S&P Capital IQ

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The Hartford Financial Services Group, Inc. NYSE:HIG

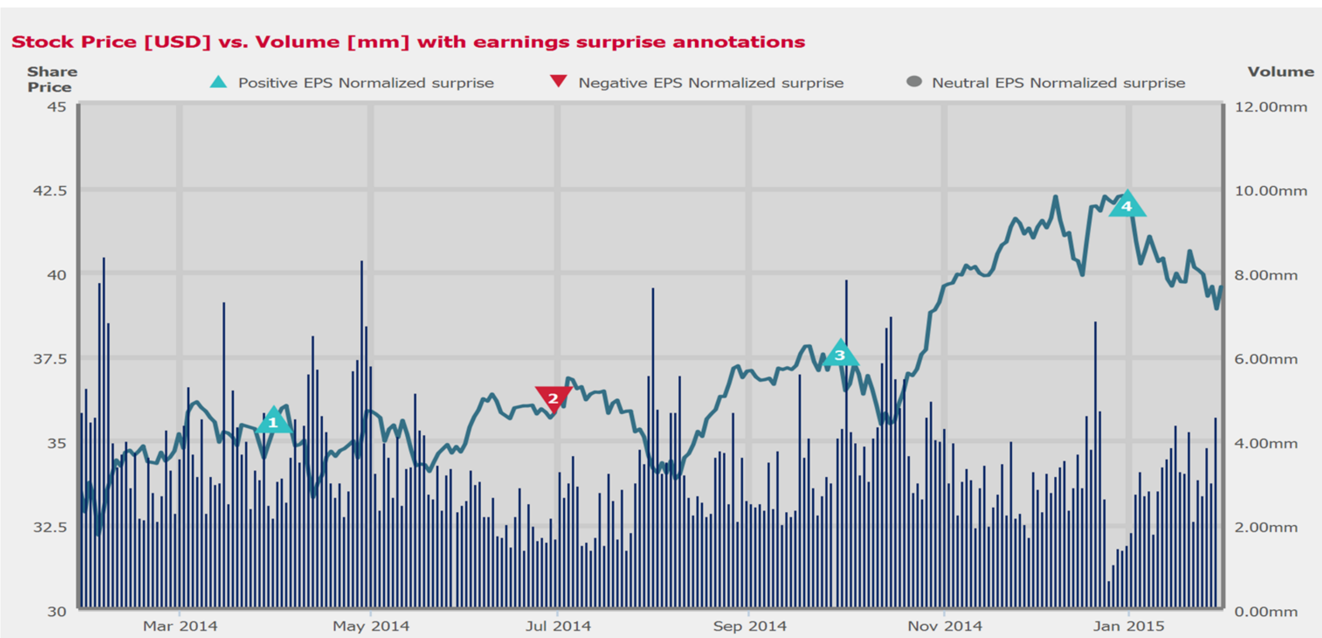
FQ1 2015 Earnings Call Transcripts

Tuesday, April 28, 2015 1:00 PM GMT

S&P Capital IQ Estimates

	-FQ1 2015-			-FQ2 2015-	-FY 2015-	-FY 2016-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.97	1.04	▲7.22	0.78	3.78	4.15
Revenue (mm)	4718.69	4617.00	▼(2.16 %)	4662.96	18809.46	19576.72

Currency: USD
Consensus as of Apr-28-2015 11:52 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ1 2014	0.93	1.18	▲1 26.88 %
FQ2 2014	0.67	0.31	▼2 (53.73 %)
FQ3 2014	0.84	1.06	▲3 26.19 %

FQ4 2014	0.93	0.96	▲3.23 %

Call Participants

EXECUTIVES

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Chief Financial Officer and Executive Vice President

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Chairman & CEO

Douglas G. Elliot
President

Sabra R. Purtill
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Presentation

Operator

Good morning. My name is Shawn. I'll be your conference operator today. At this time, I would like to welcome everyone to The Hartford's First Quarter 2015 Financial Results Conference Call. [Operator Instructions] Thank you. Head of Investor Relations, Sabra Purtill, you may begin your conference.

Sabra R. Purtill
Senior Vice President of Investor Relations

Thank you, Shawn. Good morning, and welcome, everyone, to The Hartford's first quarter 2015 financial results webcast. Our news release, investor financial supplement, first quarter financial results presentation and 10-Q were all filed yesterday afternoon, and they are available on our website. Our speakers today include Chris Swift, Chairman and CEO of The Hartford; Doug Elliott, President; and Beth Bombara, CFO.

Following their prepared remarks, we will have about 30 minutes for Q&A.

Just a few notes 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 forward-looking statements, and investors should consider the risks and uncertainties that could cause actual results to differ from these statements. A detailed description of these risks and uncertainties can be found in our SEC filings, which are available on our website.

Our presentation today also includes several non-GAAP financial measures. Explanations and reconciliations of these measures to the most comparable GAAP measure are included in our SEC filings as well as in the news release and the financial supplement.

I'll now turn the call over to Chris.

Christopher John Swift
Chairman & CEO

Thank you, Sabra. Good morning, everyone, and thank you for joining the call. Last night, we reported financial results for the first quarter. Our results show that we're off to a good start for the year and that we are managing the increasing challenges in the marketplace. We continue to execute on our strategy and make progress across all of our businesses.

Compared to the same period last year, core earnings per share for the first quarter 2015 rose 11% adjusted for net favorable items in both periods, and book value per share, excluding AOCI, increased 3%.

In addition, we delivered a 12-month core earnings ROE of 8.1%. Our operating businesses performed well despite low interest rates in an increasingly competitive pricing environment. Let me share a few highlights from the quarter.

In P&C, our combined ratio of 91.7 is essentially flat compared to prior year when adjusted for CATs, prior-year development and the New York assessments. This is a good result given the weather conditions, and Doug will discuss more about each line of business in a few moments.

In Group Benefits, core earnings margin increased 0.8 points to 5.9%, with outstanding first quarter sales that increased 67%. These results reflect our focus on pricing in underwriting as well as superior service in claims handling.

Our Mutual Fund business has generated 28% growth in sales and more than $0.5 billion in positive net flows in the quarter. In addition, we continue to successfully manage the runoff of Talcott with a $500 million return of capital during the quarter and year-over-year declines in variable and fixed annuity contract counts.

