S&P Global
Market Intelligence

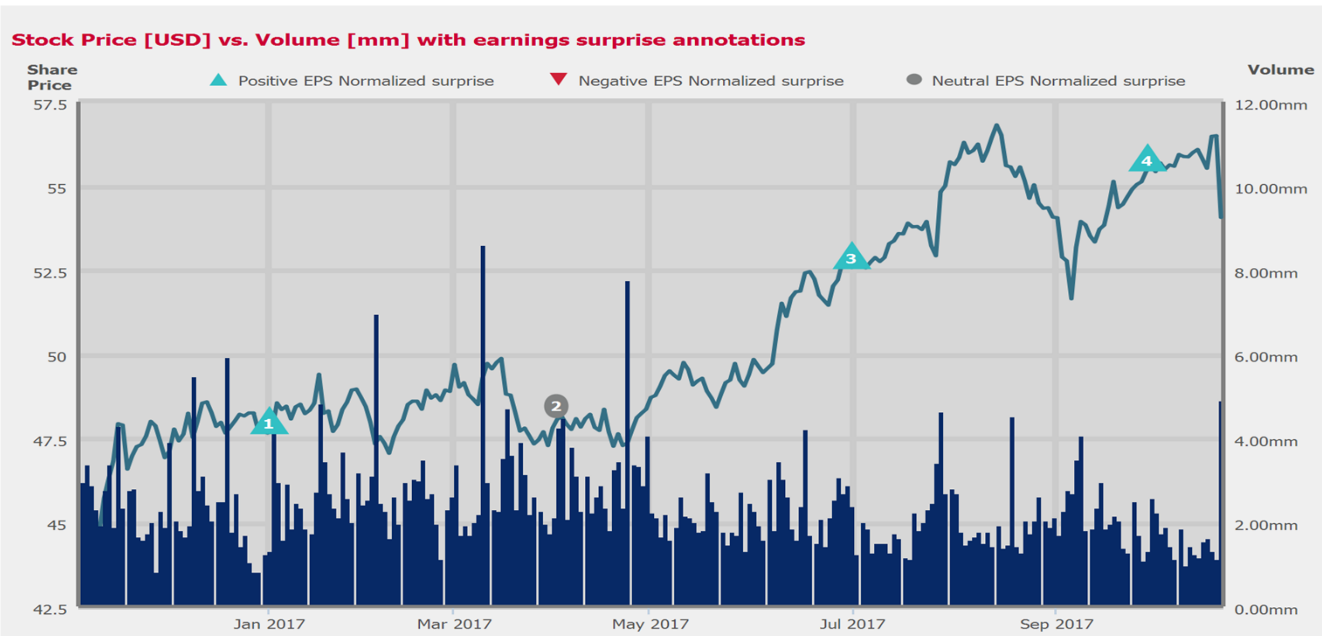
The Hartford Financial Services Group, Inc. NYSE:HIG
FQ4 2017 Earnings Call Transcripts

Friday, February 09, 2018 2:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ4 2017-			-FQ1 2018-	-FY 2017-	
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	ACTUAL
EPS Normalized	0.73	0.81	▲10.96	1.11	2.77	2.74
Revenue (mm)	4542.02	4539.00	▲(0.07 %)	4592.00	18436.12	16974.00

Currency: USD
Consensus as of Feb-09-2018 12:05 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ4 2016	0.93	1.08	▲1 16.13 %
FQ1 2017	1.00	1.00	2 0.00 %
FQ2 2017	0.94	1.04	▲3 10.64 %
FQ3 2017	0.57	0.60	▲4 5.26 %

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Presentation

Operator

Good day. My name is Jack, and I will be your conference operator today. At this time, I would like to welcome everyone to The Hartford's Fourth Quarter 2017 Financial Results. [Operator Instructions]

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

Sabra Rose Purtill
SVP, Head of Investor Relations & Treasurer

Thank you. Good morning, and thank you all for joining us today. Today's webcast will cover our 2017 financial results and 2018 outlook for selected business metrics.

We announced our fourth quarter and full year 2017 financial results last night, and the news release and investor financial supplement are available on our website.

Please note that consistent with prior year-end periods, our 10-K will be filed at the end of the month, but we have included some additional data in the investor financial supplement that will be in the 10-K, such as the P&C loss reserve roll-forward.

