S&P Global
Market Intelligence

The Hartford Financial Services Group, Inc. NYSE:HIG

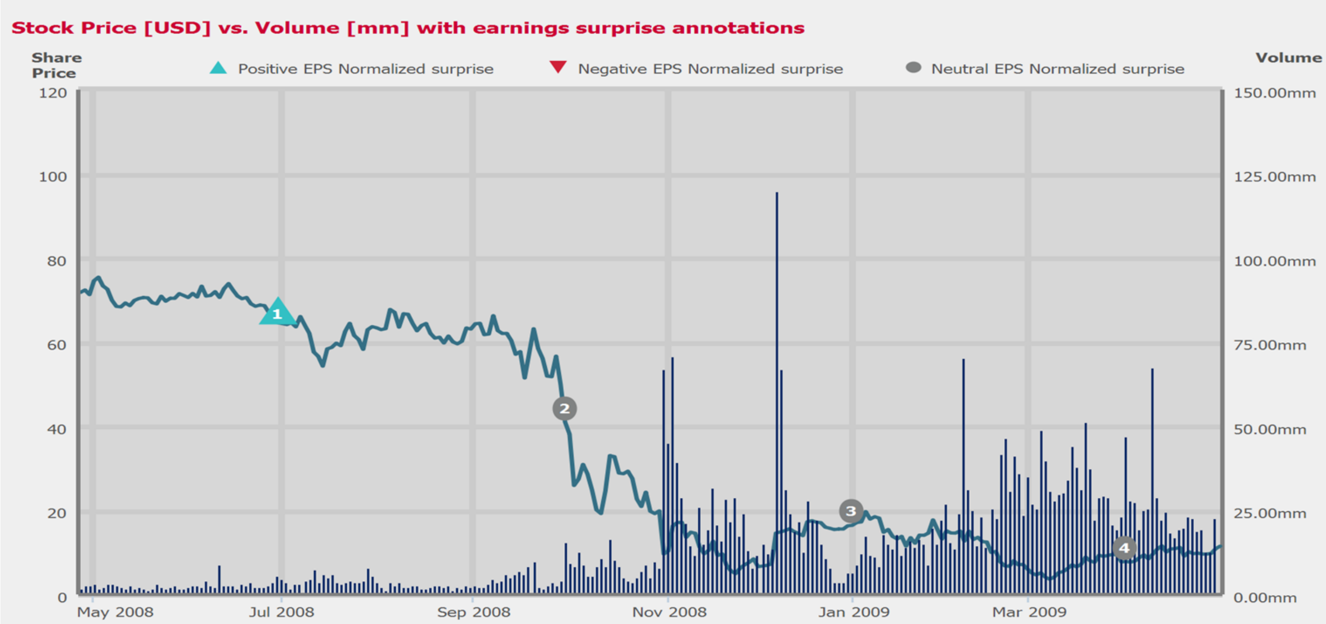
FQ2 2009 Earnings Call Transcripts

Thursday, July 30, 2009 12:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ2 2009-			-FQ3 2009-	-FY 2009-	-FY 2010-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	1.16	1.90	▲63.79	0.97	(0.24)	4.09
Revenue (mm)	-	7637.00	-	-	22774.00	24200.00

Currency: USD
Consensus as of Jul-30-2009 12:43 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ2 2008	2.10	2.22	▲5.71 %
FQ3 2008	(1.45)	(1.40)	NM
FQ4 2008	1.30	(0.72)	NM
FQ1 2009	(3.14)	(3.66)	NM

Table of Contents

Call Participants

EXECUTIVES

John Walters

Juan Andrade

Liz Zlatkus

Ramani Ayer

Rick Costello

ANALYSTS

Darin Arita
Deutsche Bank

Eric Berg
Barclays Capital

Ian Gutterman
Adage Capital

John Hall
Wells Fargo Securities

John Nadel
Sterne Agee

Josh Shanker
Citi

Larry Greenberg
Langen McAlenney

Mark Finkelstein
Fox-Pitt Kelton

Randy Binner
FBR Capital Markets

Presentation

Operator

At this time, I would like to welcome everyone to The Hartford Second Quarter 2009 Earnings Conference Call. (Operator Instructions).

I would now like to turn the call over to Mr. Rick Costello, Senior Vice President of Investor Relations. Sir, you may begin your conference.

Rick Costello

Good morning and thank you for joining us for today's second quarter 2009 financial results conference call. As you know, our earnings release, 10-Q and financial supplement were issued yesterday. To help you follow our discussion, a slide presentation is available on our website, at thehartford.com.

Ramani Ayer, Chairman and CEO; and Liz Zlatkus, CFO, will provide prepared remarks this morning and we will conclude with a Q&A session. Also participating on today's call are Juan Andrade, President and COO of our P&C company; Greg McGreevey, Chief Investment Officer; John Walters, President and COO of our Life company; and Alan Kreczko, General Counsel.

Turning to the presentation on slide two, 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 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 quarterly reports on Form 10-Q, our 2008 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 second quarter of 2009, in the press release we issued yesterday and in the Investor Relations section of The Hartford's website, at www.thehartford.com.

Please turn to slide three, and I will hand the call over to The Hartford's Chairman and CEO, Ramani Ayer.

Ramani Ayer

This past quarter was a critical one for The Hartford. We took a number of significant actions to set the company on the right path to deliver value for our shareholders.

On the first quarter call, I told you that we were considering a number of actions relating to The Hartford's strategic direction. Now that those considerations have been completed and our strategic direction affirmed, I want to begin this morning with a brief overview of The Hartford's strategic path. Then we will cover our second quarter results and look at some important metrics that point to our being on the right track.

As we said last quarter, The Hartford's Board of Directors working with management conducted a comprehensive strategic review of the company's business operations. The overriding goal throughout the process was to enhance shareholder value, while preserving our commitments to policyholders.

