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Bloomberg Transcript

Q2 2019 Earnings Call

Company Participants

- Beth Costello, Chief Financial Officer
- Christopher J. Swift, Chairman and Chief Executive Officer
- Doug Elliot, President
- Susan Spivak Bernstein, Vice President, Investor Relations

Other Participants

- Brian Meredith, Analyst
- Elyse Greenspan, Analyst
- Josh Shanker, Analyst
- Mike Phillips, Analyst
- Mike Zaremski, Analyst
- Paul Newsome, Analyst
- Randy Binner, Analyst
- Ryan Tunis, Analyst
- Yaron Kinar, Analyst

Presentation

Operator

Hello and welcome to today's Hartford's Second Quarter 2019 Financial Results Conference Call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session. (Operator Instructions) Thank you.

I would now like to turn the call over to Ms. Susan Spivak. Ma'am, you may begin the conference.

Susan Spivak Bernstein {BIO 1514699 <GO>}

Thank you. Good morning, and thank you for joining us today for our call and webcast to discuss second quarter 2019 earnings. We reported our results yesterday afternoon and posted the -- all the earnings related materials, including the 10-Q on our website. Please note, that we reported results a bit later than usual due to the financial reporting integration-related to the closing of the Navigators acquisition in May.

Before we begin today's presentation, I want to highlight a couple of upcoming dates. First, Beth Costello will be participating in a fireside chat on September 9th at the Barclays Conference in New York City. Second, the tentative date for our third quarter earnings release is November 4th.

For today's call our speakers are Chris Swift, Chairman and CEO of The Hartford; Doug Elliot, President ; and Beth Costello, Chief Financial Officer. Following their prepared remarks, we'll have a Q&A period.

Just a final 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 the 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.

Our commentary today include 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 financial supplement. 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 one year.

I'll now turn the call over to Chris.

Christopher J. Swift {BIO 3683719 <GO>}

Good morning and thank you for joining the call this morning. The Hartford second quarter financial results were strong, with excellent Group Benefits margins and solid P&C margins, including lower catastrophe losses than last year. We closed the acquisition of Navigators in May, which brings expanded market and growth opportunities in Commercial Lines. I remain highly confident of the strategic and financial benefits this acquisition will produce.

Second quarter core earnings rose 18% over prior year to $485 million or $1.33 per diluted share. Our businesses are performing well. The P&C underlying combined ratio was 92.6 in the quarter and the Group Benefits core earnings margin was 7.5%. The consolidated 12-month core earnings ROE was 11.7%, well in excess of our cost of equity and among the best in the industry. During the quarter, we began share repurchases under the $1 billion authorization and expect to continue to return excess capital to shareholders in '19 and 2020 from share repurchases and quarterly dividends, helping drive long-term shareholder value creation.

Doug and Beth will cover segment results in more detail, but I wanted to touch briefly on a few high-level items. Commercial Lines underwriting results, which included Navigators for just five weeks remained solid. Ongoing investments in technology, digital and product are driving enhanced capabilities and growth. The cost of these investments put slight pressure on the expense ratio, which is expected to continue for the near term.

Year-to-date, the underlying combined ratio for Commercial Lines is 92.9, a solid result in a competitive market. Personal Lines results were much better than last year, with a lower current accident year loss ratio including reduced catastrophe losses. Planned marketing and other initiatives continued, increasing the expense ratio, but also driving a 49% increase in new business.

Group Benefits earnings continued to be simply outstanding with a year-to-date loss ratio of 74.7%, almost 2 points better than last year along with a slightly lower expense ratio. Persistency in new business levels are solid and include continued growth in voluntary product sales. We recently appointed Jonathan Bennett, a talented and versatile Hartford leader, Head of Group Benefits following the announced retirement of Mike Concannon. Mike has been with The Hartford for more than two decades with a long list of accomplishments and contributions and we wish him well. Jonathan and I will be working closely to ensure a smooth transition and a continued track record of success in Group Benefits. Finally, higher equity capital markets helped Hartford's funds recover from the earnings impact of the fourth quarter decrease in assets under management.

Turning to Navigators, this quarter results include charges related to the acquisition for; one, the purchase of the previously announced adverse loss development cover; and second increase in loss reserves from the completion of our review for the 2018 and prior accident years and the 2019 loss picks.

With the reserve review completed, we are fully focused on achieving the strategic and financial benefits of this acquisition. Only 2.5 months after closing, a significant amount of progress has been made on multiple initiatives and I am pleased with the continued positive feedback from agents and brokers about the combined potential of our business. We expect a smooth trend -- excuse me -- we expect a smooth integration and remain confident of the future benefits we will realize from expanded product and underwriting capabilities. In addition, we expect to generate good returns on this investment, reaching approximately $200 million in core earnings, excluding the amortization of intangibles, within the next four years to five years.

We are also encouraged by the recent firming in Commercial Lines pricing, particularly in global specialty, which is better than anticipated when we first announced the acquisition. Doug will discuss the market in more detail, but I would note that loss trends in certain lines needed increased pricings to achieve acceptable returns, and in part, informed our judgments on the acquired reserves and the 2019 accident year loss picks.

The team is focused on capturing the benefit of improving pricing, terms and conditions, particularly in international, where results in recent years have been poor. In addition to the trends in global specialty, we are also seeing stronger pricing and growth opportunities in middle and large commercial. I am pleased to see the previous investments in expanded industry verticals, are generating strong new business growth. To conclude on the quarter in year-to-date, our performance is strong, Commercial Lines has momentum and the Navigators integration is going well.

The outlook for Commercial Lines in the second half of 2019, which includes Navigators, remains largely consistent with our view, provided earlier this year. We expect an underlying combined ratio of 92 to 94. This outlook is essentially flat with last year, including the impact of Navigators, which has a slightly higher combined ratio then The Hartford Commercial Lines book. In total, we are well positioned to achieve or exceed the business metric outlook we provided in February and to sustain a strong consolidated ROE.