Also, please keep in mind that as a result of the agreement to sell Talcott Resolution, current and prior financial results for this former segment have been accounted for as discontinued operations, which is in our Corporate segment, as required under U.S. GAAP. This change does not change net income for prior periods, but it does reduce core earnings as income from discontinued operations is included -- is not included in our core earnings calculation. If you have any questions about this change, please consult the IFS and the 10-K when filed, but also feel free to give the Investor Relations team a call with any questions about the accounting.

Our speakers today include Chris Swift, Chairman and CEO of The Hartford; Doug Elliot, President; and Beth Bombara, CFO. Following their prepared remarks, we will have time for Q&A.

Just a few comments before Chris begins. Today's call includes forward-looking statements as defined under the Private Securities Litigation Reform Act of 1995. These statements are not guarantees of future performance, and actual results could be materially different. We do not assume any obligation to update information or forward-looking statements provided on this call. Investors should also 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 commentary today also includes non-GAAP financial measures. Explanations and reconciliations of these measures to the comparable GAAP measure are included in our SEC filings as well as in the news release and financial supplement.

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

I'll now turn the call over to Chris.

Christopher Jerome Swift
Chairman & CEO

Good morning, and thank you all for joining us today. 2017 was an eventful year at The Hartford with several major accomplishments, including the acquisition of Aetna's U.S. group life and disability business and the agreement to sell Talcott Resolution. However, bottom line results were negatively impacted by the loss on sale of Talcott and the charge for U.S. tax reform.

Core earnings were up 11%, and core earnings per diluted share were up 19% despite exceptionally heavy catastrophe losses in 2017. This is an outstanding result, reflecting the strength of the organization.

Commercial Lines margins were strong. Personal auto profitability improved greatly. Group Benefits and Mutual Fund results were excellent, and we had very good investment returns across the board.

Looking back over the year, I am truly pleased with our results and impressed with our team's ability to deliver on the numerous initiatives we have underway.

In Personal Lines, I am very pleased with the strong improvement of our auto line, where the underlying combined ratio improved by 4.2 points. Improving auto profitability has been a top priority for our management team, and this is a significant milestone as we position the business to return to growth by leveraging the historical strengths of our AARP relationship. Overall, Personal Lines results were significantly affected by the major catastrophe events of 2017, with full year CAT losses more than double our average annual expectations.

In Commercial Lines, we began 2017 focused on maintaining our strong underlying margins as we correctly anticipated increasing competitive forces. Margins did remain strong, although with expected pressure in workers' compensation and general liability. However, as Doug will discuss more fully in his comments, we have some optimism that pricing environment may improve in 2018, and our disciplined approach to underwriting and pricing will serve us very well as the market pivots.

We also advanced a number of strategic initiatives in Commercial Lines that continue to strengthen our value proposition and extend our competitive advantages. For example, in Small Commercial, we continue to innovate with an ever-improving agent and customer experience. We have now integrated E&S product capabilities within our ICON quoting platform, becoming a one-stop provider to more customers, including an integrated billing option. We also started offering automatic quotes through ICON for Group Benefit products at point of sale, enabled by our advanced data and analytic capabilities.

In Middle Market, our industry verticals are building momentum, led by outstanding teams of industry veterans who have joined The Hartford in recent years, excited to combine their underwriting and product expertise with our distribution and service excellence.

In Group Benefits, we posted excellent financial results on both the top and bottom line. Our value proposition on service and claims management for life and disability, coupled with our voluntary product offerings, resonates very well with our customers, and we see the benefit of that in our retention. Lastly, we welcome more than 1,800 new teammates from Aetna to our company, further strengthening our market-leading capabilities.

In Mutual Funds, we continued to grow core earnings, supported by sales and positive net flows from strong investment performance and expanded fund offerings.

And last but not least, in December, we signed a definitive agreement to sell Talcott Resolution for a total value to shareholders of about $2.7 billion, with an expected closing date by June 30.

Across the enterprise, we are making investments necessary to compete in a digital world defined by customer experience. We are expanding our digital portals in Commercial Lines, Personal Lines and Group Benefits to give agents and customers greater access and flexibility in managing their coverage, billing and claims. We are deploying robotics in operations, allowing us, for example, to process e-mailed requests for certificates of insurance in minutes. And we are especially committed to our data and analytics journey. We continue to invest heavily in the talent, technology and data that we believe is increasingly defining our business. This work is generating new insights on risk, underwriting and claims management, which in turn elevates our customer experience and improves our financial performance.

