S&P Capital IQ

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The Hartford Financial Services Group, Inc. NYSE:HIG

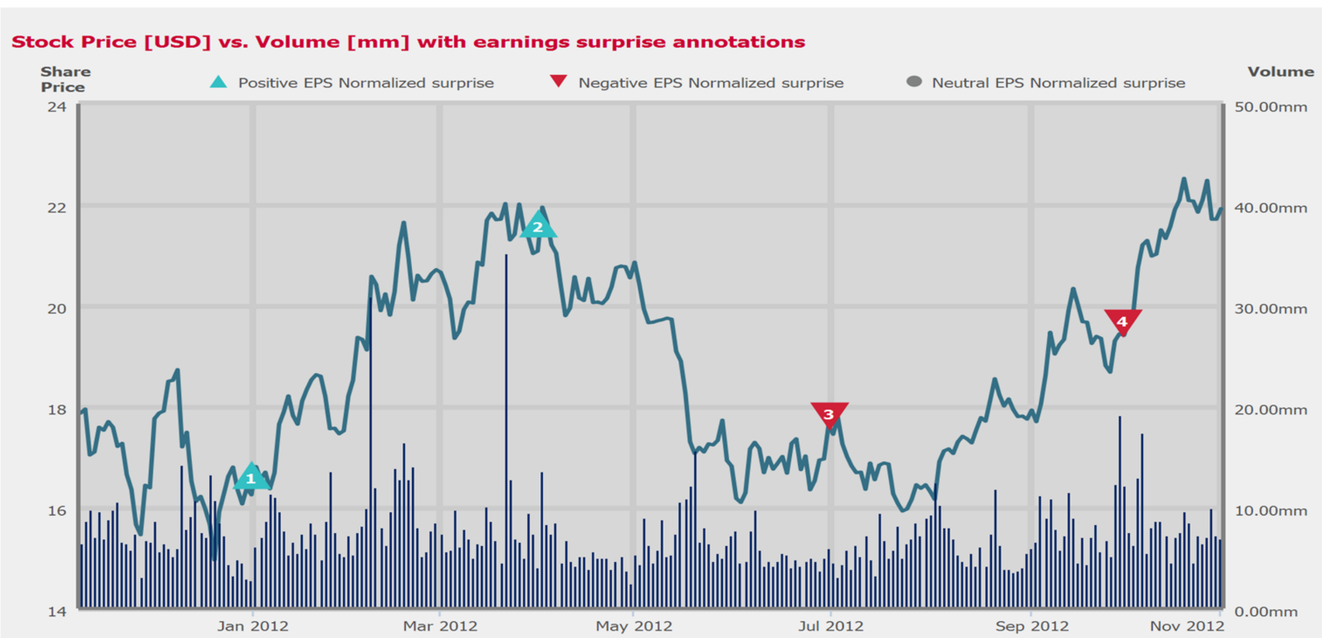
FQ4 2012 Earnings Call Transcripts

Tuesday, February 05, 2013 2:00 PM GMT

S&P Capital IQ Estimates

	-FQ4 2012-			-FQ1 2013-	-FY 2012-	
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	ACTUAL
EPS Normalized	0.35	0.54	▲54.29	0.79	2.58	2.88
Revenue (mm)	6300.00	7735.00	▲22.78	5424.98	21917.40	26412.00

Currency: USD
Consensus as of Feb-05-2013 1:33 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ4 2011	0.62	0.69	▲1 11.29 %
FQ1 2012	1.06	1.25	▲2 17.92 %
FQ2 2012	0.47	0.23	▼3 (51.06 %)

FQ3 2012	0.82	0.78	(4.88 %)

Call Participants

EXECUTIVES

Andre A. Napoli
Former Executive Vice President and President of Consumer Markets & Enterprise Business Services

Beth A. Bombara
Chief Financial Officer and Executive Vice President

Christopher John Swift
Chairman & CEO

Douglas G. Elliot
President

Liam E. McGee
Former Chairman

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Presentation

Operator

Good morning. My name is Tiffany, and I will be your conference operator today. At this time, I would like to welcome everyone to The Hartford's Fourth Quarter Conference Call. [Operator Instructions] Sabra Purtill, Head of Investor Relations, you may begin your conference.

Sabra R. Purtill
Senior Vice President of Investor Relations

Thank you, and good morning, everyone. Welcome to The Hartford's 2012 financial results and 2013 outlook conference call. Our speakers today include Liam McGee; and Chris Swift; as well as Doug Elliot, President of Commercial Markets; and Andy Napoli, President of Consumer Markets. Other members of our executive management team are also available for the Q&A session.

Today's prepared remarks are longer than normal in order to cover the 2013 outlook, as well as Doug and Andy's presentations about their businesses. We will still have about 30 minutes for Q&A at the end of our prepared remarks.

As detailed on Page 2 of the presentation, today's statements concerning future results or actions are forward-looking statements as defined in the Private Securities Litigation Reform Act of 1995. These statements are not guarantees of future performance, and actual results may differ in a material manner from these statements. In addition, we do not assume any obligation to update the forward-looking statements. Furthermore, you should consider the risks and uncertainties that may cause actual results to differ, including those in our press release, our 2012 10-K and other filings we make with the SEC.

Finally, please note that our presentation includes financial measures that are not derived from GAAP. Definitions and reconciliations to the most directly comparable GAAP measures are provided in the Financial Supplement press release and 10-Q available on our website.

I'll now turn the call over to Liam.

Liam E. McGee
Former Chairman

Thank you, Sabra. Good morning, everyone, and welcome. As you saw from our release last night, The Hartford had a strong finish to 2012, and the fourth quarter completed a successful year of strategic transformation, as well as execution for the company. Following the life divestures, we enter 2013 with a sharper focus on the Property & Casualty, Group Benefits and Mutual Funds businesses. We are transforming and profitably growing the organization with the continued goal of delivering greater shareholder value.

As Sabra mentioned on today's call, Chris and I will speak, and then Doug Elliot and Andy Napoli will review the Commercial Markets and Consumer Markets results and preview their 2013 outlooks. We're going to use this format going forward so Doug and Andy can share greater detail about the operating fundamentals of their businesses.

Chris will provide an update on the impact of Storm Sandy, but I do want to express our deep appreciation for the professionalism and excellence demonstrated by our claims team in their response to the storm. Their dedication to serving our customers is a hallmark of The Hartford about which we're all very proud.

Before we start, I also want to say thank you for the many wishes of good luck and good health. I'm feeling great, as well as very fortunate, and we are back to business as usual.

Since I arrived at The Hartford in 2009, our top priority has been to restore the operating performance of the company and deliver increased shareholder value. We have taken significant steps to improve the company's financial strength and stability. As examples, we repaid the TARP funds, refinanced the Allianz debt, successfully repositioned the investment portfolio, implemented a tail hedge in Japan, and executed a series of necessary expense actions.

As you know, to accelerate our progress, last March, we announced a sharper strategic focus that returns The Hartford to its historical strengths in underwriting, distribution and claims management. The strategy aligns the company's resources with ongoing businesses that have competitive market positions, strong capital-generating ability and lower sensitivity to capital markets.

Roughly 9 months later, on January 2, we closed the last of the life divestitures. The transactions were executed at attractive valuations with strong strategic buyers. I'm proud of what the team has accomplished. We made difficult decisions, then executed them as planned. These changes position the company to continue to grow shareholder value in the years ahead.

With the sale successfully closed, we're pleased to share our capital management plan with you. The capital plan is accretive to shareholders and is the culmination of a thoughtful, comprehensive process that effectively balances several critical goals.

We have reviewed the plan with the rating agencies and have received approval from the Connecticut Insurance Department. In the first quarter of 2013, we will make a $1.2 billion extraordinary dividend from our Connecticut domiciled life insurance companies, and also in line to our Vermont life reinsurance captive, and move about $300 million up to the holding company as well.

First, we are allocating $500 million to a share repurchase program, which we will execute over 2013 and '14. Looking ahead, our intention is to continue of a consistent capital management approach of returning excess capital as appropriate to our shareholders.

