, I think the data is different in the business. It's been different for some time. I get asked all the time, "Are we pleased or not that other people seem to be getting good at it?" I think it's great. I think the more people understand the cost of goods sold in our business and the risk associated with it, the more we look like a normal financial services business and less of one that's operating in the dark.

So, I think that we may have led this. In fact, I'm sure we did. But, the fact is that you see it in virtually everyone's reporting, greater reliance on analytics and return focus, and that's, I think, what's causing it. We're allowing it to happen perhaps is a better expression.

Alan Schnitzer

And Randy, the other thing I'd point you to is the rate at which insurance companies by and large are returning capital to shareholders. And if you look at that trend over a long period of time, I think you'll see a lot more capital being returned. So, to the extent capital can't be deployed at acceptable returns, I think you see a trend toward getting it back.

Randy Binner

All right. Thank you very much.

Gabriella Nawi

Next question, please.

Operator

Our next question comes from the line of Kai Pan with Morgan Stanley. Please go ahead.

Kai Pan

Good morning. Thank you. The first question regarding to the fall off of the pricing trend. Just wonder if the trend stabilized, would we see the margin also stabilizing at this level or could there potentially be

some margin pressure relative to the [indiscernible] trend side.

Alan Schnitzer

Yeah, Kai. It's Alan. Let me take that as well, and I guess it depends on how you look at it. So, let's just say rates are a point or a point and a half at the moment. We've said that loss trend is running at about four. So, if you're looking on a very narrow basis at the relationship of those two things, maybe you'd say that rate isn't covering loss trend. But, there's obviously a lot more in margin.

So, you've got volume, mix, claims handling practices, underwriting initiatives, expenses, weather. All those things come through the margin every quarter, and there's always going to be movements in those things. So, I would say that where rate and loss trend are sort of too close to call where margins are going to drift over time given the current relationship of those two things.

Kai Pai

So, non-cat weather benefits the quarter overall?

Alan Schnitzer

Non-cat weather in— well, weather overall in the quarter compared to the prior year was favorable if you take cats and small weather. Small weather was about the same year-over-year.

Kai Pai

Okay. Great. Follow-up question—

Alan Schnitzer

You know what? Kai, I'm sorry about that. I was looking at the wrong number. There was a benefit in the quarter in small weather.

Kai Pai

Great. A follow-up question on management succession. Jay, you have been running the firm fabulously well like for the past ten years, and you also like some management change recently show you have a deep bench there. I just wonder what [indiscernible] consideration about management succession planning?

Jay Fishman

Yeah, actually, thank you for asking the question. I'll actually answer it a little bit broader just in case anybody really wants to, but is uncomfortable because it's a perfectly reasonable question given our announcement a year ago about my health status to ask about what's going on.

So first, I observe that we've been, I'd say, as open as anyone can be about my own personal health status and more importantly, perhaps most importantly, I've kept my partners on the board of directors here completely apprised, knowledgeable as I've gone along in that process. I am very much on the job, and fully engaged. And at least from my own perspective, there's no decline in my cognitive skill. Maybe others around here might disagree, but I don't feel I'm struggling in that regard.

Now, we've always taken succession planning seriously, whether it was 5 years ago when I was 57 if I did the math correctly, or now that I'm going to be 63 and dealing with a health issue. It's no different. We take it as seriously now as we did then, and there is absolutely a plan in place with certainty, I will tell you that. And for the moment, all good and when we have more to say about succession, and given the fact that I'm going to be 63, we will have more to say, we're going to say it. And until then, I'm on the job and we're doing just fine.

Kai Pai

Great. Well, thank you so much.

Jay Fishman

Thank you.

Operator

Our next question comes from the line of Michael Nannizzi with Goldman Sachs. Please go ahead.

Michael Nannizzi

Thank you. I guess one question may be for both Jay Fishman and Jay Benet on the capital generation, capital deployment side. I mean recently you've been deploying more cash than you've generated when we look at operating cash flows and deduction for dividends and buybacks. Is that something that you expect to continue to do just given capital efficiency that you're generating? And when we think about potential M&A, or capacity for M&A, or maybe a desire to do something, to bolt something on, does that pattern need to change to be able to create more of a base to start from? Thanks.

