

Q3 2019 Earnings Call

Company Participants

- Beth Costello, Chief Financial Officer
- Chris Swift, Chairman and Chief Executive Officer
- Doug Elliot, President
- Susan Spivak, Investor Relations

Other Participants

- Amit Kumar, Analyst
- Brian Meredith, Analyst
- David Motemaden, Analyst
- Elyse Greenspan, Analyst
- Gary Ransom, Analyst
- Jimmy Bhullar, Analyst
- Mike Zaremski, Analyst
- Paul Newsome, Analyst
- Ryan Tunis, Analyst
- Yaron Kinar, Analyst

Presentation

Operator

Good day, and welcome to Hartford Financial Services Group, Inc. Third Quarter Financial Results Conference Call and Webcast. All participants will be in listen-only mode. (Operator Instructions) After today's presentation, there will be an opportunity to ask questions. (Operator Instructions) Please note this event is being recorded.

I would now like to turn the conference call over to Susan Spivak of Investor Relations. The floor is yours ma'am.

Susan Spivak {BIO 1514699 <GO>}

Thank you, and good morning and thank you for joining us today for our call and webcast on third quarter 2019 earnings. We reported our results yesterday afternoon and posted all the earnings related materials, including the 10-Q on our website. For the call today 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 will have a Q&A period.

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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 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.

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 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.

Chris Swift {BIO 3683719 <GO>}

Good morning, and thank you for joining us today. The Hartford had an excellent quarter with strong financial results across all our business lines. Third quarter core earnings rose 31% over prior year to \$548 million or \$1.50 per diluted share, with lower catastrophe losses and continued solid investment results. Our businesses are performing very well.

Book value per diluted share, excluding AOCI was up 8% to \$42.55 from year end. The consolidated 12-month core earnings ROE was 12.3%, an impressive result in the current market environment. The strong execution of our strategy is demonstrated by our consistent operating performance quarter-to-quarter, delivering on key integration milestones, and continuing to invest in our business to enhance customer experience inefficiency.

Doug and Beth will cover results in more detail, but I wanted to touch briefly on a few items. Commercial Lines highlights in the third quarter include core earnings of \$303 million, up 14% over prior year. Solid top-line growth with and without Navigators and a renewal pricing rate acceleration compared to the first half of the year.

When we announced the acquisition of Navigators more than a year ago, an important part of our strategy was to broaden our underwriting in product capabilities as a Global Specialty player, and added benefit was the expansion of our distribution relationships into the wholesale channel to serve more risk needs of customers. Nearly six months of past since we've closed the Navigators transaction.

The progress to-date is on track and I'm very pleased with the collaboration amongst the teams and the positive reception from distribution partners. Our book is benefiting from the strong pricing tailwinds in the market, providing the opportunity to restore certain product lines within Global Specialty to targeted financial returns.

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Personal Lines core earnings were \$87 million, up 85% benefiting from lower catastrophe losses and favorable prior year development. While up slightly from prior year, the underlying combined ratio of 92.3 for Personal Lines was a strong result. Our primary focus in this business has been returning to growth, with new business up 34% in the quarter.

Overall, net favorable reserve development for Property & Casualty was \$47 million in the quarter. They were both favorable and unfavorable development in various lines. Our experienced actuarial and claims teams have demonstrated the ability to identify emerging trends within our data, which is used to update our estimates each quarter. Overall, I am confident in our loss reserve estimates.

Group Benefits delivered another excellent quarter with core earnings of \$141 million, up 38%. The increase versus prior year was driven by favorable loss ratio, higher net investment income and lower amortization of intangibles. This was partially offset by increased investments in technology, claims management, and higher commissions related to our voluntary products.

The total loss ratio improved 4.4 points, driven by favorable disability results, partially offset by a deterioration in the life loss ratio. The improvement in the disability continues to come from favorable incidence trends. Results also benefited from updates to our claim recovery assumptions and the recognition of an experience refund related to New York Paid Family Leave product or accident year 2018.

In Group Life, severity was elevated in the quarter. However, we don't see any consistent trend other than normal volatility. On the top line fully insured ongoing premiums were just off slightly versus prior year. Persistency is running slightly below historical trends, as we adjust pricing on targeted segments of the Aetna book. Importantly earned premium on the Aetna book of business is in line with our deal assumptions and conversions of cases continues to go very well from both a platform and pricing perspective. Overall, we are very pleased with the operational execution and financial performance of Group Benefits.

Before I turn the call over to Doug, I wanted to make a few comments on the macro environment. The Property & Casualty industry is facing a number of challenges that have been well documented. Net investment income is under pressure and what is likely a prolonged period of low interest rates, affecting new money in overall portfolio yields.

The frequency of severe weather related storms, as well as other catastrophic events such as wildfires are elevated, pressuring rates to keep up with CAT trends. Social inflation related to larger claim settlements continue to put pressure on loss cost trends. However, social inflation is not a new phenomenon. We have been monitoring these trends for years, taking the appropriate actions to ensure our pricing models in underwriting reflect these realities.

To conclude, with one quarter left in the year, our experience through the first-nine months is generally consistent with the outlook we provided with no major surprises. The successful integration and execution of our two recent transactions, strong financial

results, and capital management demonstrate our strategy is working. It is an exciting time at The Hartford for all our stakeholders, customers, employees, distribution partners, and shareholders. I am confident in our ability to produce consistent results contributing to shareholder value creation.

Now I'll turn the call over to Doug.

Doug Elliot {BIO 3700927 <GO>}

Thank you, Chris and good morning, everyone. The Hartford's Property & Casualty results for the quarter were strong. Top line growth was fueled by the Navigators acquisition, while underlying organic growth in commercial lines was a solid 4%. In Personal Lines, new business growth is up significantly from third quarter 2018, but is moderated from earlier in the year. We're pleased with the underlying returns across all of our Property & Casualty businesses as each continues to execute effectively.

