Company Name: Hartford Financial
Company Ticker: HIG US
Date: 2018-07-27
Event Description: Q2 2018 Earnings Call

Market Cap: 18,627.04
Current PX: 51.97
YTD Change($): -4.31
YTD Change(%): -7.658

Bloomberg Estimates - EPS
Current Quarter: 1.085
Current Year: 4.631
Bloomberg Estimates - Sales
Current Quarter: 4886.000
Current Year: 19251.500

Q2 2018 Earnings Call

Company Participants

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

Other Participants

- Elyse B. Greenspan
- Thomas Gallagher
- Josh D. Shanker
- Jay A. Cohen
- Brian Meredith
- Gary Kent Ransom
- Ryan J. Tunis
- Ian J. Gutterman
- Jay Gelb
- Randy Binner

MANAGEMENT DISCUSSION SECTION

Sabra Rose Purtill

GAAP and Non-GAAP Financial Measures

Our commentary today also 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, which are also available on our website

Christopher J. Swift

Business Highlights

Core Earnings

- Second quarter marked another strong performance for The Hartford
- Core earnings were up 36%, core EPS rose 40% and book value per share excluding AOCI was up 8% since year-end 2017
- Our annualized core earnings ROE for H1 2018 was 13%
- Earnings growth came from Commercial Lines, Group Benefits and Mutual Funds, including the lower effective tax rate

- Personal Lines underlying margins continued to improve but were outweighed on the bottom line by higher catastrophe losses
- Despite higher CAT losses in H1, we remain on track to achieve our underlying margin and profitability outlook for the full year

Net Cash

- During the quarter we achieved progress on several other important goals
- First we closed the sale of Talcott on May 31, just eight weeks ago
- Net cash consideration to the holding company was about $1.5B
- In addition, we retained a 9.7% equity stake in Talcott, which is carried on our books at $164mm at June 30

Aetna Group Benefits Integration

- Second, the Aetna Group Benefits integration, about eight months underway, is proceeding well
- Given the complexity of the numerous activities involved, I am very pleased and impressed with the pace and overall progress
  - We are optimistic that we can reduce expenses by more than our original $100mm target

Group Benefit

- Aside from the integration, Group Benefit sales are off to a strong start in 2018
- H1 sales totaled $539mm, almost double from last year
- This includes $7mm of life and disability product sales to Aetna's group medical customers
- These sales are the result of our agreement with their major medical sales force to work with us and continue to market group life disability products to their customers
  - These results speak to the success of our cross-sale partnership
- We are also executing on projects across the company that are making The Hartford a customer-centric and easier company to do business with
- It's a long list, with an emphasis on technology and digital tools working in an agile environment

ICON Platform

- One example is in Small Commercial
- On our ICON platform we have increased the percent of accounts that can be quoted on the glass
- We have streamlined the underwriting process and reduced the time it takes to get a quote, which is an important competitive advantage in this market
- Another example is the expansion of our underwriting capabilities in specialty product orientation to achieve our goal of being a broader and deeper risk player

Middle Market

- In Middle Market, we have grown and added industry verticals, responding to increasing demands from agents for deeper industry underwriting expertise with a broader product suite
- This aligns with our strategy to expand account rounding with our worker's compensation policyholders who value our claims and customer service capabilities
- Examples of our focus on industry verticals include technology, a traditional strength at The Hartford, which grew premium 4.5% over the last two years
  - In addition, our construction practice has grown premiums 35% over the past four years

Energy Market

- Lastly, we entered the energy market late 2016 and over the past four quarters wrote $24mm in gross written premium
- These are just a few examples of our approach to organic business development
- Taken all together, we sustained very good momentum this quarter in all our businesses
- I am thrilled with our progress and our future potential

Dividend

- Last week we announced a 20% increase in our quarterly dividend
- This decision was based on the strong performance of our businesses, the sale of Talcott and lower tax rates, consistent with our longstanding dividend philosophy
- Last week's dividend declaration was the sixth consecutive annual increase and it will increase our dividend yield and payout ratio to be more in line with peers

Strategy

- With regard to other uses of excess capital, our philosophy has not changed
- Investing in our company remains the cornerstone of our strategy
- We want to achieve profitable organic growth, particularly where we have attractive returns and strong competitive advantages

Acquisitions

- Along those lines, acquisitions that are aligned with our long-term strategic and financial goals are a compelling use of capital
- Acquisitions can help build greater competitive advantages, add operational capabilities, and accelerate earnings growth compared with building a business from the ground up
- For example, in 2016 we acquired Maxum which allowed Small Commercial to expand into the E&S market
- In 2017, we purchased the Aetna's U.S. group life and disability book, which was a unique opportunity to expand our market position while acquiring an industry-leading claims and lead management platform

Share Repurchase Plan

- As I shared last quarter, when we assess areas of our business that could benefit from the accelerants of an acquisition, we have a focus on specialty lines and industry verticals in the commercial insurance segment that would expand our product sets in underwriting expertise
- Since the recent sale of Talcott, there has been speculation and questions about future share repurchase plans
- This is understandable as our prior capital management actions have included a large amount of debt reduction and share repurchases
  - While capital management remains a valid alternative, it is not our primary focus at this time
- Therefore, we have not authorized a new share repurchase plan
- We will continue to evaluate options that will generate long-term earnings growth at good returns

Capital Deployment

- And if we conclude that there is not an alternative option to support growth, a share buyback plan could be put into place relatively quickly
- But, as I've stated previously, we will be thoughtful and patient regarding capital deployment with our focus on creating long-term sustainable shareholder value, which is why we are maintaining the option of investing capital to expand the business

