S&P Capital IQ

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The Hartford Financial Services Group, Inc. NYSE:HIG

FQ4 2016 Earnings Call Transcripts

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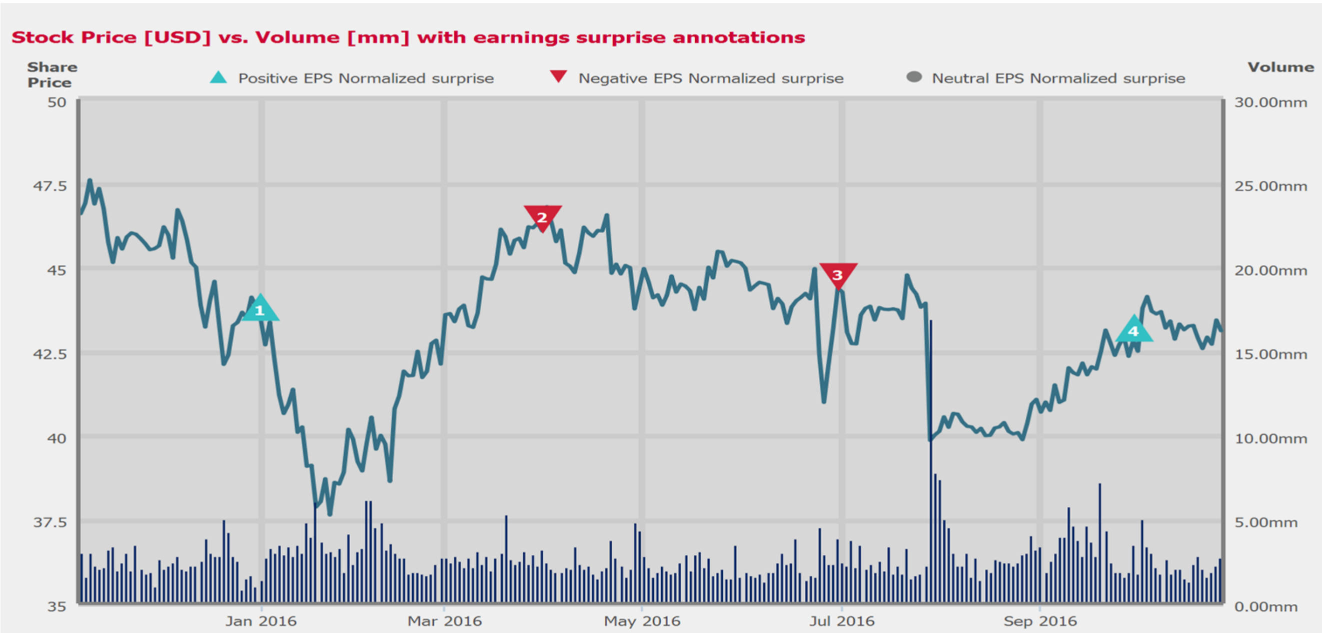
S&P Capital IQ Estimates

	-FQ4 2016-			-FQ1 2017-	-FY 2016-	
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	ACTUAL
EPS Normalized	0.93	1.08	▲16.13	1.06	3.25	3.38
Revenue (mm)	4771.50	4537.00	▼(4.91 %)	4907.00	18535.00	18300.00

Currency: USD
Consensus as of Feb-03-2017 10:34 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ4 2015	0.98	1.07	▲1 9.18 %
FQ1 2016	1.01	0.95	▼2 (5.94 %)
FQ2 2016	0.80	0.31	▼3 (61.25 %)

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FQ3 2016	0.95	1.06	▲11.58 %

Call Participants

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Chairman & CEO

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Presentation

Operator

Good morning, my name is Liza, and I will be your conference operator today. At this time, I would like to welcome everyone to The Hartford's Fourth Quarter 2016 Earnings Results Conference Call. [Operator Instructions] Thank you.

Sabra Purtill, Head of Investor Relations, you may begin your conference.

Sabra R. Purtill
Senior Vice President of Investor Relations

Good morning, and welcome to The Hartford's Webcast for Fourth Quarter 2016 Financial Results. The news release, investor financial supplement and slides for this quarter were all posted on our website yesterday. Please note that we will file our 10-K on February 24. Our speakers today include Chris Swift, Chairman and CEO of The Hartford; Doug Elliot, President; and Beth Bombara, CFO. Following their prepared remarks, we will have about 30 minutes for Q&A.

Just a few comments before Chris begins. 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 information or forward-looking statements provided on this call. Investors should consider the risks and uncertainties that could 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 available on our website.

Our presentation today also includes 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 news release and financial supplement.

Finally, please note that no portion of this conference call may be reproduced or rebroadcast in any form without The Hartford's prior written consent. Replays of this webcast and an official transcript will be available on The Hartford's website for at least 1 year.

I'll now turn the call over to Chris.

Christopher John Swift
Chairman & CEO

Thanks, Sabra. Good morning, everyone, and thank you for joining us today. The Hartford delivered strong results in Commercial Lines and Group Benefits despite sustained competition this quarter, while personal auto performance remains under pressure from loss cost trends.

Doug will cover P&C and Group Benefit results in a few minutes, but I wanted to highlight notable 2016 accomplishments that demonstrate The Hartford's underwriting discipline, effective execution and fundamental strengths of our platform. Commercial Lines delivered an exceptionally strong underlying combined ratio of 89.4 for the full year. The performance reflects The Hartford's best-in-class operating capabilities, strong market positions and disciplined underwriting. During the year, we also made progress on our strategy to broaden our risk appetite, including entry into the E&S space with the acquisition of Maxum; expanded multinational capabilities through our partnership with AXA; and the launch of a dedicated energy practice.

