S&P Global
Market Intelligence

The Hartford Financial Services Group, Inc. NYSE:HIG
FQ2 2019 Earnings Call Transcripts

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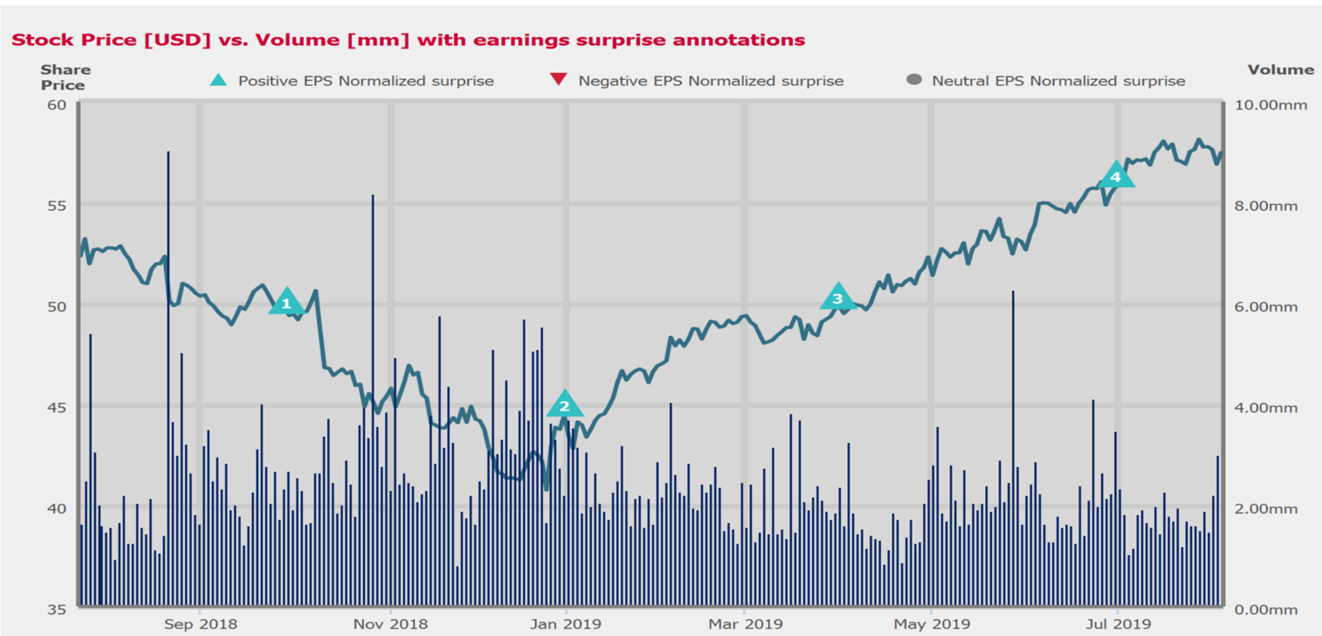
S&P Global Market Intelligence Estimates

	-FQ2 2019-			-FQ3 2019-	-FY 2019-	-FY 2020-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	1.14	1.33	▲16.67	1.20	5.16	5.49
Revenue (mm)	5070.50	5092.00	▲0.42	5187.00	20392.34	21454.14

Currency: USD
Consensus as of Aug-02-2019 11:49 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ3 2018	1.05	1.15	▲1 9.52 %
FQ4 2018	0.57	0.78	▲2 36.84 %
FQ1 2019	1.24	1.39	▲3 12.10 %
FQ2 2019	1.14	1.33	▲4 16.67 %

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Call Participants

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Executive VP & CFO

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Presentation

Operator

Hello, and welcome to today's Hartford Second Quarter 2019 Financial Results Conference Call. [Operator Instructions] Thank you.

I would now like to turn the call over to Ms. Susan Spivak. Ma'am, you may begin the conference.

Susan Spivak Bernstein
Senior Investor Relations Officer

Thank you. Good morning, and thank you for joining us today for our call and webcast to discuss second quarter 2019 earnings. We reported our results yesterday afternoon and posted all the earnings-related materials, including the 10-Q, on our website. Please note that we reported results a bit later than usual due to the financial reporting integration related to the closing of the Navigators acquisition in May.

Before we begin today's presentation, I want to highlight a couple of upcoming dates. First, Beth Costello will be participating in a fireside chat on September 9 at the Barclays conference in New York City. Second, the tentative date for our third quarter earnings release is November 4. For today's call, our speakers are Chris Swift, Chairman and CEO of The Hartford; Doug Elliot, President; and Beth Costello, Chief Financial Officer. Following their prepared remarks, we'll have a Q&A period.

Just a final few comments before Chris begins. Today's call includes forward-looking statements as defined under 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 the 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 include 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. Finally, please note that 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.

I'll now turn the call over to Chris.

Christopher Jerome Swift
Chairman & CEO

Good morning, and thank you for joining the call this morning.

The Hartford's second quarter financial results were strong with excellent Group Benefits margins and solid P&C margins, including lower catastrophe losses than last year. We closed the acquisition of Navigators in May, which brings expanded market and growth opportunities in Commercial Lines. I remain highly confident of the strategic and financial benefits this acquisition will produce.

Second quarter core earnings rose 18% over prior year to $485 million or $1.33 per diluted share. Our businesses are performing well. The P&C underlying combined ratio was 92.6 in the quarter and the Group Benefits core earnings margin was 7.5%. The consolidated 12-month core earnings ROE was 11.7%, well in excess of our cost of equity and among the best in the industry.

During the quarter, we began share repurchases under the $1 billion authorization and expect to continue to return excess capital to shareholders in '19 and 2020 from share repurchases and quarterly dividends, helping drive long-term shareholder value creation. Doug and Beth will cover segment results in more detail, but I wanted to touch briefly on a few high-level items.