Jay Fishman

We're both going to answer that because I think there are parts of it that are relevant to both of us. I just couldn't have imagined accumulating cash over the last 10 years, hoping that there'd be an acquisition opportunity that would make that judgement with hindsight look thoughtful. You all would have been highly critical I suspect of that, and our returns would have been considerably lower. And one of the things I learned from working with Sandy for as long as I did is that if a transaction makes sense, you get it financed, and that treating your shareholders' money like it's a bank account to just sit on is really not appropriate.

So, I think we've done exactly the right thing, and when there is a transaction that we want to do, we will do it. We will go ahead and we will do it. So, I'll let Jay speak more to the capital and its timing, but philosophically, we've done exactly what we wanted to do.

Jay Benet

Jay said the key word, timing. In any quarter, our share repurchases are going to be based upon what our views of prior capital build up has been. So, just because in one quarter or a series of quarters it's higher than what the earnings look like is really not an indication of a fundamental change in philosophy. It's still being driven by the creation of operating income and therefore, capital in excess of what's needed to support our business.

And we will look for opportunities to organically grow our business, which will require capital. There may be, as Jay said, some M&A activity that requires capital like we did in Brazil or with Dominion, but overall, it's a matter of finding those opportunities that provide the appropriate returns. Where we don't find those opportunities we return the excess capital on a real time basis to you.

Michael Nannizzi

Thanks, and then just a quick one for Doreen in Personal Lines. Any frequency trend as a result of kind of employment or other environmental factors that you saw in 2Q, or departure from trends so far this year? And thank you, Jay and Jay, for those answers.

Doreen Spadorcia

We've obviously been paying very close attention to miles driven and unemployment, which we've heard others speak about. But I'll tell you, at this point, our trend is 3%, which it has been historically.

So, we're not seeing anything out of the ordinary. There's been a little bit of non-cat weather, but that was just in Q1. But, our trend remains consistent.

Michael Nannizzi

Great. Thank you so much.

Operator

Our next question—

Doreen Spadorcia

Oh, you know what? I'm sorry. I just wanted to correct; three is our trend overall. That includes frequency and severity. That's what I meant, but Debbie wanted to make sure.

Gabriella Nawi

Next question, please.

Operator

The next question comes from the line of Jay Gelb with Barclays. Please go ahead.

Jay Gelb

Thank you. My first question is just a follow-up on the potential for industry consolidation. The last major deal I believe that Travelers had completed was the St. Paul merger around 12 years ago. I just want to clarify that if there's a large deal that presents itself and strategically and financially Travelers feels it's the right deal to do that, the company would be willing to issue stock for that.

Jay Fishman

Yes, no question about it. I would observe, by the way, that Dominion was— for most people, that would be considered a not insignificant transaction on its own, but I grant you that the kind of mega transaction dates back to that one, yes.

Jay Gelb

Okay. Thank you. Then with regard to the— I don't want to dig in too much on the commentary on Chubb, but I just wanted to clarify. Did Travelers get a chance to look at the Chubb deal before Ace announced the transaction?

Jay Fishman

I said everything on the transaction I think that's appropriate for me to say.

Jay Gelb

Fair enough. Then finally, the third quarter annual asbestos review, it's probably in process. Any updates on that front?

Jay Benet

No updates at this point. We do continually look at asbestos on a quarterly basis. We have the annual in-depth claim review that takes place, and we expect to complete that in the third quarter.

Jay Gelb

Okay. Thank you.

Gabriella Nawi

Next question, please.

Operator

Our next question comes from the line of Josh Stirling with Sanford Bernstein. Please go ahead.

Josh Stirling

Good morning, and thank you for taking the call. So, I wanted to talk a little bit about not so much Ace and Chubb, about the company and so on and so forth per se, but just generally, as the market evolves, if there's going to be more concentration in the independent agency market. There's maybe some more competition that comes from people that have to drive growth to pay for the revenue synergies that they promised. How does that play out?

You obviously have a bunch of claims capabilities and pricing capabilities, and you're sort of number one or number two with most of your agents. But, is there going to be a sort of strategic need to get larger, to drive either greater market power, or expense leverage, or something like that, or should we just imagine that there's a lot of different companies and you're going to basically stick to your knitting, looking at one policy at a time and sort of keep doing what you're doing?

Jay Fishman

It's Jay Fishman. You answered the question at the end there. That's exactly right. We don't— we're going to keep doing what we're doing. There isn't anything that we expect will happen or contemplate will happen that would require any kind of change in our own strategy.

Now having said that, there's lots of companies that are out there; not just new ones, but old ones too. And each of them operates every day and presents their offerings to agents and their services and their people, and we compete against all of them. And we expect we're going to continue to compete against all of them, and I really don't anticipate any change.

