Keefe, Bruyette, & Woods Insurance Conference

Company Participants

- Christopher Campbell, Analyst
- Sabra Rose Purtill, Senior Vice President, Investor Relations & Treasurer

Other Participants

- Scott Frost, Analyst

MANAGEMENT DISCUSSION SECTION

Christopher Campbell {BIO 20262752 <GO>}

Okay. All right. Hi. Good morning, everyone. Thank you for joining us. I'm Chris Campbell, I'm one of the P&C analysts at KBW. And with me today, I have Ms. Sabra Purtill, The Hartford's Treasurer.

Sabra Rose Purtill {BIO 1764408 <GO>}

And Head of Investor Relations.

Christopher Campbell {BIO 20262752 <GO>}

And Head of Investor Relations. I would say you have a new title.

Sabra Rose Purtill {BIO 1764408 <GO>}

Yeah.

Christopher Campbell {BIO 20262752 <GO>}

But you still have Investor Relations.

Sabra Rose Purtill {BIO 1764408 <GO>}

Yes.

Christopher Campbell {BIO 20262752 <GO>}

Okay.

Sabra Rose Purtill {BIO 1764408 <GO>}

And I just want to say, first of all, I don't normally volunteer myself for podiums. Not that I can't manage a podium, but I prefer to fly under cover and let Beth and Chris do all the public speaking. But I just felt it was important given the recent announcements to acquire the Navigators Group, to give people an opportunity and Reg FD (00:00:50) follow-up questions or the rest. So, I'm happy to be here. (00:00:57-00:01:26) fingers crossed for the third quarter and into the fourth. So, for that, I'll let Chris just take a swat at all the questions.

Christopher Campbell {BIO 20262752 <GO>}

Okay.

Sabra Rose Purtill {BIO 1764408 <GO>}

... here to the U.S. Open (00:01:35).

Q&A

Q - Christopher Campbell {BIO 20262752 <GO>}

Great. Yeah. Okay. I just want to start, you had mentioned HIG acquisition of Navigators. Can you give us some background on why Navigators as the specialty platform? They're very, very nichey versus like maybe more a general specialty platform, just given the scale that Hartford's business is offering, why was the Navigators attractive?

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

Yeah. Well, I would start from first of all saying it's been a kind of long-standing interest of Chris and Doug to expand our capabilities in the specialty lines area, as well as in industry verticals in what we would call our Middle Market space. And we've looked at a lot of things. So, I would say that we looked at things that were rumored and that we didn't pursue or didn't find to be a strong enough fit that we were the highest bidder at the end of the day for.

And for Navigators, we've been in touch with them about – it started about four years ago with a conversation about their businesses. We were attracted mostly for what I would call the specialty lines orientation within their Financial Products, D&O, E&O. You guys know we have a business in that, but we're relatively small. Combined with them, we'll be much bigger platform together.

But also because they are a true underwriting-focused industry company, I mean, they get in and out of markets, but they started 44 years ago as an MGU focused on the marine markets and mostly the maritime industry, I would say. They've expanded their marine lines coverage to construction and energy, life sciences, and a bunch of other different industry verticals, but it was that orientation that attracted us.

And the other thing that Chris would say is that their culture is very similar to ours in terms of owning the underwriting results. So, while there's still got that specialty orientation of entering markets when they're hard and pulling back when they get a lot softer, they really do as an underwriting basis reward and focus on the underwriting results over time, which we felt was important given our franchise, our brands.

Clearly, we still have to make some decisions about how we're going to be branding the different entities going forward. But we didn't want to kind of mar our reputation with being with somebody who like is known for like entering the market and then exiting five years later. We wanted more consistency and tradition and support within the certain lines of businesses that they are.

So, from our perspective, the attraction was principally in their U.S. insurance business. They also have a strong international business, including the Lloyd's platform, which I would note, in Lloyd's, a lot of their business is still U.S. risks, because they're following their energy maritime liabilities, some of their liability clients into that market. So in total, about 75% of their premiums are U.S. risks. But we did find it intriguing with their international platform as they've expanded into Europe first following really, again, the maritime industry into Stockholm and towards Rotterdam, but also then adding professional lines businesses in those areas. So, we found that kind of interesting, particularly as we think about servicing our U.S. customers' international needs.

I think many of you might be aware that we do not have a foreign flagged footprint at The Hartford itself. We actually sold our last UK runoff operation about two years ago. But we do have a relationship with AXA, which kind of enabled us to provide international coverages for our domestic clients. And given AXA's acquisition of XL, we've been thinking about whether or not that arrangement will be as robust going forward. So, like I said, the international aspect of the Navigators was interesting to us and we're very, very focused on kind of maximizing the value of that relative to our U.S. platform. And so, when we looked at the combination of their product, their industry expertise, largely U.S. focused, underwriting culture, very, very strong and tenured management.