Group Benefits delivered very good results for the full year with a core earnings margin of 5.7%. We generated profitable growth in this segment, reflecting strong sales, persistency and an improved loss ratio. We continued to execute on our Group Benefits growth strategy, enhancing the product suite with the addition of dental and vision for the small-case market and new voluntary offerings.

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At Talcott, we continue to effectively and efficiently manage the runoff of the annuity blocks. Over the past 2 years, Talcott has returned $1.75 billion of capital to the holding company, and we expect an additional $600 million in 2017.

During 2016, we also addressed our legacy P&C exposures, which, over the past few years, has generated substantial adverse development. In July, we agreed to sell the runoff U.K. subsidiaries to Catalina, which we expect to close in the next few months. And at year-end, we reinsured the remaining legacy U.S. A&E liabilities to National Indemnity. While these actions resulted in modest book value dilution, we believe that the economic trade-off was well worth the near-term cost.

Turning to Personal Lines. We are encouraged about moderating frequency but remained concerned about bodily injury liability severity trends. As a consequence, we have strengthened prior year reserves and current accident year loss picks. In setting year-end calls for accident years 2015 and 2016, we placed higher weight on the most recently emerged bodily injury severity experience. We are intently focused on improving the profitability of this business. During the year, we accelerated pricing, distribution and underwriting initiatives resulting in a sharp drop in new business. Doug will provide you with more background on these actions and the progress we have achieved over this past year, and I am confident that we will deliver improved results in 2017.

Finally, before turning the call over to Doug, I'd like to briefly cover our 2017 goals and expectations. Given the significant progress The Hartford has made over the past several years, I am confident in our ability to continue to perform well in an environment that we expect to remain challenging in 2017. We expect competition to remain robust for the coming year with new entrants aggressively seeking inroads into our markets and peers fighting hard to retain their business. Technological innovation and its potential effect on business models is also adding to the competitive intensity.

In addition to these trends, 2017 presents higher regulatory, fiscal and macroeconomic uncertainty. We are closely monitoring developments on Capitol Hill, including corporate tax reform, infrastructure spending and the possible repeal or replacement of ACA and other changes in regulations, all of which could impact us.

With that backdrop, our strategy and focus in 2017 remain consistent. The Hartford will prioritize long-term growth initiatives by investing in products, distribution, data and analytics and digital capabilities to provide more value to our agents and customers. These investments are aimed at providing us with critical insights and creating seamless interaction for customers across each of our businesses. Specifically, in 2017, we intend to maintain strong margins in Commercial Lines and Group Benefits and to improve auto profitability. Our goal is to grow core earnings and book value per share supported by continued capital management, including $1.3 billion of share repurchases and efficient debt management. We will continue to relentlessly scrutinize our expense structure, recognizing the importance of operating efficiency to competitive strength.

In closing, I am proud of what The Hartford accomplished in 2016: We delivered strong financial results, excluding auto; we returned $1.7 billion of shareholders -- or $1.7 billion of equity to shareholders through repurchases and common dividends; and continued to reduce debt outstanding. And we significantly improved our operating capabilities and expanded our risk appetite. As we enter 2017, I am confident we are taking the right steps in our competitive markets as we continue to invest for long-term growth and shareholder value creation.

Now I'll turn the call over to Doug.

Douglas G. Elliot
President

Thank you, Chris, and good morning, everyone. We had an excellent 2016 in Commercial Lines and Group Benefits, particularly in light of the growing competitive dynamics we've seen in these markets. Before I share details on our commercial businesses, let me get right into Personal Lines, where I only can describe 2016 auto loss trends as challenging and our financial performance as disappointing.

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For the fourth quarter, we posted a Personal Lines core loss of $17 million. CAT losses for the quarter were $28 million, $7 million higher than in 2015. The underlying combined ratio, which excludes catastrophes and prior year development, was 101.8, deteriorating 8.3 points from last year. This is primarily due to higher auto loss cost, partially offset by lower expenses. In homeowners, the underlying combined ratio for the fourth quarter of 74.7 deteriorated 2.3 points versus last year. The fourth quarter of 2015 experienced very favorable results compared to our longer-term average. Overall, our homeowners performance remains very solid, and we continue to effectively manage rate needs and underwriting execution.

In Personal Lines auto, we continue to see higher-than-expected overall loss cost trends. On the positive side, our current estimate of the change in frequency for the second and third quarters of 2016 has moderated versus our estimates 90 days ago. The change in bodily injury severity, on the other hand, has increased and continues to be an area of intense focus, affecting both current and prior accident years. We recorded $20 million of prior year development in auto liability, primarily related to accident year 2015. We also increased the accident year 2016 loss ratio by approximately 2.5 points.

Throughout the year, we've been executing on substantial rate, underwriting, agency management and new business actions. We have provided a new exhibit in our slide package that depicts our progress within segments of our auto book. We're measuring and managing our actions by state and customer cohort very closely.

Let me provide commentary on 3 examples of the actions we're taking. First, written pricing in the fourth quarter was 9%, increasing 3 points from prior year and 2 points sequentially. I expect this number to increase an additional 1 to 2 points over the next few quarters. The earned premium impact of this rate is ultimately based on the customers we renew, but the combination of rate increases and mix change in the book of business will drive auto margin improvement in 2017 and 2018.

Second, we reduced our new business marketing efforts in many jurisdictions until more adequate rates are in effect. Auto new business for the fourth quarter was down 58% with Other Agency off 64%. We're confident that we can return to new business growth once adequate rate levels are in place to deliver our target returns.

