The Travelers Companies, Inc.

Second Quarter 2022 Results Teleconference

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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 questions until the completion of formal remarks, at which time you will be given instructions for the question-and-answer session. As a reminder, this conference is being recorded on July 21, 2022.

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

Abbe Goldstein
Thank you. Good morning and welcome to Travelers' discussion of our second quarter 2022 results. We released our press release, financial supplement and webcast presentation earlier this morning. All of these materials can be found on our website at travelers.com under the Investors section.

Speaking today will be Alan Schnitzer, Chairman and CEO; Dan Frey, CFO, and our three segment Presidents: Greg Toczydlowski of Business Insurance, Jeff Klenk of Bond & Specialty Insurance, and Michael Klein of Personal Insurance. They will discuss the financial results of our business and the current market environment. They will refer to the webcast presentation as they go through prepared remarks, and then we will take your questions.

Before I turn the call over to Alan, I would like to draw your attention to the explanatory note included at the end of the webcast presentation. Our presentation today includes forward-looking statements. The Company cautions investors that any forward-looking statement involves risks and uncertainties and is not a guarantee of future performance. Actual results may differ materially from those expressed or implied in the forward-looking statements due to a variety of factors. These factors are described under Forward-Looking Statements in our earnings press release and 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 Investors section on our website.

And now, I'd like to turn the call over to Alan Schnitzer.

Alan Schnitzer
Thank you, Abbe. Good morning, everyone, and thank you for joining us today.

We are pleased to report a very strong second quarter, including an excellent bottom line result, double digit top line growth in all three segments, strong and improved profitability in our commercial business segments, progress addressing the environmental headwinds facing the personal insurance industry, a meaningful contribution from net investment income, and another quarter of progress on a number of important strategic initiatives.

Core income for the quarter was $625 million, or $2.57 per diluted share, generating core return on equity of 9.3%. These results were driven by record net earned premiums of $8.3 billion, up 9% over the prior year quarter, and a solid underlying combined ratio of 92.8%. Given the challenging environmental issues impacting the personal insurance industry, these consolidated results reflect the benefit of our diversified portfolio of businesses. For the six months, core income was ahead of the prior year at $1.66 billion, an excellent first half result.

We're particularly pleased with the continued strong underlying results in our commercial businesses. Looking at the two commercial segments together, the combined BI/BSI underlying combined ratio was 90.7% for the quarter, an improvement of a point from the prior year quarter.

As expected, results in Personal Insurance were impacted by elevated severity in both Auto and Home. As you'll hear from Michael, we're on the right track in addressing the environmental issues.

Our excellent operating results together with our solid balance sheet enabled us to grow adjusted book value per share by 8% over the past year after making important investments in our business and returning excess capital to shareholders. During the quarter, we returned $725 million of excess capital to our shareholders, including $500 million of share repurchases.

Turning to the top line, thanks to excellent execution by our colleagues in the field and the strong franchise value we offer to our customers and distribution partners, we grew net written premiums by 11% this quarter to a record $9 billion with, as I mentioned, each of our three segments growing double digits.

In Business Insurance, net written premiums grew by 10%. Renewal premium change was 10.3%. That's the fourth highest quarterly renewal premium change going back more than 15 years. Renewal premium change included renewal rate change of 4.9%. Both measures moved up from the preceding quarter. Retention remained very strong at 86%. We have a high-quality book of business, and keeping it is a priority. Also, as we've shared previously, strong retention is a sign of a rational and stable pricing market. Underneath the headline numbers, execution in terms of rate and retention at a segmented level was excellent.

In Bond & Specialty insurance, net written premiums increased by 13%, driven by excellent production in both our Surety and Management Liability businesses. Surety net written premiums were up 24%. Management Liability premiums were up 7%, driven by renewal premium change of 8.8%, retention that increased to a very strong 88% and strong new business.

In Personal Insurance, net written premiums increased by 12%. Renewal premium change was meaningfully higher both year-over-year and sequentially in Auto and Homeowners as we continue to execute to improve returns.

You'll hear more shortly from Greg, Jeff and Michael about our segment results.

Turning to investments, our high-quality portfolio generated net investment income of $595 million after-tax for the quarter, reflecting reliable results from our fixed income portfolio and another quarter of strong returns from our non-fixed income portfolio.

Speaking of investments, given the potential for a difficult economic environment ahead, we've included on page 19 of the webcast presentation a slide breaking down the composition of our investment portfolio. Consistent with our long time focus on risk-adjusted returns, we're underweight compared to most in terms of risk assets as a percentage of shareholders' equity.

Our investment philosophy has served us well over many years and through many different market cycles. It starts with asset allocation. More than 90% of our $80 billion portfolio is invested in fixed income securities. That sets us apart. Inside that, we also have a relatively high allocation to municipal bonds, where the default rate has been meaningfully lower as compared to corporate bonds. Even within munis, we're discriminating. We are invested in only about a thousand municipal issuers out of an estimated 80,000. Virtually all of our municipal bond holdings are rated AA- or higher.

Our corporate bond portfolio is curated with the same level of discipline. Virtually all of it is investment grade, and within that we are meaningfully overweight Double A and Single A credits and meaningfully underweight Triple B credits.

During times of economic distress, credit quality is key. And in the sometimes foreseeable and sometimes unforeseeable lead-up to those times, when spreads widen and volatility increases, the market doesn't allow for a graceful repositioning of a portfolio, so we stay true to the strategy that has served us well over decades.

Our level of actual impairments over a long period of time has been remarkably low. In 2008 and 2009 when the Moody's default percentage reached 2% to 2.5%, our default rate never reached 1%. And, in the COVID charged turmoil of 2020 when the Moody's default rate hit 1%, our portfolio default rate was around 10 basis points.

Given the credit quality of our portfolio and the fact that we hold the vast majority of fixed income securities to maturity, decreases in market value due to rising interest rates, as the market is experiencing now, have little to no impact on how we run the business or how we view the strength of our capital position.

