S&P Capital IQ

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The Hartford Financial Services Group, Inc. NYSE:HIG

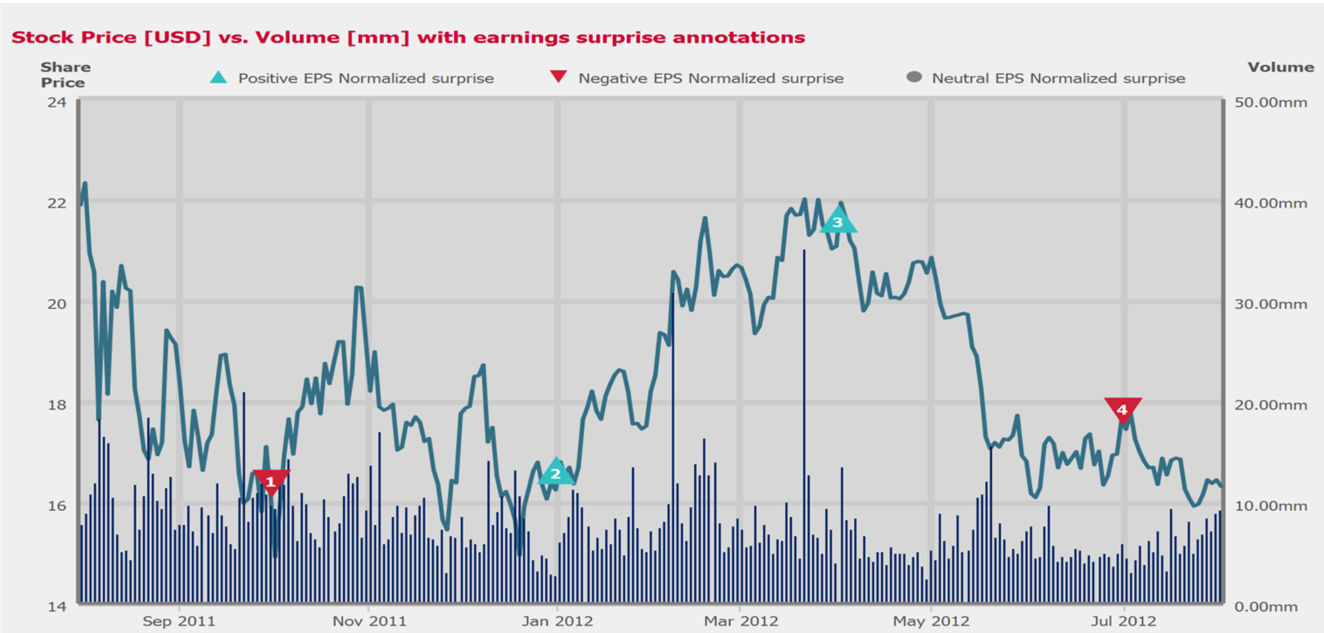
FQ3 2012 Earnings Call Transcripts

Friday, November 02, 2012 1:00 PM GMT

S&P Capital IQ Estimates

	-FQ3 2012-			-FQ4 2012-	-FY 2012-	-FY 2013-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.82	0.78	(4.88 %)	0.78	3.10	3.54
Revenue (mm)	5909.34	6442.00	9.01	5884.22	22186.17	20333.81

Currency: USD
Consensus as of Nov-02-2012 11:35 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ3 2011	0.25	0.05	(80.00 %)
FQ4 2011	0.62	0.69	11.29 %
FQ1 2012	1.06	1.25	17.92 %

FQ2 2012	0.47	0.23	(51.06 %)

Call Participants

EXECUTIVES

Beth A. Bombara
Chief Financial Officer and Executive Vice President

Christopher John Swift
Chairman & CEO

Douglas G. Elliot
President

Liam E. McGee
Former Chairman

Sabra R. Purtill
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Presentation

Operator

Good morning. My name is Felicia, and I'll be your conference operator today. At this time, I would like to welcome everyone to the Third Quarter 2012 Earnings Call. [Operator Instructions] After the speakers' remarks, there will be a question-and-answer session. [Operator Instructions] I would now like to turn the conference over to Ms. Purtill. Ma'am, you may begin.

Sabra R. Purtill
Senior Vice President of Investor Relations

Thank you. Good morning, and welcome to The Hartford's Third Quarter 2012 Conference Call. Our speakers today are Liam McGee, The Hartford's Chairman, President and CEO; and Chris Swift, our CFO. Other members of our executive management team present today include Beth Bombara, Doug Elliot, Brion Johnson, Alan Kreczko, Andy Napoli and Bob Rupp.

As detailed on Page 2 of the presentation, statements concerning The Hartford's future results or actions should be considered forward-looking statements as defined in the Private Securities Litigation Reform Act of 1995. These forward-looking statements are not guarantees of future performance. Actual results may be materially different. We do not assume any obligation to update the forward-looking statements. You should consider the important risks and uncertainties that may cause The Hartford's actual results to differ, including those discussed in our press release, our third quarter 10-Q, 2011 10-K and other filings we make with the SEC.

Please note that our presentation includes financial measures that are not derived from Generally Accepted Accounting Principles, or GAAP. Definitions and reconciliations of these measures to the most directly comparable GAAP measures are provided in our financial supplement, press release and 10-Q.

I'll now turn the call over to Liam.

Liam E. McGee
Former Chairman

Thank you, Sabra. Good morning, everyone, and thank you for joining us today.

