S&P Capital IQ

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The Hartford Financial Services Group, Inc. NYSE:HIG

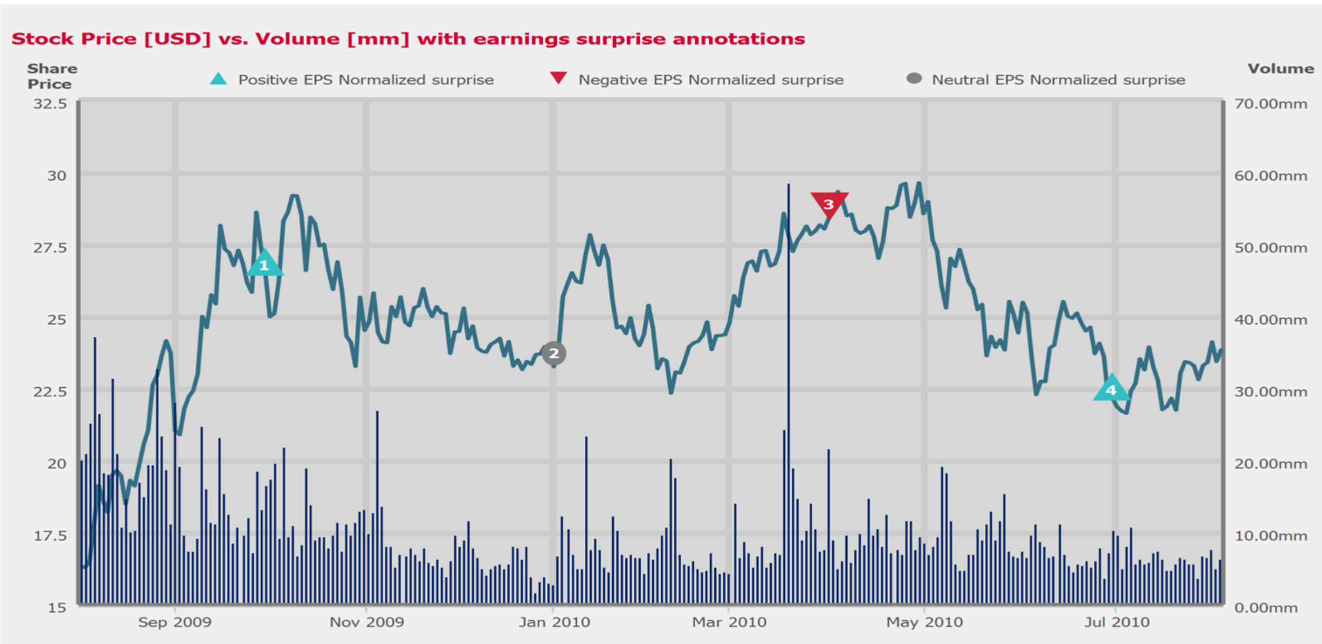
FQ3 2010 Earnings Call Transcripts

Wednesday, November 03, 2010 2:00 PM GMT

S&P Capital IQ Estimates

	-FQ3 2010-			-FQ4 2010-	-FY 2010-	-FY 2011-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.93	1.43	▲53.76	0.92	2.55	3.68
Revenue (mm)	5826.07	6673.00	▲14.54	5411.71	21092.08	19189.27

Currency: USD
Consensus as of Nov-03-2010 11:25 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ3 2009	1.42	1.56	▲9.86 %
FQ4 2009	1.51	1.51	0.00 %
FQ1 2010	0.25	0.14	▼(44.00 %)

FQ2 2010	0.77	0.92	▲19.48 %

Call Participants

EXECUTIVES

Christopher John Swift
Chairman & CEO

David N. Levenson
Former Executive Vice President and President of Wealth Management

Liam E. McGee
Former Chairman

Richard Costello

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Presentation

Operator

Good morning. My name is Kamiko, and I'll be your conference operator today. At this time, I'd like to welcome everyone to The Hartford Third Quarter 2010 Earnings Conference Call. [Operator Instructions] I would now like to turn the conference over to your host, Mr. Rick Costello. Sir, you may begin.

Richard Costello

Thank you, Kamiko. Good morning, and thank you for joining us for The Hartford's Third Quarter 2010 Financial Results Conference Call. The earnings release and financial supplement were issued yesterday. Our slide presentation for today's call is available on the company's website at www.thehartford.com. Chief Executive Officer, Liam McGee; and Chief Financial Officer, Chris Swift, will provide prepared remarks this morning and we will finish with Q&A. Also participating on today's call are Dave Levenson, President of Wealth Management; Andy Napoli, President of Consumer Markets; Andy Pinkes, Acting Head of Commercial Markets; Greg McGreevey, Chief Investment Officer; and Alan Kreczko, General Counsel.

Turning to the presentation on Slide 2, please note that we will make certain statements during the call that should be considered forward-looking statements as defined in the Private Securities Litigation Reform Act of 1995. These include statements about The Hartford's future results of operations. We caution investors that these forward-looking statements are not guarantees of future performance and the actual results may differ materially. Investors should consider the important risks and uncertainties that may cause actual results to differ, including those discussed in our press release issued yesterday, our 2010 quarterly reports on Form 10-Q, our 2009 annual report on Form 10-K and other filings we make with the Securities and Exchange Commission. We assume no obligation to update this presentation, which speaks as of today's date. Today's discussion of The Hartford's financial performance includes financial measures that are not derived from Generally Accepted Accounting Principles or GAAP. Information regarding these non-GAAP and other financial measures, including reconciliations to the most directly comparable GAAP measures, is provided in the investor financial supplement for the third quarter of 2010 and in the press release we issued yesterday, as well as on the company's website, all of which can be found at www.thehartford.com. Now, I will hand the call over to The Hartford's Chairman, President and CEO, Liam McGee.

