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The Hartford Financial Services Group, Inc. NYSE:HIG

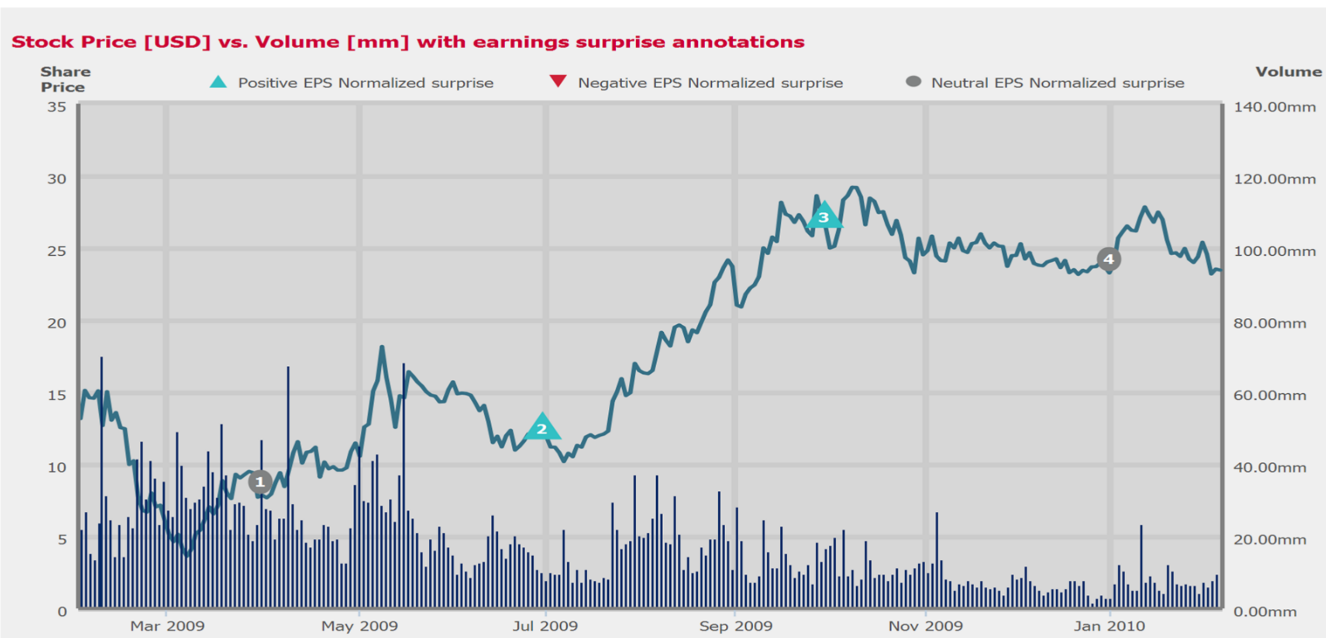
FQ1 2010 Earnings Call Transcripts

Friday, April 30, 2010 1:00 PM GMT

S&P Capital IQ Estimates

	-FQ1 2010-			-FQ2 2010-	-FY 2010-	-FY 2011-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.25	0.14	▼(44.00 %)	0.91	3.10	3.86
Revenue (mm)	4294.23	6319.00	▲47.15	4333.30	18517.87	17680.93

Currency: USD
Consensus as of Apr-30-2010 12:36 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ1 2009	(3.14)	(3.66)	NM
FQ2 2009	1.16	1.90	▲1 63.79 %
FQ3 2009	1.42	1.56	▲2 9.86 %

FQ4 2009	1.51	1.51	0.00 %

Call Participants

EXECUTIVES

Christopher John Swift
Chairman & CEO

Gregory G. McGreevey
Former Chief Investment Officer, Executive Vice President and Member of Office of the Chairman

John Clinton Walters
Former Executive VP, President of Life Operations and COO of Life Operations

Juan Carlos Andrade
Former President and Chief Operating Officer of Property & Casualty Operations

Liam E. McGee
Former Chairman

Richard Costello

ANALYSTS

Andrew Kligerman
UBS Investment Bank, Research Division

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Deutsche Bank AG, Research Division

Jamminder Singh Bhullar
JP Morgan Chase & Co, Research Division

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

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Macquarie Research

Randolph Binner
FBR Capital Markets & Co., Research Division

Scott Frost
HSBC

Thomas George Gallagher
Crédit Suisse AG, Research Division

Presentation

Operator

Good morning. My name is Conchetta, and I will be your conference operator today. At this time, I would like to welcome everyone to The Hartford First Quarter 2010 Earnings Conference Call. [Operator Instructions] Thank you. Mr. Rick Costello, you may begin your conference.

Richard Costello

Thank you, Conchetta. Good morning, and thank you for joining us for The Hartford's First Quarter 2010 Financial Results Conference Call. Our earnings release and financial supplement were issued yesterday. The slide presentation for today's call is available on the Company's website at thehartford.com.

CEO, Liam McGee; and CFO, Chris Swift, will provide prepared remarks this morning, and we will finish with Q&A. Also participating on today's call are Juan Andrade, President of the Property and Casualty Operations, John Walters, President of the Life Operations, Greg McGreevey, Chief Investment Officer, and Alan Kreczko, General Counsel.

