Q2 2017 Earnings Call

Company Participants

- Beth Ann Bombara, Chief Financial Officer & Executive Vice President
- Christopher J. Swift, Chairman & Chief Executive Officer
- Douglas G. Elliot, President
- Sabra Rose Purtill, Senior Vice President, Investor Relations

Other Participants

- Brian Meredith, Analyst
- Elyse B. Greenspan, Analyst
- Ian J. Gutterman, Analyst
- Jay A. Cohen, Analyst
- Jay Gelb, Analyst
- Josh D. Shanker, Analyst
- Kai Pan, Analyst
- Mark Dwelle, Analyst
- Meyer Shields, Analyst
- Ryan J. Tunis, Analyst
- Thomas Gallagher, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good morning. My name is Heidi, and I will be your conference operator today. At this time, I would like to welcome everyone to The Hartford's Second Quarter 2017 Financial Results Conference Call. Thank you.

Sabra Purtill, Head of Investor Relations, you may begin your conference.

Sabra Rose Purtill {BIO 1764408 <GO>}

Thank you, Heidi. Good morning, and welcome to The Hartford's second quarter 2017 webcast. Our speakers today include Chris Swift, Chairman and CEO of The Hartford; Doug Elliot, President; and Beth Bombara, CFO. Following their prepared remarks, we will have about 30 minutes for Q&A.

Just a few comments before Chris begins. Today's call includes forward-looking statements as defined under the Private Securities Litigation Reform Act of 1995. These statements are not guarantees of future performance and actual results could be materially different. We do not assume any obligation to update information or forward-looking statements provided on this call. Investors should also consider the risks and uncertainties that could cause actual results to differ from these statements. A detailed description of those risks and uncertainties can be found in our SEC filings which are available on our website. Our commentary today includes non-GAAP financial measures. Explanations and reconciliations of these measures to the comparable GAAP measure are included in our SEC filings as well as in the news release and the financial supplement. These materials, including the10-Q, are all available on our website.

Finally, please note that no portion of this conference call may be reproduced or rebroadcast in any form without The Hartford's prior written consent. Replays of this webcast and an official transcript will be available on The Hartford's website for at least one year after the webcast.

I'll now turn the call over to Chris.

Christopher J. Swift {BIO 3683719 <GO>}

Thanks, Sabra. Good morning, everyone, and thank you for joining us today.

The Hartford's second quarter core earnings increased significantly over the prior year. Each business segment contributed to the results with clear progress in personal auto, solid investment returns including favorable limited partnership results. Capital generation remains strong, and we returned over $800 million to shareholders in the first half of the year including share repurchases and dividends, while repaying $416 million of debt. Performance over the past year increased core earnings ROE to 9.3%, or 11.3% excluding Talcott Resolution.

One of the most important accomplishments in the quarter was the improvement in personal auto results. I'm encouraged by the frequency and severity trends we're seeing in the loss experience. Adjusting second quarter 2016 results for the unfavorable development during the year, we delivered a 2.4-point improvement in the underlying combined ratio this quarter. While we have more work to do, the quality of the auto book is much better today due to the success of the profitability initiatives we launched over the past 18 months, and we are on track to meet the combined ratio goal we set for the year.

With improved profitability, we will increase marketing spend in the second half of 2017 in selected areas to begin growing new business again. Our 30-plus-year relationship with AARP remains strong, and we working in close partnership as we transition to growth.

Commercial Lines achieved an excellent 90.9 underlying combined ratio, reflecting disciplined underwriting in markets that remain competitive. Small commercial, again, delivered outstanding results, with 6% written premium growth and a superb underlying combined ratio of 87.2 despite some pressure in auto. We will continue to focus on growing in this important segment of the market, and are investing significantly in data and digital capabilities that are enhancing underwriting and improving agent and customer experience. I am confident we are well positioned to continue to lead this small commercial insurance market into the future.

The middle market underlying combined ratio was 94.9, a 3-point deterioration mainly due to several large property losses occurring late in the second quarter. The competitive environment in middle market remains challenging for both new and renewal business, which is likely to persist in the second half of the year. We will continue to prioritize disciplined risk selection and retention of our best accounts, while competing in areas where it makes sense.

Group Benefits continued to deliver excellent results. Core earnings increased 33% to $61 million, resulting in a core earnings margin of 6.7%. The increase in earnings reflected improved group life mortality, and better disability experience with strong persistency supporting top line growth. The voluntary business, while still small, is building momentum with our new hospital indemnity product now approved and quoting in 44 states. We're focused on growing this business, and are investing in new and enhanced capabilities to increase penetration with agents and brokers who specialize in this market.

Mutual Funds had another great quarter, with total assets under management reaching $108 billion. In the first half of 2017, the segment achieved positive net flows in excess of $2.6 billion, with strong investment performance across the fund lineup. I am optimistic about the continued growth of this business, with our two outstanding subadvisors, Wellington and Schroders, and our recent entry into the smart beta asset class.

Before turning the call over to Doug, I'd like to make a few comments about the City of Hartford.

Currently, the city is in the midst of a significant financial crisis with its future very much tied to the actions of the State of Connecticut. As a company founded and headquartered in Hartford for over 200 years, we remain vested in the city's future, and believe its success is vital to the state's economy and overall strength.

While the city faces immense challenges, we believe it also holds enormous potential. Connecticut and the greater Hartford area offer tremendous quality of life and enjoy one of the most educated and talented workforces in the country. In many ways, the seeds of the city's future success have already been sown in the form of recent investments in new housing, education and transportation. These green shoots of progress are why The Hartford along with other large insurance employers recently offered financial support to help supplement the city's finances, contingent on the development of a comprehensive and sustainable solution for the capital city.

