S&P Capital IQ

CONTENTS

The Hartford Financial Services Group, Inc. NYSE:HIG

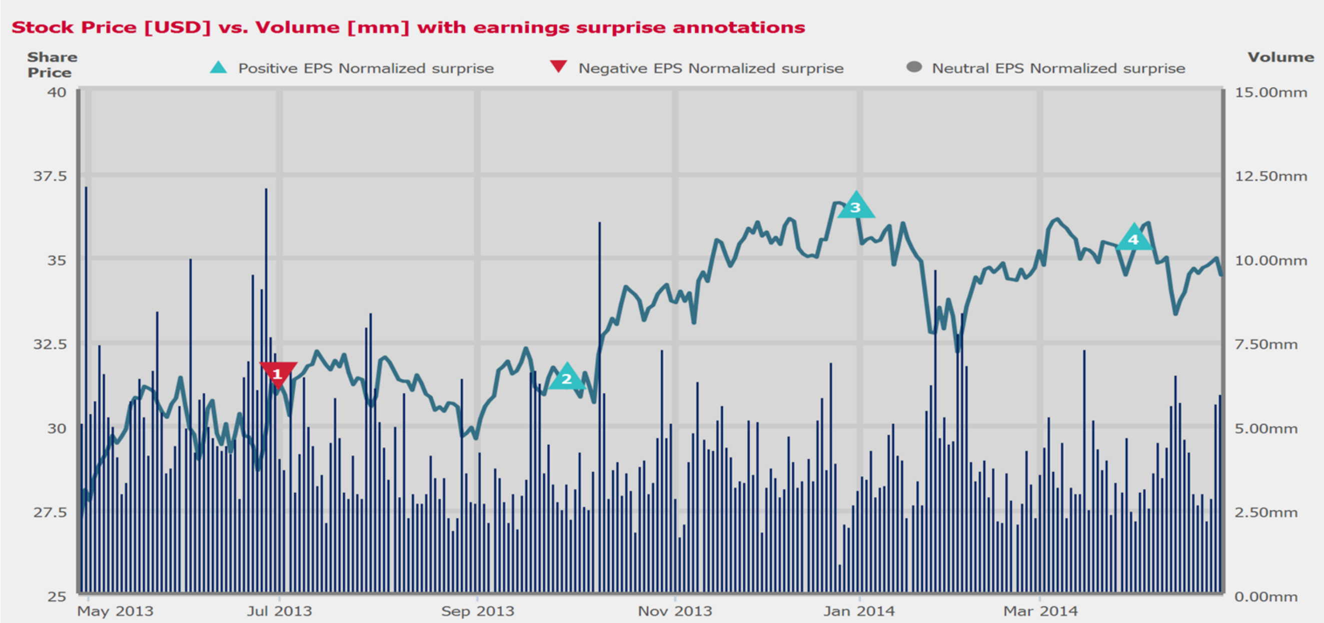
FQ2 2014 Earnings Call Transcripts

Thursday, July 31, 2014 3:00 PM GMT

S&P Capital IQ Estimates

	-FQ2 2014-			-FQ3 2014-	-FY 2014-	-FY 2015-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.67	0.31	▼(53.73 %)	0.78	3.27	3.80
Revenue (mm)	5502.29	4616.00	▼(16.11 %)	6181.00	20154.61	21371.66

Currency: USD
Consensus as of Jul-31-2014 1:10 PM GMT



- EPS NORMALIZED -	CONSENSUS	ACTUAL	SURPRISE
FQ2 2013	0.71	0.66	▼1 (7.04 %)
FQ3 2013	0.83	1.03	▲2 24.10 %
FQ4 2013	0.90	0.94	▲3 4.44 %

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FQ1 2014	0.93	1.18	▲26.88 %

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Chairman & CEO

Douglas G. Elliot
President

Liam E. McGee
Former Chairman

Sabra R. Purtill
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Presentation

Operator

Good morning. My name is Laurel, and I will be your conference operator today. At this time, I would like to welcome everyone to The Hartford Second Quarter 2014 Financial Results Conference Call. [Operator Instructions] I'll now turn the call over to Sabra Purtill, head of Investor Relations. Please, go ahead.

Sabra R. Purtill
Senior Vice President of Investor Relations

Thank you. Good morning, and welcome to The Hartford Second Quarter 2014 Financial Results Conference Call. We released these results and also filed the investor financial supplement 10-Q and financial results presentation, which includes our third quarter 2014 outlook, yesterday afternoon. All of these documents are available on the Investor Relations section of our website. Our speakers for today's call include Liam McGee, Chairman of The Hartford; Chris Swift, CFO; Doug Elliott, President; and Beth Bombara, CFO. Following their prepared remarks, we will have about 30 minutes for Q&A. I would note that other members of our executive leadership team are also available for questions during that section of the call.

As described on Page 2 of the financial results presentation, today's call includes forward-looking statements as defined under the Private Securities Litigation Reform Act of 1995. These statements are not guarantees of future performance, and actual results could be materially different. We do not assume any obligation to update forward-looking statements, and investors should consider the risks and uncertainties that cause actual results to differ from these statements. A detailed description of those risks and uncertainties can be found in our SEC filings, which are also available on our website.

Our presentation today includes several non-GAAP financial measures. Explanations and reconciliations of these measures to the comparable GAAP measure are included in our SEC filings, as well as in the earnings release and financial supplement. I'll now turn the call over to Liam.

Liam E. McGee
Former Chairman

Thank you, Sabra. Good morning, everyone. It's really good to be with you. You know in my life, I don't have much experience working less than full time. So the last few weeks have been welcome as I've been able to focus on my health. And I do appreciate the many expressions that I received from so many of you. And I'm very pleased to report that I'm feeling much better and stronger. I have also had time to reflect on The Hartford's remarkable turnaround and transformation. The Hartford faced severe challenges when I arrived in 2009, and its future was unclear. Today, with a focus on growing profitable businesses, the company's prospects are bright.