Turning to the presentation, on Slide 2. Please note that we will make certain statements during the call that should be considered forward-looking statements, as defined in the Private Securities Litigation Reform Act of 1995. These include statements about The Hartford's future results of operations. We caution investors that these forward-looking statements are not guarantees of future performance and 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 report on Form 10-Q for the first quarter of 2010, our 2009 annual report on Form 10-K and other filings we make with the Securities and Exchange Commission. We assume no obligation to update this presentation, which speaks as of today's date.

Today's discussion of The Hartford's financial performance includes financial measures that are not derived from Generally Accepted Accounting Principles or GAAP. Information regarding these non-GAAP and other financial measures, including reconciliations to the most directly comparable GAAP measures is provided in the investor financial supplement for the first quarter of 2010, in the press release we issued yesterday and in the Investor Relations section of The Hartford's website at www.thehartford.com.

Now I will hand the call over to The Hartford's Chairman, President and CEO, Liam McGee.

Liam E. McGee
Former Chairman

Thank you, Rick, and good morning, everyone. And thank you again for joining us today. Before we get started, I want to welcome Chris Swift to his first Hartford Earnings Call. I'm pleased to have him on-board and appreciate his contributions to what the Company has accomplished in the past 60 days. I also want to thank those of you who joined us earlier this month for our investor presentation, either in person in New York or on the webcast. We appreciate the positive feedback, as well as the questions we've received and we're now focused on executing our strategy in achieving the financial targets we set, high single-digit core earnings growth and an 11% ROE by 2012.

I'll provide some additional color on the strategy today and share some of our earlier progress. Obviously, success will not come in one quarter and instead, will be measured by the results we generate over the next few years. And as I've said, since my arrival, our goal is to deliver superior shareholder returns over time through a sustained profitable growth, and that is what we intend to do.

We made good progress in the first quarter. We continue to execute on our 2010 plans, strengthen the balance sheet with a successful capital raise and the TARP repayment and launched our new strategy. While there is more to do, frankly, we got a lot done. I want to thank The Hartford team for all their hard work and efforts.

With net income of $319 million, the first quarter marked our second consecutive profitable quarter and as a company committed to driving sustained profitability, this is an important result. A strong equity market, our continued commitment to underwriting discipline, and improving credit markets, all contributed to our results.

Chris will go into more detail, but we did have a few one-time charges for the quarter, relating to the TARP repurchase, the settlement of a litigation matter and the impact of new federal healthcare legislation. Without these items, core earnings would have been over $1.30 per share. The first quarter also showed growing top line momentum across many of our business lines, including Mutual Funds, Retirement Plans and P&C commercial lines. Both Small Commercial and Middle Market continued to generate profitable new business growth in the first quarter. They also reported meaningful increases in policy retention. In fact, in Small Commercial, we added more new business policies and had the highest policy count retention in three years.

In Wealth Management, net flows were positive and sales showed year-over-year gains in most of our ongoing businesses. Mutual fund sales were up 63% over the prior year and retirement plan deposits were up 15%. In individual life, we posted a year-over-year sales increase for the first time, since the second quarter of 2008. In consumer markets, the AARP through agent program continues to generate top line growth, accounting now for 20% of new business in the states where it's available. We're on track to have the AARP through agent offering in 42 states in the second half of this year. For the rest of 2010, we anticipate a modestly improving economic environment, which should help to drive top line improvements in our more economically sensitive lines.

Finally, we were pleased to finish the quarter with book value per common share 61% higher than last March at $38.94. More important is the fact that book value per share was essentially flat. We think this is a good result, as rising prices on our fixed maturity holdings and the earnings power of our businesses offset the dilutive impacts of the capital raise.

We made significant progress strengthening the balance sheet this quarter. We had a very successful capital raise and were pleased by the reception we received from investors. We believe The Hartford now has the right capital structure for this environment and is positioned to move forward with a balance sheet that can handle any reasonable stress scenario.

As you know, we announced our go-forward plan earlier this month. The strategy leverages The Hartford's key strengths: a strong brand, a unique product breadth, enviable distribution and a large growing customer base across our organization. To ensure that we execute this plan and instill discipline and accountability for delivering results, Chris has established a team that will drive consistency in terms of our changed processes and how we will measure progress and success. We are already well underway on work related to commercial markets, operations, IT and overall efficiency.

The Hartford's organization is shifting to the customer-focused structure. And teams are working together to call on customers, leverage best practices and importantly, win new business. As an example, within the last couple of weeks, our Commercial Markets business, a combination of Group Benefits and P&C commercial lines has had some early customer wins. Sales teams are beginning to join together, sharing information about relationships, sales practices and industry appetites. They are quickly uncovering new opportunities and we are encouraged by these early results. Brokers and agents have expressed support and enthusiasm, as this is the way many of them go to market. And they see the value of having a partner with a single point of accountability.

