S&P Global
Market Intelligence

The Hartford Financial Services Group, Inc. NYSE:HIG

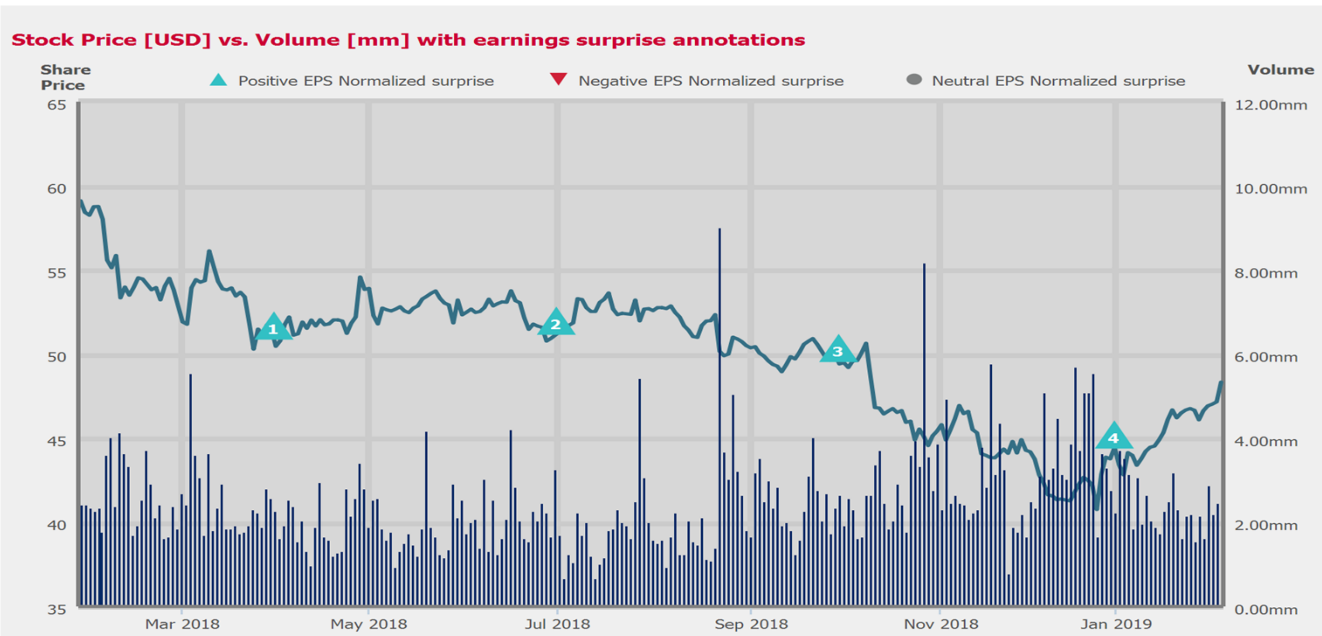
FQ4 2018 Earnings Call Transcripts

Tuesday, February 05, 2019 2:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ4 2018-			-FQ1 2019-	-FY 2018-	
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	ACTUAL
EPS Normalized	0.57	0.78	▲36.84	1.24	4.13	4.33
Revenue (mm)	4728.33	4633.00	▲(2.02 %)	4798.00	19145.18	18955.00

Currency: USD
Consensus as of Feb-05-2019 12:18 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ1 2018	1.07	1.27	▲18.69 %
FQ2 2018	1.02	1.13	▲10.78 %
FQ3 2018	1.05	1.15	▲9.52 %
FQ4 2018	0.57	0.78	▲36.84 %

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Call Participants

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Chairman & CEO

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Presentation

Operator

Good morning. My name is Shelby, and I'll be your conference operator for today. At this time, I would like to welcome everyone to The Hartford Announces Fourth Quarter and Full Year 2018 Financial Results as well as 2019 Outlook Conference Call. [Operator Instructions]

I would now like to turn the call over to Ms. Sabra Purtill, Head of Investor Relations. Please go ahead, ma'am.

Sabra Rose Purtill
SVP, Head of Investor Relations & Treasurer

Thank you. Good morning, and Happy Chinese New Year. Thank you for joining us today for our webcast to discuss the 2019 key business metric outlook and fourth quarter and full year 2018 financial results, which were all released yesterday afternoon. The news release, investor financial supplement and financial results presentation slides are available on our website as well. The 10-K will be filed by the end of February 22.

Our speakers today are Chris Swift, Chairman and CEO of The Hartford; Doug Elliot, President; and Beth Bombara Costello, Chief Financial Officer. Following their prepared remarks, we will have a Q&A period.

Just a few comments before Chris begins. Today's call includes 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 could be materially different. We do not assume any obligation to update information or forward-looking statements provided on this call. Investors should also consider the risks and uncertainties that could cause actual results to differ from these statements. A detailed description of those risks and uncertainties can be found in our SEC filings.

Our commentary today includes non-GAAP financial measures. Explanations and reconciliations of these measures to the comparable GAAP measure are included in our SEC filings as well as in the news release and financial supplement.

No portion of this conference call may be reproduced or rebroadcast in any form without The Hartford's prior written consent. Replays of this webcast and an official transcript will be available on The Hartford's website for 1 year.

Finally, please note that Chris and Beth will be at the Bank of America Merrill Lynch Insurance Conference on February 13 with a fireside chat at 10:00 a.m. And in addition, John Wilcox, our Chief Strategy and Ventures Officer, will be on an innovations panel that starts at 11:45 a.m. that day. Both will be webcast.

I'll now turn the call over to Chris.

Christopher Jerome Swift
Chairman & CEO

Good morning, and thank you for joining us today. 2018 was another great year at The Hartford. We had numerous accomplishments, including excellent financial results despite a second consecutive year of high catastrophe losses. Full year 2018 net income was $1.8 billion, and core earnings were $1.6 billion or $4.33 per diluted share, up 58%. The core earnings ROE for the year was 11.6%, well in excess of our cost of capital.

With the exception of catastrophe losses, business metrics were in line or better than our outlook. Group Benefits had an outstanding year with better-than-expected disability experience and investment income. Commercial Lines delivered strong results, including superb Small Commercial underwriting performance, new business production and retention. The Commercial Lines' underlying combined ratio improved about 50 basis points to 91.5, among the best in the industry.