In terms of our investments in alternative asset classes, we don't reach for yield. Our private equity portfolio is well diversified across strategies, sectors and general partners. Our owned real estate is high quality and entirely unlevered and we have little in the way of hedge funds and higher risk assets.

Although we see potential short-term headwinds from recent declines in the equity markets, we also see near-term and potentially ongoing tailwinds from higher interest rates that will benefit our returns going forward. You'll hear from Dan shortly about how the recent rise in interest rates positively impacts our outlook for fixed income NII.

Like everything we do, it all starts with our talent. We have a world-class investment team that is responsible for executing on our investment philosophy. Those with decision making authority have worked with us and with each other for an average of around 20 years. That reinforces the long-term perspective we bring to our investment portfolio. I'm always grateful for their excellent work but, particularly at times like this, I'm reminded of the wisdom of our approach. It has contributed to a long history of industry-leading returns and industry low volatility.

To sum things up, building on our excellent results in the first half of the year, we are confident about our outlook. Benefitting from years of strategic investments as part of our Perform and Transform call to action, guided by our decades of experience successfully executing in a variety of macroeconomic conditions and supported by an outlook for improving fixed income returns, we remain well positioned to deliver industry-leading returns and shareholder value over time.

With that, I'm pleased to turn the call over to Dan.

Dan Frey
Thank you, Alan.

Core income for the second quarter was $625 million and core return on equity was 9.3%. These results were very strong, especially considering the high level of cat losses, which is typical seasonality for us in the second quarter. While core income declined from the prior year quarter, remember that the prior year quarter included a very benign level of cat losses and record returns from the non-fixed income portfolio.

Our second quarter results include $746 million of pre-tax catastrophe losses, and while cats were higher year-over-year, they were not outsized relative to our modeled estimates for the second quarter. On a year-to-date basis, we have accumulated $935 million of qualifying losses toward the aggregate retention of $2 billion on our Property Aggregate Catastrophe XOL Treaty.

Our after-tax underlying underwriting gain of $444 million was down slightly from the prior year quarter. We generated record levels of earned premium and reported an underlying combined ratio of 92.8%. Improvements in the underlying combined ratio in both Business Insurance and Bond & Specialty were more than offset by an increase in the underlying combined ratio in Personal Insurance. Greg, Jeff and Michael will provide more detail on each segment's results in a few minutes.

At the same time that we continued to make significant investments in strategic initiatives, the second quarter expense ratio improved 70 basis points from last year to 29%, driven by the combination of our focus on productivity and efficiency and strong top line growth. We had been expecting the full year expense ratio to be around 29.5%, but now expect it to be more like 29% this year, getting down to that level a little sooner than we had expected.

Turning to prior year reserve development, we had total net favorable development of $291 million dollars pre-tax in the second quarter. In Business Insurance, net favorable PYD of $202 million was driven by better-than-expected loss experience in Workers' Comp across a number of accident years and favorable movement in CMP, partially offset by an increase in General Liability reserves, including for run-off operations. In Bond & Specialty, net favorable PYD of $73 million was driven by better-than-expected results in Fidelity and Surety. Personal Insurance had $16 million of net favorable PYD with modest movement in both Auto and Home.

After-tax net investment income decreased by 13% from the prior year quarter to $595 million. We were pleased that returns in our non-fixed income portfolio were strong, but as expected they were less favorable than last year's record quarter. Fixed maturity NII was again higher than in the prior year quarter as the benefit of higher invested assets more than offset the impact of lower average yields during the quarter. With interest rates having moved higher during the second quarter, we are again raising our outlook for fixed income NII including earnings from short-term securities to approximately $470 million after-tax in the third quarter and then to $495 million in the fourth quarter. New money rates as of June 30 are about 100 basis points higher than what is embedded in the portfolio, so NII should continue to improve as the portfolio gradually turns over and as the portfolio continues to grow.

Recall that results for our private equities, real estate partnerships and hedge funds are generally reported to us on a one quarter lag. While not perfectly correlated, our non-fixed income returns directionally follow the broader equity markets, which were down significantly during the second quarter. Through the first half of the year, the S&P 500 was down 21% with about three quarters of that decline occurring in Q2. Accordingly, we expect that to impact our non-fixed income results next quarter.

Turning to capital management, operating cash flows for the quarter of $1.4 billion were again very strong, all our capital ratios were at or better than target levels, and we ended the quarter with holding company liquidity of approximately $1.6 billion.

Interest rates increased and spreads continued to widen during the quarter and, as a result, our net unrealized investment loss increased from $1.4 billion after-tax at March 31 to $3.8 billion after-tax at June 30. As we've discussed in prior quarters, the changes in unrealized investment gains and losses generally do not impact how we manage our investment portfolio. We regularly hold fixed income investments to maturity, the quality of our fixed income portfolio remains – as Alan discussed – very high, and changes in unrealized gains and losses have little impact on our statutory surplus or regulatory capital requirements.

Adjusted book value per share, which excludes net unrealized investment gains and losses, was $112.37 at quarter end, up 2.4% from year end and up 8.2% from a year ago. We returned $725 million of capital to our shareholders this quarter, comprising share repurchases of $500 million and dividends of $225 million. We have approximately $3 billion of capacity remaining under the most recent share repurchase authorization from our Board of Directors.

It's also worth noting that in June we early renewed our $1 billion credit facility for a five-year term. While the size of the facility and the group of participating banks was unchanged, we reduced our annual cost of the facility primarily through lower undrawn pricing while also improving other terms and conditions. In a time of rising borrowing costs and tightening credit terms, our financial strength, strong operating performance, and consistent fiscal discipline still enabled us to obtain very favorable terms – you can see all the details in our 10-Q.

Similarly, during the second quarter we issued a new four-year cat bond, providing uninterrupted coverage upon the expiration of our prior cat bond. The new bond, Long Point Re Four Limited, increases the amount of coverage available to $575 million – the recently expired cat bond had provided $500 million worth of coverage. Specific terms are shown on page 20 of the webcast presentation, and we're very pleased with the result. Here again our disciplined underwriting and consistent outperformance in the property line enabled us to increase our coverage and attain a reasonable rate on line at a time when some parts of the market are finding reinsurance capacity harder to come by.