Innovation is an important element of our strategy. And earlier this week, we launched an important new product that combines, in a unique way, our expertise in workers' compensation, a traditional P&C discipline and group benefits, a traditional life discipline. With this innovative offering, which we call The Hartford Productivity Advantage, employers will be able to manage all types of employee leaves, workers' compensation, short-term and long-term disability and FMLA in one system. For an employer, this will make it easier for them to manage this complex process and will help them achieve efficiencies and improve productivity. This product gives us a distinct market advantage. This is something that a P&C-only or life-only company cannot easily match and it provides considerable advantages to time- and-moneystrapped benefit managers. This is just the first of what we expect will be more one-of-a-kind value-added offerings that leverage our product breadth.

So in summary, the first quarter was a profitable and productive one for The Hartford. We executed our 2010 plan, strengthened the balance sheet and launched our go-forward strategy. We are moving forward to generate sustained profitable growth with strength, confidence, focus and discipline.

The Hartford will celebrate its 200th anniversary on May 10. And over the next few weeks, you can expect to see the Hartford brand highly visible, as we celebrate our history, but more importantly, our future. Our employees and partners are excited to take this company into our third century. With that, I'll turn it over to Chris Swift, who will get into more detail on our financial results and outlook. Chris?

Christopher John Swift
Chairman & CEO

Thank you, Liam. Good morning, everyone. It's great to be with you today.

Let's begin on Slide 4. As we reported yesterday, net income for the first quarter was $319 million and core earnings were $545 million. On a per-share basis, we reported core earnings of $0.14 and a net loss of $0.42. These numbers reflect the $440 million CPP repayment charge that was previously disclosed. Because the CPP charge runs through retained earnings, it reduces the computation of per-share amounts for net income and core earnings. The first quarter core earnings impact from this charge was $1.03 per share. First quarter results were generally in line with our expectations that reflect strong performance in most segments. The quarter also benefited from several items, including an $85 million DAC unlock, net prior-year reserve releases of $58 million and lower realized capital losses.

As Liam mentioned, several one-time charges impacted first quarter results. In addition to the CPP charge, we accrued a litigation charge of $47 million or $0.11 per share. This relates to an agreement in principle that we reached earlier this month to resolve a 2005 class action related to our structured settlement business. The quarter also included a $19 million tax charge arising from the new federal healthcare bill, as we disclosed on April 1. In total, these one-time items amounted to roughly $1.18 per share in the quarter.

As Liam also mentioned, all-in book value per share was essentially flat in the quarter when compared to year-end 2009. As we said at our April 1 investor event, going forward, we will report diluted book value per share excluding AOCI. This calculation has two benefits. First, it eliminates volatility from mark-to-mark [mark-to-market] changes in our investment portfolio. And second, it takes into account the preferred shares we issued in March, as well as the outstanding warrants. You could see in the slide that diluted book value per share, excluding AOCI, ended the first quarter at $39.85.

Finally, core earnings ROE for the 12 months ended March 2010 was 10.6%. This includes the benefit of approximately $750 million of positive DAC unlocks over the past four quarters. This benefit was partially offset by the $440 million CPP charge in the first quarter. Excluding these two items, core earnings ROE was 9%.

Let's move to Slide 5. Before I begin, I want to update you on a few changes in our segment reporting. In our investor event in April, we announced that we would organize The Hartford around its customer segments. The process of reorganizing the company is underway and we intend to align our segment reporting with the new organization later this year, beginning with our third quarter results.

That said, we did make two changes in our Life segment in the first quarter. The first change was to move the Mutual Fund business from the old Retail segment into a new segment called Retirement. The new Retirement segment includes Mutual Fund and Retirement Plans businesses. The first quarter investor supplement restates prior periods to reflect this change. The second change was to combine all mutual fund related assets and results within the Mutual Fund business. This change was made on a prospective basis only, beginning with the first quarter of 2010.

Previously, the mutual fund related assets and results were reported in several segments. As a result, it was impossible for investors to see the totality of our mutual fund complex. With almost $98 billion of assets under management, we believe it was important to clarify the size and scale of this operation.

Now moving back to Slide 5. Let's discuss our operating performance for the quarter. Although we intend to formally change our reporting structure for our third quarter results, my comments in the slide are organized around our new customer-centric businesses.

First, consumer markets. We continue to strike the right balance between growth and profitability. Written premiums were $941 million, essentially flat to last year. The current year accident year combined ratio was 91.1%, excluding cats [catastrophe], which were in line with our expectations. We've been taking a number of actions to improve profitability in both auto and home. These steps include improving rate in both lines, while focusing new business on more profitable 40-plus preferred and near-preferred consumer segments. We are seeing the benefits of these actions, as 80% of the new business in the first quarter came from these more profitable segments. Additionally, premium retention improved to 87%, driven by 5% and 9% increases in auto and home, respectively. We are pleased with the growth opportunities in this business. Policies in force grew year-over-year in both auto and home, even as we raised rates. A significant contributor to that growth is our unique AARP relationship, which we continue to expand with our AARP-through-agents initiative.