It was a relatively benign quarter for catastrophes, as losses were well below third quarter 2018. Current year CAT losses in the quarter totaled \$106 million, \$63 million less than a year ago. In aggregate, Property & Casualty reported favorable prior year development of \$47 million this quarter. Improving severity trends across workers' compensation, small commercial package business, and personal lines auto all drove favorable reserve releases. Partially offsetting these releases was reserve strengthening in commercial auto liability, and general liability driven by some large loss activity.

As Chris has already mentioned, there's been a fair amount of commentary during the quarter regarding social inflation and we're certainly not immune to these unfavorable (inaudible) trends. However, keep in mind, our Hartford book is made up primarily of smaller customers with lower limit profiles. In addition, the adverse development cover we purchased on the Navigators loss development provides another layer of protection.

Over the past few years, while we've observed higher loss trends, we've also adjusted general liability and commercial auto reserves accordingly. At the same time, we've made underwriting and pricing adjustments to our book in response to these trends. We actively monitor these trends and we'll continue to take appropriate actions as necessary.

Let me now shift into the results for our business segments. The underlying combined ratio for Commercial Lines which excludes catastrophes and prior year development was 93.9, deteriorating 0.2 point from last year, but a strong performance nonetheless. As expected, the Navigators book generated approximately 1 point of increase on the combined ratio. This was partially offset by favorable non-CAT property results.

I'm encouraged by the pricing environment in the quarter. Our renewal written pricing in standard Commercial Lines was 2.8%, up 40 basis points sequentially from second quarter and up 90 basis points from prior year. This positive pricing change remain somewhat depressed by the current workers compensation pricing environment.

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Middle market pricing, excluding workers' compensation was 5.6% in the quarter, up 130 basis points from second quarter and up a 180 basis points from the prior year. This strong improvement reflects the rate actions we're taking across our core lines. Given industry loss trends and operating performance in these non-workers' compensation lines, I expect this pricing trend to persist.

Let's now take a look inside our Commercial Lines business units. Small Commercial continued its excellent performance with an underlying combined ratio of 87.9. The margin improvement versus last year was driven primarily by lower non-CAT property losses and lower underwriting expenses. Written premium was flat to prior year due to renewal written pricing, decreases in workers' compensation, and the completion of the new business rollover from the foremost renewal rights transaction. Excluding foremost, new business premium growth was up a very strong 13% for the quarter, driven by workers' compensation and package business.

We expect continued new business growth to come from the launch of our next-generation package offering we call Spectrum. This is much more than just a new product release, with this modular policy and the enhanced platform that supports it. We've taken our industry-leading capabilities to a new level making buying small business insurance easier than ever. A consumer buying small business insurance from The Hartford now receives tailored recommendations for their coverage or the ability to customize their own. Their agent is able to view real-time pricing much the same way and online retail shopper can see a running total of the costs of products placed in their cart. As of today, we're live in 32 states and we'll be in 45 by year-end. We are already seeing increases in quotes, an additional, optional covered selections. This game-changing product launch only adds to our excitement about our long-term prospects for growth in this segment.

In Middle & Large Commercial, the underlying combined ratio of 99.6 improved 1.6 points from 2018, driven primarily by lower non-CAT property losses. Notably inland marine losses, which were elevated in the second quarter have moderated. Written premium was up 12% over last year, due in part to the addition of certain legacy Navigator businesses within Middle & Large Commercial. EX-Navigators written premium was up 7% with strong production in national accounts, large property and programs as well as in verticals such as construction and energy. We're achieving rate increases across Middle & Large Commercial. Our property and auto rate increases are up sequentially in the quarter over 100 basis points with liability not far behind.

In Global Specialty, the underlying combined ratio of 96.2 deteriorated 6.4 points, primarily the result of including the Navigators book this quarter. Since the acquisition, we've been aggressively re-underwriting and repricing portions of the Navigators book. In the third quarter, we achieved double-digit rate increases on both the Navigators US and international business, where significant rate acceleration during the quarter and since the first quarter of this year.

In the US, we achieved strong underwriting results in our management and professional liability and surety lines. We're also pleased with both renewal pricing and new business generation from our wholesale distribution channel in the US. In international, we've taken significant actions to address two plus years of sub par returns in our Lloyd's syndicate

and London market portfolio. In addition to the aggressive pricing actions we're taking on this book, we've exited certain underperforming lines and reduced significantly the number of binders, MGAs and line slips across the portfolio. We've also materially reduce the overall limits deployed in several lines including D&O, E&O and Casualty.

Our Global Specialty team is off to a terrific start. They are actively addressing opportunities in the book, as well as taking advantage of favorable market conditions where appropriate. Integration efforts continue, including expertise, sharing and data science, technology, product design, claim and many other areas. Executing across core risk functions will play an important role in improving the financial performance of this business. We fully expect Global Specialty to be a significant contributor to commercials premium growth as profit returns to target return levels.

Moving to Personal Lines. The underlying combined ratio of 92.3 deteriorated 50 basis points from the third quarter of 2018, but still a very good overall results. The expense ratio increased nearly 1 point due to the impact of lower earned premium, while the loss ratio improved 40 basis points. The loss ratio improvement is reflected in both our auto and homeowner results driven by earned pricing increases and non-CAT homeowners experience. New business growth was up 34% compared to prior year. This was another positive new business quarter as marketing spend and product adjustments continue to gain traction.

In AARP Direct to auto, our critical production levers, including flow, close ratios, and new sales, all improved compared to prior year. Importantly, we're pleased with the underlying profile of this growth and encouraged by the improving trends. Despite continued strong improvement in direct new business growth, total written premium was down 4%, though we've made progress to improve the profitability of our ERP book more work is needed on retention and new business to return to positive growth.