Before turning the call over to Doug, I wanted to note that we recently published our 2018 Sustainability Report, which provides a summary of our commitment to environmental stewardship, communities and giving, diversity and inclusion, and ethics and governance. As a company in business for more than 200 years, we understand what it takes to be sustainable, and how the Company's actions align with our mission to underwrite human achievement. We are proud of The Hartford's track record and are committed to achieving the specific goal summarized in our report. You could find that report along with other information on our Sustainability Programs on our website.

Now, I'll turn the call over to Doug.

Doug Elliot {BIO 3700927 <GO>}

Thank you, Chris, and good morning everyone. This was a strong quarter for our business units and as Chris noted, strategically significant as we closed our acquisition of Navigators. Our Hartford Property and Casualty business units performed very well, with strong execution on the top and bottom line and Group Benefits posted another quarter of outstanding earnings. Underlying performance in the former Navigators business units, which excludes prior-period development and catastrophe losses, was in line with our expectations as we've positioned these lines for profitable growth in a rapidly improving specialty marketplace, where underwriting is tightening and pricing is firming.

In the second quarter, we booked prior accident year reserve adjustments for Navigators in several lines of business and also reset the 2019 accident year loss selections. Beth will be discussing these actions in greater detail.

Our integration is off to a strong start. We've hit the ground running with teams working together in the market and across all parts of our enterprise to align strategy, resources and outcomes. Over the summer months, we're conducting nearly 400 agent and broker meetings to roll out our combined product capabilities. Talent and expertise were primary drivers of the deal, and we're very excited to have over 800 new teammates join our ranks. The market leadership and underwriting skill these experienced professionals bring to the combined organization is already evident. Efforts began immediately to jointly market our expanded product portfolio as we're now able to effectively deliver a broader range of coverage solutions to agents, brokers and customers.

I'm very encouraged by several recent wins and the positive reaction of the agents and brokers to writing more lines of business per account with us. Our teamwork is evident to the marketplace and I'm confident we will continue to find more opportunities for growth. I'll provide more commentary on Navigators performance and current marketplace trends in a moment, but let me begin the review of our business results with Group Benefits, which delivered another outstanding quarter, posting core earnings of $115 million with a margin of 7.5%. The increase versus prior year was driven by favorable disability results, higher net investment income and lower amortization of intangibles. This was partially offset by a slightly higher life loss ratio, increased investments in technology and customer experience, and higher commissions. The lower disability loss ratio reflects favorable incident trends across recent accident years.

Shifting over to Personal Lines, we had a solid quarter with an underlying combined ratio of 91. In Personal Lines auto, the underlying combined ratio of 96.7 was 0.2 point [ph] higher than 2018 with favorable frequency trends and a severity in the low to mid single digit range. Collision severity remains elevated due to higher repair costs associated with newer vehicles and a larger mix of total losses.

Overall loss cost trends are developing within our expectations. We remain focused on returning to growth in AARP direct auto, our lead product for marketing and new customer acquisition. New business in this line grew 44% for the quarter. Direct marketing response rates continue to be strong and our conversion ratio was up versus prior year. Over the last few years, AARP auto retention has improved several percentage points. We remain focused on further increases to retention as a key factor and achieving total written premium growth.

Turning over to Commercial Lines, the second quarter underlying combined ratio was 93.2, up 3.2 points versus 2018. The increase was primarily due to elevated inland marine loss experienced in middle market, higher expenses and the addition of Navigator results for five weeks post closing. For the quarter, renewal written pricing in standard Commercial Lines was 2.2%, up slightly from first quarter of the year. Pricing, excluding workers' compensation was 5.5%, up several tenths of a point versus first quarter, driven primarily by increases in middle market. Pricing in auto is nearly double digits and we saw solid increases in property and general liability.

Margins in workers' compensation were strong across our business units and consistent with our expectations. Results to-date indicate that we're managing market forces effectively, and I remain pleased with our workers' compensation pricing and underwriting strategy as we seek to balance margins and growth.

Let me touch on a few additional details for our commercial businesses. Small Commercial had another excellent quarter with an underlying combined ratio of 87.8. Written premium grew 6% with $183 million of new business and excellent retention in the high-80s. New business was led by the Foremost renewal rights deal. In addition, we also experienced excellent growth from our core book, with new business up 10% versus prior year. New business flow from the Foremost deal is essentially complete at this point. This is a great opportunity for us to scale our market leading platform and to extend our partnership with many of our existing agents.

We also developed a number of new agency relationships that have been growing steadily over the last year. Our team executed flawlessly on this transaction and we're well prepared for similar opportunities in the future. In Middle & Large Commercial, the underlying combined ratio was 100.9, increasing 3.8 points versus last year. We experienced another quarter with a number of large losses in The Hartford inland marine book, specifically builders' risk. Approximately 3 points of this increase is attributable to large water intrusion claims that occurred near project completion. Several of these losses resulted from less experienced workers on the job in this tight labor market. We've taken action to address this part of our business and expect performance to improve.

The expense ratio was also slightly higher, driven primarily by commissions. Written premium in Middle & Large commercial increased 15%. Retentions were solid and new business production was outstanding at $177 million for middle market, up 31% versus prior year. New business growth continues to be fueled by our industry practice groups in areas such as construction, programs and energy. We're also seeing strong growth in our other core industries, including manufacturing, technology and professional services. Our strategy of underwriting specialization is helping to drive this growth and increase our focus on pricing and margin improvement.