Second, as part of the plan, we will reduce holding company debt by $1 billion. This will save about $55 million pretax of annualized interest expense by the end of 2014. Debt reduction is an important capital use for 2 reasons. First, it's appropriate to reduce debt levels for the lost earnings from the divestitures. In addition, given The Hartford's increasingly P&C centric businesses, our goal is to reduce the company's debt leverage ratios to levels that are more consistent with a capital structure of other leading P&C companies. Our year-end 2014 target for debt to capitalization is in the low 20s range.

Third, we're retaining additional capital in the life companies to supplement our financial flexibility to take actions to reduce risk in the legacy annuity blocks, ranging from customer-oriented offers and exchanges to transactions with third parties. We have the necessary resources to take future economical actions to address the legacy annuity liabilities, which should create significant shareholder value.

As we look to 2013, we're focused on achieving profitable growth in each of our go-forward businesses primarily by driving margin improvement. We saw a good progress in 2012 particularly in P&C Commercial and personal lines homeowners.

In standard P&C Commercial, we achieved 9% renewal written price increases in the fourth quarter and 8% for the year. This contributed to improvement in the combined ratio, ex CAT and ex prior year, and we expect these positive pricing trends to continue through 2013.

We are also better balancing our mix of P&C Commercial business, building on our historic strengths in worker's compensation. We've expanded our property capability significantly over the past year, which positions us to be a broader risk taker in the marketplace.

In Consumer Markets, I'm pleased with the progress Andy and his team have made improving margins and growing new business. And Andy will talk more about that later in the call.

In Group Benefits, our disciplined repricing of the book has resulted in the shedding of some unprofitable accounts but has also improved margins and returns. We think this is a good tradeoff, and we're encouraged by the profitability trends in this business. We saw a nice recovery during the fourth quarter, and the 2013 outlook is positive.

Our Mutual Funds business is positioned for profitable growth through its expanded relationship with the Wellington Management. We saw improved sales and net flows in the fourth quarter, and fund performance for 2012 was outstanding, with 80% of our funds beating their peers.

So we took significant steps in 2012, and the goal for '13 is to continue to drive profitable growth in the go-forward businesses.

We are determined to reduce the size and risks of the legacy annuity liabilities. As you know, last year, we put the annuity business into runoff and named Beth Bombara to lead that effort. She and the team have been evaluating a number of contract holder initiatives and other actions to reduce the risk embedded in these liabilities with the ultimate goal of being to isolate or separate them from The Hartford.

As you know, as an initial step, we're launching the enhanced surrender value offer for a subset of U.S. VA policyholders. Communications about the offer started in January. We believe this offer will be attractive to certain policyholders and will result in an increase in surrender activity in this block.

As you know, global equity markets posted strong results in the second half of 2012 and that continued in January. In addition, the yen has weakened significantly against the dollar and the euro over the past several months. These market conditions have positive economic implications for The Hartford and have significantly improved the in the moneyness of the U.S. and Japan VA blocks.

For example, the net amount at risk for the Japan income benefit has declined significantly from $6.1 billion at the end of the third quarter to $1.9 billion at the end of January. And the general consensus is that the yen will continue to weaken, which would be positive for us.

Our goal is to maximize shareholder value by effectively managing the runoff of these liabilities and reducing the amount of capital needed to support them. Improving market conditions may make it more attractive for policyholders to take actions, such as surrender annuitization, and should also create expanded opportunities for us to explore risk transfer transactions with third parties. All of these actions would reduce our exposure to this business and result in lower capital required to support these liabilities.

As Chris will detail, we will hold an Investor Day in April, and much of the agenda will focus on our runoff annuity operations, which we've named Talcott Resolution, and how we will maximize shareholder value by managing these liabilities, particularly in the context of the recent market improvements.

Chris will cover our 2013 earnings outlook of $1.375 billion to $1.475 billion, which reflects lost earnings from the life company sales, better margins in the ongoing businesses, declining assets under management at Talcott, an increase in the budgeted CAT load in our P&C businesses, and the elimination of expenses from the divested life businesses, 90% of which will be taken out by year-end 2013.

So to close, the fourth quarter was a strong end to a transformational year for The Hartford. We feel very good about what we've accomplished. With our focus on driving profitable growth in the ongoing businesses and reducing the size and risk of the annuity liabilities, we are confident in our ability to execute our plan and drive increasing shareholder value.

With that, now, I'll turn the call over to Chris.

Christopher John Swift
Chairman & CEO

Thank you, Liam. Good morning, everyone. This morning, I will focus on 4 areas. First, I'll briefly cover fourth quarter and full year 2012 results. Second, I will provide an update on our Life runoff operations, which we have named Talcott Resolution. Third, I'll discuss our capital management plan. And last, but not least, I'll cover our 2013 core earnings outlook.

Let's begin on Slide 7. Fourth quarter 2012 core earnings were $265 million or $0.54 per diluted share. This quarter, we changed our definition of core earnings, which now excludes restructuring and other costs and DAC unlocks. We believe this definition gives a better view of fundamental operating results.

Storm Sandy generated significant CAT losses this quarter. 2 months have passed since we released our preliminary estimate, which is the same as what we recorded in this quarter's results. This quarter, this storm generated more claims than any other CAT event in our history. To date, we've closed about 80% of property claims and 90% of auto claims. For the quarter, total pretax CAT losses were $335 million, including the $350 million for Sandy. This means that fourth quarter CATs after tax were $174 million higher than our original guidance.

Core earnings in the quarter, after excluding CATs, prior-year development and a small retiree tax benefit, were about $0.87 per diluted share, above our November outlook of $0.77 to $0.82 per diluted share. Improved group LTD results, lower expenses in Talcott Resolution and favorable non-CAT weather results were the principal drivers over this outperformance.

Slide 8 summarizes full year 2012 results. Core earnings were $1.4 billion or $2.88 per diluted share. Excluding prior year development and the retiree tax benefit and catastrophes above forecast, 2012 core earnings were $1.6 billion or $3.27 per diluted share.

Turning to Slide 9. The Hartford's book value per diluted share rose by 5% to $46.59 over the past year. Net income and higher AOCI were partially offset by charges for the Allianz debt refinancing and warrant share repurchase in April of 2012, both of which reduced shareholders equity.

Excluding AOCI, book value per diluted share declined slightly to $40.79, principally due to the Allianz transactions. For 2012, core earnings ROE was 7%, a strong improvement from the 5.6% in 2011. We continue to focus on improving core earnings ROE.

This quarter, we also realigned our financial reporting to reflect the company's focus on its P&C, Group Benefits and Mutual Funds businesses. In order to help you reconcile your models to prior recording, we posted a schedule on our website for both the new core earnings and the line of business presentations.

On Slide 10, you can find our consolidated P&C results, which include P&C Commercial, Consumer Markets and P&C Other Operations.

P&C results improved significantly in 2012. 2012 P&C core earnings totaled $714 million compared with $279 million in 2011, reflecting improved underwriting results and lower prior year development.

Our accident year P&C underwriting margins improved over 2011. The P&C combined ratio, excluding CATs and prior year development, declined to 94.8% versus 95.5% in 2011. We achieved underwriting margin improvements in both P&C Commercial and Consumer Markets although we still have work to do.

The P&C full year combined ratio was 101.9%, almost 5 points better than the 106.8% in 2011. We had much lower prior year development and slightly lower current accident year CATs in 2012. 2012 prior year development was favorable by $4 million before tax compared with unfavorable by $367 million in 2011, which had significant charges for legacy asbestos exposures and workers' compensation.

Let's turn to results for Mutual Fund, which are summarized on Slide 11. So far in 2013, we are pleased to see positive momentum in key areas of the business, including sales, net flows, fund performance and market appreciation.

Fourth quarter retail Mutual Fund sales were good, rising 34% from prior year. Net outflows, while still negative, improved significantly versus prior year as redemptions slowed. Overall, the team is making progress on its distribution and product expansion goals, which are key tactics for generating profitable growth in this segment.

Fund performance also improved substantially in 2012, with 80% of our funds ranked in the top half of their Morningstar peers. In particular, the Capital Appreciation Fund went from bottom quartile performance in 2011 to top quartile in 2012, outperforming the S&P 500 by about 400 basis points. These metrics are very important to retail broker sales, and we are optimistic that this will help to improve 2013 net flows compared with the last 2 years.

