S&P Capital IQ

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The Hartford Financial Services Group, Inc. NYSE:HIG

FQ2 2013 Earnings Call Transcripts

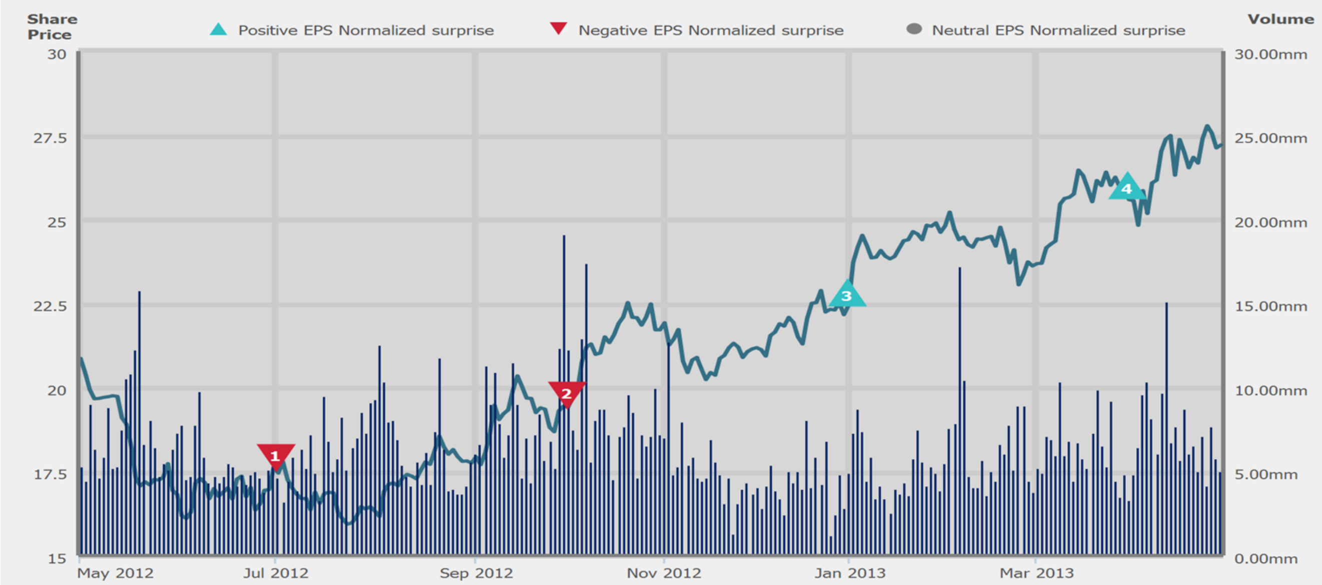
Tuesday, July 30, 2013 1:00 PM GMT

S&P Capital IQ Estimates

	-FQ2 2013-			-FQ3 2013-	-FY 2013-	-FY 2014-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.71	0.66	(7.04 %)	0.75	3.23	3.60
Revenue (mm)	5776.50	5465.00	(5.39 %)	5721.50	26367.50	21726.00

Currency: USD
Consensus as of Jul-30-2013 11:10 AM GMT

Stock Price [USD] vs. Volume [mm] with earnings surprise annotations



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ2 2012	0.47	0.23	(51.06 %)
FQ3 2012	0.82	0.78	(4.88 %)
FQ4 2012	0.35	0.54	54.29 %

FQ1 2013	0.83	0.92	▲10.84 %

Call Participants

EXECUTIVES

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Former Executive Vice President and President of Consumer Markets & Enterprise Business Services

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Chief Financial Officer and Executive Vice President

Christopher John Swift
Chairman & CEO

Douglas G. Elliot
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Presentation

Operator

Good morning. My name is Laurel, and I will be your conference operator today. At this time, I would like to welcome everyone to The Hartford's Second Quarter Financial Results Conference Call. [Operator Instructions] I would now like to turn the call over to Ms. Sabra Purtill, Head of Investor Relations. Please go ahead.

Sabra R. Purtill
Senior Vice President of Investor Relations

Good morning, and welcome to the Hartford Second Quarter 2013 Financial Results Conference Call. Our speakers today include Liam McGee, Chairman President and CEO; Doug Elliot, President of Commercial Markets; Andy Napoli, President of Consumer Markets; and Chris Swift, Chief Financial Officer. Other members of our executive management team available for the Q&A section of this call today include Beth Bombara, President of Talcott Resolution; Brion Johnson, Chief Investment Officer; and Bob Rupp, Chief Risk Officer.

As detailed on Page 2 of the presentation, today's presentation includes forward-looking statements as defined in the Private Securities Litigation Reform Act of 1995. These statements are not guarantees of future performance, and actual results may differ in a material way. We do not assume any obligation to update today's forward-looking statements, and investors should consider the risks and uncertainties that may cause actual results to differ.

Our news release, 10-Q, 2012 10-K and other filings we make with the SEC, contain a detailed description and explanation of those risks and uncertainties. Finally, please note our presentation includes non-GAAP financial measures. We provide definitions and reconciliations of these measures to the comparable GAAP measure in the news release, financial supplement and SEC filings. I'll now turn the call over to Liam.

Liam E. McGee
Former Chairman

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

We're pleased to report another quarter of strong execution at the Hartford. We continued to deliver on our objectives of generating profitable growth in the go-forward businesses and reducing the size and the risk of the legacy annuity blocks. In June, we also announced a significant expansion of our capital management program. As you saw last night, The Hartford delivered second quarter core earnings of $324 million, up 18% over the prior year. Driven by improving fundamentals, aggregate core earnings in Property & Casualty, Group Benefits and Mutual Funds were up 28%. This earnings growth reflects the continuation of positive pricing momentum in Property & Casualty and Group Benefits, as well as product and distribution initiatives that are generating profitable growth.

We continue to achieve meaningful price increases in Property & Casualty commercial. Renewal written pricing increased 8% on average in the Standard Commercial lines in the second quarter, consistent with the company's last 3 quarters and well ahead of loss cost trends.

Our philosophy and approach is unchanged, and we will continue to be aggressive and smart in our pricing actions. We are optimistic that this disciplined approach to pricing combined with loss costs that remained benign, would drive additional margin expansion going forward.

In Consumer Markets, Andy and his team have continued to leverage our relationship with AARP, expanding margins and delivering 2% written premium growth. This was the third consecutive quarter of year-over-year written premium growth. For AARP sold to agents, which as you know, is a key growth opportunity for this business, written premiums were up 63% in the second quarter.