In summary, this was a very strong quarter across our Property & Casualty businesses, We're executing effectively against our plans while responding to loss cost trends and competitive market dynamics. We're taken appropriate pricing actions and making disciplined underwriting decisions. This is driving clear progress in lines and accounts that need to improve overall profitability.

Meanwhile, we remain extremely encouraged by the product breadth and depth of the underwriting talent that the Navigators acquisition is contributing and we're already seeing the impact of these additions in our businesses and with our distribution partners. The positive progress on key milestones drive my bullish outlook on our future. I look forward to updating you all in another 90 days.

Let me now turn the call over to Beth.

Beth Costello {BIO 15349374 <GO>}

Thank you, Doug. Today, I'm going to cover third quarter results for the investment portfolio Hartford Funds and Corporate and provide an update on capital management.

Our investment portfolio continues to perform very well, with strong limited partnership returns and generally stable investment yields. Net investment income was \$490 million for the quarter, up \$46 million or 10% from the prior year. Excluding Navigators net investment income was \$462 million or 4% higher than the prior year. The annualized limited partnership return was 15.3% in the quarter due to higher valuations on underlying funds.

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Lower interest rates and tighter credit spreads increased net unrealized gains on fixed maturities after tax to \$1.8 billion at September 30, up from \$1.4 billion at June 30. Unrealized and realized gains on equity securities classified and realized capital gains in the income statement were \$19 million before tax in the quarter and a \$181 million before tax through September 30. The credit performance of the investment portfolio remains very strong. Net impairments in the quarter totaled \$1 million, flat with third quarter 2018.

Given the increasing likelihood of sustained low interest rate, I wanted to touch on how we manage the portfolio in this environment and the impact of the portfolio yield due to lower rates. We have a broad range of investment capabilities and a well-diversified portfolio. Our strategy does not pursue lower credit quality for the purpose of making up for lower yields and we will continue to invest in a diversified manner. For the quarter, our current yield before tax excluding limited partnerships was 3.6% equating to \$425 million. Taking into consideration potential lower reinvestment rates projected using the forward curve, we could see the portfolio yield excluding limited partnerships declined by close to 10 basis points in 2020 reducing the quarterly run rate of net investment income by approximately \$10 million before tax.

Turning to Hartford Funds. Core earnings of \$39 million were down 5% from last year, but up \$1 million sequentially. Daily average AUM rose 2% from second quarter 2019, reflecting strong market performance, partially offset by net outflows. Investment performance remains very strong. As of September 30, about 70% of Hartford Funds outperformed peers on a one, three and five year basis. Corporate core losses of \$37 million improved by \$8 million from third quarter 2018. The principal driver of the improvement this quarter was \$11 million of income after tax from our retained equity interest in Talcott compared to \$1 million in third quarter 2018.

During the quarter, we continued to repurchase shares. Year-to-date through November 1, we have repurchased 2.2 million shares for \$126 million. With strong capital generation and financial flexibility, we are pleased to be able to both invest in our businesses and return capital to shareholders. During the third quarter, we issued \$1.4 billion of debt comprised of \$600 million, 10-year 2.8% senior notes and \$800 million 30-year 3.6% senior notes. We used the proceeds to redeem approximately \$1.65 billion of debt with a weighted average coupon of 5.3%.

The redemption resulted in a loss on extinguishment of debt of \$90 million before tax. We continue to plan to repay our \$500 million, 5.5% senior notes maturing in March 2020, which will put us in line with our leverage targets. Book value per diluted share, excluding AOCI was \$42.55, up 8% year-to-date and 9% at September 30, 2018. Core earnings ROE over the last 12 months was 12.3%, well in excess of our cost of equity capital.

A few other items to comment on before I close. We have included disclosure in the 10-Q about the potential for subrogation recoveries from PG&E related to losses incurred uncertain 2017 and 2018 California wildfires. Given uncertainties with respect to approval of the PG&E bankruptcy plan, we have not recognized any subrogation recoveries to date. Based on subrogation claims submitted by all insurers to PG&E and the terms of the proposed settlement, which is contingent upon approval of the bankruptcy plan.

We would expect gross subrogation recoveries to be approximately \$325 million, although the actual amount we collect to subject to uncertainty. The first \$116 million of any such subrogation recoveries would reduce reinsurance recoverables we have recorded under our CAT Reinsurance Treaties. Accordingly any benefit to income would be for subrogation recoveries in excess of \$116 million.

Turning to fourth quarter, it has already been an active quarter for catastrophe related events. Our budget forecast in the fourth quarter is approximately \$80 million pre-tax. Before considering any losses from the current California wildfires, we are approaching \$80 million of catastrophe losses in the month of October, including losses from tornadoes in the Dallas area and other wind events. While it is still too early to make an estimate of losses we may incur from the current California wildfires, we are monitoring the fires closely in the areas we have ensured properties and businesses at risk.

As a reminder, in the fourth quarter, we will complete our annual study of a spasticity environmental reserves. Under the adverse development cover we purchased in 2016, we have \$977 million of remaining coverage available for increases in these reserves. Also we did not see any additional net loss reserves in the third quarter to our adverse development cover for Navigators. So we continue to have \$209 million of coverage available on that book of business.

To summarize, the execution of our strategy is generating strong results across our business lines. The integration of Navigators is on track and we look forward to continuing to update you on our progress.

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

Susan Spivak {BIO 1514699 <GO>}

Thank you, Beth. We have about 30 minutes for questions. Operator, can you please repeat the instructions for asking a question.

Questions And Answers

Operator

Yes. We're through. We will now begin the question-and-answer session. (Operator Instructions) And the first question we have -- will come from Elyse Greenspan of Wells Fargo. Please go ahead.