Now as you know, while we made many changes over the last 5 years, I believe 3 were critical to our success. And we'll continue to deliver shareholder value.

We brought clarity to the company's strategic direction, focusing on businesses where we could compete and win. We have invested and we'll continue to invest in new capabilities for those businesses. The result has been sustained margin expansion, with more expected. We significantly lowered the risk profile of the company to a more reasonable level, most importantly recently, with the sale of Japan. This will reduce the volatility of The Hartford's results and will lower our cost of capital going forward.

Finally, we focused on generating and freeing up capital. We retained businesses that could create capital and sold other businesses that were capital-consumptive. We also reduced the size and risk of the Talcott Resolution liability, freeing more capital in the process. As a result, The Hartford now has a very strong balance sheet, with the capital flexibility to take accretive actions to create shareholder value. These 3 steps: reducing risk, narrowing the strategic focus and generating capital, were key to the transformation and position us well for the future.

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The CEO transition from me to Chris has gone smoothly. Over the last few years, I spent a great deal of time on talent development and succession planning with the Board of Directors, and this thoughtful preparation enabled the board to act quickly and decisively when I decided to step aside as CEO. And I must emphasize that I couldn't be more confident in The Hartford's future with Chris Swift as CEO, Doug Elliot as President, and Beth Bombara as Chief Financial Officer, as well as the entire executive leadership team. Personally, I have fully transitioned to my new role as Executive Chairman and I look forward to supporting this team.

Finally, I want to thank you, our investors and analysts. I have valued your support and insight, but if I could be candid, some days more than others, and in the early days of my tenure, your patience with this banker, who as I was reminded was relatively new in the industry. I appreciate your support.

I particularly want to thank The Hartford's employees of whom this management team has asked a lot, and they have consistently delivered with great pride and integrity. Without a doubt, the nearly 18,000 teammates are The Hartford's greatest strength. With that, I'm proud to turn the call over to the Chief Executive Officer of The Hartford, Chris Swift. Chris?

Christopher John Swift
Chairman & CEO

Thank you, Liam, for your comments. On behalf of the board, the management team and 18,000 Hartford teammates, I want to thank you for all that you've done for our company. Your willingness to make tough decisions, along with your guidance, leadership and passion, drove the successful transformation of The Hartford. You have positioned the company for great success and the leadership team and I are committed to achieving our vision of an exceptional Hartford. Personally, I am deeply appreciative of our partnership over the last 5 years. Thank you, Liam. I'm honored to serve as CEO of this great company, and I am excited about the path we are on. We continue to execute the company strategy, profitably growing the P&C, Group Benefits, the Mutual Fund businesses, reducing the size and risk of the legacy annuity blocks, and transforming The Hartford into a more effective and efficient organization. We have made tremendous progress. Profit margins are expanding in P&C, Group Benefits and Mutual Funds. All the businesses are growing the top line, with the exception of Group Benefits, where margins have recovered strongly and the top line has stabilized.

Although prior year A&E development and elevated storm activity impacted The Hartford's second quarter results, the underlying trends in this quarter reflect a positive momentum in the businesses. In the P&C lines, written premiums grew 3%, and the ex-CAT ex-prior year combined ratio improved 0.9 points from the second quarter of 2013. Written premiums in Small Commercial were up 6%, and the underlying combined ratio was 85.4%, an improvement of 2.2 points compared to the second quarter of 2013. Core earnings in Group Benefits and Mutual Funds increased over the prior year quarters. I am confident we will continue to expand margins. Our pricing levels are higher than our loss cost trends in the P&C and benefits businesses.

In Middle Market, new property and general liability capabilities are driving profitable growth in selected markets, a dramatic improvement over the past 2 years. In Group Benefits, earnings have sharply rebounded, and we expect the business to produce a sustainable after-tax core margin of around 5.5%. We are rolling out new voluntary offerings, and I expect to see top line growth beginning next year.

The Talcott Resolution team has meaningfully reduced the size and risk of the annuity liabilities in the U.S., and of course, in Japan. For the U.S. blocks, we will continue to use targeted initiatives to accelerate the annuity runoff. As we said before, we will consider transactions as a potential tool, but I expect that we will create the most value for shareholders if we manage the runoff of the U.S. block ourselves.

With a more focused company, we must operate more effectively and efficiently, while investing in new capabilities. We have done well in our cost neutrality efforts, having eliminated the stranded cost from the Life and Retirement Plans businesses, and we will continue to manage expenses as Talcott shrinks. We also will continue to invest to increase our competitiveness in key markets and improve the quality of our customer experiences. I am confident in The Hartford strategy. I'm also very confident in this management team. With the changes announced Tuesday, the team possesses an outstanding mix of

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experience and skills, perfectly suited to The Hartford. Doug Elliot has demonstrated he is one of the best P&C operators in the business. As president, his new responsibilities now include all of P&C and Group Benefits, including claims, providing greater accountability and alignment across these businesses. Beth Bombara has been an outstanding leader in both finance and operating roles at The Hartford, most recently in Talcott Resolution. Beth's financial skills and business expertise will be critical factors in this team's success. Bill Bloom is a great addition for The Hartford. He has deep technology and customer service operations experience, but equally important, he knows the insurance business. I'm also excited to have Ray Sprague join my leadership team as leader of Strategy and Business Development. Ray is a seasoned P&C industry veteran, who has done a terrific job in building our industry-leading Small Commercial business. Ray will work closely with me and other senior leaders to accelerate the pace of growth across the enterprise. In addition, Ray will serve as acting head of Consumer Markets to replace Andy Napoli. We appreciate Andy's contributions to the company over the past few years and we wish him great success in his next opportunity.

Finally, I'm pleased that Brion Johnson will lead Talcott Resolution in addition to continuing as the Chief Investment Officer. Brion has annuity experience in his background and he's the ideal leader for Talcott, as it continues to reduce the size and risk of the U.S. annuity liabilities.