By the end of the process, it had become clear that the best way to deliver long-term value as an organization was to return to our historical strengths as a US-focused insurance and financial services company.

We're confident in the opportunities in front of us. We're going to focus on our strong portfolio of protection businesses, primarily property and casualty, group benefits and life insurance. We're also going to continue to invest in our strong wealth management and retirement businesses, including retirement plans, mutual funds and a restructured US annuities business.

Our intent is to drive profitable growth from three key areas of opportunity; protecting individuals and families, protecting businesses and their employees; and managing wealth and retirement.

First, protecting individuals and families through personal insurance and individual life insurance. With our 25-year history with AARP and our network of more than 8,000 independent agents, we are well positioned to continue to grow in automobile and homeowners insurance. In addition, we are seeing signs of success with our efforts to deliver our AARP product through the independent agent channel. The results from our four-state pilot have been better than expected and we will be adding 16 more states by yearend, giving us a 20-state presence accounting for two thirds of our agents.

In individual life insurance, we have a broad portfolio of competitive products and are number three in variable universal life and number one in life insurance sales through banks, financial institutions and stockbrokers.

Across the industry, life insurance sales are down significantly from 2008. The challenge for The Hartford was compounded in the first part of 2009 by uncertainty about our ratings. Going forward, with our strengthened capital position, we are trying to win back some of those lost sales. We'll continue to expand in the independent distribution space, to drive our strong point-of-sale franchise through advisers and to differentiate with our award winning service platform.

Our second area of opportunity is protecting American businesses and their employees through business insurance and group benefits. Business insurance is core to The Hartford. We have been investing in our product offerings and have industry-leading underwriting capabilities. Our distribution network, including more than 7,500 appointed agencies, has shown remarkable resilience over the past three quarters. Our agents have steadfastly remained loyal to The Hartford.

Now that the future direction of the company is clear, our agents just want to get back to business and so do we. In small commercial, our Spectrum small-business owners' policy is the most comprehensive for its value in the industry and we'll continue to compete aggressively in the small business market. In middle market, we're investing in product development to broaden our risk appetite and accelerate our underwriting process to improve productivity for our agents.

The Hartford's group benefits business is a leader in providing life and disability products and services for employers, ranking number two in disability premium and number three in group life insurance premium. We will be looking to grow in group benefits where we have significant competitive advantages, including innovative claims management and outstanding service capabilities.

The third opportunity is managing wealth and retirement with retirement income protection products designed for today's market. There is an important need for wealth and retirement solutions and consumers remain interested in products that help them accumulate money for retirement and give them steady income they can rely on.

On the wealth management front, we plan to continue to grow in retirement plans and mutual funds. We expect to generate operational efficiencies in retirement plans through the integration of our acquisitions and to focus on the small and mid cased retirement plan markets.

Through this market turmoil, our mutual funds have continued to see solid deposits, largely a credit to our ability to deliver strong, long-term performance, an experienced wholesaling force and broad distribution. We expect to drive significant growth in assets and earnings going forward.

On the annuity front, we will focus on simplicity and protection at a reasonable cost. We are planning to introduce a new variable annuity product in the fall of 2009. We will be providing more details as we get closer to launch. The product will provide growth and guaranteed income for policyholders without exposing The Hartford to the same degree of equity market risk. With our new strategic direction, we're focusing our efforts in those markets where we have the best tools to compete.

Now please turn to slide four to review a number of other important actions we have taken. In June, we finalized our $3.4 billion investment agreement with the US Treasury, fortifying our capital position. In April, we announced a number of important steps in the restructuring of our global VA business and we made a lot of progress during the second quarter.

The suspension of new business sales in Japan and the UK has gone smoothly. We have taken a number of actions to reduce the scope of our international lines and we will do more in the third quarter. We expect that by the end of this year we will have eliminated more than 50% of the January 1, 2009 expense base in our international operations.

In our property and casualty operations, we took a critical step earlier this month by naming Juan Andrade as our new President. Juan has played a key role in setting the strategy for the P&C business in recent years and ensuring the continued strong performance of our property and casualty operations during this recently challenging period.

Juan brings with him a great depth of industry expertise from both within and outside of The Hartford. He is the right leader for our organization and I know he will do a terrific job for the business.

We've also continued to cut costs. With equity market declines and a narrower strategic focus, we must sharply reduce our expense base. To that end, we have accelerated our cost savings efforts and are now targeting a goal of cutting $400 million across the enterprise in 2010 as compared to our 2008 expense base. In the life company, we are on track to cut the expense base by nearly $300 million or 18% of the 2008 levels by the end of '09.

Now let's turn to slide five to review our second quarter results. I want to start with book value where we saw strong sequential improvement. With significant spread tightening in the quarter on our investment holdings, book value per share jumped to $32.20, a 33% increase from the end of March. Net income was basically flat in the second quarter of 2009 as core earnings were slightly overtaken by net realized losses. We recorded a net loss of $15 million or $0.06 a share.

Core earnings of $622 million got a significant lift from improving equity markets in the second quarter with a $358 million DAC unlock benefit using a reversion to the mean estimation technique. Net realized losses were just over $350 million in the quarter, excluding our obligations to Allianz stemming from the closing of the US Treasury investment.

Now please turn to slide six to discuss our property and casualty results. Our property and casualty franchise demonstrated tremendous resilience in the second quarter. Despite strong economic headwinds and ratings concerns earlier in the year, our operational performance remains solid as evidenced by strong underwriting profitability and other key metrics.

Total net written premiums were $2.5 billion, a drop of about 5% from the second quarter of 2008. Similar to the first quarter of 2009, the recession continues to be the primary driver of the premium reduction as payrolls and exposure levels shrink.