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Q - Elyse Greenspan {BIO 17263315 <GO>}

Good morning. First off on that I do, the -- appreciate the new kind of streamline disclosure within the press release that was helpful this quarter. My first question for you is on capital. Just following up on some of your prepared remarks, it seems like you guys got the majority of the tax attributes you are expecting this year as of the end of the third quarter, just looking at the 10-Q disclosure. So I just -- I wanted to walk through that and get a sense of share repurchases for the fourth quarter. And then for next year on the capital side is, could you just give us a sense of the dividends, you could upstream from the P&C subs in 2020 and also there is any change in the tax attributes you expect as well?

A - Beth Costello {BIO 15349374 <GO>}

Sure. So first of all, thank you for the comment on the press release. I'm glad that you like the new format. So yes, as it relates to holding company cash. I would say overall, we're on track with what we expected at the beginning of the year. Yes. The timing of the tax benefit we received from our AMT refunds did come in a little bit earlier than we anticipated, but we were anticipating that this year. So we took all of that into consideration as we have projected sort of our view of share repurchases over the course of this year and into next year. And we continue to target for this year about a total of \$200 million in share repurchases and then the remainder of our \$1 billion authorization would be used in 2020.

As it relates to then dividend streams as we go into 2020 again, as a reminder, we did not take any net dividends from P&C in 2019. But we do anticipate going back to our normal cadence in 2020. As we've talked about in the past, we see dividends sort of in the \$850 million to \$900 million range. Obviously, it will depend on actual results from our Group Benefits business. We're typically in the 300 to 350 range obviously results in Group Benefits have been very strong. So we've seen some increases in those dividends through the years. And then mutual funds usually is in that \$100 million to \$125 million.

And then we do still have some remaining tax benefits that we would expect to receive in 2020. So when we look at 2019, we're probably a little bit over \$700 million in tax benefits that will come through. And as we look to 2020, we'd be just slightly under \$600 million. So again, very much in line with what we have laid out previously. And then again, I'll just remind you, as I said in my prepared remarks, we do still anticipate paying our maturing debt of \$500 million in March of 2020.

Q - Elyse Greenspan {BIO 17263315 <GO>}

Thanks. That's very helpful. And then my second question, if we want to kind of keep track of how Navigators is trending, you guys highlighted some earnings projections for that business going a couple of years out, so I'm just trying to get a sense. Can you kind of set the stage or give us a sense how much earnings came through in the quarter or is the best way for us to really look at the Global Specialty margin to get a sense of how Navigators is tracking?

A - Chris Swift {BIO 3683719 <GO>}

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Elyse, thank you for your question. I would say what we've commented upon in the past as far as our goals, it related to the financial performance of Navigators are really unchanged. I think we did say that the slope of it might be slightly different and the components might be slightly different, but we still see a path to earning \$200 million of core earnings prior to amortization of intangibles in that four year to five year period of time and still excited, obviously there's a lot of rate have been taken in the specialty space broadly defined, but Doug, that's what I would say over the long term, but what would you say in the near term?

A - Doug Elliot {BIO 3700927 <GO>}

Just add that this quarter, we made very few adjustments to the prior Navigators loss ratios across their lines either prior year or in the current action year. We tweak auto liability slightly in the quarter, but other than that Beth, it was a pretty quiet quarter relative to actuarial assumptions.

Q - Elyse Greenspan {BIO 17263315 <GO>}

Okay. And then can you give us a sense of the rate that you're getting just within their book of business.

A - Chris Swift {BIO 3683719 <GO>}

Yeah. I mentioned in my commentary Elyse that it was double digits. And in the quarter, essentially the US book was right on top of 10. Internationally, they were getting closer to 16 and when you put the two together, we're tuck-in 12-ish -- 11 to 12 points of price. I also said that it was accelerating in the quarter. So we're quite pleased about that as you think about the run rate July through September. And in early peak of October keeps me optimistic, October, it looks a lot like September. So I think we're off to a really good start. I'm very pleased with progress, Vince's team working hard to change the outcomes here.

Q - Elyse Greenspan {BIO 17263315 <GO>}

Okay. Thank you very much. I appreciate the color.

Operator

Next, we have Paul Newsome of Sandler O'Neill.

Q - Paul Newsome {BIO 1541286 <GO>}

Good morning. Thanks for the call. I was hoping you could weigh in a little bit more on some of the auto trends that we have seen it other companies both the commercial auto trend and the severity in frequency seems to be a little bit different by company and kind of how you vary that? What are your experiences have and so why you think its behind it? And then sort of second question, the football with the private passenger and they ask kind of the same questions about frequency and severity, all states saw a little bit of a spike in their frequency for physical damage and I don't know if you've seen the same thing, but anyway those are my two questions.

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A - Doug Elliot {BIO 3700927 <GO>}

And Paul, let me just clarify Personal and Commercial both you want me to, -- okay. Let's start with personal. We continue to be pleased by the trends we see in our Personal Lines auto book, frequency has been in good shape for several quarters now. And severity were mindful of collision severity, but essentially our loss trends are within our expectations and feel good about progress in overall performance of the personal line's auto line.

In Commercial, bit of a different story in the sense that our small commercial book much smaller vehicle, we've been working right now for five years to six years, we have transformed that book, we're essentially not a monoline player except in certain circumstances. Improvement there, but more improvement necessary in the commercial auto small commercial space. In the middle, again, this is not especially auto sector. This is essentially commercial auto fleets attached to our middle market accounts, slightly heavier than small commercial. We also have been chasing rate here over the last six years to seven years. We've made progress, but not at all acceptable relative to our operating performance in the line today.

So we continue to make underwriting adjustments. We will continue to work hard on rate. Very pleased that our rate was up over 10 points in Q3 and auto. We'll continue to work at that in Q4 and into 2020. When I think about loss trend, they look to us like they are in the mid-single digits maybe plus a little bit in that 5 to 6 -- 6.5 range commercial auto. We're mindful that which means our pricing needs to be on top of that plus some to make appreciable progress in combined ratio. Chris or Beth anything?