Commercial Lines underwriting results, which included Navigators for just 5 weeks, remained solid. Ongoing investments in technology, digital and product are driving enhanced capabilities and growth. The cost of these investments put slight pressure on the expense ratio, which is expected to continue for the near term. Year-to-date, the underlying combined ratio for Commercial Lines is 92.9, a solid result in a competitive market.

Personal Lines results were much better than last year with a lower current accident year loss ratio, including reduced catastrophe losses. Planned marketing and other initiatives continued, increasing the expense ratio, but also driving a 49% increase in new business.

Group Benefits earnings continue to be simply outstanding with a year-to-date loss ratio of 74.7%, almost 2 points better than last year, along with a slightly lower expense ratio. Persistency and new business levels are solid and include continued growth in voluntary product sales.

We recently appointed Jonathan Bennett, a talented and versatile Hartford leader, Head of Group Benefits, following the announced retirement of Mike Concannon. Mike has been with The Hartford for more than 2 decades with a long list of accomplishments and contributions, and we wish him well. Jonathan and I will be working closely to ensure a smooth transition and a continued track record of success in Group Benefits. Finally, higher equity capital markets helped Hartford's funds recover from the earnings impact of the fourth quarter decrease in assets under management.

Turning to Navigators. This quarter results include charges related to the acquisition for: one, the purchase of the previously announced adverse loss development cover; and second, increase in loss reserves from the completion of our review for the 2018 and prior accident years and the 2019 loss picks. With the reserve review completed, we are fully focused on achieving the strategic and financial benefits of this acquisition.

Only 2.5 months after closing, a significant amount of progress has been made on multiple initiatives, and I am pleased with the continued positive feedback from agents and brokers about the combined potential of our business. We expect a smooth integration and remain confident of the future benefits we will realize from expanded product and underwriting capabilities.

In addition, we expect to generate good returns on this investment, reaching approximately $200 million in core earnings excluding the amortization of intangibles within the next 4 to 5 years. We are also encouraged by the recent firming in Commercial Lines pricing, particularly in Global Specialty, which is better than anticipated when we first announced the acquisition.

Doug will discuss the market in more detail, but I would note that loss trends in certain lines needed increased pricings to achieve acceptable returns and in part, informed our judgments on the acquired reserves and the 2019 accident year loss picks. The team is focused on capturing the benefit of improving pricing, terms and conditions, particularly in international where results in recent years have been poor.

In addition to the trends in Global Specialty, we are also seeing stronger pricing and growth opportunities in Middle & Large Commercial. I am pleased to see that previous investments and expanded industry verticals are generating strong new business growth.

To conclude on the quarter and year-to-date. Our performance is strong, Commercial Lines has momentum and the Navigators integration is going well. The outlook for Commercial Lines in the second half of 2019, which includes Navigators, remains largely consistent with our view provided earlier this year. We expect an underlying combined ratio of 92 to 94. This outlook is essentially flat with last year, including the impact of Navigators, which has a slightly higher combined ratio than The Hartford Commercial Lines book. In total, we are well positioned to achieve or exceed the business metric outlook we provided in February and to sustain a strong consolidated ROE.

Before turning the call over to Doug, I wanted to note that we recently published our 2018 sustainability report, which provides a summary of our commitment to environmental stewardship, communities and giving, diversity and inclusion and ethics and governance. As a company in business for more than 200 years, we understand what it takes to be sustainable and how the company's actions align with our mission to underwrite human achievement. We are proud of The Hartford's track record and are committed to achieving the specific goals summarized in our report. You can find that report, along with other information on our sustainability programs, on our website.

Now I'll turn the call over to Doug.

Douglas Graham Elliot
President

Thank you, Chris, and good morning, everyone. This was a strong quarter for our business units, and as Chris noted, strategically significant as we closed our acquisition of Navigators.

Our Hartford Property & Casualty business units performed very well with strong execution on the top and bottom line. And Group Benefits posted another quarter of outstanding earnings. Underlying performance in the former Navigators business units, which excludes prior period development and catastrophe losses, was in line with our expectations as we position these lines for profitable growth in a rapidly improving specialty marketplace, where underwriting is tightening and pricing is firming.

In the second quarter, we booked prior accident year reserve adjustments for Navigators in several lines of business and also reset the 2019 accident year loss selections. Beth will be discussing these actions in greater detail.

Our integration is off to a strong start. We've hit the ground running with teams working together in the market and across all parts of our enterprise to align strategy, resources and outcomes. Over the summer months, we're conducting nearly 400 agent and broker meetings to roll out our combined product capabilities. Talent and expertise were primary drivers of the deal, and we're very excited to have over 800 new teammates join our ranks. The market leadership and underwriting skill these experienced professionals bring to the combined organization is already evident. Efforts began immediately to jointly market our expanded product portfolio as we're now able to effectively deliver a broader range of coverage solutions to agents, brokers and customers. I'm very encouraged by several recent wins and the positive reaction of agents and brokers to writing more lines of business per account with us. Our teamwork is evident to the marketplace, and I'm confident we will continue to find more opportunities for growth. I'll provide more commentary on Navigators performance and current marketplace trends in a moment.

But let me begin the review of our business results with Group Benefits, which delivered another outstanding quarter, posting core earnings of $115 million with a margin of 7.5%. The increase versus prior year was driven by favorable disability results, higher net investment income and lower amortization of intangibles. This was partially offset by a slightly higher life loss ratio, increased investments in technology and customer experience and higher commissions. The lower disability loss ratio reflects favorable incident trends across recent accident years.

Shifting over to Personal Lines. We had a solid quarter with an underlying combined ratio of 91. In Personal Lines auto, the underlying combined ratio of 96.7 was 0.2 point higher than 2018 with favorable frequency trends and a severity in the low to mid-single-digit range. Collision severity remains elevated due to higher repair costs associated with newer vehicles and a larger mix of total losses. Overall, loss cost trends are developing within our expectations.