Personal Lines results were negatively impacted by 2 hurricanes and the largest U.S. wildfire loss in insurance industry's history. However, the underlying Personal Lines combined ratio of 91.2 was in line with our outlook and 2 points better than 2017.

New business levels were up in Personal Lines this year, which was a key goal that aligns with AARP objectives. This partnership, which is approaching 35 years, is truly unique and collaborative. We provide their membership with unique products and quality service, and we are working together to grow the book with a focus on AARP's younger cohort, ages 50 to 60.

In addition to financial results, I am pleased with our effective and consistent operational execution in 2018. We continue to make investments in people, processes and technology, enhancing service quality and speed. Our customers and distribution partners value the enhanced digital capabilities, broader product offerings and an expanded risk appetite that we are bringing to them.

Net Promoter Scores continue to climb, and claims quality ratings are strong. This year, we also made progress on our innovation agenda, including the launch of the Small Business Innovation Lab located in New York City and a purchase of Y-Risk, a company specializing in the sharing and on-demand economy.

Finally, major strategic activities in 2018 included the sale of Talcott, substantial progress on the integration of Group Benefits and the announcement of The Navigators acquisition.

Related to the acquisition. Yesterday, we announced the new operating model and organizational structure and the formation of a new global specialty business. This structure aligns with The Hartford's Commercial Lines businesses with The Navigators' U.S. and global operations and will optimize underwriting expertise and distribution relationships. Integration planning is well underway, and the new teams will be out in the market quickly after closing. In addition to its strategic contributions, we expect it to generate an attractive financial return, with incremental annual core earnings before amortization of intangibles of approximately $200 million within 4 to 5 years after closing.

In 2019, we will build on our accomplishments and momentum. Doug will cover the outlook for key business metrics in more detail, but I have a few macro observations.

Overall, we expect our businesses to perform well. U.S. economy remains in a relatively strong position compared to Europe and other parts of the world. That said, we expect some slowdown in the U.S. economy. In addition, with Brexit still unresolved, volatile equity and bond markets, slowing global growth and continued uncertainty about global trade and tariffs, previous tailwinds maybe become headwinds, particularly for investment performance.

In P&C generally, we expect underwriting margins and earnings to remain strong in 2019. With lower catastrophe losses, we expect Personal Lines to improve and underlying margins to remain healthy. In Commercial Lines, we expect underlying margins to remain very attractive but with some modest pressure on workers' comp. Finally, we expect the Group Benefits core earnings margin to remain very strong, although slightly down from 2018 due to lower projected limited partnership returns, consistent with our long-term view.

For 2019, our strategic priorities remain consistent, and we will strive to maintain core earnings ROEs well above our cost of equity capital. Achieving this, along with growing book value, excluding AOCI, and dividends per common share, will drive long-term shareholder value creation.

Turning to operational goals. Expanding product capabilities and risk appetite remain key pillars of our strategy. With the recent acquisitions, we will have what we need, and we'll be intensely focused on realizing the combined potential, including deepening distribution relationships and meeting a broader array of customer needs.

In addition to product depth and breadth, our strategy also emphasizes customer focus and talent management as well as building capabilities that make us an easier company to do business with.

We take pride in our ability to attract and retain talent and having a diverse and inclusive workforce with a strong ethical culture. We are consistently recognized for leadership in these areas, including being designated the World's Most Ethical Company for the past 10 years by Ethisphere and a member of the Bloomberg Gender-Equality Index for the fourth consecutive year. Recently, we were named a Best Employer for Women by Forbes in their first ranking on gender equality. Finally, we expect our organic capital generation to remain strong in 2019 and beyond, which will help fund the $1 billion share repurchase authorization we announced yesterday.

Beth will discuss our approach in using the plan, but I want to emphasize that our capital management philosophy has not changed. We remain committed to a strong balance sheet and will continue to balance investing in the businesses for profitable growth, with returning excess capital to shareholders that exceed business requirements.

To conclude, 2018 was an excellent year, and I'm really pleased about our operating performance and execution mindset. We are working hard to maintain and expand the momentum of progress and look forward to sharing the results with you.

Now I'll turn the call over to Doug.

Douglas Graham Elliot
President

Thank you, Chris, and good morning, everyone. 2018 was an excellent year for Property & Casualty and Group Benefits. Each of our business units delivered strong underlying financial performance. And operationally, we continue to hit aggressive targets on our major initiatives.

It was an outstanding year for Group Benefits. We're meeting or exceeding all milestones for the Aetna integration. Sales are very strong, and we delivered a year of record core earnings.

In Commercial Lines, we continue to set the bar for superior customer service and underwriting performance among small businesses. Our Middle Market industry verticals are gaining traction. And with the acquisition of Navigators, we are poised to deepen our relationships with customers and brokers with an expanded product suite and new underwriting expertise.

In Personal Lines, our underlying auto results were strong, and the business is better positioned for both auto and home new business growth in 2019. This is the second year in a row marked by severe wildfire losses and hurricane activity. Our claims team and our entire enterprise continue to respond with care and professionalism in the aftermath of these tragic events. However, the losses were significant to our fourth quarter results.

We continue to evolve our catastrophe risk management strategies based on the loss events in recent years with increased focus on wildfire. This includes refinement of our loss models, exposure limits, underwriting guidelines and risk transfer arrangements. While we're generally pleased with how our overall book of business and risk management program performed given the CAT events of 2018, we will continue to refine our wildfire and tornado/hail catastrophe underwriting approach.

Let me pivot now to summarize our financial performance for 2018, and then I'll conclude with some thoughts about 2019. Beginning with Group Benefits, we posted core earnings for the year of $427 million, up $193 million from 2017 with a core earnings margin of 7%. This outstanding performance relative to our outlook was due to favorable disability loss cost trends and limited partnership income.

The group disability loss ratio for the year improved by 3.4 points due to the emergence of favorable incident trends on the most recent accident years and, to a lesser extent, slightly higher pricing. The group life loss ratio remained solid but was up 1.7 points versus prior year, due mainly to a mix of larger accounts from the acquisition, which carry a slightly higher loss ratio.

Fully insured ongoing sales for 2018 were $704 million, exceeding our expectations for the year. And persistency on our employer group block of business was stable at approximately 90%. This was simply an outstanding result from our sales and underwriting teams.

As I noted earlier, our integration plans are on track. Our 2019 results will include approximately $85 million of our $120 million expense savings target. We expect to achieve the additional expense savings as we complete the conversion of business to our new systems.