Liam E. McGee
Former Chairman

Thank you, Rick. Good morning, everyone, and thank you for joining us today. Before we begin, I want to take a moment to remember JR Riley of The Hartford's Investor Relations team. As you probably heard, JR passed away unexpectedly a few weeks ago. I know many of you interacted with him on a regular basis. He was a valued and respected member of our team and a friend, and his untimely passing was truly tragic. We miss him. And his family remains in our thoughts and prayers.

In the third quarter, we delivered strong financial results based on solid execution, receiving a lift from rising equity markets and light catastrophe losses. I am confident that we are on the path to delivering more predictable and consistent performance, as well as achieving the targets we set out in April. Core earnings were up 8% from last year at $710 million or $1.43 per diluted share. Net income was $666 million or $1.34 per diluted share. The investment portfolio improved significantly in the quarter. Chris will provide details but by almost any metric, the portfolio was substantially stronger than it was a year ago. While some of the improvement is due to lower interest rates and spread tightening, it also reflects the significant actions that Greg McGreevey and his team have taken to appropriately derisk the portfolio.

Investment improvements helped drive book value per share to $45.80 on September 30, up 21% year-over-year and 11% sequentially. Our statutory surplus position increased about $700 million. During the quarter, we also put on additional equity and currency hedge protection to mitigate surplus volatility. We managed The Hartford surplus volatility with a combination of reinsurance and hedging programs and by holding appropriate amounts of surplus capital. Over time, we will continue to reduce our exposure to changes in the capital markets in a prudent fashion, balancing economics and risk just as we've done in derisking the investment portfolio.

So in summary, the third quarter performance was very good and is a testament to The Hartford's strong focus on execution. We are making good progress implementing the strategy we outlined in April. We said then that this is a strategy of evolution, not revolution. And that consistent strong execution, quarter after quarter and year after year is key to our success. We've completed the reorganization into a customer-focused structure and this quarter, as you know, began reporting financial results reflecting this new segmentation. Leadership within the businesses is in place and the teams are moving ahead. Andy Pinkes is running the Commercial Markets business, where we have good momentum. Andy is a talented and strong leader with deep knowledge of the insurance industry and has been an integral part of the P&C leadership team for the last five years. We are considering internal and external candidates for the Head of Commercial Markets and expect to name a permanent leader in early 2011.

Commercial Markets delivered good results this quarter, despite some headwinds in Group Benefits. Written premiums in P&C Commercial lines were up 4% over the prior year, led by growth in Small Commercial and Specialty Casualty. Policies-in-force in our standard commercial lines were also up 4%. Underwriting profitability in commercial Property & Casualty improved over the prior year. Excluding caps in prior year development, P&C Commercial posted a combined ratio of 92.2%, about a full point better than the prior period quarter. This reflects The Hartford's commitment to underwriting discipline, as well as benign loss cost trends. I'm very pleased with these results, particularly given the competitive nature of the commercial P&C market. Similar to many of our peers, we are working hard to retain existing profitable business. At the same time, we are pursuing new business where we feel good about the underwriting risks and we recognize this is a balance. Our goal is to increase submission flow in the areas where we want to grow, especially where The Hartford has a unique product offering or underwriting expertise to offer its customers. With small businesses as an example, we continue to have a competitive advantage and are writing new, profitable business that we like. We've also had success with our industry specific programs and are expanding this effort. In areas such as technology and healthcare, we have already developed market specific expertise in products that differentiate us from the competition. Our new outpatient healthcare offering is performing very well, contributing to more than $16 million in new healthcare business year-to-date in the Midsized Customers segment. And most recently, we've launched a renewable energy practice. Excellence in sales execution also makes a difference in this environment. Our sales regions are working to develop new opportunities, maximize existing relationships, manage individual sales performance and reduce the variability of process and output. In short, in this environment, we will not sacrifice profitability for growth.

In Group Benefits, we continue to experience elevated claims incidence and lower terminations in our disability lines during the third quarter. The GBD management team is very focused on taking corrective measures to improve the business results, including taking rate as appropriate. Along with members of the Commercial Markets team, I was at the CIAB conference in Colorado Springs last month, meeting with many of the company's largest agents and brokers. Their response to The Hartford and the changes we are making was positive. They are generally supportive of our new strategy, particularly around the combination of Group Benefits with our commercial Property & Casualty business. This model is consistent with the growing trend of agencies to provide value-added solutions as opposed to a product-centric approach. We launched our new sales approach in support of the combined P&C commercial and GBD strategy in August. Since that time, we have quoted over 200 accounts and built a pipeline of nearly 200 additional qualified opportunities. And to date, in just those few months, we've written over $30 million of joint customer, that being commercial P&C and Group Benefits business. In Consumer Markets, in August, we named Andy Napoli to lead the business. Andy has broad industry operational experience, as well as a background in Personal Lines and affinity of relationships. He is making good progress to date in sharpening the businesses focus on the levers that will drive profitable growth. Selling the AARP product to agents, deepening our relationship with AARP, focusing on specific customer segments and developing new affinity programs. We have hired the Kessler Group, a firm with an excellent track record of developing the type of affinity relationships we are looking for. We're focused on this opportunity and are having conversations with potential new partners.

Under Dave Levenson's leadership, Wealth Management is now organized to focus on four key areas: global annuities, mutual funds, retirement plans and life insurance. In U.S. annuities, Personal Retirement Manager, which we launched last fall, was designed to offer consumers a simpler, lower cost annuity alternative. But in an environment of equity market volatility and low interest rates, customers have sought out richer equity guarantees. As a result, sales of the product have not met expectations. As we said on the second quarter call, Dave and his team are evaluating the annuity strategy. While this work is still underway, I can say our goal is to develop a rational sweep of annuity products, including Personal Retirement Manager, to meet the demands of a range of distributors and customers, with acceptable risk and profitability parameters for The Hartford. The $5 billion target we have articulated is a proportional guide to how we're thinking about The Hartford's desired level of market participation over the long term. But we will not take unacceptable risks to achieve it.