Conclusion

To wrap up my comments, The Hartford had very strong performance for H1, both financially and operationally

We are intently focused on continuing to execute on our goals and sustain our momentum through H2

I look forward to updating you on our progress over the balance of the year

Douglas G. Elliot

Q2 Highlights

Personal Lines

- This was another strong quarter in Property & Casualty and Group Benefits as we advance our key initiatives and address evolving market conditions
- Commercial Lines had a strong quarter as we continued to balance growth with competitive market conditions
- In Personal Lines, improved auto trends continued, although overall results were hampered by catastrophe losses
- And in Group Benefits, we had another excellent quarter with strong favorable trends in group disability

Property & Casualty

- Before I touch on second quarter results for each business segment, let me cover current and prior-year catastrophe losses for Property & Casualty

- In the quarter, we had $188mm of current year CAT losses, $33mm higher than a year ago driven by significant wind and hail storms in various regions across the country
- Included in prior-year development is the reduction of our estimates for prior-year catastrophes, largely attributable to hurricanes in Q3 2017

Gross Loss

- As a result of lowering these estimates, we no longer expect to receive a recovery against our aggregate catastrophe reinsurance treaty for the 2017 accident year
- The benefit from the aggregate treaty was allocated to each business unit based on our estimate of ultimate losses for the full year
  - This quarter, as you can see on page 13 of the slides, 2017 gross loss estimates decreased in both Personal Lines and Commercial Lines, causing total P&C losses to fall below the attachment point for the c
- However, the decrease in gross losses was greater in Commercial Lines than Personal Lines and, therefore, unwinding the aggregate cover resulted in net adverse development for Personal Lines

Commercial Lines

- Let me now shift into the results for our business segments
- In Commercial Lines, the combined ratio improved 4.5 points from prior year to 90.1 driven by favorable prior year development, partially offset by slightly higher current year catastrophe losses and expenses
- The prior year development was primarily due to continued favorable trends in workers' compensation and lower estimates on catastrophe reserves as I just covered, partially offset by an increase in reserves for higher hazard general liability exposures
  - This portion of our general liability book remains profitable, but we are responding to an increase in loss trends in accident years 2015 through 2017
- Trends in the remainder of our general liability book have been slightly better than our expectations

Non-CAT Property

- The underlying combined ratio for Commercial Lines, which excludes catastrophes and prior-year development, was 90, improving 0.9 of a point from last year
- The improvement was largely driven by favorable loss trends, particularly non-CAT property as well as general liability
  - This was offset by higher expenses and slight margin compression in workers' compensation

Workers' Compensation

- Let me provide a few additional thoughts on workers' compensation, touching on three important factors; frequency, severity, and rates
- First on frequency, in both Small Commercial and Middle Market, our frequency has been trending slightly higher during 2018
  - We see this as a broad-based economic-driven trend across many states and industry classes

- Keep in mind that absolute frequency is still at historical low levels and margins remain attractive, however expanding participation in the labor market often means less experienced workers are on the job, a driver of frequency

Wages and Medical Costs

- Second, on severity, we continue to closely watch inflation trends for upward pressure on both wages and medical costs, drivers of severity
- Although accident year 2018 data is immature at this point in the year, severity remains within our expectations

Cost Trends

- And third, on rates, loss costs in workers' compensation have been quite benign for several years and, as a result, the NCCI and other bureaus have been filing negative loss cost changes in many jurisdictions
- Industry rate filings are based on these loss cost trends and have put downward pressure on rates in 2018 and will likely do so in 2019

Middle Market and National Accounts

- Combining these three factors, we continue to expect some margin compression in our Small Commercial and Middle Market books of business
- Since each of these businesses has unique market dynamics for pricing and growth, our approach to successfully managing these rate changes is also dynamic
- In Middle Market and national accounts, greater weight is placed on individual risk characteristics when pricing the account
- In Small Commercial, pricing is more heavily weighted to class factors, making book management a critical tool

Pricing, Underwriting and Claims Management Initiatives

- Over the last five years, we have significantly advanced our actuarial analytics and data science capabilities to improve our ability to identify these trends and respond confidently with pricing, underwriting and claims management initiatives
- Given our strong margins and organizational capabilities, we will continue to execute a disciplined pricing and book of business management strategy in the months ahead

Renewal Written Pricing

- Moving to pricing in the quarter, I'm very pleased that our renewal written pricing in standard Commercial lines was 3.1%, up from 2.4% in Q1 the year
- As I suggested in my comments last quarter, we saw positive movement in Middle Market across property, general liability and workers' compensation with strong increases continuing to come from commercial auto
- Our pricing on standard Commercial Lines excluding workers' compensation was 5.2% in the quarter

Commercial Lines Business Units

- Looking at our Commercial Lines business units, Small Commercial had another strong quarter with an underlying combined ratio of 85.6
- Written premium was off slightly, the result of downward pressure on workers' compensation rates and competitive market conditions for both new business and renewals
- The margin improvement vs. last year was driven by non-CAT property, general liability and auto, partially offset by higher expenses

Middle Market

- In Middle Market, the underlying combined ratio of 94.1 improved 0.8 point from 2017 mainly due to non-CAT property and general liability
- This was partially offset by modest margin compression in workers' compensation and higher expenses
- Written premium was up 3% over last year with new business production of $138mm

Specialty Commercial

- And in Specialty Commercial, the underlying combined ratio of 98.5 deteriorated 2.6 points
- This was driven mainly by higher expenses and margin compression in national accounts and financial products
- Written premium was up 9% for the quarter reflecting strong growth in bond and financial products