Every member of the team understands the insurance business model, a trust-based business where confidence is earned one day at a time with customers and partners. When that confidence and trust accumulates over time, it develops into a powerful brand and a market leader. This team is determined to win and build an exceptional company.

On July 1, we announced the closing of the sale of the Japan annuity business. We went from signing to closing in 60 days, an outstanding accomplishment. Both parties worked diligently to get this done, and I appreciate everyone's effort. The Japan sale is an important milestone. It accelerates the strategic transformation of The Hartford and significantly improves the company's risk profile. The sale also enables us to increase the company's capital management plan for 2014 and 2015 by $1.275 billion. Consistent with our prior programs, the expansion will be balanced between equity and debt repurchase, in this case, about 60% equity and 40% debt. We plan to put most of that additional capital to work by the end of this year.

In addition, we have increased the common stock dividend by 20% to $0.18 per quarter, based on the improving earnings power of the P&C, Group Benefits and Mutual Fund businesses. With the expansion of the capital plan, the total share repurchase and debt repayment for 2014 and 2015 is nearly $4 billion. Over time, the generation of excess capital from profitable growth in the businesses and the runoff of U.S. annuity block and the use of that capital in accretive ways, will be critical to driving ROE improvement and increasing book value per share.

In closing, I am thrilled to take on this new role. I am very confident in the future of this company. The ingredients for success are here. And I am proud of all that this team has accomplished, and we are relentlessly executing on The Hartford's strategic plan with a focus on creating shareholder value.

Now I will turn the call over to The Hartford's President, Doug Elliot. Doug?

Douglas G. Elliot
President

Thank you, Chris, and good morning, everyone. Before I review the financial results for Commercial and Consumer markets, a few comments on our new team. I'm excited about working more closely with our Consumer Markets group. We have an excellent team and a terrific brand in the consumer space and I'm looking forward to being their partner. I'm also excited about Bill Bloom joining our team. Bill and I have worked together in the past. The leadership and expertise he brings to our organization will be invaluable for our journey ahead, and an excellent fit with the strong technology and operations team that we already have in place. Likewise, I'm very pleased about Ray Sprague's broadened responsibilities across the enterprise. He's a proven leader with deep insurance experience that we will leverage to further expand our franchise. And lastly, we are very fortunate to have Stephanie Bush ready to step into the role

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as head of Small Commercial. Stephanie has a long and successful track record in P&C Commercial here at The Hartford, and has ideally prepared to take this business to new levels of growth and performance.

Now let me get into our results. I'll cover P&C Commercial first, move on to consumer, and conclude with Group Benefit. We had a very solid second quarter in P&C Commercial. Across our business units, we posted quality earnings and delivered strong top line results, even as the market shows signs of growing competitive pressure. Overall, I remained pleased with our execution and confident in our ability to navigate changing market conditions. For the quarter, we delivered core earnings of $213 million on an all-in combined ratio of 94.2. Compared to the second quarter of 2013, this is an increase of $15 million in core earnings, and an improvement of 4.2 points on the combined ratio. Underwriting gains were up $66 million in the quarter versus last year, offset by a decrease in net investment income. Current accident year CATs were relatively modest for the second quarter of 2014 and $9 million less than the quarter 1 year ago. The underlying combined ratio, excluding catastrophes and prior development was 91.1 for the second quarter of 2014, an improvement of 2 points versus prior year, reflecting our strong execution across all business units.

Turning to the top line, our total written premium was up 2%. Excluding the decline in our programs business of $28 million, which is a result of our re-underwriting actions, P&C Commercial grew 5% for the second quarter. We also continued to drive written pricing gains, achieving a 6% increase for Standard Commercial. We are watching our pricing trends very closely, given growing competitive pressure and diligently executing our pricing segmentation methodologies. Importantly, pricing continued to outpace loss cost trends.

Let me now drill down in each of our P&C Commercial businesses. We had another excellent quarter in Small Commercial, with an all-in combined ratio of 89.3. Last quarter, I noted that our top line momentum was building. Those trends continued this quarter, with policy retention improving to 84% and new business of $140 million for the quarter, up 12% over prior year. Equally impressive, our underlying combined ratio of 85.4 improved 2.2 points versus second quarter 2013. Our Small Commercial team is driving top line, written pricing gains and superior underwriting results. We could not be more pleased with our path forward.

Moving to Middle Market. I continue to be encouraged by our steady progress here, posting an underlying combined ratio of 95.1. Although this is essentially flat versus prior year, we are executing well in critical priorities. Renewal written pricing at 6% remained ahead of loss cost trends, and our underlying combined ratio in Middle Market worker's compensation is down nearly 5 points for the quarter versus last year. Offsetting these results was an increase in our property losses. We see nothing specific beyond these losses other than the normal volatility associated with the property line. Over the last several years, our team has done a great job of balancing our worker's compensation book with more writings in property and general liability. In fact, we're very excited to have just locked in a new property per risk reinsurance treaty that provides CAT capacity up to $500 million. This is a very important line of business in our strategy, and we expect to thoughtfully continue our property expansion. Commercial auto has been a more challenging line across the industry, including us as well. Our Middle Market written pricing in this line is in the high single-digits, as we continue to address loss cost trends. Our retentions have remained quite strong, despite the rate increases, indicating to us that the overall market is also raising rates.

Middle Market premium was up 3% in the quarter, primarily driven by improved retention. New business of $112 million was down slightly from last year, with a well-balanced product mix. Pricing and underwriting actions remained disciplined and the rate adequacy of our Middle Market book is significantly improved from prior years.

Turning to Specialty Commercial. National accounts delivered another strong quarter of written premium growth, up 7% versus last year. We continue to believe that available new business in the market is down slightly from 2013, but we're still seeing opportunities to write new accounts. Our retention rates continue to exceed 90%. The repositioning of our programs business remains on track as is progress in our Financial Products business as well.