Conversion of Middle Market and large case customers to our newly launched Ability Advantage claims platform has commenced and will continue throughout 2019 and 2020. The reception of our new capabilities among customers, prospects and brokers has been overwhelmingly positive.

In Personal Lines, results for 2018 swung to a core loss of $28 million, including catastrophe losses of $546 million before tax or 16.1 points versus our 2018 outlook of 5.6 points. The full year underlying combined ratio, which excludes catastrophes and prior year development, improved 1.8 points to 91.2, driven by better results in both home and auto.

The Personal Lines auto underlying combined ratio improved 1.5 points to 98.2 for the full year, driven by earned rate increases and moderate loss cost trends, partially offset by higher expenses due to increased marketing efforts.

Commercial Lines core earnings were approximately $1.2 billion for the year on a combined ratio of 92.6. This includes catastrophe losses of $275 million or 3.9 points versus our outlook of 2.6 points. The underlying combined ratio was 91.5 for the year, improving 0.5 point over 2017, driven by general liability and commercial auto.

The underlying combined ratio for Standard Commercial Lines workers' compensation was generally in line with 2017, which was a very strong result given the competitive market and recent loss trends.

Renewal written pricing in Standard Commercial Lines was 2.1% for the full year, down 1.1 points from 2017, driven by workers' compensation. Fourth quarter 2018 renewal written pricing was down sequentially from third quarter, driven largely by Small Commercial workers' compensation.

Overall, I'm very pleased with how effectively our team is balancing growth and profitability. We continue to be confident in our ability to manage workers' compensation loss cost trends despite the slight uptick in frequency we've noted in recent quarters. In the fourth quarter, we began to see those trends flatten. Accordingly, we made no changes this quarter to our workers' compensation loss picks for accident year 2018. This flattening suggests that 2018 may have been a onetime step change as the economy adjusts to recent growth and record employment levels.

Shifting to our other business units. Small Commercial had another outstanding year. The underlying combined ratio was 87, improving 0.8 point from prior year. Retentions remained strong, and new business increased to $637 million for the full year, up 7%. Total written premium increased 1%.

In Middle Market, we posted an underlying combined ratio of 96.1 for the year, essentially flat with 2017. The slight loss ratio increase was more than offset by a lower expense ratio and a decrease to policyholder dividends. Retentions remained solid, and new business production of $553 million was up 14% versus prior year. Total written premium increased by 5%.

We're achieving positive results from our investments in new industry verticals and efforts to improve our underwriting process, which allows our underwriters to focus on building a strong new business pipeline while making appropriate risk decisions.

In Specialty Commercial, the underlying combined ratio was 97.5, 0.3 point lower than 2017, driven by an improved expense ratio. Total written premium was up 2%.

In National Accounts, our underlying combined ratio improved by 3 points, primarily due to a lower expense ratio. Bond delivered consistent underwriting results and 4% written premium growth. And in Financial Products, our Middle Market-centric platform delivered strong written premium growth of 8%.

Before I turn things over to Beth, I'd like to share a few thoughts about 2019. In Group Benefits, we remain focused on successfully converting customers to our newly deployed Ability Advantage claims system. This platform is a distinctive capability that puts us at the forefront in using data and analytics to better manage disability and workplace absence.

January is off to a solid start, with renewal retention and new sales on par with prior year. For the full year, we expect the Group Benefits core earnings margin to be between 6% and 7%. In Personal Lines, we will continue to drive new business growth in AARP Direct. For 2019, we expect to achieve a Personal Lines combined ratio of 97.5 to 99.5, including 6.5 points of catastrophes.

In Commercial Lines, our top priority for 2019 is the successful integration of Navigators into our business operations to accelerate our strategy. However, my comments this morning provide 2019 insights regarding the current commercial business of The Hartford. Across the marketplace, we continue to see varied competitive conditions based on line of business, geography and industry. In property, general liability and commercial auto, we expect renewal written pricing to be generally consistent with 2018. In workers' compensation, we expect pricing to be flat to down modestly. With 2018 accident year frequency flattening in the fourth quarter, we believe this continues to be a very manageable level of pricing change. And while margins may compress slightly, profitability for the line remains attractive. As a result, we expect the 2019 Commercial Lines combined ratio to be between 94.5 and 96.5, including 3 points of catastrophes, generally consistent with our performance for 2018.

Overall, 2018 was a strong year for all of our business units across Property & Casualty and Group Benefits. We're a disciplined underwriting organization committed to maintaining strong margins and seeking growth when it meets our profit targets. We continue to effectively segment our business to determine those accounts that need price increases to reach target margins as we balance growth and margins.

2019 represents a new and significant phase in our journey. With our acquisition of Navigators, we are well positioned to advance the key elements of our strategy: profitable product and underwriting expansion, deep partnerships with our distributors and outstanding value to our customers.

Let me now turn the call over to Beth.

Beth Bombara Costello
Executive VP & CFO

Thank you, Doug. I'm going to cover results for the investment portfolio, Hartford Funds, and Corporate and also comment on the announced share repurchase authorization.

The investment portfolio continues to perform very well. Net investment income was $457 million for the quarter, up 16% from the prior year quarter. Net investment income of $1.8 billion was up 11% for the year, primarily due to higher partnership income and higher invested assets. The increase in invested assets was driven primarily by the Group Benefits acquisition and receipt of proceeds from the sale of Talcott Resolution. For the year, limited partnerships generated a 13% return, primarily due to strong private equity results and gains from real estate partnerships versus our outlook of 6%.

The total portfolio yield for the full year was 4% and excluding LPs was 3.7%, both flat with 2017. During the year, the average reinvestment rate rose to 4% from 3.5%, which reflects the impact of higher interest rates. However, this increase was offset by the lower yield on the invested assets acquired from Aetna after giving effect to the purchase accounting requirements to record the portfolio on the acquisition date at current market yields. The after-tax portfolio yield rose from 3% in 2017 to 3.3% in 2018, driven primarily by the decrease in the corporate tax rate.

The credit performance of our investment portfolio remains very strong, with net impairment losses of only $1 million for the year. During the year, we repositioned the acquired Aetna portfolio to align with our long-term portfolio model, which generated a modest amount of capital losses due to the increase in interest rate since that portfolio was acquired.