The funny thing, as I reflect on it often, about taking a lower price to drive revenue synergies is that the arithmetic doesn't really work. If you cut your rate, your premiums go down. You want to raise premiums, you got to do a whole lot more new business at lower levels of profits just to get back to where you were.

So, the simple arithmetic of taking a lower rate on a large book in the hope of driving revenue synergies is often a fool's errand. Now, it is a way; some people can do it perhaps elegantly, but there haven't been too many of them.

So, I suspect that the market will continue to think about interest rates and weather, and the cost of capital and all that it seems to be incorporating as it prices its product with an unknown cost of goods sold. I don't expect a lot of change. I could be dead wrong, but that's one person's view.

Josh Stirling

That's helpful. That's helpful. If, I guess, I could maybe honestly ask a sort of similar question, but at the other end of the spectrum. So, six months or so ago, one of your big [indiscernible] competitors on the auto side announced a deal to get into the homeowners insurance business. Obviously, it's probably not material yet, and maybe it won't be for some time, but this is a big business for you guys. It's a source of margins, and it's been a place where you've really invested and built a franchise.

But, I'm wondering if there's some risk here either from losing some of the value you have with agents from having the bundled offering and the market share that you do, or I mean I believe you guys distribute a lot with some other— with at least one or two other direct insurance companies, and I'm wondering if there's a risk that you would lose some of the business if it becomes sort of popular to

bring the homeowners business back in house.

Doreen Spadorcia

This is Doreen. I'll answer your question. As we've stated before, our business strategy is based on account business and overall service to consumers. To the extent that a certain company has acquired a homeowners capability, we think that that's probably a good thing for them if we were looking at it. It's smart, but it's a startup. It's very small.

And I think you heard Brian or Jay's points in the beginning, that we're the number one homeowners franchise with independent agents. We don't take that for granted. We're going to be very, very aggressive about maintaining that position. And so, while I think it's an interesting twist of things, I think it more validates what our view is about the importance of the product to the customer.

Jay Fishman

I would add one other— this is Jay Fishman. I'd add one other point. We really like the homeowners business.

Doreen Spadorcia

Yeah, we do.

Jay Fishman

We really do. We're not in reluctantly. Quite the contrary. The record that we've posted there is really remarkable. I think if you look over the past now even 11 and 12 years, it was one year we had a combined ratio in the homeowners business in excess of 100, and that was actually 2011. It was Tuscaloosa and it was Joplin and it was Irene. Other than that, we've been subpar 100 every year. So, we're in it 'because we like it and we think we're real good at it. So, it's okay. We'll keep going.

Josh Stirling

Okay. Thanks, guys. They're probably ten years late, and we'll check back in about five.

Jay Fishman

It's okay. We were ten years late on Direct. So, we'll trade them. We'll trade them.

Josh Stirling

That's fair. Thank you.

Gabriella Nawi

Next question, please.

Operator

Our next question comes from the line of Ryan Tunis with Credit Suisse. Please go ahead.

Ryan Tunis

Hey, thanks. Good morning. I guess my first question is just for Jay. I guess Travelers has probably had more experience than any other company integrating large companies, or large P&C companies over the last two decades. It's obviously a deal specific question, but in what ways do you see it as easier or harder to integrate a large company today versus say ten years ago either from a cost save standpoint, revenue synergy, any of that type of stuff?

Operator

Ladies and gentlemen, please continue to standby. The call will resume momentarily.

Operator

Ladies and gentlemen, the call will begin momentarily. Please continue to standby.

Jay Fishman

I'm sorry. I've got someone looking to see about paying our AT&T bill. I apologize. We have no idea what happened, and I don't know where we lost you. I'll just go back for 30 seconds.

These are hard to do. They're hard from the human side of the news. People get concerned about their own jobs, their families, their positions, all legitimate concerns and lots of really good talented people, and it's hard. The people side of this is a very, very hard thing to do, and that's kind of my experience.

I never rely too much on revenue synergies. I used to worry a lot about revenue losses. My goal—our goal was to keep it intact. If we thought we could keep it intact, we were actually pretty good given some of the pressures that emerge from it. So, synergies, I have absolutely no idea, but, yeah, it's hard. It's a tough job.

Gabriella Nawi

Next question, please.

Operator

Our next question comes from the line of Jay Cohen with Bank of America Merrill Lynch. Please go ahead.