Personal Lines

- Moving to Personal Lines, the underlying combined ratio of 90.4 improved 2.2 points from a year ago driven primarily by improvement in auto and to a lesser degree better homeowners performance
- The underlying combined ratio in personal auto improved 2.6 points to 96.5
- We continue to experience relatively stable loss cost trends and we are satisfied with our bottom line performance
- Personal Lines premium was down 7%
- Consistent with my comments in recent quarters, our marketing spend continues to accelerate and we're focused on driving new business growth

AARP Direct Auto

- In AARP Direct auto, our bellwether line, new business was up 19% in the quarter
- This is an encouraging result as we focus on growth through new business and improved retention
- We're implementing additional product and process changes throughout the remainder of the year that I expect will continue to improve our top line trends

Group Benefits

- Turning to Group Benefits, we had another excellent quarter with core earnings of $104mm and a margin of 6.9%

- Drivers were similar to last quarter, including favorable disability results, lower tax rates, and the contribution from our 2017 acquisition partially offset by slightly higher life mortality
- Persistency on our employer group block of business remains strong at approximately 90% and fully insured ongoing sales of $85mm were up from prior year
    - This was a solid sales quarter and we're pleased with our traction in the market

Aetna Group Life and Disability Business

- Our integration of the Aetna group life and disability business remains on track and is picking up momentum
- We began converting small case business to our current platform this month and we will ramp up those efforts throughout the year
- The new disability claim platform, now branded The Hartford Ability Advantage, is expected to come online for new cases effective in 2019
- As Chris noted in his comments, our expense reduction efforts are on track and as our business conversion process continues in 2019 and 2020, we are confident that we will be able to exceed our original savings target

Summary

In summary, this was another strong quarter for our Property & Casualty and Group Benefits businesses

At the halfway point for 2018, I'm pleased with our execution and our performance

We're responding to loss cost trends with appropriate pricing action and disciplined underwriting

- We continue to innovate in all areas of our business to deliver a superior customer experience

And we're committed to becoming a more relevant partner for our agents and brokers with an expanded product portfolio to better meet customer needs and deliver profitable growth to The Hartford

Beth Ann Bombara

Financial Highlights

Investments

- My comments today will cover second quarter results for the investment portfolio, mutual funds and corporate, impacts on the quarter from the sale of Talcott and June 30 book value and debt leverage before taking your questions
- Starting with investments, net investment income performance and yields remain steady
- Pre-tax limited partnership investment income was flat with the prior-year at $39mm for an annualized return of 9.5% in second quarter 2018
- Excluding LPs, the annualized portfolio yield before tax was 3.7%, down slightly from 3.8% in second quarter 2017 due to the impact of the Group Benefits acquisition

P&C Yield

- The P&C yield was flat y-over-y at 3.8%
- Consistent with Q1, the yield on the consolidated Group Benefits investment portfolio is lower than last year because acquisition accounting rules require that the acquired portfolio is marked to market
- As a result, the annualized yield before tax excluding LPs and Group Benefits was 4.3% in third quarter 2017 before the acquisition but dropped to 3.7% in Q4
    - This quarter the Group Benefits annualized portfolio yield was 3.9%, up slightly from first quarter 2018
- This is a result of our reinvestment of the acquired portfolio towards our target sector allocation with less municipal bond exposure resulting in a higher pre-tax yield
- Investment credit performance remained excellent this quarter with no net impairments due to a generally benign credit environment and the credit strength and diversification of our portfolio

Mutual Funds

- Turning to Mutual Funds, second quarter core earnings were $38mm up 58% from last year due to the combination of lower tax rates and higher AUM from positive net flows and higher market values
- Income before taxes rose 21% as a result of the operating leverage in our operations with a 6% increase in revenues but only a 3% increase in expenses
- AUM growth is due to net flows which totaled $1.9B over the last four quarters and changes in market value which totaled $8.2B.

ETP Business

- Our ETP business drove $500mm of net flows over the last four quarters
- Hartford Funds' strong performance is driving the positive net flows with 61% and 66% of funds beating their peers on a three-year and five-year basis respectfully (sic) [respectively (00:22:36)
- Corporate core losses totaled $76mm, higher than first quarter 2018 due principally to a tax true-up for the reallocation from the business segments to Corporate for the impact of non-deductible executive compensation

Net Income

- Income from discontinued operations was $148mm, up from $112mm in second quarter 2017
- In second quarter 2017, this represented Talcott's net income for the quarter
- In contrast, in this quarter, about 90% of the income reflected an increase in our estimate of the retained tax benefits from Talcott due to a change in our estimate of Talcott's tax basis
    - This change increases our estimate of the value of retained tax benefits to about $830mm

Corporate Segment

- Going forward, other revenue will include the return on our investment in Talcott, which will be included in core earnings and in the Corporate segment along with other Talcott impacts
- The other impacts include, beginning this quarter, income from investment management and transition services, as well as the related operating expenses

- The amounts recorded this quarter reflect one month of activity and did not have a significant impact on the Corporate bottom line
  - We expect transition services and stranded costs to decrease over the next 12 to 18 months

Core Earnings

- In total, The Hartford second quarter core earnings were $412mm, up from $303mm in second quarter 2017, due to higher Commercial Lines, Group Benefits, and Mutual Funds earnings before tax, as well as a lower federal income tax rate
- The effective tax rate on income from continuing operations was 19% in the quarter, compared with 18% in Q1 2018, due to the slightly higher proportion of income from underwriting results and taxable investment income as all income other than municipal bond interest is taxed at 21%