In Global Specialty, comprised of US, international and reinsurance business units, the underlying combined ratio was 90.7. Given that Navigators are only included for five weeks of the second quarter, I'll focus my commentary on current business performance and marketplace trends. Overall, the specialty markets are in positive transition. Industry financial results support the need for pricing and underwriting actions as prior years have been developing unfavorably in several lines.

Our global specialty team has experienced progressively firming market conditions each month during the quarter. Renewal pricing for Navigators business block was in the high single digits for the quarter, up more than 5 points from the first quarter and also from prior year. Lines of business with particularly strong pricing include marine cargo, excess casualty, D&O and property. This is an important time for our teams to be focused on business fundamentals and now that the deal is closed, our Number 1 priority is improving margin performance.

Let me now turn to the individual business units of Global Specialty. In the US, we recorded prior-year development largely in the ocean marine, primary casualty and D&O books, with only modest adjustment to the current year loss ratios in casualty. Underlying performance year-to-date has been solid with strong returns in management and professional liability lines and bond. Given the market momentum I just described, our trends is for -- our outlook is for favorable renewal pricing trends exceeding expected loss trends.

The international business primarily comprised of Lloyd's Syndicate and London market portfolio has been under financial stress due to its historical growth focus. We've increased our prior and current accident year loss ratio picks in financial and casualty lines and are fundamentally repositioning portions of this book through underwriting and non-renewal actions. The rapidly firming market will provide a tailwind as we execute our business plans for needed margin improvement. In global reinsurance, our business is mainly comprised of accident and health, property, global credit, Latin American surety and other casualty lines.

During 2019, underwriting results have been challenged in the accident and health, resulting in prior-year reserve development and an increase to the current year loss ratio. This is largely a medical stop loss business and we're aggressively tightening our underwriting and increasing pricing while non-renewing accounts that do not meet our financial thresholds. As we look ahead with Global Specialty, I am more convinced than ever that our expanded talent and product capabilities are a powerful addition to our Commercial Lines platform. Vince Tizzio, our Global Specialty leader along with a very experienced team comprised of both Navigators and Hartford teammates, are driving business plans with great acumen and energy. As we work together every day and now with the full engagement of our agents and brokers, I see our strategy unfolding in the market, positioning us for further success as a commercial lines leader.

Based on our year-to-date results, our outlook for commercial lines in the second half of 2019 is for a combined ratio of between 95 and 97, with an underlying combined ratio of between 92 and 94. Total commercial lines earned premium for the six months is expected to be approximately $4.4 billion. In closing this quarter represents an exciting milestone in our journey. Our integration with Navigators is in full swing.

We're operating as a combined organization bringing broad capabilities and deep underwriting expertise to the market and we continue to see new opportunities to leverage these skills in all parts of our Commercial Lines business. This important step forward along with the strength of our Group Benefits and Personal Line businesses, positions The Hartford for continued success. We look forward to updating you on our progress in the quarters ahead.

Let me now turn the call over to Beth.

Beth Costello {BIO 15349374 <GO>}

Thank you, Doug.

Today, I'm going to cover second quarter results for the investment portfolio, Hartford Funds and corporate including capital management activities as well as the impact of the Navigators acquisition. The investment portfolio continues to perform very well with no impairments, strong LTE returns, and generally stable investment yield. Net investment income was $488 million for the quarter, up $60 million or 14% from the prior year quarter. Excluding Navigators, net investment income was $476 million or 11% higher than the prior year quarter.

Limited partnership returns were strong in all asset classes with an annualized return of 14% for both the quarter and year-to-date. This compares to an annualized yield of 9.5% in second quarter 2018. The annualized portfolio yield was 4.2% before tax and 3.4% after tax, slightly above second quarter 2018. Excluding LPs, the second quarter 2019 annualized portfolio yield was 3.1% after tax, flat with second quarter 2018.

Lower market interest rates and tighter credit spreads increased net unrealized gains on fixed maturities after tax to a total of $1.4 billion at June 30th from about $700 million at March 31st and almost no net unrealized gain at year-end 2018. As a reminder, unrealized gains on equity securities are classified and realized capital gains in the income statement and are not included in AOCI. Total realized and unrealized gains on equity securities were $30 million before tax in the quarter and $162 million before tax year-to-date.

Turning to Hartford Funds, core earnings of $38 million were flat with last year and up $10 million sequentially. Daily average AUM rose 5% from first quarter 2019, reflecting strong market performance, partially offset by modest net outflows and was up about 1% over second quarter 2018. Investment performance remains very strong. As of June 30th, 2019, about 70% of Hartford Fund outperformed peers on a one, three and five-year basis. Corporate core losses of $35 million were 54% lower than second quarter 2018, principally due to higher investment income and lower interest expense due to net debt reduction over the last year.

As a reminder, the three main drivers of corporate results, our investment income on cash and short-term investments, interest expense and preferred dividends and net income from our investment in Talcott. Taking into consideration the reduction in average cash and short-term investments due to the $2.1 billion purchase price for Navigators as well as interest expense and timing of preferred dividends, I would expect the quarterly run rate in corporate to be a loss of $55 million to $65 million after tax, before consideration of net income from the Talcott investments. The impact of our proportionate share of Talcott's net income is harder to predict and was $22 million after tax in the first quarter and $2 million after tax this quarter.

During the quarter, we began share repurchases under the $1 billion authorization. Since its inception and through the end of July, we have repurchased about 800,000 shares for $43 million. As previously discussed, we expect to use this program with discretion based on current and projected holding company cash position and liquidity needs and expect to utilize the majority of the program in 2020.

In total, second quarter core earnings of $485 million and core earnings per diluted share of $1.33 were both up 18% over second quarter 2018. Excluding AOCI, book value per diluted share was $41.55, up 5% year-to-date and 9% since June 30th 2018. Core earnings ROE over the last 12 months, which includes fourth quarter 2018's wildfire catastrophe losses, was 11.7%. Our year-to-date annualized core earnings ROE is 13.4%. The closing of the Navigators acquisition on May 23rd impacted our results in several areas. I will briefly review these and additional details are included on pages 6 and 7 of the slides.