We strongly encourage elected leaders and other key stakeholders to come together to implement the long-term solutions necessary to address the financial challenges facing the city and state, and continue to cultivate Hartford as a vibrant urban center, capable of attracting critical talent of the future.

In closing, I am proud of the strong financial results we delivered this quarter and the progress we've made in the first half of 2017, which put us on track to meet the outlook we provided earlier this year.

Now I'll turn the call over to Doug.

Douglas G. Elliot {BIO 3700927 <GO>}

Good morning, everyone. As Chris said, we're very pleased with our second quarter across Property, Casualty and Group Benefits. Commercial Lines delivered strong results against the backdrop of a competitive market. In Personal Lines, auto improvement improved consistent with our expectations. And Group Benefits had an excellent quarter, with strong earnings driven by favorable trends in both group life and disability.

Let me get right into the second quarter details on each of our business units.

In Commercial Lines, the combined ratio was 94.6, improving 0.4 points from 2016 primarily due to lower catastrophe losses and prior-year development partially offset by slightly higher current accident year losses before catastrophes. The underlying combined ratio for Commercial Lines was 90.9, deteriorating 1.1 points. This was largely driven by commercial auto, consistent with trends in first quarter 2017 and large loss volatility in middle market property.

Market conditions continue to be competitive, particularly in middle market and national accounts. And we're executing effectively to balance retention, margins and new business opportunities. Renewal written pricing in standard Commercial Lines was 3.5%, up slightly from the first quarter of 2017, with the highest increases continuing to come from commercial auto. Small commercial had another strong quarter with an underlying combined ratio of 87.2. Written premium was up 6% resulting from strong retention and $147 million of new business including $14 million from Maxum.

In middle market, the underlying combined ratio was 94.9, deteriorating 3 points from 2016, mainly due to several large losses in our property and marine books of business. These losses can be volatile and our results for the first six months are within our longer term run rate. Written premium decreased 2% versus prior year. New business production of $107 million was off 14%. Although recent loss cost trends in lines such as workers' comp and general liability have been favorable, our view is that we must consider historical trends in our decision-making given the long-term nature of these liabilities.

Overall, I believe we struck an appropriate balance between new business, pricing and underwriting quality in this competitive marketplace.

On the in-force book, we took targeted non-renewal actions on a program for service and maintenance contractors. Excluding these actions, our retention remained solid and consistent with prior quarters. Middle market operating expenses were also higher in the quarter as we continued to invest in the talent and technology necessary to compete in this business long term.

Moving to specialty commercial, the underlying combined ratio of 95.9 deteriorated 0.5 points. This was driven by a slightly higher loss ratio in auto liability, again consistent with our results in first quarter 2017. Written premium in specialty commercial was down 3% for the quarter, largely the result of slightly lower new and renewal premium in national accounts partially offset by continued growth in bond.

Moving to Personal Lines, the second quarter combined ratio was 101.4, improving 11.2 points from a year ago. 8.9 points of the improvement was driven by a change from unfavorable prior-year development in second quarter 2016 to slightly favorable development this year. Expenses and catastrophe losses were also lower versus 2016. The underlying combined ratio of 92.6 improved 1.6 points. This was primarily driven by improving auto trends, partially offset by homeowner results, with the homeowners underlying combined ratio for the second quarter of 77.6 deteriorating 3.4 points versus last year, due to higher non-catastrophe weather losses.

In Personal Lines auto, the underlying combined ratio improved to 99.1. After adjusting second quarter 2016 for net development affecting the quarter, the 2017 auto loss ratio has improved approximately 1.3 points. The expense ratio was also down this year by 1.1 points, due primarily to reduced new business acquisition expenses. As a result, on an adjusted basis, the underlying combined ratio for the second quarter of 2017 improved 2.4 points.

This progress is right in line with our expectations, as our pricing, underwriting and agency management actions begin to earn their way into our book of business. Auto loss cost trends have been relatively stable and moderate in recent quarters, more in line with historical levels. Frequency trend is essentially flat, and severity trend is in the low single digits, both improving from our experience in 2016 and 2015.

The year-to-date auto combined ratio was 99.1. We expect the second half of the year to run higher due to normal seasonality. Importantly, we remain on track to achieve our full-year auto combined ratio outlook of 101 to 103, which included approximately 1 point for catastrophes. This represents 2 to 3 points of expected improvement in the underlying auto loss ratio for the full year.

Personal Lines written premium for second quarter 2017 was down 7%. Consistent with recent quarters, our marketing spend was down versus a year ago resulting in lower new business as we address our rate needs with added filings and improved underwriting segmentation. We have made substantial progress to-date. And as we noted last quarter, we are increasing our AARP new business marketing efforts over the second half of the year. Due to the lead times between marketing and customer conversion, we expect to see positive growth in AARP direct new business premium late in the fourth quarter.

Turning to Group Benefits, we had an excellent second quarter, with core earnings of $61 million and a margin of 6.7%. The total loss ratio improved this quarter by 2.4 points versus prior year, with favorable results in both group life and disability.

In second quarter 2016, we experienced some volatility in our group life results with higher-than-normal severity. Results in 2017 have been better than expected with improved group life results and favorable incidence and recovery trends in group disability. The improvement in both lines can be attributed to our ongoing execution in underwriting, pricing and claims management as well as favorable trends relative to historical experience. We continue to expect the long-term core earnings margin of this business to be in the 6% range.

On the top line, second quarter fully insured ongoing premiums increased 2%. Overall book persistency on our employer group block of business remained strong at approximately 90%, and fully insured ongoing sales were $67 million. Although down from prior year, it was a solid sales quarter, and we're well positioned for a strong second half of the year.

In summary, our Property, Casualty and Group Benefit businesses delivered excellent second quarter results. Now halfway through the year, I'm extremely pleased with the consistent execution of our team and the performance of our businesses. We're maintaining our disciplined and balanced approach to deliver profitable growth.