Before I begin, on behalf of all of us at The Hartford, our thoughts and prayers are with those who have been affected by Storm Sandy. And on a personal note, we at The Hartford hope that each of you and your family are faring well during these very challenging times because, clearly, this was a devastating storm with a large footprint and tropical force winds that impacted a highly populated area. At The Hartford, our catastrophe team has been on the ground working 24/7 to help our policy holders, and I want to express my deep appreciation to our claims teammates and others in the field. In addition, we are also very thankful for the emergency personnel and volunteers who are providing basic needs and critical services.

I know you all are interested in loss estimates, but it's much too early for us to provide data with any level of certainty. We're still waiting for clearance from local authorities to access some areas. Yesterday, for example, was the first day we were able to get adjusters into Long Island. Now clearly, this is a significant event for those who suffered losses. But Storm Sandy is well within the planning scenarios we use to manage catastrophe risk at The Hartford. This is a major storm, but it is a manageable exposure for The Hartford. As we have more certainty around The Hartford's losses, we will provide you with details.

Now let's cover third quarter results and activities. I am pleased with The Hartford's third quarter achievements. First, we announced the sale of the 3 Wealth Management businesses we committed to sell last March, ahead of our year-end target. The businesses are going to strong, strategic buyers. And the sales are expected to generate about $2.2 billion of statutory capital benefit for The Hartford. Second, The Hartford generated strong overall financial results in the third quarter, with core earnings of $378 million, significantly better than the $50 million last year. Net income was also up strongly, rising from $60 million to $401 million. Third, The Hartford's go-forward businesses demonstrated increasing earnings momentum, benefiting from strong pricing trends, along with improved retention in Property & Casualty Commercial and new business growth in Consumer Markets. Mutual Funds also showed improved net flows. Core earnings from the 3 go-forward segments totaled $294 million this quarter compared with $121 million last year.

Now while much of that improvement was due to last year's high catastrophe losses, combined ratios, excluding caps in prior development, improved in both Property & Casualty Commercial and Consumer Markets, as did the loss ratio in Group Benefits.

In Property & Casualty Commercial, we continued to generate sustained written price increases, with an 8% increase in standard commercial lines this quarter, up from 7% for the first half of 2012. Our focus on pricing discipline will continue in the fourth quarter and into 2013. Doug and his team are doing an excellent job balancing margin expansion with retention and pricing. Our primary goal, particularly in Middle Market, is to drive to acceptable levels of profitability. So there will continue to be a dampening effect on the top line as less profitable accounts move to other carriers.

We are pursuing similar tactics in Group Benefits. The Hartford was among the first to recognize and respond to the adverse incidents and termination trends. However, given the 3-year contract terms in this line, it takes longer for the results of pricing actions to fall to the bottom line. In the third quarter, core earnings trends benefited slightly from an improvement in termination rates, although they do remain lower than historical levels. Improving terminations, combined with our pricing initiatives, should slowly expand margins.

In Consumer Markets, Andy and his team are focused on maintaining margins in auto, expanding margins in homeowners, continuing new business growth and improving retention. We recently enhanced the pricing segmentation in our Open Road Advantage auto product, which has helped lift conversion rates. New business production is up, and we feel good about the mix of business. Homeowners continues to need rate, and we have been diligent in pursuing it. Efforts to improve retention are yielding positive results, with continuing quarterly improvements in auto and home.

The Mutual Funds business also made good progress during the quarter, as its balanced and fixed-income funds posted more favorable net flows. Overall flows remain negative due to continuing industry-wide withdrawals from domestic equity funds. However, the company's third quarter flows were the best we've seen since the first quarter of 2011. Several funds generated particularly strong performance in the quarter. For instance, the Balanced Income Fund had top quartile Lipper performance, both for the quarter and year-to-date, and was one of our top funds in gross sales at $385 million for the quarter. In addition, our World Bond Fund was recently recognized as a newcomer of the year by the Wall Street Journal.

In our Runoff division, third quarter financial results were in line with our expectations, with core earnings x DAC unlock declining 6% from the prior year, reflecting lower earnings from U.S. annuity. Beth Bombara and her team have been examining a range of options to address the legacy annuity blocks. One area of focus is on contract holder initiatives, such as the enhanced surrender value option -- offer that we filed earlier this week with the SEC. This option will be offered to contract holders who represent about 15% of our U.S. GMWB book in terms of account value, but more importantly, nearly 45% of the U.S. GMWB net amount at risk. Similar to programs introduced by several other companies, it offers the contract holder the option to surrender the policy at a premium to the current account value. We continue to aggressively examine other options to accelerate the runoff of the U.S. and international annuities and look forward to updating you on our progress. With any actions we take, we will continue to honor our obligations to contract holders.

Finally, I'm pleased that we reached definitive sales agreements for Individual Life, Retirement Plans and Woodbury Financial Services this quarter, ahead of our year-end target. We're selling these businesses at good values that will generate an estimated net statutory capital benefit of approximately $2.2 billion. Furthermore, they are being sold to market-leading strategic buyers who saw value in our innovative products, strong distribution and employee expertise. We expect to close the Woodbury transaction by year-end and Individual Life in the first quarter of 2013. We're working to close Retirement Plans by year-end, but it may slip a little into the new year as we work through the necessary regulatory approvals.