Talcott Resolution results, my second topic, are on Slide 12. The principal goal for Talcott is to reduce the size and risk of its liabilities. As a result, between the business sales and the decline in annuity blocks, we expect reduced core earnings in 2013 and thereafter as fee income shrinks.

Consistent with this outlook, Talcott's account values shrank during 2012, although core earnings were up by 7% compared to the fourth quarter of 2011 primarily due to lower expenses.

Year-over-year, U.S. variable annuity account values declined 6% as surrenders more than offset strong U.S. equity market appreciation. The surrender rate rose to approximately 16% for the year, and U.S. variable annuity net outflows totaled $11.4 billion. The full surrender rate, which excludes partial surrenders and withdrawal benefits, was 10.9% for 2012, about 1.5 points higher than 2011.

As Liam mentioned, we are now beginning to launch the ESP program. In our initial phase, we will reach about 45% of eligible policyholders. Contract holder outreach began in late January, but it will take a few months for us to gauge customer response.

I'd now like to turn to VA results. On Slide 13, it provides a summary of the 2012 VA impacts, including hedging. The significant driver of the $716 million GAAP loss was yen hedge losses for our Japan VA book, where the corresponding liability is not fair valued under GAAP. As we have shared with you previously, our hedging programs are focused on economics through which neither GAAP nor statutory are a good estimate. Nevertheless, we know you are keenly interested in our statutory results.

The negative statutory impact in the quarter was $439 million pretax and before fee income. Net of hedging, we expected a modest negative statutory impact due to the improving market environment, which generated hedge losses. The final impact was higher due to about $300 million of nonmarket related impacts for assumption changes on reserves from increased expenses and the duration extension of the macro hedge program. I would note, the cost structure of our macro hedge program has improved, which is now estimated to be approximately $75 million to $100 million annual cash spend, down from the previous $200 million to $250 million.

Before moving on, I wanted to talk about the yen. We are encouraged by the weakening of the yen, which reduces net amount at risk and improves the net economics of the book. We also expect this may influence policyholder behavior at annuitization.

Based on the January 31 closing price of JPY 91.7 to the dollar, our net retained death benefit NAR declined 31% from $4.8 billion at year end to $3.3 billion, while the net income retained benefit NAR declined 42% from $3.3 billion to $1.9 billion. These are significant moves in the month of January.

The weaker yen will reduce the book's in the moneyness and could accelerate the runoff of this block, which ultimately reduce our economic liability to contract holders. We are encouraged by this trend, and we'll continue to maintain our dynamic hedging program for Japan.

Now I'm going to cover our capital position, which is summarized on Slide 14 along with our capital management plans. The Hartford's capital resources totaled $16.6 billion at December 31, 2012. This was a decrease from September, but was more than offset by the $1.7 billion statutory gain from the sales transactions.

The far right-hand column of Slide 14 shows that we would have reported an approximate $500 million increase in surplus if the transactions had closed by December 31 versus early January. Further down that column, you can see the pro forma capital position after the $1.5 billion dividend and return of surplus. Pro forma life statutory surplus would be about $6.6 billion and total capital resources would increase to $18.3 billion.

The end result is, our capital position remains strong. We estimate that the pro forma RBC for the Hartford life entities would be approximately 420%, taking into account the net reduction and required capital due to the business sales and the dividend payment. We intend to keep the life companies well capitalized for their business risk and consistent with their current ratings.

In addition to the transactions in the VA impacts, we moved the Mutual Funds legal entities out of the life stack to the life holding company, which reduced life surplus by $200 million.

Finally, other statutory impacts include deferred tax assets and additional reserves for fixed rate liabilities in this low-interest rate environment.

Total holding company cash and short-term investments at year end totaled $1.4 billion, equal to last quarter. This will increase to $2.9 billion after the dividend associated with the capital management plan. Let me turn to that now.

Last night, we announced that our capital plan had been reviewed and approved with the Connecticut Insurance Department and the 4 rating agencies. We expect to dividend $1.2 billion from our Connecticut domiciled life insurance companies in the first quarter of 2013. In addition, as a result of the Individual Life sale, we expect to dissolve our Vermont life reinsurance captive in the near term and return approximately $300 million of surplus to the holding company.

Let me now cover the capital management plan. As mentioned in the press release, we are launching a $500 million share repurchase program. We expect to execute the program ratably between now and year end 2014 at about $50 million to $100 million per quarter. Second, we will reduce the outstanding by approximately $1 billion. We currently expect to pay off the $320 million July 2013 and the $200 million March of 2014 maturities when due.

Our goal is to lower The Hartford's debt to total capital ratio into the low 20%, and over time, to improve the fixed charge coverage ratio to about 5 to 6x.

I'd now like to cover our 2013 outlook and summarize the key assumptions. These assumptions and other macroeconomic factors are included in the table on Slide 15.

Our outlook for 2013 core earnings is $1.375 billion to $1.475 billion, which includes the impact of lower investment yields and the $260 million to $280 million decline in Talcott Resolution's earnings due to the continued shrinkage of the VA books and the sale of Individual Life and Retirement Plans.

In our P&C and Group Benefits business, we expect to see improvements in our accident year combined ratios before catastrophe losses based on the pricing and underwriting margins we have achieved in 2012, which we expect to continue into 2013.

In P&C Commercial, our outlook calls for a 92.5% to 95.5% combined ratio compared with the 96.6% actual in 2012.

The Consumer Markets outlook is 89.5% to 92.5% compared with 90.8% in 2012. Keep in mind that we've increased the budgeted CAT loads for both Commercial Markets and Consumer Markets in 2013 as compared to 2012.

In Group Benefits, our loss ratio outlook is 77% to 80% compared with the 79.5% in 2012. We expect a mid- to high teens increase in core earnings as the impact of our pricing and underwriting initiatives flow through an additional year of earned premium. Doug will talk about this in a minute.

On a consolidated basis, our outlook assumes that corporate core losses decline by approximately $40 million in 2013, reflecting the sale of Woodbury and the reduced reduction of interest expense although actual amounts will depend on debt repayment timing and results. We'll update you on our progress on the debt plan as it is completed.

With respect to the share repurchase program, we plan to be active each quarter, and we will start buying back shares once the 10-K is filed.

Finally, I'd like to briefly review first quarter expectations. Our current outlook is for core earnings of $0.75 to $0.80 per diluted share, including budgeted CATs of $57 million after tax. The first quarter is normally a light CAT quarter and so far, that trend is holding. This amount does not include restructuring and other costs, which we expect to be in the range of $15 million to $20 million after tax.

We expect to report first quarter earnings in the last week of April, and as Liam mentioned, we look forward to seeing you in April for a financial and risk review of Talcott Resolution. A formal invitation will be sent out soon, but we will have that meeting on April 11 here at our Hartford campus.

To wrap up, we ended 2012 with significant accomplishments and we begin 2013 with momentum. We are focused on continuing our transformation of The Hartford by strengthening profit margins and improving operating efficiencies, and we have a balance sheet with increased capital flexibility. Finally, we are preparing to launch our capital management plan.

I'll now turn the call over to Doug to talk about the P&C Commercial and Group Benefits results and outlook. Doug?

Douglas G. Elliot
President

Thank you, Chris, and good morning, everyone. I'm going to cover our P&C Commercial and Group Benefits results for the fourth quarter and full year 2012. I'll also provide some commentary on the marketplace, and our 2013 business objectives and outlook.

The P&C Commercial segment made strong pricing progress during 2012, including a very solid fourth quarter. We're confident that our end-market actions are driving improvement in our underwriting margins. And while these actions put pressure on our new business and retentions, our continuously improving risk analytics convince us that we're making the right tradeoffs on a daily basis.

Our all-in combined ratio for the year was 102.9%, a decrease of 1.7 points from the 104.6% in 2011. This margin improvement reflects our focus on pricing and targeted underwriting actions, as well as lower unfavorable prior year development versus 2011. I'll cover each of these shortly.

Catastrophes were a major contributor to losses during the fourth quarter due almost entirely to Storm Sandy. Current accident year CATs were 5.2 points on the full year 2012 combined ratio, which coincidentally, is the same as 2011.