In P&C Commercial, Doug and his team have complemented The Hartford's traditional expertise in workers' compensation with expanded product and underwriting capabilities in property and liability. This is particularly apparent in Middle Market, where we continue to diversify new business production. Through these actions, The Hartford is becoming a stronger and a more balanced commercial P&C player. In Group Benefits, profitability continued to improve in the second quarter as a result of our disciplined approach to pricing and our management of the book. We also benefited from improving disability incidence rates, a positive change from the company's experience over the past few years. Small Commercial just launched an expansion of its agency new business platform called ICON. This will improve the quoting and sales experience for agents and their CSRs, providing us the opportunity to quote and bind a higher percentage of available business. We're also rolling out a new top-of-the-line P&C claims handling system, which will improve the speed and efficiency of our claims process. We expect to begin implementation of the system in mid-2014.

The Hartford is investing significantly in initiatives like ICON and the claims system to strengthen our capabilities and competitive advantage. With improving execution and these investments, I am confident that we will achieve additional margin expansion and profitable top line growth in 2013 and beyond. In Mutual Funds, Jim Davey and his team continued to make progress with strong growth sales and solid investment performance against benchmarks in the second quarter. We remain optimistic about our ability to improve net flows and grow assets under management. The Talcott Resolution team made further progress reducing the size and risk of the legacy annuity blocks. In the U.S., the enhanced Surrender Value program has been more successful than we expected, with a 30% cumulative take rate to date. This contributed several points to the U.S. full surrender rate, which rose to 17.5% annualized for the second quarter. In Japan, the annualized full surrender rate jumped to almost 35% in the second quarter, driven by the significantly improved moneyness [ph] of the book. To put this number in perspective, until 2013, the annual surrender rate in Japan averaged less than 4%. While we cannot predict future lapse rates with certainty, at current market levels, we believe Japanese surrenders will remain much higher than our prior experience. The Talcott team also reached an agreement in June to sell the U.K. variable annuity business. The transaction which we expect to close by year-end eliminates the risk and expense associated with this VA block.

Finally, in June, we announced the $750 million expansion of our 2013, 2014 equity repurchase program to a total of $1.25 billion. In addition, the quarterly dividend was increased from $0.10 to $0.15 per share. This announcement resulted from our success over the past few years to focus The Hartford on capital-generating businesses, to reduce the size and risk of the annuity blocks and to achieve capital self-sufficiency in the Talcott operations. The Hartford is committed to delivering profitable growth in our businesses and further reducing risk. We are delivering on these objectives, which will continue to create shareholder value.

I'll now turn the call over to Doug for a discussion on Commercial Markets. Doug, welcome.

Douglas G. Elliot
President

Thank you, Liam, and good morning, everyone. I'm going to cover our P&C Commercial and Group Benefits results for the second quarter of 2013. I'll also provide some commentary on the marketplace and updates on several key business objectives. Margin improvement through effective underwriting and pricing actions remains at the top of our priorities, and we're pleased with our continued progress during the second quarter.

Let me begin on Slide 5. P&C Commercial had a combined ratio for the quarter of 98.4%. We continued to experience very solid pricing gains at 8%, generally consistent with our prior quarters.

Our results for the quarter include a charge of $80 million for the elimination of the New York Workers' Compensation, 25-A fund. Excluding this charge, our combined ratio was 93.2%, 7.3 points lower than the second quarter of 2012. Lower cat losses in the quarter accounted for 2 points of this improvement. Our prior year development, excluding the adjustment for New York 25-A was positive news of $43 million in the quarter. Underlining all of these factors, our second quarter combined ratio, x-cat and x-prior year development, was 93.1%, 1.4 points lower than the second quarter of 2012.

Our focus on underwriting and pricing continues to drive favorable accident year profitability trends. Our Group Benefit business had an outstanding quarter. Core earnings of $37 million were up $7 million from the first quarter of 2013. On a year-to-date basis, earnings are up 72%. Before I review the results of our business segments, I'd like to spend a few minutes discussing our pricing approach and our supporting analytics. We have a highly segmented approach for determining the rate need within our book of business. This sophistication has allowed us to successfully target increases within underperforming segments, while retaining those segments that are adequately priced.

As our pricing execution has become more sophisticated, so too have the analytical tools we use to capture the results of our actions. We have made refinements this quarter to the calculation we used to determine renewal written pricing, to better reflect rate changes on our renewed mix of business.

Let me now share some specific thoughts about each of our 4 business segments, starting on the Property Casualty side with Small Commercial on Slide 7. Written premiums of $787 million were up 2% in the quarter. Our current accident quarter combined ratio of 91.5% improved 2 points from second quarter of 2012, driven primarily by lower cats. Pricing in this business remains strong at 8%, well in front of our loss trends. And I'm very pleased with our ability to effectively manage profit margins.

We have consistently outperformed the market, achieving industry-leading combined ratios over many years. Our formula for managing profitability in this business has not changed, and we're well-positioned to maintain our performance in this business as we continue to refine our margins.

As Liam mentioned in his comments, we also continued to strengthen our Small Commercial market position with the rollout of ICON for our business owners' package policy. ICON is our new business quoting platform for Small Commercial, and we have completely redesigned this tool to improve the speed, responsiveness and accuracy process for our agents. We now have our Small Business worker's compensation and package products available on the new platform, and response from our agents has been very positive. Once commercial auto is released in 2014, we'll have our entire core small Commercial product suite available for new business production through this state-of-the-art automation platform. All in all, a very good quarter for our Small Commercial business.

Moving to Slide 8. Our Middle Market segment also had a very good quarter with a current accident quarter combine ratio of 97.6%. This result is 5.6 points lower than 2012, with 2.4 points of that improvement attributable to favorable catastrophes. This business has come a very long way from where we were 2 years ago. Written pricing for the quarter, although down approximately 1.5 points sequentially, registered a solid 8% increase year-over-year. Coupled with our underwriting actions, margins have continued to improve across all of our core lines, especially worker's compensation.

Over the last 8 quarters, we've been intensely focused on executing our pricing strategies in Middle Market and we've made substantial improvements in our book of business quality and performance. Our current accident quarter loss ratio, excluding cats, is down nearly 5 points from last year. We remain aggressive on our pricing approach, particularly for business that continues to underperform. This is especially important for our worker's compensation line, which has needed more rate action than any other portion of our book. This quarter, worker's comp renewal written pricing in the Middle Market achieved a 10% increase. Although down from the low teens a year ago, this rate level continues to drive margin expansion on an improved book profile.