And third, lower new business also results in reduced marketing expense and lower operational costs, which contributed to a 3.5-point improvement in the expense ratio for the fourth quarter. These actions and others will have a favorable effect on our loss ratio as higher average premium per policy and improved book of business mix are reflected in our earned premium.

In Commercial Lines, we delivered $277 million of core earnings for the fourth quarter on a combined ratio of 91.3, 3.2 points higher than 2015. Catastrophe losses for the quarter were $20 million higher than in '15, driven mainly by Hurricane Matthew and hail events in the Southwest.

The fourth quarter also included 1.2 points of unfavorable prior year development versus 1 point of favorable development in the fourth quarter of 2015. The unfavorable prior year development was related to commercial auto and package business, partially offset by prior year development in workers' compensation being favorable. Commercial auto continues to be under pressure in our book of business and across the industry. We recorded $38 million pretax of prior year development to address severity trends, primarily in Small Commercial related to accident year 2015. We continued to achieve high single-digit written price increases in this line and have taken aggressive underwriting actions, including enhanced referral criteria, resulting in lower retention and lower new business. We also recorded $15 million pretax of prior year development in the package business to address general liability severity trends in Small Commercial.

The underlying combined ratio for Commercial Lines was 88.2 for the fourth quarter, flat compared to 2015. This reflects improved current accident year results in workers' compensation offset by weaker results in commercial auto. Renewal written pricing in standard Commercial Lines was 2% for both the full year and the fourth quarter, holding steady throughout the year.

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I'm very pleased with this outcome, which reflects the underwriting rigor and discipline of our team in a competitive marketplace. Written premium of $1.7 billion for the quarter was up 3% from 2015, driven primarily by growth in Small Commercial, including the acquisition of Maxum.

Let me provide some detail on each of our commercial business units. Small Commercial had a solid fourth quarter to cap off an outstanding year. The underlying combined ratio for the quarter was 86, up 0.9 point from 2015. Written premium for the fourth quarter grew by 7%, driven by strong retentions and $145 million of new business, including Maxum.

In Middle Market, we demonstrated strong underwriting and pricing discipline, delivering an underlying combined ratio of 88.9 for the fourth quarter, improving 0.1 point from 2015. Written premium increased 1% based on solid retentions and new business production of $133 million, up 17% versus prior year. We are encouraged by these results, which we attribute to growing momentum on a number of strategic initiatives, including our recently launched energy practice and our expanded multinational capability. We have received very positive feedback from our agents and customers that we're delivering a well-integrated and comprehensive solution for their international needs. As a result, we're finding opportunities to win new accounts based in the U.S. with international exposures that we might not have quoted in years prior.

In Specialty Commercial, the underlying combined ratio of 94.8 for the fourth quarter improved from 98.1 in 2015. This was driven by strong performance in National Accounts workers' compensation, bond and financial products.

Now let me turn to Group Benefits. Core earnings for the fourth quarter increased to $59 million, up from $40 million in 2015 with a core earnings margin of 6.5%. The group disability loss ratio for the quarter deteriorated by 1.1 points compared to prior year due to higher severity, partially offset by pricing as well as favorable incidence and recovery trends. The volatility we experienced in prior quarters in group life abated this quarter. The group life loss ratio improved 5.4 points versus 2015, largely due to favorable changes in reserve estimates.

Looking at the top line, fourth quarter fully insured ongoing premium increased 2%. Overall book persistency on our employer group block of business held in the high 80s for the year, and fully insured ongoing sales were $43 million.

Looking back on '16, we're pleased with the performance of our Commercial Lines and Group Benefit businesses, particularly as we navigate these competitive markets. In Personal Lines, we're addressing our challenges with clear actions and a commitment to sustainable financial progress in 2017.

Before I turn it over to Beth, let me offer a few comments on 2017. We expect that the market will be as competitive or more than the market we faced in 2016. We remain committed to underwriting discipline and delivering strong margins, only seeking growth when it meets our profit targets.

In Commercial Lines, we're focused on leveraging our expertise and tools to aggressively compete at the front line. We'll continue to improve our capabilities to better meet the changing demands of both customers and distributors, who are seeking new product capabilities, increased access to our expertise and greater convenience in their service transactions.

Due to competitive markets in the marketplace, we expect that for lines of business with strong returns, long-term loss cost trends will continue to outpace written pricing increases. As a result, we expect an overall 2017 Commercial Lines combined ratio between 92.5 and 94.5, including 2.3 points of catastrophes. At the midpoint, this is slightly higher than our results in 2016 yet still performing at attractive return levels. We will remain vigilant in addressing long-term loss cost trends as well as taking immediate action in areas that are under pressure.

In Personal Lines, we will continue our disciplined actions to restore profitability in auto by continuing to execute on our pricing, underwriting and agency management actions. We're investing in capabilities to better harness data and thereby, refine our underwriting and pricing analytics. We remain deeply committed to our long-term partnership with AARP with initiatives to deliver greater customer value and achieve higher levels of customer satisfaction. We expect to achieve a Personal Lines combined ratio

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of 99 to 101, including 5.8 points of catastrophes. This implies an auto combined ratio of 101 to 103 with approximately 1 point of catastrophes. Although clearly not at our target performance levels, this represents substantial progress toward that goal.

In Group Benefits, we're looking to drive growth in our core employer group offerings as well as our voluntary product suite. January 2017 renewal retention is tracking consistent with prior year, and January sales include a number of solid wins but will be down from a year ago. We will add hospital indemnity in April of this year to our current voluntary lineup of DisabilityFLEX, critical illness and accident.

