Company Name: Hartford Financial
Company Ticker: HIG US
Date: 2017-07-28
Event Description: Q2 2017 Earnings Call

Market Cap: 19,925.39
Current PX: 54.695
YTD Change($): +7.045
YTD Change(%): +14.785

Bloomberg Estimates - EPS
Current Quarter: 1.039
Current Year: 4.234
Bloomberg Estimates - Sales
Current Quarter: 4684.333
Current Year: 18468.333

Q2 2017 Earnings Call

Company Participants

- Sabra Rose Purtill
- Christopher J. Swift
- Douglas G. Elliot
- Beth Ann Bombara

Other Participants

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

MANAGEMENT DISCUSSION SECTION

Sabra Rose Purtill

GAAP and Non-GAAP Financial Measures

Our commentary today includes non-GAAP financial measures

Explanations and reconciliations of these measures to the comparable GAAP measure are included in our SEC filings as well as in the news release and the financial supplement

Christopher J. Swift

Business Highlights

Capital

- The Hartford's second quarter core earnings increased significantly over the prior year
- Each business segment contributed to the results with clear progress in personal auto, solid investment returns including favorable limited partnership results
- Capital generation remains strong, and we returned over $800mm to shareholders in H1 including share repurchases and dividends, while repaying $416mm of debt

- Performance over the past year increased core earnings ROE to 9.3%, or 11.3% excluding Talcott Resolution

Auto Book

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

Profitability

- With improved profitability, we will increase marketing spend in H2 2017 in selected areas to begin growing new business again
- Our 30-plus-year relationship with AARP remains strong, and we working in close partnership as we transition to growth

Commercial Lines

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

Middle Market

- The middle market underlying combined ratio was 94.9, a 3-point deterioration mainly due to several large property losses occurring late in Q2
- The competitive environment in middle market remains challenging for both new and renewal business, which is likely to persist in H2
- We will continue to prioritize disciplined risk selection and retention of our best accounts, while competing in areas where it makes sense

Voluntary Business

- Group Benefits continued to deliver excellent results
- Core earnings increased 33% to $61mm, resulting in a core earnings margin of 6.7%

- The increase in earnings reflected improved group life mortality, and better disability experience with strong persistency supporting top line growth
- The voluntary business, while still small, is building momentum with our new hospital indemnity product now approved and quoting in 44 states
- We're focused on growing this business, and are investing in new and enhanced capabilities to increase penetration with agents and brokers who specialize in this market

Mutual Funds

- Mutual Funds had another great quarter, with total assets under management reaching $108B
- In H1 2017, the segment achieved positive net flows in excess of $2.6B, with strong investment performance across the fund lineup
- I am optimistic about the continued growth of this business, with our two outstanding subadvisors, Wellington and Schroders, and our recent entry into the smart beta asset class

City of Hartford

- Before turning the call over to Doug, I'd like to make a few comments about the City of Hartford
- Currently, the city is in the midst of a significant financial crisis with its future very much tied to the actions of the State of Connecticut
- As a company founded and headquartered in Hartford for over 200 years, we remain vested in the city's future, and believe its success is vital to the state's economy and overall strength
  - While the city faces immense challenges, we believe it also holds enormous potential

Investments

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

Long-Term Solutions

- We strongly encourage elected leaders and other key stakeholders to come together to implement the long-term solutions necessary to address the financial challenges facing the city and state, and continue to cultivate Hartford as a vibrant urban center, capable of attracting critical talent of the future
- In closing, I am proud of the strong financial results we delivered this quarter and the progress we've made in H1 2017, which put us on track to meet the outlook we provided earlier this year

Douglas G. Elliot

Q2 Highlights

Personal Lines

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

Commercial Lines

- Let me get right into Q2 details on each of our business units
- In Commercial Lines, the combined ratio was 94.6, improving 0.4 points from 2016 primarily due to lower catastrophe losses and prior-year development partially offset by slightly higher current accident year losses before catastrophes
- The underlying combined ratio for Commercial Lines was 90.9, deteriorating 1.1 points
    - This was largely driven by commercial auto, consistent with trends in first quarter 2017 and large loss volatility in middle market property

Market Conditions

- Market conditions continue to be competitive, particularly in middle market and national accounts
- And we're executing effectively to balance retention, margins and new business opportunities
- Renewal written pricing in standard Commercial Lines was 3.5%, up slightly from Q1 2017, with the highest increases continuing to come from commercial auto
- Small commercial had another strong quarter with an underlying combined ratio of 87.2
- Written premium was up 6% resulting from strong retention and $147mm of new business including $14mm from Maxum