For the year, CATs totaled $325 million pretax, with Storm Sandy contributing $207 million in the fourth quarter. Excluding prior year development and catastrophes, the combined ratio on P&C Commercial improved to 96.6% for the year, down slightly compared to 97.3% in 2011.

Our fourth quarter results further highlight the significant improvements we're seeing and the depth and speed of our actions since a year ago. The ex CAT, ex prior year combined ratio for the quarter was 97.8% versus 101.1% for the prior year period, a solid improvement. Our cumulative rate change in Middle Market over the last 6 quarters positions us among the more aggressive companies in the industry and sets us up well for margin improvement in 2013.

On an ex CAT basis only, the fourth quarter combined ratio was 98.9% versus 107.8% for the same period in 2011. Last year's fourth quarter included significant prior year reserve development in our workers' compensation line. Our pricing and underwriting actions have taken hold and are now beginning to earn through to the bottom line. We continue to refine our reserve position as we evaluate new data to make sure that we're on top of our indications. We see current actions very much as business as usual compared to last year's more significant prior and current accident year adjustments.

Unfavorable prior year development for the quarter was $18 million while full year was $72 million pretaxed. Both numbers compare favorably with 2011 actions.

Workers' compensation and auto liability were the primary drivers of loss development, while our general liability lines continued to release favorable news.

We achieved margin improvement across most lines of business but with a more intense focus on Middle Market worker's compensation. In this line, we achieved 15 points of written price increases for the fourth quarter and 14 points for the full year.

Using our risk analytical tools, we aggressively managed our mix of business as well to retain our better performing accounts while shedding our least performing, increasing margins overall.

Middle Market results, which are heavily influenced by our workers' compensation book of business, improved 3.6 points in 2012 to a full year combined ratio ex CAT, ex prior of 99.3%. Still more work to be done but terrific progress.

Another area for us of focus was in Middle Market has been the expansion of our property line. Despite the increased CAT losses over the last several years, we continue to see property as a strategic opportunity, balancing our portfolio and providing us an account-based value proposition to our agents and customers. David Carter, who joined us in late 2011, and our property team spent a good part of the year refining our property underwriting approach, updating our pricing and coverage, and driving the enhanced offering throughout our frontline organization.

As you may recall, at our December 2011 Investor Day, I talked about our long-term goal of moving property premiums from about 10% of our Middle Market commercial book to closer to 20% over time. We've made major strides to set the foundation for this change. This year, our new business writings in property were up nearly 28% and the total combined ratio for our property line was down more than 14 points.

Our Small Commercial segment had another strong year in 2012. As an aside, our Small Commercial business has now posted a combined ratio over 120-plus years, and even with the weather events of 2012, that record remains intact.

Workers' compensation in Small Commercial has performed extremely well over these years. However, this book of business, while still providing strong returns, has experienced margin compression in 2012 driven by not only the economic downturn but also some class and territorial factors. We've been aggressive in taking corrective actions. Written pricing was 6% for the full year and nearly 8% for the fourth quarter, double our targets just 12 months ago. We've adjusted our appetite in certain industry classes and implemented rigorous underwriting standards.

2012 also presented some challenging trends in auto liability for our Small Commercial segment. Similarity, we're addressing these trends with rate increases and tightening underwriting standards as well. Even with these headwinds, Small Commercial posted a 2012 full year ex CAT, ex prior year combined ratio of 91.1%. A strong result, but not quite at the 89.5% we achieved in 2011. For the quarter, the Small Commercial combined ratio ex CAT, ex prior was essentially flat at 92.8%.

In specialty, national casualty had an outstanding year with double-digit growth on both the top and bottom line. Our program in captive area had mix results with some fine tuning occurring on underperforming accounts and implementation of tighter underwriting standards for our auto liability programs.

Efforts to reposition our financial products business continue to be successful as we become a more Middle-Market focused insurer, driven less by the Fortune 500 and large financial institution segments.

Now let's turn back to overall P&C Commercial. Written premium was up 1 point in 2012, which is in line with our expectations and consistent with the pricing and underwriting actions we took during the year. While policy retentions held up well at 83% in Small Commercial and 77% in Middle Market, new business premium was down 8% and 21%, respectively, consistent with our margin objectives. We're very comfortable with this tradeoff, and we'll continue to balance retention, new business and pricing to improve margins in 2013.

Turning to 2013 overall, our goals remain consistent with 2012, continued focus on margin improvement, drive greater product diversification in property and general liability, and build on our momentum across the business portfolio.

We expect flat to modest growth in net written premiums across our Standard Commercial lines in 2013 as we continue to balance underwriting, pricing retention on our renewal book and exercise discipline in our new business efforts.

In specialty commercial, we expect the top line to decline by 7% to 10% as we continue to streamline our programs business and adjust the mix of our D&O book.

We expect to see further improvement in underwriting results in 2013 as we continue to earn in 2012 rate increases and focus on overall profitability. Our current outlook is for our 2013 ex CAT, ex prior year combined ratio range of 92.5% to 95.5% compared to 96.6% in 2012.

Offsetting some of the improvement in underwriting results is the increase in CAT load that Chris mentioned.

In P&C Commercial, our 2012 CAT budget was 1.9 points, but the actual results were 5.2. We are raising our CAT budget assumption to 2.5 points in 2013, reflecting higher loss assumptions as well as the expected growth of our property business.

Let me now turn to our Group Benefits segment, which ended the year on a high note, with core earnings of $39 million in the quarter.

As you know, we've been focused on improving the margins of this book of business for about 2 years now through rate increases, underwriting discipline and overall improvement in our sold price to guide on new and renewal business. Given the multi-year contract terms and long-term disability incident rates that remain at elevated levels, we still have work remaining to return our performance to more acceptable levels. However, we are pleased with progress to date and believe our actions are beginning to pay off.

In 2012, Group Benefits core earnings were $101 million, up 17% over 2011. The improvement has been driven by our pricing actions on both STD and LTD, as well as improving claim trends on our disability business. High unemployment levels continue to put pressure on disability experience. However, we're confident that our actions address margin challenges we face, and any improvement in the U.S. economy will add momentum to our efforts. Our disciplined rate actions have impacted the top line of this business, declining by 7% in 2012. We are intently watching the balance between renewal rate actions and persistency, as well as new business pricing and close rates as we continue to target improved profit margins. Although our core margins improved during 2012 to 2.4% from 1.9% in '11, we're still not at target levels of performance.

We had a very strong fourth quarter with earnings of $39 million. Adjusting for favorable disability seasonality and a onetime expense benefit, we ended the year at a quarterly run rate more in the $30 million range, still very solid.

We have more work ahead, but I'm encouraged that we're starting to see a more rational marketplace and confident we're taking appropriate steps to drive continued improvement in our performance.

Turning to 2013 for Group Benefits, we expect the top line to continue to decline. The early 2013 pricing view is extremely positive, with rates increasing in the 15% to 18% range for long-term disability. However, we did not renew our largest account effective January 1 after being unable to agree on terms and have not renewed a segment of our program business. These 2 decisions will contribute to an overall top line decline in 2013 of approximately 10% to 15%, but will have minimal impact on our bottom line performance.

In fact, we expect core earnings growth in the mid- to high teens despite the top line decline. Improved disability results, both STD and LTD, will be the primary driver between -- behind our 2013 earnings growth.

Overall, we think the loss ratio in 2013 will be in the range of 77% to 80% compared with 79.5% in 2012. Taken together, I'm very proud of the work our Commercial Markets team has done in the past year. We have improved alignment and accountability across our Property & Casualty divisions. We have made seamless leadership changes in 3 of our 4 divisions, all while continuing to build momentum in the market. Our outstanding claim operation continues to be a market leader. And we dealt with 2 years of significant CAT activity, but kept our focus on the fundamental blocking and tackling needed to improve P&C Commercial and Group Benefits results. That focus will remain unchanged, and we expect you'll see a continued progress in 2013.

I'll now turn the call over to Andy Napoli.