In addition, we are pleased with the upgrades to our ratings from S&P and Moody's, which we received last week. These upgrades represent a notable milestone for us and are an affirmation of our improved balance sheet, operating performance and financial flexibility.

As we look ahead, we are committed to expanding our capabilities to support our growth. This includes making investments in our technology platform, where we have a number of significant programs in flight. Two of these programs are currently being deployed and are having a very positive impact on our distribution relationships and the customer experience.

First is our new P&C claims system, which continued its rollout across the country. Our colleagues continue to comment on their vastly improved user experience and how that translates into improved customer experience. With enhanced data collection, we are improving our ability to assign the right expertise to resolve claimant needs in a timely and supportive manner.

Second is our new consolidated underwriting desktop for Middle Market. We have modernized our underwriting process with this application, delivering immediate benefits in quote turnaround time and communication with our agents. Over time, this platform is the vehicle by which we will deliver new tools and decision support to all our underwriters, which is an exciting step forward.

I'm happy about the rollout of these important new technologies and look forward to updating you on our continued progress in the future.

One of our strengths at The Hartford is our deep pool of talent. Since our last call, we've made some leadership changes that I wanted to share with you.

David Robinson will assume the role of General Counsel when Alan Kreczko steps down from the position at the end of May. David has been with us since 2006 and has a broad range of legal and business experiences, including playing a key role in our transformation. And we welcome him to the executive leadership team.

I would like to acknowledge and thank Alan for his loyal service to our company. Few people have played such an influential role in our company as Alan, who served as General Counsel to 3 CEOs and helped us to manage through difficult times and a successful transformation. We thank him for his countless contributions and wish him all the best.

We also appointed Ray Sprague as permanent Head of Personal Lines. Ray joined The Hartford in 1985 and has held leadership positions in both Strategy and Property & Casualty, including running our market-leading Small Commercial business.

Personal Lines is an important part of our strategy, and we remain committed to improving our performance as we go forward.

In closing, I want to reiterate that the first quarter was a good start to 2015. I'm confident that we are well positioned to navigate the more competitive market in a continued low interest-rate environment. We will maintain our underwriting and pricing discipline, while also investing in our businesses with the goal of increasing our ROE and book value per share to drive shareholder value creation.

Thank you. Now I'll turn the call over to Doug. Doug?

Douglas G. Elliot
President

Thanks you, Chris, and good morning, everyone. Our Property & Casualty and Group Benefits businesses started 2015 with solid results for the first quarter. Retentions continue to be strong, helping to post modest top line growth.

Loss trend in our major lines of business remain benign and within our pricing targets. And in general, our operating performance was very steady, an outcome we're pleased with.

We're locked in on our core metrics and performance indicators as we continue to balance margins and growth amid increasing competition. We're focused on new business risk selection, retention of our best-performing accounts and overall rate adequacy.

The marketplace has grown more competitive over the last quarter. We're beginning to find that there are fewer new business opportunities transacting at our target return levels. We're also seeing more pressure on our renewals, as the rate adequacy of our book has clearly improved in recent years.

We are going to compete aggressively. However, we're not going to chase business outside of our underwriting and profitability parameters.

Our intense operating focus over the last several years, as well as the investments we've been making in product, underwriting and technology, position us on a solid foundation to compete effectively under various market dynamics. I'll share a bit more about this as I recap the first quarter performance for our business units.

In Commercial Lines, we delivered core earnings of $234 million with a combined ratio of 95.9. This was an earnings decrease of $30 million from first quarter 2014, largely driven by last year's onetime expense benefit from changes in New York Workers' Compensation board assessments. Adjusting for this item, our combined ratio improved 0.4 points.

Renewal written pricing in standard Commercial Lines was 3% for the quarter. This is actually down about 0.5 points from fourth quarter, although both quarters rounded to 3%. Overall pricing is being buoyed somewhat by increases in commercial auto. And workers' compensation improved rate adequacy for the industry has resulted in greater competition, especially in Middle Market, where our renewal written pricing of 1% was down just over 2 points from fourth quarter.

In Small Commercial, workers' compensation renewal written pricing was 2%, declining by just 0.5 points. Our loss trends in workers' compensation continue to be favorable, and our returns are within our target range.

Catastrophe losses for the first quarter 2015 were very similar to what we experienced a year ago, although storms this year were much heavily concentrated in the Northeast than last year's widespread activity.

We, again, saw higher loss activity in Commercial Lines rather than Personal Lines, largely attributable to the different geographic concentrations in these businesses.

In Small Commercial, written premium for the quarter grew 5% with strong policy retention and a slight uptick in new business. The underlying combined ratio, excluding catastrophes and prior-year development, was 89.6, up 0.4 points versus last year after adjusting for the New York assessment benefit. The increase reflects higher expenses as we continue to make investments to improve the customer experience, enhance our products, deploy new technology features and add local sales representatives. We also saw an increase in agency supplemental compensation costs driven by improvements in our loss ratio.

We remain very pleased with our overall margins in this business and the capabilities we're bringing to market. Catastrophes hit our Small Commercial business a bit harder in this quarter versus last year, largely the result of winter storms here in the Northeast, where we have a higher concentration of business. As always, our claims response was outstanding, and we will continue to evolve our catastrophe modeling and pricing to keep pace with emerging weather patterns.

In Middle Market, we posted another solid quarter with an underlying combined ratio of 93.7, improving 1.1 points after adjusting for the New York assessment benefit in 2014. Much of this gain is coming from margin improvement in workers' compensation as our pricing and underwriting mix actions earn through the book of business.

Written premium growth was 3% as retentions remain steady and new business production benefited from a higher mix of larger accounts. As I mentioned in my opening, we're seeing a slowdown in our new business pipeline for accounts that meet our underwriting profile. Both the selection of new accounts and the renewal of existing accounts is driven by the talent, portfolio management tools and data analytics we've enhanced in recent years. We will continue to write business when it's well priced, and exercise the discipline to walk away when it's not.

Middle Market commercial auto has been an area that has not met our return targets. In particular, our corrective actions have taken longer to gain traction and show the improvements we expected. Price increases in the quarter were in the high-single digits, and we're continuing to push even harder to achieve rate adequacy in this line.