Shifting over to consumer. We experienced elevated property losses in the second quarter, posting an all-in combined ratio of 106.3. Excluding CATs in prior year development, the underlying combined ratio was

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89.6, up 0.7 points from a year ago. Like others in the industry, weather adversely affected both auto and homeowners results on a CAT and ex-CAT basis. The largest CAT event in the quarter was a string of May hailstorms that crossed 11 states from Montana to South Carolina, accounting for nearly 1/3 of our CAT losses.

Outside of CATs and weather, we experienced higher fire losses in the quarter versus last year, contributing 4 points to the underlying homeowners combined ratio. At this point, we don't see an unusual pattern developing with respect to fire losses, other than the usual volatility associated with this peril. Top line momentum continued with 4% written premium growth, driven in part by auto new business production, particularly strong in both agency channels. Premium retention was flat for auto and homeowners and a solid result given continued written pricing gains of 5 and 8 points, respectively. Perhaps most noteworthy was our auto PIF growth of 1% in the quarter, a direct result of more precise pricing segmentation and service delivery improvements.

Our expense ratio decreased this quarter to 23.2. This is due to the timing of technology and marketing spend, which is weighted more to the back half of the year. We expect our full year expense ratio to be comparable to the 23.8 we reported in the first quarter.

Now let's move to Group Benefits. This was another strong quarter for Group Benefits with core earnings of $52 million, up 41% from last year. Profit improvement this quarter is driven largely by the life and AD&D lines, where we benefited from favorable life mortality. Disability trends were slightly elevated in the quarter yet remain favorable year-to-date through June.

For the quarter, long-term disability incident trends continue to be favorable, offset by lower recoveries versus a year ago, resulting in a slightly higher disability loss ratio. We continue to see favorable effects of our underwriting, pricing and claims management initiatives reflected in the achieved margin improvement across our employer group life and disability block. The rate of improvement has been significant in recent years, and we will remain disciplined with these operating leverage.

Looking at the top line. Fully insured ongoing premium declined 7% compared to prior year. As we've noted previously, the decrease is primarily attributed to our exit of an agreement with a third-party targeting sales through financial institutions. Excluding the premium from this arrangement, our top line is down about 1% to prior year. Overall book persistency on our group life and disability business exceeded 90% through June, which is up over 10 points from 2013. We are very pleased with our renewal block and the overall persistency rebound versus 2012 and 2013.

Industry data indicates that new sales are trending down slightly. Our sense is that in early 2014, large case customers have taken a tempered approach to moving their business, particularly as they sort through the dynamics of the Affordable Care Act and the trend to our more employee-direct benefit options. We believe this may have been a factor in our own strong book persistency, and contributed to our lower quarter-over-quarter fully insured ongoing sales of $45 million. We continue to actively quote business and we believe that we're competing effectively for new accounts, leveraging our expanding service and claim capabilities.

In closing, this is a solid quarter for us across P&C and Group Benefits. While P&C Commercial competition continues to grow, I would still characterize the environment as rational. Our aggressive and disciplined actions in Standard Commercial over the last 3 years have us in strong position to compete moving forward. And we continue to make the people and technology investments that will be necessary to succeed in the years ahead.

Now let me turn the call over to Beth Bombara.

Beth A. Bombara
Chief Financial Officer and Executive Vice President

Thank you, Doug. Last evening, we reported second quarter core earnings of $144 million or $0.31 per diluted share. Second quarter results included $178 million after tax or $0.38 per diluted share of unfavorable items. The largest item was $164 million after tax of A&E unfavorable prior year development, consisting of $146 million for the annual asbestos reserve study and $18 million for environmental. Aside

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from these 2 annual studies, unfavorable prior year development was not material, totaling $10 million before tax, of which $7 million was for accretion of discount on worker's compensation reserves.

During the quarter, current year catastrophes totaled $127 million after tax, slightly above our outlook. There were 13 named catastrophes with winds and hail being the highest cost perils this quarter. The net loss for the quarter was $467 million or $1 per diluted share compared with the net loss of $190 million or $0.39 per diluted share in the second quarter of 2013. The largest contributor to the net loss for the quarter was the loss in discontinued operations due to the Japan annuity sale, which totaled $617 million after tax.

P&C, Group Benefits and Mutual Funds generated core earnings of $113 million, down from $197 million in second quarter 2013, primarily due to the A&E prior year development.

As you know, we complete the annual asbestos and environmental studies in the second quarter. Environmental reserve development totaled $27 million before tax in part due to increased cleanup cost on a few water waste sites. The $212 million before tax increase in the asbestos reserve primarily arises from a small number of insured. For those insured, a higher-than-expected frequency and severity of mesothelioma claims drove the reserve increase. We continue to proactively pursue legislative and legal remedies to manage these claim cost, including transparency around the various asbestos bankruptcy trusts. Mutual Funds core earnings rose 5% over the prior year, due to higher fees resulting from increased assets under management. Performance remains solid with 76% of funds outperforming their peers over the last 5 years.

We continued to see sales momentum, up 5% in total, and up 38% of our equity funds, while redemptions also declined. However, net flows were slightly negative due to our previously announced decision to liquidate target date funds, which had $709 million in assets under management. Excluding that liquidation, net flows were positive by about $300 million. Talcott's core earnings for the quarter were $101 million, which was above our outlook, principally due to higher investment income, including limited partnerships. The risk of our U.S. VA book continued to decline. With U.S. equity markets up 5% in the quarter, 95% of the GMWB contracts are out of the money.

We continue to pursue various policyholder programs to reduce the size and risk of the Talcott books of business. In addition to the ISV program for U.S. retail fixed annuities that was launched in the first quarter, during the second quarter, we rolled out a second Enhanced Surrender Value program for certain of our lifetime benefit contracts. With the impact of these programs and surrender activity, fixed annuity accounts decreased by 7% and variable annuity contracts decreased by 3% during the quarter.