Jay Cohen

Yes, a couple of questions. The first is will you— in the 10-Q you give kind of an outlook for 2016 margins. I think that's the first time you did that in the business, kind of the underlying margins. You're suggesting relative stability as you go into 2016. I guess to read into that, is it fair to assume you believe pricing will remain relatively stable through at least the first half of next year?

Alan Schnitzer

Yeah, Jay. It's Alan. So, embedded in that outlook in 2016, we think there will be some improvements in the large losses and the weather. But, in terms of pricing, I'd direct your attention to another part of that outlook where we do talk about renewal premium change. We don't get into the distinction between exposure and price, but we do give you a sense there of relatively stability in renewal premium change.

Jay Cohen

That's great. And then maybe a question for Jay Benet. You talk about potential M&A, and you mentioned you would be able to finance it and not worry about excess capital and holding onto it, but what kind of leverage do you think you could deploy if it was a good, solid acquisition?

Jay Benet

We operate at the holding company with a leverage target of somewhere in the 15% to 25% relative to total capital. And we're running a little under 22% at this point in time. That's consistent with our ratings objective. It's consistent with the discussions we have with the rating agencies. If there was some transaction that caused it to go the higher end of that target range, I would think the rating agencies would be very comfortable with it. I think you could probably go a little higher if you had plans to bring it down over a period of time. There's some flexibility there, but that's the general characteristic of a leverage ratio that we think of.

Jay Fishman

I actually agree, and I think that you could— of course, Jay, he's smiling [indiscernible]. I just want to make a little bit of a different point. I think you can take it somewhat above the limit, recognizing that you would not be in the share buyback position for some time. It would not make sense to be out issuing shares and then turn around very quickly and be buying back. It doesn't make a lot of sense. So, the redirection of cash flows gives you some leverage capacity as well.

Jay Cohen

Got it. Thanks for the answers.

Operator

Our next question comes from the line of Larry Greenberg with Janney. Please go ahead.

Larry Greenberg

Hi. Good morning. Thank you. Just a little bit of clarity on the non-cat weather comments, specifically in Personal Lines. The year ago non-cat weather, if my memory serves me, was a bit worse than what you might characterize as normal. So, recognizing that this quarter was better than a year ago, was it also better than what you would characterize as normal?

Doreen Spadorcia

I think for homeowners it was. For auto, it was slightly negative.

Larry Greenberg

So, aggregate for the segment?

Doreen Spadorcia

Was net positive, but it was a little different by line.

Larry Greenberg

Okay. Thanks. And then, just to talk a little bit about the expense ratios, and I might be microscoping things a little bit too much here, but it looks like in Business and Personal lines the expense ratio has been trending a little bit higher this year. I know the year ago first quarter had some unusual workers' comp stuff in it. So, that was exaggerated. But, adjusted for everything, it looks like expense ratios are marginally higher.

And I guess I would have thought with Quantum and Personal Lines, and maybe the continued integration of Dominion on Business and International that expense ratios might be trending down at this point. So, just wondering if there's any thoughts on that.

Brian MacLean

Well, Larry, this is Brian. Really, two different stories, but why doesn't Alan do the BI piece and that segment and Doreen can touch on Personal Lines.

Alan Schnitzer

Sure, Larry. Let me start with that. So, in the quarter, expenses did tick up a little bit, and I would caution you that every quarter there's going to be things that sort of come and go in the expense line. This quarter, we had a little bit of expenses— I mean technology expenses running through. But, I think what I would really point you to is the expense ratio for the first half of the year if you're looking for what we would consider broadly speaking as sort of a reasonable run rate number. But again, I'd put a corridor around that because there's always going to be things that come and go.

Doreen Spadorcia

And I'll move to PI for a minute. So, you know that we set out to take \$140 million of expense out so that we could price Quantum 2.0 at a competitive level. And that was made up of separate pieces. So, you won't see everything in the expense line. We had about a third of that from ULAE, a third from commissions, and then the other third was our own operating expense.

And I think what we're seeing with some of that not reducing is that we had a higher level of growth in a good way than we had planned. So, your acquisition expenses in terms of report ordering and inspections, all of that really are upfront costs. And we also are having such a good property year that we contributed to our contingent commission.

So, I think they're all explainable. I will just say that the things that we've done have allowed us to compete from a new product perspective. So— oh, and just to reiterate, we did— I think we did a reconciliation for you at the end of— for the fourth quarter, and we did achieve the \$140 million in savings. It's just those others—

Jay Fishman

It shows up in the loss.