Let me now turn the call over to Beth.

Beth Ann Bombara

Thank you, Doug. I'm going to cover our other segments, investment performance and capital management activities before taking your questions.

Our P&C Other segment had core earnings of $18 million compared with a loss of $154 million last year, which included $174 million of adverse development on an asbestos and environmental reserves. As a reminder, in the past, our annual A&E study was completed in the second quarter. After the purchase of the A&E reinsurance cover from National Indemnity last year, we moved this annual study to the fourth quarter, so there is no impact from A&E in this quarter's results.

Turning to Mutual Funds, strong net flows and market appreciation as well as the addition of the Schroders funds drove total segment AUM up 18% to $107.7 billion and core earnings up 20% to $24 million. We continue to benefit from strong investment performance, with 77% of our funds beating their peers on a five-year basis. Sales of $6.2 billion generated positive net flows of $1.3 billion in the quarter. Through the first half of 2017, net inflows of $2.6 billion are up significantly compared with net outflows of $600 million in the first half of 2016.

Talcott's core earnings were $80 million, down from $91 million in the second quarter of 2016. Over the past four quarters, VA contract counts decreased 10% and fixed annuity contracts decreased 6%. Talcott's statutory surplus was $4.3 billion at quarter end. We expect Talcott to pay a $300 million dividend to the holding company in the third quarter for a total of $600 million in 2017.

In the Corporate segment, we had core losses of $52 million compared with core losses of $50 million in the prior year. Operating expenses in the second quarter of last year benefited from the reversal of a legal accrual, which masked the benefit over the past year of the decline in interest expense resulting from the reduction in debt.

On an all-in basis, the Corporate segment had a net loss of $540 million, reflecting a pension settlement charge of $488 million after tax, or $1.31 per diluted share, due to transfer of approximately $1.6 billion or 29% of our U.S. defined benefit pension obligation to Prudential. As a reminder, the pension charge includes a $344 million loss that was previously included in AOCI. So while the charge to net income was $1.31 per diluted share, the impact to book value per share was lower at $0.39.

The investment portfolio continues to perform well with generally stable portfolio yields, strong LP returns and modest impairments. Total LP investment income was $48 million before tax for an annualized yield of 8% compared with $40 million or 6.1% in the second quarter of 2016. Excluding LPs, the total before-tax annualized yield was 4.05% this quarter, compared to 4.14% in second quarter 2016.

To conclude on earnings, second quarter core earnings per diluted share were $1.04, up significantly from $0.31 in second quarter 2016 which included a $0.44 per share charge for A&E. Excluding that charge, core earnings per share were up almost 40%, which includes the effect of a 7% reduction in weighted average diluted shares outstanding. The improvement in core earnings was primarily driven by better Personal Lines results, along with higher core earnings from each of the other segments with the exception of Talcott.

Our core earnings ROE for the past 12 months was 9.3%, up 1.9 points from a year ago, and our core earnings ROE, excluding Talcott, was 11.3%. P&C core earnings ROE was 13.1%, a very strong result despite Personal Lines results being below our long-term targets, while Group Benefits was 11.2%.

Turning to shareholders equity, book value per diluted share was $46.84, down slightly from a year ago. Excluding AOCI, book value per diluted share was up 2% since June 30, 2016.

Before taking questions, I wanted to provide a quick update on capital management. During the quarter, we repurchased $325 million of stock and through July 25, we repurchased about 1.6 million shares for $85 million for third quarter to-date. This leaves approximately $565 million available under the $1.3 billion equity repurchase authorization for 2017.

To conclude, this quarter's results demonstrate continued strong and steady operating results with consistent and disciplined execution in competitive markets. We are pleased with the continued progress in personal auto, where our results are clearly improving. And Commercial Lines, Group Benefits and Mutual Fund results remain strong, supported by top line growth.

I will now turn the call over to Sabra so we can begin the Q&A session.

Sabra Rose Purtill {BIO 1764408 <GO>}

Thank you, Beth. Just a reminder that we have about 30 minutes for Q&A. If you have to drop off or if we run out of time before we get to your question, please email or call the Investor Relations team and we will follow up with you as soon as possible today.

Heidi, could you please repeat the Q&A instructions?

Q&A

Operator

Certainly. Your first question comes from the line of Kai Pan from Morgan Stanley. Please go ahead.

Q - Kai Pan {BIO 18669701 <GO>}

Thank you, and good morning. First question is on the personal auto. It looks like you're making great progress in the turnaround. I just wonder if you're looking out any further. What's your profitability long-term target? And how quickly can you get there?

A - Douglas G. Elliot {BIO 3700927 <GO>}

Thanks, Kai. This is Doug. As we've described in prior calls, our goal in the auto line is to achieve a 96.5 ex-X auto target. So that is our goal. It isn't quite at our longer term profitability targets, but it's certainly our near-term focus and we intend to do everything we can to get there by the end of 2018.

Q - Kai Pan {BIO 18669701 <GO>}

Okay. And then sort of like the second half higher, so in order to achieve this year's target, second half must be higher than the first half in terms of personal auto, the core combined ratio. I just wonder, you mentioned about higher seasonality, how much is that contributing to it? And do you have any plan to increase the expense ratio as you try to grow your business again?

A - Douglas G. Elliot {BIO 3700927 <GO>}

Kai, yeah, let me try to take each of the pieces a little bit separate. So, traditionally, seasonality has impacted our auto and homeowners loss ratios, but certainly we're talking about auto now. Fourth quarter has been our most challenging weather auto quarter and we expect the second half of 2017 to be in line with prior years. So that's why the numbers are working as they do. And as you see, our full-year guidance you know and you can back into what the second half of the year will look like. I think I'll leave it at that. Beth, is there anything you want to add to that?