Now let's turn to Slide 6 for the discussion of the commercial markets results. Our Property and Casualty commercial lines continue to execute well in the quarter. Underwriting profitability was strong, with x cat accident year combined ratio of 92.8%. This ratio reflects strong performance in small commercial, middle market and specialty commercial operations, with lost costs remaining within expectation. Our renewal pricing was positive in middle market and small commercial, as we continue to take rate where appropriate. Written premiums for the first quarter were essentially unchanged from the first quarter of 2009. The weak economy continues to depress exposure levels, particularly for our larger policy holders. In middle market, a reduction in auto premiums lowered year-over-year growth by three percentage points. However, improving policy and premium retention and new business growth were enough to offset the impact of the weak economy in the quarter. Small Commercial business climbed 9% in the quarter and year-over-year policies in force grew 4%, driven by the success of our growing Spectrum business owner's policy.

Also highlighted on Slide 6, is our Group Benefits business. Fully insured premiums for group insurance had been pressured by lower payrolls. The lower premium, along with the increase in morbidity and higher commissions in our loss-rated business, weighed down first quarter results. Quarter also reflected typical seasonality we expect, with respect to severity.

Now let's turn to the first quarter Wealth Management results on Slide 7. Our Wealth Management business showed increasing sales momentum in the first quarter. Mutual Fund business had another outstanding quarter with deposits totaling $4.4 billion, up 63% over first quarter of 2009 on a comparable basis. The significant growth was driven by a combination of strong fund performance and improving equity markets. Looking ahead, we have launched several initiatives to increase institutional mutual fund activity in the remainder of 2010.

In Retirement Plans, strong fourth quarter sales drove a 15% year-over-year increase in first quarter deposit to $2.6 billion. First quarter sales were also strong and we could end the year closer to the top end of our deposit guidance if payrolls rise and plan sponsors restart their matching programs. We also saw a top line improvement in individual life, with sales up 5% year-over-year. The growth was driven by traction in the independent producer channel, activity levels have been steadily rising and we are optimistic about sales growth potential from this new distribution opportunity. As expected, U.S. variable annuity sales for the first quarter were down from prior year at $454 million.

Feedback on our Personal Retirement Manager product continues to be positive. However, the process of launching the product in all states and with all our key distribution partners is frankly, taking longer than we anticipated. In light of first quarter sales and the slower product launch, we have lowered our full year guidance for VA sales to range from $1.4 billion to $2.2 billion.

Finally, profitability in all our Wealth Management businesses in the first quarter was significantly higher than prior-year levels. Margins have increased due to strong equity market appreciation and the expense action the company completed in 2009. In addition, we have benefited from positive net flows in our Non-Annuity businesses.

Now let's turn to Slide 8 for a review of our investment results. We saw significant improvements in our investment portfolio in the first quarter. Slide 8 shows the extent to which unrealized losses declined, spread tightening was the primary driver for the improvement. This favorable trend has continued in April, as prices in the CMBS markets have continued to improve. First quarter impairments were $152 million, this is the lowest level The Hartford has seen since before the financial crisis. Primary source of the impairments was collateral deterioration in specific CMBS and CRE CDO security. We also recorded a mortgage loan valuation allowance of $112 million in the first quarter. In connection with our ongoing de-risking efforts, we have been selling mezzanine loans and BPs [ph] loan participation. During the quarter, we sold approximately $600 million of these loans.

We've also identified another $400 million of loans that we intend to sell over the next 90 to 180 days. Most of the valuation that we accrued in the first quarter is attributable to these loans. Once we complete the planned sales, the carrying value of the company's mezzanine and BPs [ph] loans will be less than $500 million, down over 70% since year-end 2008. These actions have meaningfully reduced the risk in our ongoing portfolio and Greg and his team are doing an outstanding job in this effort.

Now let's turn to Slide 9 for our updated guidance. As we announced last evening, our new core earnings guidance for 2010 is between $2.70 and $3 per share. The updated range takes into account our first quarter results, as well as a slightly weaker Group Benefits outlook for the remainder of the year. A number of assumptions embedded in the guidance are listed on Slide 9. I won't review them with you today, but they are key to understanding the guidance. Finally, you will see in our earnings release, that we updated guidance for deposits, net flows and ROA in our Mutual Fund business to reflect the reporting changes we made.

Our first quarter results can be summarized as follows: Core earnings were generally in line with our expectation; top line momentum is building across many of our ongoing businesses; our investment portfolio benefited from favorable credit markets, a trend that we continue to see in April; and finally, we increased our full year core earnings guidance by $0.10 per share. With that, I'll turn the call over to Rick, as we move into the Q&A session.

Richard Costello
Thank you, Chris. Before we begin the Q&A session, I would ask each caller to limit himself or herself to two questions. This will allow us to get to as many callers as possible. Conchetta, you may now open the call to questions.

Question and Answer

Operator

[Operator Instructions] And your first question comes from the line of Andrew Kligerman with UBS.

Andrew Kligerman
UBS Investment Bank, Research Division

One, the targeted ROE for '12 of 11%, just looking at the Property-Casualty business, where I might have the most skepticism, would the combined ratio x cat prior-year development need to be in your guided range of 91.5% to 94.5%? That's the first question. And then real quickly on the alternative investment income, what is it, about $1.7 billion of investments? I think you earned about $6 million this quarter, not a big yield, and you've got zero guidance for the balance of the year. When is it going to -- when might you expect to see an improvement? What might it take for that to turn and generate some material yield to The Hartford?

Liam E. McGee
Former Chairman

Andrew, this is Liam. I'll have Juan answer the first question and then Greg will take the second question.