Chris will discuss the company's expense initiatives. The bottom line, however, is that we will reduce about $850 million in expense. The vast majority of which relates to the elimination of all expenses of the divested businesses. Moreover, approximately 90% of the expenses will be eliminated by the end of 2013.

With the sales announced, I know investors are interested in our capital management plans. We are developing holistic capital management plans, which we will discuss with regulators and rating agencies and which we will share with you in early 2013, after the transactions are closed. Our goal in managing capital is to pursue accretive actions for shareholders while both maintaining a balance sheet sufficient for adverse economic environments and the current ratings of our go-forward businesses and preserving financial flexibility to be opportunistic in taking future actions to address the company's legacy annuity liabilities. Therefore, we expect that our capital management plans will include: debt repayment to reduce leverage and improve our interest coverage ratios over time; share repurchases, which at current prices are very accretive; and retaining some capital to take future actions for permanent solutions to reduce the size and risk of the legacy annuity liabilities, which should create significant shareholder value.

To conclude, The Hartford had a successful third quarter. We reached agreements in all 3 of the planned sales ahead of schedule at attractive prices and with strong buyers who value the skills and expertise of our teammates. We had strong core earnings. We demonstrated pricing and margin momentum in our go-forward businesses. And our Life Runoff team is considering options to accelerate the runoff of the legacy annuity blocks, including the recent filing of the enhanced surrender value program offer.

The Hartford is becoming a more focused company that has the potential to create greater shareholder value while providing policyholders with the protection and service that they depend on. I am confident that we are on the right path, and I look forward to communicating our continued progress.

I'll now turn the call over to Chris, who'll cover our financial results in more detail. Chris?

Christopher John Swift
Chairman & CEO

Thank you, Liam. Good morning, everyone. This morning, I'm going to focus on 3 topics: first, I'll cover key aspects of this quarter's financial results; second, I will provide an update on our expense initiatives, including efforts to remove all the direct and indirect expenses of the businesses we are selling; and third, I'll provide an outlook for fourth quarter and full year 2012 results.

I'll begin on Slide 5. Third quarter 2012 core earnings were $378 million or $0.78 per diluted share. These results were in line with our outlook of $0.75 to $0.80. On a run rate basis, core earnings were $0.77 per share, which excludes the items summarized on Slide 5, which totaled $0.01 per share. These items included a modest charge for reestimating current accident year prior quarter loss reserves for workers' compensation and commercial auto of approximately $0.05 per share. Restructuring expenses totaled $34 million after tax or about $0.07 per share, slightly above our August estimate.

Turning to Slide 6. The Hartford's book value per diluted share rose 10% over the past year to $48.13, including a $2 billion increase in net after-tax unrealized gains on fixed maturity investments as a result of continued low interest rates and tighter credit spreads over the last year. It also includes the approximately $900 million or $1.83 per share reduction in shareholders' equity due to the Allianz debt refinancing and warrant share repurchase in the first half of 2012. Book value, excluding AOCI, was $41.35 per diluted share, flat with prior year, as net income over the past year was largely offset by the impact of the Allianz transactions. For the last 12 months, our core earnings ROE was 7.2%, up from 6% for the 12 months ended September 30, 2011.

Slide 7 has a high-level summary of P&C Commercial results. Core earnings were $160 million, up 84% from prior year. Catastrophe losses came in at $7 million after tax compared with $60 million last year. In addition, the increase in core earnings reflects improved margins in Middle Market. The third quarter 2012 combined ratio, x cat, x prior year, was 97.5%, down from 99.4% in prior year. Favorable expenses and better experience in property lines were partially offset by a deterioration in commercial auto liability results.

Third quarter 2012 included $39 million of current accident year prior quarter loss reestimation or 2.5 points on the loss ratio. This compares to $47 million or 3 points on the loss ratio last year. This year's changes were due to higher severity in commercial auto, particularly in small commercial, and a slight adjustment for lost time workers' compensation claims. Even with this change, the 2012 workers' comp accident year loss ratio is approximately 4 points better than 2011 accident year. This reflects the pricing and underwriting actions we have taken over the last 12 to 18 months. Our pricing and underwriting discipline in P&C Commercial has resulted in pricing increases across the portfolio, and we remain committed to driving actions necessary to improve margins in the fourth quarter and beyond.

Middle Market workers' compensation is a key contributor to our achieved pricing increases, with rate increases averaging 15% this quarter, consistent with the rate achieved in the second quarter. In Middle Market property, rates increased 10% compared with 8% in the first half. Our team is proactively managing renewal rate increases, account retention and new business growth to optimize overall profitability. While aggregate rate increases may have leveled off, our focus on margin improvement will continue.

Group Benefits results are summarized on Slide 8.

Although below historic levels, we're pleased with the trends we're seeing in the segment. Core earnings were $23 million, up 15%, due to improved loss trends. The loss ratio was 79.3%, an improvement over prior year's 80.1% and reflected better LTD results, offset by less favorable mortality in Group Life this quarter. As a result of our sustained pricing actions over the past 2 years, Group Benefits premiums declined 7% year-over-year. We expect this trend will continue into 2013 due to the impact of our renewal pricing strategies on persistency. Year-to-date, persistencies averaged 62%.

Turning to Consumer Markets on Slide 9. Core earnings were $93 million, a turnaround from core losses of $10 million in the third quarter of 2011, which had a significant level of catastrophes. This quarter had no net catastrophe losses as the $16 million of after-tax losses from the third quarter events, including Hurricane Isaac, were offset by favorable development on catastrophes from the first half of 2012. We continue to be pleased with the progress that Andy Napoli and his team are making, balancing profitability and growth. Consumer Markets underwriting margins, excluding catastrophes, have expanded as we take rate increases.