Middle Market

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

Operating Expenses

- Overall, I believe we struck an appropriate balance between new business, pricing and underwriting quality in this competitive marketplace
- On the in-force book, we took targeted non-renewal actions on a program for service and maintenance contractors
- Excluding these actions, our retention remained solid and consistent with prior quarters
- Middle market operating expenses were also higher in the quarter as we continued to invest in the talent and technology necessary to compete in this business long term

Specialty Commercial

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

Personal Lines

- Moving to Personal Lines, Q2 combined ratio was 101.4, improving 11.2 points from a year ago. 8.9 points of the improvement was driven by a change from unfavorable prior-year development in second quarter 2016 to slightly favorable development this year
- Expenses and catastrophe losses were also lower vs. 2016
- The underlying combined ratio of 92.6 improved 1.6 points
    - This was primarily driven by improving auto trends, partially offset by homeowner results, with the homeowners underlying combined ratio for Q2 77.6 deteriorating 3.4 points vs. last year, due to higher non-catastrophe weather losses

Expense Ratio

- In Personal Lines auto, the underlying combined ratio improved to 99.1
- After adjusting second quarter 2016 for net development affecting the quarter, the 2017 auto loss ratio has improved approximately 1.3 points
- The expense ratio was also down this year by 1.1 points, due primarily to reduced new business acquisition expenses
- As a result, on an adjusted basis, the underlying combined ratio for Q2 2017 improved 2.4 points
    - This progress is right in line with our expectations, as our pricing, underwriting and agency management actions begin to earn their way into our book of business

Auto Loss Cost Trends

- Auto loss cost trends have been relatively stable and moderate in recent quarters, more in line with historical levels
- Frequency trend is essentially flat, and severity trend is in the low single digits, both improving from our experience in 2016 and 2015

YTD

- The YTD auto combined ratio was 99.1
- We expect H2 to run higher due to normal seasonality
- Importantly, we remain on track to achieve our full-year auto combined ratio outlook of 101 to 103, which included approximately 1 point for catastrophes
  - This represents 2 to 3 points of expected improvement in the underlying auto loss ratio for the full year

Marketing Spend

- Personal Lines written premium for second quarter 2017 was down 7%
- Consistent with recent quarters, our marketing spend was down vs. a year ago resulting in lower new business as we address our rate needs with added filings and improved underwriting segmentation
  - We have made substantial progress to-date
- And as we noted last quarter, we are increasing our AARP new business marketing efforts over H2
- Due to the lead times between marketing and customer conversion, we expect to see positive growth in AARP direct new business premium late in Q4

Group Benefits

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

Long-Term Core Earnings Margin

- In second quarter 2016, we experienced some volatility in our group life results with higher-than-normal severity
- Results in 2017 have been better than expected with improved group life results and favorable incidence and recovery trends in group disability
- The improvement in both lines can be attributed to our ongoing execution in underwriting, pricing and claims management as well as favorable trends relative to historical experience
  - We continue to expect the long-term core earnings margin of this business to be in the 6% range
- On the top line, second quarter fully insured ongoing premiums increased 2%
- Overall book persistency on our employer group block of business remained strong at approximately 90%, and fully insured ongoing sales were $67mm

- Although down from prior year, it was a solid sales quarter, and we're well positioned for a strong H2 the year

Property, Casualty and Group Benefit

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

Beth Ann Bombara

Financial Highlights

P&C Other Segment

- I'm going to cover our other segments, investment performance and capital management activities before taking your questions
- Our P&C Other segment had core earnings of $18mm compared with a loss of $154mm last year, which included $174mm of adverse development on an asbestos and environmental reserves
- As a reminder, in the past, our annual A&E study was completed in Q2
- After the purchase of the A&E reinsurance cover from National Indemnity last year, we moved this annual study to Q4, so there is no impact from A&E in this quarter's results

Mutual Funds

- Turning to Mutual Funds, strong net flows and market appreciation as well as the addition of the Schroders funds drove total segment AUM up 18% to $107.7B and core earnings up 20% to $24mm
- We continue to benefit from strong investment performance, with 77% of our funds beating their peers on a five-year basis
- Sales of $6.2B generated positive net flows of $1.3B in the quarter
- Through H1 2017, net inflows of $2.6B are up significantly compared with net outflows of $600mm in H1 2016