Within Specialty Commercial, the underlying combined ratio of 99.1 improved versus prior year after adjusting for the New York assessment benefit in 2014. At this combined ratio, the overall business is operating within our target return range, reflecting particularly strong performance in bond and financial products.

Favorable prior-year development in Financial Products contributed to Specialty Commercial's combined ratio of 94.5. D&O claim trends since the financial crisis have been more favorable than our initial estimates, and we continue to see strong performance in the E&O line.

These coverages are becoming an important part of our overall value proposition across all our commercial line business units, and it's great to have strong results coming from Financial Products.

National Accounts continues to perform well, and we're pleased with the overall profile of this business. We feel comfortable with our retentions and new business hit rates in a very competitive market.

In Personal Lines, core earnings were $75 million for the quarter, down from $101 million last year. The underlying combined ratio of 89.9 deteriorated 1.2 points from last year, largely driven by auto, where we've seen a slight uptick in our physical damage severity trends.

Total written premium for the quarter grew slightly better than 1%. That included 1% growth in AARP direct and 23% growth in AARP through agents. We're pleased with the momentum of the AARP offering through independent agents, and we continue to balance growth with overall rate adequacy to ensure that we're building a strong book of business.

On the direct side, we're adjusting our advertising campaign, and early test results have been positive. Our focus on member value, with the support and inside of the AARP organization, continues to evolve this program and drive its success.

In the non-AARP Agency channel, written premium was down 7% versus the first quarter of 2014. This was partly due to the highly competitive comparative rater dynamics of the channel and partly due to our own underwriting actions. We continue to see opportunity in this channel to grow our business through highly partnered agents. These actions will better position us to align with our best distributor relationships and deliver competitive products to their customers.

Shifting over to Group Benefits. Core earnings for the first quarter were $52 million, up 16% from 2014, delivering a core earnings margin of 5.9%. We continue to see favorable trends in our group life and disability loss ratios versus prior year, although the rate of improvement has slowed.

Looking at the top line, fully insured ongoing premium, excluding association financial institutions, was up 4% for the quarter. Overall, book persistency on our employer group block of business is in the low 90s, and we continue to achieve our renewal pricing targets.

Fully insured ongoing sales were $300 million for the quarter, a strong start to '15, and as I have previously indicated. Approximately 25% of the sales gains are win-backs, customers that left us in recent years but have now come back.

We consistently hear that our service capabilities are a key differentiator and the primary reason clients come back. We're proud of our Hartford teammates, who make that value proposition real every day, and we're continuing to invest in the tools and technology necessary to meet the needs of our customers.

Let me conclude with a few general themes.

Across our Property & Casualty and Group Benefits businesses, we are well positioned to compete. We've made important investments to improve our capabilities and taken some hard actions to address shortcomings in our portfolio. Notwithstanding this consistent progress in recent years, there are always pockets where we can and will do better. We will continue to dig deep into our business metrics to effectively manage our performance, retain our best customers and build value. 2015 is showing signs of greater competition, and this is the time for our skill and experience to guide our actions for long-term success. We have a much stronger foundation for 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 briefly cover first quarter results for the others businesses, and then provide an update on the investment portfolio and our capital management activities.

Mutual Funds' core earnings rose 5% in the first quarter, primarily due to an increase in fees from higher average assets under management, excluding Talcott variable annuity funds.

As expected, Talcott-related AUM continued to run off, which reduced the segment's total AUM compared with a year ago.

Fund performance remained solid this quarter, with 70% of funds outperforming their peers over the last 5 years.

Our strong performance track record has helped drive strong mutual fund sales, resulting in net positive flows of $529 million. Talcott posted good results this quarter with core earnings of $111 million, about $20 million above our expectation because of higher investment returns, including limited partnership returns.

We model limited partnership income at a 6% annualized return. Assuming that return, Talcott's quarterly core earnings for the balance of the year would be in the $85 million to $90 million range.

As Chris mentioned, Talcott's annuity contract counts continue to decline. Our ISV and ESV programs added slightly to the variable and fixed annuity runoff, and we will continue to look at contract-holder initiatives and other programs that can help accelerate the decline in these books of business. Since we put Talcott into runoff, variable and fixed annuity contract counts have dropped by almost 1/3, down 32% and 29%, respectively, since June 30, 2012.

During the quarter, Talcott paid a $500 million dividend to the holding company, which contributed to the decline in statutory surplus to $5.1 billion from $5.6 billion.

We generated about $63 million of net statutory surplus this quarter, in line with our prior outlook of $200 million to $300 million of surplus generation for the full year. However, low interest rates could provide downward pressure on that estimate as we approach year-end.

We do not expect this to impact our current intentions to take 2 dividends of $500 million each from Talcott: one in the second half of 2015 and another one again in early 2016.

Corporate segment first quarter 2015 core losses were about flat to the prior year. We expect some reduction in interest expense during 2015, as we repaid $280 million of maturing debt during the quarter and also intend to repay another $167 million of scheduled debt maturities later this year.

In addition, we will utilize up to $500 million for additional debt management, including the call of our October 2017 debt maturity we recently announced.

Turning to investments. The credit performance of our portfolio remains strong, with a modest $15 million of impairments during the quarter. Our portfolio yield also held up reasonably well this quarter despite the headwinds from low interest rates, with an annualized yield of 4.1% excluding limited partnerships.

In addition, we had more fixed income make-hold premiums this quarter than normal, which added a few basis points to the all-in yield compared with fourth quarter.

New money yields remain low, although within the range we expected for the year, which will continue to put pressure on investment income levels.

Limited partnership returns, on the other hand, were well above our outlook, with an annualized return of about 14%, consistent with the prior year, but more than double the 6% average we use for planning purposes. This impacted Talcott's result in particular, as I noted earlier.

Our private equity and real estate partnerships drove most of this upside, while our hedge fund investments, which are principally global macro funds, had low-single-digit annualized returns, consistent with our outlook.

To wrap up on our results, we had a good quarter with consolidated core earnings per diluted share up 11%, excluding net favorable items in both periods, such as catastrophes below budget, prior-year development and the New York assessments.

In addition, book value per diluted share, excluding AOCI, rose 2% from year-end 2014, reflecting net growth in shareholders' equity and the accretive impact of the share repurchase program. Growing book value per share is a key financial goal for The Hartford and an important driver of shareholder value creation over time.