Juan Carlos Andrade
Former President and Chief Operating Officer of Property & Casualty Operations

Andrew, this is Juan. If I understood your question correctly, I think you're asking us if in order for us to generate target ROEs in our range, whether we need to be within the combined ratio guidance range that we have provided. The answer is the combined ratio guidance we have actually will produce better ROEs than that. It would complement with the profitability that we're currently generating.

Andrew Kligerman
UBS Investment Bank, Research Division

And Juan, I mean, and I guess this kind of ties back to Chris, I mean when you look out to '12, do you need to stay in that range in '12? Or can it even go outside that range and you would feel comfortable with an 11% ROE?

Juan Carlos Andrade
Former President and Chief Operating Officer of Property & Casualty Operations

So from Property-Casualty standpoint, I think you do have some flexibility in going outside of that range. Now we clearly don't discuss the target combined ratios per segment, but you can actually have some flexibility with that range.

Andrew Kligerman
UBS Investment Bank, Research Division

So the company could, overall, the corporation could do an 11% ROE. I guess I understand P&C ROEs. I'm talking Hartford corporate overall.

Christopher John Swift
Chairman & CEO

Andrew, it's Chris. That is -- the guidance and the objective and the goals Liam and I sent out in April, an overall 11% ROE for the organization in 2012. So we have some flexibility within the loss ratio. The guidance also, for the remainder of the year, does not include any other, I'll call, a favorable development. So we're not predicting at it at this point in time. We do have our other operations guidance that we continue to give. But again, I think your overall question is, what is the overall Hartford enterprise target? It is 11%.

Andrew Kligerman
UBS Investment Bank, Research Division

Right. And just to make sure I'm clear, if the combined ratio went out of 94%, the high end a little bit, you think you could still do it?

Christopher John Swift
Chairman & CEO

Yes, we have flexibility. Again, the overall strategy, if you recall, is driven by organic growth. So we think we have ability to continue to generate organic growth, and then we'll have other, I'll call it, capital management levers to utilize it at the appropriate time. Greg, do you want to take the second part to answer the question?

Gregory G. McGreevey
Former Chief Investment Officer, Executive Vice President and Member of Office of the Chairman

Yes. So anyway, just on the alternative side, our alternative performance, it improved significantly, as you pointed out in the first quarter compared to prior quarters over the past year. And let me give you just a couple of pieces of information. We didn't have very strong returns in private equity funds, and to a lesser extent, hedge funds, which were offset by additional price declines in our real estate funds. So we're encouraged by these results, clearly, but we do want to see longer-term stabilization of results before changing any projections of returns, especially as it relates to the real estate market. Overtime, we do anticipate, as I think I mentioned on the last call, getting back to average historical returns in this asset class of somewhere in the 7% to 8% range.

Operator

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

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

I'm wondering if you could give us maybe a little bit more behind the increase in your guidance for 2010? I'm looking at the segment guidance in your release, and it looks like everything is sort of flat, maybe even down a little bit modestly in some of the Life cases. So just wondering what's driving the $0.10 increase in the overall guidance. Is that something on the investment income line? Is it lower share count than you previously expected? Or is it just a function of the market?

Christopher John Swift
Chairman & CEO

John, it's Chris. It's really a function of our actual first quarter results that we've printed, and then, I'll call it, the remaining three quarters, plus the favorable tailwinds that we feel in the market and the general improvements that we're experiencing.

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

I have a philosophical one for you. It may be Chris, especially in light of the change, the transition now as CFO, The Hartford reports the results of hedging programs, I guess especially related to the VA business below the line or outside of your operating earnings. And clearly, hedging is a cost of doing that business or being in that business. And if I compare you guys to just about everyone of your larger peers, they include those costs and operating results but you don't. I'm wondering if you'd contemplate a change there.

Christopher John Swift
Chairman & CEO

John, as we sort of get up to speed here, it's a good point. I can tell you honestly, we don't contemplate any changes at this point in time. We're fully aware of the economics and manage it that way. But from a reporting side, we haven't concluded if we're going to make any changes at this point in time.

Operator

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

Jamminder Singh Bhullar
JP Morgan Chase & Co, Research Division

For Juan, maybe, just on favorable reserve development in your P&C business, it sustained a lot longer and at a higher level than I would have assumed maybe a year or two years ago. So if you could just give us some color on which accident years are developing positively across your various businesses. And then secondly, on employee benefits, your sales were weak this quarter, both Group Life and Group Disability were down. I'm assuming this is partly because of disruption and capital issues around midyear last year. But if you could comment on -- have things stabilized in over the last few months and whether you expect a recovery from this? Or is the first quarter of market share that you'd have a new base of that you would growth?

Juan Carlos Andrade
Former President and Chief Operating Officer of Property & Casualty Operations

So let me address first the question on prior-year reserve development. So we continue to have a very strong reserve position. For the quarter, we had releases before tax of $90 million. Those were primarily in the liability lines, including middle market umbrellas, specialty casualty, general liability and also professional liability, directors and officers. With specific question regarding the accident years that they came from, it really depends on the line of business. So for example, if we look at the financial lines, those were primarily accident years 2001 to 2006. If you look at the umbrella prior-year development, those were accident years 2004, 2008. And also, if you look at our personal lines, you're looking at also essentially 2005, 2006. So essentially, that provides you a context for the accident years.