In addition, rates and other lines such as commercial, auto and property are up versus same time 2012. Some segments of our business are now performing extremely well after several cycles of pricing and require more modest rate increases to remain ahead of loss cost trends. We still expect to achieve margin improvement on these accounts, but not at the pace of 2 years ago. These shifts are the result of our analytics, which allow us to manage pricing and retention for overall results.

Early in my tenure, we established a strategic goal to become a more balanced Middle Market underwriter, complementing our expertise in worker's compensation with equal skill in the property and general liability lines. This goal supports both our intent to profitably grow our franchise and the desire to mitigate the risks that follow from over concentrations in a single line of business. We have made substantial progress on this front, and our mix of business continued to improve in the second quarter.

Worker's compensation new business in the quarter accounted for 29% of total new business, compared with 46% during the same period 2 years ago. Retentions have remained steady and our new business opportunities in property and general liability are growing, as the marketplace recognizes our strength and competencies in these lines.

Total written premium in the quarter was slightly positive, which is the first time I can say that since our reunderwriting actions took hold in the third quarter of 2011. Overall, this was another good quarter of progress for Middle Market. Our approach to profit management remains steady as we look to reach our long-term target returns.

The performance of our Specialty business on Slide 9 remains largely consistent with the first quarter. Our success with national accounts, primarily in the $1 million to $5 million segment, continues. We wrote 24 new accounts in the quarter and our retention of existing accounts remains strong. Pricing in this market segment has been rational and we're achieving rate levels consistent with our long-term targets. Financial products had a good quarter with continued positive mid-single-digit pricing across the portfolio. As you may have already noted, we released $30 million of professional liability reserves as we continue to examine our results for all accident years.

Shifting over to our programs area. Reunderwriting actions continued during the quarter with particular focus on auto liability exposures. With almost all the transportation programs now nonrenewed, our book quality is improving. We did take a charge of $40 million to our auto liability line, of which $35 million related to our program business. Much of this reunderwriting is behind us and we feel better about the positioning of this segment moving forward.

As summarized on Slide 10, our Group Benefit business had an outstanding quarter, as I had earlier mentioned. We've been very disciplined in our management actions and the results are clearly paying off.

Core earnings for the quarter were up $3 million over prior year, achieving a margin of 3.9%.

Year-to-date, core earnings of $67 million increased $28 million, doubling our margin versus the same period 1 year ago.

Our disability loss ratio of 82.7% in the quarter was favorable to last year by over 10 points, driven by earned pricing and improvements in our claim trends.

Pricing in the quarter remains favorable with long-term disability rate increases of 6%.

Year-to-date, our long-term disability rate increases nearly 13% due to a much larger first quarter renewal premium base versus the second quarter. And new sales in the quarter were $103 million, up 56% from 2012, as pricing in certain sectors of the new business marketplace improved.

In previous quarters, we've commented that our claim recoveries were improving. That improvement continued this quarter across our long-term and short-term disability books. We're also encouraged by the early signs of declining incidence rates in our 2012 book. As you recall, incidence rates have been stable for several quarters, but at historically elevated levels.

As our 2012 data has matured, we have observed a modest but consistent decrease in incidence rates, approaching levels we've not seen in several years. We'll be watching our data very closely in the quarters ahead to determine the sustainability of this improvement. We have nearly completed a full cycle of pricing and underwriting actions on our multiyear contracts. Our January 2014 renewal block will complete much of that effort and this disciplined execution is delivering results. We're committed to staying in front of loss trends with deeper claim and pricing analytics.

These positive signs in our Group Benefits performance are a direct result of the aggressive actions we've taken over the last few years. Stepping back from the details, this a very good quarter for Commercial Markets. Our performance and trends were consistent with the strong start in the first quarter, and we continue to see the positive results of underwriting and pricing decisions made over the last few years. Overall, pricing is still outpacing our loss cost trends and driving margin improvement. There's still much work ahead, but I'm excited about our progress.

Let me now turn the call over to Andy Napoli.

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

Thanks, Doug. In Consumer Markets, our continued focus is to improve margins while steadily improving our growth trajectory, and we're pleased with the progress we've made. Our combined ratio for AARP direct auto continues to perform at/or better than our target. We're making good strides in non-AARP agency auto as our x-cat, x-prior year combined ratio was 8 points better than second quarter 2012.

In Homeowners, favorable weather experience is contributing to improving profitability. Core earnings for the quarter were $15 million versus a loss of $47 million last year. The improvement in core earnings was generated from 3 primary sources. First, our x-cat and x-prior year combined ratio improved 2.4 points to 88.9%; second, cat losses were lower this year; and third, we had higher favorable prior year development, primarily related to prior year cats.

Current accident year cat losses for the quarter were $142 million, primarily related to wind and hail events across the Midwest and Plains states, including the tornado that hit Moore, Oklahoma. We had the same number of events in the quarter, as we did last year, but with lower severity.

We also released $31 million of reserves related to Storm Sandy and other prior year cats. Claims severity for this sort of event is always challenging to estimate. And as it turns out, property and auto loss severities have emerged favorably, and auto salvage returns are coming in better than expected.

Focusing on auto profitability. Our combined ratio, x-cat and x-prior year, improved to 93.8%, just over 2 points better than last year.

From a loss trend perspective, we're seeing favorability and auto liability frequency, in particular, lower-cost fender benders and personal injury protection or PIP claims. Auto physical damage severity trends have moderated slightly, and we'll continue to watch this closely.

In homeowners, our combined ratio, x-cat and prior year, dropped just over 2 points to 77.9%, reflecting continued favorable non-cat weather frequency and strong earned pricing in excess of expected loss cost.

Now let's transition to growth. Written premiums grew 2% and we're positioned to maintain that level throughout the remainder of the year. Written premiums were up 1% in auto and 3% in homeowners. Contributing to the growth were renewal written pricing increases of 5% and 7%, respectively, and improved policy retention in both product lines. New business increased 9% to $93 million in auto and 13% to $34 million in homeowners.

New business production was driven in part by a 28% increase in the number of authorized AARP agency locations, now at over 6,600, and a 32% increase in Internet responses for our AARP direct business.