We remain focused on returning to growth in AARP Direct auto, our lead product for marketing and new customer acquisition. New business in this line grew 44% for the quarter. Direct marketing response rates continue to be strong, and our conversion ratio is up versus prior year. Over the last few years, AARP auto retention has improved several percentage points. We remain focused on further increases to retention as a key factor in achieving total written premium growth.

Turning over to Commercial Lines. The second quarter underlying combined ratio was 93.2, up 3.2 points versus 2018. The increase was primarily due to elevated inland marine loss experience in Middle Market, higher expenses and the addition of Navigator results for 5 weeks post-closing.

For the quarter, renewal written pricing in Standard Commercial Lines was 2.2%, up slightly from first quarter of the year. Pricing excluding workers' compensation was 5.5%, up several tenths of a point versus first quarter, driven primarily by increases in Middle Market. Pricing in auto is nearly double digits, and we saw solid increases in property and general liability.

Margins in workers' compensation were strong across our business units and consistent with our expectations. Results to date indicate that we're managing market forces effectively, and I remain pleased with our workers' compensation pricing and underwriting strategy as we seek to balance margins and growth.

Let me touch on a few additional details for our commercial businesses. Small Commercial had another excellent quarter with an underlying combined ratio of 87.8. Written premium grew 6%, with $183 million of new business and excellent retention in the high 80s.

New business was led by the Foremost renewal rights deal. In addition, we also experienced excellent growth from our core book, with new business up 10% versus prior year. New business flow from the Foremost deal is essentially complete at this point. This is a great opportunity for us to scale our market-leading platform and to extend our partnership with many of our existing agents. We also developed a number of new agency relationships that have been growing steadily over the last year. Our team executed flawlessly on this transaction, and we're well prepared for similar opportunities in the future.

In Middle & Large Commercial, the underlying combined ratio was 100.9, increasing 3.8 points versus last year. We experienced another quarter with a number of large losses in The Hartford inland marine book, specifically builders risk. Approximately 3 points of this increase is attributable to large water intrusion claims that occurred near project completion. Several of these losses resulted from less experienced workers on the job in this tight labor market. We've taken action to address this part of our business and expect performance to improve. The expense ratio was also slightly higher, driven primarily by commissions.

Written premium in Middle & Large Commercial increased 15%. Retentions were solid and new business production was outstanding at $177 million for Middle Market, up 31% versus prior year. New business growth continues to be fueled by our industry practice groups in areas such as construction, programs and energy. We're also seeing strong growth in our other core industries, including manufacturing, technology and professional services. Our strategy of underwriting specialization is helping to drive this growth and increase our focus on pricing and margin improvement.

In Global Specialty, comprised of U.S., international and reinsurance business units, the underlying combined ratio was 90.7. Given the Navigators results are only included for 5 weeks of the second quarter, I'll focus my commentary on current business performance and marketplace trends.

Overall, the specialty markets are in positive transition. Industry financial results support the need for pricing and underwriting actions as prior years have been developing unfavorably in several lines. Our Global Specialty team has experienced progressively firming market conditions each month during the quarter. Renewal pricing for Navigators business block was in the high single digits for the quarter, up more than 5 points from the first quarter and also from prior year. Lines of business with particularly strong pricing include marine cargo, excess casualty, D&O and property. This is an important time for our teams to be focused on business fundamentals. And now that the deal is closed, our #1 priority is improving margin performance.

Let me now turn to the individual business units of Global Specialty. In the U.S., we recorded prior year development largely in the ocean marine, primary casualty and D&O books with only a modest adjustment to the current year loss ratios in casualty. Underlying performance year-to-date has been solid with strong returns in management and professional liability lines and bond. Given the market momentum I just described, our trend is for -- our outlook is for favorable renewal pricing trends exceeding expected loss trends.

The international business, primarily comprised of Lloyd's syndicate and London market portfolio, has been under financial stress due to its historical growth focus. We've increased our prior and current accident year loss ratio picks in financial and casualty lines and are fundamentally repositioning portions of this book through underwriting and nonrenewal actions. The rapidly firming market will provide a tailwind as we execute our business plans for needed margin improvement.

In Global Reinsurance, our business is mainly comprised of accident and health, property, global credit, Latin American surety and other casualty lines. During 2019, underwriting results have been challenged in the accident and health, resulting in prior year reserve development and an increase to the current year loss ratio. This is largely a medical stop loss business, and we're aggressively tightening our underwriting and increasing pricing while nonrenewing accounts that do not meet our financial thresholds.

As we look ahead with Global Specialty, I'm more convinced than ever that our expanded talent and product capabilities are a powerful addition to our Commercial Lines platform. Vince Tizzio, our Global Specialty leader, along with a very experienced team comprised of both Navigators and Hartford teammates, are driving business plans with great acumen and energy. As we work together every day, and now with the full engagement of our agents and brokers, I see our strategy unfolding in the market, positioning us for further success as a Commercial Lines leader.

Based on our year-to-date results, our outlook for Commercial Lines in the second half of 2019 is for a combined ratio between 95 and 97 with an underlying combined ratio between 92 and 94. Total Commercial Lines earned premium for the 6 months is expected to be approximately $4.4 billion.

In closing, this quarter represents an exciting milestone in our journey. Our integration with Navigators is in full swing. We're operating as a combined organization, bringing broad capabilities and deep underwriting expertise to the market, and we continue to see new opportunities to leverage these skills in all parts of our Commercial Lines business. This important step forward, along with the strength of our Group Benefits and Personal Line businesses, positions The Hartford for continued success. We look forward to updating you on our progress in the quarters ahead.

Let me now turn the call over to Beth.

Beth Costello
Executive VP & CFO

Thank you, Doug. Today, I'm going to cover second quarter results for the investment portfolio, Hartford Funds and Corporate, including capital management activities as well as the impact of the Navigators acquisition.