Liam E. McGee
Former Chairman

Jimmy, John is going to take the Group Benefits question since that business reported to him this past quarter.

John Clinton Walters
Former Executive VP, President of Life Operations and COO of Life Operations

Jimmy, on the Group Benefits side, I think we've been saying for some time that we expected sales in the first quarter to be slower because of the disruption that we had last year. This is our longest sales cycle business that is in the Life Company. So we expected it to be the longest to see the downturn, and therefore, the upturn should occur during 2010, culminating in the first quarter of 2011, which when we get all of our national account sales. So the biggest clients that we have, which is about 60% of our business, are generally one-on-one clients for when the sales occur. And that's what you're seeing in the first quarter here. We do see positive trends developing now, although the market continues to be very competitive from a pricing standpoint. And there is somewhat less activity in the market as people are effectively defending their existing positions.

Jamminder Singh Bhullar
JP Morgan Chase & Co, Research Division

Another one on Group Benefits, your loss ratio has been relatively stable year-over-year. I think it was up by 10 basis points or something. Have you seen an uptick in the disability claims with the economy getting worse? It doesn't seem like you have on a year-over-year basis, though.

John Clinton Walters
Former Executive VP, President of Life Operations and COO of Life Operations

We're seeing some normal volatility in disability claims experience. We're seeing some minor uptick in things that we would say are more economically sensitive, but not enough yet to call that a conclusion as to really affecting our disability claims experienced. It's something we're watching closely and carefully managing but we can't say yet that that's really a driver of it.

Operator

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

Randolph Binner
FBR Capital Markets & Co., Research Division

This question is probably for Chris Swift. But just wondering, it sounds like you sold almost $1 billion or you're planning to sell almost $1 billion of these subordinated mortgage loans. Is there a material RBC pick-up there? And also wondering where you might be looking to reinvest some of those proceeds.

Liam E. McGee
Former Chairman

We'll have Greg take that one, Randy.

Gregory G. McGreevey
Former Chief Investment Officer, Executive Vice President and Member of Office of the Chairman

I guess two parts to it. We have sold or in the process of selling $1 billion down in capital structure financials. Then when we look at that, we will take a small loss on those sales, but at the same time, we will get some capital impact from the investments that we're going to be taking that cash and reinvest it into. As we've talked about before, we're continuing to reinvest assets and high-quality corporate bonds primarily and driving towards our long-term model portfolio. So when you kind of think of this on a capital basis, we really think that the trades that we're doing are going to be capital-neutral over time, and we'll have little impact to ongoing and future income. So it would probably be capital-neutral, I guess, is the easiest way to think about it from a capital standpoint.

Randolph Binner
FBR Capital Markets & Co., Research Division

Any thoughts on the proposal from some NAIC [National Association of Insurance Commissioners] members to potentially increase the base rate for commercial mortgages?

Gregory G. McGreevey
Former Chief Investment Officer, Executive Vice President and Member of Office of the Chairman

We've been part of the working group discussions with the NAIC and have been monitoring that very closely. Clearly, it's our understanding that the NAIC proposal is open to further comment. That comment is being considered by proposal by the ACLI [American Council of Life Insurers]. It's really too early to tell right now because the proposal is still open to interpretation. I think the important thing for you to realize is if the NAIC draft of new proposal was adopted as written, we expect it would have a very insignificant impact on our capital base somewhere around $100 million or so.

Randolph Binner
FBR Capital Markets & Co., Research Division

So insignificant impact on capital base or on RBC overall?

Gregory G. McGreevey
Former Chief Investment Officer, Executive Vice President and Member of Office of the Chairman

On RBC, and that's on a levered RBC. So we think that if the proposal is adopted as is, that on a levered basis, the total impact from an RBC standpoint would be $100 million dollars or less on our portfolio.

Randolph Binner
FBR Capital Markets & Co., Research Division

So much less than the Moody's. The recent Moody's report on the subject might imply?

Gregory G. McGreevey
Former Chief Investment Officer, Executive Vice President and Member of Office of the Chairman

That is correct.

Operator

And your next question comes from the line of Darin Arita with Deutsche Bank.

Darin C. Arita
Deutsche Bank AG, Research Division

Just a question on capital. I appreciate all the work that Hartford's done here with its stress scenarios and that makes sense, given everything that we've gone through. But I'm sort of wondering also if we could flip it around and say what could go right. What happens if the markets continue to rise? Or if the S&P gets up to, say, 1,400 or 1,500 rather then the stress scenarios of 700?

Liam E. McGee
Former Chairman

Well, at high level, Darin -- this is Liam. At a high level as we've talked about in our investor conference, we're well aware that we could conceivably have capital flexibility in the future. Obviously, we think 30 days after showing you our stress scenario, it's too early to anticipate that. And it's also too early, if it were to occur, to speculate on what actions we might take. We think today and particularly in view of what happened in the markets around Greece this week, that we have the appropriate amount of capital for any reasonable stress scenario. If the scenarios you describe occur, obviously, we're running the firm to maximize shareholder value. We'll evaluate our options at that time.