Turning to investment income. The general account is producing solid investment returns with modest impairment. We have a highly diversified portfolio with investments in a broad array of asset classes. Our overall credit risk profile is not materially different from a year ago. Yields have held up relatively well despite the low interest rate environment, without increasing credit risk or portfolio duration. The decline in total investment income from the prior year quarter was principally due to lower assets as a result of the runoff of Talcott and lower limited partnership income. Excluding limited partnership return, the annualized portfolio yield in the quarter was 4.1%, down approximately 10 basis points from a year ago. Low interest rates and tight credit spreads remain a challenge. We will continue to evaluate opportunities to enhance returns by leveraging our investment capabilities without compromising portfolio quality. For instance, in the second quarter, we achieved a reinvestment rate of 3.8%, aided by attractive opportunities in private placement securities and commercial mortgage loans, where we could maintain credit quality in yield by capturing liquidity premium. The Hartford's book value per diluted share, excluding AOCI at June 30, 2014, was $39.21, down slightly from year end, but up 2% from June 30, 2013. The growth in book value per share over the last year was due to the positive impact of net income and share repurchases over the last 12 months, which were partially offset by shareholder dividends. During the second quarter, we repurchased 10.2 million common shares for $351 million at an average price of $34.53 per share.

For the 12 months ended June 30, 2014, our core earnings ROE was 7.8% compared with 6.1% at June 30, 2013. I would like to point out that core earnings ROEs for all periods presented have been recast

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to reflect Japan earnings as a discontinued operation, which has the effect of reducing our core earnings ROEs.

Looking forward, we would expect our full year 2015 core ROE to improve to the low 9% level, after giving effect to the full execution of our capital management plans, as well as continued profitable growth in P&C, Group Benefits and Mutual Funds.

On July 1, we announced the closing of the sale of the Japan annuity business for cash proceeds of $963 million. As a result of the additional financial flexibility and risk reduction provided by this sale, our capital management plan for 2014 and 2015 has been increased by $1.275 billion to a total of almost $4 billion. And in addition, we increased our common dividend by 20%. The combination of the capital benefit from the sale, improved cash flow generation from Talcott, and strong earnings power from P&C, Group Benefits and Mutual Funds, enables us to execute this plan and will contribute to future ROE improvement. The $1.275 billion increase is comprised of 2 pieces. First, a $775 million increase in equity repurchases, including a $525 million accelerated share repurchase plan or ASR, that was executed yesterday and will be completed by year end. Second, we allocated $500 million for additional debt reduction, including associated premiums and transaction expenses, which also will be completed this year.

With the expansion of the share repurchase plan, beyond the portion being used for the ASR, we expect that equity repurchases will be about $300 million a quarter. Actual repurchases will, of course, depend on market conditions and other factors that may impact market access and timing. In the third quarter through July 29, we have purchased approximately 3.9 million shares for $140 million. Yesterday, we also declared a quarterly dividend of $0.18 per common share, up 20% from the $0.15 that we began paying in mid-2013, and the third increase in 3 years.

Before turning to your questions, let me provide a brief summary of our third quarter outlook. Our core earnings outlook for the third quarter of 2014 is $335 million to $355 million or $0.74 to $0.79 per diluted share, assuming $452 million shares outstanding. Talcott earnings are projected at $75 million to $85 million. This outlook assumes catastrophe losses of $87 million after tax, which is equivalent to about 5.2 points on a combined ratio. This outlook is about a 15% increase in core earnings per share after adjusting third quarter 2013 for items that included a favorable $55 million corporate settlement, cash below budget and prior year development. To wrap up, the second quarter was another quarter of significant progress. Despite challenging catastrophe and non-CAT weather conditions, underlying performance in P&C, Group Benefits and Mutual Funds continued to improve, and Talcott made a significant leap forward in reducing the size and risk of its portfolio with the sale of Japan. We remain focused on achieving greater operating efficiency and effectiveness. And the combination with these accomplishments and our expanded capital management plans, we are on the right path to achieving book value growth and higher core earnings ROEs, which will continue to create shareholder value. And we'll now turn the call over to Sabra to begin the Q&A session.

Sabra R. Purtill
Senior Vice President of Investor Relations
Thank you, Beth. Laurel, could you please repeat the Q&A instructions? [Operator Instructions]

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Question and Answer

Operator

[Operator Instructions] Your first question comes from the line of Jay Cohen with Bank of America.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

A couple of questions, maybe first, a big picture question for Chris. As you look out a couple of years, Chris, is there some ROE range that you think the company can achieve if you're looking out to '16 or '17?

Christopher John Swift
Chairman & CEO

Jay, I think Beth tried to describe what we see in the near term through '15 with our announced capital management plans and where we see the momentum of the go-forward business is. When you get in the '16, '17, we previously -- continue to believe we can expand ROE in those years as we continue to grow and manage capital accretively, but probably not at the rate of pace that we see through -- now through the end of '15. So we still believe we're in that 30 to 40, 50-basis-point continual improvement through those years at this point in time. But as you know, when you get further out, Jay, a lot of dynamics in the economics of the P&C cycle and the businesses, but we're still confident that we're going to be able to expand beyond where we see 2015 currently.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Got it. That's helpful, Chris. And second question, maybe for Doug. In the Consumer Markets business, you highlight a certain elevated level of non-CAT weather and fire losses. I'm wondering if you can discuss those losses relative to a normal quarter? How much above typical were those losses?

Douglas G. Elliot
President

Jay, it's Doug. Couple of thoughts, you have our detail inside the supplementals. You know that our core accident year, essentially quarter-over-quarter was up 2 points. And that was due to non-CAT, both weather and fire. I would also describe that 2-point change as roughly above normal as well. So I think I would use a couple of points as the answer on both accounts.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

I guess I was talking just about the Consumer business. Did I say Commercial? I meant Consumer, if I...