Book Value per Share

- Book value per diluted share at June 30, 2018 was $34.44, a 7% decrease from December 31, 2017
- The after-tax unrealized gain on our fixed maturity portfolio at June 30, 2018, was $211mm, down from $1.8B at December 31
  - This decrease was due to the Talcott sale and the reduction in the market value of our fixed maturity portfolio due to higher rates and wider credit spreads
- Book value per share excluding AOCI was $38.15, an increase of 8% from December 31, 2017, reflecting the increase in retained earnings as a result of net income in excess of dividends for the first six months of the year
- The core earnings ROE was 8.4%, calculated using rolling four quarter earnings and average stockholders' equity since June 30, 2017
- On an annualized YTD basis, core earnings ROE was 13%, which was above our outlook for the year

Debt Leverage

- Turning to our debt leverage, in June we called at par $500mm in junior subordinated debt, reducing our total debt outstanding by $323mm since year-end 2017
- Despite the repayment of debt and strong earnings, our rating agency debt to total capital ratio of about 30% was flat with March 31, due to the inclusion of AOCI in this calculation

AOCI

- Over the long-term, our focus is to reduce the rating agency adjusted debt to total capital ratio to the low to mid 20s
- However, since it includes the favorable or unfavorable impact of AOCI, this ratio can be volatile during periods of changing interest rates
- So we also focus on the total leverage ratio, which is calculated by dividing total debt, including hybrids and preferreds at par, by total debt and capital excluding AOCI
- At June 30 our total leverage ratio was 25%, which is still at the high end of our long-term goal
  - We continue to focus on decreasing this ratio over time

Conclusion

To conclude, we remain on a very good path in 2018, with strong underwriting and investment results and success in both closing the sale of Talcott and the continued integration of the Group Benefits acquisition

QUESTION AND ANSWER SECTION

<Q - Elyse B. Greenspan>: My first question, in terms of the Commercial Lines margin, pretty strong improvement this quarter. I was hoping we can get a little bit more color – if you can break down how much you saw coming from favorable non-CAT property, also from liability, and then also from the auto, the three things you called out in the press release. If you could just give us a sense of the contribution from each?

And then is the 90BPS of improvement, just based off of how you see the rating environment and what's going on in comp, is that the right level we should think about in Commercial going forward?

<A - Douglas G. Elliot>: Elyse, good morning. This is Doug. Let me try to tackle both of them separately. When I look across our markets, as I mentioned, both small and middle had excellent non-CAT property quarters, and small about a point better quarter-to-quarter, and middle a couple of points, 2.5 points better, so significant drivers of positive performance. Small on the workers' comp side, about our expectations, and I mentioned that just slightly – we made an adjustment to our workers' comp in middle, a small amount. So when I look across, I feel good about all the non-comp lines. In middle we made an adjustment in comp. And all-in, a very, very solid quarter for Commercial Lines relative to combined ratios.

Can you repeat the other question a little bit more?

<Q - Elyse B. Greenspan>: Yeah, I guess I was just trying to think about going forward, is kind of the 90BPS of underlying margin improvement you saw in Commercial Lines this quarter, is that the right level we should be thinking about? Or maybe adjust a little bit just for the favorable non-CAT weather in the quarter?

<A - Christopher J. Swift>: Well, first off, I think that the improvement of 90BPS was a terrific quarter. And so I'd love to think we could outperform like that going forward, but that is – that will take experience and the next couple of months for us to be able to determine that. I am suggesting that we're seeing a little bit of turn in our frequency in the workers' comp line, so we expect to see some compression there because rates are moving in one direction and frequency is moving the other. So we're watching carefully what that means to our book of business, and we'll take appropriate actions going forward. But, as you know, there are headwinds on the pricing side in workers' comp because those loss cost trends over the last several years are so favorable that they're dropping in state by state to the pricing algorithms. And so we're making adjustments as appropriate there. So, feel great about our improvement in the quarter. Love to think we can continue it. But that's going to take some time for us to show that through the P&L.

<Q - Elyse B. Greenspan>: Okay. Great. And then on the capital side, so I appreciate the disclosure about how you guys are now evaluating M&A, as well as capital return. I guess I also was wondering how you guys also think about managing down your leverage. Pro forma for the debt maturity that comes due early next year, your leverage is probably still running in the high 20s. So how does managing down your leverage balanced against if you end up with excess capital and how you're thinking about potential for buybacks?

<A - Beth Ann Bombara>: Yeah, great question. So, as we talked about before, we do have maturing debt, as you pointed out, at the beginning of 2019, which our current intention would be to pay that down. And when we look at that combined with just the earnings power of our businesses, we believe that puts us on a very good track as we think about managing that ratio down. So I think we've done a good job in the past of using maturing debt – the opportunity for that without having to pay a large premium to reduce our debt outstanding. And I'd say just we'll continue on that path.

<Q - Thomas Gallagher>: First question, Chris, just on the capital management commentary you made, does the priority of M&A over buybacks suggest that you see current attractive opportunities in M&A? Or is that more of a medium term comment, that you'll patiently look for opportunities and like to build a bigger capital position while you wait for those opportunities?

<A - Christopher J. Swift>: Yeah, thanks, Tom. Again, we're just talking about things that we've talked about before. So I would say, again, from the building the business, investing in our business, looking at acquisition opportunities, I mean, that's been our consistent philosophy for a number of years now, so I'm not signaling any change one way or other, it's just sort of our playbook of priorities that we would go down and explore. And, as I said in my prepared remarks, if we can't find a good use for our excess capital, we're more than comfortable in returning it to shareholders.

<Q - Thomas Gallagher>: Got you. So really no change, just consistent with getting maybe to a bigger level of excess before you'd consider using it for alternatives, like buybacks?