In other Wealth Management businesses, we are making good headway. We reported a 13% year-over-year increase in retirement plan deposits and Individual Life sales were up 14% over the prior year, with sales in the independent channel up 45%. In mutual funds, we plan to launch global fixed income funds in 2011. This will compliment our existing equity and domestic fixed-income offerings and respond to customer trends. When we communicated our strategy in April, we talked about our intent to improve efficiency at The Hartford. We're making good progress on that front. We have significant opportunities to simplify the company and its processes, making The Hartford easier to do business with and more efficient as a result. As an early example, we have combined service operations throughout the company into one enterprise operations structure. We also announced in mid-October that Jim Eckerle joined us to lead an enterprise-wide effort to simplify our business processes and help us become a more efficient company. I have known Jim for many years and he is widely recognized in financial services for his success in project management, process improvement and enhancing efficiency.

Finally, I want to comment on the economic environment and its impact on The Hartford. As we have said for the last few quarters, we expect a slow and choppy economic recovery. While there are some signs of improvement, broad economic factors continue to impact our business, including tepid job growth and cautious spending by consumers and businesses alike. Similarly, we also do not expect near term relief from the current low interest rate environment. However, we do think rates will rise over time, particularly given expanding government balance sheets around the world. We continue to target a long-term 13% to 15% ROE when we put business on the books. But in this environment of low interest rates and intense competition, achieving these returns is challenging. That is why we're working so hard on many fronts. We are paying close attention to rate adequacy. In businesses such as Consumer Markets and Group Benefits, we're taking rate and we're letting business go when we need to. We are focusing on market segments where we have sustainable competitive advantages, and we continue to drive for outstanding sales execution and better efficiency.

I want to thank all of my Hartford teammates for their outstanding performance this quarter. Their commitment to the company and to executing in the marketplace everyday is unmatched. I appreciate all they're doing to move The Hartford forward.

So to summarize, we delivered strong results in the third quarter. We are making very good progress executing on our strategy and we are confident that we are on a path toward delivering on the 2012 targets we established. Our goal is to execute quarter after quarter and year after year, delivering consistent operating results and effectively managing the company's risks. Now, I'll turn it over to Chris for a deeper dive on this quarter's results. Chris?

Christopher John Swift
Chairman & CEO

Thank you, Liam. Good morning, everyone. Let's begin on Slide 4. The Hartford generated very strong third quarter results, with net income of $666 million or $1.34 per diluted share. Core earnings were $710 million or $1.43 per diluted share. These results were driven by the five following items: First, solid performance in most of our operating businesses; second, the DAC unlock benefit; third, favorable prior year development in our Property & Casualty businesses; fourth, positive returns on our alternative investments; and fifth, favorable caps. All-in book value at the end of September stood at $45.80, up 11%

from the end of June and 21% over prior year. Diluted book value per share, excluding AOCI, grew 2% during the quarter to $41.72.

Now, let's move to Slide 5 to discuss two new financial metrics that we are using internally to track progress against our strategic plan. They are adjusted core earnings and the expense efficiency ratio. Adjusted core earnings excludes significant one-time items, as well as the volatile items like prior year reserve development and DAC unlock. Making these adjustments will provide a clearer picture of the underlying profitability trend of our business. It will also serve as a baseline from which we will measure core earnings growth in future years. We've also quantified the efficiency ratio. As you will recall, at our April Investor Day, we set a goal of reducing our efficiency ratio 200 basis points by the end of 2012. Now, let's discuss the numbers.

Adjusted core earnings for the third quarter were $485 million or $0.98 per diluted share. This excludes two items. First, the DAC unlock and second, Property & Casualty prior year reserve development. The DAC unlock benefit's core earnings was $166 million. The majority of this benefit was driven by global equity market appreciation. About $15 million of this benefit reflected our annual review of assumptions used in calculating DAC and other similar balance sheet items. The most significant assumption changes were a decrease in withdrawal levels in the U.S., an increase in future annuitization levels in Japan. We also continued to benefit from positive reserve development in the third quarter, both in our P&C Commercial lines and Consumer Markets. In total, net prior year reserve releases were $99 million after tax. We continue to reserve appropriately and our reserves remain strong. Some of the positive reserve development was offset by an increase to environmental reserves. The after-tax impact was about $40 million.

Slide 5 also includes a reconciliation of adjusted core earnings for the third quarter, as well as year-to-date. Adjusted core earnings ROE over the last four quarters is 8.9%. This measure reflects adjusted core earnings and also excludes a $440 million write-off relating to the repayment of CPP in the first quarter. We've also quantified our efficiency ratio and included details about the calculation of the ratio in the appendix. The numerator is the expense number and represents all controllable expenses. The denominator includes all revenues other than trading security and realized capital gains and losses. Year to date, the ratio has improved more than 100 basis points. This reflects the significant expense actions the company took over the course of 2009. We are also benefiting from expense discipline and higher revenues in 2010.

Looking ahead to 2011, we expect the efficiency ratio to increase modestly. This will be driven by investments we are making to execute on our overall strategy, including growth and efficiency initiatives. This should leave us well-positioned to deliver the full 200 basis point run rate improvement by the end of 2012. Much of the future expense saves will come from process improvements across the organization. Our intent is to make our systems work better for customers and employees and to become a simpler and more efficient organization. We will continue to report on this efficiency ratio, along with progress and actions in this area in the quarters ahead.