The third quarter combined ratio, excluding cats and prior year development, was 93.3%, down more than 2 points from 95.5% last year, are duly because of improved homeowner results. Auto results were comparable to the prior year. We remain focused on achieving rate increases consistent with the loss cost trends. Loss costs continue to be slightly higher in auto due to physical damage severity, although it moderated from the first half of 2012. The increase in physical damage severity was largely offset by favorable trends on auto liability frequency this quarter. We achieved written rate increases of 6% in homeowners and 4% in auto this quarter.

On the growth side, new business premiums are up 9% this quarter and 18% year-to-date. AARP Agency is a strong growth source. In the first 9 months of 2012, written premiums in AARP Agency were $96 million, almost double that of the prior year period. Retention has also improved, up 2 points in auto and 3 points in homeowners compared to a year ago.

Mutual Fund results are summarized on Slide 10. Core earnings were $18 million, down from the prior year but flat with the second quarter of 2012. The principal reason for the decline was lower fees, reflecting lower average assets under management and higher distribution and marketing expenses as we execute our strategy with Wellington. Net flow performance has significantly improved from the past several quarters as a result of stronger deposits into our fixed income and balanced fund choices. We are optimistic about the prospects for this business as we work with Wellington to expand marketing for The Hartford funds.

The results of our combined Life and P&C Runoff division are on Slide 11. Core earnings x DAC unlock were $168 million, comprised of $147 million from Life other operations and $21 million from P&C. The DAC unlock included in core earnings for the quarter totaled a charge of $11 million compared with a $126 million charge in the third quarter of 2011. For the quarter, surrenders averaged 14.7% on the U.S.

variable annuity book and 3.6% for Japan VA, slightly higher than historical levels but lower than the 17.5% and the 4.5%, respectively, we saw in the second quarter.

We recently filed for approval with the SEC an enhanced surrender value option, which Liam discussed. This represents our first of initiatives to provide contract holders with additional choices for their contract that also meet our objectives of reducing risk with reasonable economics.

Turning to the impact of the VA book in capital resources. Slide 12 provides a summary of VA hedging results for the quarter. During the quarter, the net statutory impact of our VA liabilities and hedges was a negative $4 million before tax, excluding fees earned in the quarter and other impacts to surplus. It's been about a year since we've completed the buildout of our Japan hedging program. The goal of all our hedging programs is to manage our economic exposure, which is our continued focus and which is performing as we expect in these market conditions. We have retained some market risk, although throughout 2012, we have increased interest rate protection. You can find our updated sensitivities in our 10-Q.

Slide 13 is a new slide that combines our statutory surplus roll-forward with our total capital resources. Total U.S. statutory surplus before dividends to the holding company increased by approximately $100 million from June 30, reflecting $215 million of increased P&C surplus that was offset by a slight decrease in U.S. Life surplus. After $200 million of dividends to -- from the P&C company to the holding company, surplus was essentially flat. Year-to-date, Life statutory surplus is up about $150 million. We perform our annual cash flow testing at the end of the year, which will impact full year results given sustained low interest rates and tighter credit spreads. Consistent with our prior outlook, we continue to expect U.S. Life statutory surplus to be flat or slightly down for the full year.

Our capital resources, which include U.S. statutory surplus, as well as the $1.3 billion in Japan capital, were equal to the $18 billion we had at the end of June 30. Holding company cash and short-term investments totaled $1.4 billion.

Looking forward, the 3 sales transactions are expected to increase our statutory surplus by approximately $1.4 billion, for a total net statutory capital benefit of about $2.2 billion based on current estimates. As Liam mentioned, we are working on our capital plans, and we look forward to sharing them with you in early 2013.

Turning to the second item on my agenda, Slide 14 sets forth our updated expense initiatives. As Liam mentioned, we expect to reduce expenses by approximately $850 million before tax, most of which will be completed in 2013. Slide 14 breaks out the components of the expense reductions. In addition to our prior efficiency commitments, we will reduce expenses by another $100 million related to putting U.S. VA into Runoff and $615 million related to the 3 businesses being sold. We have detailed plans for execution and have begun reducing expense levels in 2012, which will continue into 2013.

As a result of these initiatives, we expect to incur a restructuring charge of approximately $45 million to $50 million after tax in the fourth quarter. This charge will accrue for all planned 2013 severance costs for approximately 500 positions affected over the course of 2013, as well as other fourth quarter items, such as retention payments. At year-end, we will have expensed about 85% of ultimate restructuring costs we anticipate. In 2013, we currently expect to have approximately $30 million after tax of additional restructuring and other expenses. Bottom line, we have significant expense-reduction goals and have a high degree of confidence in our ability to achieve them.

Finally, my last item before taking questions is to look at our year-to-date results and our fourth quarter outlook. As summarized on Slide 15, our core earnings, excluding DAC unlock, prior year developments, cats above budget and restructuring charges for the first 9 months of the year, totaled $1.2 billion or $2.40 per diluted share.

Our current fourth quarter outlook projects core earnings of approximately $375 million to $400 million or $0.77 to $0.82 per diluted share based on an estimated diluted share count of approximately 486 million shares. This outlook does not include any estimate of DAC unlock or prior year loss development and is also before the previously mentioned restructuring charge, which approximates $0.10 per diluted share.