A - Beth Ann Bombara

No, I'll just follow-up with a comment on the expense ratio. Yes, if we do increase, as our plan is marketing spend in the second half, we would expect to see some uptick in that expense ratio. But, again, that was contemplated overall when we provided our guidance at the beginning of the year. So, as Doug said, overall, we see things performing very consistently with our expectations.

A - Douglas G. Elliot {BIO 3700927 <GO>}

And, Kai, just in closing, we expect this year on a loss ratio basis in personal auto. We're expecting 2 to 3 points of improvement. So, we haven't backed off that. First half of the year was right in line with that, and as we play out the second half, we expect to achieve those targets.

Q - Kai Pan {BIO 18669701 <GO>}

That's great. Last one, if I may, just, there's a lot of talk in the marketplace about digital small business insurance. You guys are market leader there. I just wonder how do you position yourself, both your internal initiatives as well if you're looking out there's other opportunity through acquisitions?

A - Christopher J. Swift {BIO 3683719 <GO>}

Yeah. Kai, it's Chris. What I would say is, yeah, there is a lot of activity in the FinTech space, in general, if I understood your question with money and activity. Obviously, we're very proud of our leadership in the small commercial space in general. We participate in those activities through our venture group, whether it be finding partnerships, doing experiments, allocating capital to startups. We have all types of activities in that space.

And I said in my prepared comments, we are going to continue to be a leader in this space as things continue to change. So, a lot of our investment dollars are targeted towards more of a digital business model. And if you think of some of the M&A activity that's occurring in the space, and particularly what we did a little over a year ago acquiring Maxum, Maxum was specifically targeted to the small commercial end of the market. So, with our technology, with E&S capabilities, with enhancing digital experiences, I feel good about the path that we're on.

A - Douglas G. Elliot {BIO 3700927 <GO>}

Kai, I guess the only thing I would add is that there's been an awful lot of discussion about not only disruption, but clearly, the frontend sales quoting and changes that may occur there. I'd also remind you that in addition to those skills required, there's still an awful lot behind that is important to the equation. So, having world-class service centers, having a terrific claim operation, having dynamic sales professionals, right, having the data and analytics and the science behind the engine. So, we're working on all facets of our small commercial operation. We do see change coming. We see it probably quicker today than we did a year ago. We're being responsive to that change and we're working hard to take advantage of it as it comes.

Q - Kai Pan {BIO 18669701 <GO>}

Thank you so much for all the answers.

Operator

Your next question comes from the line of Joshua Shanker from Deutsche Bank. Please go ahead.

Q - Josh D. Shanker {BIO 5292022 <GO>}

Yeah. Good morning, everyone. Two questions, hopefully quick ones. Can we talk about the cash tax rate as opposed to the GAAP tax rate for this quarter and what the outlook is for that?

A - Beth Ann Bombara

Sure. So, from a cash tax rate, when you're thinking about our earnings, keep in mind that we obviously do benefit from the utilization of net operating losses, but given the amount of preference items we have, both from a dividends received deduction and the tax exempt interest on municipal bonds, we do find ourselves in the position of paying AMT tax. So actually from a cash tax perspective, if you're looking at our GAAP earnings, we're probably paying a rate in cash that's a little bit higher than the statutory rate.

Q - Josh D. Shanker {BIO 5292022 <GO>}

And you expect that to persist for the next 12 months or so?

A - Beth Ann Bombara

Yeah. As we look at our forecast going forward, and again continuing to utilize net operating losses, but continuing to see ourselves in an AMT position, yes, that situation would continue.

Q - Josh D. Shanker {BIO 5292022 <GO>}

Okay. And looking over the fiscal supplement on page 18, you give some disclosures about rate increases both for auto and home. Obviously, the problems have been in auto, but it looks like you're very much seeking rate increases in home as well. And also seems that the gap between the written price increases and the earned price increases isn't very different. In trying to think about going out into the coming year, shouldn't there be a earned lag on all the work that you've done that it should accelerate through the year? Or are we already kind of at the full earn-through of the amount of work you've been doing?

A - Douglas G. Elliot {BIO 3700927 <GO>}

Let me work each side of the question. So, the first piece is that we're working equally as hard on homeowners. And actually if you extend that over the past three to four years, we've been working diligently in homeowners for multi years, dealing with cat zones and deductibles, et cetera. So, that's the reason where you see the homeowners pricing as is.

On the automobile side, on a written basis, I would suggest that as we look out, we expect to continue to see, at least over the next couple of quarters, more quarters in the pricing realm written like you're seeing in June, the second quarter. The earned pricing is starting to catch up. So, as I think about the last four quarters, we've moved on an earned auto basis from 6 to 7 to 8 to 9, and that will approach 10 as we move into the third quarter. So, yes, it's catching up. And at some point, if there is a deceleration in our auto written because our rate adequacy improves, there will be a point where an earned is greater than written, but that's all math, right? And we'll see that as it comes.

Q - Josh D. Shanker {BIO 5292022 <GO>}

Okay. Well, thank you and good luck.

A - Douglas G. Elliot {BIO 3700927 <GO>}

Thank you.

Operator

Your next question comes from the line of Tom Gallagher from Evercore ISI. Please go ahead.

Q - Thomas Gallagher {BIO 3311667 <GO>}

Good morning. First question. Chris, just with all the recent news articles on Talcott, just a quick question on that. How should we think about you holding out for the best possible value in a potential sale versus the strategic flexibility that a sale will give you if you sell sooner versus later, even if it's at a bit of a discount, what you view as intrinsic? So, just wanted to get an update just overall view on that.