Now, let's move to a discussion of third quarter business results, beginning with Commercial Markets on Slide 6. The P&C Commercial lines performed very well in the third quarter, with year-over-year improvements in written premium and underwriting profitability. P&C Commercial reported a 92.2% current accident year combined ratio, excluding cat, almost one point better than the third quarter of 2009. These continued solid underwriting results were driven by our rigorous underwriting and pricing process, coupled with favorable severity from the lower inflationary pressures like wage, and material cost. On the top line, written premiums turned positive with 4% growth over prior year. Some of this reflects an easy comparison against last year's third quarter, when large auto premium adjustments reduced premiums. On the other hand, some of the written premium growth reflects sustainable trends. Renewal pricing remains positive, plus 1% in standard commercial line, a good result in this competitive marketplace. In addition, there was a slight improvement in exposure base during the quarter, suggesting that the decline in exposures has flattened out.

In Group Benefits, sales continue to be soft due to the weak economic environment and the competitive marketplace. Margins remain pressured by disability experience. We continued to experience elevated claims incidence and lower terminations in our disability lines in the third quarter. We have closely reviewed our disability claims experience and the increased frequency continues to be widespread and not specific to any industry or plan size. We are responding appropriately to these higher loss costs. For 2011, we are increasing disability rates, taking into account the elevated claims experience, as well as the lower interest rate environment. As always, we determine rates on a case-by-case basis. We are committed to maintaining our underwriting discipline. We expect to remain competitive in these key markets.

In summary, it was a good quarter for Commercial Markets segments. The P&C Commercial lines reported written premium and combined ratio improvements. In Group Benefits, we're making progress on necessary actions to address pressures on profitability.

Now, let's turn to Slide 7 for a discussion of our Consumer Market results. In Consumer Markets, we are implementing our strategy to increase profitability and position ourselves to drive growth. We continue to take meaningful rate increases. Renewal written price increases for auto and home were 8% and 11%, respectively in the third quarter. Written premium declined 3% from prior year. This was driven by two factors: Pricing and underwriting actions and our decision to shift our focus to a preferred market segment. Premium retention is relatively flat as pricing increases offset an expected reduction in policy retention. Profitability in the third quarter was lifted by light cat activity. Excluding cat, the current accident year combined ratio was 93.3%, more than 1% better than prior year. Going forward, we are looking to increase our AARP penetration and to sharpen our agency focus. We expect new business premiums to begin to grow again in 2011 in response to targeted marketing and new product launches. In agency, we are steadily increasing our focus on the 40-plus age group. More than 80% of agency new business flow in the quarter came from this demographic. We will report this metric going forward and you should expect it to steadily climb. We plan to have our universal auto product in 39 states by the end of the first quarter of 2011. This will further improve our ability to increase penetration across all of our targeted segments.

In summary, the fundamentals in this business are headed in the right direction. We are taking rate and underwriting actions where appropriate, our combined ratio is improving and we are focusing our efforts on target markets.

Now, let's turn to the Wealth Management results on Slide 8. Excluding the effects of DAC unlock, profitability in Wealth Management continued to improve, with core earnings up 10% over prior year. Margin expansion is being driven by equity market appreciation and positive net flows outside of annuities. Core earnings, ex the DAC unlock for the combined annuity segment, was $146 million in the third quarter, an 8% increase over prior year. Rising account values have more than offset net outflows to generate earnings growth. In our Life Insurance business, third quarter results were again strong. Ex the DAC unlocks, core earnings were $57 million. Mortality was a bit unfavorable in the quarter, but within an expected level of volatility. Individual Life sales were up 14% over prior year. We are making excellent progress with our monarch program, our initiative to increase our penetration with some of the largest independent Life producers in the country. We believe momentum here is building, with a record sales month in September and we are excited about growth in the fourth quarter and into 2011.

In mutual funds, deposits totaled $3.1 billion. Retail mutual fund deposits were off 19% from prior year. The decline in deposits is consistent with generally weak industry flows into equity funds. In contrast, industry flows into fixed income funds remains at historic highs. We are working to grow AUM in this environment, with a more robust fixed income product offering in 2011. Also, we announced two weeks ago the planned sale of our Canadian mutual fund business, which is expected to close in the fourth quarter. This is a non-core operation, with under $2 billion of AUM. As we've said, we will regularly review our portfolio of businesses to ensure that we are focused on the right mix to drive our strategy. Our Retirement Plans business posted solid third quarter. Core earnings, excluding the DAC unlock, were $10 million, up 25% over prior year. Deposits were $2 billion, up 13% over prior year. To summarize third quarter results in Wealth Management, we saw a good flows in non-annuity businesses, margin improvement driven by account value growth and strong sales and profitability in Life Insurance.

Now, let's turn to Slide 9 for a discussion of capital and risk management. We've received a lot of valuable feedback from investors since the second quarter call, indicating they want more clarity about changes in our statutory surplus. We've heard you and we thank you for your input. As a result, we're providing expanded information this quarter. We continue to believe we have sufficient capital for any reasonable stress scenario. Slide 9 presents a roll forward of third quarter changes in stat surplus and our Property & Casualty and U.S. Life Entity. In aggregate, surplus improved about $700 million in the third quarter to $15.2 billion. Working across the slide, VA-related surplus impacts totaled $400 million. I will discuss that in more detail in the next slide. Our Property & Casualty operations generated $300 million of surplus in the quarter. Credit related impacts provided a benefit. Impairments were more than offset by price improvements in several mark to market fixed income portfolio. Dividends from the P&C companies were about $200 million, consistent with our stated plan. In our Life Statutory entities, excluding the impact of the VA business, surplus declined about $100 million. This was caused by reserve increases related to our fixed annuity due to the low interest rate environment.