Turning to Hartford Funds. Core earnings were up 3% for the quarter and 37% for the year, reflecting a lower corporate tax rate and, for the full year, higher average daily assets under management. Although markets were down in the fourth quarter, our investment performance remained strong, with 68% of our funds beating peers on a 5-year basis. Given the significant market volatility in the fourth quarter and consistent with industry trends, net flows were negative and totaled $1.7 billion. For the year, net outflows were $300 million as Mutual Fund outflows of $1.7 billion were offset by ETF inflows of $1.4 billion.

The Corporate core loss was $46 million for the quarter and $233 million for the year. For the fourth quarter, the core loss was modestly lower than the prior year due to lower interest expense and higher net investment income.

For the quarter, Talcott Resolution did not have a significant impact on earnings since investment management fees, transition service revenues and income from our retained equity interest offset the cost of providing investment management and transition services.

Corporate net investment income totaled $26 million in the quarter. Once we close The Navigators acquisition, pro forma quarterly corporate net investment income will decrease by about $15 million.

At December 31, holding company resources totaled $3.4 billion, which declined to $2.9 billion at January 31 after repayment of $413 million of maturing senior notes and quarterly dividends and interest payments. After the payment of $2.2 billion for The Navigators acquisition, which includes transaction expenses, holding company resources will be close to our liquidity target of 12 months projected interest and dividend expense or approximately $700 million.

In the fourth quarter, we completed our annual asbestos and environmental reserve review. Before cession to the adverse development cover we have in place, net reserves increased by $238 million before tax, comprised of $167 million for asbestos liability and $71 million for environmental. Since inception of the adverse development cover, including the impact of the 2018 study, we have ceded losses of $523 million compared to a limit of $1.5 billion. There is additional detail on our A&E reserves and the adverse development cover in the appendix of the slide deck.

To summarize. Fourth quarter core earnings were $0.78 per diluted share, down 4% from last year, while full year 2018 core earnings were $4.33 per diluted share, up 58%. Aside from catastrophe losses, our actual business results were in line or better than the ranges we provided last February. Book value per diluted share, excluding AOCI, rose 12% for the year to $39.40. And our 2018 core earnings ROE was 11.6%, a strong result in light of heavy catastrophe losses for the year. Total value creation, which includes both the change in book value per share, excluding AOCI, and dividends paid to shareholders, was 15%.

Turning to the balance sheet. We ended 2018 with a debt-to-capital ratio ex AOCI of 24.2%, down almost 4 points from year-end 2017. Including the preferred stock we issued in November, our debt and preferred stock to total capital ratio ex AOCI was 25.9%, and our rating agency debt to total capital ratio was 29.2%. Our goal is to keep the debt leverage within the low to mid-20% range. Between the January debt repayment and the assumption of The Navigators senior note as part of the acquisition, we expect net debt reduction of about $150 million in 2019.

Finally, we are pleased to announce a share repurchase authorization of $1 billion effective through December 31, 2020. We expect to use this plan with discretion, taking into consideration the amount of excess capital as well as the timing of future sources and uses of holding company resources. Given our projected cash flows, which were summarized on Page 7 of the slide deck, we would expect most of this program to be utilized in 2020. As noted earlier, upon closing The Navigators acquisition, holding company resources will be close to our liquidity targets. As holding company resources build in 2019 from subsidiary dividends, utilization of NOLs and AMT refunds, we will have some flexibility to utilize a portion of the authorization this year.

To wrap up, 2018 was an excellent year for The Hartford despite high catastrophe losses. In addition to posting strong financial results, we achieved important operational and strategic goals, including the sale of Talcott and a smooth integration of the Aetna book of business.

In 2019, we are focused on continuing our momentum with the goal of maintaining and improving, where possible, strong margins and top line growth. We are intently focused on maximizing the potential of the 2 acquisitions in Group Benefits and with Navigators and are excited about the opportunities we see to continue to build and strengthen our position as a leading property/casualty and group benefits insurance company.

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

Sabra Rose Purtill
SVP, Head of Investor Relations & Treasurer
Thank you. We have about 30 minutes for questions today. Shelby, can you please repeat the instructions for asking the question?

Question and Answer

Operator

[Operator Instructions] Your first question comes from Brian Meredith of UBS.

Brian Robert Meredith
UBS Investment Bank, Research Division

A couple of quick questions here for you. First, Doug, I'm just curious, your commercial auto results are much better than the rest of the industry. Do you think that has something to do with, like, mix of business? Why do you think that is, why others are seeing some issues with it right now?

Douglas Graham Elliot
President

Brian, so commercial auto has been a focus of ours for -- Chris and I talked last night, at least 5 years. We had some signs in our book 5, 6 years ago that were not acceptable to us, so we worked on closing down some programs. We've been working rate hard. Again, our commercial auto book is largely the complement to our Middle Market strategy and Small Commercial. So it has been a core priority of ours. Keep in mind, we're still not pleased and don't think we've reached the end zone on where our returns are today in commercial auto, but they are much improved from where they were a couple of years ago, and we'll continue to work at the line. As we close up 2018, I feel very satisfied, confident in our reserve calls on the prior years.

Brian Robert Meredith
UBS Investment Bank, Research Division

Great. And then if I take a look at your outlook for the underlying commercial ex -- combined ratio here going forward, a, you've mentioned you're factoring in some deterioration in workers' comp. Any offsets there that we could be thinking of, like in the general liability or improvement in commercial auto? How should we be thinking about how your book should play out here?

Douglas Graham Elliot
President

Yes, it's a good question. So yes, we expect some margin compression in comp, but we also think that we're going to see improved results across general liability, property. And again, we're going to work rate, and we think we can improve our auto book as well. So rate and underwriting, attacking those 3 other lines, I think we're going to see an improved number for performance in 2019. And I think that'll offset some of the workers' comp compression.

Operator

Your next question comes from Ryan Tunis of Autonomous Research.

Ryan James Tunis
Autonomous Research LLP

I just had a couple for Beth. Especially just looking at stat earnings and sources for dividends over the next couple of years, it looks like a really strong stat earnings year. Should we think about -- if you have another like $400 million of stat earnings in Group Benefits, $1.1 billion in P&C, that's higher than what you've guided to for dividends. Does all of that translate to higher dividend to the holdco income over the next couple of years? Or would some of that upside be held in the subs? I'm just trying to understand how that amounts to what could be deployable.