Also, on page 20 of the webcast presentation, you'll find a summary of our July 1 reinsurance renewals. The structure of our main cat reinsurance program is generally consistent with the expiring program, and while, as expected, we did see some price increase, it was in line with the price increases we're obtaining on the direct property premiums we're writing, so there's no adverse impact on margins. It's also worth noting that we increased the coverage under our Northeast Property Treaty by $150 million to $750 million, part of $850 million above the same $2.25 billion attachment point.

To sum it up, we had an excellent second quarter with double digit premium growth in all three segments, solid underwriting profitability, and an improved outlook for fixed income NII – all of which bodes well for our future returns.

With that, I'll turn the call over to Greg for a discussion of Business Insurance.

Greg Toczydlowski
Thanks Dan.

Business Insurance continues to have a strong 2022 with another terrific quarter in terms of both financial results and execution in the marketplace. Second quarter segment income was $666 million, up about 4% from the prior year quarter, driven by higher net favorable prior year reserve development and higher underlying underwriting income.

The quarter's very strong underlying combined ratio of 92.4% was about a point better than the second quarter of 2021, driven by improvement in the expense ratio resulting from the combination of the leverage from higher earned premiums and the benefits of our strategic focus on productivity and efficiency. The underlying loss ratio was about flat to the prior year quarter reflecting the benefit of higher earned pricing as well as elevated property loss activity in the current quarter.

Net written premiums were up in all domestic markets and lines of business, reaching $4.4 billion for an increase of 10%. Premiums benefited from strong renewal premium change and retention, both of which were once again historically high.

Turning to domestic production for the quarter, renewal premium change of 10.3% was once again exceptionally strong. RPC includes renewal rate change of 4.9%, which was up a half a point from the first quarter, and exposure growth of almost 6%. Retention was very strong at 86%. New business premium was about $500 million for the quarter.

We're pleased with these production results and our strong execution in the marketplace. Given our high-quality book as well as several years of segmented rate increases and improvements in terms and conditions, we're thrilled to continue to produce historically strong retention levels. The rate gains we achieved in the quarter reflect deliberate execution given the significant improvements in profitability across the portfolio, while continuing to price for the persisting headwinds and uncertainty in the current environment. As always, we will continue to execute our granular pricing, careful management of deductibles, attachment points, limits, sub-limits, and exclusions to achieve profitable growth.

As for the individual businesses:

In Select, renewal premium change was strong at over 9%, while retention of 83% was up 3 points from the prior year quarter. New business was up 8% from the prior year quarter, driven by the continued success of our BOP 2.0 product. In addition to contributing to growth, the new BOP product is also contributing to improved margins in this business through industry-leading segmentation. So, overall for Select, we're pleased with the improvement in profitability levels as well as the continued momentum in new business growth.

In Middle Market, renewal premium change remained very strong at over 10%, while retention remained historically high at 88%. Underneath the RPC of 10%, renewal rate change of 4.8% was up a half a point from the first quarter, while exposure growth was nearly 6%.

To sum up, Business Insurance had a terrific first half of the year. We continue to deliver strong results while investing in capabilities to enhance our data and analytics leadership, digitize the commercial transaction, and develop sophisticated and relevant products to drive profitable growth for the future.

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

Jeff Klenk
Thanks Greg.

Bond & Specialty had a terrific quarter on both the top and bottom lines. Segment income was $228 million, up 22% from the prior year quarter, driven by a higher level of net favorable prior year reserve development and higher underlying underwriting income.

The underlying combined ratio was an excellent 82.2%, an improvement of 1.2 points from the prior year quarter.

Turning to the top line, net written premiums grew a very strong 13% in the quarter to a record high with contributions from all our businesses.

Domestic Surety posted exceptional 24% growth in the quarter driven by larger average bond premiums.

In Domestic Management Liability, we are pleased that we drove a 2 point improvement in retention, while renewal premium change of 8.8% remained strong following six straight double digit quarters. We are also pleased that we increased new business 16% from the prior year quarter.

So, both top and bottom line results for Bond & Specialty were terrific this quarter, reflecting excellent execution across our business and the value of our market-leading products and services to our customers and distribution partners.

And now, I'll turn the call over to Michael.

Michael Klein
Thanks Jeff, and good morning, everyone.

For the second quarter, Personal Insurance reported a combined ratio of 111%. While it is not unusual for us to generate an underwriting loss in the second quarter given it typically has the highest weather-related loss activity, this quarter's results were also impacted by the inflationary pressure that we and the industry have been experiencing for the past few quarters.

In total, the combined ratio increased 11.5 points compared to the prior year quarter and included a higher underlying combined ratio, higher catastrophe losses, and lower favorable prior year reserve development. The 5 point increase in the underlying combined ratio reflects elevated loss severity in both Automobile and Homeowners & Other, and a comparison to a low level of Automobile losses in the prior year quarter.

Catastrophe losses were nearly five points higher than in the prior year quarter, but not out of line with our assumption for second quarter catastrophes.

Net written premiums for the quarter grew 12%, driven by higher renewal premium changes in both Domestic Automobile and Homeowners & Other.

In Automobile, the second quarter combined ratio was 104.3% and the underlying combined ratio was 101.8%, an increase of about 10 points relative to the prior year quarter. The increase reflects elevated vehicle replacement and repair costs. To a lesser extent, the increase is also a result of a comparison to a prior year quarter that still reflected lower claim frequency related to the pandemic.

Our primary response to the environmental challenge of inflation is higher pricing. We are pleased with our actions to increase rates over the past few quarters and remain confident in our ability to achieve further increases. As we have indicated in past quarters, it will take some time for rate actions to fully earn into our results.

In Homeowners & Other, the second quarter combined ratio was 118.0% and included 29 points of catastrophes, primarily from severe wind and hail events across several regions of the U.S.

The underlying combined ratio for the quarter was 90.3%, comparable to the prior year quarter. We continued to experience higher loss severity related to a combination of labor and material price increases, but that was largely offset by various items, including a comparison to a prior year quarter that included elevated non-weather losses as well as the current quarter benefits of earned pricing.