Core Earnings

- Talcott's core earnings were $80mm, down from $91mm in Q2 2016
- Over the past four quarters, VA contract counts decreased 10% and fixed annuity contracts decreased 6%
- Talcott's statutory surplus was $4.3B at quarter end
- We expect Talcott to pay $300mm dividend to the holding company in Q3 for a total of $600mm in 2017

Corporate Segment

- In the Corporate segment, we had core losses of $52mm compared with core losses of $50mm in the prior year

- Operating expenses in Q2 last year benefited from the reversal of a legal accrual, which masked the benefit over the past year of the decline in interest expense resulting from the reduction in debt

Net Loss

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

Investment Portfolio

- The investment portfolio continues to perform well with generally stable portfolio yields, strong LP returns and modest impairments
- Total LP investment income was $48mm before tax for an annualized yield of 8% compared with $40mm or 6.1% in Q2 2016
- Excluding LPs, the total before-tax annualized yield was 4.05% this quarter, compared to 4.14% in second quarter 2016

Core EPS

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

Core Earnings ROE

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

Shareholders Equity

- Turning to shareholders equity, book value per diluted share was $46.84, down slightly from a year ago
- Excluding AOCI, book value per diluted share was up 2% since June 30, 2016
- Before taking questions, I wanted to provide a quick update on capital management
- During the quarter, we repurchased $325mm of stock and through July 25, we repurchased about 1.6mm shares for $85mm for third quarter to-date

- This leaves approximately $565mm available under the $1.3B equity repurchase authorization for 2017

Conclusion

To conclude, this quarter's results demonstrate continued strong and steady operating results with consistent and disciplined execution in competitive markets

We are pleased with the continued progress in personal auto, where our results are clearly improving

And Commercial Lines, Group Benefits and Mutual Fund results remain strong, supported by top line growth

QUESTION AND ANSWER SECTION

<Q - Kai Pan>: First question is on the personal auto. It looks like you're making great progress in the turnaround. I just wonder if you're looking out any further. What's your profitability long-term target? And how quickly can you get there?

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

<Q - Kai Pan>: Okay. And then sort of like H2 higher, so in order to achieve this year's target, H2 must be higher than H1 in terms of personal auto, the core combined ratio. I just wonder, you mentioned about higher seasonality, how much is that contributing to it? And do you have any plan to increase the expense ratio as you try to grow your business again?

<A - Douglas G. Elliot>: Kai, yeah, let me try to take each of the pieces a little bit separate. So, traditionally, seasonality has impacted our auto and homeowners loss ratios, but certainly we're talking about auto now. Fourth quarter has been our most challenging weather auto quarter and we expect H2 2017 to be in line with prior years. So that's why the numbers are working as they do. And as you see, our full-year guidance you know and you can back into what H2 will look like. I think I'll leave it at that. Beth, is there anything you want to add to that?

<A - Beth Ann Bombara>: No, I'll just follow-up with a comment on the expense ratio. Yes, if we do increase, as our plan is marketing spend in H2, we would expect to see some uptick in that expense ratio. But, again, that was contemplated overall when we provided our guidance at the beginning of the year. So, as Doug said, overall, we see things performing very consistently with our expectations.

<A - Douglas G. Elliot>: And, Kai, just in closing, we expect this year on a loss ratio basis in personal auto. We're expecting 2 to 3 points of improvement. So, we haven't backed off that. H1 the year was right in line with that, and as we play out H2, we expect to achieve those targets.

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

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

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

capabilities, with enhancing digital experiences, I feel good about the path that we're on.

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

<Q - Josh D. Shanker>: Two questions, hopefully quick ones. Can we talk about the cash tax rate as opposed to the GAAP tax rate for this quarter and what the outlook is for that?

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

<Q - Josh D. Shanker>: And you expect that to persist for the next 12 months or so?

<A - Beth Ann Bombara>: Yeah. As we look at our forecast going forward, and again continuing to utilize net operating losses, but continuing to see ourselves in an AMT position, yes, that situation would continue.

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

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

On the automobile side, on a written basis, I would suggest that as we look out, we expect to continue to see, at least over the next couple of quarters, more quarters in the pricing realm written like you're seeing in June, Q2. The earned pricing is starting to catch up. So, as I think about the last four quarters, we've moved on an earned auto basis from 6 to 7 to 8 to 9, and that will approach 10 as we move into Q3. So, yes, it's catching up. And at some point, if there is a deceleration in our auto written because our rate adequacy improves, there will be a point where an earned is greater than written, but that's all math, right? And we'll see that as it comes.