Now, let's move to Slide 10 to examine the VA surplus impacts in greater detail. VA related statutory income, excluding changes in reserves and hedge assets was about $300 million in the quarter. The two largest drivers of VA related surplus movements are typically changes in statutory liabilities and hedge assets. In the third quarter, these two essentially neutralized one another. With the rising equity markets, statutory VA liabilities declined about $700 million. Conversely, our hedge assets declined in value about $800 million. There are two key drivers for this result. First, while the U.S. equity market recovered much of its second quarter decline, the yen continued to strengthen against the dollar. Second, we increased hedging levels for both global equity protection and yen-dollar protection. That extra equity protection lowered surplus in the quarter due to rising equity markets. Looking ahead to future quarters, you generally should not expect the changes in hedge assets to so closely offset the change in liability. As we've said, our first risk management priority is to manage tail risk. So although we have taken steps to mitigate surplus volatility, you should still expect to see point-to-point volatility in the future.

Bottom line, we feel good about our capital position. We articulated a prudent capital philosophy in March. Our goal is to be prepared for any reasonable stress scenario. Since that time, the fixed income market has steadily recovered but other Capital Market variables have been more volatile. The significant recovery in bond prices combined with our derisking efforts have meaningfully reduced The Hartford's credit risk. In connection with our March capital raise, we analyzed our investment portfolio under a severe stress scenario that included a double dip recession and additional declines in commercial and residential real estate prices. In total, we anticipated about $2.8 billion of credit-related impacts over 2010 and 2011.

Now, when we analyze our portfolio as of the end of September under the same scenario, the impact has declined to about $1.4 billion over 2010 and 2011. On the other hand, the yen and interest rates remained at stress levels, which partially offset the improvements in credit. As we've said, we continue to feel very confident in our capital position. However, given continued market and economic uncertainty, it is premature to change our capital management philosophy.

Now, let's turn to Slide 11 for a discussion of interest rates. A number of you have asked us about the low interest rate environment. As you know, lower reinvestment rates will reduce net investment income. We can offset this by lowering crediting rates on our spread based liability, but this is only a partial offset because many of those liabilities are at their contractual minimums already. We typically use the forward interest rate curve in our planning process. As a result, our plans

incorporate today's views of future rate level. However, if interest rates were to stay at their current levels through the end of 2012, we estimate that the incremental core earnings impact will be about $30 million in 2011 and $100 million in 2012.

Finally, a sustained low interest rate environment over a two-year period should not have a significant impact on DAC or goodwill, which are generally not sensitive to rates in the near term. So bottom line, the interest rate environment is a manageable headwind for The Hartford from an earnings perspective. At the same time, it is a critical factor in our thinking about pricing and returns on new business going forward.

Now, let's turn to Slide 12 for a brief review of our investment results. Declining interest rates and some spread tightening drove significant improvements in the investment portfolio in the quarter. We flipped to a net unrealized gain position at the end of September as the value of our fixed-income holdings increased. Impairments and mortgage loan valuation allowances continued to trend downwards. Total impairments, including OTTI and mortgage loan valuation allowances were $122 million. The primary source of these impairments was weaker collateral performance on a handful of structured commercial real estate securities. Also, included in the $122 million number are $44 million of impairments related to securities we intend to sell given the recent improvements in valuation. Net investment income, excluding trading securities, was $1.1 billion, 3% higher than prior year. Improved partnerships returns more than offset the effect of lower reinvestment on our fixed income portfolio.

Now, let's turn to Slide 13 for our updated 2010 guidance. As we announced last evening, we are increasing our full year core earnings guidance to between $2.60 to $2.70 per share. This range incorporates actual third quarter results, as well as the impact of unseasonably high catastrophe losses in Consumer Markets and P&C Commercial in October. This was driven by severe storm activity in the Southwest United States. We had planned to guide the fourth quarter core earnings of little over $0.90 per diluted share. But in light of October's estimated cat losses, we had lowered our outlook by about $0.09 a share. Therefore, we expect a little over $0.80 per share in the fourth quarter, at the midpoint of our guidance range. Looking ahead, we will share our 2011 outlooks with you early next year. This ends my prepared remarks, which were a little longer than usual. We wanted to provide additional details and insights on capital and interest rates. I hope you found it helpful. With that, I'll turn the call over to Rick, as we move into the Q&A session.

Richard Costello
Thank you, Chris. [Operator Instructions] Kamiko, please open the call for questions.

Question and Answer

Operator

[Operator Instructions] And your first question is from Darin Arita at Deutsche Bank.

Darin C. Arita
Deutsche Bank AG, Research Division

I had a question on first Slide 11, on the effect of low interest rates and I was wondering how much of that is coming from lower investment income in the -- your Property & Casualty insurance businesses?

Christopher John Swift
Chairman & CEO

Darin, it's Chris. I did not split it out by Property & Casualty Life, but we did it more in the analysis in total. I mean, we could get that information to you but I don't have it split out right now between Property-Casualty and Life.

Darin C. Arita
Deutsche Bank AG, Research Division

I guess, it's fair to assume that you're assuming pressure from that business, but you're not assuming any corresponding price changes to offset the low rate environment?

Christopher John Swift
Chairman & CEO

Well, again, it's from an in-force perspective. So it's sort of running off the in-force book and as you heard, we are trying to take pricing actions in most lines where appropriate. So I would bifurcate the analysis here. This is in-forced future pricing, we're trying to take that rate where appropriate.

Darin C. Arita
Deutsche Bank AG, Research Division

And then just turning to the Group Benefits and P&C Commercial joint sales, Liam, I appreciate the data that you're giving out at the start of the call. Just curious what are the size of accounts that Hartford is targeting here for the joint sales and where do you think this can get to?

Liam E. McGee
Former Chairman

Well, initially, Darin, initially most of the cross sales tend to be at the higher end of the market. But as we go forward, we're very focused on the Middle Market. We think that is the highest potential for us and we're beginning to see interest there from agencies who have come to the same conclusion.

Darin C. Arita
Deutsche Bank AG, Research Division

And the sales, where do you think that can get to that's $30 million now?