Turning to quarterly production, we continue to make excellent progress in achieving pricing increases.

For Domestic Automobile, renewal premium change was 6.3%, up a full 3 points from the first quarter of 2022. We continue to increase renewal premium changes and expect RPC to reach double digits by the fourth quarter.

For Domestic Homeowners & Other, renewal premium change increased about a point and half from the first quarter to a record high of 13.5%. The increase in renewal premium change was from both higher insured values and increased rate.

While our primary focus is on improving profitability, we're not distracted from continuing to invest in capabilities to sustain our success. For example, in the quarter we introduced new artificial intelligence-enabled aerial imagery insights to enhance our property underwriting and risk selection while simplifying the quoting process for agents and customers. This is just one example of how we continue to advance our sophistication in risk expertise as part of our innovation agenda.

With our focus on both performing and transforming, we remain confident in our ability to improve profitability over time, while continuing to build the business for the future.

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

Abbe Goldstein
Thank you, and we are ready to open up for Q&A.

QUESTION AND ANSWER

Operator
Thank you. At this time, I would like to remind everyone in order to ask a question, press star, one on your telephone keypad.

Your first question comes from Michael Phillips from Morgan Stanley. Please go ahead.

Michael Phillips
Thank you, good morning, everybody.

First question on Auto, for Personal Auto, it feels like your rate activity has been a little bit later to take hold than peers and may be still a little bit below loss trends. I wanted to see if you agree with that, and if so, a two-part question to that. How do you view your profitability of the current book in Auto? You're taking on some good new business there, so how is the profitability of the current book?

We've seen some actions from others in prior year development, and I guess just confidence that that's not going to be the case for you guys.

Michael Klein
Sure, so I'll take the rate activity question, this is Michael Klein and, then Dan will probably talk about prior period development.

Michael, I think we've talked about rate pretty much every quarter for the last three or four. As I said in my prepared remarks, we're pleased with our progress. There are certainly some peers who have reported bigger headline rate numbers than we have, although when we look at the overall marketplace and compare our rate filing activity and our rate increase levels with the broader marketplace, we're largely in line with the overall industry, if not a little bit ahead of the industry average.

Again, there's a couple of peers in particular that have talked about bigger headline numbers than we have, but in aggregate we continue to be very active on the rate filing front, continue to incorporate new data into our indications, and, as I mentioned, our outlook is we're confident in our ability to continue to increase pricing to the point where we think RPC for Personal Auto will exceed double digits or get into double digits in the fourth quarter.

We continue to drive to improve profitability and make progress, and in terms of the new business, the $318 million this quarter is up about 6% from the prior year quarter. More of that increase is from RPC now than it was a quarter before, and as you look at the PIF growth, it is starting to decelerate, responding to the rate we're putting into the marketplace, so that's sort of the trajectory we're on, and again the priority is to continue to drive pricing to improve profitability.

I'll turn it over to Dan to talk about PYD.

Dan Frey
Hi Mike, it's Dan.

On the PYD question, I'd bring you back to accident years '20 and '21, when we were talking about seeing favorability, largely frequency driven, but we were seeing favorability in Personal Auto, we were seeing favorability in Commercial Auto, we were seeing favorability in non-COVID claims in the Workers' Comp line, and we said at the time that we were recognizing some of that favorability in our results, but that there was also uncertainty in the environment. And, one of the things we talked about was uncertainty around what the ultimate severity of some of those claims might be, and in PI we talked specifically about the fact that claims were happening at higher speeds and we were seeing some more severity.

We said pretty consistently in 2020 and in 2021 that we were being cautious in our reserving in order to make sure that we were allowing for the additional level of uncertainty that we felt was possible. And so at least so far, the way things are playing out seems to bear that out.

Michael Klein
Yes, and Michael, this is Michael Klein again. I just wanted to add one other comment on the pricing conversation, which is—we get a lot of conversation about the headline rate number that people are getting today. It's also important, and we've talked about this in the past, to look back at the history, and our renewal premium change in Personal Auto never went negative, and we didn't talk about that as much back then when some other carriers had renewal premium change that was negative.

The starting point matters, I guess, is the point that I would add.

Thanks for the question.

Michael Phillips
Yes, okay absolutely. Perfect. Thank you for that. That's very helpful.

Second question, switching gears, completely switching gears then on Comp, has there been any change in mix on the type of claims you're seeing recently in Comp, either mix by permanent versus temporary or partial versus total, that mix change that might in fact impact closure rates of your claims, either faster or slower over the past year?

Greg Toczydlowski
Michael, this is Greg. Yes, we haven't seen any real material mix change. Of course, as we went through the pandemic, we had a certain mix of claims, and so as you normalize that, if we look at our claim mix today to pre-pandemic, there isn't any real material change.

Michael Phillips
Okay, thank you guys.

Operator
Your next question comes from Alex Scott from Goldman Sachs. Please go ahead.

Alex Scott
Hi, good morning. I was hoping you could just comment on just the overall outlook for Business Insurance margins and for further underwriting margin improvement.

Certainly, we can look at your renewal rate change and we can think about loss cost, which I think have got to be getting impacted, at least some, by the CPI inflation that we're seeing. But there's obviously parts that aren't quantifiable for us and we'd just be interested in understanding some of those pieces and how you see it unfolding.

Alan Schnitzer
Alex, it's Alan. Let me start and then I'll turn it over to Greg.

Let me just start with, we're starting from a pretty good place. The underlying loss ratio and the overall underlying combined in BI is starting at a very good place, and we don't give outlook on those measures but let me just make a broad comment, which is—if you look at where our overall pricing is today, we would say all other things being equal, it's ahead of loss trends, so as that earns in, we would expect some improvement from there.

Let me just caveat that with all things are never the same, and so this quarter, for example, we're calling out some elevated level of property loss activity, and it was just a couple of quarters ago when we were calling our favorable property loss activity, so that kind of stuff is always going to be a little episodic. But when we look at the factors that we would consider to be run rate, for lack of a better word, and we look at where pricing is and where we think loss trend is, we think the outlook again from a pretty good place is positive.