Beth Bombara Costello
Executive VP & CFO

Yes, that's a great question. So when we do our projections for dividend to the holding company, we do tend to look at sort of over the long term, what we've seen from a performance perspective. So that we have a strong degree of confidence that even if business activities are a little different from our outlook, that those dividends should -- can still come to the holding company. So over time, if we see those businesses performing strongly, we can expect to see increase in dividends in outer years. But we try and go into our planning period, putting some degree of looking at just kind of historically what we've seen there.

Ryan James Tunis
Autonomous Research LLP

Got it. And then just trying to get a better feel for the run rate in Corporate once you've closed the acquisition. I think you said that the net investment income is going to come down a decent clip, but I think there might be some other positive offsets to that. Any -- I mean, is there any way you can help me in terms of what the run rate is once we're done with this?

Beth Bombara Costello
Executive VP & CFO

Sure. Yes, it is -- can be a little complicated when you look at the line item-by-line item view of Corporate. But I think if you step back from it, there's really 2 primary drivers of our results in Corporate. The first is going to be interest expense after tax and our preferred dividend. So if you look at 2019, we'd expect that to be about $230 million, and you'd expect to see that pretty ratable over the 4 quarters. And then on investment income, it's really going to be a function of just what cash we have at the holding company. So again, right now, it's a little elevated. I'd expect that to come down. And we're probably more in the $10 million to $15 million range for investment income. And those are really the 2 primary drivers of what you see in Corporate. There obviously is other activities as it relates to the investment management fees that we get from managing the assets of Talcott, but those are pretty much offset by the cost of performing those services. So there's not a lot that drops to the bottom line on that. And then the last item I'd point to is obviously, we'll be picking up our share of our interest in Talcott, the 9.7% ownership that we have. And then obviously, that can vary. So when I put all that together and you sort of look through it, kind of getting to a more normalized run rate on investment income, you're looking at a loss per quarter in the $45 million to $50 million range.

Operator

Your next question comes from Elyse Greenspan of Wells Fargo.

Elyse Beth Greenspan
Wells Fargo Securities, LLC, Research Division

My first question and going back to the Commercial Lines outlook for the coming year and then just trying to drill down a little bit more into the commentary on comp. So it sounds like you guys are expecting stable frequency trends, continuation of what you saw in the fourth quarter. And so can you just expand, is that something you expect within both Small Commercial and the Middle Market books? And were the trends more or less in line within both of those books in the fourth quarter?

Douglas Graham Elliot
President

Elyse, improvement in frequency in both Middle and Small in the fourth quarter and very stable, so pleased about that. And we're expecting that to continue into 2019. So I think you've got a fair summary of what we see moving out relative to frequency.

Elyse Beth Greenspan
Wells Fargo Securities, LLC, Research Division

Okay. And then what should we, from the outside, pay attention to? What do you think it would take for frequency trends to turn negative again? Or is it just kind of more or less paying attention to any changes in the unemployment rate?

Douglas Graham Elliot
President

Well, we're spending a lot of time paying attention to unemployment, for sure. We're watching job growth. We're watching all the economic indicators, including sales. As we look out, we're obviously managing our book of business by territory, et cetera, by class. We're looking for high-growth industries. We're being very careful about how we price forward. So I think the general categories that I talked about on the third quarter call are all key areas that we're focused on. We're also spending a lot of time in our claim group, making sure that we're doing everything possible, with nurse case managers managing major medical. Our managed care networks, we're spending a lot of time because we think we have been able to bend the curve. We think our durations in comp are top of market. And the combination of sound underwriting and excellence in claims, I think, is a really good formula for us to compete moving forward.

Elyse Beth Greenspan
Wells Fargo Securities, LLC, Research Division

Okay, great. And then my second question is related to capital. The disclosure on the slides is very helpful. Beth, in terms of the cash tax receipts, that $600 million to $700 million, it seems like that's going to be a big driver of capital to the holdco to finance what you might repurchase in 2019. Could you give us a sense of timing there? And then I think you said in your prepared remarks that you guys are now looking to keep about 1x interest and dividends at the holdco. I thought in the past, that was 1 to 1.5x. So are you guys okay going forward kind of keeping that at about 1x?

Beth Bombara Costello
Executive VP & CFO

Yes. So -- great. I'll take both of those questions. So on the tax receipts in '19, they're coming from 2 sources. One would be a refund that we're due relative to our AMT credits, and those we'll receive right after -- shortly after we file our tax return. So we typically file our tax return in the third quarter. We'll obviously look to see if there's things we can do to speed that process up, but that's dependent on that. And then the NOLs, the way that, that works through our tax-sharing arrangements with the subsidiaries is we true up quarterly kind of where we are vis-à-vis estimates of taxable income. So there's a source of cash flow that's kind of coming in each quarter related to that. And when you think about the projection that we have for tax receipts that we shared, I'd say a little bit more than half of that is from NOLs, with the remainder coming from AMT. And then for holding company resources, yes, in the past, we've talked about 1 to 1.5x. We've been grading down to 1x as sort of the risk profile of the company itself has changed. And so again, that's the target. It's not an absolute amount, but we feel comfortable being able to maintain holding company liquidity there as we sort of assess all of our access to liquidity across the company.

Operator

Your next question comes from Mike Zaremski of Crédit Suisse.

Michael David Zaremski
Crédit Suisse AG, Research Division

The first question is a follow-up to Brian's question about underlying commercial margins. Were non-catastrophe losses materially above or below expectations for the full year '18? If they were, I hope that you offer some quantification.

Douglas Graham Elliot
President

Let me take that, Mike. For the year, our non-CAT losses in property were pretty much on our expectations. I would say, in our Middle Market business, slightly elevated to our normal patterns, so something that's got our attention, but nothing more than that. And in Small Commercial, we had a very good year.

Michael David Zaremski

Crédit Suisse AG, Research Division

Okay, great. And then a follow-up for Beth on investment income, excluding limited partnership returns. And thanks for all the color on the call so far about the Corporate segment. But my question is, if I look at the new money reinvestment rate, it ticked up 30 basis points this quarter. And I was curious if that's sustainable into 2019.

Beth Bombara Costello
Executive VP & CFO

And I'm assuming your question is on overall portfolio yield, not just in Corporate. But as we look at where we ended the year and what our yield was on an ex partnership basis before tax for 2018, we'd expect to see maybe some increase to that as we go into '19, and obviously, to your point, will be really dependent upon just what -- where reinvestment rates end up being for the full year. But we're expecting to see a slight increase there.