A second key financial goal is increasing our core ROE. The 12-month core earnings ROE was 8.1%, a good improvement over the prior year, which included the benefit from several net favorable items. While this remains below our cost of capital, we intend to improve the ROE over time with continued core earnings growth and capital management.

The 12-month unlevered ROE for our P&C, Group Benefits and Mutual Funds businesses was 10.6%.

Before turning to Q&A, I'd like to provide a brief update on our capital management plan.

As a reminder, the 2-year plan initiated in 2014 was $2.775 billion for share repurchases and $1.2 billion for debt capital management. That plan remains unchanged. And through April 24, we have repurchased approximately $2.1 billion of common equity, totaling 57 million shares for an average purchase price of $36.93.

We have $656 million remaining under the equity program, which we will complete over the balance of the year, including a total of approximately $250 million during the second quarter. Under the debt management program, we repaid maturing debt of $200 million in 2014, $289 million in 2015 and expect to repay $167 million in November, which leaves approximately $500 million for other debt capital management.

On Friday, we noted the custodian of our intention to call the 4% notes due in October 2017, which have prior outstanding of $296 million. Including accrued interest and the make-hold premium, this bond call will use approximately $320 million of the remaining $500 million. We expect to use the balance for other debt management actions.

As I previously mentioned, during the second half of 2015, we expect Talcott to dividend $500 million to the holding company, and P&C, Group Benefits and Mutual Funds to also generate about $700 million of debt -- of dividends. We have made significant strides in reducing debt and improving our balance sheet and risk profile over the past several years, which contributed to the S&P and Moody's upgrades.

We expect our capital management plans to include both equity and debt as we look for opportunities to redeploy excess capital accretively, both with capital management and investment in our businesses.

We will continue to execute the current capital management plan. And during the second half of this year, we will update you on our capital management outlook for the remainder of the year and 2016.

To summarize, first quarter results were a good start to the year. Our strategy remains unchanged as we remain focused on growing core earnings in our P&C, Group Benefits and Mutual Fund businesses to offset the runoff of Talcott's core earnings. While competitive conditions may be more challenging, the underlying returns in our businesses have improved significantly compared to several years ago. And we are well positioned, both financially and competitively, to continue to create shareholder value.

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. As I noted earlier, we have about 30 minutes for Q&A. [Operator Instructions] Shawn, could you please give the Q&A instructions?

Question and Answer

Operator

[Operator Instructions] Your first question comes from the line of Michael Nannizzi from Goldman Sachs.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

So a couple of questions, I guess. Is there any way we could quantify, Doug, the technology investments and the higher commissions based on business profitability on 1Q results?

Douglas G. Elliot
President

Mike, we don't share the details to allow you to do that. I would say this, that Chris and I have shared that our technology invest plan over this 3-year period is a $1 billion-plus plan. That's putting a little bit more than half of the -- well, about half of the expense pressure namely inside Small Commercial, as I called out this morning. As I mentioned, we obviously are seeing a very solid profitable run through our loss ratio. So we're feeling a little expense pressure in our supplementals because we've got a 3-year trigger for loss ratios with many of our agents and brokers.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Okay, got it. Okay. So I mean, so as that continues, and we could expect to see -- I guess, we'll continue to see the expense pressure from supplementals. And then as you work through your technology spend, then we should probably see that normalize at some point?

Douglas G. Elliot
President

Yes, I would say that. And clearly, as we replace '12 with '15, '15 starts out in a good spot from a loss ratio standpoint. The 3-year run with '15 will be '13, '14, '15, which will be 3 good years. '15 clearly is in a better place than '12 would have been. So I think now we get to a normalized level as we approach '15.

Christopher John Swift
Chairman & CEO

Michael, it's Chris. I would just add on the expense side. I mean, we are harvesting gains today, right? So you should not think that we're not trying to be efficient today and improve our existing processes, particularly as we spend money on new technology, which will continue. We do capitalize some of those investments that will be amortized over a 5- to 7-year period, depending on the project. But we ultimately expect a pay back through increased, I'll call it, productivity, reduced unit cost and, ultimately, faster growth. So that's how Doug and I have been thinking about it.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Great. And then just one quick one on the upgrades this last week. I guess, Beth, I mean, thinking about this, where did those fall in your sort of expectation? I mean, clearly, you've been -- you're working towards this type of recognition. I mean, is this earlier than you expected, earlier affirmation than you expected? And does this change in any way how you're thinking about your sort of capital management plan as you start penciling the second half of the year?

Beth A. Bombara
Chief Financial Officer and Executive Vice President

Thanks, Mike. So obviously, we're very pleased with the actions that both S&P and Moody's have taken. Obviously, over the last several years, we've been working with them closely to share with them our plans, and we plan to continue to work for continued improvement. So I don't see it changing our views relative to our capital management plans. Again, it's nice to get the recognition for the improvements that we have made.

Operator

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

Brian Robert Meredith
UBS Investment Bank, Research Division

A couple of questions here for you. Doug, just curious, on the increase that we saw in some of the severity on the personal auto, would you attribute that to kind of industry? What's going on? Or is anything -- any of that relate to maybe some selection issues with the big rapid growth you get in the AARP Agency business?

Douglas G. Elliot
President

Brian, good morning. We're looking at every component of that, and we do feel like there are some things happening here that we need to kind of lean into and we have some work programs around. We're clearly looking at vehicle year and making sure that our new open road product is appropriately pricing those. In the quarter, it looked like our subrogation was a little light. So we're leaning into subrogation, and you understand that. That's something we can catch back up with. So we've got a number of things that we're looking at internally, but we understand there's probably been a little bit of physical damage pressure across the industry as well.

Brian Robert Meredith
UBS Investment Bank, Research Division

Great. And then staying on the P&C topic, I'll let you keep going here, Doug, commercial auto. What exactly kind of are the issues with your book that you're kind of dealing with right now? It seems like some other companies are actually saying they're finally getting to the right profitability level on commercial auto.

Douglas G. Elliot
President

Yes, Brian, I would start by saying the pressure we're feeling today in commercial auto is very different than some of the programs and captives we had several years back. So those are in our history, and I feel good about the way we've moved away from those programs. This is more organic Middle Market and, to a lesser extent, small pressure just across severity. We're seeing severity trends in those books of business. We're pricing for them. We're looking at vehicle weights against our price per pound. We're looking at driver experience. I would say that we're leaning probably a little bit more aggressively into driver experience this year than we had in the past. So we're working across that auto book. We're going to get this book performing much better as soon as possible. And I would say, right now, we're leaving no stone unturned.