This outlook includes a budgeted cat load of approximately $68 million before tax. This cat load does not include an estimate of expected losses from Sandy. Our plan is to update you on the impact of this major storm event when we have good estimates.

Combined with year-to-date results, our current 2012 outlook, excluding the DAC unlock, prior year development and other items listed on Slide 15, totals approximately $1.5 billion to $1.6 billion for the year, slightly less than our December '11 outlook of $1.6 billion to $1.7 billion. We are pleased with this result given the challenging microeconomic environment, as well as the significant strategic actions we took this year, which were not anticipated in our December outlook.

We are currently working on our 2013 plan, which we expect to share with you in February on our fourth quarter 2012 earnings call.

To conclude, I am pleased with both our business results and our strategic accomplishments this quarter and this year. Despite the weak economy and low interest rates, our business has performed largely in line with our expectations. Our capital resources remain strong and stable, and our hedging programs continue to protect us against adverse economic and market conditions.

At this point, I'd like to turn the call over to Sabra to begin our Q&A session.

Sabra R. Purtill
Senior Vice President of Investor Relations
Thank you, Chris. We have about 30 minutes of time for Q&A. Felicia, could you please give the instructions for asking a question?

Question and Answer

Operator

[Operator Instructions] Your first question comes from the line of Mark Finkelstein with Evercore Partners.

A. Mark Finkelstein
Evercore ISI, Research Division

So first, a quick question on the enhanced surrenders that you're doing on the variable annuities. I'm just curious if the offers -- how do the offers and the -- kind of the premium that you're going to be offering, how would that roughly compare to the reserves that you're holding against those guarantees?

Liam E. McGee
Former Chairman

Mark, this is Liam. I'm going to have Beth Bombara, who runs our Runoff division, answer that question.

Beth A. Bombara
Chief Financial Officer and Executive Vice President

Okay. Thanks, Mark, for the question. So the way I think about it is, obviously, with the enhanced surrender value option, we are paying a premium above the current account value. That might be slightly higher than the reserves that we carry today. But the way that we really look and evaluate these programs is we look at what it does to the requirements in our stress scenarios because, as you know, we hold capital for our stress scenarios, and we would anticipate that the cost of the program would be less than what the benefit is we would see from reductions in required reserves in those stress scenarios.

A. Mark Finkelstein
Evercore ISI, Research Division

Okay. Second question is for Chris. I guess on Slide 12, you kind of gave a comparison of the hedged mark-to-market asset versus the change in the VACARVM liability, which was essentially flattish in the quarter despite markets obviously being a little bit higher. I'm just kind of curious in a broad -- from a broad perspective, are we at that kind of point where we should start to see -- if markets continue to cooperate, if we should start to see statutory earnings in the Variable Annuity business?

Christopher John Swift
Chairman & CEO

Mark, thanks for the question. I think your point's a good one. This quarter was negative $4 million, as we talked about. And I remind you that, again, we're -- our hedge programs aren't, I'll call it, managing all the economics, so we still have risk positions on. So you're always going to have, I'll call it differences between your VACARVM liabilities and your changes in fair value of hedge assets. But as we've said before, generally, at the 1450 S&P level, we start to feel very good about the performance of the VA block going forward. You could see it in I'm going to call it the net amount of risk coming down this quarter. So we're at that inflection point where if markets continue to improve -- and it won't happen overnight, Mark, where we would generate a lot of statutory surplus off the VA block, but over time, with steady market performance, it is very positive for us. I would have to point out that offsetting that is really the continued low interest rate environment. So as much as equity markets are positive around the world, low interest rates in the U.S., Europe and in Japan are still a significant headwind for our statutory surplus creation on the Life side.

A. Mark Finkelstein
Evercore ISI, Research Division

Okay. And then just one quick follow-up to that point. In your last year presentation, you kind of gave an estimated long-term economic cost to hedging, kind of 40 basis points on the U.S. block; 15 dynamic, 25 macro. As you look out, does that change at all with kind of how the block has moved in the markets?

Christopher John Swift
Chairman & CEO

Not really. I mean, if I look at, I'll call it the cost, what we're expending and sort of the path-dependent performance of our hedges, I mean, it's fairly consistent with what we started, the year end [ph]. So as we head into '13, Mark, if we're going to modify any of our hedging programs, which we are always considering how to make it more economic beneficial, we'll update you. But right now, as we head into the fourth quarter, I'd say those estimates are still the best ones we have.

Operator

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

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

So a couple quick questions. I'm looking at Slide 14, the expense reduction target. Obviously, 2 pretty large pieces of that pie won't really start to come through until the sales close. But with respect to the remaining $235 million of expense reductions, I'm wondering how much of that is already in your run rate earnings currently?

Liam E. McGee
Former Chairman

I'll have Chris give you a little more detail, John. Thanks.

Christopher John Swift
Chairman & CEO

John, thanks. I would say, let's take the pieces, the $100 million for U.S. annuity shutdown, there's probably -- we're probably 30% achieved on our mission through '12, so there is some in there. There'll be more that will come out, particularly as we shrink shared services in 2013. The $135 million of, I'll call it expense efficiencies, I'd say most of that will relate to our 2013 plan. So I wouldn't say that there's very much in our run rate at this point in time. That's the incremental goal that we established for '13.