Profitability, on the other hand, continued to be very good. The ex-cat current accident year combined ratio in ongoing operations for the second quarter was 90.4, an important measure of the value of The Hartford's underwriting discipline. Catastrophe losses at 5.8 points of earned premium were lighter than last year, but higher than we would typically expect in the second quarter. A number of multi-state wind and hail events hit particularly hard in personal lines in the quarter.

We again saw favorable prior year developments in our ongoing operations with $59 million of net reserve releases. Total reserves in ongoing operations continue to develop favorably.

In our other operations segment, we conducted our annual asbestos reserve study in the second quarter and we strengthened net reserves by $138 million. Increased severity and higher loss adjustment costs in certain smaller insureds was the largest driver of the adverse development.

Before we move to slide 7, I want to comment briefly on the market. The property and casualty industry remains very competitive. While we continue to see a deceleration in rate decreases in our commercial lines, a dramatic shift to higher rates is unlikely due to the impact of the recession. We believe that commercial lines rate declines will continue to moderate at a slow, but steady pace. Rates are already increasing in personal lines and we expect that to continue.

Going forward, even as rates begin to harden into next year, top-line growth will be challenged by the business environment. The economic downturn continues to drive increased shopping as agents and policyholders shop policies at renewal in an effort to reduce the cost of coverage. We have seen this also drive a decline in our average written premium as customers engineer their policies towards higher deductibles and lower limits.

Now please turn to slide seven to discuss some indications that our property and casualty franchise is intact and that we are effectively competing in the market. The second quarter can be separated in three periods. April was a continuation of the first quarter of 2009. In the middle of the quarter, a new challenge presented itself in the form of media speculation about The Hartford's future direction.

By the end of May, we had provided clarity on our strategic direction, and in June, we closed the US Treasury investment. Since this time, we have seen important signs of continued positive momentum across the property and casualty franchise.

In personal lines, written premium was up 2% driven primarily by a 3% increase in AARP. Auto policies in-force grew over 25,000 during the second quarter as our marketing efforts saw steady success.

Going forward with the economic downturn driving increased consumer shopping, we expect to see continued new business growth in the second quarter of 2009. Actually in the second quarter of 2009, new business was up 44% over the prior year.

Premium retention, which declined several points during 2008, remained stable in the 85% to 86% range during the second quarter of '09.

In small commercial, which saw a written premium decline of 5% in the second quarter, new business growth bottomed early in the quarter, then grew in May and June, as our future became clear. This trend has continued as July new business growth is on track to finish more than 20% higher than 2008.

Of course, the economy will remain a headwind. Small businesses are closing and fewer new businesses are being created. I'm pleased that we were able to increase policies in-force by almost 7000 in the second quarter in this economic environment.

Written premium declined 9% in the second quarter in middle market. At the same time, new business premium in our key accounts line, which is a subsegment in middle market, jumped to 27% in June, as we saw a significant increase in engagement among our agents and brokers. There was a similar trend in premium retention where the June level of 73% was nearly 6 points better than May.

For the second quarter, middle market policy retention was down year-over-year. We expect some of that to reverse over the second half of the year, but it is really important to understand that some of the decline in retention is attributable to maintaining our pricing discipline in a very competitive market.

In specialty commercial, we have stabilized our public company D&O business. We experienced ratings pressure in that line in the fourth quarter of 2008 and the first quarter of 2009, which contributed to a written premium decline of 16% for specialty commercial in the second quarter of '09.

In June, a number of HFP, Hartford Financial Product staff, left the company. We immediately put new management in place and we have been intently focused on retaining existing accounts. Although it's early, we have had a lot of successes and you will note that we have not changed our specialty commercial written premium guidance for full year '09.

Overall, we are pleased with the trajectory of our property and casualty business. The franchise is intact. We are receiving favorable feedback from our agents and brokers and we continue to deliver solid profitability.

Let's turn to our life operations on slide eight. Strong equity market performance was the key driver in the second quarter of 2009. Assets under management increased 6% sequentially, which drove higher fee income levels in our retirement plan, mutual funds and variable annuity businesses.

Core earnings in the second quarter of 2009 increased over the prior year quarter. This was primarily driven by the $358 million DAC unlock benefit. Core earnings, excluding the DAC unlock, increased 21% from the first quarter of '09, an indication that our results are beginning to stabilize.

Year-over-year profitability in our life operations remains challenged by the twin effects of lower equity markets, with the S&P down 28% from the end of the second quarter of '08 and an 11% year-over-year decline in pre-tax net investment income.

Margins have been compressed across the board. Looking forward, though, we expect that margins will begin to improve. Part of that will be driven by expense control.

As I mentioned earlier, the life management team has taken decisive action to bring the expense structure in line with our revised strategy. We estimate that by the end of '09, about $300 million or 18% of the '08 expense base run rate will have been eliminated. You will see some of the impact in the second half of the year with more lift coming in 2010.

Let's move to the segments. Our group benefits business was affected by the economic downturn, which led to lower payrolls. Fully insured premium dipped 2% from the prior year. We also saw an uptick in the GBD loss ratio to 76.5, up from 73.7 in the prior year quarter. Much of the loss ratio increase can be attributed to unfavorable disability claim development relating to the '08 incurral year. We also saw a continuation of higher group life mortality in the second quarter after years of favorable mortality in the middle of the decade, and we are taking appropriate action in response.

Looking ahead, the group benefits business will be a significant contributor to The Hartford's earnings. As net investment income begins to improve, we'd expect the core earnings run rate to average around $80 million a quarter through 2010 with variances, of course, for seasonality and loss volatility.

In individual life, we saw important signs of recovery in the second quarter. Sales increased 22% from the first quarter and we expect sales to grow through the balance of the year. Our distribution is intact and our sales office model gives us an important competitive advantage.