Q - Paul Newsome {BIO 1541286 <GO>}

Do you have any particularly theory about the commercial business. It might be different from other folks about why we're seeing this a very trend and whether or not it's deteriorating [ph]?

A - Doug Elliot {BIO 3700927 <GO>}

I would just offer that our book of business on the Commercial side, EX-NAV is largely primary auto. So we're not a significant player in the excess space. I do think the excess layers have had some pressure over the past three years, four years. Navigators has an especially auto book. We're very mindful that. We're working closely with them, sharing our trends, working actuarial assumptions et cetera, and taking quite a bit of rate there. So our rate change in the Navigator auto book is substantial. But I don't have any greater insight, because I don't have insight into other competitor books like I do our own.

Q - Paul Newsome {BIO 1541286 <GO>}

Thanks. Congratulations to the quarter. Thank you.

A - Doug Elliot {BIO 3700927 <GO>}

Thanks, Paul.

Operator

Next, we have Brian Meredith of UBS.

Q - Brian Meredith {BIO 3108204 <GO>}

Yeah. Thanks. A couple of quick ones here. First, I'm just curious in the Commercial Lines segment, the expense ratio declined year-over-year only around 17% growth G&A expenses I expected to be a little bit higher than that. Was there anything unusual there? Or is that a decent run rate with respect to kind of G&A expense growth and what we're seeing with the expense ratio?

A - Chris Swift {BIO 3683719 <GO>}

Yeah. Good question, Brian. And there are some thing is happening in both Q2 and Q3 that make that compare a little bit challenging. So let me do my best unpack it. In Q3 quarter, we actually had some credits that ran through from taxes, licenses and fees and also some bad debt credits. And when you kind of laser them and you basically get a quarterly expense ratio more like 34.5. In Q2, we had some one-timers that put some upward pressure on the expense.

And I'd also point out to you, as the Navigators book comes into our expense ratios as a typical specialty company sometimes have -- they've got slightly higher expense base. So between the US and certainly the international, there is a little bit of inflation on the expense coming in from NAV that we work our way through over the next couple of years as we earn our way toward those profit targets we've talked about. So I look at the run rate Q3 more in the 34.5 range I think that's kind of where we'll be Q4 as I look out.

Q - Brian Meredith {BIO 3108204 <GO>}

Great. Thanks. And then my second question in the Small Commercial area, you talked about how it's a little bit more insulated from the social inflation environment given the kind of limits profile of that business. I'm curious, have you seen any increasing competition in that area as a result of what's going on in the loss cost inflation environment?

A - Chris Swift {BIO 3683719 <GO>}

Yeah. Brian, this is Doug. Here we respond to -- I would say, again across many of our businesses, there is always competitive pressure. There is new entrants. There's FinTech related or insured tech-related activities, but I wouldn't say it's rapidly changing in a more competitive environment where everyone is piling in, I would say when heard us talk about this before, we have a 30-year history here with a lot of data, a lot of capabilities, a lot of deep trusted agent relationships that does provide an element of advantage to us, but we are really tuned in on the emerging trends and our own mindset of, what do we need to do to continue to get better every day. What do we need to continue to differentiate ourselves as one of the top go-to-market, so that's our mindset. And Doug, if you would add anything?

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A - Doug Elliot {BIO 3700927 <GO>}

Yeah. So maybe just a couple of comments about our new Spectrum and then comments on what we've been working on the last couple of years, so very excited Brian about this launch of NextGen Spectrum. We've been kind of in the design and building stage for a couple of years now, and I think it's going to be a terrific product in the market much in the way. The digital experiences that we're all used to on our personalized because of that launch we've been laser-focused these last couple of years to get our rate adequacy on our spectrum product where they need to be because it's very difficult, if your profit challenge in the current line and then go to launch new product.

So as we think about loss trends over these last couple of years, we've continued to make sure we're on top of those trends with pricing. We see liability trends in that spectrum area, still in the mid-single digits and our pricing has been matching that over time and we feel good about our balance sheet in terms of the reserves that are recorded on our ledger. So yes, we've been very focused on loss trends here I think good progress and now exciting that we launch our new effort into the latter half of 2019 into 2020.

Q - Brian Meredith {BIO 3108204 <GO>}

Great. Thank you.

Operator

Next, we have Jimmy Bhullar of JP Morgan.

Q - Jimmy Bhullar {BIO 4278955 <GO>}

Hi. Good morning. I've a couple of questions for Doug. And first on commercial lines. How do you think about your ability to take advantage of improving pricing in the overall market, especially given that you've got a big exposure to workers' comp where prices are actually obviously under pressure?

A - Doug Elliot {BIO 3700927 <GO>}

Well, we're optimistic that our non-workers' compensation pricing continues to improve, as I suggested that certainly that was the case in Q3. And I expect that to continue into Q4. Yes. We recognized we have some headwinds on the workers' comp environment, I would again point out the profitability of the books is excellent particularly small commercial. So we're mindful of those headwinds and navigating in the middle account by account and being thoughtful about class selection and state and geography and small commercial. So yeah, it is a tale of two where we're working hard to improve our core pricing, while we understand it's a very competitive workers' comp dynamic that matters greatly to us.

Q - Jimmy Bhullar {BIO 4278955 <GO>}

And then on Personal Lines, I think you would hope that at some point over the next few quarters, you'll start to see stabilizing premiums and maybe an improvement in

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premiums, but it seems like more and more companies are sort of shifting their focus from reviving margins to accelerating growth just comments on competition whether it's still rational and your expectation of when you can sort of get to flat to positive premium growth in that market?

A - Chris Swift {BIO 3683719 <GO>}

Jimmy, obviously we're not going to give any guidance or specific drivers, but the overall focus is both Doug and I've comments upon has been growth orientation. But you are right, I mean it's a dynamic marketplace just because we want to grow and there's a lot of other competitors that are shifting to that same mindset.