Core earnings had a modest net contribution from Navigators as the closing occurred more than halfway through the quarter. Net income included several acquisition-related charges. First, in the quarter, we recorded transaction and integration-related costs of $31 million before tax, of which $21 million was related to Navigators. We expect to incur additional charges through 2021 for a total of $90 million to $100 million before tax, of which $15 million [ph] relates to integration activities.

Second, upon closing, we entered into the previously announced adverse development cover and recorded a charge of $72 million after tax. Finally, we made two adjustments to Navigators reserves after closing. We increased the pre-acquisition 2019 accident year reserves by $29 million before tax. We also increased our estimate of prior-year loss reserves by $159 million, of which $91 million was ceded to the ADC, resulting in a net charge of $68 million before tax.

After these actions, there remains $209 million of coverage under the ADC for development for 2018 and prior accident year reserves. Overall, the reserve actions we have taken incorporate our methodologies and judgments. Going forward, Navigators reserves will be part of our normal quarterly reserve review process.

To summarize , second quarter results were very strong. We are hard at work on the integration of Navigators and focused on maximizing the potential of all of our businesses with our combined teams and enhanced product and underwriting capabilities. With strong capital generation and financial flexibility, we are pleased to be able to both invest in our businesses and return capital to shareholders. We look forward to updating you on our progress.

I'll now turn the call over to Susan so we can begin the Q&A session.

Susan Spivak Bernstein {BIO 1514699 <GO>}

Thank you, Beth. We have about 30 minutes for questions. Carmen, could you please repeat the instructions for asking a question?

Questions And Answers

Operator

(Operator Instructions) And your first question comes from the line of Brian Meredith with UBS. Brian, please go ahead.

Q - Brian Meredith {BIO 3108204 <GO>}

Hello, can you hear me?

Operator

Yes, we can hear you.

Q - Brian Meredith {BIO 3108204 <GO>}

Okay, great. So, first question for you all. Chris, just curious, could you kind of walk through from the Navigators perspective, now that you've got it integrated -- integrated on your books, how does your kind of accretion forecast look? Are we at the low end, high end, kind of what are your expectations for it ?

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

Sure, thanks for joining us, Brian. As we said, both Doug and I and Beth in our prepared comments, I mean, we're confident about both the financial and strategic aspects here. I think, on a longer-term basis, we'll still see the ability to generate $200 million of core earnings, ex-amortization of intangibles over the next four to five years. I think there's four levers that remain the same that we've talked about, what's going to contribute to that. One would be expenses, two would be NII, three would be, you heard from Doug, the actions that we're beginning to take on the in-force management to improve the margins on the existing book. And then, fourth a contributor, but not a large one is the cross-sell revenue. So, I would say those are the components. The waiting might be a little different, Brian, than we first thought six months to nine months ago, particularly with lower interest rates, but I would say that we didn't expect this level of pricing firming as rapidly as it has been.

So, we've taken the adjustments so -- we think we needed to, particularly on the '19 year loss picks, which is generally in line with our pricing models and our deal models, maybe slightly a little higher, but equally, I think there is more rate environment, more rate to capture. So, we see all those pieces fitting together to generate that $200 million of core earnings and remainder, really, really confident and pleased with how the teams have been interacting and behaving particularly in the marketplace.

Q - Brian Meredith {BIO 3108204 <GO>}

Excellent. And then another question, I'm just curious, could you talk a little bit about your thoughts and exposure to the reviver statutes and kind of what we're seeing -- what's going on all these states?

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

Sure. I guess, there is one another point I would just mention as it relates to the integration activities. I mean, we did guide in our prior call to $110 million to $145 million of core earnings in 2020, Brian. I would say that's still a valid range, but I would anchor a little bit more on the lower end, particularly given the interest rate environments. We thought we were going to get a little quicker lift with interest rates even after marking the balance sheet to market. So we still see $110 million-ish [ph] in 2020 as far as an accretion potential.

Q - Brian Meredith {BIO 3108204 <GO>}

Great.

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

As it relates to the reviver statutes and activities I would say, first, we've got a long history of managing and dealing with, I'll call it, complex claims in this area, particularly bodily injury, mass tort. And John Kinney, who heads our team and his lawyers in claims professionals just, I think, do an outstanding job whether it's on a primary basis or excess basis. Remember, we have a lot of excess claims experience, particularly coming through our First Interstate operations in Boston. So I would then say on a social side, I understand the desire to make people -- allow people to talk about their injuries and present claims. But on the other end, that's a slippery slope to sort of open up years of case law and litigation and how contracts are resolved, but I know that's occurring.

But I would also say that, for us, we're primarily focusing on three major areas, the liability associated with injuries particularly in commercial auto, obviously the sexual abuse and reviver claims and then head injury. I'm not going to go into specifics on any particular aspect other than we're well aware. We've been on top of these trends for a long, long time. And as I've always said, Brian, we're in the business of paying claims and we want to pay claims that are legitimate and where people are injured.

But equally in some of these areas, we're going to be sensitive and that's a polite word of saying, if there was contributory actions or inaction that have consequences on our terms and conditions, in our policies, we'll be equally vigilant in asserting our rights because the rest of our policyholders would expect that and that's where the social inflation comes into effect that everyone's talking about. It affects everyone and we'll be thoughtful, we want to be fair, but also make sure that people are living up to the terms and conditions in our contract. So that's what I would -- I'll say at this point in time.

Q - Brian Meredith {BIO 3108204 <GO>}

Okay. It makes sense. But have you reevaluated your reserve positions given what's been going on?