We expect Group Benefits performance to be relatively consistent with 2016, excluding a guaranty fund assessment for Penn Treaty. Our current estimate of this assessment is approximately $13 million after tax. For Property & Casualty and Group Benefits overall, we will continue to compete in an aggressive and disciplined manner in 2017.

Competition from not only traditional names, but newer entrants as well, continues to intensify versus a year ago. Our core priorities remain unchanged: profitable product and underwriting expansion, deep partnerships with our distributors and outstanding value to our customers.

In summary, 2016 was a very strong year in so many respects, yet very challenging in others. As always, there's work in front of us for 2017, and we're fully committed to the journey ahead.

Let me now turn the call over to Beth.

Beth A. Bombara
Chief Financial Officer and Executive Vice President

Thank you, Doug. I'm going to cover the other segments, our investment performance and update you on our capital management plans. Mutual Funds core earnings totaled $17 million this quarter, down from $20 million in the fourth quarter of 2015, principally due to transaction expenses for the acquisition of Lattice and the adoption of Schroders U.S. mutual funds. Asset management fees rose about 3% from the prior year due to higher average daily AUM, although the growth in fees continues to be impacted in part by the shift to lower fee mutual funds. Total AUM increased 6%, including the impact of both market appreciation and almost $3 billion from the Schroders funds.

Talcott continues to perform well. Core earnings were $111 million, up strongly from $83 million in the fourth quarter of 2015 due to higher returns on limited partnerships and a $14 million tax benefit from a prior year federal tax audit. Aside from these items, Talcott's core earnings declined due to lower variable annuity fee income, driven by the runoff of the book. During 2016, VA contract counts decreased by 10%, which we expect will drive a similar rate of decrease in Talcott's 2017 core earnings, excluding the favorable items in 2016.

In the slides posted to our website last night, we also provided our annual update of Talcott's statutory capital allocation by product. The capital allocation has not changed materially since last year. Consistent with prior years, a significant portion of Talcott capital supports our institutional and individual fixed annuity blocks. At year-end, statutory surplus totaled $4.4 billion, and the capital allocation shows expected 2017 dividends of $600 million, $300 million of which we received in January.

We also provided an update on capital margins in base, stress and favorable scenarios. Our analysis of Talcott's capital adequacy remains focused on the stress scenario, not based on current capital or market conditions. Our goal is to maintain at least 200% company action level risk-based capital in the stress scenario and also considers liquidity, intangible assets and other factors. The assumptions used for these scenarios, which we also provided, are generally consistent with prior years. The stress scenario has a 40% drop in equity markets from current levels or roughly 1,350 on the S&P 500, lower interest rates and significant credit losses.

As summarized in the slides, in the stress scenario, we estimate the capital margin to be about $1.4 billion at year-end 2018 compared with $2.9 billion in the base case. Both scenarios include $600 million of dividends in 2017. Consistent with prior years, the primary impacts in the stress scenario come from interest rates and credit losses, primarily in the individual fixed and institutional annuity blocks

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and decreased fee income on the VA block. This amount of capital margin demonstrates that Talcott is adequately capitalized for adverse capital market environments.

Turning to investments. All-in results were strong this quarter and included high returns on real estate and private equity LPs. Total LP investment income was $73 million before tax compared to $12 million in the fourth quarter of 2015 for an annualized return of 12% this quarter and 8.5% for full year 2016. Excluding LPs, the total before-tax annualized portfolio yield was 4.2% this quarter, slightly better than 4.1% last year, largely due to nonroutine investment income such as prepayment penalties on mortgage loans and make-whole payments on fixed maturities. These items are episodic and were especially high this quarter, totaling $32 million before tax, about 2.5x higher than the fourth quarter of last year. Excluding LPs and nonroutines, the annualized portfolio yield was essentially flat.

For the P&C portfolio, the annualized yield, excluding LPs, was 3.9%, up from 3.7% in fourth quarter 2015, but relatively flat adjusted for the nonroutine items. Full year P&C net investment income was about $1.2 billion, including $101 million from -- for LPs. Looking at 2017, based on current interest rates, we expect P&C net investment income, excluding limited partnerships, to decline about 7% to $1 billion before tax for 2 principal reasons: The first driver of lower P&C investment income is that we expect a slightly lower P&C portfolio yield, excluding LPs. The full year portfolio yield was 3.8%, but 2016 reinvestment yields were about 60 basis points lower than sales and maturities, resulting in a sequential decline in the portfolio yield during 2016. Although higher reinvestment rates could offset some of this pressure, credit spreads have also tightened, and we would expect a lower level of nonroutine items in a higher rate environment. To give you an idea of the sensitivity to higher interest rates, we estimate that if 2017 reinvestment rates were 50 basis points higher across the curve, 2017 full year P&C net investment income would increase by about $20 million before tax.

The second factor driving P&C net investment income lower in 2017 is that P&C investment portfolio will decrease by about $1 billion or 3% early in the year due to the net impact of the $650 million we paid in January for the national indemnity cover and the pending sale of the U.K. P&C runoff subsidiaries.

Turning to credit performance. Our experience remains very good with total impairments and mortgage loan valuation reserve charges of $12 million before tax, down from $42 million in the fourth quarter of 2015, which included losses on some energy, mineral and mining-related exposures.

To conclude on earnings, fourth quarter core earnings per diluted share were $1.08, essentially flat with the $1.07 in fourth quarter 2015 as the impact of our share repurchase program offset the 7% decrease in core earnings.