Operator

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

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

Just a quick follow-up on just the previous question on the auto loss cost side. So just with this hitting the physical damage severity side, I'm curious if this is the result of just greater actual damage to vehicles or if there's any inflation in the repair cost. And the reason I ask you is if it's on the actual damage levels to the vehicles, I'm wondering if there's any type of correlation on the bodily injury side, just maybe to a lesser magnitude.

Douglas G. Elliot
President

Vince, this is Doug again. We are looking at year of vehicles. So obviously, the newer vehicles will have more technology in the bumpers on both sides. So that's something that's got our full attention. We obviously feel great about our claim process, but we're going back. As you know, we have a new claims system that is rolling out as we speak. So we're looking at the work streams that now revolve around that new system and looking at symbol, type and year to make sure we're on top of all those trends.

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

Okay. And I assume your driver base isn't as sensitive to gas prices, but any notable shifts on the frequency side?

Douglas G. Elliot
President

A general upshift, but not dramatically. We've watched this carefully over the last 10, 12 months. And so not that I think this is inside our patterns relative to loss at the moment.

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

Okay. And if I can squeeze another one on just pricing on the workers' comp side. Workers' comp is a generalization of a lot of smaller micro-markets and geographies and industry class codes. I'm curious, based on your comment this morning, within those aggregate numbers, if there are any pockets of really favorable or destructive pricing that you have to watch out for.

Douglas G. Elliot
President

I think you probably have a great sense of the marketplace. In general, there has been a downward pressure across the filings in workers' comp. So some of the major states are looking at moves in the pricing realm that now are flat to down. I would say across the Middle Market, I don't see major swings from the geographic standpoint. I think we're competing well. I think the tools are in place. The books are very adequately priced. So the improvements we've made over the last 3 years, I think, do position a bit more competition, which is what we're seeing. But we're going to keep our discipline, and I'm very comfortable that we're going to be thoughtful as we play this out.

Operator

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

Jay H. Gelb
Barclays PLC, Research Division

First, on Talcott, I just want to get a bit of a better understanding why you feel the quarterly run rate of earnings will be $85 million to $95 million given the strong or much stronger performance you saw in the first quarter. Was that just all simply due to excess limited partnership income?

Beth A. Bombara
Chief Financial Officer and Executive Vice President

Yes. Jay, it's Beth. Yes, that's exactly what drove the outperformance for the quarter. So when we look at just normalizing the run rate for investment income, it gets back down within the range that we previously gave.

Jay H. Gelb
Barclays PLC, Research Division

Okay. And then on the capital structure, Beth, I'm looking at Page 5 of the supplement. I think this lays it out pretty clearly. Could you remind us where you feel that target range should be for the dollar amount of debt? And also debt to capital? My guess, is you're focused on rating agency adjusted debt to capital? If you could remind us your targets there, that'd be helpful for modeling purposes.

Beth A. Bombara
Chief Financial Officer and Executive Vice President

Yes, absolutely. So we do focus on the last line that you see on that schedule, which is the rating agency adjusted debt to capitalization. So ended the quarter at 27.3%. When we look forward to the year and anticipate the debt reduction that I covered in my remarks, all things else being equal, we'd expect that 27.3% to be kind of slightly under 25%. And we stated all along, our goal has been marching down to the low 20s.

Jay H. Gelb
Barclays PLC, Research Division

Okay. So even after the company finishes up its debt reduction for this year, that seems to imply there could be more to come in the years ahead to get that ratio lower.

Beth A. Bombara
Chief Financial Officer and Executive Vice President

Yes. So as we look forward and we think about capital management actions in the future, debt reduction was something we will always consider. As we said in the past, we don't need to get to that target immediately. So we intend to continue to be balanced in how we approach that. But obviously, as you do equity repurchases, that also puts pressure on the ratios. So we're really just looking to balance all of that. And I would call it a steady march down to the low 20s.

Operator

Your next question comes from the line of John Nadel from Piper Jaffray.

John Matthew Nadel
Piper Jaffray Companies, Research Division

A question for Doug on the Commercial Lines side, and maybe it's sort of wrapping up a couple of the earlier questions maybe in one maybe easier fashion for us to understand. I think for 2015, you had targeted a combined ratio x CATs in prior year between 89.5 and 91.5. 1Q was definitely a bit above that range, but obviously tough weather. But also on the expense side, it sounds like things are going to be a little bit higher. Can you give us a sense that you still feel good about that range for 2015? Or could this expense component push you modestly above the upper end of that?

Douglas G. Elliot
President

John, I would say that we still feel like that range is achievable. A couple of thoughts. One is I do think the first quarter on the expense side is a tough compare because of the one-timers that were achieved last year. But we're conscious of that. And as Chris said before, we're driving efficiencies inside this operation. So although we're driving some of those dollars back inside the invest part of our business, we are looking to become a more streamlined, efficient company over time. And I do think, obviously, we've got to wait and see how weather plays out in the second and third quarter. But I look at this as a solid start to the year, and those targets, definitely achievable.

John Matthew Nadel
Piper Jaffray Companies, Research Division

Okay. Then separately, I guess, maybe a question for Beth on the runoff annuity block. The variable annuity surrender rate remains high, although, I guess, it's coming down modestly, but can't stay in the

20s forever, I'd suppose. But the fixed annuity surrender rate in this quarter dropped pretty significantly. Was there any specific thing that happened there?

Beth A. Bombara
Chief Financial Officer and Executive Vice President

Yes. I'll remind you, John, we had a program in place in 2014 that increased that surrender rate, our ISV program. So that obviously impacted those surrender rates that we saw in '14 and then going into '15. And as I said in my remarks, we'll continue to look at ways that we can target specific portions of the book, as we have in the past. And obviously, that can make the surrender rates sort of ebb and flow.

John Matthew Nadel
Piper Jaffray Companies, Research Division

Okay. So x some sort of modified program, we should expect probably something more in the mid to -- low- to mid-single digits on the fixed annuity block?