Alex Scott
For my follow-up question, I think you mentioned higher insured values when you were talking about the personal lines business, but I'd just be interested on the Business Insurance side of things, the growth is coming in pretty nicely there as well. We can see the exposure units going up.

How impactful are the audits around the insured values for the growth, and how much do you expect that to be helping the top line here?

Greg Toczydlowski
Yes, Alex, this is Greg. Clearly our underwriters are looking at terms and conditions and insured values in this environment and constantly trying to get the right insurance to value on the exposure right, on both new business and renewal. So that's been an active lever – very similar to the Personal Insurance side – that's more on the transactional side.

And on the flow side of Select, we do have an inflationary protection guard that we're actively managing to make sure that that keeps up with the inflation environment, so very much an active management lever for us on the Business Insurance side.

Alex Scott
Got it, thank you.

Operator
Your next question comes from Greg Peters from Raymond James. Please go ahead.

Greg Peters
Yes, good morning. The first question I had is – the market seems to be projecting or anticipating a recession, either later this year or next. I was wondering if you could talk about how you might think Business Insurance and Domestic Bond & Specialty might perform and where the areas of pressure might be if there is indeed a recession.

Then related to that, I'm just curious, as you strategize, how you might change your approach to management of the Company if this were to come to pass.

Alan Schnitzer
Thanks for the question and let me just make a couple of general comments, and feel free to follow up if I don't scratch the itch. In a recession, we are going to do what we do. We serve our customers, we serve our distribution partners, we take care of our communities, we take care of our employees, and so from that perspective it's business as usual for us.

Now, we insure the output of the economy, so we'd expect some impact to the top line, and that's going to impact everybody, but we're pretty well positioned. The work we've done to improve productivity and efficiency positions us well, and we've got the resources and financial strength to continue to make investments in our business without interruption.

In terms of credit sensitivity, as I shared in my prepared remarks, the investment portfolio is very high quality, high credit quality, as is our Surety business.

I guess the only other point I would make, in a recession, again you'd expect some maybe pressure on the top line, but if history is any guide, at least from the commercial businesses, maybe you get some relief on loss trend.

We run the business for the long term. We say that all the time, so there's really not a lot we need to do differently. You can just look and see how we've performed through various economic cycles over the years, including recessions, financial crises, etc. We think we're very well positioned, and we'll do just fine.

Greg Peters
Got it. Dan, in your comments regarding investment income, you talked about the non-fixed income piece, and you mentioned the fact that the market was down, the S&P was down, what, 21% year-to-date.

Is it conceivable that the actual marks in this area of your portfolio might turn negative in the third and fourth quarter, considering the dramatic performance of the market? Or in a broader sense versus saying it's just going to get worse, can you just give us some sort of context of what you think it might look like in the second half of this year?

Dan Frey
Yes Greg, I think it's very hard to predict. We've got a portfolio that is individually underwritten, and so that's why we say it's not going to perfectly correlated, but directionally, if you see weakness in the equity markets, we'd expect to see at least some slowdown in the level of strength.

We have, although rarely, seen negative returns in the alternative portfolio in times of extreme disruption, like we did at the end of the first or second quarter of 2020 at the onset of COVID, but over a pretty short period of time when the markets came back, we got all that back and then some.

So we're not really in a position to give a forecast of whether we expect alternative NII to be less robust than it has or how low it might go, but again we're doing this for the long term, and if you look at our results over a long term, even in really significant downturns for the broader markets, we've done probably better than most.

Greg Peters
Got it. Well, thanks for your perspectives.

Alan Schnitzer
Thank you.

Operator
Your next question comes from Elyse Greenspan from Wells Fargo. Please go ahead.

Elyse Greenspan
Hi, thanks. My first question, I'm looking to get color on the BI margin. You called out higher earned pricing, you also called out elevated property losses. Could I get the impact of both of those on the current quarter?

Dan Frey
Yes Elyse, it's Dan. Directionally, without going down to a very fine level of reconciliation, we've been talking about in recent quarters the benefit of earned pricing being somewhere around a point. That's not going to change all that quickly. As written price over the last few quarters came down, you'd expect the earned basis to come down, but that takes time to come down, so that's still sort of the ballpark. With the margins relatively stable from a year ago, that would sort of imply that the property piece going the other way relative to what we expected was about a point.

Elyse Greenspan
Okay, thanks. Then my second question, you talked about higher inflation on last quarter's call and said that inflation within Business Insurance was probably in the range of 5.5% to 6%. Did you guys see any movements in your loss trend assumptions in the second quarter?

Alan Schnitzer
No Elyse, we didn't. I'll say two things. One, the loss activity you saw in the quarter was generally consistent with that, but two, loss trend is something we evaluate over a long period of time, so it doesn't typically gyrate around in a particular quarter.

But I think to be responsive to your question, the loss activity we saw was consistent with what we expected.

Elyse Greenspan
Okay, thank you.

Operator
Your next question comes from Ryan Tunis from Autonomous. Please go ahead.

Ryan Tunis
Okay, thanks. Good morning. In BI, how should we interpret the acceleration of written rate from 4.3% to 4.9%?

Greg Toczydlowski
Ryan, good morning, it's Greg. I'll give you a little bit of color from the prior quarter.

It was broadly based across many lines, led by Auto, Property, and our primary GL lines. Our underwriters look at every account that comes up for renewal in that quarter, and they're focused on making sure that they've got the right price to risk terms and conditions just to get the right rate adequacy.

On one hand, we feel great about that increase in pricing and returns are in a much better place based on the industry and our pricing over the past few years, but those headwinds that we've talked about, inflation and weather, etc., are still out there, so. It's a headline number at an aggregate level.

Our underwriters are going to continue to be focused on making sure that the accounts that come up for renewal have the right rate adequacy on it, and hopefully that gives you a little bit of color for the quarter.

Ryan Tunis
Thank you. Then for Michael, just curious from a frequency perspective, what are you observing? It's the summer, gas prices are lower, there's been some discussion of that impacting frequency trends, but just curious, sort of like how are you thinking about frequency? What are you seeing right now?