For the full year, core earnings ROE was down due to Personal Lines results and the second quarter charge for adverse development for A&E. 2016 core earnings ROE, excluding Talcott, was 8.9%, and the P&C core earnings ROE was 9.9%. Excluding the A&E charge, the 12-month core earnings ROE, excluding Talcott, was 10.3%, and P&C was 12%.

Turning to shareholders' equity. Book value per diluted share, excluding AOCI, at December 31, 2016 was up 3% compared to a year ago.

Before turning to your questions, I wanted to provide an update on our capital management plans. During the quarter, we repurchased $280 million of stock, which completed the $4.375 billion equity repurchase plan that expired on December 31. In January of this year, we repurchased about 2.3 million shares for $110 million, which leaves approximately $1.2 billion available under the 2017 equity repurchase authorization. With respect to debt management plans, in October, we repaid $275 million of maturing debt. As we previously announced, we will repay $416 million of senior notes at maturity in March, which is our only debt maturity in 2017.

In addition to these 2 actions, we also intend to call our 8 1/8% $500 million junior subordinated bond when it becomes redeemable at par in June 2018. To fund this call, this month, we will exercise our put option on the Glen Meadow contingent capital facility, which will result in the issuance of $500 million of junior subordinated debt. This debt will have a floating rate coupon of 3-month LIBOR plus 212.5 basis points or about 3 1/8% at current rates. The impact of these actions on our debt-to-total-capital ratios

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will be modest as the Glen Meadow issuance will be largely offset by the senior note maturity in the first quarter and our 2018 ratio will decrease from the repayment of the junior subordinated bonds.

In addition, coverage ratios will improve in '17 and '18 due to lower interest expense resulting from debt repayment. To conclude, fourth quarter results were very strong for Commercial Lines and Group Benefits, and the performance of our investment portfolio and other businesses was very good. In 2017, we are focused on achieving core earnings per share growth driven by better Personal Lines results, continued strong margins and investment performance in our other businesses and the impact of our capital management plans. In addition, the new reinsurance agreement covering U.S. A&E exposures should eliminate the economic impact of any adverse development.

I will now turn the call over to Sabra so we can begin the Q&A session.

Sabra R. Purtill
Senior Vice President of Investor Relations

Thank you, Beth. Liza, I'll ask you to give the instructions for Q&A in just a second. But for -- in the meantime, I just wanted to note that for those of you who are interested in catching up with us in person, Beth will be attending the Crédit Suisse Conference in Miami on Tuesday next week, and Chris will be in Boston at a luncheon hosted by Deutsche Bank on Wednesday, February 8. In addition, Chris, Doug and Beth will be at the Bank of America Merrill Lynch Conference in New York on February 15, holding a fireside chat as well as some small group meetings. And then finally, I would note that Doug will be on the Commercial Lines panel at AIFA in early March this year. We hope to see all of you at one or more of those events.
Liza, could you give the directions again?

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Question and Answer

Operator

[Operator Instructions] Our first question comes from the line of Ryan Tunis from Crédit Suisse.

Ryan James Tunis
Crédit Suisse AG, Research Division

I had one question, and then John Nadel had a follow-up. But I guess, just looking at the guidance in P&C Commercial, I guess, this year, on an underlying basis, combined ratio is 89.4, and the midpoint of the guide you're giving implies a decent amount of deterioration off of that. And I realize that this year you had some favorable items in -- with property, workers' comp. But it also seems like rate worked against you. You've also talked about commercial auto, so it seemed like there were some headwinds as well. So just trying to square the type of scenarios that would potentially get you up toward that midpoint or above that because, I guess, that just seems like a decent amount of volatility off of this year's results.

Christopher John Swift
Chairman & CEO

Ryan, it's Chris. Thanks. I'll have -- or ask Doug to add his color, too, but I would just ask you to consider just macro trends in general. The pricing environment has been soft, and our views are it's going to continue to soften into '17. So rates are coming down. Pricing is not keeping up in aggregate what we believe are long-term loss cost trends. Capital is abundant in the industry. And there's many competitors, both in the traditional markets and those that are coming from offshore to compete in our market. So you put it all together, and that's our view of the environment. We're going to work our tail off to maintain those margins. But at this point, and knowing our customer base so well, we want to retain as much as our business as we can. And if there is some give that we need to give on price to retain that, we'll consider that. So we want to retain our best customers, and we know that the price environment is very dynamic. So Doug, what would you add from a color perspective?

Douglas G. Elliot
President

Sure. Ryan, I guess, the first thing I would say is that I'm very pleased about 2016. Pleased about the trends that we've been able to work on with our claim department and our pricing actions, very pleased about Middle Market. As I lean into 2017, don't expect all those trends to continue. So as I think about what's in front of us with workers' compensation, we're still thinking that our medical trends long term are in the 6% range. And indemnity, 3% to 4%. As I look at that line, which matters a great deal for our company because we're slightly overweight in comp with our expertise, it's a line right now that's feeling some degree of pressure on the pricing side in the marketplace. So that is one of the things I think about. Clearly, we're at work on commercial auto, and expect progress there and expect improved results. But we're feeling a little bit of pressure in the general liability area across the book. And so as we planned into 2017, we try to be prudent with our loss assumptions, fair and thoughtful about what we're doing with pricing. And I just feel a bit of pressure that, yes, we were able to withstand in 2016 and hope to do that again. We'd love to repeat the performance in '17, and know that's a goal, but also want to be reasonable in our expectation.