Beth A. Bombara
Chief Financial Officer and Executive Vice President

Yes, it does tend to bounce around a bit, too. But I think on average, I would say that, that would make sense. But quarter-to-quarter, depending on just where various contracts stand relative to choices that they have to make, you can sometimes see the numbers bounce. But on average, I think that's a good place to be.

John Matthew Nadel
Piper Jaffray Companies, Research Division

Okay. And then I'm going to sneak one last one in, unless Sabra wants to beat me up. But as we look forward to an updated capital management outlook in the back half the year, can you just remind us what the ongoing cash needs of the parent company? How much cash do you want to hold there relative to interest expense and dividend payments, et cetera?

Beth A. Bombara
Chief Financial Officer and Executive Vice President

Sure. So we've talked about it in the past. When we think about holding company cash and levels that we'd feel comfortable at, we typically target around 1.5x interest and dividend requirements. And when you look at where we are with interest and dividends, you can think about that as being in like the $650 million range.

Operator

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

Jay Adam Cohen
BofA Merrill Lynch, Research Division

A couple of questions. First is, Doug, I think you mentioned that you had planned to adjust your ad campaign for the AARP business. What specifically will you be doing? And how do you think that will affect the revenues?

Douglas G. Elliot
President

Jay, what we've done in that ad campaign is we've adjusted slightly to be a little bit more value-based, tied in with the AARP membership. So as we've made some tweaks over the past 90 days, our response rate has risen positively, and our close rate on those responses also has seen some favorable reactions. So more to come as we work out the rest of 2015, but very encouraged by the early start.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Great. And then, I guess, sticking with the Personal Lines, the agency -- non-AARP Agency business, you had said it's getting pretty competitive with comparative raters. Was there a change in the quarter or is this just a gradual continuation of what you've seen over the past several years?

Douglas G. Elliot
President

I would say from the industry side, no change that we can tell. We have made some adjustments in our own strategy really around classes and vehicles and geographies, just normal tuning that goes on day-to-day. And so the combined actions of competitive pressures and our own actions kind of contributed to the quarter.

Christopher John Swift
Chairman & CEO

Jay, it's Chris. Let me just add just a perspective, too, because I called it out particularly that -- in my prepared remarks that we are -- I mean, this is -- Personal Lines is an important strategy for The Hartford and complementary, obviously, with our strong commercial capabilities. So that's why we appointed one of our seasoned leaders, Ray Sprague, to really lead this and help us to continue to improve it because we have a wonderful 30-plus-year relationship with AARP that we want to continue to leverage and serve their customers. And specifically on your ad question, if you haven't seen them, I'll get Sabra to send you a clip. But I mean, they're really powerful connections, emotional connections, Doug, I would say. They're a strong testimonial base, hearing directly from AARP members themselves and explaining sort of the value proposition that we offer as opposed to just competing on price and just minimum, I'll call it, features and capabilities in the products. So we offer a rich product that we're proud of from a coverage side. And I think we're going to try to do a better job in explaining why those coverages are needed to ensure for the unforeseen. So those are just a couple of thoughts I'd just share with you.

Operator

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

Thomas George Gallagher
Crédit Suisse AG, Research Division

I'll have a question, then I'll turn it over to Ryan Tunis for a follow-up P&C question. Beth, just coming back as a follow-up to what John Nadel asked about on the capital management front. So if I understood your answer correctly, that should leave the full, we'll call it, $500 million dividend that you expect to get out of Talcott in the back half plus the $700 million of operating dividends, or $1.2 billion, it should leave all of that for incremental capital management or other, over and above your existing capital plan. Is that right or is it some fraction of the $1.2 billion that would not have been accounted for yet?

Beth A. Bombara
Chief Financial Officer and Executive Vice President

Yes. So the way I would have you think about that, Tom, if you recall, back in February, we provided you with an update on our projections of holding-company cash and where we expected the holding company to end the year at. And that was at about $1.8 billion, and that remains unchanged. I took into consideration all the dividends that we just talked about. So when I was answering John's question on the holding company requirements, and if you think about $650 million-ish being the annual interest and dividends that the holding company pays, and our target to hold 1.5x that, I think that gives you a little bit of the math about how we think about year-end '15. And then, again, as we said, going into '16, we have the additional $500 million dividend that we anticipate taking out of Talcott, as well as just our normal dividend that we would take out of the other businesses.

Thomas George Gallagher
Crédit Suisse AG, Research Division

Got you. So that would leave a little under $1 billion then, if I'm solving -- in response to that -- with that response in mind, it will leave a little under $1 billion in terms of incremental capital management. Is that the right number to think about? And then, obviously, it's a determination of what do you use for buybacks versus debt management. But is that the right figure?

Beth A. Bombara
Chief Financial Officer and Executive Vice President

Yes. So Tom, I don't really want to get into a specific number. I mean, as we said, we are going to look to update our plans in the second half once we're going to see how the first half of '15 goes and our views of the remainder of '15 going into '16. There's nothing hidden in the math that I'm giving you, so you can draw your own conclusions. But again, when we talk about updating our plan, that would be '15 through '16.

Thomas George Gallagher
Crédit Suisse AG, Research Division

Got you. And I'll turn it over to Ryan on P&C.

Ryan James Tunis
Crédit Suisse AG, Research Division

So I guess, my question was just...

Christopher John Swift
Chairman & CEO

Ryan, let me just follow up on Tom, and I appreciate your reconciliation and trying to pinpoint it. But I think Beth said it well, is that we'll get into the second half of '15, go through our regular forward-looking planning process and see the -- and just make some final decisions. I think from my perspective, I take great comfort in the fact that the agencies have seen the improvements that we're making. We are sitting on excess capital that we intend to deploy in accretive ways. You've heard our penchant to keeping things in balance between debt and equity. So I don't think there's anything really changed. And if you could just continue to be just a little patient with us, and that we want to be a regular company and sort of looking at these things in a normal cycle and rhythm, and we'll communicate our views to you at the appropriate time. But thank you for your interest.

Ryan James Tunis
Crédit Suisse AG, Research Division

So yes, I guess, my question on the ongoing business is a little bit higher level on Personal Lines. I guess it's for either Ray or Doug. But I guess, just looking at auto, 7% renewal rate increases this quarter. Should we expect margin improvement in that business this year given the magnitude of those rate increases? Or would you say those rate increases are necessary just to keep up based on some of the elevated physical damage that you already mentioned?