I'd like to focus for a moment on this online component of our direct operating model. As many of you know, the foundation of our 28-year partnership with AARP is an effective multimedia direct model that aligns well with current personal lines channel trends. Historically, the vast majority of our direct responses end up in our phone centers as new business acquisition opportunities, and we've enjoyed a great deal of success with this phone-centric model.

Recently, we've made a concerted effort to increase our digital throughput. In other words, to have more direct responses finish online. Given industry consumer buying trends, we believe our ability to generate and close business online will be a significant component of our growth and profitability story in the future. Most notably, we recently started providing customers the ability to bundle auto and home in one integrated online quote. Our efforts are beginning to yield positive results.

We like this channel as it is more efficient and online business has tended to have higher retention and therefore could contribute higher lifetime value than other channels in our operating model.

In closing, we're pleased with our results for the second quarter and the first half of this year, and the remainder of 2013 continues to look positive. We'll continue to take rate increases in both auto and home to either maintain or achieve our combined ratio targets, and we'll closely monitor the impact on new business and retention while continuing to execute our strategy to deliver profitable growth.

I'll now turn the call over to Chris.

Christopher John Swift
Chairman & CEO

Thank you, Andy. Good morning, everyone. This morning, I will cover 3 topics: first, I will review key items from the quarter; second, I will update statutory capital and holding company resources, including VA impacts in the Group Benefits' legal-entity separation project; and third, I will provide a third quarter outlook.

Let's begin on Slide 16. Second quarter 2013 core earnings were up 18% to $324 million or $0.66 per diluted share. We produced strong results this quarter, even before adjusting last year's results worth $39 million of earnings from the Individual Life and Retirement Plans businesses, which were sold in January of this year.

This quarter's core earnings growth was driven by improved margins in the Commercial and Consumer Markets, which Doug and Andy just covered, and Mutual Funds growth.

Excluding prior year development, core earnings per diluted share were about $0.85, which is above the outlook we provided in April of $0.65 to $0.70 due to better underwriting results, higher Talcott earnings and higher limited partnership returns. Annualized limited partnership returns were 13% this quarter, well over our 6% outlook, resulting in excess returns of about $0.05 in core earnings per diluted share.

Mutual funds core earnings were up 5% relative to the second quarter of 2012. Jim Davey and his team continue to build momentum in key areas, including sales, distribution initiatives and fund performance.

Sales were up 32% over the prior year. Net flows were negative, including $2.5 billion in 2 large redemptions, one of which was a $1.4 billion institutional account that was expected to redeem. In P&C other operations, core losses increased this quarter due to a $141 million pretax charge for additional reserves related to our annual asbestos and environmental study. $130 million of this charge or $85 million after tax, was for legacy asbestos exposures. The majority of the development was from increased severity in frequency on a small number of our direct accounts, about 50 out of 1,100 policyholders. These policyholders are not -- are peripheral defendants, meaning that they did not produce asbestos but may have used another company's asbestos in their business.

Talcott's core earnings were down 2%, which I'll cover in a few minutes. In the Corporate segment, core losses improved $11 million over the prior year quarter, principally due to lower interest expense from debt repayments.

Turning to Slide 17. Second quarter core earnings included prior year development of $95 million after tax or $0.19 per share, including the asbestos charge. Aside from asbestos, this quarter's prior year development included $80 million before tax for increased worker's compensation loss reserves in New York State as a result of the legislative closing of the fund for reopened cases in that state. This is a onetime charge for estimated future claims that could occur if currently closed worker's compensation claims reopen in the future.

Aside from the New York charge, we had favorable development in P&C Commercial of $43 million, principally on professional and general liability, catastrophes and uncollectible reinsurance. We had some unfavorable development on commercial auto, almost entirely in the Specialty line. Beyond the New York charge, worker's compensation had almost no net prior year development.

Consumer Markets had favorable development of $32 million, largely due to favorable prior year catastrophe development, Storm Sandy in particular. You'll notice that second quarter cat losses were right on our forecast and cats were a lot lower than last year. Finally, our trailing 12-month core earnings ROE was 7.6%, a significant improvement from a year ago. We expect to achieve a 2013 core earnings

ROE of approximately 8% for the full year, which is at the high end of our outlook of 7.5% to 8% that we communicated earlier this year.

Turning to Slide 18. There are 2 principal items which reduced our strong core earnings and generated a second quarter net loss of $190 million. First, net realized capital losses not included in core earnings were $413 million after tax, mostly due to the Japan VA hedging losses; and second, losses from discontinued operations were $126 million, due to the sale of Hartford Life International Ltd.

Turning to Slide 19. The Hartford's book value per diluted share, excluding AOCI, was $38.44, down 4% from the $40 at year-end, principally due to the items that I just covered, as well as the first quarter Japan DAC write-off, and loss and extinguishment of debt.

Book value including AOCI was $38.59 per share at June 30, down 16% from $45.80 at year-end. The change in book value includes a $900 million reduction in net unrealized gains in AOCI during the first quarter due to the business sales. Since March, AOCI has reduced principally due to the impact of higher interest rates and credit spreads on the market value of our $82 billion general account portfolio.

As you can see on the chart on the bottom of this slide, after tax unrealized gains on our investment portfolio declined from $2.8 billion in March to $1.3 billion at the end of June, as the 10-year treasury yield rose from 1.87% to 2.49%.

Since year end, we have repurchased about 60 -- excuse me, $166 million of equity, including $118 million during the second quarter. In June, as Liam mentioned, we expanded our repurchase program to $1.25 billion. Going forward, our repurchase activity will be about $200 million a quarter through year-end 2014, subject to legal restrictions and market conditions.

Now let's turn to Talcott results on Slide 20. As I mentioned, Talcott core earnings were $196 million, down 2% over prior year, which included $39 million of Life and Retirement Plans businesses that were sold in January of 2013. The quarter included $23 million of after tax costs related to the ESV program. This quarter also had lower DAC amortization, most of which was due to the first quarter write-off of the Japan DAC asset, which eliminated future DAC amortization.

Talcott's second quarter earnings also benefited from $39 million of pretax limited partnership income, up slightly from $32 million in the second quarter of 2012 and up from $24 million in the first quarter of 2013. Our focus for Talcott is reducing its size and risk, and we are pleased with the progress this quarter.

On Slide 21, full surrenders on the Japan block more than tripled for the first quarter. This reflects higher market levels, which significantly improved policyholder account values.

At the end of June, 57% of Japan GMIB contracts were in the money for policyholders compared with 99% a year ago. And the average in the moneyness was 7%, down from 20% for June 2012.