John Matthew Nadel
Crédit Suisse AG, Research Division

So this is John. Chris, there's increasing chatter about a potential sale of Talcott over the -- that chatter has been increasing over the past several months. I'm not asking -- I wouldn't ask you to comment on that, but I am interested in what your preference is for use of proceeds if you assumed a transaction were to occur. Should we expect you to focus on trying to replace those lost earnings contribution via acquisitions? Or should we expect that you'll continue to focus more on returning freed up capital to shareholders via incremental buybacks and debt management?

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Christopher John Swift
Chairman & CEO

Thanks for not asking about Talcott directly. I think the point in time where we're at right now, John, is we've done a lot, particularly, you saw with the legacy P&C liabilities this year. So Talcott contributes as it does today. We talk about managing the risk effectively and returning capital, and we're perfectly comfortable doing that. But hypothetically, how we think about any capital that would be freed up, first, we would focus on rightsizing debt-to-equity ratios, and then we would think in terms of how do we replace those earnings via growth strategies, both those that we can control from an organic side and then acquisition side. So that would be a high priority. I think we've been talking about that for at least the last 9 to 12 months as far as the priority of our capital. So yes, I would prioritize growth in earnings over just share buybacks at that point.

Operator

Our next question comes from the line of Jay Gelb from Barclays.

Jay H. Gelb
Barclays PLC, Research Division

I just want to level set for Talcott. I believe you said earnings will be down for Talcott 10% in 2017, adjusting for normalized items -- or adjusting for unusual items in 2016. So what's the baseline you're using for 2016?

Beth A. Bombara
Chief Financial Officer and Executive Vice President

Yes. So if you look at our results over the last 12 months, we have benefited from partnership returns sort of in excess of our plan and some of these onetime items. So if you adjust for that and take -- think about a 10% reduction in sort of run rate of Talcott, I think you're -- you'll see that you'll kind of get in that $300 million range for 2017.

Jay H. Gelb
Barclays PLC, Research Division

That's helpful, thanks Beth, and basically in line with what we were expecting. The other question I had, a little more broadly on the return on equity profile. Based on all the puts and takes you're expecting for 2017, and we've already known about the pace of share buybacks, $1.3 billion, where do you think that roughly puts you for return on equity in 2017?

Christopher John Swift
Chairman & CEO

Jay, it's Chris. Well, I appreciate the call -- or the question on the call here. So if I look at -- and we've been trying to talk to our key ROE metric as ex-Talcott. As I think everyone knows, there is a number of trapped capital in Talcott. So if I look at where we ended '16 at 8.9% on a trailing 12-month basis, I think if we perform to the plan that we outlined and the metrics that we gave you, that could be up 200 basis points, especially without an A&E charge in '17.

Operator

Our next question comes from the line of Thomas Gallagher from Evercore ISI.

Thomas George Gallagher
Evercore ISI, Research Division

Chris, I will ask a direct question on Talcott. Just from an M&A standpoint, can you comment on where you would see kind of bid-ask spreads right now? I think from what I've heard from you guys before, there were some challenges related to the VA part considering regulatory developments and some tax questions. But as you guys show, majority of capital is not backing the VA part, it's backing the general

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account part. So I assume the environment has gotten a lot better from an M&A standpoint, but just curious what you're thinking there.

Christopher John Swift
Chairman & CEO

Appreciate the direct question. And look, we're not going to speculate on what we may or may not do. I think Beth and I have been consistent in talking in terms of risk is managed well. We have been taking excess capital out and plan to, as you saw in '17. And if there are counterparties out there, we'll continue to work hard to find parties that are interested in buying 2 legal entities that have both variable and fixed annuities, both deferred and payout in them. And you can't just point to one block of business and exclude the other because -- just given the legal entity nature. And we're at the point in our cycle right now where simple reinsurance transactions really don't accomplish our mission, Tom. So you put all that together, and I'll let you conclude. Rising rates help, robust equity markets, growth prospects for the future. So I'm actually bullish on our economic outlook in general, which I think bodes well for these types of liability structures going forward.

Thomas George Gallagher
Evercore ISI, Research Division

Okay, I appreciate that. And then just a question on the NICO deal. The $650 million of premium, I just want to understand, with that, did you transfer long-term bonds? Or was that cash? And can you comment on roughly what the lost yield would have been for you on that transaction?

Beth A. Bombara
Chief Financial Officer and Executive Vice President

Yes. So Tom, we transferred cash. But obviously, when you think about taking $650 million of cash out of the system, that comes with thinking about liquidating other assets. So we provided, I believe, in our press release when we announced the transaction that we'd expect some decrease in net investment income coming from that, modest. And that's all contemplated in the guidance that we've given relative to P&C net investment income for next year.

Thomas George Gallagher
Evercore ISI, Research Division

But Beth, I guess my question was, I assume there was a long-duration portfolio backing that line. And were those associated bonds the ones that were sold? So was there a disproportionate loss of yield? Or was it not -- was it that -- not that big of a yield drop for you?

Beth A. Bombara
Chief Financial Officer and Executive Vice President

Yes. I wouldn't think about it that way. Again, to some extent, yes, there's assets backing that portfolio. But when we look to manage the portfolio on a P&C side, it's a little bit probably more fungible than you probably think of on the life side. And so net-net, we took all that into consideration in looking at what we're anticipating for the net investment income for P&C next year, including some of the modest declines that we see in overall yield. But I wouldn't point to that as a significant driver of a decrease in P&C yield.

Operator

Our next question comes from the line of Brian Meredith from UBS.