Douglas G. Elliot
President

Did I say Commercial? I was talking Consumer.

Operator

Your next question comes from the line of Vincent DeAugustino with KBW.

Vincent M. DeAugustino
Keefe, Bruyette, & Woods, Inc., Research Division

To start, asbestos is something that we generally can sometimes look through, and so I don't want to get too hung up on it. But we've seen a number of asbestos retro deals, particularly with births [ph] around industry. And I'm just curious if this is something that you'd consider doing and then along with that, how

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dilutive something like that might actually be relative to the downside on policy limits, sort of as a worst case scenario?

Christopher John Swift
Chairman & CEO

Vincent, I think we're very aware of the third-party solutions that are out there and available in the marketplace. And with that said, where we are today is we haven't found anything that we think is economical for us at this point, and believe really managing these liabilities off ourselves is the optimum strategy. I think also you need to consider that these are really complex claim matters and again, we feel best suited with the expertise that we've built longer -- in a long period of time with John Kinney and his outstanding claims team. And it's really in our best interest to manage our own claims also during this period of time. So you put the economics, you put our claim handling and expertise available, and that's where our current thinking is.

Vincent M. DeAugustino
Keefe, Bruyette, & Woods, Inc., Research Division

Okay, good. And then just for a quick follow-up. On the product development side, and with a lot of the defensive work here being a complete to many of Liam's earlier points. I get the sense that there's been an incremental step-up, sort of if we can call it your offense strategy here in 2014. I was hoping to maybe get a preview of any of the new products or distribution opportunities that you might have here on the radar with the new leadership structure.

Christopher John Swift
Chairman & CEO

Vincent, I'll just give you a perspective and I know Doug will want to share his view. So I think you're specifically referring to Ray Sprague joining my leadership team as the head of Strategy and Business Development. And he's got a broad mandate, and the broad mandate is obviously to accelerate our growth and our capabilities and Doug and I, when we talk, and we talk in terms of product, we talk in terms of distribution, we talk in terms of geographic presence. So Ray's got a great track record in being very innovative, creative in the Small Commercial area. So Doug and I want to leverage that capabilities across a broader platform. Doug, what color would you...

Douglas G. Elliot
President

Maybe a few more ideas Vincent on top of Chris that I will share with you. In the second quarter, we did announce a new partnership with AARP in the Small Commercial space, so that will be a growing opportunity we look after and work at. Secondly, as we've commented previously, we have a number of initiatives in our Group Benefits space. We rolled out a critical illness product in the second quarter and still working on other products as we move through '14 and to '15. And lastly, and I know we've shared quite a bit of this with you, our journey to round out our Middle Market workers comp book continues. We feel very good about progress in the property and general liability area. But as noted now, new upside structure relative to reinsurance capacity and property, I think allows us to continue to expand. So a lot of work in the product development area across all these businesses.

Operator

Your next question comes from the line of Erik Bass with Citigroup.

Erik James Bass
Citigroup Inc, Research Division

It's a question for Doug. In commercial lines, as you highlighted, you continue to get rate above your loss cost trends. Just based on what you're seeing in both the industry pricing trend, as well as Hartford's specific dynamics, how much longer do you think that this can continue? Maybe what are you doing that's enabling you to outperform the industry?

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Douglas G. Elliot
President

Erik, maybe few thoughts for you. First thing I would say is, as we look out 90-plus days. We don't see something dramatic occurring that will have a dramatic shift or impact on the trend line. So I could be wrong, but as I think out and I look at what we're trying to accomplish third quarter beyond, our behavior's going to be very consistent. That's our attempt. Secondly, I'll remind you and others that as we think about margin improvement, and we're constantly thinking about that, there are other levers that we're constantly working. So we're working underwriting, nonrenewal renewal strategies, we have a number of initiatives in our claims area. And so we're working on a number of areas, not just pricing against loss trend, and we feel good about what we've accomplished to date. I know that I've referenced our work in the auto area, it's not a line where we're pleased with the overall performance today. It is getting additional attention. I talked to you about our rate gains in the second quarter. Those gains will continue. That's our intent into quarters 3 and 4 and beyond. So a lot of work going on, and I'm bullish that what we've accomplished so far will be the beginning of a really good path forward.

Erik James Bass
Citigroup Inc, Research Division

If I can ask quickly on Group Benefits, where do you think the margins can get to over time? And is it achievable to get back to kind of the 7% range where you were in 2007, 2008?

Christopher John Swift
Chairman & CEO

Erik, it's Chris. In my prepared remarks, we talked in terms of 5.5 on a sustainable basis. So I would temper your expectations a little bit on 7%.

Erik James Bass
Citigroup Inc, Research Division

Got it. And what does that translate into an ROE?

Christopher John Swift
Chairman & CEO

I would say again, with the statutory capital and the GAAP capital that we hold against that businesses, we think we could operate in the low double-digits and try to grow it from there.

Operator

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

Jay H. Gelb
Barclays PLC, Research Division

Chris, with regard to the -- or Beth, with regard to the ROE outlook, I'm thinking that since the life business has the greater portion of the common equity of The Hartford ex AOCI than P&C, but P&C delivers the lion's share of the earnings that it might make sense to explore every avenue to continue to shrink that, the runoff life business, including the U.S. variable annuity. I know you mentioned, you prefer to keep that in-house, but perhaps you could expand your thoughts on that.

Christopher John Swift
Chairman & CEO

Jay, it's Chris. Let me just take the strategy point and then Beth will talk about the ROE implications and the allocation of capital. I think if you think about it, where we're at right now, now that we've sold Japan, we're really left just with a U.S. platform. You've always heard us talk about that we think that risk is -- we understand it very well. It's been managed historically very well. We know how to hedge it. We make about $300 million a year on that VA line of business. Our hedge costs are low, obviously, at these new market levels, including our macro program. So that we really are positioning Talcott as a steady capital

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provider to the holding company in years to come. And then we'd like to use that capital again to redeploy into higher accretive purposes. So that's sort of a simple model. But I always did say we're always aware of, I'll call it, options out there as a potential tool. But what we see right now for the next -- a couple of years at least, is what we'd like. So Beth, would you share your comment?