Andre A. Napoli
Former Executive Vice President and President of Consumer Markets & Enterprise Business Services

Thanks, Doug. 2012 was a year of significant progress for Consumer Markets in which we improved profitability and established the foundation for a return to growth in 2013. Our financial results for the fourth quarter and the full year were strong and demonstrate the effectiveness of our strategy.

In 2011 and into 2012, our primary focus was restoring profitability to auto and homeowners in both our AARP Direct and the Agency channels. In 2010 and 2011, we were willing to accept decreases in retention in new business levels as we implemented above-market rate increases across the board.

As our margins improved, our pricing moderated, and we saw retention and new business begin to recover nicely in 2012.

Now let's shift to our fourth quarter results. Both auto and homeowners were significantly impacted by Storm Sandy, as current accident year catastrophes accounted for 13.8 combined ratio points in the quarter. Excluding CATs and prior year development, our combined ratio improved to 90.0% in the fourth quarter, a 2.4-point improvement from last year, a result we're very pleased with. In homeowners, the improvement was driven by strong earned pricing, coupled with favorable non-CAT weather frequency. Homeowners loss costs also dropped in the quarter due to lower severity of fire losses.

Auto margins also improved, driven by earned pricing increases and favorable liability frequency. The physical damage severity trend increases that began in the second half of 2011 appeared to have leveled off, increasing only slightly in the fourth quarter.

In the quarter, written premium was flat over last year. Auto policy retention improved to 86%, up 3 points over last year and 1 point sequentially. Homeowners improved as well, up 4 points from last year and 1 point sequentially. Auto new business was flat to last year, while homeowners was up 30%, which was driven by the rollout of our Hartford Home Advantage product, most significantly in California where we have very favorable margins.

Now let's shift to Consumer's full year results. Our combined ratio improved about 4 points to 97.4%, driven by an almost 19-point improvement in homeowners, which ended the year at 97.0%, a nice improvement but still work to do to achieve its target.

The combined ratio for auto deteriorated slightly from 2011, finishing at 97.6%. This was largely due to the trend of higher physical damage severity that has since made it into our pricing models.

I'd like to note that these results combined AARP Direct and Agency. AARP auto is performing better and finished near its combined ratio target, reflecting favorable loss experience inherent with this preferred customer segment.

Shifting to growth for the full year, we continued to drive new business in our AARP Agency channel. We grew written premium in AARP Agency by $64 million or 89%, authorizing more than 6,400 agents to write the AARP product.

As mentioned previously, a more -- a majority of AARP members prefer to shop for their insurance through a local agent. And with our AARP auto and home programs now in market across the country, we continue to be very excited about the upside potential of this channel.

Top line trends for AARP Direct have also improved dramatically from a year ago, benefiting from a 2-point lift in both auto and homeowners policy retention, along with improvements in overall marketing effectiveness.

We're growing top line in markets where we expect to be profitable, and AARP members across both channels now accounts for 78% of total written premium, up from 72% 3 years ago.

Now let's move to our 2013 outlook. In 2013, we expect to return to total written premium growth with an estimate of flat to plus 2%, driven by growth in both AARP Agency and AARP Direct.

Growth in AARP Agency will be driven by more deeply engaging our authorized AARP agents as they capitalize on the value proposition offered by The Hartford and the AARP brand. Within AARP Direct, we expect strong new business growth and further improvement in premium retention as we continue to take mid-single-digit written pricing increases in auto and high single-digit written pricing increases in homeowners.

In both auto and homeowners, pricing is being taken to stay ahead of loss cost trends in such a way to achieve or maintain our combined ratio targets.

In terms of auto profitability, we expect an additional point of ex CAT current accident year improvement in 2013. We believe auto frequency will continue to be favorable and that auto severity, both in bodily injury and auto physical damage, will be moderate.

For homeowners, it's important to note that non-CAT weather frequency in 2012 was much better than the historical average, and we expect non-CAT weather loss cost to revert to a more typical level in 2013. Thus, even though we're taking written rate increases in excess of loss cost trends, our outlook calls for a slightly higher ex CAT loss ratio for homeowners in 2013. We expect written pricing increases for homeowners will be a bit higher in 2013 as our rate indications reflect higher CAT loads after several years of damaging tornado and hail events.

In addition to pricing, we've taken action to mitigate risk in homeowners, instituting higher win deductibles and introducing roof value schedules that adjust the claim payout based on the age of the roof. All in, we expect the combined ratio before catastrophes and prior development to fall within a range of 89.5% to 92.5%.

In closing, we're very pleased with the results in Consumer Markets for 2012, and our ability to improve profitability while positioning the division for growth in targeted markets in 2013, and we began the year with positive momentum and focused execution.

I'll now turn the call back over to Liam.

Liam E. McGee
Former Chairman

Thanks, Andy. Thanks to Doug and Chris as well. As you heard from our comments, this was a good quarter for The Hartford and a strong end to a transformational year, and we all feel very good about our progress in the ongoing businesses.
So operator, let's turn it now over to Q&A.

Question and Answer

Operator

[Operator Instructions] Your first question comes from the line of Tom Gallagher with Crédit Suisse.

Thomas George Gallagher
Crédit Suisse AG, Research Division

My first question is just on the earnings guidance. I guess for Chris, can you just remind us the -- how much of a back-end loading we should expect to get from the expense savings here? Maybe if you can frame it in the way of, how are we going to start out in 1Q, where are we going to be by 4Q in terms of the bottom line benefit of cost saves? That's my first question.

Christopher John Swift
Chairman & CEO

Sure. Happy to, Tom. I think just to remind everyone, we had an $850 million total plan and we think about $500 million is already out with the transactions plus cuts we made at the end of 2012. We have $285 million to take out this year. I would say that it is more back-ended because there is a little bit of an expense drag in the first couple quarters primarily. So it's hard to slope precisely, but I would make -- weight more the expense saves. It will start to come out in the second half for the year.

Thomas George Gallagher
Crédit Suisse AG, Research Division

So Chris, that -- the $285 million, is that from now to the end of the year? That's going to be the bottom line pretax benefit that we would expect to see by the end of 4Q?

Christopher John Swift
Chairman & CEO

Tom, those are the gross saves that we need to achieve that we set for ourselves in essence to make up for the lost revenue. So I don't think of it as all dropping to the bottom line, or a very little dropping to the bottom line, in fact, because those are -- revenues and expenses have gone away, and that is the corporate overhead we need to cut in essence to maintain our existing revenue streams. Now there is an incremental goal. In there, you have about a written [ph] $80 million that will improve margins overall. But the vast majority was to cut our overhead expenses in relation to revenues that are going away.

Thomas George Gallagher
Crédit Suisse AG, Research Division

Yes, understood, Chris. I just wanted to make sure because I know you're going to lose the associated revenues in 1Q, but that you would expect to essentially get that back by the end of 2013. Is that the way we should be thinking about it?

Christopher John Swift
Chairman & CEO

Liam addressed this...

Liam E. McGee
Former Chairman

Yes, about 90% of the stranded costs, Tom, that were not transferred to the buyers will be out by the end of this calendar year, the other 10% will come out early in the first quarter. And then, and I will -- I want to be very clear on this. We have this down to the dollar, to the head. We know exactly where it's coming from. We have a very disciplined plan. Yes, this will occur.

Thomas George Gallagher

Crédit Suisse AG, Research Division

I appreciate that. So the -- just moving on to the net amount of risk improvement in Japan. I just want to understand from your standpoint, what does this practically mean for you? Because obviously, when you see a reduction in net amount of risk of that magnitude from 3Q to now, it's been cut more than half, you would sort of assume that an associated liability would be going down pretty meaningfully and potential capital lift or capital getting freed up, but then you have the complexity of money being tied up in captives here. So anyway, just, I guess broad question, what does this mean for you in terms of the yen weakening and the reduction in net amount of risk and the liability from a practical standpoint?