Brian Robert Meredith
UBS Investment Bank, Research Division

A couple questions here. First, Doug, I just wanted to dive back into the Commercial Lines guidance a little bit here. And the question, I guess, I have is, how different is your kind of trend assumption that you're thinking about for '17 today versus when you were going into '16 and providing guidance? Are you still

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kind of thinking long-term trend? Or have things kind of deteriorated, or you're seeing that deterioration happening, which makes you more concerned about what's happening in '17 from a trend perspective?

Douglas G. Elliot
President

Fair question, Brian. I would say in the comp area, pretty consistent. Our view of go-forward versus what we're experiencing, very consistent. Auto, the severity in our commercial auto book, we've got higher expectations of loss trend in '17 than we did in '16, absolutely. And in GL, slightly higher as well. So nothing radically different, but we're feeling a little bit of tort pressure across the liability book. We're on it. We're pricing for it. But we also see the market and the competitive dynamics around us, and I think we just wanted to pick a prudent path.

Brian Robert Meredith
UBS Investment Bank, Research Division

Got you, appreciate that. And then my second question is, looking at the benefits business, I know that you all were -- had some initiatives to develop products and stuff basically to kind of cater to the ACA. I believe it was supplemental products. Has your thoughts on that changed now that there could potentially be repeal of that or changes to that? And kind of what are you thinking on that?

Christopher John Swift
Chairman & CEO

Brian, it's Chris. Generally, no. I mean, those supplemental products, as you said, had some strict definitions around of it, given ACA. So if ACA gets repealed a little bit, we'll have to watch to see the impact on the supplementary market. But we would not be interested in getting into any, I'll call it, mini medical plans or things along those lines. We think the nature of these products, the more we market them, the more we educate our customer base on them, will fit the needs with or without major ACA refinement.

Douglas G. Elliot
President

Brian, the only thing I would add is that clearly, the last 3 years, major focus on getting our voluntary suite up to par and where it needs to be. Secondly, and Chris, I think, has talked about this in the past, we are leaning into A&H over the next year or so. We've had an A&H product out there. We've looked at it. We think it needs some retooling. We're working on that now. And I think more to talk about as we move through 2017.

Operator

Our next question comes from the line of Meyer Shields from KBW.

Meyer Shields
Keefe, Bruyette, & Woods, Inc., Research Division

If I can just jump off of Brian's question. Do your 2017 auto trend expectations, are those in line with what you saw in the fourth quarter 2016?

Douglas G. Elliot
President

They are, Meyer.

Meyer Shields
Keefe, Bruyette, & Woods, Inc., Research Division

Okay. So that means you're not expecting further acceleration going forward?

Douglas G. Elliot
President

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No. But we are -- similar to Personal Lines, we do see this world in terms of a new norm, so we're expecting some of the pressure that we're feeling, and have felt in 2016, to continue into '17 and we're making those types of choices in our trend assumptions, both on Personal Lines and also on Commercial. The difference in Personal Lines is that, as you know, we've talked about a number of initiatives. We think we can bend the loss trend curve based on the initiatives that we've enumerated, and we're working hard to do that. That's how we're going to make progress against that stated goal because we've got some work to do to get our auto loss ratio -- auto combined ratios into those 96, 96.5 category.

Meyer Shields
Keefe, Bruyette, & Woods, Inc., Research Division

Okay, that's helpful. Two more questions on the commercial side. One, it looks like Small Commercial pricing improved a little bit from the third quarter to the fourth quarter, so I was hoping you could talk about that. And also maybe some more detail on the new entrants. I guess I'm a little more surprised that there's -- there are new entrants into the Standard Commercial Lines rather than Specialty.

Douglas G. Elliot
President

Yes. Let me take them one by one. We are clearly leaning into auto and our package liability business, and you're seeing that in the marketplace. So we are looking for more rate in Q4, and we're looking for a little bit more rate in Q1 of 2017. So there's an escalation based on the pressures we're feeling with loss trends. That's driving what's happening in Small Commercial. And relative to new entrants, fourth quarter was pretty much a normal quarter for us. So yes, there are new names. They're coming at Small from different directions. I don't think there's anything different in our results that was impacted by any of those names, and we'll continue to respect and watch and think about our strategy going forward. But I feel very good about where our Small Commercial business is operating and pleased that we're leaning in relative to building new product and some of the tools that we're rolling out for customers in the coming quarters.

Operator

Our next question comes from the line of Jay Cohen from Bank of America Merrill Lynch.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

I guess a couple questions for Doug. First, on the commercial side, specifically in the small and mid, the fourth quarter accident year loss ratio was kind of the best you saw all year. That was a very good trend as the year progressed, the fourth quarter being very good. Was there anything helpful there? A low level of non-CAT weather? Or were you adjusting kind of the full year loss ratios in the fourth quarter?

Douglas G. Elliot
President

There isn't anything that sticks out in my mind, Jay. Obviously, when we get to year-end, we want to make sure and do our best job at making sure the accident year full year is where it needs to be. In general, fourth quarter weather is slightly better, non-CAT, so there's a little bit of a positive bias on our property side, both small and middle, and we experienced some of that in the fourth quarter. Obviously, December is the month that triggers whether you have a good property quarter or not in fourth quarter, but there isn't anything to speak about that I think I would raise to that level.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Okay, great. Second question, on the auto side, I guess, it could be argued that size and scale are increasingly important in auto insurance and likely will be going forward. You're shrinking this business, obviously, due to profitability issues. Do you get concerned that by shrinking the business, you're losing out on the scale that you might need in the future to compete very effectively?