Michael Klein
Sure Ryan, thanks for the question. I would say two things. One, specific to your question on gas prices, I think we talked about this a little bit last quarter, we don't see huge sensitivity in our miles-driven data to gas prices. We actually think employment has a bigger impact on miles driven than gas prices do, so really the impact of the price upswing we saw two, three months ago and the slight relief we've seen over the last month or so isn't really driving change in driving behavior, based on the data we're observing.

Then in terms of frequency, again I think two comments are important about this quarter. One, second quarter of last year still showed favorable frequency because driving levels were still depressed, and so though return towards pre-pandemic normal is a bad guy year-over-year, but in terms of driving behavior and claims frequency, we would say it remains in that space of approaching pre-pandemic normal levels.

Ryan Tunis
Thank you.

Operator
Your next question comes from Meyer Shields from KBW. Please go ahead.

Meyer Shields
Thanks. First question overall, I was hoping you could take us through how you're thinking about medical inflation potentially lagging the really high overall inflation that we've seen broadly and how that impacts loss trend selection.

Alan Schnitzer
Yes Meyer, good morning. A couple comments on medical inflation.

Given that it impacts long-term lines like Workers' Comp and GL, you could imagine, one, we watch it very closely, and two, as we've shared before, we take a very cautious approach to reserving those long-term lines.

Having said that, while medical inflation certainly isn't immune from the broader inflationary environment, the recent trends on the whole continue to be, I would say, relatively benign.

The other thing is you've got to make a distinction between medical inflation and the types of inflation that impact loss cost. Workers' Comp and GL, for example, are driven by a subset of medical costs. We're treating workplace injuries, we're treating accidents, we're not treating chronic diseases, and those components of medical inflation that impact Workers' Comp and GL are increasing at lower than the headline medical CPI.

Also, in terms of Workers' Comp, for example, we've got fee schedules and other medical management practices that mitigate the types of inflation that could impact those loss costs, so there's a little bit of a narrative on medical inflation, and hopefully that's responsive.

Meyer Shields
No, that is very helpful. Then a quick question for Michael. Within specifically on the Home side, other than actual rate changes, how do average premiums policy respond to rising replacement costs?

Michael Klein
Yes, Meyer, so in Home, really RPC is a combination, right, of rate and those insured values, and so in terms of how they respond, that renewal premium change number that we share with you is a blend of the rate change we're getting on renewals and the impact of increased values.

Just one step deeper into the process, we evaluate replacement cost data on a regular basis, and typically update our annual increase limit factor, is what we call it, AIL, on an annual basis. In this environment, we're actually looking at it more frequently, and have actually updated it a second time this year, which is part of why you're seeing that RPC in Home continue to rise. That's why I mentioned in my prepared remarks that the increase in RPC in Home is a combination of increased rate and increased limit.

Meyer Shields
Okay, so that sounds like it's broadly margin neutral, if I'm understanding you correctly.

Michael Klein
What I would say is both the rate and the increased limit are responsive to the inflation that we're seeing.

Meyer Shields
Okay, got it. Thank you so much.

Operator
Your next question comes from Brian Meredith from UBS. Please go ahead.

Brian Meredith

Yes, thanks. Just first, one quick clarification, Dan. On the Business Insurance non-cat weather losses in the quarter, you said about a point better than last quarter. I think last, second quarter, you said it was 150 basis points below trend. Would that imply that this quarter was maybe 50 basis points below typical second quarter?

Dan Frey
No Brian, if we think about the non-cat property losses that are in underlying, as you point out, last year we said they were about a point and a half better than what we would have expected in the second quarter.

This year, what we actually said is that it's about a point worse than what we would have expected, so there was actually a bigger swing in the underlying property losses, think north of two points, and then there's, as there are frequently in other quarters, a number of other things, none of which were individually big – think mix, think segmentation – that actually benefited the loss ratio in the quarter, and that got us back down to the neutral number.

Brian Meredith
Got you. That makes sense, thank you. Then just one other quick one, Workers' Compensation insurance continued to see a nice improvement in premium growth there. Is that all just exposure growth that you're seeing at this point?

Greg Toczydlowski
Brian, it's Greg. Yes, for the most part, that is absolutely from the strong exposure growth. You can certainly relate to the increases in payrolls across the economy, so that's one of the key drivers of that in that line.

Brian Meredith
Perfect, thank you.

Operator
Your next question comes from Josh Shanker from Bank of America. Please go ahead.

Josh Shanker
Yes, thank you. I was looking at the 10-K, and you have duly warned us about the variable investment income in the back half of 2022. Obviously, the markets were not so strong in the first quarter this year. I would have thought that the 2Q results would have been weaker, and when I look at you saying, hey, the back half of the year, be careful, is there more than a three-month lag when we think about these things? Do we have any reason to think that 4Q should be particularly weak at this point in time?

Dan Frey
No, Josh, it's Dan. I don't think there's any change to our historical commentary. We say generally things are on about a one-quarter lag. Second quarter was pretty strong from an alternative, if you consider it in the context of the broader market, but again, we're not necessarily going to follow that in lockstep.

We've got individual investments within the quarter, you know, real estate did pretty well, we had some energy holdings that did pretty well, we had some transportation holdings that did pretty well, so it's going to be a function of what's actually inside of our portfolio, and that's really what you're seeing as opposed to any change in the lag pattern.

Josh Shanker
All right, and then the renewal premium change is obviously a lagging indicator of what you're doing on rate. For Michael, when you look at the Auto book, or maybe even Auto and the Home book, and you know what rates you are getting, when do you hope that you are getting rates in excess or at least matching the loss trends? When do you think that renewal rate trends will sort of be matching that on the net premium earned line?

Michael Klein
Yes, great question, Josh, and a really hard one to answer in this environment. I mean, I think there's one conversation we could have around what those numbers are relative to a relatively long-term view of trends.