Beth A. Bombara
Chief Financial Officer and Executive Vice President

Thank you, Chris. And I'll echo a lot of Chris's comments on that, as we sit here day and look at not only just the GAAP earnings generation that comes from the Talcott businesses, but with the elimination of Japan and the reduced volatility from our statutory results, we really do see ourselves on a path of being able to rely more consistently on taking dividends out of the life entities. And all of that obviously, over time, will play into the ROE equation. And it is a balancing act between increasing that ROE, maybe initially and long term, what we think the economics are of this business and provides us with greater, I think, capital flexibility for the long term. But at Chris said, we're always mindful that there are other opportunities to accelerate that, but that's kind of the equation that we go back and forth in our minds with.

Jay H. Gelb
Barclays PLC, Research Division

That's helpful. And then for the low-9% return equity outlook for 2015, does that assume continued underlying margin expansion in the Property & Casualty business?

Beth A. Bombara
Chief Financial Officer and Executive Vice President

Yes, that includes our thoughts going into '15 of the margin expansion that we see in our businesses, as well as the full execution of the current capital management plan that we have.

Operator

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

Randolph Binner
FBR Capital Markets & Co., Research Division

I want to go back to asbestos, I'm afraid. I know that there's been issues across the industry, but it's still -- it's a lot of money to lose there opposed to -- for what's supposed to be a decaying liability. And I guess, I want to get a better sense you can provide us with what's going on? I get that it's peripheral defendants by mostly mesothelioma claims, but are you losing at trial? Are you settling more? Are you just spending more on claims and defense costs? I'd like to kind of understand better what's going on. And with a hope to kind of get a sense, objectively, at least, of when we think this might trail off.

Christopher John Swift
Chairman & CEO

Randy, it's Chris. Beth's prepared to give you more insights. But just from my chair and observing this over a little bit of time, you're not going to like this, but there's really nothing new here. I mean, this is still a handful of our accounts. There's nothing new that's sort of bubbling up. When you have, I'll call it, sort of elevated frequency in our accounts and you extend that out over a longer period of time when our model predicts, you can have a relatively large movement in our loss reserves. But Beth will give you a little bit more of the details on what's going on. But the key point here is there's nothing new that we're managing or that we're getting exposed to. It's more of the same.

Beth A. Bombara
Chief Financial Officer and Executive Vice President

Yes, Chris, I would agree with that. And again as we said, if you think about the charge that we took, the $212 million pretax, think about roughly 2/3 of that coming from the experience that we're seeing with

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a small number and you said all the right words, peripheral insureds, where we're seeing an increase in meso claims. And we would have expected to see a decrease. And given the severity that comes with meso claims, and we extrapolate that out through our models, we get the increase that you saw -- that we recorded this quarter. The medical science continues to point to the fact that we should start to see a decrease in these claims. And depending on what activity affects our insureds and the type of coverage that we provided to those specific insureds that see these increases, this is the result that we see. But as Chris said, it's not really anything new. It's just how that activity is affecting our insureds and how it runs through our models where we extrapolate over many, many years.

Randolph Binner
FBR Capital Markets & Co., Research Division

No, that's helpful. So I mean these are legitimate meso claims. These is not the -- the expansion of liability is more to the peripheral of the defendants but the actual claim is legit, and so you're just having to post more to settle more, basically.

Beth A. Bombara
Chief Financial Officer and Executive Vice President

Yes, exactly. This is not like what we saw years and years ago, whereas people who were claiming that they were affected but they had no manifestation of an actual disease.

Operator

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

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

A couple of quick questions on the quarter. Doug, you mentioned, I believe in your prepared remarks an expectation for the Consumer Markets expense ratio for the remainder of this year. I was wondering if you could give us any help on your expectations on the Commercial side for the expense ratio as well.

Douglas G. Elliot
President

John, let me frame that. There aren't any variations that I think affect your model. And Chris, I can't think of anything relative to run rate that are either front loaded, back loaded, or has some seasonality to it. So John, I think what you've seen is a good indication of where we are, and I think you can move forward from there.

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

Okay, very helpful. Then on the new Enhanced Surrender program, can you just give us a little bit of color on what you're expecting there? How much account value or number of contracts you're targeting? Should we think about the cost benefit analysis there as being pretty similar to the most recent surrender program on the VA side?

Beth A. Bombara
Chief Financial Officer and Executive Vice President

Yes, sure, this is Beth, I'll take that. So again, there's 2 programs. There is, we refer to as the ISV, which is focused on a fixed annuity block, and it's about 4 billion to 5 billion of account value that we are making this offer to. And our expectations on that is that we would see about a 15% take rate. On the ESV program, it's similar to the program that we did last year with some modifications. And again, it is targeted at our variable annuity book and a specific tranche of about $6 billion of account value. And we're assuming there that we'll probably see about a 15% take rate as well. That's down from what we saw with our first program. But we think given the fact that this program -- the offers are a little bit less than before, and we've also been out to this group of policyholders with our first offer so we expect the rate to

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be a little bit less. And when we put the combination of both programs together and at those take rates, we'd expect to see about $150 million-ish of capital benefit when we look at sort of our stress scenario capital.

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

And that $150 million is both of them put together?

Beth A. Bombara
Chief Financial Officer and Executive Vice President

Both of them put together, yes.

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

Got it, okay. And then just one final quick question. So I think you ended the quarter with about $1.3 billion of cash and short-term securities at the parent. Can you just sort of roll us forward, because here in a few days, or maybe in the month of July, a lot of things happened, right? You brought in the cash proceeds from the Japan annuity sale, you've done a decent amount of buybacks, including the ASR. So on a pro forma basis at the end of July, would it be correct to just sort of take those couple of things into account and roll it forward, or is there anything else more significant?