So, the trick in that environment, at least in my judgment is going to remain disciplined. You got, again, segment appropriately your new business by states or territories that makes sense for you compared to where your pricing is and the team is executing very well. It's just we're getting the responses just not converting as many new business opportunities as feasible, but Doug, that's what I would say?

A - Doug Elliot {BIO 3700927 <GO>}

Yeah. I agree Chris. And I think we laid out in the supplement, you can see we've made very good progress on the retention front. So I think there's a little more work to be done there and I think there is a little bit more left. And then absolutely, we are focused on adjusting and thinking carefully about what we do on the new business front because we want to raise those levels new business successes.

Q - Jimmy Bhullar {BIO 4278955 <GO>}

Okay. Thank you.

Operator

Next, we have Ryan Tunis of Autonomous Research.

Q - Ryan Tunis {BIO 16502263 <GO>}

Hey, thanks. Good morning. First question for Doug on, I guess keep it here on commercial auto and just thinking about, it seems like over the past call, half decade. We've been talking about commercial auto reserve development, and it seems like we've been talking about are probably more Hartford than a lot of competitors, maybe not so much over the past year, but I'd just be curious to maybe hear your thoughts on the extent to which maybe you feel like you got ahead of some of these trends maybe in '15, '16 and '17? And to the extent that you're seeing something new, what is new in this 2019 environment that you potentially had reserve for contemplated prior to this?

A - Doug Elliot {BIO 3700927 <GO>}

Ryan, thanks. Let's just start on the quarter and then I do want to comment, because I think you're onto something relative to the prior trends. So in this quarter, we made an adjustment to our prior year development based on some large losses we had seen in

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our national account book, so it's largely national accounts. I would say almost all national accounts 80% of the change is national accounts. And it's something that we had not adjusted in the -- last several years, so really exclusively our National book.

If you go back over five years to six years correctly stated, we have been adjusting auto. I would say back in the '12, '13 time period, we had a broader specialty auto book transportation vehicles that caused some of the adjustment and actually raised our attention to this commercial auto dynamic that we've been working hard on for five years or six years. So I would agree with you. If you've looked at what we've done in the commercial auto space on our reserves and our current actual year underwriting and pricing. This has been an ongoing work in process for us. We did some tuning in the quarter, but more importantly, we continue to leverage the findings in our book of business to do the best job we can and underwriting a profitability book going forward and we're sharing them with Navigators as we come together.

Q - Ryan Tunis {BIO 16502263 <GO>}

Perfect. And then, then maybe for Chris. Chris just on Group Benefits are we seeing some very favorable trends there? And I guess what surprises of P&C analysts, how well pricing seems to hold up? So I'm curious, in your view, how does the pricing cycle kind of work for Group Benefit? Are you seeing more competition there, what insulates Group Benefits from seeing I guess some of the same trends we've seen in workers' comp over the next couple of years?

A - Chris Swift {BIO 3683719 <GO>}

Sure, Ryan, I would say, yeah, we are performing very well, and I said in my commentary, I think we've provided enough data to say that there were a couple of one timers in this quarter. So I'd look at it that the quarter was roughly more in line with that \$120 million earnings, and 8% margin, but clearly above our long-term views that we've guided to which is still six to seven. I think the thing that you just have to keep in mind, there is a lot of the results that are emerging today are based on pricing and commitments we've made two years, three years ago that are just outperforming. So unlike P&C, we generally make three year rate guarantees. We're very thoughtful and disciplined in making those three year rate guarantees because that's the commitment. So we're just outperforming the expectations both on incidences and recoveries that is contributing to that current outperformance. So hopefully that helps you.

Q - Ryan Tunis {BIO 16502263 <GO>}

It does. Thanks.

Operator

Next, we have David Motemaden of Evercore.

Q - David Motemaden {BIO 18818634 <GO>}

Hi. Thanks. Good morning. Just a question for Doug. I just wanted to get a bit more detail on the changes that you guys made to reserves in GL. And also just talk about what you're

assuming on severity going forward in your loss picks and what sort of rate you're seeking in the market right now?

A - Doug Elliot {BIO 3700927 <GO>}

That was a multiple component question, so let me do my best to work our way through. In other liability, general liability, we made some tweaks really across years, across businesses I would say a series of small tweaks couple in the product area, a couple of umbrellas et cetera, nothing significant in any one pocket but largely across our middle market book of business. Construction included a little bit of our specialty general liability book. So that really is the basis for the tweaking we did in the quarter for general liability.

In a broader sense, we think about loss trends. Overall, our loss trends are somewhere in that mid-single digit range, when you combine all our lines and I'm thinking primarily about auto liability and GL which are the two lines that really formed the basis for most of your question. So they may move a bit between small and middle and some of our specialty lines with the specialty -- Global Specialty book, but we're talking about trying to be on top of mid-single digit trends. And now our pricing across various lines is either on top of slightly advancing on or appreciably on top of in the case of some of our specialty excess areas.

So I share with you, we're really pleased about some of the specialty areas that we've had substantial movement in pricing, double-digit moves in pricing where I feel like we're going to see the benefits of that kind of work into our book in 2020 and beyond.

Q - David Motemaden {BIO 18818634 <GO>}

Got it. Great. Thanks. And a question for -- just for Chris on the group business and top line specifically, sales were down a decent amount year-over-year, just sort of wondering what you're seeing competitively. And also more specifically what your outlook would be for top line earned premium growth here over the next few years as that knows is more fully integrated?