<A - Christopher J. Swift>: Yeah, I'm not going to try to sort of size the level of capital here. I mean we just closed Talcott. We've gotten excess capital. You've heard Beth just comment about what we want to do with debt. We're comfortable where we are right now and giving ourselves a little time. I mean, it's not – we're not looking for years and years and years here. We just want the option and the flexibility to explore using our capital to invest in businesses and/or new revenue streams.

<Q - Thomas Gallagher>: Got it. And then just a question on Group Benefits. From the disclosure in your Q it looks like you had another good quarter of very favorable prior-year development. By our estimate, it's more than half of the earnings for that segment. Now, you've been having that favorable development for several years now, so it doesn't appear to be a one-timer, seems pretty sustainable. So my question is, should we think about most of that development being recent in accident year releases or is a lot of that coming from recoveries of older accident years? Can you provide some perspective on how that – where that's coming from and then maybe the sustainability of it?

<A - Beth Ann Bombara>: Yeah, sure, it's Beth, I'll take that. So, again, on the Group side and specifically on the disability side, as we look at our trends, we have been seeing favorable trends, more so in the more recent years, as those exposures develop. I think in the disability block, it's important to remember that there's a lag in the timing of when someone goes on disability and then when they actually end up on long-term disability. So, we peg those lines and then look at how the development comes in over time. And our incidence rates and our recoveries on all those fronts have been very favorable. It's hard to predict, obviously, going forward, but we're very happy with the trends that we've been seeing as we kind of go into H2 this year.

<Q - Josh D. Shanker>: I don't know if I'm going to get a better answer than the prepared remarks, but you talked about being more confident about the cost savings associated with the Aetna transaction. You were formerly at $100mm. I look at about $400mm of run rate expenses coming with Aetna. Can you sort of break out what's in that $400mm and why we couldn't expect half of it to go down, or how we should think about that?

<A - Christopher J. Swift>: Hey, Josh, let me just provide an opening commentary and then we could add additional color. I mean, we're – as I said, in essence, eight, nine months [ph] since the Aetna (00:36:18) integration, we feel very good about the integration both from an operational side, a go-to-market sales force side, customer retention side. And all we're signaling right now is that our nine-month indication is that we, most likely, will outperform our $100mm target over a longer period of time.

And if you remember, why we say a longer period of time is we're timing the conversion of a lot of these policies and books of business from Aetna paper to our paper over a two-year period of time so that we don't disrupt that customer base. We just completed installing their claims system on our technology and our hardware here, so the real conversion process just begins. So it is a little longer term than maybe a typical integration activity, given we're dealing with three-year rate guarantees and moving the entire administration platform into our network and our capabilities right now. But I look to – Doug, if you want to provide any additional commentary, Doug.

<A - Douglas G. Elliot>: I think, Chris, that's a really good baseline. Josh, the number I have in my head for the Aetna baseline on cost is roughly $330mm. So when I think about $100mm or $100 million-plus, pretty significant change. In addition, what Chris said relative to us moving accounts, we are being very careful trying not to disturb relationships of account managers and account executives on key Aetna renewals. So this is a multi-year process that I think we are very pleased about the initial nine months, but it is a several-year effort. And as we move through that period of time, I know we're going to find opportunities to be more effective and efficient in operations and we'll capitalize on those.

<Q - Josh D. Shanker>: And look, there's always numbers. You gave a good detail on what's going on in workers' comp. You took down reserves there, but you took up your accident year pick, and then on GL you added to reserves and then took down your accident year pick. I'm just sort of wondering how past information is different from what you're doing on the current accident year?

<A - Douglas G. Elliot>: Yeah. Really good question. So let me attack both comp and GL separately. When we think about our comp book of business and our reserves that we currently carry, we feel very good about the adequacy of our reserves. And, in fact, this quarter we did release some of those prior year reserves, primarily accident years 2014 and 2015. But our position on the balance sheet is very solid, and we feel good about.

When we're talking about accident year 2018, we're starting to see some headwinds and we're looking at frequency, which is a leading indicator. And so we've made an adjustment in Middle Market, but we're connecting the dots through the accident years. And I just want to point out, there's a difference between what we're carrying and what we're seeing today, so that's really what's happening in the comp world.

In the general liability world, our normal GL book is performing according to our expectations. What we did in the quarter, we have a specialized high-hazard, heavy products group in Middle Market, and that is the book that we saw some increase in both frequency and severity in older accident years. So we took action to strengthen those years. That was our high hazard book. I want to differentiate that from what we're seeing in our normal go-forward GL book, and there we continue to watch but feel pretty good about current conditions.

<Q - Jay A. Cohen>: A couple of questions. First is the Commercial insurance expense ratio, that did tick up. I understand on the Personal Lines side, you're spending more from a marketing standpoint. What's driving the higher expense ratio on the Commercial side?

<A - Christopher J. Swift>: Jay, I'm looking at Doug, he'll add his commentary, but I would just say we continue to invest in our infrastructure technology and digital experience for the customer. So, yeah, it is elevated from trends over the years. But, again, it's a conscious part of our strategy. I would say particularly from the Commercial Lines capability side, we're probably 60%, 70% through some of the core systems that we want to replace.

And I would say the other – there are always true-ups from quarter-to-quarter on commissions, whether it, in essence, be profit-sharing or anything else commission-wise. So, Doug, that's what I would say. But what would you add?

<A - Douglas G. Elliot>: Yeah, that's a large piece and there's a little bit of compensation in there, Chris, as well. So, as we look at plans and we look at performance through six months, just some true-ups that we normally do, but IT is a driver, and are continued to invest inside our businesses.

<Q - Jay A. Cohen>: Got it. Makes sense. The other question, on M&A, without issuing stock and given your leverage, can you give us a sense of how big a deal, in dollars, you could do at this point?