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

As I tried to say, I mean, we've been managing these types of activities for a long, long time. I would say that we have case reserves and IBNR established for known losses and obviously incurred, but not reported losses, but we're going to have to really see sort of the volume of the new activities that really come in. So as we sit here today, I feel really good about the balance sheet, but not knowing what's going to come out in the future from new claims, new activities, new theories, you can never -- you can never be absolute. But just know we do have provisions that we feel comfortable at right now.

Q - Brian Meredith {BIO 3108204 <GO>}

Great. Thank you.

Operator

Your next question comes from the line of Elyse Greenspan with Wells Fargo. And Elyse, your line is open.

Q - Elyse Greenspan {BIO 17263315 <GO>}

Hi, good morning. Can you hear me?

A - Susan Spivak Bernstein {BIO 1514699 <GO>}

Yes, we can hear you.

Q - Elyse Greenspan {BIO 17263315 <GO>}

Hi, thanks. My first question on the disclosure within Commercial Lines, on the standard commercial earned premium rate. So that was 2.2% in the quarter. It trended down sequentially and then when we look back last year. I know you guys are getting more written price right now, but I'm just trying to think about the earned premium that you're seeing and expectations rate that you are earning through the balance of this year and also into 2020 as I think about the underlying margin profile for Small Commercial and mid to large -- your mid to large account segments and just thinking of the rate versus trend and kind of the underlying margin expansion you might see or contraction there?

A - Doug Elliot {BIO 3700927 <GO>}

Elyse, good morning. It's Doug. I would suggest that the earn trend is going to follow some of this momentum on the written side. So, obviously it's a calculation and as we see slightly upward signals in those pricing indicators, the earned premium will follow that, number one. Number two, we gave you a comp/ex comp split right. So you know that we've got a little bit of negative pressure on pricing, particularly in Small Commercial that will play out, and the mechanics of that, our loss trend at the moment might be slightly ahead of where the Small Commercial pricing is. But in middle, we've done a nice job of achieving flat to just slightly down pricing in comp, and so very pleased with what we're seeing in middle.

In the non-comp lines, we're feeling better than we were 90 days ago about signals in the marketplace and our ability to get a little bit of rate. I know that the changes are not up materially, but they matter to us and several key lines, they're moving in the right direction. So we're on the rate push hard. We're working hard account by account and I'm encouraged by what I see as we close out the second quarter.

Q - Elyse Greenspan {BIO 17263315 <GO>}

Okay. Thank you. And my second question, on the Navigators book, so you guys took a true-up on prior year and then also on the current year. So, on the current year adjustment, I'm assuming the adjustments were really saturated kind of in the same lines where you took the prior-year development. And then, can you also just give us a sense of where the underlying margin you're starting with for that business given that you've now trued it up versus your expectations when you announced the deal.

A - Beth Costello {BIO 15349374 <GO>}

Sure, I'll start with that and, Doug, please feel free to add in. So the lines that we adjusted for the current year some were consistent again than the US wholesale casualty area and a little bit in the D&O and E&O book and as Doug mentioned, kind of in the international casualty area. And when we look at the -- our projections back at the time of the acquisition, we had anticipated needing to increase those accident year picks a bit, I would say, the final adjustments that we made were probably 1 point or 1.5 point higher than that, but relatively speaking, sort of in line with what we were thinking.

So, a lot of the things that Doug talked about as it relates to the book and actions that we're taking and pricing will obviously help improve those margins going forward. And our views on their underlying margins were included in the overall guidance that we gave for the second half of 2019. And again, their book, we would expect to run at a higher combined ratio than our historical Hartford book.

A - Doug Elliot {BIO 3700927 <GO>}

The only thing I would add, Beth, is that some of that Navigator combined ratio dynamic is playing into the fact that our new outlook is just slightly up 1 point or so on the underlying. So, the mixing in of that Navigators book in accident year and calendar year 2019 is causing a little bit of that bump.

Q - Elyse Greenspan {BIO 17263315 <GO>}

Okay. Thank you very much.

Operator

Your next question comes from the line of Josh Shanker with Deutsche Bank.

Q - Josh Shanker {BIO 5292022 <GO>}

Yeah. Thank you very much for taking my question. Obviously, there's the reserve strengthening on the, I guess, I don't know, is it the 1Q Navigators or is it the first five months just as a better understanding?

A - Beth Costello {BIO 15349374 <GO>}

So, Josh, are you talking about the current accident year?

Q - Josh Shanker {BIO 5292022 <GO>}

Yeah, the 2019.

A - Beth Costello {BIO 15349374 <GO>}

Yes, yes. So it would be for the first five months.

Q - Josh Shanker {BIO 5292022 <GO>}

First five months, okay. This then implies --

A - Beth Costello {BIO 15349374 <GO>}

Through the date of acquisition.

Q - Josh Shanker {BIO 5292022 <GO>}

Yeah, this then implies a increase to the Navigators combined ratio about 500 basis points in addition to what's going on in the rate market right now. When you think about modeling or the next year, how much attritional policy and premium decline do you expect as you put through the necessary rates to get to a Hartford level of conservatism in the book?

A - Doug Elliot {BIO 3700927 <GO>}

Josh, this is Doug. I would say it's a little premature for us to take you all the way down through that path. We are building those plans. We had original plans obviously. We've been updating over the course of last two quarters, but there are so many moving pieces. And as you know, as Chris commented on, several of their core lines are going through an aggressive degree of firming at the moment. So, we are making decisions and plans around what we see in the current marketplace around retentions -- required retentions, pricing, and also new business levels that we think are appropriate for not only the combined ratio as it sits here today, but also what we think the opportunity is in that book moving ahead. So, we'll provide more of that as we go forward the next several quarters.