A - Chris Swift {BIO 3683719 <GO>}

Sure, David. I would say, I was trying to explain that I mean it is still a competitive environment out there, but there is still an element of rationality that I see most of our competitors are exhibiting, you might have an account or two or new business opportunity where someone does something more aggressive, but generally competitive but balanced. So I would say the year-over-year numbers that you're looking at it does look down but really when you adjust for so in New York, the family paid leave product that launched in '18. You really have sort of a \$40 million delta between year-to-date '19 compared to year-to-date '18. So you really you can consider it slightly down to flattish.

So again, I think we're still performing at a high level from our sales side. We do still get some contribution to sales in that \$40 million to \$50 million range from Aetna's medical staff that is still referring business and jointly selling. So we feel, good about the overall sales performance. So I said in my opening comments, premiums are slightly down 1% on an earned basis, primarily due to just higher lapses, lower persistency on the Aetna book

as we are taking targeted actions to reprice those book. So everything is according to plan, but as we look forward, I still see modest growth in top line for Group Benefits. Really supported by some of our ancillary lines anchored in A&H and voluntary.

Q - David Motemaden {BIO 18818634 <GO>}

Great. Thanks for the answers.

Operator

Next, we have Mike Zaremski of Credit Suisse.

Q - Mike Zaremski {BIO 20606248 <GO>}

Hey. Good morning. I wouldn't mind maybe trying to get more color on next-gen spectrum in terms of maybe you can just kind of isolate what the major changes are, is it - from the commentary, is it easier for your -- the business owners to self service. I'm just curious, is there a direct selling component to potentially for small businesses? And then also is there ultimately to measure the success to you, you expect sales to accelerate or better profitability? Just any more color would be great since it seems like it's a big deal.

A - Doug Elliot {BIO 3700927 <GO>}

Yeah. Good question, Mike and thank you for asking it. I'd start by saying, yes, this is a sales tool that essentially will sit on the desktop of our CSR's customer service reps around the country and all the agents and brokers we do business with. It's a tool that will allow them to be faster, more insightful and help their customers make choices. I would say inside the tool you should think about good-better-best type dynamics, all the coverage is very tuned to what a certain customer or SIC class would require. What types of optional coverages, are there, et cetera. So, I think it's a best-in-class selling tool with advice that either, comes out of the blocks with a terrific offer a customer or offers additional coverages that a CSR will work with a potential customer to purchase.

So that is at the basis of this exciting innovation for us. And then secondly, yeah, we do expect over time. Our new sales and spectrum to lift. It's hard to predict, but our expectations over the next couple of years we will see some change in our new business sales and we'll watch that carefully and report on that as we go through time.

Q - Mike Zaremski {BIO 20606248 <GO>}

Okay. That's helpful. Yeah. Lastly, if we step back and kind of talk about in a broader sense about commercial pricing versus loss cost trend. What -- is it fair to say that there is -- if there is a gap it's not, it hasn't changed much quarter-over-quarter or taking into account workers' comp and I mean -- so it sounds like there hasn't been any meaningful notable changes over the last quarter.

A - Chris Swift {BIO 3683719 <GO>}

And is your question more in the loss trend area or the pricing area. Just so --

Q - Mike Zaremski {BIO 20606248 <GO>}

It's kind of both. It seems like pricing is moving north and trend might be moving a little bit north. So net-net kind of similar to last quarter.

A - Chris Swift {BIO 3683719 <GO>}

Yeah, I would agree with your statement in the aggregate. And then I think we have to parse it apart by specialty, by excess, by primary, financial lines, spectrum et cetera. So in the aggregate, yes, we see lifting in pricing across middle, non-workers' comp, as we've examined our loss trend, I would say, largely in the primary space pretty consistent with Q2. Yeah. Maybe we are little careful to make sure we're catching some uptick in the social inflation dynamic, but I don't think material in any given way. And then in the Specialty book, yeah, we're spending a lot of time inside our excess and umbrella, our specialty areas and we're mindful of where trends are expecting a little bit of upward lift in those trends and therefore our pricing has been pretty aggressive there so pleased with progress on both fronts, but I think you have it about right.

Q - Mike Zaremski {BIO 20606248 <GO>}

Thank you very much.

Operator

Next, we have Amit Kumar of Buckingham Research.

Q - Amit Kumar {BIO 15025799 <GO>}

Thanks and good morning. Two quick follow-ups. So maybe going back to Mike's question on rate versus loss trend. So if you blend I guess all the moving parts and look at small commercial. As we head into 2020, is your sense that the loss trend will end up running harder than what we expected, hence the rate versus loss trend metric does not expand or is it more a function of the book?

A - Doug Elliot {BIO 3700927 <GO>}

So let me start and Beth and Chris, can grow it up. We're not prepared today to take into 2020 yet. What I am very pleased about is, if you look at our metrics on our XX [ph] combines across commercial. And you see him for our segments, I think we've done a nice job and dealing with loss trend getting improving rate performance and across both our most profitable segment, which is small commercial kind of holding in margins that are terrific.

And we are mindful that we need to make more meaningful change in the middle and large commercial areas. So I look at an all-in Q3 number on top of Q2 and feel pretty good about it. And as I mentioned in my earlier commentary, we know there was a little bit of upward pressure from the NAV book coming in. We'll work our way through that and at some point, that'll be a positive because we'll start turning the tide on that number as we move into 2020.

Q - Amit Kumar {BIO 15025799 <GO>}

And I must -- Chris or anyone has to add something to that.

A - Chris Swift {BIO 3683719 <GO>}

All right. Again I think Doug is accurate as always. I think the trick is going to be here -- everything sort of more granular, right. These days, whether it would be states products, accounts. So when you add it all up, I think what Doug says makes perfect sense. My particular point of view is that this could be a dynamic environment for the next couple of years for sure, because I don't think it's realistic at least in my expectation that 15 points of rate in Specialty book in aggregate is going to get you back to targeted returns.

As I said, particularly as it relates to Navigators, we're taking a multiple year journey to get to targeted earnings and returns. And I think a lot of others are going to be in that same position where just one year of feeling good about high-single digit or low-double digit rates in certain lines primarily specialty isn't going to cut it and it's going to require a multiyear approach.