Darin C. Arita
Deutsche Bank AG, Research Division

And then secondly, if I look at the Mutual Fund business, that franchise is coming together very well. I was wondering if you could give a little more detail in the initiative that you're taking to increase the institutional Mutual Fund business later this year.

Liam E. McGee
Former Chairman

John will take that, Darin.

John Clinton Walters
Former Executive VP, President of Life Operations and COO of Life Operations

We're very excited about how the Mutual Fund business is going today. We have very strong performance across a broad array of different asset classes, and you can see that in the sales number from the first quarter. The strongest part of our sales in the first quarter was in the Institutional space, where, for sometime, we've had an Institutional team that is out there trying to build that business. I would say, we're getting increased traction. We have reorganized that team to align better with the rest of our Mutual Fund business over the last six months. It used to be in our Institutional segment. We've aligned it with the Mutual Fund segment to give a better opportunity there. But we're also expanding into more of the Registered Investment Advisors space with that team, which is a group of independent advisors that can move large dollars in that business and where we think we've got the right product line to be successful. And so that's very early. But we expect to see improving trends there over time. It will be somewhat lumpy. So when you look quarter-to-quarter, you may see strong quarters and weaker quarters because they can be very large deposits. But we think that the trend overall will be positive.

Operator

And your next question comes from the line of Paul Sarran with Macquarie.

Paul Sarran
Macquarie Research

A question on variable annuities. It seems that with the delays in getting the Personal Retirement Manager product rolled out nationwide that Hartford could maybe be at risk of becoming increasingly out of sight, out of mind among producers, advisors and so on. So my question is, with each kind of extra month or quarter of delay in getting the product approved in the bigger states, does that make it incrementally more difficult for The Hartford to re-establish prominent position in the VA market once the product rollout is finally complete?

Liam E. McGee
Former Chairman

This is Liam, and then John may certainly have some detail. I think it's important to emphasize two things. First of all, because it's a new product and a new concept, it has taken longer than we expected to get it approved in states and with the large distributors, as John indicated. However, to your point of relevance and out of sight, out of mind, as John can elaborate, the distributors themselves are very excited about the product. It's a different concept. And it reminds you that we said, we are aiming to generate about $5 billion in annuity sales by the year 2012. We're going to run our Annuity business against those three principles that we've been consistent in communicating. We want it to be a lower-cost product for the customer. We want it to be a simpler product, and we want it to be focused on guaranteed income.
So because it's different in concept, it is taking longer. But that should not take from the fact that the distributors are actually quite excited about it. So a slower startup, but I actually think it will be quite relevant.

John Clinton Walters
Former Executive VP, President of Life Operations and COO of Life Operations

In the mean time, in the states where we're not yet approved with the new product, we are continuing to sell our existing product. So we're not out of those states in the meantime. I think that's very important to understand. We have an outstanding sales organization that is continuing to actively engage with all of our historical producers and new producers, and to lay the groundwork for the new product as it comes out. We will be launching one of our key distributors in the month of May, which is a big next move for us. There's only one other major distributor that we're preparing to bring on. And then as we've said, we had got a couple of key states that are pending, and we're optimistic that those will get approved either in the second or early third quarters.

Paul Sarran
Macquarie Research

Are you seeing any higher turnover or maybe other signs of frustration within your internal producers, wholesalers, just with the sales levels down so significantly from a year ago and the delay in getting the product rolled out? Have you seen any effect there?

John Clinton Walters
Former Executive VP, President of Life Operations and COO of Life Operations

No, we really haven't. We made the decision almost six months ago now to streamline our sales force. We think we retained the very best talent, and we have put programs in place to make sure that we continue to retain them. Their enthusiasm for the new product is quite high, and so it's a question of executing on it and getting the sales momentum to build, which they are very focused on at this point.

Paul Sarran
Macquarie Research

One other question on the macro hedging strategy. Has there been any change in the approach to this strategy? And can you just maybe update us generally how you're thinking about the program?

Christopher John Swift
Chairman & CEO

It's Chris. Again I think, generally, you could think in terms of things that are consistent. I think the one major change that we could talk about is that we extended our macro equity protection into 2011 within the last two weeks, again, which we think is prudent, given that we took advantage of the market levels and some lower volatility and put on a little currency protection, again as the yen particularly weakened. We took some opportunities to put some protection on there just to cover some tail risk. So I would say, generally, as we've thought about or if you've thought about the program in the past, it's relatively consistent with another year of protection on a macro equity basis.

Paul Sarran
Macquarie Research

And so the equity program is still essentially buying straight equity puts. And from a cost basis, if the market kind of trends as expected, should we continue to see its losses around $75 million, $80 million a quarter?

Christopher John Swift
Chairman & CEO

Yes, it's a good point. Again I would call it out-of-the-money puts on the equity side. And again, given the market levels, I think you should maybe begin to think about it as $60 million a quarter as far as the cost of the new program in 2011.

Operator

And your next question comes from the line of Thomas Gallagher with Crédit Suisse.