A - Christopher J. Swift {BIO 3683719 <GO>}

Tom, thank you. You're going to be disappointed. I really just feel, at this point, speculation on a transaction, the whole theory behind holding, selling, just is not helpful at this point in time. I think we've been pretty consistent on saying that we've run Talcott off over the last five years. We're pretty comfortable continuing to do that, but at some point in time, we're not the natural owner of it going forward. So, why don't we just leave it as that, that Talcott is contributing the way it is, and if anything is done, it will always be based on an economic conclusion for shareholders. And I think we've been pretty consistent in our approach over the last five years as we've restructured the operation. But beyond that, Tom, now is not the appropriate time to comment.

Q - Thomas Gallagher {BIO 3311667 <GO>}

I had to give it a shot. And just a question for Doug. Just curious how you're feeling about workers' comp results and any signs of claims inflation coming through yet? Or still pretty favorable performance there?

A - Douglas G. Elliot {BIO 3700927 <GO>}

Tom, we're feeling very good about our workers' comp book of business, both small commercial, which workers' comp's a big part of our profile, and also middle market and national accounts casualty. So, our trends, very consistent, frequency, severity, medical severity, et cetera. So, in general, all the signs inside the book are in very good shape. It's also causing a bit of competition in the marketplace. I think people see good numbers on the workers' comp side, so, competing effectively, like where we are. I think we have a strong value prop in the comp marketplace, continue to do so, but also drawing some lines, particularly in middle market where we see, at times, some very aggressive behavior. We're trying to make good economic choices and I like where we are with our comp decisions.

Q - Thomas Gallagher {BIO 3311667 <GO>}

Okay. Thanks, Doug.

Operator

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

Q - Brian Meredith {BIO 3108204 <GO>}

Yeah, thanks. Two questions. First, Beth, I'm just curious, I think originally in your plans you were planning on taking $500 million to $600 million of dividends out of Talcott this year. I know you did, I believe, $250 million in the first quarter. Have you applied for the dividend or taken the dividend yet for the second half of the year?

A - Beth Ann Bombara

Yeah, Brian. So, we planned for $600 million of dividends from Talcott this year. We took $300 million in January. And then as I said, we anticipate taking $300 million this quarter, so sometime in August or September.

Q - Brian Meredith {BIO 3108204 <GO>}

August or September. So, have you applied for it yet? I'm just curious.

A - Beth Ann Bombara

Yeah. So, typically when we apply for a dividend, it comes out very shortly thereafter. So, no, we've not put an application in, and yes, but again, we anticipate doing that sometime in August or September.

Q - Brian Meredith {BIO 3108204 <GO>}

Great, thanks. And then, Doug, I'm just curious, looking at your Commercial Lines, what's going on with renewal written pricing kind of picking up a little bit here. How far away are we from that kind of matching loss trend and maybe seeing some stabilization in the underlying combined ratios, loss ratios there?

A - Douglas G. Elliot {BIO 3700927 <GO>}

Good question, Brian. Number one, I'd say, we're pleased with our overall pricing in second quarter, just up slightly from first quarter. So, in an aggregate sense, pleased with the stability there. I think everybody knows, though, that auto is a driver. So, we're pleased with our progress in auto. My focus is in the casualty lines and what's happening in property. And there where I'd like to see a little more rate. I think, over time, as carriers look at their exiting results, we will see adjustments. But over the next couple quarters, I'm not sure I see anything in the near term that says the quarters are going to behave differently.

Our small commercial results, as we share with you in our supplement, good pricing in small commercial. It's middle where there's an awful lot of competition. And so, our new business is down and I think there's a direct correlation between us deciding to walk away and just not seeing enough economic activity that makes sense for us. We'll gauge that and share with you as we go through the next couple quarters what the results look like.

Q - Brian Meredith {BIO 3108204 <GO>}

Great. Thank you.

Operator

Your next question comes from the line of Jay Cohen from Bank of America. Please go ahead.

Q - Jay A. Cohen {BIO 1498813 <GO>}

Yeah. Couple of questions. First, on the personal auto side, you talked about frequency and severity seemingly reverting back to a more normalized trend. I'm wondering how much of that is due to the actions you've taken, how much of it is due to just the normal variability in overall trends?

A - Douglas G. Elliot {BIO 3700927 <GO>}

Jay, very difficult to understand and be able to determine. But, I will say this, we watch the fast-track signals carefully. They are a quarter in arrears, and you can get that data. So, we always match our statistics against fast-track. And so, we've looked at first quarter. I do believe, though, that the actions we've taken over the past 18 months are clearly driving some of the positive change we see in our book of business.

So, and as you look at the overall signals in the marketplace through fast-track, you still see some bodily injury pressure and that hasn't totally gone away. It's still there. We feel it in Commercial and we still see a bit of it in Personal Lines. But, in general, I feel like the work we're doing across our class plans and through our agency plant are having a very positive impact on our Personal Line results and we continue to play this story out.

Q - Jay A. Cohen {BIO 1498813 <GO>}

Thanks, Doug. The other question, on Talcott, if there were going to be a disposition, let's say for a minute that it's below GAAP book value, what are the tax implications for the company for disposing of it at that price?

A - Beth Ann Bombara

So, Jay, it's Beth. So, first of all, it gets a little complicated to start talking about tax impacts on hypothetical transactions, but one thing that I will point out when you think about that is that the tax basis of Talcott is lower than the GAAP basis. So, the tax basis is probably more in line with the statutory book value. So, I don't know if that helps you in your thinking. But, again, tax and tax impacts are always really based on actual terms of a transaction. So, it's kind of hard to comment hypothetically.

Q - Jay A. Cohen {BIO 1498813 <GO>}

Yeah. And I appreciate the complexity, but that comment is definitely helpful. Thanks, Beth.

Operator

Your next question comes from the line of Meyer Shields from KBW. Please go ahead.