The investment portfolio continues to perform very well with no impairments, strong LP returns and generally stable investment yield. Net investment income was $488 million for the quarter, up $60 million or 14% from the prior year quarter. Excluding Navigators, net investment income was $476 million or 11% higher than the prior year quarter.

Limited partnership returns were strong in all asset classes with an annualized return of 14% for both the quarter and year-to-date. This compares to an annualized yield of 9.5% in second quarter 2018. The annualized portfolio yield was 4.2% before tax and 3.4% after tax, slightly above second quarter 2018. Excluding LPs, the second quarter 2019 annualized portfolio yield was 3.1% after tax, flat with second quarter 2018.

Lower market interest rates and tighter credit spreads increased net unrealized gains on fixed maturities after tax to a total of $1.4 billion at June 30 from about $700 million at March 31 and almost no net unrealized gain at year-end 2018. As a reminder, unrealized gains on equity securities are classified in realized capital gains in the income statement and are not included in AOCI. Total realized and unrealized gains on equity securities were $30 million before tax in the quarter and $162 million before tax year-to-date.

Turning to Hartford Funds. Core earnings of $38 million were flat with last year and up $10 million sequentially. Daily average AUM rose 5% from first quarter 2019, reflecting strong market performance, partially offset by modest net outflows, and was up about 1% over second quarter 2018. Investment performance remains very strong. As of June 30, 2019, about 70% of Hartford Funds outperformed peers on a 1-, 3- and 5-year basis.

Corporate core losses of $35 million were 54% lower than second quarter 2018, principally due to higher investment income and lower interest expense due to net debt reduction over the last year. As a reminder, the 3 main drivers of Corporate results are investment income on cash and short-term investments, interest expense and preferred dividends and net income from our investment in Talcott. Taking into consideration the reduction in average cash and short-term investments due to the $2.1 billion purchase price for Navigators as well as interest expense and timing of preferred dividends, I would expect the quarterly run rate in Corporate to be a loss of $55 million to $65 million after tax before consideration of net income from the Talcott investment. The impact of our proportionate share of Talcott's net income is harder to predict and was $22 million after tax in the first quarter and $2 million after tax this quarter.

During the quarter, we began share repurchases under the $1 billion authorization. Since its inception and through the end of July, we have repurchased about 800,000 shares for $43 million. As previously discussed, we expect to use this program with discretion based on current and projected holding company cash position and liquidity needs and expect to utilize the majority of the program in 2020.

In total, second quarter core earnings of $485 million and core earnings per diluted share of $1.33 were both up 18% over second quarter 2018. Excluding AOCI, book value per diluted share was $41.55, up 5% year-to-date and 9% since June 30, 2018. Core earnings ROE over the last 12 months, which includes fourth quarter 2018's wildfire catastrophe losses, was 11.7%. Our year-to-date annualized core earnings ROE is 13.4%. The closing of the Navigators acquisition on May 23 impacted our results in several areas. I will briefly review these, and additional details are included on Pages 6 and 7 of the slides.

Core earnings had a modest net contribution from Navigators as the closing occurred more than halfway through the quarter. Net income included several acquisition-related charges. First, in the quarter, we recorded transaction and integration-related costs of $31 million before tax, of which $21 million was related to Navigators. We expect to incur additional charges through 2021 for a total of $90 million to $100 million before tax, of which $50 million relates to integration activities. Second, upon closing, we entered into the previously announced adverse development cover and reported a charge of $72 million after tax.

Finally, we made 2 adjustments to Navigators reserves after closing. We increased the pre-acquisition 2019 accident year reserve by $29 million before tax. We also increased our estimate of prior year loss reserves by $159 million, of which $91 million was ceded to the ADC, resulting in a net charge of $68 million before tax. After these actions, there remains $209 million of coverage under the ADC for development for 2018 and prior accident year reserves. Overall, the reserve actions we have taken incorporate our methodologies and judgments. Going forward, Navigators reserves will be part of our normal quarterly reserve review process.

To summarize, second quarter results were very strong. We are hard at work on the integration of Navigators and focused on maximizing the potential of all of our businesses with our combined teams and enhanced product and underwriting capabilities. With strong capital generation and financial flexibility, we are pleased to be able to both invest in our businesses and return capital to shareholders. We look forward to updating you on our progress.

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

Susan Spivak Bernstein
Senior Investor Relations Officer
Thank you, Beth. We have about 30 minutes for questions. Carmen, could you please repeat the instructions for asking a question?

Question and Answer

Operator

Okay. And at this time, we'll go to the Q&A. And your first question comes from the line of Brian Meredith with UBS.

Brian Robert Meredith
UBS Investment Bank, Research Division

So first question for you all. Chris, just curious, could you kind of walk through, from the Navigators perspective, now that you've got it integrated and everything -- or not integrated, be -- on your books, how does your kind of accretion forecast look with the low end, high end? Kind of what are your expectations for it?

Christopher Jerome Swift
Chairman & CEO

Sure. Thanks for joining us, Brian. As we said, both Doug and I and Beth in our prepared comments, I mean, we're confident about both the financial and strategic aspects here. I think on a longer-term basis, we'll still see the ability to generate $200 million of core earnings ex amortization of intangibles over the next 4 to 5 years. I think there's 4 levers that remain the same that we've talked about, what's going to contribute to that. One would be expenses. Two would be NII. Three would be, and you heard from Doug, the actions that we're beginning to take on the in-force management to improve the margins on the existing book. And then fourth, a contributor, but not a large one, is the cross-sell revenues. So I would say those are the components.

The weighting might be a little different, Brian, than we first thought 6 to 9 months ago, particularly with lower interest rates. But I would say that we didn't expect this level of pricing firming as rapidly as it has been. So we've taken the adjustments we think we needed to, particularly on the '19 accident year loss picks, which is generally in line with our pricing models and our deal models, maybe slightly a little higher. But equally, I think there's more rate environment, more rate to capture. So we see all those pieces fitting together to generate that $200 million of core earnings and remain really, really confident and pleased with how the teams have been interacting and behaving, particularly in the marketplace.