I think Stan Galanski has been the CEO there for about 17 years. It just all kind of fits. And the end result is that we feel very strongly that this will significantly accelerate where we wanted to be in Middle Market and specialty lines, which would've taken much longer to get there through organic growth, if at all, in fact possible given how competitive those lines can be.

So, we're very - like I said, we're very pleased to have reach an agreement with them. They, as you know, have a go-shop no-shop period. So, they have - our - under the terms of our agreement, they can openly solicit other offers right now. So, I would note that once we get through that period, which is about 30 days where they can basically actively shop and then another 15-day period where they have to conclude any of the conversations that they've started during the 30-day period. Once they get through that, if there's not any competing offers, then we'll move to the next stage, which is the shareholder and the regulatory approval. So...

Q - Christopher Campbell {BIO 20262752 <GO>}

All right. Now, I'm going to make the assumption that Hartford and Navigators end up together. Now, I'm just thinking about Navigators' book is, kind of, at least the way it's structured now, is inherently volatile. They have like a lot of excess business, and it's typically a little bit harder to reserve. And that's kind of made their earnings – well, at least from our perspective, it would've been difficult to predict on a quarterly basis.

So, how does The Hartford is much more – I mean, I know you have the (00:07:53), but how do you incorporate that volatile local book into the more stable Hartford's earnings stream?

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

Sure. Well, first off, you just have to keep in mind the relative scale. So, for Navigators, $1.7 billion gross premium book of business and in the lines that they were, obviously that volatility ran all the way down to the bottom line, right. You saw it on the per share book. Within the context of The Hartford, we have about a $17 billion premium book of business including our Group Benefits businesses. And as you know, most of our businesses are more stable, more flow type businesses, right, Small Commercial in particular, Personal Lines as well. So, that inherent volatility in the underwriting results that they have will obviously be dampened within our combined operation.

And then, secondly, that's one area where we have noted in terms of harmonizing approaches to reserving and losses that I think we'll figure out as we go through the integration process. But, I would suspect that just given what you've seen from The Hartford over the course of the last really seven years since Doug has joined us that we do tend to approach reserving with some conservatism as well as some, shall we say letting the reserve season before we start letting – releasing the redundancies.

We've gotten comments from people for several years now about our workers' comp redundancy and like when we're going to release it and all the rest. So, I think that as we harmonize the books of business, there will be probably more stability and just how we approach that book.

And then, the other area to which Chris has talked about is, just given the nature of their reinsurance structure, that's another area where I think we'll probably look at whether we want to use less or different structures and the rest, because again, The Hartford balance sheet can take that kind of volatility. And, in fact, it probably could enhance our returns on the transaction a little bit more if we were willing to take more of that volatility onto our books.

Q - Christopher Campbell {BIO 20262752 <GO>}

Okay. And then, I think one of the financial metrics out there were 4 to 5 years, $200 million in core earnings. Obviously, Navigators is a little bit more volatile today. So, how do we get to that $200 million core accretion? I mean, you don't have to give specifics, but I mean, you had mentioned the reinsurance restructuring to take off there.

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

Right. So, there's multiple levers, but what I would start with by saying is that Navigators as a company, again, 44-year track record, started with no capital on the business, grew to $1.2 billion of capital, their approach as a company at least from my observation and Chris having followed them, can probably add his (00:11:10) is that they took the risk on the underwriting side. And really, the rest of the balance sheet has been pretty conservative.

So, some of the levers to look at for returns, again, are relatively simple when you look at it as a part of The Hartford. So, one example would be their investment portfolio is much more conservative on both credit rating, liquidity, and duration than ours is. Our portfolio is about a single A plus (00:11:38). Our duration runs around 5, 5.5 years. And obviously, duration is going to be related to the liabilities, but given that they have a largely casualty book. I would still argue that that duration might be a little short.

And they also generally invest in corporate or public securities; whereas given our past history and the life insurance business, we actually have sleeves of investment expertise in structured finance, commercial home loan, mortgages, things like that. So, one of the levers, like I said, is going to be on the investment portfolio.

The other is really focused on revenue synergies, which I know people hate to see and talk about, but they are, again, a specialty lines player that has grown organically. We think with the benefit of The Hartford brand, financial strength, capital, as well as the fact that they have never sold workers' compensation insurance into their distribution channel and their distribution channels are a little bit different. They have more of a wholesale focus in their business, we're more retail and in addition even where they are retail, they have a slightly different tier of brokers than what we have on the retail side.