Q - Josh Shanker {BIO 5292022 <GO>}

Okay, and I guess, this is another easy one. Was there any prior-year reserve development on the Navigators loss reserves not applicable to the Nikko cover and how should we consider the risks associated with that non-Nikko covered part of the portfolio.

A - Beth Costello {BIO 15349374 <GO>}

Good question. So, as it relates to the actions that we took in the second quarter for prior years, all of it was applicable to the cover. I'll remind you that there was probably about $100 million of reserves that we excluded from the cover, which was primarily covering things like unallocated loss adjustment expenses. We are obviously taking the exposure on reinsurance collectability, and then a handful of specific claims that were not covered. So, as it related to the actions we took, we saw no need to make any increases to those reserves that were not covered by the reinsurance agreement.

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

Josh, it's Chris. One, welcome. Thanks for joining the call after your Rolling Stones concert last night. Second, I would just add a little color, again, the allocated -- unallocated loss adjustment expense in the reinsurance, it's similar to other transactions we've done with Nikko and the handful of claims that Beth described, I would say, relate to pollution exposures that we judged favorably. So, I don't think there's going to be any big surprises that are going to materially change any view on reserve positions and/or the reinsurance transaction in total.

Q - Josh Shanker {BIO 5292022 <GO>}

Okay, thank you. I appreciate the answers. I'll re-queue, maybe I'll get lucky. Thank you.

Operator

Your next question comes from the line of Mike Zaremski from Credit Suisse.

Q - Mike Zaremski {BIO 20606248 <GO>}

Hey, good morning. Thanks for taking my question. First question, thanks for the color on the expense ratio increase. Curious about, I believe you said, some of it's due to upwards pressure on brokerage commissions and I think you also mentioned that in -- on last quarter's call. Maybe you can help us understand as like what -- how big of a component that is and is that -- and what's kind of driving that? Is that being driven by some of the private equity backed brokers or is it all of them kind of doing the same thing?

A - Doug Elliot {BIO 3700927 <GO>}

Mike, this is Doug. It's more run rate commission. And so, when I think about quarter-to-quarter, a 1 point -- 1 point, 2 points [ph] of change in the expense area, but half of that is coming from commission. Much of that is coming from small commercial where we either have special deals happening. We've got terrific profitability indicators. So, our contingencies around loss are up a little bit year-to-year and I would just characterize what we see in small as normal, competitive, commission adjustments.

What we see in the middle, more related to reinsurance. I don't even think of that in the case of normal brokerage. It's just we have some ceded commissions and reinsurance, a little bit different than they were last year. So, that's why I describe the commission piece as really normal operating circumstances.

Q - Mike Zaremski {BIO 20606248 <GO>}

Okay , that's helpful. And lastly, switching to Group Benefits, clearly excellent results continue. Doesn't look like you guys changed your guidance there. Maybe you can kind of update us on the competitive environment in Group?

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

Mike, let me just speak to guidance and Doug can give you some of his color on the competitive environment. The 6% to 7% guidance on margin, we still believe is a long-term guidance that is reflective of long-term conditions. Obviously, in the near term here, we've been outperforming which we would honestly expect to continue at least through the second half of '19. So, we're not changing -- not updating, but we are -- acknowledged that we are performing better primarily from incidences, but I would remind you that it is still a competitive environment, Doug, and the Top 10 Group Benefit players control large portion of the market, but competition is still fierce as ever and we're remaining disciplined. I don't know if you would add any color, Doug?

A - Doug Elliot {BIO 3700927 <GO>}

No, I would agree with that. I think we are competing well in the space. The numbers are pretty good shape. Across the industry, our numbers are obviously outstanding. Second quarter is not as large a quarter as the first quarter, but our sales were up a bit in the first quarter. We feel good about that. We continue to grow our specialty products, our voluntary products. So you see that in our supplement. Just very encouraged, and Chris, our disability trends are in good shape. So a strong quarter for our Group business.

Q - Mike Zaremski {BIO 20606248 <GO>}

Thank you.

Operator

And our next question comes from the line of Paul with Sandler O'Neill.

Q - Paul Newsome {BIO 1541286 <GO>}

Good morning. Just one question. You didn't mention any changes to reinsurance related to the Navigators acquisition. I was wondering if that might change significantly over time given Navigators was a pretty heavy user of reinsurance over time.

A - Doug Elliot {BIO 3700927 <GO>}

Paul, in the short term, I would suggest that reinsurance programs are largely going to stay in place. Our teams are working diligently on a combined basis, evaluating what programs need to come together over time, what programs will be less standalone et cetera. So, as I think about the rest of 2019 and the early part of '20, largely think of their programs intact and then we'll adjust over time and share some of that information as it comes.

Q - Paul Newsome {BIO 1541286 <GO>}

As you've now re-examined the book, are there any pieces of Navigators that you want to shrink or re-address significantly?

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

Paul, again, we just closed -- what? 75 days ago? Really excited and we've been focused on obviously our go-to-market activities in the US and in London taking the corrective actions that Doug has talked about. We like all the pieces that we see, but we're just -- are going to continue to learn. It's why we're keeping the reinsurance programs the same and to learn from the Navigators team and adjust accordingly. And I would say the same thing with any major pieces of the business. All fits together, it works. We like it, but we've only owned it for 75 days.

Q - Paul Newsome {BIO 1541286 <GO>}

Thank you and best of luck for the rest of the year.

Operator

Thank you. And your next question comes from the line of Yaron Kinar with Goldman Sachs.

Q - Yaron Kinar {BIO 17146197 <GO>}

Thank you very much. Good morning, everybody. My first question, I guess it is a multi-part question with regards to the large property losses that you're seeing in Commercial. So one, are those related to the large losses you saw in the first quarter or part of the same trend. Two, could you maybe elaborate a little bit on the actions you're taking? And three, when do you expect these actions actually result in lower margins?