Surrender activity was at an annualized rate of 34.8% for the quarter. Surrender activity to date has been highly correlated to market levels. Once policyholders are out of the money, meaning that their account value is higher than their guarantee, we have seen surrenders sharply increase. July surrender activity has been approximately 30% on an annualized basis.

Slide 22 covers our U.S. VA block. Full VA surrenders in the U.S. increased to 17.5% for the quarter, primarily due to the ESV program and higher market levels. The ESV program has performed much better than our original expectations with an overall take up rate of 30% to date. As a result of market levels and surrenders, NAR has decreased on both the Japan and the U.S. VA block since March 31.

Japan GMIB NAR was $851 million, down 34% from first quarter and down 87% from the $6.5 billion at June 30, 2012. U.S. GMWB NAR was 300 -- excuse me, $282 million at the end of June, down the slightly from March, but down 72% since June, 2012.

Keep in mind, our NAR calculation is not discounted or adjusted for policyholder behavior assumptions. It also does not include the benefits of hedging.

Let's now turn to our capital position, which is summarized on Slide 23. As you can see, The Hartford's capital resources totaled $18.1 billion at June 30, compared with $18.7 billion at the end of March, principally due to lower U.S. life statutory surplus, which I'll cover in a minute.

U.S. P&C surplus was down slightly due to the normal quarterly dividend paid to the holding company. Holding company resources were $2.2 billion before the $320 million July debt repayment and third quarter share repurchases.

Slide 24 shows the components of the change in U.S. statutory surplus. As you can see, the largest impact on U.S. life statutory surplus was the negative VA impact of approximately $600 million. This decline was principally due to the Japan VA hedging losses, as the majority of the Japan VA hedges are in U.S. life legal entities, but only a portion of the policyholder liability is in our U.S. life legal entities.

Our hedge programs performed this quarter as designed. As a reminder, our hedging programs target the economic value of the VA block, not statutory or GAAP accounting. However, our hedge results closely match the change in the economics of the book, which we call market consistent value or MCV. The MCV has improved over the past quarter with the weakening of the yen, higher global equity markets and higher interest rates.

Aside from the VA impacts, statutory capital impacts were relatively modest this quarter, and I would draw your attention to the positive life statutory earnings reflecting better group benefits and fixed annuity results.

Although statutory capital declined during the quarter, our overall capital margins remained strong and has improved since year end, reflecting the reduction in risk of our business, including the impact of business sales. Overall, current capital resources were $18.1 billion compared with the $16.6 billion at December 31, 2012, before the closing of the Life and Retirement Plans sales.

I also wanted to update you on our Group Benefits legal entity separation project. Slide 25 shows our current legal structure on the left side, and on the right, what it will look like once we complete the legal entity separation project. Part of our Group Benefits business is included in Talcott Resolution legal entities, which we want to restructure, so that management and legal entities are aligned.

The legal entity separation process requires regulatory licensing approval from New York for Hartford Life and Accident, which we call HLA, to write Group Benefits business in New York. We intend to move some capital within the life group in order to capitalize HLA to higher standalone RBC levels, which will require approval from the Connecticut Department of Insurance to move the funds within the life group. We do not expect to use holding company or P&C capital resources for this legal entity separation. We are also working on operational initiatives needed to achieve this separation, and are on track to complete by early 2014.

Now I'd like to cover our third quarter outlook on Slide 26. Our third quarter outlook projects core earnings of approximately $345 million to $370 million or $0.70 to $0.75 per diluted share, assuming a weighted average share count of approximately $490 million. Included in this outlook are the following: first, catastrophe losses of $86 million after tax; second, Talcott core earnings of $160 million to $175 million, including approximately $7 million in after tax costs for the ESV program; third, prior year development for the accretion of discount on worker's compensation reserves of $6 million after tax, no other prior year development is included in this outlook; fourth, our outlook for a limited partnership investment income is about $5 million before tax, lower than our annual 6% assumption due to the expected fund performance in the third quarter; finally, around $200 million of share and warrant repurchases in the third quarter.

As a reminder, core earnings do not include restructuring charges or DAC unlocks, including any impacts from our annual policyholder behavior study in the third quarter.

To wrap up the second quarter, let me summarize a few themes. Our go-forward businesses are producing strong results, reflecting disciplined pricing actions. We are confident in our ability to profitably grow and improve margins, which will offset the decline in Talcott earnings going forward. We are focused on continuing our transformation of The Hartford by improving our overall cost competitiveness, with a continuous process improvement mindset. We are pleased by the trends we see at Talcott, which contributes to the goals of reducing the risk and size of the VA blocks.

Capital resources and margin remain robust with Talcott remaining capital self-sufficient. Lastly, we have a positive outlook for the remainder of the year with expanding margins, assuming cats are in line with expectations.

Now I'll turn the call over to Sabra, so we could begin the Q&A answer session. Sabra?

Sabra R. Purtill
Senior Vice President of Investor Relations
Thank you, Chris. We know our prepared comments went a little long this morning, but we've reserved about 30 minutes for Q&A. Please be considerate of others and limit yourself to 1 question and a follow-up. And you're, of course, welcome to requeue for additional question. Laurel, could you please give the Q&A instructions?

Question and Answer

Operator

[Operator Instructions] Your first question comes from the line of Erik Bass with Citigroup.

Erik James Bass
Citigroup Inc, Research Division

Just the first question, just given the increase in the pace of runoff for the VA blocks, can you talk about the potential timing for taking a dividend from Talcott? And is there any possibility of taking out money in 2014?

Liam E. McGee
Former Chairman

I'll turn that over to Chris.

Christopher John Swift
Chairman & CEO

Well, thank you. I think just the context on that is, yes, we are pleased with what we're seeing in Talcott, both in Japan and the U.S. as far as increased lapses. I think what we said in our Investor April Day, it remains true today, is that we do expect to take dividends out of Talcott in early 2015 or possibly late 2014. But do -- surrenders do help? No doubt about it. But I think we'd like to see where they sort of normalize out on a basis going forward, and we'll revise our thinking probably in early '14. And once we do, we'll let you know if we have any changes to our dividend plans.

Erik James Bass
Citigroup Inc, Research Division

Okay. And just one follow-up. Any -- given the success of the ESV program, any interests or opportunities for further Enhance Surrender programs going forward?

Liam E. McGee
Former Chairman

Erik, Beth will take that.