Liam E. McGee
Former Chairman

Well, clearly, the high level, and I'm sure Chris and Doug may have some -- their own perspectives, Tom. At a high level, prima fascia, the economics of the book have improved very significantly. And as I commented, I think the general market consensus is the yen, as it relates to dollar and euro, is likely, worse case, to stay where it is and perhaps even weaken further. So the economics are better. I think you're well aware that our hedging program is very dynamic. And so as the yen weakens, it enables us to take more risks, if you will, which gives us a greater upside. And clearly, as I commented and Chris reiterated in his remarks, the improving economics should give us a greater ability to consider potential derisking transactions either to reduce the risk or permanently move the risk. So I think, from all those perspectives, and ultimately, as these things annuitize, and if they annuitize at these kind of values over the next 4 years, that's also attractive to us from an economic and cash flow perspective. So I think we're quite encouraged by this. I think that the magnitude of the reduction and the net amount of risk, I think, does give shareholders a view of -- with more normal yen-dollar, yen-euro, the economics are much more manageable for us.

Christopher John Swift
Chairman & CEO

Yes, I think you're right on, Liam. And I think, Tom, also, I think the April Investor Day, the real intent is to dive deeper with Beth and her team into exactly some of those questions, how we see these blocks running off, policyholder behavior, sensitivities, more economic values. So stay tuned. But we'll try to be much more clear of why we think the net economics of these blocks are improving significantly, as Liam said.

Thomas George Gallagher
Crédit Suisse AG, Research Division

Got it. And then just my last follow-up on that is, Chris, you had mentioned the annual cash spend on hedging has gone from $200 million to $250 million to $75 million to $100 million. Is that mainly the currency hedge getting -- being able to hedge less, it's -- or it's cheaper, or is that not related to the currency?

Christopher John Swift
Chairman & CEO

Not related to the currency. That reference, I thought the words that I used were macro hedged. So as the macro equity protection that -- with Bob Rupp and the team, we just made much more economics virtually for the same amount of coverage. So we cheapened up that program, and the risk management techniques of managing Japan is still our dynamic program, where we manage interest rates, currency and equity dynamically.

Thomas George Gallagher
Crédit Suisse AG, Research Division

And I believe, you had said you were spending $200 million on a currency hedge or so annually, is that still about the same?

Christopher John Swift

Chairman & CEO

No, never talked in those terms, Tom.

Thomas George Gallagher
Crédit Suisse AG, Research Division

Okay. And any guidance you can give us on what you're spending on currency hedges for Japan?

Christopher John Swift
Chairman & CEO

Again, I think, we could give you general views but we'd like to spend a little bit more time with you in April -- so we save that for April, and we could be more scenario specific, and then you could see the effects of the hedging programs and the economics that emerge.

Liam E. McGee
Former Chairman

Tom, this is Liam. Just one final comment I make. I think the ability to purchase effectively the same protection on our macro hedge at half or less of our historic cost, I hope it is an indication to investors on how far along our risk management has come in the last year.

Operator

Your next question comes from the line of Jay Gelb with Barclays.

Jay H. Gelb
Barclays PLC, Research Division

Liam, I'm very glad to hear you're feeling better as I'm sure everyone else is.

Liam E. McGee
Former Chairman

Thank you, Jay. Very kind of you. I feel -- I actually feel great and very blessed.

Jay H. Gelb
Barclays PLC, Research Division

Glad to hear it. With regard to the capital deployment, the proceeds from the sale of the units was around $2.2 billion, and it appears currently around $1.5 billion of that is being deployed into debt repurchase and share buybacks. So I think what a lot of people are wondering is, why hold back the $700 million?

Liam E. McGee
Former Chairman

Well, you're correct, Jay, that, first of all, we presented management and the board's capital management plan, and work collaboratively with our regulators, and we're gratified that they approved the plan that we presented to them. I'll just go back to the concept, which I think I've been very consistent about over the last 3 quarters, is, first of all, we are going to do share repurchases, the $0.5 billion that we have outlined, which clearly will be accretive for shareholders. Second of all, we will reduce the holding company debt by $1 billion. A couple of additional perspectives, as I make on that. First of all, as you recall, The Hartford, during the financial crisis, significantly levered up, number one. Second of all, the foregone earnings from the sold businesses require us to delever a little bit. And third, we do want, we've said all along that we want to be more of a P&C centric, a leading P&C-oriented company, and we want to get our leverage down, as Chris and I both said, in the low 20s and our debt service coverage up in that 5 to 6 range, also accretive for shareholders. $55 million reduction in our interest cost as well. I've always been clear that it was likely that we were going to preserve capital in our life subsidiaries, which I think is even more important now with the improving markets that we just discussed with Tom when transactions, whether it'd be customer offers either in the U.S. or Japan, potential permanent transactions or other risk reduction transactions, may be more available and we want to be ready to act as soon as those things present themselves. So I think this is a very thoughtful, balanced plan. It is very friendly to shareholders. And that third element of being able to either reduce or permanently eliminate VA liabilities is also very good for shareholders. I think you'd agree. So I think it's thoughtful, it's balanced. We feel very good about it. And I remind you, as I said, I think Chris alluded to it, our intention particularly with the historic capital generating ability of our go-forward businesses, as well as what we expect will be some success reducing or permanently eliminating VA liabilities of these market values, our intention is to continue to have a consistent capital management approach of returning excess capital as appropriate to our shareholders. But this is our plan now for '13 and '14, and we feel good about it.

Jay H. Gelb
Barclays PLC, Research Division

Okay. On the variable annuity guarantee exposure, last night, as I'm sure you saw, Berkshire Hathaway announced a deal with Cigna to reinsure the remainder of those guaranteed minimum benefits. Would something like that have an attraction to Hartford as well, knowing that already a good portion of it is -- of that exposure is reinsured?

Liam E. McGee
Former Chairman

Well, at a high level, Beth may have some comments. I would say, first of all, obviously, I can't comment on conversations we may or may not be having for obvious reasons. What I can assure you of, particularly with the capital flexibility and I think more normal market scenario we have today, Beth and her team are leaving no stone unturned in terms of ways to move the risk off or reduce the risk, which very well could include transactions. Beth, anything you'd like to add?

Beth A. Bombara
Chief Financial Officer and Executive Vice President

Yes, I think Liam has said it very well. He said from the beginning that we are open to looking at transactions where they make sense, so we're -- our view of the underlying economics are there, and we can maximize the use of our resources and our capital to reduce our risk. So we continue to work with our advisers, and we'll continue to evaluate opportunities in that space. I think seeing transactions getting done, seeing different players that are interested in these exposures, I think, is all positive for us.

Jay H. Gelb
Barclays PLC, Research Division

Okay. And then just a quick one for Chris or Sabra. The corporate expense in 2013, that's going to -- I believe you said $40 million less. Is that $40 million less than the $315 million that was the full year 2012 core corporate impact?

Christopher John Swift
Chairman & CEO

Yes.

Operator

Your next question comes from the line of John Nadel with Sterne Agee.

John Matthew Nadel
Sterne Agee & Leach Inc., Research Division

Let me echo Jay's comments. Liam, I'm very happy to hear you're in good health. A couple -- just one quick follow-up on Tom's question about the expense saves or cuts. I just wanted to clarify. So should we think about $285 million as the total expense saved for all of 2013, and should we think about that as a run rate by the fourth quarter? So something like $70-or-so million by the fourth quarter?

Christopher John Swift
Chairman & CEO

No. That -- you think about that as the actual cuts that will happen in 2013, so that's a run rate reduction that will be achieved by the end of '13.

Liam E. McGee
Former Chairman

John, our commitment was -- we've all been associated with selling businesses and not getting the costs out. Our commitment was we're going to get all the costs out, and so we're -- that's why we've been so clear about it. And again, I'll reiterate, we're very disciplined about it in the company. Those -- this will be a cost neutral exercise at the end of the day.

John Matthew Nadel
Sterne Agee & Leach Inc., Research Division

Fully appreciate that. The guidance for 2013, what -- if you could give us sort of a modest ROE range, what type of ROE are you expecting to achieve?

Liam E. McGee
Former Chairman

John, I think at a high level, we're going to give you some more details in ROE in April. I think '13 is a year where if we see ROE increase, it will be very modest. The real increase in ROE is going to occur in '14 -- in '14 and 15. We'll show you that. You should expect pretty significant increases in ROE in '14 and '15. But with all the moving parts, the kick-in over time of the capital management actions, the loss of the earnings, and as Chris said, a bit of a lag in getting the costs out and we've increased our CAT load as well. I think '13 is a year where if we see ROE increase, it will be modest.