Unfortunately, the environment that we're in—and you can pick your statistic—I mean, it's really a pretty unprecedented environment in terms of loss cost inflation and the personal lines business. You can look at body work CPI, I think is the highest it's been since 1980 in low double digits. You can look at shingles prices, lumber prices. The Manheim Used Vehicle Index was up 30%-plus last year, and it stayed there. So, it's really hard to put a point on when rate will exceed loss trend until we fully understand how long this elevated inflation is going to last.

From that standpoint, that's why our focus really isn't on picking that point. Our focus is on continuing to incorporate the latest data into our pricing and underwriting processes and continuing to raise rate as we see that evidence of further need.

To your point, and it's a good one, the 6.3% RPC as an example that we reported in Auto is the written impact of the rate we've taken, essentially, over the last three or four quarters as it hits renewals. And, so one important point to make is even if we didn't file for any additional rate, which we are, that number would rise next quarter because we haven't yet seen the full written impact of the rate that we've already gotten filed and approved.

But again, importantly, we've got that rate already in the pipeline that will drive that number higher, and we are continuing to seek additional increases which will continue to drive that number higher and, again, drive it into the double digits by the fourth quarter of this year, speaking specifically to Auto.

Josh Shanker
Thank you for the fulsome answers.

Operator
Your next question comes from Tracy Benguigui from Barclays. Please go ahead.

Tracy Benguigui
Good morning. I'm just trying to reconcile your deteriorating underlying loss ratios in both BI and PI on a sequential basis and your premium growth achievement. Is the idea that you're happy with your risk-adjusted returns so you don't feel like you need to withdraw underwriting capacity just yet?

I guess I'm just trying to figure out if you're trying to be more discerning where you're growing from here, even if it's just pockets of your business.

Dan Frey
Tracy, it's Dan. I'll start, and I think we've done this before, but again, I think there's a reason that we don't look at combined ratio on a sequential basis, and part of that is what you see in the second quarter in particular, because whether it's cat losses or underlying property, we expect more activity in the second quarter than the rest of the quarters of the year.

To go back to the comments that Alan was making and that Greg made, if we look at where the underlying combined ratios are and the returns are coming out of 2021, in which we had north of a 13.5% core ROE and the first half of the year this year, that's 12.4% through the first six months of the year, we feel like the business as a whole is in a pretty good place. We've got a balanced portfolio. Some parts of the portfolio are going to be stronger than others at certain times, but we're managing the business for the long term and we're not thinking about withdrawing capacity at this point. We've got plenty of capital and we think there's plenty of good business in the marketplace to write that's going to serve us well in the long term.

Tracy Benguigui
Okay. Could you maybe unpack your favorable prior development in BI, specifically within CMP? Was that liability or non-liability? The reason I'm asking is because you experienced unfavorable development in GL, and I noticed the releases from CMP came from recent accident years, which would make more sense for short-tail lines.

Dan Frey
Yes, it's not a big number, Tracy, so I'm just not going to break it down any further than that.

Tracy Benguigui
Okay, okay. Perfect.

Operator
Your next question comes from David Motemaden from Evercore. Please go ahead.

David Motemaden
Thanks, good morning. Just a question for Michael on Personal Auto. Could you talk a little bit about how you're handling closing claims quickly and claims resolutions? I would think that your book has more preferred business and newer cars that are more complex to repair, which you know, it sounds like you guys feel like you're on top of that potential issue, but maybe you could just talk about how you're approaching closing claims in a timely fashion on the Auto book.

Michael Klein
Sure David. I would say yes, we're on top of it. Our claim team is top notch. They're terrifically talented and capable, and we've got great discipline and process inside the claim organization. They're really just terrific partners in support of the business.

That said, we're not immune from the environmental pressures that you read about, and you've seen and heard others talk about. So while we are on top of things, and while the way you described our portfolio makes sense, it is taking longer to get parts, it is taking longer to get a time slot in a body shop. That is putting pressure on the length of time it takes to make repairs, that is putting pressure on average rental days for non-drivable repairs.

We're doing a lot and really all we can to work with customers to help manage that. One example is being in dialog with the customer and ensuring, for example, that if their vehicle is drivable, that they wait to take it to the shop until we and they have verified that the parts and labor are available, so doing a lot of things to try to manage that, but the length of time to repair on average is extending, and it's really one element of the process. Salvage and subrogation take longer these days. For totaled vehicles, availability remains a challenge. We're faced with all those challenges, but I think our claim organization is doing a terrific job of managing and navigating those.

David Motemaden
Got it, thanks. Then just a question for Dan. I think you mentioned your expense ratio getting down to 29% for the full year, a little bit ahead of schedule. Should we be thinking about a lower expense ratio than 29% as we think about '23 or '24, or do you feel like 29% is a good level to operate at going forward?

Dan Frey
David, we're not going to give '23 or '24 outlook here. I'd just say, you know, a couple years ago we were talking about being pretty comfortable with a 30%, and then a quarter or two ago, we were talking about being more comfortable with a 29.5%.

We're not really setting a target expense ratio. We're managing the business as a whole to overall combined ratio and returns. We're making all the investments that we want to make. What we find is that we've been able to do that inside a still-improving expense ratio.

I think last quarter we said we might get down to 29% sometime in the next year or two. And, another quarter of success, it looks like we'll probably be there this year. I'm not really inclined to give any outlook beyond that.

David Motemaden
Okay, fair enough. Thank you.

Operator
We have time for just one more question, coming from Yaron Kinar from Jefferies. Please go ahead.

Yaron Kinar
Good morning and thank you for still sneaking me in here. First question for Michael around the loss trends in Personal Auto, I heard you talk a lot about physical damage. Are you also seeing a bodily injury component there? Because it's something that we've certainly heard from a lot of the other Auto insurers as of late, maybe you could quantify or qualify that a bit.

Michael Klein
Yes, Yaron, thanks for the question, and I'll qualify it probably and not quantify it.

But similar to the comment I made last quarter, we haven't spiked out bodily injury loss trend as a driver in the sort of year-over-year comparisons and relative to expectation, not because it hasn't been elevated and not because we haven't seen elevated bodily injury loss trends. And, in particular, we've seen elevated inflation in bodily injury. There's been a little bit of favorability in bodily injury frequency offsetting some of that severity, and we had a pretty healthy assumption around what the bodily injury loss trend was going to be, and so it just hasn't jumped out as a delta relative to our expectation.