Liam E. McGee
Former Chairman

I'm not sure we're prepared to quantify it yet, Darin. I would say that we're very encouraged. The teams are working together very well. As I noted, agencies are -- see the wisdom of it. They're working with us not only to sort through how we deliver it to them, but how they deliver it to their customers. And we're very excited about it. I think the first stage is what we're talking about is the joint sales between our two sales forces. But we understand the next stage or iteration will be more about product innovation as well.

Operator

Your next question is from Chris Giovanni with Goldman Sachs.

Christopher Giovanni
Goldman Sachs Group Inc., Research Division

Question for Chris. Do you think you could provide a bit more detail around the hedges you put on in terms of the global equity markets and the yen in terms of maybe potential around pricing, as well as the timing of those hedges?

Christopher John Swift
Chairman & CEO

Sure. I think what I would point out is that we've been building our FX positions during the second and third quarter, working with risk management. Those positions were put on a different, obviously yen levels, dollar levels but I think we've built a substantial base of protection on currency. We've spent approximately $170 million run rate accumulative year-to-date on the program. If program expires -- most of it expires early 2011. We do anticipate putting on protection in '11. We're working through the exact strategy and the dynamics of that. We're trying to balance as we always said, risk, capital, earnings and do the right thing from a long-term shareholder perspective. So hopefully, that's enough detail to give you a feel for it.

Christopher Giovanni
Goldman Sachs Group Inc., Research Division

I guess, different from some of the past quarters where you provided sort of RBC estimates, I haven't seen that this quarter. Do you have an update in terms of where that stands and where you expect it to end the year?

Christopher John Swift
Chairman & CEO

If the question is from RBC from our main life company, HLA, I would say that it's well north of 4.25 on an estimated basis at this point in time.

Operator

Your next question comes from Nigel Dally of Morgan Stanley.

Nigel Phillip Dally
Morgan Stanley, Research Division

With the surplus volatility in hedging, can you discuss where you stand with regards to hedging interest rates on your global annuity book. Is that an area that's fully hedged or is that one of the areas where additional work is still needed to reduce the volatility going forward? Second with group disability, obviously still seeing weakness, but I understand, you're pushing through some relatively price increases, so can you provide an update on the renewal process? Are clients accepting the price increases or should we expect some estimated lapses as we look to 2011?

Christopher John Swift
Chairman & CEO

Nigel, it's Chris. I'll try to take the first one going forward. I think your question was on interest rates and surplus volatility. I would say again, if you look at our WB program, we do have some interest rate protection, let's say about at the 50% level. When you translate that into the statutory world VA CARVM, you don't have that significant volatility. So from an interest rate side, there isn't that much volatility on the VA CARVM. It does consume a little capital -- in this lower interest rate environment. When you just model different benefits and things and along those lines more from a valuation side, but not a hedging side. So hopefully that's clear. Andy?

Company Speaker

Nigel, Andy Pincus. In terms of the competition and the rates that we're talking about taking, really, we believe that higher incident rates that we're seeing and the lower termination rates are really a marketplace phenomenon, as well as the challenge that low interest rates are providing generally. So we are responding to those appropriately we believe. We're going to take price. We believe that the market is going to do the same as well. We'll see in 2011, but we expect to remain competitive and we will proceed forward and as we've said, we are seeing others seeing the same challenges and certainly interest rates are out there for them as well.

Nigel Phillip Dally
Morgan Stanley, Research Division

I guess, my question was more about the renewal process. You're largely through that process now, so what have been the reaction of clients. Is everyone sort of trying to push forward price or are you actually still keeping the client or is there some pushback from clients as to the prices that you're trying to push forward?

Company Speaker

Well, I think like most of this, there's mix but I think we're seeing both. And so we're going to take these one at a time as we underwrite these and we're going to make the right judgment for us about what business is priced appropriately and what business we should walk away from.

Operator

Your next question is from Eric Berg at Barclays Capital.

Eric Noel Berg
Barclays PLC, Research Division

You indicated that your -- in the annuity area, your Personal Retirement Manager continues not to meet your expectations. Can you describe what your domestic annuity strategy is going to be therefore? Since this one hasn't worked, and since the existing guarantee-based products prior to this are essentially winding down, where do we go from here on the annuity business?

Liam E. McGee
Former Chairman

I'll make a comment and then Dave may want to make some comments on his own perspective. Eric, I would just go back to what I said in my remarks, which is we are candid and realistic about the performance of the PRM. For the factors that you and I both describe. Second of all, Dave and his team are hard at work on a go-forward annuity strategy and we anticipate that being a mix of products that will be suitable for various distributors and customers. As we said in April, the $5 billion was always a proportional guide as compared to the $15 billion plus that we did at our peak. We don't see ourselves playing at that level. And finally, as I said, we will not chase that target and cede either profitability or take undue risk. Dave, anything else you'd like to add?

David N. Levenson
Former Executive Vice President and President of Wealth Management

I guess, what I would add is we're not going to be a single product provider on go-forward basis. So as we look at PRM, it did not work well in this macroeconomic environment. In a different environment, we think it may work quite well. But we do have to complement that with other products and that's really what's in the lab right now.

Operator

Your next question is from Ed Spehar of Bank of America.

Edward A. Spehar
BofA Merrill Lynch, Research Division

On the DAC unlock and I think there was a comment made that the assumption changes were only about $15 million benefit. And that they were concentrated in a decrease in withdrawal rates assumed in the U.S. and an increase in annuitization in Japan. I guess, if that's correct, we're at a point now where it's a good thing if we have higher annuitization rates in Japan and the business is more persistent in the U.S., is that correct?