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Christopher John Swift
Chairman & CEO

Jay, it's Chris. I'd say we are taking the corrective actions necessary to improve our profitability, and that will obviously require some top line shrinkage. I think -- we focus primarily on the older age market. We think we have a niche that we've understood for a number of years. Our relationship with AARP is deep and very strategic for us and trusted. So I don't think scale, in and by itself, in that market is required. If we were ever to think in terms of more of a mass market strategy, then I'd say scale and how we would think about it differently, but we're not thinking about that. So I think we have the appropriate underwriting skills, the appropriate insights into that, call it, customer segment. And I think we have the appropriate claim skills embedded in the organization across the country to effectively manage it. We're in a rough spot now, no doubt, but we're not giving up, and it continues to be a strategic niche for us going forward.

Operator

Our next question comes from the line of Elyse Greenspan from Wells Fargo.

Elyse Beth Greenspan
Wells Fargo Securities, LLC, Research Division

Just a couple of questions on the personal auto side. When we're putting together some of your comments, it seems like when you came to your outlook, you're assuming we're going to maintain the high BI severity trends. So I'm assuming kind of to start '17, it's basically the trends that you ended '16 with. Just kind of confirming that. And then as you think about the components to get to your margin goal, are you assuming that there's some improvement both from the loss as well as earning through some of the expense initiatives -- additional expense initiatives next year? And then as we think a little bit further out, do you think -- is 2018 when you see -- obviously, you pointed to taking more rate that we'll return to profitability in the auto book as you think about going out a little bit further than '17?

Douglas G. Elliot
President

Elyse, let me try to tackle the pieces that all add up to, obviously, our overall performance. So on the pricing side, we've given you pretty clear insight into the progress we're making. And just a few moments ago, I also gave you a little bit of lens into 2017 and the fact that our written pricing will go up over the next couple of quarters. So as that earns its way into the book, we're getting a positive contributor to our progress against targets. At the core of your question, relative to loss trends, we are expecting, from a gross perspective, our loss trends in '17 to be about where they are in '15 -- I'm sorry, '16. So as we think about our data, our expectation for the accident year '16 is that our loss trend total frequency and severity put together is in that 6 range, 5.5 to 6. And that's essentially where we're planning for our gross trend in '17. What's different about '17 is now, the number of initiatives that we've been working and putting into market over the past 4 to 5 quarters, we expect some traction, and we're beginning to see that traction. So we're expecting several points of improvement against that loss trend. And the combination of earned rate working through and a bending of the loss trend curve drives our expectation of improvement in performance both in '17 and candidly, accelerating into '18 as well.

Elyse Beth Greenspan
Wells Fargo Securities, LLC, Research Division

Okay. And then there is -- when you think about that, though, do you think you also get some level of expense improvement in '17 when you come to your guidance? Or it's more driven off of improvement on the loss ratio side in the auto book?

Douglas G. Elliot
President

Yes. The core of our change is in the loss arena. I think our expenses, we've managed our expenses accordingly. I don't see a lot there. In fact, 2 and 3 and 4 quarters from now, I expect to be in a very

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different rate adequacy spot, and we've got places around the country where we're feeling much better today that we're pricing for the norms of the exposures in loss trend. And I think you'll see us begin to be more aggressive and thoughtful in our growth aspect.

Operator

Our next question comes from the line of Mark Dwelle from RBC Capital Markets.

Mark Alan Dwelle
RBC Capital Markets, LLC, Research Division

I wanted to ask a question related to the asbestos transaction. I mean, is there anything left there at all? Or maybe said differently, when you do your A&E study next summer, is there anything that can produce a change to reserves that will impact results either positively or negatively?

Beth A. Bombara
Chief Financial Officer and Executive Vice President

So I'll take it. It's Beth. So a couple things. One, just to be clear, and this will be in our 10-K, we intend to do our A&E studies in the fourth quarter going forward. Just given the transaction that we did, we don't anticipate it to be as significant, obviously. As it relates to our exposure that's left as it relates to A&E, again, this treaty covers substantially all of the A&E exposure that we have remained once we complete the sale of our U.K. subsidiary. The one thing, though, that we did retain as part of the transaction is to the extent that there's any uncollectible reinsurance that comes from our A&E exposures, we would still bear that risk. So that has not been a significant driver of our A&E reserve increases over the last couple of years, but that is one aspect of it that we did retain.

Christopher John Swift
Chairman & CEO

Mark, it's Chris. The only thing I would add is, as you know, asbestos language and policy forms changed in '85 for an absolute exclusion. There is some post '85 reserves that we had that we also ceded. So I think in terms of pre- and post-'85, A&E reserves are part of this cover.

Mark Alan Dwelle
RBC Capital Markets, LLC, Research Division

Okay, that's helpful. And then in your comments related to the Group Benefits, you mentioned a $13 million charge related to Penn Treaty. Maybe I missed it in the earlier remarks. Did you specify when that would be taken? Or any timing on that?

Beth A. Bombara
Chief Financial Officer and Executive Vice President

So again, that's going to be based on facts and circumstances. The charge will -- we will incur once the assessment is made and the liquidation begins. We think that could be first quarter, but it's really outside of our control. And we can't -- we won't book the amount until there's been a declaration.

Operator

We have no further questions in queue. I'll turn the call back to the presenters.

Sabra R. Purtill
Senior Vice President of Investor Relations

Thank you, Liza, and thank you all for joining us today and for your interest in The Hartford. If you have additional questions, please don't hesitate to follow up with Investor Relations by e-mail or phone, and we'll get back to you as quickly as possible. And as I mentioned, we hope to see you all soon at one of the events we'll be attending. Thank you, and we wish you a good weekend.

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

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