A - Doug Elliot {BIO 3700927 <GO>}

Thank you, Yaron, this is Doug. So a few comments about our marine book. We did see some adverse experience in the first quarter which I did comment on first quarter call, a bit more in the second quarter. Again, second quarter leaned a little bit heavier into builders' risk. It's a policy we offer associated with construction sites where essentially we replace the damaged property on the site. I think there's quite a bit of volatility in the second quarter. We have pulled the covers back across all those losses. I mentioned water intrusion in my commentary. So in a number of pipes, couplings, connections damaged material values in some of our construction sites. So we're on it.

We changed the leadership in the underwriting profile of that business about 15 months ago. That process is well underway. These projects run several years. We know exactly where our inventory is today. Yeah, I don't think this is over at the end of June, but I do think this is well-managed, well-contained. Both claim engineering and also our underwriting teams are working together. And there's a little volatility in a pretty small line first and middle, we'll have a little volatility, but it isn't something that right now is keeping me up. I think the line is not just putting pressure here at The Hartford. I think there are others in the business that are feeling that pressure, but as I think about the rest of 2019 and 2020. we'll get this issue behind us. I don't think it's a huge deal and we'll share a little bit about that journey as we go forward.

Q - Yaron Kinar {BIO 17146197 <GO>}

Okay. Thank you, and that's helpful. And then my second question relates to the personal auto book. I think, you were saying that you're seeing severity in the low-to-mid single digits, which just seems a little lower than what we've been hearing or seeing among other carriers. Can you maybe talk about what would drive severity to be a bit lower. Is the Hartford book -- is it a different mix of cars? Is it different policy type? Different negotiated arrangements with auto shops? What's driving that?

A - Doug Elliot {BIO 3700927 <GO>}

It gets really hard for me to compare ourselves to others. There are many different nuances, the various books. And when I talked about severity, I'm combining all elements of severity right, our collision is up a little bit, our liability severity is in pretty good shape. And obviously, our frequency numbers are in a very strong shape for the first six months of the year. So, I don't know how to contrast our book with others. It is heavily AARP-dominated, that plus 50 crowd, that matters relative to drive -- miles driven, parts of the year etc, but I don't think there is something that sticks out to me right now that is saying our severity is causing something that others might not be seeing.

Q - Yaron Kinar {BIO 17146197 <GO>}

Doug, you were cut out. I think I only heard the last sentence of your response?

A - Doug Elliot {BIO 3700927 <GO>}

I don't think there is one reason. Can you hear me, Yaron?

Q - Yaron Kinar {BIO 17146197 <GO>}

Yes.

A - Doug Elliot {BIO 3700927 <GO>}

I don't think there is any one reason that suggests our book will perform differently than others. We manage aggressively all of the comp liability and physical damage collision matters for our customers. And I think we do a very adequate job. We work with terrific partners on the outside and have a dedicated competent team inside. So I think we are thoughtful about our claim process and I don't have a reason to suggest our numbers -- or understand why they're different than others.

Q - Yaron Kinar {BIO 17146197 <GO>}

Okay. Thank you.

Operator

Thank you. And your next question comes from the line of Randy Binner with B.Riley FBR.

Q - Randy Binner {BIO 15145081 <GO>}

Hey, good morning, thanks. I actually had, I think, a couple related to commercial auto. The first is a question on the inland marine losses that are disclosed has been elevated. Could you describe what those are? I'm just curious if they are related to wheels-based [ph] loss or something else?

A - Doug Elliot {BIO 3700927 <GO>}

Yeah, the builders' risk essentially would be equipment, materials on the job site. So I don't think auto there. I think water intrusion causing damage to all kinds of equipment in (inaudible) on the walls, et cetera. There were earlier in the year a couple of marine losses in transit, when you think in transit marine, that would have involved the (inaudible) there was a little commercial auto pressure there, but primarily second quarter I'm talking about intrusion of water in a four-wall structure.

Q - Randy Binner {BIO 15145081 <GO>}

Okay, got you. And then just on the commercial auto overall. It has not been a topic that's come up on this call, but it is still a major issue for the group and so I'm curious kind of where you think pricing versus loss cost is there and kind of where The Hartford sits in the process of the industry getting on top of those liabilities?

A - Doug Elliot {BIO 3700927 <GO>}

Yeah. I guess I'd start by suggesting make up of our book is largely Small Commercial with the middle market fleet book as well and now Navigators brings, especially auto component to us. In terms of our core book, we've been managing aggressively auto for six, seven years now. Our exposures are down materially over the last five years, plus 30% tip change in auto, still not satisfied with our rate adequacy today. Our combined ratios are still not acceptable across both small and middle. And so there's still more work to be done.

Given where we see pricing today, yeah, I think that pricing from our view, in our middle and small books is on top of loss trend, which means we are now delivering better margins, but we're very careful -- with a very careful eye watching 2016, 2017 , 2018 some of those years that are closing up and this line has our full attention and we'll over the next several quarters for sure.

Q - Randy Binner {BIO 15145081 <GO>}

Is it a growth opportunity the if you have your pricing right relative to loss trend? Are you seeing a lot more opportunity to write business?

A - Doug Elliot {BIO 3700927 <GO>}

Well, there's a lot of business in the marketplace. It is on the top of our growth priority. We're certainly not a major monoline provider and I'm talking about historical Hartford at the moment. We certainly look at it when we're rounding out accounts and we want to protect our account. So, no, it's not on the top of our queue list to be chasing monoline auto. With our specialty auto division now with Navigators, I think, a good opportunity. They've got terrific instincts. They've got great data and they'll be thoughtful about their opportunities, but I would ask you to think about the different pieces of our book and all told, we're not an enormous auto player relative to the industry in general.