Douglas G. Elliot
President

Thanks, Ryan. This is Doug. So as we start the year, trend is -- loss trend is certainly eating into our pricing equation. We hope that that'll change. We've got a number of work streams to try to bring incremental margin back inside that book. I would remind you that overall, our auto book is in actually pretty reasonable shape; and clearly, on the AARP side, very solid shape. We have some work to do in the agency channel, and we've chatted about that in the past. So I hope that we can turn that pricing into a benefit inside the ratio. That's the goal.

Operator

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

Erik James Bass
Citigroup Inc, Research Division

I just wanted to touch on the Group Benefits business. Obviously, it's a very strong quarter for sales, and you cited the benefit from the win-backs. Can you also talk about the contribution from new products, and maybe also just discuss the competitive trends that you're seeing in the Group Benefits market?

Douglas G. Elliot
President

Thanks, Erik. This is Doug. I'll try to cover a few of those items in the question, which was a good one. Very pleased with the quarter, obviously, strong sales quarter, our strongest sales quarter in several years. Although I would remind you that we've had quarters like that in the past when this business was really running well for us, back in the late 2000s and even into 2010. So pleased with our start to 2015. You can also see that a bit more success has been on the Life side. So as we look at the long-term duration contracts in LTD, strong start, but not as strong probably as we had seen on the Life contract side. So just something in terms of marketplace. Yes, we're excited about the new product development over the past several years. We've got 2 new voluntary products in market, including a new DisabilityFLEX product. We have sold several of those deals. I will also tell you that we're looking to populate them with employees of the contracts that we've written them on, but I think off to a good start. They're recognized by many of our policyholders. And I think we're going to begin to see that success play out in 2015. So very pleased with our Group Benefits start.

Erik James Bass
Citigroup Inc, Research Division

Got it. And just any comment on kind of the overall competition? I guess, when you talked about your comments around competition picking up generally, it seems was more related to P&C. But anything similar that you're seeing on Group Benefits side or is it still a relatively benign environment?

Douglas G. Elliot
President

I would say it's a relatively consistent environment. So we see competition there, maybe a bit more on the LTD side than what we had experienced in the past. And again, what's so interesting about the Group Benefits world is that, particularly in the National Accounts, we're working 6, 9 months in advance. So some of the successes we had in the first quarter were really the result of actions and proposals that went on last summer. But we're feeling good about our ability to be successful in the Middle Market. That will be an increasingly important part of our Group Benefits strategy. But I do think rational competition really across in a consistent manner.

Christopher John Swift
Chairman & CEO

Erik, this is Chris. I would just add a couple of things that Doug explained. One, I mean, if you look at sort of sales, the Life TI [ph] piece is interesting. So shorter duration versus longer duration. We're having a little bit more success, particularly in a low interest rate environment. Two, it's obviously a heavy National Accounts season, the 1:1 [ph]. But equally, there's a lot of good contribution that Doug and the team have been focused on in the Middle Market and Small side. So our balance of sales is spread amongst the different segments. And then thirdly, the channel, I would say exchanges are beginning to contribute in a way that we anticipated, but is a positive development, too. So we're realigning our existing agents and brokers, but there are a number of exchanges that we're participating in that are contributing nicely to our increase in sales.

Operator

You next question comes from the line of Randy Binner from FBR.

Randolph Binner
FBR Capital Markets & Co., Research Division

A lot of good stuff, so mostly answered, but I want to actually jump back to the commercial auto discussion, and then some comments in the opening script that D&O and E&O claim activities have been favorable. So it's a reserve question, in that the net reserve release in the quarter for Commercial Lines was relatively flat, and it was relatively flat overall. So the question is, was there adverse PYD in commercial auto that offset the more favorable D&O and E&O activity? Or was there not PYD in those items this quarter?

Douglas G. Elliot
President

Randy, I think you can see in the sup that, yes, we had some adverse auto liability actions taken on our reserve position for sure, mostly Middle Market, I might comment. And then the Financial Product good news essentially did offset that. Just a thought about the Financial Product D&O, E&O book. We were heavier in the financial institution block back during the recessionary period. So we made appropriate reserve position judgments back in that period. We watched them play out as the last 5 or 6 years have played out. This quarter, we came to the decision that we had -- it was time to make some of those adjustments. So the netting of those 2 is what's playing out in our reserve position on the prior, and I think it's well laid out in the sup for you.

Randolph Binner
FBR Capital Markets & Co., Research Division

So then the follow-up there is just on thinking of more recent accident years. So if -- especially with the D&O and E&O, with the economy continuing to be good and loss costs relatively benign, especially in '12 and '13, there's better pricing. I mean, is there an early read you have on some of those -- the casualty lines written in those more recent accident years and how they may develop?

Douglas G. Elliot
President

I think it's too early for us to comment on that. We have a well-balanced book of business across sector, geography, et cetera, but I think it will be early for me to make a call on '14 and '13.

Operator

Your next question comes from the line of Jimmy Bhullar from JPMorgan.

Jamminder Singh Bhullar
JP Morgan Chase & Co, Research Division

Many of my questions were actually answered, but on the Personal Lines side, can you discuss just what's going on in the non-AARP Agency channel premiums? They have been down for a while. So is it competition or are you being more selective in what you are choosing to underwrite? And then Beth had mentioned in her remarks on Talcott surplus being sensitive to interest rates. Maybe if you could quantify or give us some color on just how sensitive it would be to like 20, 30, 50 basis points of a change in rates.

Douglas G. Elliot
President

Jimmy, this is Doug. I'll start and take the first half, and then we'll flip to Beth. I would say that with Ray's leadership, and he and I now have been engaged heavily with the group over the past 9 months, it's a great chance for us to do a refresh. We've mentioned that we are rolling out a new auto class plan. That always encourages tuning as these things roll into market. And so I would consider what we're doing in the marketplace kind of normal for a competitive product-adjustment strategy that we will continue to evolve as we move forward. Yes, it's a competitive channel, but I think our returns are really in very solid shape. We'd like them to be a bit better, but I'm satisfied with where we are. And I think we'll continue to do tuning as we move forward.