John Matthew Nadel
Sterne Agee & Leach Inc., Research Division

Okay. And then just finally. Given all the shifts in capital in the life side, in particular, reflecting the business unit divestitures, the dividend, et cetera, is it fair for us to assume that the vast majority of what's remaining pro forma at $6.6 billion or $6.7 billion of life statutory capital relates to the runoff U.S. VA business? Or is there something else still remaining in there, the Group Benefits business or other?

Christopher John Swift
Chairman & CEO

John, I think you're right. We tried to talk about this the last time. We think of sort of $6.6 billion as the new beginning normal, $4 billion for the life statutory surplus. Of that, approximately $1.5 billion, it would be, I'll call it, allocated to Group Benefits, and there's a little bit allocated to the reinsurance sort of recoverables from our transaction. So that's how we think about it. And then, we have obviously the holding company liquidity also. But from a statutory bluebook side, that's how we think about it.

Operator

Your next question comes from the line of Mark Finkelstein with Evercore Partners.

A. Mark Finkelstein
Evercore ISI, Research Division

I've got a few. I guess my first question, kind of back to Gallagher's question a little bit. And maybe the way I'll frame it out is, back in -- what was it, October of 2011, you gave some scenarios around the Japan block and kind of a benign scenario, as well as a kind of an adverse scenario. The question I would ask is when you look at where things are today, the yen kind of JPY 93, market is higher, et cetera, should we expect a meaningful improvement in that net cashflow in that benign scenario in the Japan block?

Christopher John Swift
Chairman & CEO

It's a definition of meaningful. It is improved, and I would say, particularly, if the trend continues, it can be meaningful. But it is a definite improvement, and again, something we could talk more about in April, and we plan to. So if you could let us update our complete models and present them to you, I think that would be very helpful.

A. Mark Finkelstein
Evercore ISI, Research Division

Okay. And then Chris, just how do we think about statutory capital generation in the life company going forward? Obviously, you've had some expenses in annuities, markets are a tailwind, you've got Group Benefits improvements. I mean, how should we think about free cash generation in the life business?

Christopher John Swift
Chairman & CEO

I'm more positive on it, particularly at these market levels and condition. You've always heard us talk about the low interest rates and sort of the constraints that, that has and some of the additional liabilities we put up at the end of the year. But I would say, there's more tailwind mark to have a modest expansion in statutory surplus going forward in '13. Beyond that, a lot depends just on market conditions and policyholder behavior. But I'm encouraged with the potential to do increase in gross surplus in 2013.

A. Mark Finkelstein
Evercore ISI, Research Division

I guess, just a follow-up on that. I mean, just if things kind of trended from here the way you would ordinarily expect them or how you normally model them, would you expect the VA business to generate capital in '13?

Christopher John Swift
Chairman & CEO

Yes. I would say I'm not hesitating, I'm just trying to quantify it from a range. I mean, it's in the range of a couple hundred million we could generate from the VA book over time. And then I'd remind you, that the life -- the Group Benefit operations are also in there, but we do have some interest sensitive liabilities that will still feel some pressure from interest rates. So I'm trying to be balanced on the positives but still, the existing pressure on certain blocks of business.

A. Mark Finkelstein
Evercore ISI, Research Division

Okay. And then just one quick final question is, I saw the cut in the macro hedge costs more than in half. Are there any changes in how we should think about the below the line kind of structural loss on the dynamic hedge, which I think historically has been around 15 bps? Or is that about the same going forward?

Christopher John Swift
Chairman & CEO

On the dynamic program was your question or the macro?

A. Mark Finkelstein
Evercore ISI, Research Division

No, you told us the macro, I'm thinking more about the dynamic.

Christopher John Swift
Chairman & CEO

Right. The dynamic for both pieces, Japan and, I'll call it, the U.S., I would say, are generally remain consistent. And we've talked generally about it in total, about 40 bps for both programs.

A. Mark Finkelstein

Evercore ISI, Research Division

Right. But the macros -- I assume the macro is much lower than the 25 that you've historically talked about, is that wrong?

Christopher John Swift
Chairman & CEO

The macro, we just said, was $75 million to $100 million in annual spend. I mean, I think you could do the translation, which less is coming down. But the dynamic program for the U.S. VA block and the Japan block still is in -- around 40 bps.

Operator

Your next question comes from the line of Brian Meredith with UBS.

Brian Robert Meredith
UBS Investment Bank, Research Division

Just a couple of quick questions here. First, with respect to the capital management, one quick question, Chris. You've got like, I guess, $520 million of debt coming due over the next 2 years. How do you plan on dealing with the remaining $40 million? Do you have any call provisions in any of your debt? Or will you have to go into the marketplace and buy it?

Christopher John Swift
Chairman & CEO

I'd rather not be too specific. It really involves a tender process. So we're going to be active here in the near term, but we are looking at trying to reduce that debt that ultimately is NPV positive compared to any premium that we might pay.

Brian Robert Meredith
UBS Investment Bank, Research Division

Okay. So in the $1 billion -- the $1 billion is a part reduction, right, so it could cost you a little more than $1 billion to actually reduce it?

Christopher John Swift
Chairman & CEO

Yes. So the $520 million is the component of the $1 billion, and then the rest would come to reducing the amount that we will tender for.

Brian Robert Meredith
UBS Investment Bank, Research Division

Great. And then the next question, I'm just curious to know you've kind of carried [ph] by this, how did you come up with the $500 million of share buyback by year-end '14, particularly given the additional liquidity, you've got the holding company and the capital generation you'll have over the next 2 years, which should be pretty substantial?

Liam E. McGee
Former Chairman

I think I'll just go back to what I said. We're really working -- management working with our board. I believe this is the most prudent, balanced approach. All 3 elements of it are very accretive for shareholders. And for the reasons that I noted, both the amount of leverage that the company added during the crisis, the earnings loss from the sold businesses and our desire to get a balance sheet that is consistent with our go-forward strategy of being a P&C-centric company, as Chris -- I think, as Chris has noted, the $1 billion was the right number. We thought $0.5 billion was the appropriate number for buybacks. I think, as Chris has said, we'll be pretty methodical about that. And then lastly, I think, for reasons that should be even more apparent now, preserving incremental capital in the life subsidiaries to potentially do the most accretive thing, which is to either reduce or eliminate VA, and particularly Japan VA risk, we thought was a really good balance, and as I said earlier, I feel really good about the plan. And then I'd reiterate for the reasons that I said earlier, we -- Chris and I intend to have a consistent capital management approach of returning excess capital as appropriate to shareholders going forward once this plan is complete.

Brian Robert Meredith
UBS Investment Bank, Research Division

Okay, great. And then just a quick question with respect to the specialty business, Doug, it was -- wonder if you could tell a little bit about what needs to be done to really improve the profitability there. Is it a pricing issue? Is it a risk selection issue? And how quickly do we think we can get those underlying combines down into, call it, mid-90s area, where they probably need to be?

Douglas G. Elliot
President

Yes, good question, Brian. And let me just give you some context. I think this will help all of you think through this. Inside our specialty businesses, we really have 4 businesses. We've got our national account business, which largely is an excess -- casualty excess workers' comp line. In the program captive area, we have some dollar 1 programs, but we also have pretty significant excess casualty programs in there as well. And then, obviously, we have our D&O financial products business. When you look at the 4 businesses, 2 of those businesses have target combined ratios for our levels excess 100% right? So we have a mixed component of businesses in there. Our national account casualty business for returns in the teens has target combined ratios in excess of 107% to 110%. So when you look at combined ratio, you can't just think of specialty as, okay, where is my D&O book running? So I give you that as an outdrop. Number two, our national account book had a terrific 2012. We're very satisfied with our returns. We feel good about that book. And as I've mentioned, we have work right now underway inside our program and excess program captive group as well. And last but not the least, our D&O book needs work just as others in the industry would describe as well. So we are attempting to achieve rate. Our rate incline so far for 2012 fourth quarter in the mid single-digits, but we're not satisfied yet with our combined ratio performance in our professional practice.