Operator

Your next question comes from Tom Gallagher of Evercore.

Thomas George Gallagher
Evercore ISI Institutional Equities, Research Division

Doug, I just want to be clear that I understand your comments on workers' comp frequency. I think you said they flattened out in 4Q. So does that imply that they recovered from the elevated levels from 3Q? Or were they consistent with 3Q levels?

Douglas Graham Elliot
President

Yes. I'm sorry, let me be very specific. The fourth quarter compare, which did flatten out, so I'm talking 0, would have been a compare to fourth quarter '17, okay? Every time we do our quarterly comparison, we're looking at same quarter last year. So that would have been an improvement over the prior several quarters where we had positive frequency change, meaning more workers' compensation claim losses in the quarters compared to the same quarter prior year.

Thomas George Gallagher
Evercore ISI Institutional Equities, Research Division

Got you. So from what you can see, it does look like that was a temporary increase, and now you think it's more likely to trend where it's recovered to in 4Q.

Douglas Graham Elliot
President

Our thought process that we've shared externally is that it looked to us like '18 was going to be a bit of a step change. '17 was a terrific year, maybe the best year we've seen in quite some time in comp. The absolute level now that we expect moving forward probably looks more like '16 than '17. But at this point, we don't see something further deteriorating from the earlier part of the year, and we're watching the economy, as I said before, very closely.

Thomas George Gallagher
Evercore ISI Institutional Equities, Research Division

Got you. And then my follow-up is just on Group Benefits. I'm not sure if I caught this correctly, but I thought I heard you say Group Benefits sales were strong in the quarter, and I'd noticed they were down a lot year-over-year. So I just want to know what you meant by that.

Douglas Graham Elliot
President

Yes. I was really referring, Tom, to the full year. We felt very good about the full year. As you know, a lot of the Group Benefits sales are -- they lean into the first half of the year. So I felt very good about the overall effort, particularly with our Aetna book. And then I did comment further about the beginning of '19, which we feel pretty good about. And when I say pretty good, we've had some nice successes. We had a Paid Family Leave at a new case that came on 01/1/18. So when I adjust for that and allocate our core disability and core life sales, I feel very good about 2019.

Beth Bombara Costello
Executive VP & CFO

And I think the only thing I'd add to that, Doug, is when you look at the year-over-year compare for the quarter, in the prior year, we had a very strong one case sale that skews the result when you look at it sort of year-over-year.

Thomas George Gallagher
Evercore ISI Institutional Equities, Research Division

But as you -- and I guess as you think about momentum for top line, though, would you say it's a good setup for sales persistency? And also, I'd be curious what you're seeing on rate. Only because your results have been so strong, I'm wondering if you have to give back something on price right now.

Douglas Graham Elliot
President

So many of our accounts are rated on their own experience, experience-based. So it really is a case-by-case answer for much of our National Account book, but let me just step back. We feel really good about these last 15 months as it pertains to how the Aetna book has combined the talent, the ability for us now to stand up a very different, unique claims platform. So yes, I'm feeling very bullish about our ability to compete in the marketplace. There are situations where we're giving back a little bit of rate because of the performance. There are also some cases that need a little bit more rate, and we've been able to achieve that. So I think a really strong year in '18 and off to a good start in '19.

Christopher Jerome Swift
Chairman & CEO

Tom, I would just add, from your top line orientation. Remember, we've built over the last 3 years a voluntary capability. We've added some new A&H products and refreshed some old one. We're doing things differently and creatively with some distribution relationships on the A&H side. So we still think there's momentum and upside potential from here. But it is a competitive marketplace. As you well know, there's a lot of good competitors out there. But I think the agents and brokers we deal with and the clients recognize that we've really upped our game. And we're seeing opportunities, particularly on the large case side, we wouldn't have seen years ago. So you put it all together, particularly how the models and how actual results are performing compared to our purchase expectations, it's been rock-solid.

Operator

Your next question comes from Paul Newsome of Sandler O'Neill.

Jon Paul Newsome
Sandler O'Neill + Partners, L.P., Research Division

I was hoping you could talk a little bit about what appears to be some growth strains in the Personal Lines side and just if there's sort of an arc where we can see some of that strain reduced and the timing of that.

Douglas Graham Elliot
President

Paul, let me give you some color. So as I think about our return to growth in Personal Lines, number one, we're very pleased with the progress on the profitability front. Our new sales in Personal Lines were up, as you can see in the chart, materially from last year. We expect more of that moving forward. Our direct AARP auto sales in the fourth quarter, new to new, 4Q to 4Q, were up roughly 24%. I expect more quarters like that as we move into next year. So we're working hard as more and more of our territories are rate adequate to compete in the marketplace appropriately. And I think that continued trend is within our sights and certainly expectations for '19.

Operator

Your next question comes from Kai Pan of Morgan Stanley.

Kai Pan
Morgan Stanley, Research Division

My first question is on your guidance. The combined ratio guidance, that's not including Navigators acquisition. Navigators, historically, having higher combined ratio than Hartford's. So I just wonder, would that be dilutive to your, like, combined ratio going forward? And what's your plan in that $200 million earnings target in 4 to 5 years, included some improvements in underwriting at Navigators?

Christopher Jerome Swift
Chairman & CEO

Yes. Kai, thank you for the question. So you are right, it doesn't include it. I think we've been pretty clear, Beth and I and Doug, that once we close, we will update our guidance. So as we think about the $200 million of incremental core earnings before amortization intangibles, I think we've laid out a path and a track that we've talked about before in that basically 50% of that incremental increase will come from investment income and expense saves. 1/4 of that incremental increase will come from what I would just describe as profit improvement opportunities in their book of business. And the other 1/4 would come then from synergies, cross-sell activities of how we would go to the marketplace. I would share, and then Doug could add his color, that obviously, he's announced the operating model and the organizational structure. But doing all that work, getting to know The Navigators team, both domestically and internationally, we've made trips there, we're going back this weekend to London, I'm coming away more and more impressed with the talent, the skills, the deep underwriting knowledge they have in the organization. And I think as a -- just as a larger company, I think we can bring them more capabilities from the technology side, the management routine side while still being entrepreneurial, while still having a distributed decision-making model. So I feel even more confident that this is going to fit like a hand in glove going forward, Kai.