<A - Christopher J. Swift>: [ph] I mean, as you say, yeah (00:41:46), at this point – and really, Jay, I'm going to sort of probably disappoint you a little bit and refrain really from a lot of speculation here, because it just doesn't do anyone any good, but I think the metrics that we've talked about in the past really are in the premium range. Sort of $2B premium company is still accurate as a target as a bolt-on. So that's what we define. So that's what I would just say right now, is that we're still in that bolt-on category, and that's what I would leave you with.

<Q - Brian Meredith>: So a couple questions here. Chris, just quickly, back on the whole M&A thing, can you remind us how you think about GAAP earnings accretion when you balance M&A vs. share buyback?

<A - Christopher J. Swift>: Happy to, Brian. Again, we tried to address it in an early-on question.

<Q - Brian Meredith>: Yeah.

<A - Christopher J. Swift>: It's part of the equation, on the metrics, on timeframes, payback periods, IRRs, returns on tangible, intangible capital, so we look at it all. And I'm not going to tell you there's a hard and fast rule, but we do want to earn acceptable returns, as we always define it, above our cost of equity capital, in a relatively near term. And we define that term somewhere in the three to four year period of time. So that's what I would say right now.

<Q - Brian Meredith>: Great, thanks for that. And then I'm just curious, looking at your small commercial business. Policy count retention has continued to kind of slip for the last, call it, year and a half to two years. What's going on there and what are you guys doing to maybe improve that policy count retention?

<A - Douglas G. Elliot>: Brian, we certainly focused on both the retention and the new. There's a little bit of pressure in the micro space. I think we've seen more entrants in the micro and the small, but there isn't anything material that I would point out that is worthy of spending a lot more time on this morning.

Overall, we've been very steady growers of this business organically over the past five years. I know in the quarter we were a little off. There's a workers' comp dynamic to it, there's competition to it. But we're being thoughtful about this business. We continue to innovate, some of the innovations that we're dropping into our platform I do expect will show progress and growth in future quarters. So, I don't look at this as the full trend for the next couple of quarters, but I do remind you that workers' comp is an important part of our small commercial platform and therefore we're going to be in a different pricing environment over the next couple of quarters than what we've seen in the prior probably two, three years.

<Q - Brian Meredith>: Got you.

<A - Christopher J. Swift>: And Brian, I would also add too, some of that trend, you're talking about policy counts and retentions influenced by the commercial auto environment broadly.

<Q - Brian Meredith>: Got you.

<A - Christopher J. Swift>: So, I mean, there's been a little bit of a – my words would be pruning of mono line commercial auto, so that's affecting those trends a little bit. And as you know, that market is still not at adequate return. So we've been very thoughtful about putting additional premiums on in that line of business.

<Q - Gary Kent Ransom>: I was going to ask for a little more detail on underlying loss trends. You did give us a little bit of a picture on workers' comp and high hazard liability lines, but I wonder if you could just give us a sense of the entire array of what you're seeing. I mean, is workers' comp the good end of the loss trends, still relatively benign? And then what's at the worse end from your perspective? Is it commercial auto, or is it some other liability line?

<A - Douglas G. Elliot>: Good morning, Gary. I would say that the reason I made mention of workers' comp is we do have full attention on this frequency dynamic. As I think across the rest of the lines in commercial, yeah, we had a little spike in our high hazard GL in our prior book, but generally, all of our other lines are still in a relatively benign low single-digit loss trend environment. So I don't think a lot has changed as we looked at the quarter and our loss performance relative to trends, and I spoke about the line that we saw some degree of change in workers' comp.

<Q - Gary Kent Ransom>: Yeah. So there's a lot of talk about inflation, not just you, but other companies as well, and yet it doesn't really seem to be showing up in the numbers. Everyone's concerned about it, but it's not quite there yet. Is that something you're able to respond to realistically? If you have the concern of inflation, can you raise rates in small commercial? Or is that part of what's – competitive activity is not allowing you to do that?

<A - Douglas G. Elliot>: Well, I shared our ex-comp pricing in the quarter at 5% plus and feel very good about that, and I feel good about the small commercial component of that, and the Middle Market. So we've been working at not only comp but the other elements of our book of business from a pricing perspective over time. And I think our performance demonstrates the progress of that pricing. Yeah, it is a competitive marketplace, but the quarter we just punched, I feel really good about. I think in terms of absolute performance, a very strong quarter, Gary, and I would say we've been able to price for what we've seen in the marketplace relative to the trend successfully over the last couple of years.

<Q - Gary Kent Ransom>: No doubt today was a great day, but I'm always thinking about tomorrow and what comes next.

<A - Douglas G. Elliot>: I know, so are we.

<A - Beth Ann Bombara>: So are we.

<Q - Gary Kent Ransom>: But thank you very much.

<Q - Ryan J. Tunis>: Just a couple, I guess, follow-ups on workers' comp for Doug. I guess I'm sort of just thinking about the commentary on accident year margin pressure in workers' comp being a function of a few things, is it safe to say, though, it's still mostly the fact that pricing just isn't as good? That's probably the biggest reason why you're talking about the margin headwinds there?

<A - Douglas G. Elliot>: Well, I would say that in 2018, the biggest reason is really twofold. One is, yes, we're watching these loss costs drop in and we're dealing with the state-by-state dynamics of where our loss experience is and what to do about our multiplier in these various states, So that's point A.

Point B is that we've got a bit of an inflection on frequency that we're watching very carefully. So two quarters don't make a full trend, but we've had a couple of quarters now of positive frequency, and that's the first time we've seen that in several years. So there's full attention on what our own book of business is telling us relative to signals in frequency.