Beth A. Bombara
Chief Financial Officer and Executive Vice President

Sure, thank you. So as both Liam and Chris said, we've been very pleased with the success of the ESV program. And we plan to continue to evaluate the potential for other types of programs, and we'd expect that we would continue to be very targeted in how we would look at those. I'd also point out, there are other things that we're doing, as it relates to just managing the book and looking at ways to reduce the risk. So we are in the process right now of utilizing certain provisions at our contracts to increase writer fees, to turn off some investment options for subsequent payments or transfer of funds, as well as enforcing, in some limited situations, investment allocation restrictions.

Operator

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

Jay H. Gelb
Barclays PLC, Research Division

On the Japan surrenders, can you give us a sense of -- I know that the annualized surrender level came off a bit in July, but would you anticipate that we should approach a more normalized level at some point? Or can we still keep running at these double-digit levels?

Liam E. McGee
Former Chairman

Beth will take that, Jake.

Beth A. Bombara
Chief Financial Officer and Executive Vice President

Okay. Yes, so let me give you a little bit of color on the surrender rate. If we look back over the last several months, so as we said, 34.8% for the quarter. But if you look at it by month, in April we were running at about 23%. May, we spiked up to 50%. June was at 29.5%. And as Chris said, for July, we're running at about 30%. So it's hard for us to predict at to what levels things will level off at. But we are seeing that as markets continue to improve and as markets stay at these levels, the activity rates continue to be high.

Jay H. Gelb
Barclays PLC, Research Division

Okay. And then separately in Commercial P&C, premium growth turned positive for the first time in a few quarters. I'm trying to get a sense of whether you feel that's sustainable. And I think there was also a bit of confusion about the pace of rate increases in Standard Commercial having flattened, whereas based on some of the prior disclosure, it looks like it dipped a bit.

Douglas G. Elliot
President

Jay, this is Doug. So a few comments. One is the overall Standard Commercial is generally flat, so we were 8% in the quarter, and I think that's about where we were in first quarter. I did give you some commentary about Middle Market versus Small. And in the Middle Market, we were off sequentially a point or so from first quarter, but still very strong at 8%. So I think you've got to get inside the markets to understand that. And we feel good about that progress, and given the amount of positive change we've had the last couple of years, feel good about sustained margin improvement. The question about new business, we had a good new business quarter and our overall Middle Market growth up a touch. It's -- my comment was, it's the first quarter we've seen growth in the Middle Market in quite some time. We have done a lot of work, particularly in our worker's comp book, but we feel like a lot of that work is behind us and we're looking good about moving forward.

Jay H. Gelb
Barclays PLC, Research Division

I appreciate that. Just to clarify on that Standard Commercial renewal pricing, the disclosure looks a bit different in 2Q than 1Q in terms of the pace of rate increases. What changed there in terms of how that's being calculated?

Douglas G. Elliot
President

So we refined our approach to calculations just slightly. And first, I would say that the overall trends are very consistent throughout the periods but have moved to more an effective policy-month basis, which means that we continue to follow policies and we'll adjust accordingly on mid-term cancels, and cancels flat out an extended period and push the results back into prior periods. So with those changes, from time-to-time, you'll have some slight deviations from prior periods, and I think it's a much more effective, more accurate way for us to watch the book of business performing.

Operator

You're next question comes from the line of Mark Finkelstein with Evercore.

A. Mark Finkelstein
Evercore ISI, Research Division

Maybe stick with Doug for the first question. I guess just on Specialty, I'm trying to understand kind of the story a little bit on the program business. I think I heard you say that much of the actions have been completed and that the pricing levels are hitting targets, I may have mis-, kind of, characterized that a little bit. But then you look at the combined ratio for the quarter x-cat x-development 105.7%. So I guess I'm just trying to kind of put those -- put everything together and think about where -- like, where is Specialty in terms of the culling of the unprofitable programs and kind of repricing those? And the combined ratio outlook on that?

Douglas G. Elliot
President

Good question, Mark, this is Doug. So keep in mind, inside Specialty, there really are 3 very different books of business. Our national casualty book, which essentially is an excess casualty book, well performing at our targets. We had a good quarter of new business. And again, those targets, the target combined ratios for 10% to 15% return are much higher than our normal Standard or Small Commercial targets. They're in excess of 105% and they move based on yield levels. So that's why the overall segment will never perform at a combined ratio equal to Middle, because they've got different targets. Secondly, our financial product book. Over the last couple of years, we've done a lot of work, and that book has really shaped nicely over the last couple of years, as we've moved away from some of the larger financial institution business. And as you saw, we had a release in quarter, so we feel good about that book of business. And then in the programs area, there are about 50 programs and we've worked our way through all those 50 programs. And in some cases, we're taking very aggressive corrective strategies, in some cases, exit. I'll share with you that in the specialty auto programs, where we've had some degree of pain over the last couple of years, essentially are exiting those programs, have largely nonrenewed those blocks. So we've taken some balance sheet work in the quarter, where we strengthen reserves, and I think underwriting lies. We're in a much better spot moving forward.

A. Mark Finkelstein
Evercore ISI, Research Division

Just to follow up on that. So it's essentially the actions that you need to take, whether it's on the culling or the pricing side, largely complete at the end of the second quarter, is that the message on the kind of the third book of business that you're referring to?

Douglas G. Elliot
President

Yes, I think that's very accurate -- definitely accurate on the auto liability programs. And obviously, as we shift our way through the rest, we'll spend more time. But much better shape of that overall book of business than a year ago.

A. Mark Finkelstein
Evercore ISI, Research Division

Okay. I guess maybe just going back to the life side. I'd seem to recall, Chris, you mentioning at the Investor Day or maybe it was somebody else, but that you go through a third quarter assumption review on the life side. I'm trying to think about how the surrenders are going to factor into that, and is there any early read on how we should think about that?

Christopher John Swift
Chairman & CEO

Mark, it's Chris. I'm not sure who talked about it. But I think the context maybe just for this year's study, is if you particularly look at some of the items that we've taken already, meaning like the Japan DAC write-off in the first quarter due to expanded hedging, when I look at the assumption update, I see very minor GAAP and stat impacts, just given some of the things we've already dealt with. I think as we look out net-net, higher surrenders will most likely -- I'm hedging a little bit, but most likely be positive on a GAAP and stat basis. But we're in the midst of that study, but I generally don't expect any material surprises, charges as we complete that study, Mark.