Doreen Spadorcia

Right.

Jay Fishman

In the loss ratio, not the expense ratio.

Doreen Spadorcia

A big part of it, and some was in Property and some was in Auto.

Larry Greenberg

Okay. Great. Thanks. Thank you.

Operator

The next question comes from the line of Brian Meredith with UBS. Please go ahead.

Brian Meredith

Yeah, thanks. So, one question here. In looking at your underlying defined ratios Business Insurance area, they're pretty profitable. Loss cost pretty benign right now. Rate activity pretty consistent. I'm just curious; why aren't we seeing market share gain at Travelers at this point, and what are you doing potentially to pick up some market share? I think this is the perfect time to do that, and maybe not so much with price, but maybe with risk appetite as well.

Jay Fishman

Yeah, I'd love— it's Jay Fishman. I'll turn it over to Alan in a second, but your last line there I think is right now. We just don't think that on the margin you can grow market share by trying to fine tune a modest reduction in price. We don't have a price list, and it's individual underwriters with individual agents and individual accounts. And they bring with them every day a philosophy, a perspective, and you can't say to them, "We want you to cut price by a point and a half." They wouldn't understand. A point and a half from what? It wouldn't make sense. And so, the notion of fine-tuning pricing to achieve market share gains is an illusion. We don't know how to do it, and I'm not sure anybody else does either.

Now, if someone is willing to accept materially lower returns not only on new, but on renewal because it will bleed over; you begin getting exceptionally aggressive on new business, what you'll find is that agents will get exceptionally anxious about their renewal books. And so, you can do that, but it will have a meaningful, really meaningful impact on profitability. So—and we've seen plenty of companies do that, grow revenues with meaningfully declining profitability, not a—we don't think a successful strategy.

So, we focus on product. We focus on people. We focus on technology. We focus on doing, making it easier to do business with agents as growing our market share. So, if you look at our Middle Market business over the last, and I'm really going from memory here, over the last, I think, ten years, Middle Market went from \$2.2 billion in premium to \$3.2 billion in premium. That's substantial growth in that segment as we did that.

Now, we've had other segments that have shrunk, and they've shrunk to some extent intentionally. When we hit the financial crisis, we took a very hard look at our Surety business and our Management & Liability businesses, and we had some because we didn't do everything perfect. I think about our attempt to raise rates in Quantum pre-Quantum 2.

So, it's a very granular analysis, and I'll actually direct you to the Investor Day presentation that we did I'm going to say two years ago where we presented an analysis of individual lines of business and how they have grown and others and how they had shrunk. So, we're always interested in growing. We're just interested in growing in ways that are intelligent and actually create value over time, and we work at that relentlessly.

I don't know if you want to chime in.

Alan Schnitzer

Not much to add. I guess I would point to things like moving Mark Schmittlein over to take on the cyber project. That's an example of something we see as a real potential opportunity. And when we find those opportunities, and we do spend a lot of time looking for them, we will make every effort to try to make hay out of it.

Brian Meredith

Right. I guess maybe I was trying to go with this a little bit is, is at this point where we are in the cycle and we're pricing stuff an appropriate time to maybe dip down in [indiscernible] markets, in areas that maybe are borderline standard E&S and try to get a little bit more risk appetite from that perspective given where loss trends are right now.

Jay Fishman

So first, Fred is encouraging me to say I said Middle Market in those numbers I gave you, which are actually Commercial Accounts; so, that 2.2% to 3.2%. So, the record is corrected in that regard. The notion of the E&S market as a separate distinguished risk pool is just something that we struggle with a little bit. We're always trying to push our risk appetite out. I think about what Mark Schmittlein did in Select as he broadened the profile of the business that we're trying to do. I think about what we also did in Commercial Accounts as we broadened out the programs and products there.

E&S market, I'll let Alan speak to that more directly, but we're always trying to push our risk profile comfortably. And when you don't push it comfortably, you don't bring knowledge. You get bad results.

Alan Schnitzer

I agree. We will push ourselves on risk profile, but we will be steadfast on the return focus. So, whether it's E&S or anything else, we're certainly looking for the opportunity.

Brian Meredith

Thank you.

Gabriella Nawi

Great. This will be our last question, please.

Operator

Our last question comes from the line of Charles Sebaski with BMO Capital Markets. Please go ahead.