But that doesn't mean we don't see pressure, it doesn't mean we're not observing it, it just means it's not a significant difference from what we had anticipated.

Yaron Kinar
Got it. Then this is probably a broader question, maybe for Greg or for Alan. You are essentially the insurer of the U.S. economy, if you will, and with all this talk about potential recession, fears of recession, is there any indicator that you're seeing in your conversations with clients today that would lead you to see that actually materializing, and if so, are there specific sectors or industries that you're seeing maybe pressure emerging in?

Alan Schnitzer
Yaron, I'd say not yet. The business underlying fundamentals we're still seeing from our customers are strong. I think the macroeconomic data you see confirms that. As the Fed continues to increase interest rates in an effort to bring down demand, I think we're all reading those tea leaves and imagining it's coming, but we're not seeing it in our data, not to any significant degree.

Yaron Kinar
Okay, thank you.

Alan Schnitzer
Thank you.

Operator
Thank you. I will turn the call back over to Abbe for closing remarks.

Abbe Goldstein
Thank you very much. We appreciate everyone joining us today and, as always, if you have any follow-ups, please feel free to reach out directly to Investor Relations. Have a good day. Thanks.

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

Forward-Looking Statements and Non-GAAP Financial Measures

This transcript contains certain "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. All statements, other than statements of historical facts, may be forward-looking statements. Words such as "may," "will," "should," "likely," "anticipates," "expects," "intends," "plans," "projects," "believes," "views," "estimates" and similar expressions are used to identify these forward-looking statements. These statements include, among other things, the Company's statements about:

•the Company's outlook, the impact of trends on its business and its future results of operations and financial condition;
•the impact of COVID-19 and related economic conditions;
•the impact of legislative or regulatory actions or court decisions taken in response to COVID-19 or otherwise;
•share repurchase plans;
•future pension plan contributions;
•the sufficiency of the Company's asbestos and other reserves;
•the impact of emerging claims issues as well as other insurance and non-insurance litigation;
•the cost and availability of reinsurance coverage;
•catastrophe losses and modeling;
•the impact of investment, economic and underwriting market conditions, including interest rates and inflation;
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•the impact of developments in the geopolitical environment.

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Insurance-Related Risks

•high levels of catastrophe losses;
•actual claims may exceed the Company's claims and claim adjustment expense reserves, or the estimated level of claims and claim adjustment expense reserves may increase, including as a result of, among other things, changes in the legal/tort, regulatory and economic environments, including increased inflation;
•the Company's potential exposure to asbestos and environmental claims and related litigation;
•the Company is exposed to, and may face adverse developments involving, mass tort claims; and
•the effects of emerging claim and coverage issues on the Company's business are uncertain, and court decisions or legislative changes that take place after the Company issues its policies can result in an unexpected increase in the number of claims.

Financial, Economic and Credit Risks

•a period of financial market disruption or an economic downturn;
•the Company's investment portfolio is subject to credit and interest rate risk, and may suffer reduced or low returns or material realized or unrealized losses;
•the Company is exposed to credit risk related to reinsurance and structured settlements, and reinsurance coverage may not be available to the Company;
•the Company is exposed to credit risk in certain of its insurance operations and with respect to certain guarantee or indemnification arrangements that it has with third parties;
•a downgrade in the Company's claims-paying and financial strength ratings; and
•the Company's insurance subsidiaries may be unable to pay dividends to the Company's holding company in sufficient amounts.

Business and Operational Risks

•the ongoing impact of COVID-19 and related risks, including with respect to revenues, claims and claim adjustment expenses, general and administrative expenses, investments, inflation, adverse legislative and/ or regulatory action, operational disruptions and heightened cyber security risks;
•the intense competition that the Company faces, including with respect to attracting and retaining employees, and the impact of innovation, technological change and changing customer preferences on the insurance industry and the markets in which it operates;
•disruptions to the Company's relationships with its independent agents and brokers or the Company's inability to manage effectively a changing distribution landscape;
•the Company's efforts to develop new products or services, expand in targeted markets, improve business processes and workflows or make acquisitions may not be successful and may create enhanced risks;
•the Company's pricing and capital models may provide materially different indications than actual results;
•loss of or significant restrictions on the use of particular types of underwriting criteria, such as credit scoring, or other data or methodologies, in the pricing and underwriting of the Company's products; and
•the Company is subject to additional risks associated with its business outside the United States.

Technology and Intellectual Property Risks

•as a result of cyber attacks (the risk of which could be exacerbated by geopolitical tensions) or otherwise, the Company may experience difficulties with technology, data and network security or outsourcing relationships;
•the Company's dependence on effective information technology systems and on continuing to develop and implement improvements in technology; and
•the Company may be unable to protect and enforce its own intellectual property or may be subject to claims for infringing the intellectual property of others.

Regulatory and Compliance Risks

•changes in regulation, including higher tax rates; and
•the Company's compliance controls may not be effective.

In addition, the Company's share repurchase plans depend on a variety of factors, including the Company's financial position, earnings, share price, catastrophe losses, maintaining capital levels appropriate for the Company's business operations, changes in levels of written premiums, funding of the Company's qualified pension plan, capital requirements of the Company's operating subsidiaries, legal requirements, regulatory constraints, other investment opportunities (including mergers and acquisitions and related financings), market conditions, changes in tax laws and other factors.

Our forward-looking statements speak only as of the date of this press release or as of the date they are made, and we undertake no obligation to update forward-looking statements. For a more detailed discussion of these factors, see the information under the captions "Risk Factors," "Management's Discussion and Analysis of Financial Condition and Results of Operations" and "Forward Looking Statements" in the quarterly report on Form 10-Q filed with the Securities and Exchange Commission (SEC) on July 21, 2022, and in our most recent annual report on Form 10-K filed with the SEC on February 17, 2022, in each case as updated by our periodic filings with the SEC.

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.