Q - Amit Kumar {BIO 15025799 <GO>}

Got it. The only other question is on the last call, I guess we had fine tuned Navigators a bit and Chris on that call, you had said 0.10-ish [ph] was sort of the number for 2020. Are we still in the ballpark or based on what is evolved or we are somewhere in the middle or not?

A - Chris Swift {BIO 3683719 <GO>}

Yeah. Obviously, we are not going to give you any really specific details but the ranges that we put out. I still think are valid, as I said I'd anchor in the low end of that range. And I'm not changing our views right now at this point in time.

Q - Amit Kumar {BIO 15025799 <GO>}

Got it. Thanks for the answers and congrats on the print [ph].

Operator

Next, we have Gary Ransom of Dowling & Partners.

Q - Gary Ransom {BIO 3446828 <GO>}

Good morning. Yes. Most of my questions have been answered, but I did want to follow up on the new Spectrum policy. And I wondered specifically whether the, there's a little bit of leapfrogging going on with other competitors in their own system. Can you actually detect when someone else has something, and a new strong offering and see a little bit of lowering of your quote volume, then you put something out, you see a little bit of higher. And if you do, does that last for a while, does that have some duration? I'm just trying to get a sense of the growth components and how this might play out?

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A - Doug Elliot {BIO 3700927 <GO>}

Thanks, Gary. We do watch all of those statistics carefully. So we're able to watch quote volume, we're able to watch yield. So the number of hits or successful quotes against total quotes. I would say relative to competitors rollout, we watch what they've put out publicly. And normally there is a little bit of a buzz or discussion about enhancements or innovations in the marketplace, I'm sure, very similar to what's happening with our next-generation Spectrum offering right now. I think that's the easier way to find out about things but we study the numbers we're mindful of even the statistics I quoted in my script, right. We're watching optional purchase, optional coverage purchases right now, we're watching number of quotes and we have an expected trajectory that we expect to see over the next three quarters or four quarters, and so we'll be right on top of that.

Q - Gary Ransom {BIO 3446828 <GO>}

Is this something that will roll out to all the renewals or is it just something for new business.

A - Doug Elliot {BIO 3700927 <GO>}

Yeah. We're quoting new business right now As I said, we're in mid-30s states and by year end, we expect to be essentially 45 and then we'll deal with the last couple of states next year, but new business think Gary today.

Q - Gary Ransom {BIO 3446828 <GO>}

Okay. All right. Thank you very much.

A - Chris Swift {BIO 3683719 <GO>}

Thank you.

Operator

The next question we have will come from Yaron Kinar of Goldman Sachs.

Q - Yaron Kinar {BIO 17146197 <GO>}

Hi. Good morning, everybody. I want to start with one on the reserve development and in commercial lines, then sneak in another one on the Group Benefits. So with the reserve development, I think in recent years we've seen kind of initial loss picks in both general liability and commercial auto come in a bit below most recent picks for our prior years. Can you maybe talk about that dynamic and how comfortable you are with your picks for the more recent years considering the fact that you have been increasing the initial loss picks there? And is it just pricing that you've achieved that's offset some of the weaker picks in prior years?

A - Doug Elliot {BIO 3700927 <GO>}

Let me start and then Beth can work over the top. I would say over the past six plus years, we've been working both pricing and underwriting. So we've been adjusting our offerings

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across the marketplace in classes, monoline, group with other accounts, et cetera. So multiple different options that we've been working. In general, I would agree with you that we have been light on our Axiom picks at 12 months, which is the reason that if you look at our trend line, we've made adjustments to those prior year picks over the last six years, seven years. And I think we do a nice job of disclosing that in our supplement. So the disappointment is that loss trend obviously has been higher than we expected and we didn't get the punch that we expected on the underwriting side, and so we're doubling down now, I think we continue to make progress.

Again I'd separate some of this discussion by class of vehicle, whether we're talking small commercial with primarily private passenger and light-vans or middle mark with some heavier or the specialty area. And I think that our success or lack thereof is not very different than the overall marketplace. But what we've tried to do is when we see something in the book, we've addressed it both on our reserve levels and also on the underwriting and that's why I don't think there is anything new here. It's just -- we just need to dive even harder, Beth?

A - Beth Costello {BIO 15349374 <GO>}

No, I think that summarizes it very well, Doug.

Q - Yaron Kinar {BIO 17146197 <GO>}

Okay. Thanks. And then on the Group Benefits side, is the experience and claims recoveries that you've seen for recent vintage as you expect that to kind continue -- is that baked into your estimates today or do you expect some reversion that to me?

A - Chris Swift {BIO 3683719 <GO>}

Yeah. I would say beyond that obviously we update our statistics in views periodically that's what we did this quarter. So that reflects our best views of trends going forward that in essence, we priced product on and book reserves on. So it is our best thinking from here. Now, we've always talked about it changes in incidents and/or recoveries is somewhat employment centric related. So as long as we don't have any big shocks into the system, I would expect our estimates here to hold, but as I said, it's a dynamic world out there and when things change we just have to reevaluate our assumptions and we would change accordingly.

Q - Yaron Kinar {BIO 17146197 <GO>}

Got it. Thanks so much and thanks for (inaudible).

Operator

That is all the time we have for today's question-and-answer session. I would now like to turn the conference call back over to Susan Spivak for any closing remarks.

A - Susan Spivak {BIO 1514699 <GO>}

We appreciate all of you joining us as well as your questions, please do not hesitate to reach out, if you have any follow-up. And if we didn't get to your question within the time period, I'm available, so please just give me a call. Thank you.

Operator

The conference call is now concluded. We thank you all for attending today's presentation. At this time, you may disconnect your lines. Thank you again everyone.

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