Operator

Your next question comes from the line of Jay Cohen with Bank of America Merrill Lynch.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

A couple of questions. First, on the workers' comp, obviously, you had a little bit of adverse development, not that much, but still it is kind of an ongoing drag. And I'm wondering if you could talk about what's happening from a claim standpoint. You had talked about frequency popping up, I guess, about 1.5 years ago. What are you seeing these days?

Douglas G. Elliot
President

Jay, this is Doug. You're right. We have worked hard at our workers' comp book, both actions in the marketplace and also books and records relative to reserving. I would say this in terms of frequency severity. Our frequency has really settled down very well in our Middle Market based on the actions and drivers that we've taken over the last 5 or 6 quarters. We're seeing a little bit of continued frequency in Small Commercial. I think, we've got our focus around a few key programs that's driving it and a little bit on the geography side, but what -- we have started to take steps to address it, and that's where that margin pressure has come from in small, albeit, very, very solid returns still in that small arena. So I feel like comparing where we were 12 months ago to where we are today, I feel so much better about our comp progress. More work ahead but significant strides in the last 12 months.

Jay Adam Cohen

BofA Merrill Lynch, Research Division

Got it. And then on the -- just the buyback portion of the capital plan. I could see, over time, why you would want to be consistent in your buyback activities if it's based on earnings. But in this case, it seems to me, you've got capital free and clear, it's at the holding company, you don't need it. Why wait 2 years to return a relatively modest amount of capital to shareholders when doing it quicker would be even more accretive, if, in fact, it is free and clear?

Christopher John Swift
Chairman & CEO

Jay, it's Chris. Thank you for your perspective. I think, as Liam said, we do feel good with the overall plan on debt and equity, the priorities and sort of the amounts that we're starting with. Consistency portion is important to us. I think to your specific point, I think, you just need to keep in context that we're still managing large risk positions in our runoff block. And so we're looking...

Jay Adam Cohen
BofA Merrill Lynch, Research Division

You have capital in the runoff business to handle that.

Christopher John Swift
Chairman & CEO

Yes, but we're still managing to stress scenarios. That would indicate that we still need to move capital and liquidity around the organization if those stress scenarios emerge. So I understand your perspective when you see it. But when you stress the organization the way we share with the regulators and the rating agencies, the plan that we adopted is still the prudent one for 2013 and as we head into 2014.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Okay. And then if I could ask one last question, I don't want to overstep my bounds here. But you have seen 2 other transactions where runoff businesses have been eliminated or sold to another party. What makes your runoff business different than Sun Life or Cigna's that makes it more of a challenge for you to complete a similar transaction?

Liam E. McGee
Former Chairman

Well, Jay, I think that's a big leap to assume that's the case. Just because we haven't done one, it doesn't mean it's more or less challenging than those that have been done, number one. We certainly are well aware of the unique characteristics of certainly, the Sun Life transaction have been done for a while and what we've learned of the Cigna transaction. And again, I don't think it's appropriate for us to talk about the nature of discussions that we may be having. So what I can say is what I think Chris and I and Beth have said pretty repeatedly, as you can assume, we're talking to the parties we should be talking to or the advisers we should be talking to, and if there's a transaction that makes sense for us and for shareholders, we'll do it.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

So there's nothing specific about your business that really prevents you from engaging in such a transaction?

Liam E. McGee
Former Chairman

I think there are nuances and idiosyncrasies to every book. But at a -- in a general sense, no.

Christopher John Swift

Chairman & CEO

Jay, I would add a little color that -- and Liam's right. I mean, we're -- Beth and the team are very proactive. But as we've talked about it, the book really has 3 components, Japan, VA, U.S. VA and a big fixed block of annuities. Those characteristics are different so there isn't going to be one holistic transaction that just sort of says, yes, here it is. I think, structurally, we have some short-term limitations given that we write the Group Benefits business in life legal entities. And if you look at the deal besides the Cigna deal that you referenced, those involved legal entities, where acquirers wanted legal entities and structures to absorb. We can't do a legal entity deal right now until we deal with the Group Benefit business and where it's being written. So there are some short-term constraints. But over the long-term, you ought to think in terms of what we're thinking along those 3 blocks in trying to have buyers that have appetite for Japanese exposures, U.S. VA exposures and fixed annuity exposures here in the U.S.

Operator

Your next question comes from the line of Eric Bass with Citigroup.

Erik James Bass
Citigroup Inc, Research Division

So first question, can you just talk a little bit about how much capital do you expect the core ongoing business kind of x the runoff to generate in 2013?

Christopher John Swift
Chairman & CEO

Erik, I would estimate that the core P&C business would generate about $900 million of statutory surplus. I would estimate that the Group Benefits business would generate approximately $100 million to $125 million. And then what we did with our life Mutual Funds operations, moved it up to the life holding company. I would say that the cash-based earnings that we could have access to, thereabout $75 million.

Erik James Bass
Citigroup Inc, Research Division

Okay, that's very helpful. And then just one follow-up on -- Chris, I guess, on the point you are just making on kind of the moving of the Group Benefits business. If you could talk a little bit about maybe what that process is and then any other actions you're taking within kind of the U.S. life subs to isolate and consolidate the variable annuity blocks, and maybe a timeline for potentially completing this.

Christopher John Swift
Chairman & CEO

I think what I would just like to share, Erik, is that the Group Benefits business is strategically important to us. It's written in 2 life legal entities currently, and we're figuring out what is the right structure going forward. So there isn't anything sort of an aha here. This is just what legal entity are we going to use to write Group Benefits. And we're going to align it to Doug and his management team going forward. It's just as simple as that.

Erik James Bass
Citigroup Inc, Research Division

Okay. And then on the annuity side. The Japan block is standalone, but the, I think, the other -- the U.S. piece is in -- is it 3 different entities currently?

Christopher John Swift
Chairman & CEO

Yes. We have 3 different U.S. legal entities that write that. And we're looking at, obviously, a lot of different strategies to how to manage legal entities and books of business over the long term. But once -- if we make any changes, we'll let you know, but we're always looking to how to be more efficient with our operating structures, our hedging programs and long-term risk management.

Operator

Our last question comes from the line of Bob Glasspiegel with Langen McAlenney.

Robert Ray Glasspiegel
Langen McAlenney

On the migration to becoming a Property-Casualty company when you grow up, I mean, you talked about the -- getting your debt in line with P&C peers. I'm curious on where the investment portfolio stands on that migration? And just looking at your BBB's are 26%, your bigs [ph] are 5%. You've got 3% in CDOs. Travelers, which is probably at one end of the spectrum, is at 9% BBBs, 3% junk and no CDOs. You obviously needed to get your ROE higher to -- so there's a tension on that point. So are you closer to using an AIG game plan of cranking up risk here on the margin? Or do you want to move more towards Travelers over time, and how long would that take?

Christopher John Swift
Chairman & CEO

Bob, it's Chris. I would say, we're trying to have a prudent portfolio. We probably favor a Travelers model long term. There are some holdover and transitional issues as we migrate out of some of our life books and assets that were retained or transferred back to us that the buying parties didn't want to have. So I think we'll balance all that out over the next couple of years here. But I think, Brion Johnson and his team at HIMCO have the appropriate mindset to run a P&C and Group Benefit-orientated group going forward. I would say, again, with that Group Benefit business, there are longer duration liabilities that we need to continue to manage there similar to the workers' comp line. So the component could be just slightly different, but think more along the Travelers model long term.

Robert Ray Glasspiegel
Langen McAlenney

So let's say, a couple of years from now, what do you think BBB's would be versus 26% today, down a couple of points or down 5 to 10 or?

Christopher John Swift
Chairman & CEO

Bob, I'm just trying to get through this month and next month, so I'm not really focusing on '14 yet where it's at. But we'll see if maybe, at Investor Day, we can address that. But I don't have a vision right now for you.

Beth A. Bombara
Chief Financial Officer and Executive Vice President

Thank you. Thank you all, for joining us today. I know it's been a longer call than usual, and we appreciate all your attention. If you have any follow-up calls, please reach out to the Investor Relations department. And again, I'd like to add my invitation to you all to join us on April 11 in Hartford for an Investor Day focused on Talcott Resolution. Thank you all, and have a great day.

Operator
This concludes today's conference call. You may now disconnect.