Christopher John Swift
Chairman & CEO

Ed, it's Chris. Your point, I would say, annuitizations in Japan are not a good thing. That keeps the risk that means people are in essence using the guarantee. So again, when we updated our assumptions, obviously we planned for that because they're just more in the money so you just call it behavioral assumptions, yet we had to update. That did sort of on an all-in base, not only affecting core but that it was about a $52 million charge in DAC for that. It did also consume some statutory capital from a VA CARVM side when we made that change. Generally, in the U.S., we had been, I call it, assuming a, I call it a higher utilization rate and higher lapses, which we took down, which provided a benefit because less than the money, I call it balance more from a risk side, we're able to earn more fee income over the longer period of time. That's why that turned out to be approximately a $58 million benefit all-in on that assumption change.

Edward A. Spehar
BofA Merrill Lynch, Research Division

The one follow up on interest rates is what type of negative impact do you see if you had a period of, a multi-year period beyond the next couple of years of rates where they are today with regard to the variable annuity guarantees? Or is that not a big deal?

Christopher John Swift
Chairman & CEO

I would say, multi-year is a big deal. I mean, we worry about interest rates that probably one of the key economic factors that -- I could tell you, I just haven't modeled it out in any degree, to any detailed fashion at this point, but it's something we could talk about in the future.

Edward A. Spehar
BofA Merrill Lynch, Research Division

Chris, just the idea that you hedged half of the WB on interest rates, does it suggest that, that is not a -- when we say it's a bigger issue, is it just -- is it a really big issue or is it something that you obviously haven't been that worried about considering how much you've protected yourself?

Christopher John Swift
Chairman & CEO

I think we're just mixing and matching apples and oranges here. One, the WB program is obviously done for hedging purposes, 157 valuation purpose then you've got to look at the economics in the long term. And I would say, yes, it is an important factor that we look at and consider. So...

Operator

Your next question is from Larry Greenberg [ph] at Langen McAlenney.

Larry Greenberg
Langen McAlenney

I'm wondering if you can give us a little bit more color on the reserve releases in Property-Casualty. Past quarters, Specialty seemed to be the biggest contributor to the releases and wondering if you could maybe give us a little bit of a breakdown between what we use to know of as the old segment and then on the consumer side, was that just the normal reserving process or was there anything more substantial that went into the look at reserves this quarter?

Company Speaker

It's Andy Pinkes. So on the Property-Casualty Commercial side, the first thing I'd say is they've really have been fairly broad-based across our markets. Small, commercial and middle market have seen, in terms of the old segmentation, have seen a fair amount. But again, I would say pretty broad-based they include workers comp, really general liability, auto, we have seen favorable severity in there and particularly I would say in our longtail lines and that's really where we've seen it. We do break it out in some detail actually in the IFS (Investor Financial Supplement). There's actually a bunch of detail in there that shows it by segment, I believe.

Larry Greenberg
Langen McAlenney

And the consumer question? Consumer reserve releases?

Richard Costello

Larry, this is Rick. On the consumer releases, that's primarily going to be out of the auto liability side.

Larry Greenberg
Langen McAlenney

But it was just the normal process for looking at the reserves this quarter? I mean, the number was more favorable than it's been running.

Richard Costello

Yes, no process change, you're just seeing the emergence of severity coming out of that book.

Larry Greenberg
Langen McAlenney

And then I was just wondering if you could discuss on the consumer side the emphasis on preferred and are the agents not giving or showing you the business you're not interested when it comes up for renewal? Are you just pricing yourself out of the market there? Just how is that process working?

Company Speaker

Larry, this is Andy Napoli. I guess, I'll start with homeowners in this current year and going forward into '11, we believe our pricing will increase in response to rising loss cost, both cat and non-cat and we'll be consistent with what's happening in the market. On the auto side, our plus eight is high, but not unexpected given the profitability actions we're taking in our agency channel. As far as what's happening at the agency level, we have introduced pretty strict underwriting guidelines that are driving that mixed shift that Liam referenced and Chris in their remarks. We're pushing our new business mix 40 plus is what we call it, accounts for 80% of that new business flow. As that continues to propagate itself within the renewal book, I think we'll be in a much better place going forward.

Operator

Your next question is from Andrew Kligerman with UBS.

Andrew Kligerman
UBS Investment Bank, Research Division

With regard to the Group Benefits business, the 77% ratio there, I know you've got three-year products that take a while to reprice, but when do you think you could get back to a more normal 70% level, 72% that you were at a few years ago? The second question is around the variable annuity comments that you made earlier. Liam, it sounds like you want to get back to that $5 billion target. Do you have some living benefit products that you might launch pretty soon that could get you back into the game that might bring you in the near term toward a $5 billion annualized rate? And then just lastly real quickly, what do you estimate to be your excess or redeployable capital number at this stage in the game?

Company Speaker

Thanks, Andrew. So in terms of the time, I'd say as you referenced a large portion of our book has three-year rate guarantees. And so we are going into the market with price based on our reaction to higher incidence and lower terminations and interest rate. And so it's going to take some time, probably a number of years to work completely through. But we're still working very diligently on the higher incidence and lowered terminations piece, so we are taking actions there with regard to price. But we're also keenly focused from a claim perspective on making sure that our execution is as absolutely good as it can be. And so we will continue to be very focused there. Obviously, with the goal of improving that ratio.

Andrew Kligerman
UBS Investment Bank, Research Division

It sounds like you can gradually get it down over the next few years then, but it should directionally come down from where it is now. Does that sound right?

Christopher John Swift
Chairman & CEO

That's our goal, for sure. This trend, if it's a trend at all, is new and so we're watching it. And so we're going to continue to watch it.

Liam E. McGee
Former Chairman

Andrew, to your question, I'm going to have Dave Levenson comment or answer your specific question. But again, I would just reiterate what I said both in April and today, the $5 billion was a proportional sense, it was a third of our peak and $15 billion when we were market leader. That kind of gives you a sense of the appetite we have, but I would reemphasize that we will not chase that $5 billion with inappropriate risk or unacceptable profitability. Now Dave I know can share more about his specific thoughts.