As I mentioned, the severity signals look well within our expectation, so we're watching severity, both medical and indemnity, but feel pretty good about that. Just looking at the combination of both pricing and frequency, we are very focused on choices and options in front of us relative to workers' compensation.

<Q - Ryan J. Tunis>: Got it, and so you've seen a couple quarters of positive frequency. Should I take that to mean that – I guess you're assuming in your new loss picks that there's positive frequency in workers' comp?

<A - Douglas G. Elliot>: So I don't want to spend too much time talking about reserving process. But, in general, we're looking at earn patterns, we use historical and we bring in current year, both severity and frequency, as appropriate. So, the reason we adjusted Middle is that we're trying to make sure we're recognizing what we're seeing in our patterns in the first two accident quarters of 2018, and in the Middle we're seeing a pickup greater than we expected, which is why we adjusted our reserves. We'll have to continue to assess what third quarter and fourth quarter bring. But at the moment, we made adjustments based on everything we could see in our book of business to make sure we closed up second quarter where we should have been from a loss ratio perspective.

<Q - Ryan J. Tunis>: Got it. And then, I guess, the last one I had was just thinking about some of the favorable results in the other casualty lines this quarter, like general liability, commercial auto. And I remember you guys adding the reserves in those areas in, I think, call it, 2014, 2015, at one point that was sort of a headwind. Is there a reason those results are getting better, because you're finding out now that some of the things that you saw back then didn't end up being quite as negative or is there something else driving that?

<A - Douglas G. Elliot>: There are probably lots of things driving that. I think our behavior and our discipline in the marketplace starts that discussion. I think we've become a very solid, thoughtful underwriter, using both skill sets at desk level and also data analytics. So, I start there.

Secondly, I think with Beth and Chris, over the last, seven, eight years, we've worked hard to be disciplined on reserving to bring forward to be more current as we're looking at data. So I think our entire reserving process is much stronger today than it was over the last 10 years.

Putting all that together, we're also trying to be very consistent in our approach quarter-to-quarter. And the reflections of all those behaviors, I think lead us to feel much better about our balance sheet today than we probably did seven years ago.

<Q - Ian J. Gutterman>: Beth, can we start out, just if I recall from the Q, we have $2.3B at the holdco now. Can we just walk through what's left to come, as far as [ph] stack (00:52:31) dividends in H2 vs. the first? I know what you're talking about for the year, but I don't know what's been taken already vs. what's left to come.

<A - Beth Ann Bombara>: Sure. So, again, I'll remind you that with some of the actions that we did at the end of last year with the Aetna acquisition, that really decreased our dividend capacity for 2018. So we are not expecting dividends from P&C or Group Benefits in H2 this year. We would expect to see a modest amount from Mutual Funds. But for the most part, there's not additional dividends coming in from the subsidiaries in H2 this year. And for P&C, because some of the Talcott proceeds actually went through various legal entities to get to the holding company, our dividend capacity for ordinary dividends in P&C really probably for the most part won't be there until H2 2019.

<Q - Ian J. Gutterman>: Got it. And then do we have any tax-sharing payments coming in H2, or did those all coming in H1?

<A - Beth Ann Bombara>: Yeah, so, a little bit. I mean, obviously that will dependent upon actual taxable income forecasts for H2. But based on our current estimates, I'd anticipate probably another $150mm maybe will come in, in H2 2018 to the holding company. Again, that can bounce around just based on actual results. And then we've also in the past highlighted the fact that we will – we do anticipate a refund coming in in 2019 for our AMT credits. And that will come in when we file our tax return, which could be as late as September of 2019.

<Q - Ian J. Gutterman>: Okay, I was going to ask about that one too. So, if I take the tax sharing minus the corporate dividends, would suggest you end the year somewhere around the $2.3B you're at right now at the holdco?

<A - Beth Ann Bombara>: Yeah, it could be a little bit less than that depending on other corporate actions – I'm sorry, I hit my mic off by mistake – yeah, maybe a little bit less than that depending on other things we that might do relative to contributions to our pension plan that we make usually in Q3. But I'd expect to be roughly about $2B.

<Q - Ian J. Gutterman>: Got it. Okay. And that's without the AMT, because that doesn't hit cash until 2019?

<A - Beth Ann Bombara>: Right, that would not be in the 2018 numbers.

<Q - Ian J. Gutterman>: Perfect, okay. So, Chris, I guess I was hoping you could talk a little bit more, I know you've already commented, but on the capital side, I guess I don't understand the harm in putting an authorization out there even – you don't have to necessarily commit to using it tomorrow, but let's just say what happened with Facebook yesterday, or the President does something or whatever and the market's down 20% in the next three months. Wouldn't you want to have an authorization out there? I mean, why not have it out there as an option? Just because you put one out there doesn't say you have to use the whole thing?

<A - Christopher J. Swift>: Yeah, thanks, Ian. I understand your point of view, I do. And you communicated clearly. I guess the simplest way I can explain it is given our real intention – and I understand different scenarios that you just pointed out, but I wanted to be as crystal clear as possible that we weren't going to be buying shares, and we wanted time to continue to deploy that capital into revenue streams, if possible. Didn't want to create any confusion. So that's the simplest way as I could say it. And I didn't really want to signal that we were going to be in in the market. And you did the math on the holdco. We're not sitting on a lot of excess capital today. It does build over time. So as we sit here, here and now, and project in the near-term, Ian, I just didn't want to confuse anyone.