Kai Pan
Morgan Stanley, Research Division

That's great. Then in the past, you've been providing the P&C net investment income guidance as well as core earnings from Group Benefits. Any insight you can provide there?

Beth Bombara Costello
Executive VP & CFO

Yes. So on Group Benefits, I'll start with that, actually, our practice has typically been to show margins. Last year, we did earnings just because with the Aetna acquisition, we felt that it would be clear just to give an earnings target rather than a margin. So we actually returned for Group Benefit to our normal practice. And then for P&C investment income, we concluded that just hasn't been an area of -- an area that we needed to highlight, that I think people's models are pretty consistent on that. And as I answered previously, as we look at investment returns kind of ex partnerships, we'd expect the yield to be maybe slightly above last year. And then again, as a reminder, when we think about yields on partnerships, we budget sort of assuming a long-term view of around a 6% yield. Obviously, we're much higher than that this year, but we would not project that in the subsequent year.

Operator

Your next question comes from Josh Shanker of Deutsche Bank.

Joshua David Shanker
Deutsche Bank AG, Research Division

Looking at the guidance on the Personal Lines side, from where it was a year ago, it deteriorated a little bit. And as I look at auto over the last 3 years, it seems like you've had 28% rate increases. I'm kind of surprised, given now that some of your competitors are reporting declines in frequency or whatnot, that the combined ratio isn't better at this point in time. Do you have any thoughts there? And also, if you can talk about the change in the catastrophe outlook, you obviously have a higher CAT loss ratio being entered a year ago. Has something changed about the underwriting? Or are you just like saying, look, there's a lot more losses out there afield these days?

Douglas Graham Elliot
President

Josh, okay, let me take each of the pieces, and then Beth and Chris can come over to the top. So relative to Personal Lines, all in, in Personal Lines, the first thing I would say is that it really was an outstanding non-CAT homeowners year. So our performance far exceeded really the last 3 years, 5 years, et cetera. So as we think about that moving forward, our pick on homeowners was a longer-term view, which wasn't quite as positive as the outstanding year in '18 that we had. Relative to auto, we're watching the line. As you know, we've worked hard at that line over time. We're also spending more dollars on the marketing side. So you're seeing a little bit of expense move there. That is direct and something that we want to do to stimulate new sales. So we're very sensitive to where the overall performance of the line is, feel very solid about our picks for accident year '18 and '17, so I think we're in a good spot. But as we move into '19, you're going to see a little marketing, and then we'll watch how pricing and loss trend move together. I would note that others and including industry data have seen a little pickup in collision, collision severity. So it's something that we're watchful of. Our book isn't demonstrating the trends that Fast Track data is showing, but we're clearly watching that carefully as things like new bumpers and headlights, the replacement of those parts, I think is starting to kind of work its way into loss trend in Personal Lines auto.

Christopher Jerome Swift
Chairman & CEO

Josh, and just again, between Beth and myself, we're looking hard at our historical catastrophe numbers over the last 10 years, 5 years in particular. And we decided to make an adjustment because I think the trends were sort of undeniable, particularly from not only wildfire, which created all the attention the last 2 years, but winter storm activity, tornado, hail, particularly hail patterns moving, which I described in a non-meteorological sense, eastward away from mountains more and more. So we did make a slight adjustment. I think it translates into roughly $50 million pretax. But again, I think that the patterns are there. We adjust to it. I think it's more realistic. And ultimately, we need to begin to price for it and collect the cash from the policyholders. But as you know, regulators have a say in that. So it'll be baked into our pricing models going forward, and then it's a matter of trying to collect from policyholders over a longer period of time.

Joshua David Shanker
Deutsche Bank AG, Research Division

Let's hope for fewer catastrophes next year nonetheless.

Christopher Jerome Swift
Chairman & CEO

Understood.

Operator

Your next question comes from Yaron Kinar of Goldman Sachs.

Yaron Joseph Kinar
Goldman Sachs Group Inc., Research Division

Chris, in your opening comments, you said that you're expecting a bit of a slowdown in the U.S. economy in 2019. How does that factor into your commercial margin expectations in general and into workers' comp in particular?

Christopher Jerome Swift
Chairman & CEO

It's a great question. As Doug described, I think it does take some of the pressure off of frequency. Again, I think the analysis that we've done in here as it relates to tax benefits, economic demand, unemployment, I think we pulled a lot of economic activity forward with this stimulus. And I think that created a surge of workers, particularly new and inexperienced workers in certain industries and I think, in a strange sense, a slight slowdown. We still see positive GDP in the 2%, 2.25% range. I'm looking at Brion Johnson, our Head of HIMCO. And so I think that takes some pressure off. If Doug didn't say it, I mean, we still are always going to be conservative with our severity picks in putting up long-term trends on medical, severity in particular. So we think that's generally unchanged by economic activity and sort of separate. But Doug, what would you add?

Douglas Graham Elliot
President

So maybe as I think about adding something in the earlier questions, maybe an example that just came across my desk a couple of days ago of what -- when I talk about increased economic activity and sometimes the pressure that puts on workers' comp, I saw a claim come across. Essentially, it was a manufacturing client we've had for many years. Their demand to produce product has grown substantially in the last 9 months. So they took a piece of equipment that had been off-line for 5 to 7 years, put it back online. And the third day it was in service, not noticing that the safety guard was not attached, we had a major hand/arm accident with a worker. And that's the kind of claim, that piece of equipment was not in use during what I would say level demand times over the last 3 to 5 years. And now with -- in certain sectors, a little bit of needed increase in output, we have a loss that we might not have had last year or the year before. That's just a little example of why we're watching this economic activity so carefully.

Yaron Joseph Kinar
Goldman Sachs Group Inc., Research Division

That's helpful. And then maybe a follow-up to your answer to Josh's question on catastrophes. I did note that you reduced the limit per occurrence but also reduced the attachment point for aggregate. Does that just -- as you're looking at your CAT loss experience over the last couple of years, does that just signify that you're expecting maybe more of a frequency uptick and not necessarily a deterioration in severity per occurrence?

Christopher Jerome Swift
Chairman & CEO

Yes, I think your observations are right. I think if you look at our pattern, I think it was 2, 3 years ago, Beth, we added an aggregate protection in a more material and meaningful way to project -- to protect on multiple occurrences as opposed to just one big one. So when we think about spend and trying to maximize coverage on a tower versus aggregate cover, we spent a little bit more on an aggregate. So again, I would say it's a modest change, nothing major, Beth, but would you add any color?