Along with group benefits, individual life is a core element of The Hartford's strategy to emphasize protection businesses. Our objective for Individual Life is to generate about $40 million a quarter in core earnings on average through 2010 assuming stable mortality. When you combine group benefits and individual life, it is almost $500 million in annual run rate core earnings that aren't highly correlated to equity markets.

The second quarter was challenging for the retirement plans business, but we remain confident about the future. Deposits declined to $1.8 billion in the second quarter as fewer plan sponsors moved plans and the size of the plans that did move was smaller due to equity market declines.

We also experienced net outflows for the quarter. Now this was driven by the surrender of two plans that we had expected for some time. One plan converted to self advised status and the economics of the other plan weren't close to our hurdle rate.

The future of the retirement plans business remains strong. The integration of our three 2008 acquisitions is on track. The recent equity market declines have delayed our ability to generate at scale returns in this line, so you should expect this segment to achieve scale ROAs in the low 20s in 2011 assuming normal equity market growth.

We had an excellent quarter in mutual funds with deposits exceeding $3 billion. The story was even better on a net flows basis. We swung from $500 million of net outflows in the first quarter of 2009 to net inflows of $1.1 billion in the second quarter. With improving performance in many of our funds, we expect to see strong deposits continue.

In US variable annuities, deposits were about $700 million in the second quarter, roughly even with the first quarter. We are guiding to $500 million to $750 million in deposits in the third quarter. Beyond that point, deposit levels will be a function of consumer and distributor acceptance of the new product.

Profitability in individual annuity for the second quarter of 2009 was elevated due to the DAC benefit. Excluding the benefit of the DAC unlock, margins remained compressed. Overtime, however, as negative returns and alternative investments moderate and we benefit from the expense cuts we have made, we would expect the individual annuity line to generate $85 million to $90 million a quarter in core earnings in 2010.

As I have indicated earlier, the process of suspending sales in Japan and the UK and downsizing our international operations is going well and we should be sized to service our in-force business economically by yearend. Absent a strong rally from here in global equity markets, we would expect our international operations to generate about $35 million in quarterly run rate core earnings going forward.

In summary, we saw important signs of stabilization in our life operations in the second quarter. As we have shown, the earnings power of the businesses remains strong. We are taking the right steps to target desirable markets and to right size the organization.

Please turn to slide nine. Slide nine illustrates the second quarter improvement we saw in credit spreads, which tightened across virtually all asset classes as the global appetite for risk began to return. This led to a $3.8 billion improvement in the fair value of our investment portfolio in the second quarter, backing out the $1.4 billion impact of the new impairment accounting rules.

At the end of June, we had a significant liquidity position with over $16 billion in cash, short-term investments and treasuries. As you know, we've built this liquidity over the past year due to volatile credit markets and as a buffer to protect against potential liquidity demands. Late last year, we did see demand for liquidity from GIC holders in our institutional solutions group.

However, we haven't seen increased lapse levels in any of our other spread-based businesses. Therefore, we are planning to reduce our liquidity position by about $5 billion by yearend. About $2 billion will go to fund previously disclosed GIC withdrawals. As for the balance, we intend to put about $500 million a month to work in fixed maturities through the end of the year, which will boost investment income going forward.

What that, I will turn the call over to Liz.

Liz Zlatkus

I will begin on slide 10 with an overview of our holding company capital at the end of the second quarter. We began the second quarter with $1.3 billion of on balance sheet capital resources and we ended the quarter with $3.6 billion. The major contribution during the quarter was a $3.4 billion in CPP proceeds.

The primary uses of holding company resources were a $500 million contribution to our life operations, the repayment of about $300 million in commercial paper and the contribution of about $200 million to the Federal Trust DRIP. When you take into account $2.4 billion in untapped capacity under our contingent capital and bank credit facilities, you can see that we ended the quarter with total resources of $6 billion.

Please turn to slide 11 for a review of our statutory capital generation in the second quarter. P&C's statutory surplus increased about $300 million to $6.4 billion. This increase was primarily driven by statutory operating income as net investment related impacts were minimal for the quarter.

In our life operations, we finished the second quarter with statutory surplus of $6.1 billion or a $500 million increase from the end of the first quarter. The improvement was driven by the $500 million capital contribution we made in late June. Investment related impacts were about $300 million and were roughly offset by operating income from our VA and other life businesses.

To give you more color on VA, strong global equity markets reduced our aggregate statutory liabilities by almost $2 billion. Hedge assets declined by essentially the same amount, driven by higher equity markets, higher interest rates, lower volatility levels resulting in minimal net impact from reserve changes in hedging.

Please turn to slide 12. Looking to yearend, we have the capital resources today to withstand both a sharp decline in the equity markets as well as a significant investment related capital impacts over the balance of 2009. Beginning with our projected sources of capital, our life and P&C operations are both currently capitalized above AA standards. As I just outlined, we have significant capital resources at the holding company.

In addition, we project second half statutory operating earnings from our insurance company of about $700 million. Just to note, this also reflects a reasonable run rate for 2010. All-in, you can see we project total sources of capital of approximately $9 billion.

As for potential uses of capital, we estimate total VA related impacts, including the implementation of VA CARVM at the end of the year, to be approximately $1.3 billion at current market levels. This reflects our intent to put in place an onshore captive by yearend, the primary benefit of which will be to mitigate risk-based capital volatility, particularly at higher equity market levels.

We also include $1.6 billion of investment related impacts as a projected use of capital. This assumes continued macroeconomic deterioration and stress on the commercial real estate sector and includes impairments, mark-to-market impacts, realized gains and losses and downgrades on securities. This assumption is somewhat higher than what we saw in the first half of 2009. However, as we think about 2010, we expect the rate of investment losses to decline significantly from '09 levels.