<Q - Ian J. Gutterman>: No, that's fair. I guess the one thing I'd push back on a little bit is that you don't have a lot of excess capital today. I mean, it's a significant part of your market cap, right? And you could do another Aetna and still be fine, and then have healthy dividends for 2019, plus AMT, plus tax-sharing, right? I mean, certainly, when we project to the end of 2019, you get to some pretty significant numbers. So, I mean, can you give us a sense of timetable? Is this something every quarter we should expect another update on whether there will be a change? Or we're going to – maybe you won't address it again until you give guidance for 2019? Or sort of when should we expect another update, is maybe the best way to ask it?

<A - Christopher J. Swift>: Well, as you pointed out, I mean, the end of 2019 is six quarters away. We'll have a lot of opportunities to communicate and interact and keep you posted. As you know, I think we're very transparent. So all I would ask you to be is patient and we'll keep you posted.

<Q - Jay Gelb>: I will not ask about buybacks, how about that? First, on pace of reserve releases, it's five consecutive quarters that Hartford's been able to put up overall reserve releases. Is this something you think we should start baking in on a go-forward basis?

<A - Beth Ann Bombara>: So, Jay, it's Beth. I mean – and we've said this before, I mean we evaluate our reserves every quarter and we make adjustments accordingly. We don't predict whether or not there will be future reserve releases. We've been very pleased with the underlying trends that we've seen, and we'll just continue to evaluate it every quarter line by line, which is what we do, and give you the transparency as to where we're seeing either improvements or areas that we need to add.

<Q - Jay Gelb>: I see, okay. And then broadly on asbestos, with the new talc-related exposure for J&J, just trying to think about how that might affect Hartford, if there were some old occurrence liability policies out there from decades ago. I know the company typically does its annual review in Q4 and it does have the adverse development cover in place with Berkshire, but just wanted to get any broad thoughts you might have on talc-related exposure. Thanks.

<A - Beth Ann Bombara>: Sure. So a couple things. I'm sure it won't surprise you to know that we have a team that is constantly looking at emerging tort issues and the alleged connection between talc and ovarian cancer has been on our radar for quite some time. And we take into consideration all the facts that we know as we evaluate our reserves and overall feel very good about where our reserves stand.

As it relates to our adverse coverage, one thing that I will point out, we do have the adverse cover with Berkshire, but specifically alleged connections between talc and ovarian cancer and exposure there is specifically excluded from that cover. And we obviously take that into – we take -

<Q - Jay Gelb>: Why is that?

<A - Beth Ann Bombara>: Pardon me?

<Q - Jay Gelb>: Sorry to cut you off. Why is that? Why would it have been excluded?

<A - Beth Ann Bombara>: That was part of the contract and what we negotiated. So that was specifically excluded.

<Q - Jay Gelb>: All right. So I guess I can imply it was known about at that time, when the deal -

<A - Beth Ann Bombara>: Known that we excluded it?

<Q - Jay Gelb>: Known that it was a potential exposure?

<A - Beth Ann Bombara>: Yes.

<A - Christopher J. Swift>: Jay, as Beth said, we've been following this. I mean, we have a world-class claims team and particularly a mass tort team. So a lot of these things aren't new to us. And we've been on it for a while.

<Q - Jay Gelb>: Appreciate that. Thanks.

<A - Sabra Rose Purtill>: Thanks. I would note we're coming up on the hour and we've got a number of other people still in the queue. So, Dan, we'll take one more question now and then I can follow up with everyone else in the queue after the call.

<Q - Randy Binner>: Yeah, I just had a couple follow-ups real quick. Did you cover specifically on commercial auto where you think price vs. loss cost is now?

And then the second one on the frequency in workers' comp, I'm not sure I actually heard what it is. Is it people getting in car accidents while they're at the job or is there some kind of slip and fall thing happening out there? You alluded to less experienced workers, but if there's a thing that's actually happening that causes the frequency at work, I'd be interested in that.

<A - Douglas G. Elliot>: Okay, Randy, let me take them each separately. On the commercial auto front, we're still getting strong single-digit pricing in auto and I expect that to be on top of trend. So good news there from commercial auto. Still more work to be done, but good news in terms of where we are in the current quarter.

Relative to frequency, I suggested that we believe there's some macro factors across the industry relative to employment. And inexperienced workers that is driving the trend, it's going to take time for us to mature those observations. And we're spending a lot of time looking at SIC class, geographies, size of risk, et cetera, et cetera. But know we're cross-cutting the data very hard and, at the moment, it looks a little more broad-based than just a couple of classes and we see this inexperienced worker dynamic where they tend to be injured in a more frequent basis than more experienced workers. I don't think that's a surprise to anybody on the call. That's just a fact of something as underwriters we have to deal with every day on our risk business.

<Q - Randy Binner>: Okay. But you can't point to it being – we've seen auto accidents creep into some other workers' comp companies. So, I'm just trying to just isolate that. And I guess the answer is you don't know. And then back on commercial auto, you said you're over trying to [ph] buy it (01:02:55). Like, roughly how many basis points do you think you're over – pricing over loss cost in commercial auto?

<A - Douglas G. Elliot>: Let me just go back to your first point. At this point, I don't see the full connection. I don't think auto is driving our workers' comp frequency increase. And we'll continue to study that. And if it changes, I'll share that going forward. And secondly, we don't share specifically exactly those points, but it's a couple of points over top of loss trend at this point, relative to pricing vs. trend.

<Q - Randy Binner>: That's great. Thanks a lot.

<A - Christopher J. Swift>: But Doug, I'd make the point, too, that it's still not anywhere near where we want to be from a long-term return point of view. So the current year and maybe the last 18 months we were out-earning loss trends, but there are still a ways to get to an overall acceptable combined ratio.

<A - Douglas G. Elliot>: I agree with that, Chris.