Q - Meyer Shields {BIO 4281064 <GO>}

Thanks. Good morning. Doug, couple of questions on auto, if we can dig into that. So, you've talked about increasing marketing spend in the back half of the year and the timing for subsequent growth. Can you give us a sense based on your retention, of how much of a loss ratio impact there is as new business starts to pick up?

A - Douglas G. Elliot {BIO 3700927 <GO>}

Meyer, that's a good question. Trying to figure out how I want to answer that. I don't think I want to give you a number. I mean, in general, we've got indicators across all our lines of business in terms of what we expect, given levels of new business. Given our class plan, I would say this, our signals off our new business in 2017 are showing that it might be the best new business year from a quality and a loss ratio performance we've had in many years.

And so, as I look at the frequencies in our new – what we're putting on the books today, I look at our class plan work, et cetera, I'm very encouraged by the early signs of this year. So, our new business penalty and what we're putting on the books could be rather minor. I want to go out on a limb. It's early. The year hasn't played out and we, obviously, want to pick up our pace with growth and we're targeted around our AARP direct customer segment. But at the moment, I'm not worried about that. I'm feeling very comfortable with the progress we made. I think we're going to have good pricing, adequate terms to be competitive in the marketplace long-term.

Q - Meyer Shields {BIO 4281064 <GO>}

Okay. No, that's actually helpful. And on the Commercial side, I guess, I'm a little surprised that we're still seeing year-over-year deterioration because I had thought that commercial auto rate increases were already earning their way in. Was that a weather-related issue or was my timing off?

A - Douglas G. Elliot {BIO 3700927 <GO>}

It was a little bit more, particularly to small commercial. So, our middle market book has really been re-underwritten over the past three to four years in pretty good shape. It's just been a matter of trying to keep up with loss trend, which we've been trying to do with pricing in middle market. In the small end, we had a little bit of pressure over the past three quarters. And so, we have leaned into not only pricing, but also some underwriting actions. We've triggered a bit more referral activity to our underwriters to look at. A series of actions in our small commercial book. The business is down slightly. It's causing a little bit of a overhang on our overall growth, probably a point on our overall small commercial growth, but I think it's necessary. That line is now starting to behave better. Our combines are improving. And over the next several quarters, we'll be in better shape in small commercial auto.

Q - Meyer Shields {BIO 4281064 <GO>}

Okay. Thank you very much.

Operator

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

Q - Jay Gelb {BIO 21247396 <GO>}

Thanks very much. First question I had was on the Prudential, or the pension risk transfer deal that Hartford had with Prudential. Is there a benefit to ongoing earnings there?

A - Beth Ann Bombara

Thanks, Jay. So, first of all, we were very pleased to enter into that transaction, reduced our pension liability. From a GAAP earnings perspective, I would say in the short-term there's probably a little bit of a negative just given the nuances of pension accounting. Again, over the long-term and the volatility that comes from changes in assumption and so forth, we see this as a very favorable transaction for us.

Q - Jay Gelb {BIO 21247396 <GO>}

Okay. And then on the rating agency debt to capital, it was 25.6% in the second quarter, but that includes the pension liability. So, if we adjust for the pension risk transfer deal, what would the rating agency debt to capital be?

A - Beth Ann Bombara

So, again, the transaction settled as of June 30. So it does take that into consideration what we've disclosed in the financial supplement. I will remind you that we are right now, we did issue the Glen Meadow hybrid in February, and that was $500 million, which is there to pre-fund a June 2018 security that we intend to repay. So, again, adjusting for that, we would expect that our debt to cap ratio would come down.

Q - Jay Gelb {BIO 21247396 <GO>}

Okay. Thank you. And then, Chris, on small commercial, we've seen a lot of clear interest from generally new competitors, in terms of getting in the space, both on agency and direct basis. Hartford is obviously a major player in small commercial. Can you tell us about what Hartford's doing to make sure it defends its competitive position?

A - Christopher J. Swift {BIO 3683719 <GO>}

Yeah. Sure, Jay. I mean, I would say that, again, the amount of new business we write and the volume of our book already speak to the results of investing in this business significantly over really the last 30 years. So, you don't have 1.1 million customers, you don't have $3.5 billion, $4 billion of premium by accident. As Doug said, whether it be service centers, whether it be digital experiences, whether it be self-service capabilities, I mean, we're in the midst of, I'll call it, the next wave of digital tools that we're rolling out.

I would also say, as Doug mentioned, I mean, there will be always the need for advice, and I think risk products. No matter what size of small commercial you wanted to find, from the smallest to the largest, and it's incumbent upon carriers and our distribution partners to figure out the best way to get those customers' advice.

So, but all aspects of the business model are important from a customer experience side. It's not just acquiring customers, it's servicing, it's billing, ease of audit and more importantly, in the moment of truth when there is a claim, I mean, you have to have an experience that engenders customers to want to renew with you the next period. So, we're focused on all parts of the value chain and I'll keep it at a high level, Jay. You would not expect us to give any secret sauce out on the call here today.

Q - Jay Gelb {BIO 21247396 <GO>}

Of course. Thank you.

Operator

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

Q - Ryan J. Tunis {BIO 16502263 <GO>}

Hey, thanks. I had a couple for Doug and I think at least one for Beth. But I guess for Doug, just thinking about what's going on in commercial auto, how we're feeling about the picks from the prior years, because we had the comment again this quarter that it was weighing on the accident year results, but there was no additional strengthening. So, I'm just curious how what you're seeing is informing, I guess, the past accident years, because that was a positive surprise. I thought that there was no additional unfavorable.