Finally, we will pay $200 million to Allianz in October and second half interest payments and dividends should total about $300 million.

We have to make the same caveats we always do in making our projections. Developing estimates and assumptions about capital, whether it involves VA reserving or future investment-related impacts, is inherently difficult. There are numerous factors presently unknowable that will ultimately determine actual results.

These factors include future equity levels, interest rate volatility, currency, actual policyholder behavior, fund performance, and of course, the macroeconomic environment, liquidity, pricing in the credit markets amongst others. So be advised that actual results may deviate materially from these projections.

With those caveats, as you can see on slide 12, even incorporating substantial investment impacts and assuming current equity market levels, we would expect to finish the year very well capitalized with over $5 billion of excess capital resources. Moreover, in the event that equity markets did decline sharply to a yearend level of S&P 700, we are still well positioned to maintain AA capitalization levels.

Please turn to slide 13 for an overview of the accounting for the CPP investment. The CPP preferred stock and warrants will affect our results in several ways. First, the preferred stock dividends will reduce earnings available to our common shareholders in the earnings per share calculation by $170 million a year. In addition, earnings available to common shareholders will be reduced to reflect the accretion of the discount associated with the preferred stock. This amount is approximately $90 million year.

This discount results in the allocation of the $3.4 billion in proceeds to both the preferred stock and the warrants. The allocation of proceeds was based on the relative fair values of the instruments. We recorded the preferred stock at $2.9 billion and the warrants at $480 million.

The discount to the face amount of the preferred stock will be amortized over a five-year period using the effective yield method. The amortization amount is deducted from income in calculating earnings per share. The warrants were issued at a strike price of $9.79, which will result in an increase in diluted outstanding shares whenever the stock price exceeds that amount.

With that, I will turn the call back over to Ramani.

Ramani Ayer

Before we turn to Q&A, I just want to summarize our second quarter results. One, our strategy is set and our capital position has been strengthened. Two, in property and casualty, we are competing smartly in a challenging market.

Three, our second quarter results demonstrate that our franchise and distribution plan are intact. Fourth, in the life operations, we saw a stabilization in the second quarter and we're really taking the right actions to realign our expense base to our strategic direction going forward.
With that, let's go to Q&A. Operator, you may now open the call to questions.

Question and Answer

Operator

(Operator Instructions). Your first question comes from the line of Darin Arita with Deutsche Bank.

Darin Arita
Deutsche Bank

I had a question on page 12 with respect to the equity market sensitivity. The global VA impact at yearend '09 with the S&P at 700, that $2.1 billion, is that in addition to the $1.3 billion or is it an $800 million increase?

Liz Zlatkus

No, that is in addition.

Darin Arita
Deutsche Bank

It is in addition. Does that include the use of the onshore captive?

Liz Zlatkus

Yes, it does, except that the onshore captive actually helps us more on the upper equity market levels. It really doesn't have an impact on the lower equity market levels. We are assuming we implement the captive for 2009.

Darin Arita
Deutsche Bank

With respect to the captive, can you talk about your decision on why onshore versus offshore and what are the costs to setting this up?

Liz Zlatkus

Yes. Obviously, this has a lot of complexities as you try to determine the best result, everything from tax implications to how the rating agencies will look through things. So we felt the onshore captive was the best solution for us. In terms of the cost of setting it up, it's not significant. You have to put capital into the captive, but then that capital gets to be utilized in terms of calculating your overall capital requirement.

Operator

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

Josh Shanker
Citi

I wanted to talk about the property casualty space. In terms of considering the competition, one of your competitors has posted their numbers and talked about a downsizing of the type of coverage being purchased. It doesn't necessarily show up in the numbers that you've have shown. Given that you are successful in competing for that small business, I'd like to talk a little bit about that competitive landscape.

Juan Andrade

Clearly, what we had seen in the first six months of the year is the impact of the recession primarily on small business, but also on individual consumers where you see that being reflected in top-line or at least in your premium retention numbers, as you see an increase in audit premiums, in cancellations and endorsement activity as small businesses consolidate operations, small businesses go bankrupt, reduce coverage, et cetera.

Josh Shanker
Citi

In terms of that situation, are you finding that you can retain more policies by offering more coverage at a better price or your brokers are volunteering to take down what's being offered? How do you compete with that?

Juan Andrade

I think you're seeing a couple of dynamics in the marketplace. The impact of the economy, what I mentioned earlier, is creating a tremendous amount of churn in the marketplace, meaning customers are looking for ways to reduce their premiums, and distributors are looking for ways to retain those accounts to maintain their revenue levels at the same time. We do see that as far as new flows are concerned. We do see flow of business as being up as we take advantage of the churn in the marketplace. That is a way that we react to that.

Ramani Ayer

As Juan mentioned, the impact on renewals, obviously, because coverages are being paired back, deductibles increased, payrolls declining, it affects our retention premium year-on-year.

Josh Shanker
Citi

Can we just get an update in terms of the timing of the executive search and the process?

Ramani Ayer

As we have indicated, the Board has a search committee. It is being directed by the Board and they are very pleased with the progress. When we have something substantive to share with you, we will be delighted to.

Operator

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

Randy Binner
FBR Capital Markets

Following up on the slide 12 question that Darin had, is it possible to provide other sensitivity numbers other than S&P 700? What would that $2.1 billion be at S&P 800 or 900?

Liz Zlatkus

As you know, trying to project exact capital market impacts at each level is a bit challenging. What I will say that may be helpful is that on average our convexity has been reduced. So when you think back to Investor Day in December and some of the projections we were using then, we had more convexity, more steepness as market levels dropped.

Now, it has flattened out a bit. That's due to both the hedging that we've put on, which has obviously improved our capital position at the lower equity market levels as well as the implementation of VA CARVM, which is somewhat of a step change. In other words, on average it just increases the reserves. So, I would say, if anything, it has just flattened out a bit.