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

I think that's the big distinction, Doug, right. We're not big fleet players. I mean, we tend to ensure trucks vehicles on the small to medium-sized business. We're not national programs, it's not -- just given the environment, Randy, it's not a growth area as Doug said.

Q - Randy Binner {BIO 15145081 <GO>}

Okay. Thanks.

Operator

Your next question comes from the line of Ryan Tunis with Autonomous Research.

Q - Ryan Tunis {BIO 16502263 <GO>}

Hey, thanks, good morning. This would have already been pretty clearly confirmed but just, I guess, from my own head. So the new 92 to 94 guide wouldn't be any different if it weren't just the addition of Navigators mix and do you feel just as good about Navigators as you did at the time of the deal, is that right?

A - Doug Elliot {BIO 3700927 <GO>}

That's right. With the exception, we have built in a little bit of this pressure on builders' risk both what we experienced first half has set our view. So we've tweaked our loss ratios in the marine area, second half of the year, largely all the other lines remain on track.

A - Beth Costello {BIO 15349374 <GO>}

Yeah, and I'll just add to that, Ryan, just to be clear. So absent Navigators, we probably would be 1 point down relative to what our original thought was for second half of the year.

Q - Ryan Tunis {BIO 16502263 <GO>}

Understood.

A - Beth Costello {BIO 15349374 <GO>}

So obviously, Navigators coming in at a higher loss ratio -- combined ratio, it's kind of is in the mix. But we put it all together, we feel very good about being able to be in that range.

A - Doug Elliot {BIO 3700927 <GO>}

Ryan, I would remind you the compare on that, you have to almost go back to 2018 and think about what happened in Qs 3 and 4, we were doing some adjusting to the workers' comp line still in Q3 of last year. I think that's something that just have to factor in here.

Q - Ryan Tunis {BIO 16502263 <GO>}

Got you. And I think I wanted to go back to Elyse's question. I think, Beth did a good job talking about the accident year actions and how those compared to the original expectations at the time of the deal, but I'm still having a little bit of hard time with -- I think, there was like a $150 million of gross charges that Hartford took and there have also been some charges that Navigators had taken in the quarter since the deal -- the acquisition was announced. So, yeah, I mean, on the reserving side, would you say that all the activity that we've seen has also been around the level that you would have expected the time you announced the deal or could you just highlight some areas where things ended up being a little bit more elevated?

A - Beth Costello {BIO 15349374 <GO>}

Yeah. So if you go all the way back to the time we announced the deal, I would say that the -- our views relative to reserve increases have increased from there. We obviously took that into consideration when we started to look at purchasing an adverse development cover. I would say that the actions that we took are relatively consistent with what we would have thought at the time that we entered into the ADC. So we sort of incorporated those views when we looked to purchase protection.

And as I said in my remarks, I feel very good about the fact that the remaining $209 million under that cover and I would say the areas that we're seeing -- the increases are relatively consistent, just again some of the size of those increases has changed and we incorporated all of that as we thought about our 2019 accident picks, both what we felt needed to be adjusted from what Navigators had recorded pre-acquisition, as well as incorporating those views into our updated guidance for the second half of this year.

Q - Ryan Tunis {BIO 16502263 <GO>}

Thank you.

A - Susan Spivak Bernstein {BIO 1514699 <GO>}

Operator, we'll take one more question, please.

Operator

Yes, ma'am. Your final question will come from the line of Mike Phillips with Morgan Stanley.

Q - Mike Phillips {BIO 21023048 <GO>}

Hey, great. Thanks for having me [ph]. Appreciate it. I guess, Doug made some comments on the reserve issues in some of the smaller lines professional liability and the turn in general liability. I guess, I was looking to see maybe a little more detail and kind of what exactly you're seeing there, how confident you are that you got things fixed, and maybe some pressures going forward in those specific lines for professional liability?

A - Doug Elliot {BIO 3700927 <GO>}

Mike, I would say that if you go back and think about some of the pressure spots in Navigators towards the end of last year and early this year, obviously, there has been some pressure in the international book. Some of that marine book internationally and also the D&O book and they were addressing some of their own and essentially as we looked at the tail factors when we looked at those cases we just decided that we needed to make some adjustments.

So that's how we think about several of those lines in the US. Our view of tail and tort came together with their actuaries and we spent a lot of time debating and looking at things. So, I don't look at what we did over the last quarter. These changes as anything very, very different than our discussions last summer, but they were updated based on facts and debates as we came together and closed the second quarter.

Q - Mike Phillips {BIO 21023048 <GO>}

Okay, thanks. I guess one more on Personal Lines, and if I could turn back to that. You commented that the premium drop in Personal Lines was cut and part of it was due to non-renewal business, and I guess maybe when you expect kind of an inflection on that piece of the Personal Lines?

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

Well, our goal is to be turning into growth as we close out 2019 and move into 2020. We're encouraged, because as you can see, our new business numbers look much more positive than they were at this point last year. Again, we're working on retention, the rate change. The book is at a pretty solid profit perspective. So I think the rate change probably won't move a lot over the next six to nine months, but we think the new business will grow and if we get a little lift in retentions, we'll see those positive numbers move, approaching end of year 2019.

Q - Ryan Tunis {BIO 16502263 <GO>}

Okay, great. Thanks, Chris.

Operator

And that does conclude our question-and-answer portion of today's call. I will now turn the call back over to Susan Spivak for any closing remarks.

A - Susan Spivak Bernstein {BIO 1514699 <GO>}

Thank you, operator. In conclusion, we just appreciate all of you joining us this morning and we apologize for the technical difficulties and the sound interference during Beth's note. Please note that there will be a transcript available and we're happy to talk after this call to clarify anything that wasn't clear during our prepared remarks. Thank you and look forward to next quarter.

Operator

Thank you again for joining today's conference. You may now disconnect.