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

Okay, very helpful. Then sort of separately from the Variable Annuity business for a moment, thinking about the Fixed Annuity business. I'm just interested in whether you've seen any interest in that business given the continued M&A activity in that particular product line industry-wide. And if you could just remind us how much statutory capital, approximately, you currently have supporting that business.

Christopher John Swift
Chairman & CEO

John, if I understood your questions, it's called the Fixed Annuity Transaction Market. I know Beth and her team, we work closely with her on those opportunities. I mean, we're aware, we have intel, we've got advisers that are working with us. I think our simple analysis right now of what we see, appetite in the marketplace compared to our book of business, we just see a disconnect, particularly given the low interest rates. And as far as the capital, I haven't provided capital by product line. We might do that going forward, but historically, we haven't. How I think about capital in total, John, is you think of the $7.5 billion of capital we have in the blue books, we have approximately 150 -- excuse me, $1.5 billion of that capital allocated to Group Benefits. And the rest would be supporting VA, Fixed Annuities and our Institutional Annuity blocks going forward.

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

And that $7.5 billion, some of that, Chris, is related to the Life business, no?

Christopher John Swift
Chairman & CEO

Yes.

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

Okay. And then last quick one for you is just, given the recent move lower in longer-term new money yields, plus you combine that with the fact that you're going to sell a few businesses that are at least somewhat rate sensitives, I was just wondering if you could just update for us your outlook for how we should think about rate pressure on your go-forward businesses into 2013. Because I think previously you had talked about something along the lines of $50 million in '13, another $50 million on top of that in '14, et cetera. Is it fair to assume that that's changed a bit given the sales and given rates?

Christopher John Swift
Chairman & CEO

Thank you for the question, John. There's 2 aspects of rates that I just -- we'll touch upon. One we touched upon from a statutory cash flow testing in approaching year-end. I mean, so there is going to be some pressure on that as far as additional reserves, cash flow testing reserves, C3 Phase I impacts, so that would be the first pressure point. As we look forward then, after we sell Retirement and Life, and we'll talk more about this when we provide you the full '13 plan, we have about $4 billion of cash flows to reinvest in '13 and '14 for our ongoing businesses. And so I would say that the new pressure point for continued low interest rates on a run rate basis is probably in the $20 million range for '13. And then it would jump to $50 million in 2014.

Operator

Your next question comes from the line of Tom Gallagher with Crédit Suisse.

Thomas George Gallagher
Crédit Suisse AG, Research Division

I wanted to come back to the expense plan reduction of, Chris, I think you said $850 million all in. Just so I understand it correctly, the -- I heard, in response to John's question, what you said about the 2013 plan, which was you've only achieved 30% so far on the VA, $100 million, so that's an incremental $70 million there, and $135 million on other various initiatives. So let's just add this up to $200 million. That still leaves another $650 million. Should we assume this $650 million incremental is being offset by all the lost revenues that are going away with these asset sales? I just want to think about the other $600 million plus, and eventually, does any of that come through to the bottom line or not?

Christopher John Swift
Chairman & CEO

Tom, it's Chris. I think on the slide, if you had a chance to look at it, the $450 million of your $600 million number is really going to the new owners, so it's the employees, it's the infrastructure. So really, when we close those transactions, $450 million comes out immediately. And then what we're left with is -- that really represents $165 million, which represents, I'll call it, reducing our shared service platforms: IT, operations, finance. That approximates the 500 positions that we'll eliminate in '13. That will come out somewhat ratably in 2013.

Thomas George Gallagher
Crédit Suisse AG, Research Division

Okay, that explains that perfectly. The -- another follow-up on the Variable Annuity filing for the buyouts. Can you just give a little more color for what the target is here? I presume it's going to be the contracts that have the largest in-the-money type benefits that you'd be going after and the biggest VACARVM reserves. Can you frame it a bit in terms of size? Are you targeting -- is it 10% or 20% of your book? Is it bigger? A little more color on the scale for this and what you're sort of hoping for.

Liam E. McGee
Former Chairman

Tom, we'll have Beth do that. She'll give you a little more color in addition to the comments I made about it being about 15% of the book and about 45% of the NAR. So go ahead, Beth.

Beth A. Bombara
Chief Financial Officer and Executive Vice President

Yes. Thanks, Tom. So a couple of things just to frame it as to what policies this impacts. So it's about -- in total, about $5 billion of account value, and it's related to policies that have our LIB II [ph] rider associated with them, which is a lifetime income benefit rider. And again, the way that these programs work, as I'm sure you know, is that they're made available to all policyholders that meet the criteria that is in the filing. So as far as targeting certain policyholders, again, it's open to all. When we think about the benefits that we might see, currently, this book we see about a 5% lapse rate. When I look at what might be reasonable expectations as to what we might see for sort of an increase in the take rate, I think to the extent that, that doubles or triples, I think that's a reasonable expectation because we would never think that this choice would be right for all policyholders that have this benefit. So that -- again, that's how we're thinking about it right now. And then as we go through the approval process and we're able to actually offer this benefit to policyholders, we'll trip those estimates as we see actual take rates from the program.

Thomas George Gallagher
Crédit Suisse AG, Research Division

And is there -- when you say 45% of the NAR, is it also approximately 45% of the reserves in capital, or is it not that linear?