Randy Binner
FBR Capital Markets

There were some comments on ROA that we might see in the retirement segment in 2011. One of our challenges is trying to think about how the US VA business, retirement and even institutional and international will model out into those out years, 2010 and 2011. Is there any guidance we could see on ROA we might expect to see, especially in the US VA business or some of those other lines that are more in question or potentially heading towards runoff?

John Walters

First of all, in Ramani's comments, I think he did give you some good earnings guidance relative to the next six quarters. In IA, we said it was going to be $85 million to $90 million. In international, we said $35 million per quarter, which includes our expectations for normal market development, normal market growth, which gets you to an ROA expectation or better than that really an earnings expectation on those businesses in a stabilized environment.

The current guidance is 30 to 34 basis points ROA on IA. We do expect that the annuity ROAs that are in our guidance will improve somewhat as we go forward as we get better returns. In the investment portfolio, we do have a large fixed account there and as those returns improve somewhat, that will get better, and also the expense reductions and the impact of higher markets will improve that as well. As we go forward, we think that the numbers that Ramani shared are the right numbers for you to be thinking about and modeling toward, assuming that we get normal market environments.

I also think that on the businesses where we have not continued sales, for example Japan and the UK, that we have seen very steady asset levels there so far. Redemptions, while they spiked initially, have been fairly steady since, and so we do not expect a dramatic runoff in that business. Instead, we expect it to continue to be an earnings contributor for us and then a slow runoff after that.

Randy Binner
FBR Capital Markets

On the annuity front kind of how that goes into the end of '09, is that contemplating the rollout of the new product? How are you expecting now for the rollout of the new VA product to affect those returns as it is rolled out?

John Walters

First of all, from a financial perspective, I would expect the rollout of the new VA product to have a very marginal impact because it will take a while for it to build up. It will take a while for it to have enough volume to really impact the some odd $70 billion that we had in existing VA assets, which is really going to drive the earnings component.

That said, the new product will be different than many of the products that are in the marketplace today. As you know, everybody has been revising their products in the marketplace and we are right in the middle of that. I think we've taken a bit of a different perspective that I think will work very well over the long term, but it will take us a bit to get it established in the marketplace.

Our new product platform is designed to combine value, simplicity and transparency as to all the costs, which I think will be very well received by the marketplace. We've got good indications from the key accounts that we've been calling on about their enthusiasm for the product. It will appeal to a broader range of consumers by providing a more compelling solution for retirement income that's still guaranteed without exposing us to the kind of equity market volatility that the products over the last several years have.

That said, the sales rates for the fourth quarter, first quarter until we get this new product established and start to burn into the distributors are very uncertain. So the guidance that we've given is really third quarter guidance. After that, we'll be working hard to get the new product established and we'll be able to give you a better indication of what sales levels to expect as we get into the new product launch.

Operator

Your next question comes from the line of Larry Greenberg with Langen McAlenney.

Larry Greenberg
Langen McAlenney

There has been a lot of discussion about flight to quality in the property casualty business and understanding the issues in the specialty division. Outside of that, do you think your issues have left you as a victim of that flight to quality up until now? If so, do you think stabilization of capital and strategic plan will lessen that going forward or probably remove that issue going forward?

Juan Andrade

What I would say is that the challenge that we have faced is really the economy, not so much ratings outside of the specialty lines. If you look at our new business flows, I think that's evidence of that. For example, for the quarter, new business premium in personal lines was up about 44%. Small commercial was up about 3%. Middle market was up about 5%.

So we continue to be very viable in the marketplace. We continue to see our flows improve month-over-month. We continue to be very heavily engaged with our agents and brokers who have been very loyal to us through this period of time.

Larry Greenberg
Langen McAlenney

Do you feel that the tone has changed meaningfully second quarter versus first quarter?

Juan Andrade

I would say that certainly it has. The greater certainty that we can provide the marketplace about the stability of our balance sheet, the better it is for our distributors and for our customers overall. We have certainly seen an increase and an uptick in flows throughout the quarter.

Larry Greenberg
Langen McAlenney

Is it possible, Liz, to provide us an updated estimate on risk-based capital ratio?

Liz Zlatkus

As you know, risk-based capital is only calculated to the end of the year. What I would say is trying to do it at 6/30, you could take the number and divide it by our old risk-based capital level of about $1.3 billion. Knowing that VA CARVM is coming into play, I just think it's not really a meaningful indicator. Clearly, our capital went up in the life operations $500 million. We do not have significant asset-based charges, et cetera. So we are more than well capitalized.

Operator

Your next question comes from the line of Eric Berg with Barclays Capital.

Eric Berg
Barclays Capital

I have a question that will take us back to the beginning of your comments regarding the future direction of the company. It's apparent that you are reducing your exposure internationally and you are looking at options for your institutional business. As we think of the US business, I'm hoping you can sharpen my understanding of how the new Hartford, if you will, domestically, obviously lower costs, but how else will the new Hartford be different from the old or maybe the point is that it won't be different? I just wanted to be entirely clear on that important question.

Ramani Ayer

First of all, the new Hartford, let me talk it through in terms of product distribution and risk. The new Hartford, from a segment perspective, is very focused on becoming more insurance protection-focused. Therefore, more of our earnings growth going forward will come from the insurance-based businesses. So as you compare ourselves to five years ago, we were the dominant player in the variable annuity market. We have obviously restructured it pretty dramatically. To that extent, a protection focus is going to be the more critical driver of both earnings composition and earnings generation. So that's issue number one.