Brian Robert Meredith
UBS Investment Bank, Research Division

Excellent. And then -- and another question. Just curious, could you talk a little bit about your thoughts and exposure to the reviver statutes and kind of what we're seeing, what's going on in all these states?

Christopher Jerome Swift
Chairman & CEO

Sure. I guess there's one other point I would just mention as it relates to the integration activities. I mean we did guide in our prior call to $110 million to $145 million of core earnings in 2020, Brian. I would say that's still a valid range, but I would anchor a little bit more on the lower end. Particularly given the interest rate environments, we felt we were going to get a little quicker lift with interest rates even after marking the balance sheet to market. So we still see $110-ish million in 2020 as far as an accretion potential.

As it relates to the reviver statutes and activities, I would say, first, we've got a long history of managing and dealing with, I'll call it, complex claims in this area, particularly bodily injury, mass tort. And John Kinney, who heads our team, and his lawyers and claims professionals just, I think, do an outstanding job, whether it's on a primary basis or excess basis. Remember, we have a lot of excess claims experience, particularly coming through our first interstate operations in Boston. So I would then say, on a social side, I understand the desire to make people -- allow people to talk about their injuries and present claims.

But on the other end, that's a slippery slope to sort of open up years of case law and litigation and how contracts are resolved. But I know that's occurring.

But I would also say that, for us, we're primarily focused in on 3 major areas: the liability associated with injuries, particularly in commercial auto; obviously, the sexual abuse and reviver claims; and then head injury. I'm not going to go into specifics on any particular aspect other than we're well aware. We've been on top of these trends for a long, long time. And as I've always said, Brian, we're in the business of paying claims, and we want to pay claims that are legitimate and where people are injured. But equally, in some of these areas, we're going to be sensitive. And that's a polite word of saying if there was contributory actions or inactions that have consequences on our terms and conditions in our policies, we'll be equally vigilant in asserting our rights because the rest of our policyholders would expect that. And that's where the social inflation comes into effect that everyone's talking about. It affects everyone. And we'll be thoughtful. We want to be fair but also make sure that people are living up to the terms and conditions in our contracts. So that's what I would all say at this point in time.

Brian Robert Meredith
UBS Investment Bank, Research Division

Okay. It makes sense. But have you reevaluated your reserve positions given what's been going on?

Christopher Jerome Swift
Chairman & CEO

As I tried to say, I mean, we've been managing these types of activities for a long, long time. I would say that we have case reserves and IBNR established for known losses and obviously, incurred but not reported losses. But we're going to have to really see sort of the volume of the new activities that really come in. So as we sit here today, feel really good about the balance sheet. But not knowing what's going to come at us in the future from new claims, new activities, new theories, you can never be absolute, but just know we do have provisions that we feel comfortable at right now.

Operator

Your next question comes from the line of Elyse Greenspan with Wells Fargo.

Elyse Beth Greenspan
Wells Fargo Securities, LLC, Research Division

My first question, on the disclosure within Commercial Lines on the Standard Commercial earned premium rate, so that was 2.2% in the quarter. It trended down sequentially. And then when we looked back last year, I know you guys are getting more within price right now, but I'm just trying to think about the earned premium that you're seeing and expectations for a rate that you'll earn in through the balance of this year and also into 2020 as I think about the underlying margin profile for Small Commercial and your mid to large account segments and just thinking of the rate versus trend and kind of the underlying margin expansion you might see or contraction there.

Douglas Graham Elliot
President

It's Doug. I would suggest that the earned trend is going to follow some of this momentum on the written side. So obviously, it's a calculation. And as we see slightly upward signals in those pricing indicators, the earned premium will follow that, number one. Number two, we gave you a comp/ex comp split, right? So you know that we've got a little bit of negative pressure in pricing, particularly in Small Commercial. That will play out. And the mechanics of that, our loss trend at the moment might be slightly ahead of where the Small Commercial pricing is. But in middle, we've done a nice job of achieving flat to just slightly down pricing in comp. And so very pleased with what we're seeing in middle.

In the noncomp lines, we're feeling better than we were 90 days ago about signals in the marketplace and our ability to get a little bit of rate. I know that the changes are not up materially, but they matter to us. And in several key lines, they're moving in the right direction. So we're on the rate, push hard, we're working hard account-by-account. And I'm encouraged by what I see as we close out the second quarter.

Elyse Beth Greenspan
Wells Fargo Securities, LLC, Research Division

Okay. And my second question, on the Navigators book. So you guys took a true-up on prior year and then also on the current year. So on the current year adjustment, I'm assuming the adjustments were really saturated kind of in the same lines where you took the prior year development. And then can you also just give us a sense of where the underlying margin you're starting with for that business given that you've now trued it up versus your expectations when you announced the deal?

Beth Costello
Executive VP & CFO

Sure. I'll start with that. And Doug, please feel free to add in. So the lines that we adjusted for the current year, some were consistent, again, in the U.S. wholesale casualty area and a little bit in the D&O and E&O book and as Doug mentioned, kind of in the international casualty area. And when we look at the -- our projections back at the time of the acquisition, we had anticipated needing to increase those accident year picks a bit. I would say the final adjustments that we made were probably 1 point or 1.5 points higher than that but, relatively speaking, sort of in line with what we were thinking.

So a lot of the things that Doug talked about as it relates to the book and actions that we're taking in pricing will obviously help improve those margins going forward. And our views on our underlying margins were included in the overall guidance that we gave for the second half of 2019. And again, their book, we would expect to run at a higher combined ratio than our historical Hartford book.

Douglas Graham Elliot
President

The only thing I would add, Beth, is that some of that Navigator combined ratio dynamic is playing into the fact that our new outlook is just slightly up 1 point or so on the underlying. So the mixing in of that Navigators book in accident year and calendar year 2019 is causing a little bit of that bump.

Operator

Your next question comes from the line of Josh Shanker with Deutsche Bank.