Thomas George Gallagher
Crédit Suisse AG, Research Division

I just wanted to follow up on the hedge to something John Nadel was asking before. Can you just remind us, what is included in the operating or core earnings, what's below the line? And it's a little foggy here since it was probably a while ago before we were as obsessed about core earnings here, but my recollection was it was something like 30 basis points, or maybe it was 20 basis points of a cost was actually being run through core earnings and then everything else, like the macro hedge that were being discussed now, is all below the line. Is that accurate? Or maybe you could just give us an update on what's included in core, what's below the line related to hedge costs.

Christopher John Swift
Chairman & CEO

It's simple. I think your statements are accurate as they are here today, yes.

Thomas George Gallagher
Crédit Suisse AG, Research Division

So Chris, there is some element that's being included in core earnings, which would be more the hedge that's specifically designed to match the liability. The macro hedge, which is more of a capital hedge, is not included. Is that fair to say?

Christopher John Swift
Chairman & CEO

I would describe it as, again, generally that way. I think in terms of our reinsurance costs, obviously sort of net fees in there. And so yes, I think you're correct.

Liam E. McGee
Former Chairman

So Tom, you're describing it accurately.

Thomas George Gallagher
Crédit Suisse AG, Research Division

And then just one other question on the variable annuities. Is there a minimum level -- and maybe this is for John and/or Chris. But is there a minimum level of sales that you need to produce on the variable annuity side in order to avoid a meaningful DAC write-off. And by that, I mean, is there some fixed cost element that's DAC-able, whether it's internal wholesale or costs or the like, that would require you to produce minimum sales level of VAs that we should be aware of and/or that would require much more substantial DAC amortization to be run through the P&L?

Christopher John Swift
Chairman & CEO

It's Chris. I mean the DAC policy, I mean we've capitalized costs at sort of very width [ph] (1:06:10) and are directly related to the production of new business. So from a fixed cost side, I'm not aware meaningfully -- we're capitalizing it at this point in time.

John Clinton Walters
Former Executive VP, President of Life Operations and COO of Life Operations

The sales cannot create a big DAC write-off for us. So regardless of what the sales number is, that won't create a big DAC write-off. We are operating today at a sales level that is below what we would like to operate to fully cover all of our distribution costs. We expect to build back into that overtime. That's a conscious decision that we've made to protect the franchise as we get back into this business.

Operator

And your next question comes from the line of Scott Frost with HSBC.

Scott Frost
HSBC

I wanted to talk about the proposed new derivatives rule. There's an article out in The Times, for example, speculating on the hit that broker-dealers could take if the rules were implemented. I wanted to ask, if anyone -- I came to the call late, if you've covered this already, I apologize. But has there anyone at your shop assessed the potential effect of new derivatives rules, what they would have on your results? If so, what have they said? If not, are there plans to do so? When would you have some sort of determination as to whether the new rules would affect you and what sort of magnitude and effect that might be?

Liam E. McGee
Former Chairman

Well, Scott, as you know, it's not just a Hartford issue, it's an industry issue, number one. Number two, that is a work in flux and in change, and there's just not enough specificity for us to even speculate on that. Now I can assure you that our teammates are engaged and involved with that process, but I think it's too early to tell.

Scott Frost
HSBC

Would this effect hold GAAP results, as well -- would it affect statutory results, as well as GAAP results, do you think? Or can you give any kind of clarity with respect to that even?

Christopher John Swift
Chairman & CEO

Scott, it caused the increase through exchange-traded activities. If the Life industry does not get an exemption, we would have to record those costs, both on statutory and GAAP income statements.

Operator

You do have a follow-up question from Randy Binner. [FBR Capital Markets]

Randolph Binner
FBR Capital Markets & Co., Research Division

Maybe to touch on the other pieces of the Financial Services Reform. I guess there's Volcker Rule, there's TARP tax. Liam, I just would be curious kind of to get your take on how Hartford and the industry might be affected by those measures as well.

Liam E. McGee
Former Chairman

Well, Randy, as you know, I have to repeat what I said just a few seconds ago that we're well aware of the three primarily categories that you described that could impact our industry. But there's just not enough specificity yet for me to comment on what impacted, if any, it might have on us.

Randolph Binner
FBR Capital Markets & Co., Research Division

A follow-up to what Paul was saying, I mean, is there any thought that the new Personal Retirement Manager product might also be better suited for a different distribution channel because it's a more kind of simplified lower-cost product? Would it necessarily be something as long as you're at an inflection point in distribution in any way? Should we think of this as something that could may be distributed more through a bank or another channel instead of the heavy independent financial adviser focus?

John Clinton Walters
Former Executive VP, President of Life Operations and COO of Life Operations

This is John Walters, Randy. We think that this product will work well in all of our different channels. As you know, we had very broad distribution through banks, through independent financial advisers, through major Wall Street firms. The independent channel is where we can get the quickest traction because it's the easiest place to gain entry for a new product from a operational standpoint and approval standpoint. But we are launching it at all of our major distributors, and we expect to get traction in each of those channels. I think overtime, we'll find that some channels have greater success with it than others, but it's too early to call that at this point. We're after all of them aggressively.

Liam E. McGee
Former Chairman

As there are no more questions, thank you for joining us this morning. We appreciate your interest in The Hartford. Thank you.

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