A. Mark Finkelstein
Evercore ISI, Research Division

Okay. And then just final one, one quick question on the quality of the Japan surrenders. I mean, I know that you're going to always be distorted towards -- the more out of the moneyness, but is it a cross-section across the book? Or is it really kind of mainly the stuff that's out of the money?

Beth A. Bombara
Chief Financial Officer and Executive Vice President

So when we look at the -- where the lapses are coming from, it really is once we see the account value exceed the guarantee. And I would say, it's very sensitive right at that -- right when we get to that 100% level. So that is where we see the increase a little bit, maybe, when they're in that 95% to 100%, but it really is when they cross that line. So as markets continue to improve, and we just see more and more of the book, and it's hitting that point, that's where we're seeing the surrenders come from.

Operator

Your next question comes from the line of Jay Cohen.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

I'm with BofA Merrill Lynch. A couple of questions. For the third quarter guidance, Chris, you had mentioned a somewhat lower run rate for the performance of some of the alternative investment funds. Is that because these are reported on a lag, you have a sense of the performance already?

Christopher John Swift
Chairman & CEO

Yes, I would say a combination of that, and then just the early read into July's performance. So I would say July was pretty volatile and some of our alternative allocations actually went negative for July. So as we look really at the remaining 2 months, August and September, Jay, we just are heavily influenced by what we're seeing through June and July.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Got it, got it. Second question, on asbestos. You've been at this a long time, still taking material charges. Do you feel as if you are getting down to the short strokes? Do you have any more confidence that next year will be a much lower number than what we've seen this year?

Christopher John Swift
Chairman & CEO

Jay, it's Chris. I understand the question, and all I could tell you is when we study our process -- I mean, you know it's a comprehensive ground up process where we'd look at detailed coverage charge on our individual insurers and see the entire picture. We react to, I'll call it, the new data that we're seeing. And as I -- we wrote about in the queue, we're seeing just a little uptick in frequency compared to prior year, and again, modest severity. So there's no fundamental trends that are different this year. It's still a peripheral issue for us. I would say that plaintiff counsel has continued to be expansive in some of their theories. So as I really sit here, honestly, and look at, I'll call it, our reserves, look at our survival ratios, I mean, I feel good about what we'd reacted to this year and what we're seeing and we've made our best estimate. But as you know, it's awful hard to predict where this is going to go 2, 3 years out. And all I could tell you is, well, we do our best job every year and make the appropriate adjustments that we see are needed.

Operator

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

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

Two quick questions. I realize there's so much that goes into the calculation of a market consistent approach. But recognizing that the statutory accounting gets in the way, the reserves in Japan, the hedges in the U.S., that sort of thing, can you give us some sense given the significant surrender activity, as well as the reduction in the moneyness? Can you give us some sense for percentage-wise, maybe how much you think the market consistent value of the VA blocks increased?

Christopher John Swift
Chairman & CEO

John, it's Chris. I understand your point. Again, I think the context is, as we explained in Investor Day, particularly in Japan, that we are really sort of market-neutral at that point for Japan. So as our hedging losses -- as we hedge, I mean, the hedging losses are virtually offset entirely by gains in our MCV. And as we looked at results this quarter, that pattern, all the -- exactly the same. So that our hedging programs, as I said, are working as designed. We're hedging the economics. We took risk off the table completely in Japan. And that's a change from the first quarter where we were still under our tail hedge program. So the losses might seem large, but I can tell you that it was virtually offset by an increase in our MCV.

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

That's helpful. And then the second question I have for you is just thinking about the third quarter guidance maybe relative to second quarter results, and most specifically just thinking about non-cat weather. It seems to me that you're either building in, maybe it's just some seasonality, maybe it's some normalization of non-cat weather, but it seems like it's material. You mentioned a favorable or somewhat favorable non-cat weather in 2Q. I was just hoping you could maybe quantify for us or give us some sense for how much non-cat weather is playing into the guidance in 3Q versus 2Q?

Christopher John Swift
Chairman & CEO

John, as I just roll forward, I'll call it, second quarter to the third quarter, I think the 2 big items are lower partnership alternative returns and lower Talcott earnings. I think if I look at Doug's book of business in Commercial, I don't see that much seasonality. I think Andy probably has a little bit more with driving patterns, weather patterns. So I would say that there's some, but I wouldn't describe it as ordinarily immaterial. The more seasonalities in the second quarter with obviously a higher cats, and you saw our cat load for the quarter. So it's me, it's Talcott and it's just lower partnership returns which, again, we're reacting to data that we've seen through July here.

Operator

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

Brian Robert Meredith
UBS Investment Bank, Research Division

Just a couple of quick questions here. First, I'm just curious, the impact of the ESV program here going forward on Talcott results, should we see that largely go away in the third quarter? Or when is that going to start going away, that $23 million?

Christopher John Swift
Chairman & CEO

Brian, I think in my guidance and hopefully on the slide, I know it is. We described the ESV expenses for the third quarter estimated to be lower at $7 million after tax.

Brian Robert Meredith
UBS Investment Bank, Research Division

Okay. And will that continue to kind of run down at that trend? Do you think in the fourth quarter is that better?

Christopher John Swift
Chairman & CEO

Yes. Again, it's -- I think Beth expects. And she could describe it, the take rate at 30%. Yes, we see the sort of -- a dissipation of that take rate, so we don't think it's going to increase material -- materially going forward. So $5 million, $3 million a quarter probably -- is probably a better number going forward.

Brian Robert Meredith
UBS Investment Bank, Research Division

Great. And then Andy hasn't talked -- a quick question for Andy. On the questions, Andy, at looking at the underwriting expense, they've been dropping at about 5% a quarter for the last couple of quarters in your area, is that something we should continue to see going forward? Or is there something unusual happening in the first half?

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

Brian, it's Andy. Thanks. Yes, so you saw a 1 point improvement on a year-over-year basis in the quarter. I would say about 1/3 of that is sustainable going forward. The rest of it was sort of one-timers around timing and some other things. But it's an area that we pay really strict attention to, but I would say 1/3 of that is sustainable.

Operator

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

Christopher Giovanni
Goldman Sachs Group Inc., Research Division

I guess first question for you, just following up on the ESV program, the higher lapses in Japan and all. Certainly, I think, the pace is above what many of us have thought. I'm wondering if it at all changes kind of the leverage you would be considering in terms of accelerating the runoff of the block.