So, we do believe very strongly that with – as a part of The Hartford, we will be able to increase the amount of product that they are able to sell as well as cross offering some of our product expertise like particularly in the workers' comp. And then, we do not consider this transaction in and of itself to be driven by any change in loss picks and loss experience. But by the same token, given our size, our scale, our investment in technology, data and analytics, we do believe we will be able to help them have greater insights into the data that they can use for underwriting, pricing and risk. So that's another area.

And then, the last area I would say – and we're not expecting this in the near term, but we do believe as part of the combined organization that with higher returns, there's also an element of higher capital generation. But we're not expecting any return of capital from those subsidiaries in the first two years, in part, because we're expecting there to be some growth. As I said, there's some harmonization of the reserves. We have to figure out what our operating platform is going to be long term in operating structure and the rest. But those are the key levers.

Q - Christopher Campbell {BIO 20262752 <GO>}

Great. Do we have any questions for Sabra? Gentlemen (00:14:25)?

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

Yeah.

Q - Christopher Campbell {BIO 20262752 <GO>}

No.

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

Scott always has a question.

Q - Scott Frost {BIO 16894956 <GO>}

This is Scott Frost from State Street Global Advisors, as usual, asking you questions about this. But what I wanted to shift a little bit. Some of us just heard Goosehead in here talking about personal homeowners lines. I know this is not a big business for you, but you're familiar with it. We just heard them describe how their business model is disruptive to traditional homeowners' policy acquisition models and that mortgage brokers and bankers and realtors refer home buyers to their agents who can sidestep any binding issues in the closing process, because they could be more nimble in shifting carriers if there's a hang-up in closing, all right?

They have described for this reason the Personal Lines carrier agent-based model is broken. That's what they said. And they were very specific and not very shy about naming names. You weren't named, but they...

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

We're not a big agency company. So...

Q - Scott Frost {BIO 16894956 <GO>}

Exactly. So, my question to you is based on those statements. Do you think those statements hold water?

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

So, I'm going to take my Hartford hat off and for those of you who know me, I've been an insurance analyst since 1990. So, I'll put back on my industry analyst hat. What I would say is that it's increasingly difficult for independent agents to prove to Personal Lines customers that they add value. Most people are searching online for auto insurance these days. They're not just going to an independent agent for that. So, the fact that you have opportunities within the home-buying cycle or a real estate agent or other intermediary on the sales side to kind of push business over to an alternative provider isn't really surprising to me, and I think you'll probably continue to see that.

What we see at The Hartford – again, we are largely a direct lines company or a direct writer. We're number four direct Personal Lines company in the country through our relationship with AARP, which is a 30-year-plus relationship. So, almost all of our business comes in through the direct channel as opposed to independent agents, the relatively small independent agent platform right now. And what we would tell you is kind of the plain vanilla Personal Lines underwriter has got to have a strong relationship with the clients in order to be able to compete against the non-stop advertising you see all day long on TV, radio, whatever, for GEICO, Progressive, and Allstate.

For us, the part of the market that probably has the most value-add still for an independent agent is going to be when people start kind of climbing the wealth ladder. So, the mass affluent and obviously the high net worth market where people tend to have either higher insurance needs or more specialized insurance needs, higher liability limit, that sort of things and what you might get through a more standard, direct clients company like GEICO. But it is difficult for the independent agents. We see that in the Small Commercial side too. So, within Commercial Lines, Small Commercial is the most similar to Personal Lines, in terms of it being a flow business, low average premium. A lot of agents still feel like they make money writing it. They'd rather write $100,000 Middle Market accounts and $500 liability account for somebody who's a tech consultant working out of their home sort of thing.

We've cracked that code in Small Commercial, which is why we're a market leader in it. But we've cracked it in many instances by helping the agents basically source the business, but not have to service it. Within the Personal Lines business, the most independent agents have to both source it and service it, which is economically challenging then to make a profit at the end of the day.

Q - Scott Frost {BIO 16894956 <GO>}

And that would be a little bit different than sort of the standard been on (00:18:49) homeowners' policy. They seem to be saying that the advertising targets of the consumers is maybe the wrong targets, that it's the person who can refer the consumer to a carrier in a certain process.

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

That's probably – particularly for home purchases. I mean, I used to think that there is lifestyle, moment (00:19:06) whatever the insurance product is, right, P&C or life insurance, there are life points in people's lives where suddenly they have a need for insurance that they didn't have before. So, whether it's you have a baby, you buy a first house, you get your first car, and that's the point where you as an individual say, oh, I need insurance, where do I go? And if somebody is standing right there next to you when you're buying the car and said, oh, here's – don't worry about the insurance, here's the quote, it's all done, you can pay for it when you buy the car, you have all those sorts of things. They've got – it's an advantage for the sales process.