Beth A. Bombara
Chief Financial Officer and Executive Vice President

And Jimmy, on the question on interest rates, I don't have an exact sensitivity that I can give you vis-à-vis a basis-point change and what that might mean. What I would tell you is that when we look at the overall book in Talcott, we feel very good about the cash flow generation that we see coming from the VA book. And as we get closer to the end of the year, low rates could just put pressure on that previous range that we gave. But overall, I still feel very good about the balance sheet strength and feel very comfortable with the dividend plan that we've put out there. And as we get to the end of '15, we'll evaluate surplus levels to determine what, if any, additional dividends we would see in '16, besides what we've already announced.

Jamminder Singh Bhullar
JP Morgan Chase & Co, Research Division

And just lastly, is there a minimum level of surplus you'd want to leave in Talcott, assuming sort of a normal decline in the size of the block?

Beth A. Bombara
Chief Financial Officer and Executive Vice President

I don't have a specific target in mind over time. I mean, obviously, we focus on RBC ratios. We look at the overall surplus, especially in stress situations, and then also balancing liquidity. So again, the plan that we've announced and the dividend that we expect to take out put us well within all of those thresholds that we monitor. And again, as the book gets smaller, we'll evaluate after the surplus levels.

Jamminder Singh Bhullar
JP Morgan Chase & Co, Research Division

And those amounts you are comfortable with even with rates where they are, right?

Beth A. Bombara
Chief Financial Officer and Executive Vice President

Yes, those items that we've already disclosed, we feel very comfortable with.

Operator

You next question comes from the line of Ian Gutterman from Balyasny.

Ian Gutterman
Balyasny Asset Management L.P.

I wanted to follow up on Randy's question about the reserves in the recent accident years. Doug, I specifically focus on workers' comp. Obviously, that's your biggest area of reserves. And when I look at the recent accidents years, the reported to incurred, the initial reported to incurred is so much better than it's been historically that I can't draw any other conclusion that you seem to be reserving a lot more conservatively. The only possible exception to that is maybe there's been some meaningful shift in the book, where reporteds will be coming in later than it used to because of mix or some other underwriting change. Is there anything like that going on or should I be encouraged by seeing the early reported-to-incurred ratios looking so much better than historic?

Douglas G. Elliot
President

Ian, it's Doug. First, I'm pleased that you're encouraged. We're encouraged by our book profile over the past few years, not only on the pricing side, but really very pleased about the mix changes and how they have played out inside our earnings and reserve profiles. So I think '13, '14 are still early to call, but we're very pleased as to how they look. And we hope they continue to look as solid as they are today, but we call them as we see them. We feel good about progress, but these are long-tail lines that take a while to mature.

Ian Gutterman
Balyasny Asset Management L.P.

Of course, of course. I was thinking more of how they play out over time than expecting it this year, but that's okay. And then just a follow-up on the agency auto business for you and/or Chris. Just strategically, and you obviously talked a lot about some of the changes you're making, but just as sort of Jimmy alluded to, that book's strong for a long time, and again I was specifically talking about the non-AARP here. Does your -- are the actions you're taking enough that you can compete where you need to at this scale you're at? Or are you going to have to face a decision eventually of either you need to get bigger in the non-AARP business or maybe get out of the non-AARP business?

Douglas G. Elliot
President

Ian, I think you asked a very solid question. As Chris has suggested, we are totally committed to this space. This has been a real solid complement to not only our Personal Lines agency franchise, but also to the Commercial as well. But we've been challenged, and we've got to hit those challenges head on. From a financial standpoint, we're doing so as we speak today. I'm optimistic about what the next couple of years will bring, but I also know the challenge in the channel based on how competition competes and the comparative raters, et cetera. So I think we'll be talking about this as time plays out. Know it has our full attention, and we're on it. And we're pulling levers to drive a better financial outcome.

Christopher John Swift
Chairman & CEO

Ian, it's Chris. I think Doug said it well. But I think when you think about it also strategically, we still believe in advice that the independent agents provide, provided that we have a good competitive home and auto product. So I think when you speak of auto, don't think of -- don't forget about home and making sure that we have a total solution for our independent agents and their customers. So as Doug said it, he said it well. We are committed to figuring this out and how we can continue to add value in this segment.

Sabra R. Purtill
Senior Vice President of Investor Relations

Thank you. Shawn, we're coming up on the hour. So we have time for one more question, please.

Operator

Your last question comes from the line of Scott Frost from Bank of America Merrill Lynch.

Scott Frost

Without getting into any predictions of ratings -- credit ratings trajectory, can you give us an idea of where you think your targeted metrics map in terms of NRSRO quantitative ratings? And I have a follow-up.

Sabra R. Purtill
Senior Vice President of Investor Relations

I'm sorry, Scott, the tail end of your question got a little garbled. The metrics relative to...

Scott Frost

Yes, in terms of just the quantitative ratings that NRSROs have out there, you have targeted metrics. Where do you -- where do you think they map?

Sabra R. Purtill
Senior Vice President of Investor Relations

Right, like the 22% to 23%, for instance, on the debt-to-total cap.

Beth A. Bombara
Chief Financial Officer and Executive Vice President

Yes, I would say just slightly higher.

Scott Frost

Okay. And can you also remind us a couple of things? I want to ask about the Glen Meadows and the 8-and-8 [ph] junior subs. What Moody's basket treatment do they get? And are they within S&P's equity bucket for you? And how would you characterize the attractiveness of those 2 instruments in your capital structure?

Beth A. Bombara
Chief Financial Officer and Executive Vice President

So for Moody's, it's 25%: and for S&P, 100%. The way I think about it, we look at our debt stack in total in trying to manage to the targets that I said. So those, obviously, weigh into that as we look at really focusing on the rating agency adjusted targets. So right now, they sit very nicely. And as we continue to manage the debt stack, we really are looking at it more from the perspective of managing to those targets.

Scott Frost

So are you saying that both of those instruments are attractive to you now?

Beth A. Bombara
Chief Financial Officer and Executive Vice President

So right now, yes, they are attractive. They do help us achieve the targets that we have. Over time, that could change. But from where we sit today, we do see them as attractive.

Operator

There are no further questions.

Sabra R. Purtill
Senior Vice President of Investor Relations

Thank you, Shawn. We'd like to thank you all for joining us today and for your interest in The Hartford. If anyone has any remaining questions, please feel free to contact Shawn or myself by phone or email, and we'll be happy to help you. Thank you, and have a great day.

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