Beth A. Bombara
Chief Financial Officer and Executive Vice President

That would be the most significant item. The only other item that we did, and it's really a timing item more than anything else, is we did accelerate some of the dividends that we'd normally take out of the P&C legal entities. So if you read our Q, you'll see that in there. And that was about $500 million or so. And that really was just an acceleration of what we normally would have done over the third, fourth and first quarter on the remaining of this year and into next year. It's not an indication that overall, we plan to be taking more of the P&C company going forward.

Operator

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

Thomas George Gallagher
Crédit Suisse AG, Research Division

Just wanted to focus on what you've announced for the capital, planned the update in the capital plan. Now that Japan is behind you, should we expect that there's going to be another phase of capital return for 2015 related to risk buffer and U.S. Talcott? And if so, when do you think we'd get an update on that? Or finally, is that more -- it's something that we should be thinking about more for 2016 and not 2015?

Christopher John Swift
Chairman & CEO

It's Chris. Beth will provide some commentary too. So I think you might know this, right? We just announced what we want to do for the rest of '15. So we're going to start getting after that. I think the accelerated plan demonstrates our commitment to really deploy our excess capital in what we think is the most accretive ways. And we'll look -- we're always going to continue to look at the balance sheet, all the combinations of factors in our operating companies, our holding companies, and always challenge ourselves to being as efficient as possible with our capital. So Beth, would you provide any additional color?

Beth A. Bombara
Chief Financial Officer and Executive Vice President

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Yes, and I think Chris, that summarizes it very well. Again, when you look at the plan that we have announced, a significant amount of both equity repurchases and debt repayments that we'll be dealing for the remainder of '14 and going into '15. And I think we've demonstrated that as we look at our overall capital position and look to manage our Talcott entities at appropriate levels, that to the extent that we were to make any changes of that in the future, we obviously would share that with you. But I would not be expecting some sort of big change coming in the short term as it relates to our capital management plan. But I think more importantly, if I just could add, what we really are focused on is looking at what the statutory capital generation is in the Talcott entities and getting ourselves in a place where we can rely on a predictable stream of cash flows coming out of those entities over time.

Thomas George Gallagher
Crédit Suisse AG, Research Division

And just -- Beth, just a follow-up on that. Does the plan that you just announced contemplate utilizing U.S. Talcott dividends?

Beth A. Bombara
Chief Financial Officer and Executive Vice President

So our current plan does anticipate, kind of consistent with where we've talked about before, $250 million, $300 million of dividend, so that is contemplated in the current plan and to some extent, a portion of that was contemplated in the previous plans.

Thomas George Gallagher
Crédit Suisse AG, Research Division

You said $250 million to $300 million?

Beth A. Bombara
Chief Financial Officer and Executive Vice President

Yes.

Thomas George Gallagher
Crédit Suisse AG, Research Division

Okay. And just the last question. The $500 million additional debt reduction, can you just bring us up to speed in terms of how far out does that get you? And how should we be thinking about what maturities that takes care of? I believe that actually gets you through more than 2016 maturities, if I'm doing the math correctly, and it would get you out until 2017. Or am I not thinking about that correctly? Is there -- are you more thinking about doing early retirement of some of these maturities?

Beth A. Bombara
Chief Financial Officer and Executive Vice President

Yes, so a couple of things. So first of all, with the plan that we had announced earlier this year, as you may recall, we had indicated that we were targeting 2 of the maturities that we have in 2015, which is about $456 million. And so those will come to the normal course. The $500 million that we've allocated for debt repayment for the remainder of this year, we don't have another maturity that would happen in the third or fourth quarter of '14. So we will be looking at either calling a tranche of debt or a tender. But that would be an acceleration. We don't have a maturity that lines up with that.

Sabra R. Purtill
Senior Vice President of Investor Relations

Laurel, we have time for one more question please?

Operator

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

Brian Robert Meredith

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UBS Investment Bank, Research Division

Two quick questions here. First one, Doug, you mentioned elevated property losses in the Middle Market commercial lines space. What would that add to the underlying combined ratio in the quarter, kind of relative with what's normalized?

Douglas G. Elliot
President

So we share the underlying and the Middle Market overall combined ratio side. I'd point you there in our supplement. I would characterize the losses as primarily fire, a couple of larger losses in our property book and we also have one in our inland marine book. So somewhat outsized but not -- we don't take enormous retentions. Our retentions are normally under $10 million and so they did cause a little bit of blip in our Middle category.

Brian Robert Meredith
UBS Investment Bank, Research Division

Can you quantify what the kind of -- was it 1 point, 2 points in the underlying?

Douglas G. Elliot
President

There's so much seasonality. I will give you a sense. Our core, as I think about second quarter, non-weather losses over the last 3 or 4 years were higher than the norm by a couple of points overall. So it's not -- certainly not 10 points in the book, right? It's 2 to 3 points. They're having quarters that have had that kind of activity. But relative to 2013, we're a little outsized.

Brian Robert Meredith
UBS Investment Bank, Research Division

Next question for you Doug. Just curious, now that you're going be running the Consumer business, any changes that you anticipate making and specifically focused on your other agency business that continues to kind of contract here?

Douglas G. Elliot
President

So this is 2 days in. No changes planned. We have a terrific franchise with AARP and obviously, you know that I've been deep in the agency space on the Commercial side for the last 25 years. So excited about what we will be doing there, what we're doing there currently today. Just a lot of work in front of me and looking forward with Ray to working with his team. So more to come as we talk forward.

Sabra R. Purtill
Senior Vice President of Investor Relations

Thank you, Brian. We'd like to thank all of you for joining us today and for your interest in The Hartford. If anyone has any follow-up questions, please feel free to contact either Sean or myself by phone or e-mail. Thank you, and have a good afternoon.

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

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