But what we see is, in our book, because again, it's AARP. So, most of the people that were underwriting had been insured by another company for quite some period of time, because we're not focused on, say, the 30-year old driver market, right? We're focused on 50 years and plus. And the reason why they're switching to us is not because of a change in life moment, but because it's the price, it's the endorsement by AARP, it's the product terms, so our products have features that are unique that you can't get in other places, that sort of thing.

But, for a lot of, like I said, substandard lines customers, or companies, they've got to figure out where that life moment is where somebody says, oh, I need more liability insurance or I'm renting, I now need renter's insurance offerings.

Q - Scott Frost {BIO 16894956 <GO>}

Great. Thank you.

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

You're welcome. I'll put my Hartford hat, (00:20:32).

Q - Christopher Campbell {BIO 20262752 <GO>}

Just in time. So, turning back to legacy Hartford, right?

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

Yes.

Q - Christopher Campbell {BIO 20262752 <GO>}

Can you give us an update on workers' comp rate changes, the loss trends? Why are we seeing a frequency uptick in – that we normally see during economic expansion?

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

So, we have seen some uptick in frequency in 2018 and we would say it's higher than what we had expected. So, that is putting some pressure on our results within workers' comp. In general, what I would say is that we're examining that, right? So, we're seeing this in our data, and we have gotten many people asking us, well, why isn't anybody else talking about this? Well, we're in the number two, right, at workers' comp in the country. We have significant investment in data and analytics, and we also try to be transparent with people. So, when we see it, we basically want to brag and I mean, maybe it's a blip, but we don't really think so in 2018.

We've looked at it. It's in Small, it's in Middle. It's a little bit worse than Middle on the frequency side than it is in Small. And we think part of it is attributable to the low unemployment rate. So, you have people who are getting hired or coming to work now who have either less experience or less recent experience, working in certain businesses and there's historically been a tendency for new younger workers, just slightly higher injury rates.

There's also an element of severity where if you've got older workers staying in the workforce because of, whatever, they are earning a good living and they don't want to retire yet or their retirement savings got eviscerated by the financial crisis; older workers, because they're experienced, don't tend to have higher frequency. But because of age, we all know it takes longer to recover from our weekend warrior tennis game this day.

But what we're seeing, like I said is on the frequency side, to date, the evidence has not been statistically significant to say, oh, it's one industry or one region or one area. We're just kind of seeing that a little bit consistently across our book. And then, that combined with the fact that the rates are coming down in workers' comp. I saw Florida, NCCI recommended, I think, it was like a 14% reduction in rates for the State of Florida just the other day.

So, we're kind of balancing what we're seeing from rate decreases because of very, very good experience at workers' comp over the last couple of years with this emerging trend that we're seeing on frequency. And there's levers you can use, there's (00:23:18) and discounts and commissions and all kinds of things that you can try to use to combat that when it comes to your bottom-line margins. But, again, I think we've been pretty transparent over the last couple of years that we expected pressure in workers' comp.

Now, in 2017, we actually had better frequency than we expected. So, we kind of held the line on margins. But going into 2018, our outlook for the year was that we would see some modest deterioration in workers' comp margins. And because of that change in frequency trend, for the first half of the year, we'd say it's a little worse than we expected, but with good property results and improvement in liability results, overall, you're still seeing in our Commercial Lines book that margins are within the range of what we're expecting for the year.

But workers' comp is - it's a historically and economically sensitive line. It's just the way it is. NCCI is looking at data from 2016 and 2017 to make rate recommendations for 2018 and 2019. 2017 was probably the best underwriting year that workers' comp has seen in 20 or 25 years. So, if you're looking at that data and making rate recommendations for 2018 and 2019, yeah, you're going to come up with a rate decrease, not a rate increase.

Middle Market is a little different than what we see in Small. Small tends to have base rates kind of follow through NCCI, unless it's a state where we've got enough data that we file on our own basis. So, like, California is an example of where we might do that. But within Middle Market, it's still pretty much an account by account loss experience.

So, in the first half of the year, we're seeing modest rate decreases across - basically what the policyholder sees as a premium renewal, so the actual dollars that they're paying is down a couple of points in Small Commercial. In Middle Market, it's actually up about 2%. And part of that is just what's happening from a competitive dynamic and that your pricing account by account based on people's actual experience. So, if somebody had 10 workers' comp claims last year, you're going to price assuming that they're going to have 10 this year. So, it's a little bit better dynamic in Middle Market, which is the opposite of what it was five years ago.