Joshua David Shanker
Deutsche Bank AG, Research Division

Obviously, there's the reserve strengthening on the, I guess -- I don't know, is it the 1Q Navigators or is it the first 5 months, just as a better understanding?

Beth Costello
Executive VP & CFO

So Josh, are you talking about the current accident year?

Joshua David Shanker
Deutsche Bank AG, Research Division

Yes, the $29 million.

Beth Costello
Executive VP & CFO

Yes. Yes. So it would be for the first 5 months.

Joshua David Shanker
Deutsche Bank AG, Research Division

First 5 months, okay. I guess that implies...

Beth Costello

Executive VP & CFO

Yes. Through the date of acquisition.

Joshua David Shanker
Deutsche Bank AG, Research Division

Yes. So that implies then an increase to the Navigators combined ratio about 500 basis points in addition to what's going on in the rate market right now. When you think about modeling or the next year, how much attritional policy and premium decline do you expect as you put through the necessary rates to get to a Harvard -- a Hartford level of conservatism in the book?

Douglas Graham Elliot
President

Josh, this is Doug. I would say it's a little premature for us to take you all the way down through that path. We are building those plans. We had original plans, obviously, we've been updating over the course of the last 2 quarters. But there are so many moving pieces. And as you know, as Chris commented on, several of their core lines are going through an aggressive degree of firming at the moment. So we are making decisions and plans around what we see in the current marketplace around retentions -- required retentions, pricing and also new business levels that we think are appropriate for not only the combined ratio as it sits here today, but also what we think the opportunity is in that book moving ahead. So we'll provide more of that as we go forward the next several quarters.

Joshua David Shanker
Deutsche Bank AG, Research Division

Okay. And I guess this is another easy one. Was there any prior year reserve development on the Navigators loss reserves not applicable to the NICO cover? And how should we consider the risks associated with that non-NICO covered part of the portfolio?

Beth Costello
Executive VP & CFO

Good question. So as it relates to the actions that we took in the second quarter for prior years, all of it was applicable to the cover. I'll remind you that there was probably about $100 million of reserves that we excluded from the cover, which was primarily covering things like unallocated loss adjustment expenses. We are obviously taking the exposure on reinsurance collectibility and then a handful of specific claims that were not covered. So as it related to the actions we took, we saw no need to make any increases to those reserves that were not covered by the reinsurance agreement.

Christopher Jerome Swift
Chairman & CEO

Josh, it's Chris. One, welcome. Thanks for joining the call after your Rolling Stones concert last night. Second, I would just add a little color again. The allocated -- unallocated loss adjustment expense in the reinsurance, it's similar to other transactions we've done with NICO. And the handful of claims that Beth described, I would say, relate to pollution exposures that we judged favorably. So I don't think there's going to be any big, big surprises that are going to materially change any view on reserve positions and/or the reinsurance transaction in total.

Operator

Your next question comes from the line of Mike Zaremski from Crédit Suisse.

Michael David Zaremski
Crédit Suisse AG, Research Division

First question -- thanks for the color on the expense ratio increase. Curious about -- I believe you said some of it's due to upwards pressure on brokerage commissions. And I think you also mentioned that in -- on last quarter's call. Maybe you can help us understand this, like what -- how big of a component that is. And is that -- and what's kind of driving that? Is that being driven by some of the private equity-backed brokers? Or is it kind of all of them kind of doing the same thing?

Douglas Graham Elliot
President

Mike, this is Doug. It's more run rate commission. So when I think about quarter-to-quarter, 1 point, 2 points of change in the expense area, about half of that is coming from commission. Much of that is coming from Small Commercial, where we either have special deals happening, we've got terrific profitability indicators, so our contingencies around loss are up a little bit year-to-year. And I would just characterize what we see in small as normal competitive commission adjustments. What we see in the middle, more related to reinsurance. So I don't even think of that in the case of normal brokerage. It's just we have some ceded commissions and reinsurance a little bit different than they were last year. So that's why I described the commission piece as really normal operating circumstances.

Michael David Zaremski
Crédit Suisse AG, Research Division

Okay. That's helpful. And lastly, switching to Group Benefits. Clearly, excellent results continue. Doesn't look like you guys changed your guidance there. Maybe you can kind of update us on the competitive environments in group.

Christopher Jerome Swift
Chairman & CEO

Mike, I mean just to speak to guidance, and Doug can give you some of his color on the competitive environment. The 6% to 7% guidance on margin, we still believe, is a long-term guidance that is reflective of long-term conditions. Obviously, in the near term here, we've been outperforming, which we would honestly expect to continue at least through the second half of '19. So we're not changing, not updating. But we are -- acknowledge that we are performing better primarily from incidences. But I would remind you that it is still a competitive environment, Doug. And the top 10 group benefit players control a large portion of the market. But competition is still fierce as ever and we're remaining disciplined. I don't know if you would add any color, Doug.

Douglas Graham Elliot
President

No. I would agree with that. I think we're competing well in the space. The numbers are pretty good shape across the industry. Our numbers are obviously outstanding. Second quarter is not as large a quarter as the first quarter, but our sales were up a bit in the first quarter. We feel good about that. Continue to grow our specialty products, our voluntary products, so you see that in our supplement. Just very encouraged. And Chris, our disability trends are in good shape. So a strong quarter for our group business.

Operator

And our next question comes from the line of Paul Newsome with Sandler O'Neill.

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

Just one question. You didn't mention any changes to reinsurance related to the Navigators acquisition. I was wondering if that might change significantly over time given Navigators was a pretty heavy user of reinsurance over time.

Douglas Graham Elliot
President

Paul, in the short term, I would suggest that reinsurance programs are largely going to stay in place. Our teams are working diligently on a combined basis evaluating what programs need to come together over time, what programs will be left stand-alone, et cetera. So as I think about the rest of 2019 and the early part of '20, largely think of their programs intact, and then we'll adjust over time and share some of that information as it comes.