Issue number two, the new Hartford, as you think about it with respect to these protection businesses, carries forward its traditional strengths in both distribution and product innovation, which we believe has always been our strength both in terms of diversity of distribution as well as the quality of our distribution in terms of our relationships. Product innovation is naturally part of that. Our most recent one with the AARP launch through independent agents is actually a very exciting change for us because almost 20% of our new flow is coming from that particular platform. We are doing the same in our small business area. We are doing the same in the individual life and retirement areas. So I believe that product innovation is going to be a strength that we carry forward.

Third, from a risk perspective, we are obviously doing a lot more in terms of restructuring our thinking about risk, both with respect to the annuity platform, as well as Greg is doing a very, very good job in ensuring that our risk management practices inside of our investment operation is going to be materially strengthened so that as we look to the future and market volatility in the future, we want to be sure that our general account performance is more stable and more dependable.

So, those are the three ways in which I would say that the new Hartford is different.

Eric Berg
Barclays Capital

My second and final question relates to the mutual fund business. It continues to do very well in terms of attracting funds, but close to a decade, I guess, after the launch of the operation, it continues not to contribute meaningfully to the earnings. What are the challenges from an earnings point of view that this business faces and what would you consider to be a reasonable timetable for it to be at an appropriate level of profits?

John Walters

The mutual fund business is a very important business to us and one that we are quite proud of what we've been able to accomplish from. If everybody remembers, really a standing start in 1996. So we have come a long way in a very short relative period of time versus many of our peers. That said, we are still relatively small as a mutual fund company and this is a scale business. A lot of your expenses in mutual funds are very dependent on the average size of your account base. So, as we go through time and we are able to grow that average account size, we think there are meaningful scale benefits that we can get.

We lost some of those scale benefits in the market downturn that we just had. As both cash flows and market returns bring those scale benefits back, we think we can get back to the earnings levels that we had a couple of years ago. We think that this can be one of our fastest growing earnings components, albeit off a very small base, over the next several years as we get normalized markets and good cash flow.

Ultimately, where we want to take this business to is a 16 to 18 basis points ROA and I think it will take us several years to get there, but we feel like we have the pieces in place to do that.

Ramani Ayer

Remember, it was not too long ago that we did have a 15 basis point ROA on this business. This recent market downturn, both with respect to the breakpoint oriented scale point that John is mentioning, as well as just the severity of the market downturn caused us to fall down and we are now expecting this to improve gradually as we move forward.

Operator

Your next question comes from the line of Mark Finkelstein with Fox-Pitt Kelton.

Mark Finkelstein
Fox-Pitt Kelton

I may have completely missed it, but in your reconciliation of capital I didn't see anything on the at the market $750 million or whatever deal. What's the status of that? It looks like you didn't really do much through the end of July. I just want to know if that's still out there and how we should think about that.

Ramani Ayer

Well, as stated in our press release announcing the offering, we launched a discretionary offering to take advantage of favorable market conditions from time-to-time. As we reported in the press release announcing the closing of the CPP investment, in light of market conditions after the launch, sales were limited to about 1.2 million shares. Soon afterwards we began preparing the Form 10-Q for the second quarter, and therefore, suspended the offering.

I would say, going forward, we intend to continue to exercise our discretion in executing the offering again based on market conditions. Those would be basically the three points I would make.

Liz Zlatkus

Let me just clarify though. Any additional issuance is not included in the capital that I show on slide 12.

Mark Finkelstein
Fox-Pitt Kelton

Can you just kind of give an update in terms of distribution trends on the life side? Obviously, with the ratings downgrades and the substantial decline, particularly on the VA side in terms of production levels, have the defections at the wholesaler level leveled off? What did you see kind of in the quarter? I would ask the same question at the end distributor level. Can you just give an update on where we are and what we've had to do to keep the wholesalers that we have wanted to keep?

John Walters

I would say that broadly across the life company, I've been very pleased with how stable our distribution relationships have been. In every business that we have, we've been able to maintain all of the key distributors that we've had relationships over the years. I think we're prepared to start to regenerate momentum in each of those businesses as we go forward. We have had some businesses be more affected in the second quarter by the disruptions of the fourth quarter and first quarter than others. That was particularly true of kind of the longer sales cycle businesses like retirement plans and life group benefits and the high-end of the life insurance business. You see a quicker turnaround in the mutual fund business where the sales cycle is quite a bit shorter.

On the wholesaler side in all of these different businesses, by and large, I would say that our wholesaler retention has been excellent. We have had very little unplanned turnover. That said, we have restructured several of our different wholesaling organizations to reflect the current market environment. The most dramatic actions have been taken in our annuity wholesale force where we have changed that and we now have about 60 wholesalers going forward in the annuity business. We are confident that these are 60 great wholesalers who can carry our message to the street very effectively with our new product and we have not had any unplanned turnover that is meaningful in that particular line of business.

Operator

Your next question comes from the line of John Hall with Wells Fargo Securities.

John Hall
Wells Fargo Securities

I was looking at the potential uses of capital on page 12 or so in the presentation. I didn't see anything explicitly identified relative to Japan or the foreign annuity businesses. I was wondering, one, are there any capital demands out there that we should be thinking about, and two, if so, is it included in that global VA number?

Liz Zlatkus

In terms of that global VA, it does include all impacts from our foreign businesses. In Japan, we have capital in Japan and we really have excess capital over there, so we are well capitalized. We reinsure a large portion of that business back to the US, and so that's where it gets counted. In total, that global VA number includes all impacts of our foreign operations, including kind of risk-based capital charges that we get applied to the surplus that we hold in our foreign operations. So it's a comprehensive number.

John Hall
Wells Fargo Securities

Is it possible to break out that $1.3 billion and $2.1 billion into its US and foreign components?

Liz Zlatkus

It really wouldn't be meaningful because, again, some of the businesses reinsure back to the US. That's why we look at it in total. So I'm not sure it would be a meaningful number.