A - Douglas G. Elliot {BIO 3700927 <GO>}

Ryan, we do feel very good about our balance sheet. And we felt, as we closed 2016, we took the actions that were appropriate, given everything we saw on all of our lines, including commercial auto. Again, one of the biggest challenges every year as you start out is to anticipate loss trend and understand what you think your price will be. And so, I think about our 2017 accident year. We just tweaked auto a little bit in our national casualty excess book and also in small commercial, but I think not far from where we were. And as you know, in our small commercial space, auto is our smallest line. It's essentially 10% of the book. So, I just want to get that back closer to where it should be on profitability, but it's not causing me major moments to step back and think otherwise.

Q - Ryan J. Tunis {BIO 16502263 <GO>}

Got it. And I didn't want to read too much into this, but I did see that policy count retention in small commercial dip a little bit this quarter and was just curious what was driving that.

A - Christopher J. Swift {BIO 3683719 <GO>}

Ryan, what market did you?

Q - Ryan J. Tunis {BIO 16502263 <GO>}

Small commercial, the policy count number.

A - Douglas G. Elliot {BIO 3700927 <GO>}

Yeah. I don't think there's anything major there. We're competing well. We had a good new business quarter. Again, we're working price in our small segment, not only in auto but other lines. Competitive workers' comp space, but nothing that is out of the ordinary.

Q - Ryan J. Tunis {BIO 16502263 <GO>}

Okay.

A - Christopher J. Swift {BIO 3683719 <GO>}

And, Ryan, I would just say again, statistically Doug is right, but the inference is, we've been aggressive with commercial auto rate in middle and small. And there might be a knock-on effect for other lines as it relates to commercial auto. But Doug's larger point, and maybe it was nuanced. I mean, the marketplace in general, particularly in middle, is still highly competitive. So, as Doug said, we try to anticipate and provided, obviously, some indicators of where we saw margins going. So, halfway through the year, I feel like we made the right call. Six months ago, as far as price pressure, if you think about long-term loss cost trends that you have to price for and reserve for, we are where we are, but equally, it's also in a pretty good shape too. You continue to grind out all the activities that you have available to you to manage margins, but the simple pressure of price and loss cost trends in middle is not a surprising result, where margins are going to be under pressure for the coming quarters.

Q - Ryan J. Tunis {BIO 16502263 <GO>}

That makes sense. And then, I guess, just for Beth. From a capital returns standpoint, kind of looking forward, I guess statutory net income has been pretty good so far this year, but on top of that, I think the pension deal, I think you'd said that there's going to be $300 million of year-end contributions. I mean, how should we think about, I guess, kind of the outlook for capital return as that sort of starts to take shape for 2018? Thanks.

A - Beth Ann Bombara

Yeah. So, obviously we're going to continue on our current path for this year as it relates to the capital actions that we have underway. I would not guide you to think that the pension contribution that we have would significantly alter sort of our plans as we think about capital actions in the future. And, as we think about capital return from the operating subsidiaries, to the extent that operating income and it continues to perform well, we'll evaluate all that as we think about what capital we can take out of the subsidiaries next year.

But, very pleased that we're seeing improvement there. So, if I look at P&C, last year we anticipated taking $800 million out in dividends. This year, we're on track to take out $850 million, and we'll evaluate next year, based on our projections of what we think the capital return can be from there.

Q - Ryan J. Tunis {BIO 16502263 <GO>}

That's helpful. Thanks for the answers.

Operator

Your next question comes from the line of Elyse Greenspan from Wells Fargo. Please go ahead.

Q - Elyse B. Greenspan {BIO 17263315 <GO>}

Hi. Good morning. A few questions. First on auto, just trying to tie together some of the comments. At the start of the Q&A, you mentioned that the goal there is 96.5 on an underlying basis. I know you guys said that you would get to around 100 to 102 this year. So, I'm just trying to think together how you see, and I know that the year-end 2018 target, but how you see that level of improvement in 2018. I know there's still some level of rate, but it seems like you guys are also going to push on the advertising side and potentially go after some new business. So, just trying to tie together those comments.

A - Douglas G. Elliot {BIO 3700927 <GO>}

Good question, Elyse. No question that there are a series of compounding positive features that roll into the 2018 year and beyond. So, the rate discussion that we've had previously and also the underwriting initiatives will continue to earn their way through the second half of this year and then into 2018. So, the 96.5 is the ex-X underlying. I still think it's achievable. We're working at it. And, I don't, at the moment, think that we're going to be putting on so much new business that will get in the way of achieving that target. So, we're mindful of the target. Our lean back into new business will be geographic-driven. It'll be territorial where we have better rate adequacies and we feel better about our approach. So, I would suggest to you we're going to do it in a laser-focused way that will not disrupt our path back to 96.5.

Q - Elyse B. Greenspan {BIO 17263315 <GO>}

Okay, great. And then what are you guys seeing as loss cost in Commercial Lines kind of broadly?

A - Douglas G. Elliot {BIO 3700927 <GO>}

Generally speaking, they're low to mid single-digits in the aggregate, right? We look across our lines. Workers' comp I described before. Frequencies are flat to slightly down a little bit. Severities, depending upon medical or wage are single digits. There is a debate to be had about general liability because it takes a while to really understand what the accident year loss trends will be, but our view is that they are mid single-digit-ish. Property's got lower single-digits attached. So in general, we see a pretty stable loss cost environment, but also one that isn't stacked on zeroes, right? When we think about the non-workers' comp lines, we expect the other lines to have some degree of small loss cost inflation that we're trying to deal within our pricing.

Q - Elyse B. Greenspan {BIO 17263315 <GO>}

Okay, great. And then, Beth, I know in the outlook for the year you guys were looking for a little bit of a decline in your P&C investment income, excluding limited partnerships. It's about flat through the six months. Was there something inflating that number or maybe you guys coming in a little bit above your target for the year?