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

As you've now reexamined the book, are there any pieces in there that you usually -- you want to shrink or readdress significantly?

Christopher Jerome Swift
Chairman & CEO

Paul, again, we just closed, what, 75 days ago. Really excited. We've been focused on obviously our go-to-market activities in the U.S. and in London, taking the corrective actions that Doug has talked about. We like all the pieces that we see, but we just are going to -- just continue to learn. That's why we're keeping the reinsurance programs the same and -- to learn from the Navigators team and adjust accordingly. And I would say the same thing with any major pieces of the business. It all fits together. It works. We like it. But we've only owned it for 75 days.

Operator

And your next question comes from the line of Yaron Kinar with Goldman Sachs.

Yaron Joseph Kinar
Goldman Sachs Group Inc., Research Division

My first question -- I guess this is a multipart question with regards to the large property losses that you're seeing in commercial. So one, are those related to the large losses you saw in the first quarter or part of the same trend? Two, could you maybe elaborate a little bit on the actions you're taking? And three, when do you expect these actions to actually result in lower margins?

Douglas Graham Elliot
President

Thank you, Yaron. This is Doug. So a few comments about our marine book. We did see some adverse experience in the first quarter, which I did comment on first quarter call. A bit more in the second quarter. Again, second quarter leaned a little bit heavier into builders risk. It's a policy we offer associated with construction sites, where essentially we replace the damaged property on the site. I think there's quite a bit of volatility in the second quarter. We have pulled the covers back across all those losses. I mentioned water intrusion in my commentary. Seen a number of pipes, couplings, connections damage material values in some of our construction sites. So we're on it. We changed the leadership and the underwriting profile of that business about 15 months ago. That process is well underway. These projects run several years. We know exactly where our inventory is today. Yes, I don't think this is over at the end of June, but I do think this is well managed, well contained. Both claim, engineering and also our underwriting teams are working together. And there's little volatility in a pretty small line. First, in middle, we'll have little volatility, but it isn't something that right now is keeping me up. I think the line is not just putting pressure here at The Hartford. I think there are others in the business that are feeling that pressure. But as I think about the rest of 2019 and 2020, we'll get this issue behind us. I don't think it's a huge deal. And we'll share a little bit about that journey as we go forward.

Yaron Joseph Kinar
Goldman Sachs Group Inc., Research Division

Okay. That's helpful. And then my second question relates to the personal auto book. I think you were saying that you're seeing severity in the low to mid-single digits, which just seems a little lower than what we've been hearing or seeing in -- among other carriers. Can you maybe talk about what would drive severity to be a bit lower at The Hartford book? Is it a different mix of cars? Is it a different policy type or different negotiated arrangements with auto shops? Like what's driving that?

Douglas Graham Elliot

President

I think it's really hard for me to compare ourselves to others. There are so many different nuances to the various books. When I -- and when I talked about severity, I'm combining all elements of severity, right? Our collision is up a little bit. Our liability severity is in pretty good shape. And obviously, our frequency numbers are in very strong shape for the first 6 months of the year. So I don't know how to contrast our book with others. You know it is heavily AARP-dominated, that plus-50 crowd that matters relative to drive -- miles driven, parts of the year, et cetera. But I don't think there's something that sticks out to me right now that is saying our severity is causing something that others might not be seeing.

Yaron Joseph Kinar
Goldman Sachs Group Inc., Research Division

Doug, you were cut out. I think I only heard the last sentence of your response.

Douglas Graham Elliot
President

I don't think there's one reason. Can you hear me, Yaron?

Yaron Joseph Kinar
Goldman Sachs Group Inc., Research Division

Yes.

Douglas Graham Elliot
President

I don't think there's any one reason that suggests our book will perform differently than others. We manage aggressively all of the comp liability and physical damage collision matters for our customers. And I think we do a very adequate job. We work with terrific partners on the outside and have a dedicated, competent team inside. So I think we're thoughtful about our claim process. And I don't have a reason to suggest our numbers -- or understand why they're different than others.

Operator

And your next question comes from the line of Randy Binner with B. Riley FBR.

Randolph Binner
B. Riley FBR, Inc., Research Division

I actually had, I think, a couple related to commercial auto. The first is a question on the inland marine losses that are disclosed as being elevated. Could you describe what those are? And I'm just curious if they're related to a wheels-based loss or something else.

Douglas Graham Elliot
President

Yes. The builders risk essentially would be equipment materials on the job site. So I don't think auto there. I think water intrusion causing damage to all kinds of equipment and sheetrock and -- on the walls, et cetera. There were early in the year a couple of marine losses in-transit. When you think in-transit marine, they would have involved vehicles. So yes, there was a little commercial auto pressure there. But primarily second quarter, I'm talking about intrusion of water in a 4-walled structure.

Randolph Binner
B. Riley FBR, Inc., Research Division

Okay. Got you. And then just on the commercial auto overall, it has not been a topic that's come up on this call, but it is still a major issue for the group. And so I'm curious kind of where you think pricing versus loss cost is there and kind of where The Hartford sits in the process of the industry getting on top of those liabilities.

Douglas Graham Elliot
President

Yes. I guess I'd start by suggesting the makeup of our book is largely Small Commercial with a Middle Market fleet book as well. And now Navigators brings a specialty auto component to us. In terms of our core book, we've been managing aggressively auto for 6, 7 years now. Our exposures are down materially over the last 5 years, plus 30% PIP change in auto. Still not satisfied with our rate adequacy today. Our combined ratios are still not acceptable across both small and middle, and so there's still more work to be done. Given where we see pricing today, yes, I think that pricing from our view in our middle and small books is on top of loss trend, which means we are now delivering better margins. But we're very careful, with a very careful eye watching 2016, 2017, 2018, some of those years that are closing up. And this line has our full attention and will over the next several quarters, for sure.