Liam E. McGee
Former Chairman

Well, certainly, Chris, it's an important variable. As Chris Swift said, just a few moments ago, as we look at the business, we're going to monitor both the U.S. and Japan lapse rates very closely. And we are positioned -- I would describe as, largely unchanged. We're going to do what's in the best interest of shareholders, whether -- and watching lapse rates will be a part of that, and exploring potential permanent transfer of the Japan book, in particular, is something we'll explore as well. So having said that as a high-level comment, I'll -- if Beth has anything to add, I encourage her to do so.

Beth A. Bombara
Chief Financial Officer and Executive Vice President

No, Liam, I think you said it very well. Our view of the ways that we look to manage this block have not changed, and we'll continue to look at solutions that are in the best interest of shareholders.

Christopher Giovanni
Goldman Sachs Group Inc., Research Division

Okay. And then I just wanted to see if you guys had any comments on any potential impacts from a regulatory standpoint on some of the recent topics that have been out there around maybe your captive implications from new derivative rules. And then lastly, any backlash from the ESV programs that seem to be coming on more frequently from other carriers as well?

Christopher John Swift

Chairman & CEO

Chris, I'll cover the first 2. Beth can maybe comment upon the ESV. So the simple answer is there's really no backlash. There really isn't anything going on with our captives. We got rid of one related to the life business. We have White River, which is our Vermont onshore captive that follows USVA accounting rules, so I think it's pretty straightforward. I think all the derivative actions, as far as Dodd-Frank, we're adopting. There's really no material impact on liquidity or any issues with those related to derivatives. Beth?

Beth A. Bombara
Chief Financial Officer and Executive Vice President

Yes, on your last comment, no, we do not -- have not seen any issues that relate to regulators with the activities that we have underway. Our process, I think, is very transparent. And we continue to be very clear with our policyholders as to what their options are, and we will continue to do that.

Operator

Your next question comes from the line of Jimmy Bhullar with JPMorgan.

Jamminder Singh Bhullar
JP Morgan Chase & Co, Research Division

Some of my questions were answered. But on the Group Benefits business, can you talk about how far along you are in your repricing of the disability block? And what the environment is like in terms of what competitors are doing? And then secondly, on commercial auto, you've had several quarters of adverse development. Maybe if you could just give us some insight on what's going on there?

Douglas G. Elliot
President

Sure, Jimmy, this is Doug. Let's start on disability and just give you a sense on where that cycle is. We started repricing the disability book in the early part of 2011. But I would say probably more the second quarter into the third quarter did it pick up quite a bit of steam, which is why I made the comment today that the January 2014 block really does largely complete that cycle. So we're working, as you know, in the midst of that as we speak. And hopeful that we'll see a continued rational environment, which is how I described kind of the marketplace we're competing in today with Group. In the commercial auto space, we have seen some dynamics of severity and weakness in performance across really our middle and small books, and have been working aggressively on those strategies, if you will. Obviously, I've talked a lot about the program space, and those reiterating actions are well underway. But it's an area that has caught our attention, and I would say for the last year or so, we've really spent a lot of time focused there. And I feel like our behavior is clearly in line with improving trends that we're starting to see. And also the fact that we are, state-by-state, looking at our rate adequacy in certain places taking rate, we're moving our rate to the extent we need to move.

Jamminder Singh Bhullar
JP Morgan Chase & Co, Research Division

Has the development been more concentrated in a certain region or certain customer group?

Douglas G. Elliot
President

No. Certainly, the development has been concentrated in our program group. I think it's more of a go-forward look at the trends coming at us and making sure that we're out in front of those trends from a pricing perspective, that are margins are improving in auto the same way they are across other lines of business.

Operator

Your last question comes from the line of Randy Binner with FBR Capital Markets.

Randolph Binner
FBR Capital Markets & Co., Research Division

I just had a quick question. I think this is best for Doug, and it has to do with worker's compensation. I know that's been an area that you've been working on from a pricing and kind of a risk-reduction perspective and it's worked very well, but the top line growth is still low, as some of the other questioners kind of pointed out. And so I'm wondering now that you're expanding margins in workers' comp and the economy is getting better, which is kind of a driver of the risk in workers' comp, but you might think about increasing your appetite again there, especially in a state like California.

Douglas G. Elliot
President

So Randy, the workers' comp question is a complicated one, and I would just ask you to think about the different dynamics across our markets. In the case of Small Commercial, where we're clearly a leader, our rate adequacies and our performance has been excellent. We look forward and still see tremendous opportunity. And so as we grew in the quarter, I feel good about the quarter and good about our returns. In the middle, we've made material changes, and our performance has improved greatly. And I would describe the overall adequacy of the product and the opportunities as much enhanced today versus where they would have been a year ago and certainly 2 years ago. And one of the reasons that we grew in the quarter is that we're feeling slightly better about the rate adequacies across that overall book, including comp. So yes, we'll be looking at opportunities moving forward. We're clearly looking at those opportunities on an all lines basis, where comp is a part of it, but not the only product we'll be offering. And I feel good about our opportunities as we get those competencies really lined up and well in good shape to compete in the marketplace effectively.

Randolph Binner
FBR Capital Markets & Co., Research Division

And is there any commentary you can give us on the states? I know that you've gotten smaller in California, in particular. Is that a place where you might look to be more competitive again on package?

Douglas G. Elliot
President

So there's several key states. Obviously, the big 4 or 5 are states that we spend a lot of time on, California, New York, Texas, et cetera. But all those states have their own nuances. And I would just point out, in the case of New York State, with what looks like an improved workers' comp pricing filing coming through. We're feeling better about the opportunity for us to do a little bit more in New York. So all those states have very state-specific strategies. Their class strategies are overlaid across the states, and I think it would be a little bit unfair for me to characterize across the top in terms of exactly California. But we're feeling much better about the adequacy and the performance of our book and feel like we're clearly a little bit more in an offensive zone than we have been over the last couple of years.

Randolph Binner
FBR Capital Markets & Co., Research Division

Just one follow-up on comp. With the New York charge, is that -- I mean, should we think of that as being a kind of a nonrecurring item?

Douglas G. Elliot
President

That's certainly the way we think about it. Yes, we looked at our histories. I think you know the law changed, and we put up the $80 million to deal with what we think will be the impact for our understanding of essentially the fact that 25-A goes away.

Sabra R. Purtill
Senior Vice President of Investor Relations

Thank you, everyone, for joining us today. We appreciate your interest in The Hartford. And we are here at The Hartford this afternoon to follow up with any additional questions you might have. Thank you and have a good day.

Operator

That concludes today's conference call. You may now disconnect.