A - Beth Ann Bombara

Yeah. So, a couple things. So, as we pointed out this quarter and the same with last quarter, we did have favorable partnership returns. And in this situation, both first quarter and second quarter, that was skewed a little bit more to Property, Casualty then to some of our Other segments. So that's part of what was driving that. And then we do continue to see some non-routine income. We've talked about this in the past. We don't budget for that, but as companies tender debt and so forth, sometime we get a little bit of a pickup there, but overall, I would say the yield that we're earning is consistent with our outlook.

Q - Elyse B. Greenspan {BIO 17263315 <GO>}

Okay, great. Thank you very much.

Operator

Your next question comes from the line of Mark Dwelle from RBC Capital Markets. Please go ahead.

Q - Mark Dwelle {BIO 4211726 <GO>}

Good morning. Just a small quick numbers kind of question. You commented that you're doing your A&E reserve in the fourth quarter this year. How many dollars of reserves are still left that are sort of subject to that review? I would assume it's mostly E, not A, that's left to be reviewed.

A - Beth Ann Bombara

No, actually - and we have extensive disclosure in our 10-Qs on the various balances related to A&E, but actually, more of our reserves are A than E. And again, as we said, we will be looking to do that evaluation in the fourth quarter, but I'll just give you the page number. If you go to page 84 in our 10-Q, you can see the breakout of both asbestos and environmental reserves. And at the end of June, on a net basis, asbestos was $1.288 billion and environmental was $259 million.

Q - Mark Dwelle {BIO 4211726 <GO>}

Okay. Thank you. Thanks all.

Operator

And your next question comes from the line of Ian Gutterman from Balyasny. Please go ahead.

Q - Ian J. Gutterman {BIO 18249218 <GO>}

Great. Thank you. Doug, I first want to follow-up on Elyse's question there on the auto target for next year. Is it reasonable to assume that on a written basis that, based on what you've put through so far and assuming no change in the loss trends you've seen in the first half of the year that you shouldn't have much trouble getting to that 96.5 on an earned? Or is there still pricing you need to get from here or something else you need to execute from here to get there?

A - Douglas G. Elliot {BIO 3700927 <GO>}

You act like it's so easy to get there, Ian, right?

Q - Ian J. Gutterman {BIO 18249218 <GO>}

I said if loss trends are stable. I'm taking that one out of the equation for you.

A - Douglas G. Elliot {BIO 3700927 <GO>}

All right. So, that's a good one to take out, right? So, we're obviously assuming a baseline of loss trends. Secondly, much of the activity, the hard work, has already happened, right? So, we've got to earn in to the written activity that we now are sharing with you that you can see through the second quarter. And obviously, there's still a lot of work state by state to make happen. We've got rate change activity in the third quarter and fourth quarter. But when we see through the plan, we're executing as we expected to, this goes back nine months ago when we built that plan. And if things continue to execute like we think they will, that target is very achievable. But, I wouldn't say without sweat, right? We're working our tails off to get to 96.5. Feel good about that, but if this were a baseball game, we're not bringing the relievers in yet, right? This is still the middle of the game.

Q - Ian J. Gutterman {BIO 18249218 <GO>}

Understood. Understood. And, again, just given the impact of written versus earned, I assume that would suggest there should be some further improvement into 2019, even if I won't ask for a number.

A - Douglas G. Elliot {BIO 3700927 <GO>}

Yeah. Let's not ask for a number in 2019 yet.

Q - Ian J. Gutterman {BIO 18249218 <GO>}

Okay.

A - Douglas G. Elliot {BIO 3700927 <GO>}

But we will...

Q - Ian J. Gutterman {BIO 18249218 <GO>}

Yeah, okay.

A - Douglas G. Elliot {BIO 3700927 <GO>}

Yeah, it all depends on how quickly we get there and when we do arrive. I mean, our rate adequacies and our business plans are all built dynamically as the next 12 and 18 months kind of play out. So, pleased with progress. Another six months of progress would close up a very nice turn year for us in 2017, which we expect to happen. And then 2018's a big year to move closer to that target.

Q - Ian J. Gutterman {BIO 18249218 <GO>}

Got it. And then, Beth, I saw in the slides on Talcott there was mention of the surplus growing from favorable changes in admitted DTA. Can you explain what that means and how much it was?

A - Beth Ann Bombara

Yeah. So, in the quarter, we benefited a little bit less than $50 million from being able to admit more DTA than we could in the previous quarter. It's really just based on math of just what the rules are relative to what your admitted tax assets can be. We do see that bounce around often. And we like to point that out, just because as we've talked about before, when we think about surplus generation in Talcott, movement of DTAs from admitted, from non-admitted to admitted, we don't really think of that as generating potential for future dividends.

Q - Ian J. Gutterman {BIO 18249218 <GO>}

Got it. Got it. And then sort of semi-related on DTA, Talcott, obviously the legislation that allows you to change the entities, can you talk a little bit about how much impact that could have on DTA going forward? I assume that allows you to manage that better.

A - Beth Ann Bombara

So, that's a pretty complicated question, Ian. So, it kind of would depend on, again, how one might use division. So, I don't think I can really give you an easy answer that that would or wouldn't impact how we utilize DTAs. It's really going to be based on anything on taxes, it's going to be based on facts and circumstances.

Q - Ian J. Gutterman {BIO 18249218 <GO>}

Makes sense. All right. Thank you.

A - Douglas G. Elliot {BIO 3700927 <GO>}

Thank you, Ian.

Operator

And there are no further questions in the queue. I turn the call back over to the presenters.

A - Sabra Rose Purtill {BIO 1764408 <GO>}

Thank you, Heidi, and thank you all for joining us today and your interest in The Hartford. If you have any additional questions, please do not hesitate to follow up with Investor Relations team. Thank you for your interest and we wish you all a good weekend. Goodbye.

Operator

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