Beth A. Bombara
Chief Financial Officer and Executive Vice President

Well, I think in all things VA, things are never linear, so I wouldn't look at it exactly that way. But again, given the fact that it does have the profile that it has, you would expect that the reserves allocated to it are higher than maybe other reserves associated with other portions of our block.

Thomas George Gallagher
Crédit Suisse AG, Research Division

Okay, that's helpful. And just the last -- one last, if I could sneak it in. Chris, just on Japan, the main concern I've been hearing on that lately is rates are low. There's -- is there a risk, because of how deep in the money those contracts are in terms of the VA, that there's going to be a higher utilization than you've modeled, so there's fear that you might have to add to capital and reserves in Japan? Can you just give us some idea for, over the next 2 to 3 years, whether Japan is likely -- more likely to be a consumer or a returner of capital or something that's kind of neutral?

Christopher John Swift
Chairman & CEO

Tom, on low rates in Japan, I would say, right now, in sort of our baseline scenario out the next couple years, we don't see the need to inject capital into Japan. But as you pointed out, there are obviously pressure points from low interest rates. All I can say is that our assumptions, as I looked at them, and again, we updated all our policyholder behavior assumptions this quarter, I think are very, very prudent. We do assume a high utilization of that benefit going forward. So I think we've planned for it. But in, again, a baseline scenario, I don't think they're going to consume capital, but on the other hand, I don't think they're going to be releasing capital back to the U.S. in a short period of time either.

Operator

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

Brian Robert Meredith

UBS Investment Bank, Research Division

First one, can you just clarify your cat reinsurance program? I believe you've got a $350 million deductible on it. Is there anything else we should think about as we kind of look at Sandy and the potential loss impact here?

Liam E. McGee
Former Chairman

At a high level, Brian, you've got it, that our maximum loss retention is $350 million.

Brian Robert Meredith
UBS Investment Bank, Research Division

Great, great. And then also from where Sandy hit, how can we kind of think about your market share, is it disproportionately larger there, something like that? Anything you can kind of give us color on that?

Liam E. McGee
Former Chairman

Brian, Doug Elliot and his team have done an incredible amount of detail work on that side. And again, while it's very early, I think he can give you a flavor.

Douglas G. Elliot
President

Brian, this is Doug. I would say from a commercial perspective, we don't see ourselves out of pattern in any of the areas. Obviously, these are early days, but as we go through both our zip code and our territorial analysis across all the affected areas, I think you'll see us in line relative to market footprint across the states.

Brian Robert Meredith
UBS Investment Bank, Research Division

Great. And then I'd like to ask a question on some of the workers' comp reserve actions you continued to take here. I'm just curious, what's the challenge here in actually getting kind of loss picks right and reserves right with that line of business? And is there anything you're doing that, going forward, we're not going to see some of this current year development and adverse development on this line?

Douglas G. Elliot
President

So let's separate the current and the prior, and let me see if I can add some color and give you some confidence about some of the actions we're taking, which we feel very good about. Number one, on the prior accident year, and we look at $18 million against the base of $6 billion. I look at that, Brian, really as tuning. We did do some minor strengthening to the accident years '11, '10 and '09, and we had some releases 5, 4 and 3. But $18 million and $6 billion, really, given what we've gone through the last 5 quarters, I feel very good about our position. And we will continue to monitor aggressively and not -- there might not be little bumps on the road, but we are in a completely different spot than we were 5 quarters ago. When I think about the current year, a little bit of 2 stories. One is 2/3 of our comp actions in the year were in Small Commercial. When you step back and think about Small Commercial, our returns and combined ratios in Small are really, really outstanding, and I think they will stack up with pretty much anybody in the industry. We saw a little bit of medical severity in the quarter and a little bit of larger cases. So nothing major, but enough so that we made some minor modifications to our current accident year pick in Comp in Small. It's the first time we've had to do that in several years, but we're watching and staying very careful again, albeit you see the combined ratios and saw very solid returns and in line with outstanding rate adequacy across Small Commercial. A different story in Middle. We've talked aggressively about the rate actions we were taking in our Middle Market book the last 5, 6 quarters. We feel good about those rate actions. They do not stop in third quarter '12. We continue to march on. And as Liam mentioned, we're marching on into quarter 4. So we're out beyond our trends both on a frequency and severity standpoint and we now are improving margins. The prior actions had a little bit of Middle to them, but as I look at the current accident year, there isn't anything that concerns me. And I feel good about the actions we're taking in the marketplace and reflected in the balance sheet. So maybe some bumps along the way and a few bumps in the quarter but really very, very steady progress. And our behavior in the marketplace, both from a new business perspective and a rate retention, I think is a completely different spot than where we were third quarter 2011.

Brian Robert Meredith
UBS Investment Bank, Research Division

Great. And then just one last quick question for you, Doug. In new business, Small Commercial actually declining this quarter. Anything going on? Is that something we should continue to see going forward?

Douglas G. Elliot
President

So for us in Small Commercial, we clearly are looking at our dials, and we're making some adjustments. Our pricing in Small Commercial moved up in the quarter. That was a good thing. We've got a little bit of pressure in automobile. We're watching that carefully, and so we've adjusted pricing, and I think that has affected some of the top line. Nothing that at this moment that concerns me, but clearly not -- you're right, not at the run rate that we had for the first 6 months. So we'll stay on top of that. I want to make sure our margins stay very strong in that business, but we also are mindful that it's a business we'd like to grow, and we're thoughtful as we move forward.

Operator

Your next question comes from the line of Chris Giovanni with Goldman Sachs.