Charles Sebaski

Good morning. Thank you. The first question is on the Personal business and the Quantum 2.0. Can you give us any additional color on how much of the book now has kind of filtered through from Quantum 2.0, and what effect that could have as it kind of expands through going forward?

Doreen Spadorcia

This is Doreen, and I'll tell you there's certain things we don't normally disclose, but I will tell you, and we've said this in the past, that over 90% of our new business is now coming from Quantum 2.0. Since inception, we've now got a pretty big chunk of premium, and we've got enough earned premium that we think there's enough credibility for us to really look at the performance of the business. And I'll tell you that it's right within our expectations of how we thought it was going to perform.

Jay Fishman

And the only— the reason it's not 100% is because there are some states that—

Doreen Spadorcia

Exactly.

Jay Fishman

—that simply don't allow Quantum 2.0 as a model, as a pricing model. So—

Charles Sebaski

What state would this be?

Doreen Spadorcia

Well, I'll tell you we just rolled out California and Massachusetts. It's a new product, but it's not Quantum, and we've got a few other states (North Carolina) we have to build something separately for that. But, even in California and Massachusetts, which we were happy to bring them a new product because they didn't even get Quantum 1, it's a light version in terms of what the regulators allow us to do.

Jay Fishman

And it's largely because of the inability to use credit—

Doreen Spadorcia

That's right.

Jay Fishman

—as an upfront underwriting evaluator and pricer in those states.

Charles Sebaski

Thank you. Sorry. Didn't mean to cut you off. One additional question, I guess final, on the M&A and the consolidation front, and how you guys think of opportunities for growth internationally relative to the US. If I look at your book and the market share, market share position leaders that you're having a lot and the recent transactions with Dominion or South America, do you feel that the book, or your business is more conducive to international opportunities, and how do you weigh that on a longer-term perspective given the need for return profile and the other things you previously outlined?

Alan Schnitzer

Yeah, Charles, it's Alan. Let me start with that and then maybe Jay will follow-up. We certainly apply the same standards outside the United States as we do inside the United States. So, the question is always, is the transaction going to contribute to our ability to create shareholder value over time? So, same lens for evaluating all of it.

Given our profile in the United States, given market share, the franchises we have, that same analysis might apply differently outside the United States where there's just more GDP that we're not currently accessing. So, we like the opportunity in Brazil long-term. We like the transaction in Canada with the Dominion, and we'll continue as we've been on this journey to export our competitive advantages from the US to other markets. We'll continue to build on a platform that's scalable, and as we find those opportunities, we'll, again, make every effort to complete those transactions.

So, we're certainly out looking for them, and it's the exact same standard we would apply to a transaction in the US.

Jay Fishman

And I'd just add one comment 'cause we take it for granted. Sometimes you all forget. We are not a Fortune 100 or 200 guarantee cost casualty underwriter. We're not a liability writer broadly, general liability to what we would call global companies

So, when we talk about outside the US, we're talking about local business. This is now Brazilian companies, or Canadian companies. We're very focused on the local environment. So, where the local environment has characteristics that would allow for either another competitor to come in and succeed, or an acquisition opportunity where that local environment holds promise, we're ambitious for that. No issue at all.

But, it is a very local evaluation, not an evaluation of kind of the global insurance market.

Charles Sebaski

Does your product portfolio and how you analyze the business within the US lend itself to being able to do that internationally in the same way? I mean do you get the same access to information and underwriting ability, or are there differences that have, I guess, held you back from expanding more broadly, or rapidly internationally?

Alan Schnitzer

There are certainly differences between marketplaces, but we think our fundamental approach to the business, being disciplined about returns, being strong under writers, all those cultural attributes do translate. And we think that given the sophistication we have in this marketplace, there's opportunities for us to deploy that sophistication in other less sophisticated markets and make a difference.

But, there are definitely differences market-to-market. I wouldn't say that necessarily holds us back, but

it is one of the things that we assess and evaluate. But, I would also observe that there are differences in the states in the United States. Doreen just talked about your Quantum product and how we've got to tailor that to different markets in the US, and we really take that same skill set of assessing our competitive advantages and figuring out how to deploy them in markets around the world.

So, that's what we've done in our existing footprint, and that's what we'll continue to do whether it's in that footprint, or in new geographies.

Charles Sebaski

Thank you very much for the answers.

Alan Schnitzer

Thank you.

CONCLUSION

Gabriella Nawi

Very good. This concludes our call for today. Thank you very much for joining us, and we apologize for the disruption.

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.