John Hall
Wells Fargo Securities

I have another sort of CEO follow-on type of question. You've gone down a path here in which you've identified strategy, direction for the company and the like, while also seeking to bring in a new CEO. I guess how certain can we be of that strategy remaining intact? Are you looking for a CEO who basically signs on in total to what you've articulated as the direction for the company?

Ramani Ayer

Here is how I would answer that question. First and foremost, remember, as I mentioned in my opening comments, the Board was actively engaged in this process right along the way. Over the last six months or nine months, I am starting to lose track of time here. We went through an exhaustive analysis of our options to ensure that we were thinking about this very, very thoroughly and rigorously from a shareholder perspective, while at the same time being mindful of our policyholder concerns too. That's the first thing.

Given the Board's engagement, now not getting into any of the specifics of Board conversation, because I'm not privy to those with potential candidates, I would assume the Board and the candidates will look at the context that they are facing over the next decade and then make proper adjustments. I have to believe that the Board's conviction around this strategy was shared in this whole strategy definition.

Operator

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

John Nadel
Sterne Agee

I have two quick ones if I could. First, also on slide 12, I was hoping we could better understand a little bit the first estimate, the $2.3 billion of capital in excess of the AA minus rating level. Liz, I think earlier you mentioned that you didn't have a second quarter risk-based capital estimate. I was wondering how we arrive at the $2.3 billion.

Liz Zlatkus

I think so we just don't like to be discussing a risk-based capital number that gets utilized when it's really a yearend calculation, but obviously we have excess capital as we define it sitting here at 6/30. That's primarily at the life side, but we also have access capital at PC, so we're starting the third quarter with $2.3 billion.

My only point is we know that the implementation of VA CARVM and some of the other risk-based capital charges for VA at the end of the year are going to be impacting us. If we look at an RBC number and say its in the 450 or whatever range, we're just saying we know that on an apples-to-apples basis as we go to the end of the year the requirements change. So we just didn't think it was overly meaningful.

That capital is able to be utilized. In other words, as we go through the end of the year, we're saying we'd start with that, and then we use it when we go to the end of the year. When we look at that global VA number, we will utilize $1.3 billion of that $2.3 billion.

John Nadel
Sterne Agee

Could you give us a ballpark of what the pie looks like, how much of that $2.3 billion is in the P&C company versus the life?

Liz Zlatkus

I would say it's in the $1.5 billion to $1.8 billion range on the life company and then plus $500 million on the P&C.

John Nadel
Sterne Agee

Second question is just, if memory serves correctly, I think The Hartford's impairment process over the past four to six quarters has differed a little bit in terms of the impairments you recorded on a GAAP basis versus on a statutory basis. Maybe I am wrong on that. I was wondering, first, could you just confirm if that was the case, and second, just around that, if impairments were to catch up to GAAP, how much of an incremental would that be?

Liz Zlatkus

The first answer is, yes, there was a difference. In the past, particularly you may remember the third quarter, we had significant impairments that we took in the third quarter on a GAAP basis that related primarily to financial services where we did not feel that they would recover to 90% of their value within a two-year period.

Those rules have now changed. Now under a GAAP basis, you really look to say, is there a probability of a credit event and then you write it down to that credit. You just write it down to the amount of the credit impairment. As you see in our financials, for example, reversing some of those GAAP impairments that we took, because of that two-year rule, we reversed those under the new GAAP rules. That was $1.4 billion pre-tax or the $912 million after-tax.

So, when you kind of look cumulatively, we're more in line now. On a cumulative basis, our stat impairments are more in line with GAAP. Going forward, the rules are pretty much essentially the same.

John Nadel
Sterne Agee

Because of that FAS 115-b or whatever it was called, that brought them back in line because of the reversal on the GAAP side?

Liz Zlatkus

Absolutely.

Operator

Your final question comes from the line of Ian Gutterman with Adage Capital.

Ian Gutterman
Adage Capital

On the P&C side, the new business growth you described in June and July that accelerated meaningfully. To be honest, I don't know if I should be encouraged or discouraged by that, meaning just given the competitive environment we're in, what we are hearing from others is obviously it's good that the franchise is pulling through, but on the other side I'm worried that maybe you are being aggressive in doing that or maybe there are mixed messages between the field and headquarters, something like that.

Juan Andrade

We actually feel very good about this. One thing that's important to recognize is that we do not sacrifice profitability for growth. Our underwriting discipline here at The Hartford is deeply embedded within our culture. That's clearly evidenced in the accident year ex-cat combined ratios that we've reported, so the 90.4 for this quarter, the 90.7 for the prior year quarter and the 90.2 for second quarter of '07.

We're also walking away from business that we don't feel is adequately priced. Our second quarter pricing trends certainly would indicate that point. Personal lines was a plus 3 in written pricing for the quarter. Small commercial was flat compared to a minus 2 for the prior year quarter. Middle market was a minus 1 for the quarter compared to a minus 2 last quarter and a minus 7 for the prior year quarter.

So we feel very good about the ability to maintain our discipline while we're increasing these flows. One thing to keep in mind too is we have put a tremendous amount of investment over the past year, so in product development, in distribution and in service, we're happy to see that that is paying off.

Ramani Ayer

One last point I would add to the excellent comments that Juan has made is our pricing trends that he quoted includes both new and renewal pricing. So we measure pricing adequacy across both our new and renewal business. So we feel very confident that we are doing this very carefully and selectively.

With that, I'm going to bring the call to a close. I just want to express my appreciation for you taking the time on this call. We are delighted to share the news of our quarter with you. We are building steadily and progressively as we go along in all our major businesses trying to recapture the hearts and minds of our distribution, as well as our employees and executives.

So, I thank you for this opportunity. We look forward to our third quarter conference call. Thank you again.

Operator

This concludes today's Hartford second quarter 2009 earnings conference call. You may now disconnect.