Christopher Giovanni
Goldman Sachs Group Inc., Research Division

Just a few series of questions, I guess, on the VA buyout plans. I think last quarter, when I asked about sort of the buyout opportunity, there was a comment that, we don't know if there's evidence yet that consumers will actually kind of make that trade. So have you seen evidence now that consumers will make that trade? And then if you achieve some of the targets that Beth talked about, I guess, what would be the next most logical step for further runoff of the VA book? I guess are there conversations or extensions you may be having with other participants that some of the more deep-in-the-money contracts, if those can get cleared out, that additional opportunities would free up, or is that just too optimistic?

Liam E. McGee
Former Chairman

Chris, let me make just a high-level comment. I'll let Beth comment on the market intelligence of others have done it. Beth and her team, to your -- the second part of your question, are examining every single possibility we can reasonably consider to accelerate the runoffs of the book. And as I just said in my remarks, eventually, a permanent resolution to the size of risk of some of the books as well. So we have a variety of things in the pipeline. Some will materialize because they'll make sense, some won't, but there's no stone being left unturned in our Life Runoff business. So with that, Beth, I'll turn it over to you for any additional context that you want to give.

Beth A. Bombara
Chief Financial Officer and Executive Vice President

Sure. So as it relates to the first part of your question, Chris, as to the success of some of these programs by others. Anecdotally, we've heard that there had been some success, but really, the way we looked at designing our program was really more about looking at our book and the characteristics of the policies that we're targeting through this. And so because of that, and when we look at the offer that we're making, we do think that this will be attractive to some of the policyholders. So we do expect to see some take rate as it relates to this program once it's launched.

Christopher Giovanni
Goldman Sachs Group Inc., Research Division

Okay. And then, Liam, just one quick follow-up. I'm not asking for specifics around the deployment of the $2.2 billion, but if -- did I understand you correctly that the $2.2 billion will be used for debt pay-down, buybacks, as well as some action on further runoff of the VA book?

Liam E. McGee
Former Chairman

Well, Chris, let me take a step back, first of all. Our capital management plan will be a holistic plan, including the $2.2 billion. And as I said, our current intentions -- we certainly don't want to get ahead of our regulator and our other constituencies, and we're in conversations with them. So our current intentions would be to do debt prepayment. At these share prices, repurchases are very accretive, as you know. And third, to preserve some capital so that we could be opportunistic when opportunities to permanently reduce the size and risk of the legacy annuity liabilities, which we believe will be very attractive for shareholders.

Operator

The next question comes from the line of Randy Binner with FBR.

Daniel Keith Altscher
FBR Capital Markets & Co., Research Division

This is Dan Altscher on for Randy. A question for either Chris or Doug, on some clarification on the workers' comp accident year loss ratios. I think, Chris, you said that 2012 is running about 4 points better than 2011. Could you maybe give what the 2012 and 2011 accident year loss ratios are looking like, actual numbers?

Douglas G. Elliot
President

Right, so Randy, let me -- this is Doug -- Dan, this is Doug. When you think about accident year '11, what we're referring to is accident '11 as it sits right now, which is the 7-quarter look at '11, and that is correct that our view about accident year '12 versus '11 is about 4 points different. At the moment, third quarter '12 accident year is in the high 60s, 68. And I would say again, that's our combined standard workers' comp ratio, so it includes Middle and Small. There are different dynamics inside each, but those are the components that roll up to the total, and also a little bit of National over the top.

Daniel Keith Altscher
FBR Capital Markets & Co., Research Division

Okay, that's great. And then just a quick follow-up for Beth. You said the premium option or that the takeout of the VA buyout, the premium that's being offered is relatively attractive. Can you size that a little bit? Is it 5% above account value, 10% account value? And now with the NAR being so much lower with equity markets higher, what does that take, like are policyholders really going to be interested in that now that their accounts are much closer to being made whole?

Beth A. Bombara
Chief Financial Officer and Executive Vice President

Sure. So a couple things as it relates to that. As it relates to the program, the way that it works is that if a policyholder were to elect this option, they would be able to take out their account value with a waiver of any surrender charges that might still be applicable. And about 55% of this book still has some portion of a surrender charge that's applicable. And then the enhancement that they get above that account value is if they get a payment of 20% of what the benefit base is, or think about that as the guarantee amount, subject to a cap of overall 90%. So it does provide an enhancement. Again, as we look at this book, a significant portion of it is in the money, so that most -- there are several policyholders that, if they elect to this benefit, they would receive an amount greater than their current account value.

Douglas G. Elliot
President

Dan, let me add one other detail to you. I want to make sure that when you look at quarter-to-quarter, you go back and actually look at when we roll out our quarterly triangles. You make sure that the 7-quarter look at accident '11 is there. The year-to-date September comp all-in 3-quarter look will be 64, 64 2 [ph]. So there are lots of questions coming whether the quarter-to-date change -- the quarter-to-date change is 68, but the year-to-date will be 64.

Sabra R. Purtill
Senior Vice President of Investor Relations

Thank you. Felicia, I believe we're running out of time. We have another company who has a call starting at 10. So I'd like to thank you all for joining us today on the call. I know many of you are dealing with telecommunications and commuting challenges. Please feel free to reach out to the IR department at The Hartford for any follow-up questions, and we look forward to talking to you soon. Thank you, and have a good day.

Operator
Thank you for participating in today's call. You may now disconnect.