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

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

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

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

<Q - Brian Meredith>: Two questions. First, Beth, I'm just curious, I think originally in your plans you were planning on taking $500mm to $600mm of dividends out of Talcott this year. I know you did, I believe, $250mm in Q1. Have you applied for the dividend or taken the dividend yet for H2?

<A - Beth Ann Bombara>: Yeah, Brian. So, we planned for $600mm of dividends from Talcott this year. We took $300mm in January. And then as I said, we anticipate taking $300mm this quarter, so sometime in August or September.

<Q - Brian Meredith>: August or September. So, have you applied for it yet? I'm just curious.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

<Q - Jay Gelb>: First question I had was on the Prudential, or the pension risk transfer deal that Hartford had with Prudential. Is there a benefit to ongoing earnings there?

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

<Q - Jay Gelb>: Okay. And then on the rating agency debt to capital, it was 25.6% in Q2, but that includes the pension liability. So, if we adjust for the pension risk transfer deal, what would the rating agency debt to capital be?

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

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

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

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

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

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

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

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

<A - Christopher J. Swift>: Ryan, what market did you?

<Q - Ryan J. Tunis>: Small commercial, the policy count number.

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

<Q - Ryan J. Tunis>: Okay.

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

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

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

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

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

<A - Douglas G. Elliot>: Good question, Elyse. No question that there are a series of compounding positive features that roll into the 2018 year and beyond. So, the rate discussion that we've had previously and also the underwriting initiatives will continue to earn their way through H2 this year and then into 2018. So, the 96.5 is the ex-X underlying. I still think it's achievable. We're working at it. And, I don't, at the moment, think that we're going to be putting on so much new business that will get in the way of achieving that target. So, we're mindful of the target. Our lean back into new business will be geographic-driven. It'll be territorial where we have better rate adequacies and we feel better about our approach. So, I would suggest to you we're going to do it in a laser-focused way that will not disrupt our path back to 96.5.

<Q - Elyse B. Greenspan>: Okay, great. And then what are you guys seeing as loss cost in Commercial Lines kind of broadly?

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

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

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

<Q - Mark Dwelle>: Just a small quick numbers kind of question. You commented that you're doing your A&E reserve in Q4 this year. How many dollars of reserves are still left that are sort of subject to that review? I would assume it's mostly E, not A, that's left to be reviewed.

<A - Beth Ann Bombara>: No, actually – and we have extensive disclosure in our 10-Qs on the various balances related to A&E, but actually, more of our reserves are A than E. And again, as we said, we will be looking to do that evaluation in Q4, but I'll just give you the page number. If you go to page 84 in our 10-Q, you can see the breakout of both asbestos and environmental reserves. And at the end of June, on a net basis, asbestos was $1.288B and environmental was $259mm.

<Q - Ian J. Gutterman>: Doug, I first want to follow-up on Elyse's question there on the auto target for next year. Is it reasonable to assume that on a written basis that, based on what you've put through so far and assuming no change in the loss trends you've seen in H1 that you shouldn't have much trouble getting to that 96.5 on an earned? Or is there still pricing you need to get from here or something else you need to execute from here to get there?

<A - Douglas G. Elliot>: You act like it's so easy to get there, Ian, right?

<Q - Ian J. Gutterman>: I said if loss trends are stable. I'm taking that one out of the equation for you.

<A - Douglas G. Elliot>: All right. So, that's a good one to take out, right? So, we're obviously assuming a baseline of loss trends. Secondly, much of the activity, the hard work, has already happened, right? So, we've got to earn in to the written activity that we now are sharing with you that you can see through Q2. And obviously, there's still a lot of work state by state to make happen. We've got rate change activity in Q3 and fourth quarter. But when we see through the plan, we're executing as we expected to, this goes back nine months ago when we built that plan. And if things continue to execute like we think they will, that target is very achievable. But, I wouldn't say without sweat, right? We're working our tails off to get to 96.5. Feel good about that, but if this were a baseball game, we're not bringing the relievers in yet, right? This is still the middle of the game.

<Q - Ian J. Gutterman>: Understood. Understood. And, again, just given the impact of written vs. earned, I assume that would suggest there should be some further improvement into 2019, even if I won't ask for a number.

<A - Douglas G. Elliot>: Yeah. Let's not ask for a number in 2019 yet.

<Q - Ian J. Gutterman>: Okay.

<A - Douglas G. Elliot>: But we will…

<Q - Ian J. Gutterman>: Yeah, okay.

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

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

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

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

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