Q - Christopher Campbell {BIO 20262752 <GO>}

Right. Okay. Yeah. Any other questions for Sabra? Okay. Shifting gears to personal auto. So, you guys have taken (00:26:03) a lot of rate in that book, loss costs are (00:26:07) kind of decelerated a little bit. How relevant are lower expected claims frequencies that we're seeing to kind of your auto margin tailwind?

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

So, I would say frequency is what's been contributing to the volatility that we've seen over the last couple of years in personal auto results. The severity, by and large, has been pretty stable, so, plus 3%, plus 4% increase in severity every year. Basically, a little bit higher than the cost of inflation and that's really I think the impact of social inflation. It seems that more lawyers involved in claims settlement. But frequency has been kind of the more unpredictable variable. As we re-underwrote and re-priced our books starting in 2015 and 2016, we actually saw better frequency trends than the industry was, but that was because of the underwriting actions we were taking. We're kind of past that right now, and so what we see in our results is kind of more consistent with industry trends.

And again, going back to the dynamic of what's happening with employment, gas prices are up a little bit, employment trends are still pretty strong. So, we are still seeing basically slightly favorable - are not favorable, but positive frequency. So, accident frequency is still increasing per million miles driven that are not (00:27:38). But it's not the plus 4% and plus 5% that the industry saw back in 2015 and 2016 where I think you had just a whole confluence of the effects, much stronger change in employment trends and a big drop in gas prices.

I think there was an increase in consumer confidence as well that might have contributed to more new car buying which are - that puts more cars on the road. But the biggest indicator and I believe Allstate is the one who tracks this, from what I understand, is basically the distance between cars on the highway, so congestion, road congestion.

And we've had a very strong economy for many years. The roads in most places, unless you happen to live in like Charlotte, North Carolina, where every time I go there to visit my family, there's a new interstate through Charlotte, North Carolina. But around here, the roads haven't gotten any bigger. So, if you've got more people driving to work, then the cars are closer together and there's more accidents.

Q - Christopher Campbell {BIO 20262752 <GO>}

Okay. So, just I'm thinking, Navigators workers' comp trends, personal auto, we didn't really delve into (00:28:47) but getting all the moving parts that you have, like how should we think about capital management plans and priorities over kind of the next two years?

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

Yeah. There's - certainly from what you've seen from our activities, there's been more of a focus on investing excess capital in the businesses. Obviously, the acquisition of Aetna, which is going great, I would characterize that as a relatively straightforward bolt-on type acquisitions. Big, but very complementary to what we were already doing. And then, the announcement for Navigators and that's a change from what we were doing through most of 2012 through to 2017 when we repurchased about $6.5 billion of our stock.

In my role as Treasurer, one of the things I keep track of is and has to manage is holding company liquidity and the dividend capacity. The Navigators transaction will effectively use all of the excess capital generated by the Talcott transaction, plus I'll need to use a little bit of the 2019 dividend capacity from the P&C businesses.

So, once we get that acquisition closed and then as we move towards the end of 2019, I think that's when we'll start to have more sizable excess capital that we'll need to make some decisions about. And what Chris and Beth would both tell you is that it's premature to make decisions about what we think would be the best use of capital a year, year-and-a-half from now. But in terms of acquisitions, the Navigators transaction accomplishes significantly what we wanted to do for industry verticals and specialty lines, so that if there were to be another acquisition that would really need to be something that again made a lot of strategic and financial sense, but the near-term priorities are, like I said, closing on the Navigators transaction.

As a result of that, we're going to be assuming about $265 million of their debt. So, our debt ratios are going to be at the high end of where we want them to be. So, between 2019 and 2020, we'll probably repay some more par amount of debt, which would be one use of the excess capital. And then, I would just note, we did announce a 20% increase in our common dividend. So, that's also another use of our excess capital over the course of 2018 and 2019 with the dividend.

Q - Christopher Campbell {BIO 20262752 <GO>}

Got it.

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

Yeah. But we know – share repurchase is clearly a tool. We just felt that this was an opportunity to significantly accomplish what we needed to do strategically for our businesses. And when you look at the Navigators acquisition over time, not immediately, but over time, it does compare reasonably to share repurchases right now.

Q - Christopher Campbell {BIO 20262752 <GO>}

Right.

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

In terms of the return on the investments.

A - Christopher Campbell {BIO 20262752 <GO>}

Okay. All right. I think we're out of time. So...

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

Great. Well, thank you all and...

A - Christopher Campbell {BIO 20262752 <GO>}

Congrats on joining us.

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

All I can say, stay cool out there.