Randolph Binner
B. Riley FBR, Inc., Research Division

Is it a growth opportunity then? If you have your pricing right relative to loss trend, are you seeing a lot more opportunity to write business?

Douglas Graham Elliot
President

Well, there's a lot of business in the marketplace. It isn't on the top of our growth priority. We're certainly not a major monoline provider, and I'm talking about historical Hartford at the moment. We certainly look at it when we're rounding out accounts and we want to protect our accounts. So no, it's not on the top of our queue list to be taking monoline auto.

With our specialty auto division now with Navigators, I think a good opportunity. They've got terrific instincts. They've got great data. And they'll be thoughtful about their opportunities. But I would ask you to think about the different pieces of our book. And all told, we're not an enormous auto player relative to the industry in general.

Christopher Jerome Swift
Chairman & CEO

I think that's the big distinction, Doug, right? We're not big fleet players. I mean we tend to insure trucks, vehicles on the small to medium-size business. We're not in national programs. It's not -- just given the environment, Randy, it's not a growth area, as Doug said.

Operator

Your next question comes from the line of Ryan Tunis with Autonomous Research.

Ryan James Tunis
Autonomous Research LLP

This might have already been pretty clearly confirmed, but just I guess for my own head. So the new 92 to 94 guide wouldn't be any different if it weren't just the addition of the Navigators mix, and you feel just as good about Navigators as you did at the time of the deal. Is that right?

Douglas Graham Elliot
President

That's right. With the exception, we have built in a little bit of this pressure on builders risk. But what we experienced first half has set our view, so we've tweaked our loss ratios in the marine area second half of the year. Largely all the other lines remain on track.

Beth Costello
Executive VP & CFO

Yes. And I'll just add to that, Ryan, just to be clear. So absent Navigators, we probably would be 1 point down relative to what our original thought was for second half of the year. So -- but obviously, Navigators coming in at a higher loss ratio -- combined ratio is kind of -- is in the mix, but when we put it all together, we feel very good about being able to be in that range.

Douglas Graham Elliot
President

Ryan, I would remind you, the compare on that, you have to almost go back to 2018 and think about what happened in Qs 3 and 4. We were doing some adjusting to the workers' comp line still in Q3 of last year. I think that's something that just has to factor in here.

Ryan James Tunis
Autonomous Research LLP

Got you. And I think I wanted to go back to Elyse's question. I think Beth, you did a good job talking about the accident year actions and how those compared to the original expectations at the time of the deal. But I'm still having a little bit of a hard time with -- I think there was like $150 million of gross charges that Hartford took and there have also been some charges that Navigators had taken in the quarter since the deal -- the acquisition was announced. So yes, I mean, how -- on the reserving side, would you say that all the activity that we've seen has also been around the level that you would have expected at the time you announced the deal? Or could you just highlight some areas where things ended up being a little bit more elevated?

Beth Costello
Executive VP & CFO

Yes. So if you go all the way back to the time we announced the deal, I would say that the -- our views relative to reserve increases have increased from there. We obviously took that into consideration when we started to look at purchasing an adverse development cover. I would say that the actions that we took are relatively consistent with what we would have thought at the time that we entered into the ADC. So we sort of incorporated those views when we looked at -- when we looked to purchase protection. And as I said in my remarks, feel very good about the fact that there remains $209 million under that cover.

And I would say the areas that we're seeing, the increases are relatively consistent. Just again, some of the size of those increases has changed. And we incorporated all of that as we thought about our 2019 accident picks, both what we felt needed to be adjusted from what Navigators had recorded pre-acquisition as well as incorporating those views into our updated guidance for the second half of this year.

Operator

Your final question will come from the line of Mike Phillips with Morgan Stanley.

Michael Wayne Phillips
Morgan Stanley, Research Division

I guess Doug made some comments on the reserve issues in some of the smaller lines, professional liability and, in turn, in general liability. I guess I was looking to see maybe a little more detail in kind of what exactly you're seeing there, how confident you are that you got things fixed and maybe some pressures going forward in those specific lines in professional liability.

Douglas Graham Elliot
President

Mike, I would say that if you go back and think about some of the pressure spots at Navigators toward the end of last year and early this year, obviously, there's been some pressure in the international book, some of that marine book internationally and also the D&O book. And they were addressing some of their own. And essentially, as we looked at the tail factors and we looked at those cases, we just decided that we needed to make some adjustments. So that's how I think about several of those lines.

In the U.S., our view of tail and tort came together with their actuaries. And we spent a lot of time debating and looking at things. So I don't look at what we did over the last quarter, these changes, as anything very, very different than our discussions last summer. But they were updated based on facts and debates as we came together and closed the second quarter.

Michael Wayne Phillips
Morgan Stanley, Research Division

Okay. I guess one more on Personal Lines and if I could turn back to that. You commented that the premium drop in Personal Lines was -- part of it was due to the nonrenewal business. And I guess maybe when do you expect kind of an inflection on that piece of the Personal Lines?

Douglas Graham Elliot
President

Well, our goal is to be turning into growth as we close out 2019 and move into 2020. We're encouraged because, as you can see, our new business numbers look much more positive than they were at this point last year. Again, we're working on retention. The rate change -- the book is at a pretty solid profit perspective, so I think the rate change probably won't move a lot over the next 6 to 9 months, but we think the new business will grow. And if we get a little lift in retentions, we'll see those positive numbers move approaching end of year 2019.

Operator

And that does conclude our question-and-answer portion of today's call. I will now turn the call back over to Susan Spivak for any closing remarks.

Susan Spivak Bernstein
Senior Investor Relations Officer

Thank you, operator. In conclusion, we just appreciate all of you joining us this morning, and we apologize for the technical difficulties and the sound interference during Beth's note. Please note that we'll be -- there will be a transcript available and we're happy to talk after this call to clarify anything that wasn't clear during our prepared remarks. Thank you and look forward to next quarter.

Operator
Thank you again for joining today's conference. You may now disconnect.