David N. Levenson
Former Executive Vice President and President of Wealth Management

So Andrew, as you know, it's very hard to pinpoint a number whether it's $5 billion or $4 billion or $6 billion. So what I would say to you is again, we are trying to build a rational portfolio of products kind of an all weather portfolio, if you will. We do have a couple of ideas as I said in the lab that do meet our risk appetite, we think, it's early. And also, we're not going to do anything as Liam said that is subpar from a profitability perspective.

Andrew Kligerman
UBS Investment Bank, Research Division

David, do you think that you could come out with some products that will compete effectively with Lincoln and Prudential and Met and can be viewed in the same light?

David N. Levenson
Former Executive Vice President and President of Wealth Management

So with respect to the competitors that you mentioned, there are some things that they do that are attracting flows for them that for us may not make sense. And all I would say is that it's just a little too early for us to comment a little bit further on that.

Christopher John Swift
Chairman & CEO

Andrew, it's Chris. On your excess capital position, I would state that similar to what we said in our opening comments, there's really no change in our capital management philosophy. Hopefully, you understood the points on improving credit offset by some modest yen and interest rate declines. So from where we were in our April capital raise numbers, I would say we're modestly ahead of those numbers. But there is general no philosophy change at this point in time.

Liam E. McGee
Former Chairman

Still a lot of economic uncertainty and market volatility, Andrew, that I think reinforces the position that Chris and I have articulated today.

Operator

Your next question is from Thomas Gallagher with Crédit Suisse.

Thomas George Gallagher
Crédit Suisse AG, Research Division

First question is a follow up on the hedges you bought this quarter. What does that bring your 2011 sort of run rate hedge expenses to I think prior to 3Q, the number was $260 million. Where does that stand today?

Christopher John Swift
Chairman & CEO

Thomas, it's Chris. I think we had been talking about for the macro program was maybe about a $65 million run rate cost before that. You overlay the incremental FX positions we've been building during the second and third quarter. I put that at another $60 million run rate. So and again, as we said, the FX positions are short term in nature and expire first part of '11. So all-in, you could say right now on a run rate basis, about $125 million a quarter. Thinking about '11, again, it's still trying to design the planned balance sheet and everything I would not be uncomfortable with sort of $100 million per quarter all-in run rate cost for our macro hedging program in the short term. Right? Balancing what we might do in the long term.

Thomas George Gallagher
Crédit Suisse AG, Research Division

So that's a decent run rate to think about moving ahead. The next question I had, Chris, it's just when you all did your DAC review, are you factoring the hedge cost in? When you look at AGPs and evaluate future gross profits, are you assuming that the hedge cost is going to be continuing or is that not factored in?

Christopher John Swift
Chairman & CEO

I would say yes, we factored in a lot of things. If you're specifically referring to maybe our Japan derisking activities, those AGPs do not have I call it a defined hedging program associated with them at this point in time.

Thomas George Gallagher
Crédit Suisse AG, Research Division

I guess, it's a question both on the U.S. and Japan. If you were to overlay kind of a forward-looking assumption that you're going to continue to hedge this, would that affect the way you look at reserves and DAC on these businesses? And I guess, in particular, in Japan, it sounds like it was a fairly modest charge. Are you pretty confident that the reserves in DAC are right sized now or is there still some uncertainty there?

Christopher John Swift
Chairman & CEO

Look we've been saying, Tom, the macro programs and the FX programs are short term in nature. So by definition, if we would extend anything for a longer period of time, we would consider baking that into our AGPs depending on how we define the program. U.S. maybe less sensitive, Japan maybe a little bit more so. But I would remind you, Japan we have about $1.7 billion of DAC. If I look out over the next five years, about 65% of that will just be amortized off with our current methodologies and K factors. So it's not a long-duration asset there in Japan, that DAC asset.

Operator

And we have time for one more question and that is from John Nadel of Sterne Agee.

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

On the waterfall slide on Slide #9 in your deck, that walks us through the $700 million change in capital in stack capital. Just two quick questions. One, the $200 million positive impact of credit related impacts, I just was hoping you could give us a little bit more detail there and I guess, I was under the impression that mark-to-market is not reflected on a statutory basis. So I assume is this equity positions or a trading account that's driving that? And then the second question also on the same slide, the $100 million reduction for Life third quarter statutory earnings, I think Chris you mentioned that was largely related to the fixed annuity business. Could you give us a sense for what the assumption impacts were there or how to think about that? Does that reset those reserves to current interest rate environment or is there more to take if we remain low?

Christopher John Swift
Chairman & CEO

John, I would say on the credit related impact is primarily related to what I would call our CRC or market value adjusted annuity program, where assets we bought the assets and so there is a credit benefit there as spreads come in. And then on the statutory earnings, the negative, I would point out during the quarter, the headwinds that we faced, you alluded to one. We did record, call it an increase in reserves, in the annuity line, about $300 million due to the low interest rate environment, coupled then with some assumption changes that we put in for others that, that maybe cost us nearly $200 million. So with that, we still then were able to obviously grow statutory surplus during the quarter. So as we fast-forward to year end and doing our year end cash flow testing Q3 Phase I final judgment, actually we feel pretty good that there's not going to be any other headwinds or charges that we face at year end related to those particular items.

Operator

And there are no further questions at this time. Do you have any closing remarks?

Richard Costello

This is Rick Costello. I know we didn't get to all the questions. But we do want to be respectful of the 11:00 call that has already started. We will be available all day for follow-up questions. Thank you so much for your participation on The Hartford's Third Quarter Earnings Call, and we look forward to seeing you soon.

Operator
Thank you. This concludes today's teleconference. You may now disconnect.