Beth Bombara Costello
Executive VP & CFO

No, I'd agree with that. One thing to keep in mind is the layer on our per occurrence treaty that we eliminated was a layer that used to be able to go between either the per occurrence treaty or the aggregate. And really, all we've done is now put it into the aggregate and increase the aggregate protection by another $25 million from what we had before. So really, again to your point, as we look at our experience and where we see the potential for protection, we felt that, that was a better use of our dollars.

Operator

Your next question comes from Amit Kumar of Buckingham Research.

Amit Kumar

The Buckingham Research Group Incorporated

Two quick follow-ups. Number one, just going back to the workers' comp comments. Net-net, I think what you're saying is that 2018 might have been a blip, and the underlying CR uptick is due to the pressure on the pricing side of the equation. Can you just maybe expand on the level of pricing on comp, maybe give some color and then talk about pricing expectations in 2019?

Douglas Graham Elliot
President

Sure, let me provide a little color. And I think the exposure and loss trend piece, you have exactly on, right? We see stability moving out ahead, watchful and not moving off our long-term medical severity picks but a flattening frequency. Relative to pricing, as I said in my script, I see pricing for workers' comp flat to down. I think we're going to see a little more downward pressure in Small Commercial where we don't have the underwriting ability to deviate. Based on account experience, it's much more group rated. So we're going to see a little more pressure, minus single digits, small single digits, mid-single digits in Small Commercial. And then in Middle Market, it's going to be a risk-by-risk evaluation. And again, we see quite a bit of competition in the industry, but I see that pricing being flat to down a couple of points as well.

Amit Kumar
The Buckingham Research Group Incorporated

Got it, that's helpful. The only other question, I'll end here, is I know this is early days on the buyback discussion. But is there any thought process -- based on where the stock has traded over the past few years, would there be any desire -- let's say if we get down to end of 2019 and early 2020, could there be a possibility this buyback could be front loaded? Or am I getting ahead of myself? Or this is going to be spread out over 2020?

Christopher Jerome Swift
Chairman & CEO

Yes, I think it's probably premature to speculate on trading practices. I think Beth -- and we've been clear, historically, we've done things on a pro rata basis. But I think with this program and the intention to sort of foreshadow 2 years of demand, we'd rather be just a little bit more opportunistic when we see opportunities. Particularly as we get into later '19, it's not without -- it's feasible, we could be active sooner, but we have obviously funding requirements, and we got holding company liquidity targets that we like to maintain. So -- but as we get into later half of '19 and into '20, I think we'll be much more opportunistic in buying patterns as opposed to anything front loaded in a large program, a onetime buying opportunity or anything more mechanical. So just expect us to be more opportunistic going forward.

Operator

Your next question comes from Meyer Shields of KBW.

Meyer Shields
Keefe, Bruyette, & Woods, Inc., Research Division

Doug, I was hoping you could talk a little about what you've seen over the course of 2018 that led to the workers' compensation reserve releases and the GL reserve strengthening.

Douglas Graham Elliot
President

Okay. On the workers' comp side, we continue to reflect on positive experience in our prior accident year. So as we go quarter-by-quarter, Beth and I and our team of actuaries sit down, and those calls, we think, were appropriate given what we saw coming out of the prior year. So feel very good about our positions in all our booked accident years. Relative to GL, we've seen a little bit of product liability adverse experience in the last couple of years, so we're watchful of that. But the moves in GL from prior have largely been in the product liability area.

Meyer Shields
Keefe, Bruyette, & Woods, Inc., Research Division

Okay. Can you give us a sense as to the accident years?

Douglas Graham Elliot
President

Say that again, I'm sorry?

Christopher Jerome Swift
Chairman & CEO

Accident years.

Meyer Shields
Keefe, Bruyette, & Woods, Inc., Research Division

Which accident years?

Douglas Graham Elliot
President

Yes. On the workers' comp, we're talking about the last 4 accident years, right, '14, '15, '16. I'd have to go back and check on the GL.

Beth Bombara Costello
Executive VP & CFO

GL is -- I believe, is primarily coming from the 2015 accident year.

Operator

Your final question comes from Jimmy Bhullar of JPMorgan.

Jamminder Singh Bhullar
JP Morgan Chase & Co, Research Division

So most of my questions were answered. Just maybe a couple. On M&A, are you still interested in pursuing acquisitions once The Navigators deal closes? And if yes, what sort of product lines or regions are of the most interest?

Christopher Jerome Swift
Chairman & CEO

Yes, thanks for the question, Jimmy. I would say, again, in the context of how we've talked about excess capital, obviously, we've said what we want to do with our excess, which is authorizing a share repurchase. We are in the final stages of integrating the Aetna book of business during 2019, so there's still more substantive work to do there. And we haven't even closed The Navigators acquisition, which we are expecting to close in March or April. So I think from a practical point, as I said, I mean, we have everything we need, at least for the foreseeable future, and who knows what would happen down the road. But we wouldn't take M&A off the table per se. But if something attractive that fits within our existing strategy, something like a Foremost deal or another small bolt-on opportunity, we would look at it. But it would have to make more financial sense going forward. So that's what I would say. I mean, it's not a current focus. It's not a current priority. We have higher priorities that we need to really focus on in the next 18 to 24 months, but we'll see what things look like in 2 years.

Jamminder Singh Bhullar
JP Morgan Chase & Co, Research Division

Okay. And then just lastly, on Group Benefits, your margins over the last couple of quarters have been pretty strong. I think the rest of the industry has seen a similar trend as well. As you enter a renewal season for 2019, what was -- just a few comments on what you've seen in terms of pricing in that market.

Douglas Graham Elliot
President

It's been a pretty consistent market. It will move by account. So yes, we've had a couple of accounts with outstanding performance, and I think we've made reductions thoughtfully. But generally, I think it's a similar consistent market to what we've experienced over the last 12 to 15 months.

Operator

There are no other questions in queue.

Sabra Rose Purtill
SVP, Head of Investor Relations & Treasurer

Thank you all. Thank you, Shelby. We appreciate you all joining us today and look forward to seeing you at the Bank of America Merrill Lynch conference next week or at AIFA in early March if you are attending either of those events. And as always, if you have any additional questions, please do not hesitate to follow up with the Investor Relations team. Thank you, and have a good day.

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