The addition of the group benefits business from Aetna is additive to our efforts as we are now the #2 writer of both workers' compensation and group disability insurance, with unparalleled datasets across those businesses. This is exciting progress in our vision to become a broader and deeper risk player in the market, defined by a unique focus on agent and customer needs.

All of these 2017 successes are a part of a much broader plan to ensure that The Hartford is a contemporary company and prepared for a rapidly changing future, both financially and operationally.

Turning to tax reform. There are many positives and a few watch areas. Growth in investment should accelerate with the passage of tax reform while cash is repatriated from overseas. In the insurance sector, we are pleased that the playing field has been leveled to a certain degree. On the other hand, there is uncertainty about how the lower tax rates play out over time and the extent to which the benefit will be competed away or be subject to regulatory rate reduction actions.

For 2018, a good portion of the tax benefit will fall to the bottom line as most of the year's earned premiums were written in 2017. And many lines, including personal and commercial auto, property and liability, still need additional rate to achieve our profitability goals. We will continue to work hard to achieve them.

We also intend to use a portion of the additional cash flow we expect from tax reform to accelerate execution on our existing technology initiatives.

We begin 2018 with confidence and momentum in all our businesses, focused on our financial and strategic goals for each. With the economy expanding, we see plenty of opportunities for profitable growth. Based on the metrics we provided for 2018, we expect to generate higher earnings and a core ROE of between 11% and 12%, including the benefit of lower tax rates. We expect the improvement to come from additional margin in Personal Lines, continued strong margins in Commercial Lines and earnings growth in both Group Benefits and Mutual Funds. However, we do not expect much of an impact this year from the sale of Talcott given the expected timing for closing the transaction. As we have shared with you before, the priority for our excess capital is to generate long-term sustainable growth, either organically or with acquisitions that make financial and strategic sense. We will also evaluate debt and equity capital management opportunities, being thoughtful and focused on creating sustainable shareholder and stakeholder value.

Finally, it's not just what we did in 2017 but how we did it. Our philosophy is simple: we believe that doing the right thing every day is core to our character. Customers, agents, employees know we are a brand they can trust, that we treat people with respect and we honor our commitments to them. I'm proud of the recognition we have received for this, including our third year of being in the Bloomberg Gender-Equality Index, 9 years of recognition by Ethisphere as one of the most ethical companies and numerous Best Place to Work awards from various groups. We also believe that we have an obligation to make a difference in the communities where we work and live. You can see this in our sustainability report we publish on our website.

The Hartford supports many activities, including educating kids on fire prevention through our Junior Fire Marshal program, which celebrated 70 anniversary this year. We're also a founding sponsor of the U.S. Paralympic team, which will be competing in South Korea in March.

To conclude, 2017 was an outstanding year for The Hartford. While bottom line financial results and book value were affected by some of our strategic decisions, I am very pleased with our underlying performance, the strength of our balance sheet and the value we provided to customers during a year of record catastrophes for the industry.

Now I'll turn the call over to Doug.

Douglas Graham Elliot
President

Thank you, Chris, and good morning, everyone. Looking back on our business objectives for 2017 and the results achieved, both operational and financial, this was an excellent year for our Property & Casualty and Group Benefits businesses.

In Group Benefits, we capped off a year of outstanding earnings and solid top line growth with the Aetna acquisition. In Personal Lines, we delivered strong improvement in the underlying auto combined ratio.

And in Commercial Lines, we successfully achieved top line growth while balancing underlying profitability in competitive markets.

Our financial results were impacted by historic industry catastrophe losses, but we're pleased with how our property book performed in these extreme events. Our claims team and the entire enterprise responded to our customers with the care and diligence our brand represents. In the midst of these tragic events, we were at our best, backing our promises and helping our customers rebuild their lives.

I'd like to share a few thoughts on our 2017 financial performance for each of our business units, beginning with Group Benefits, where core earnings for the year increased to $234 million, up $30 million from 2016, with a core earnings margin of 5.8%. The group disability loss ratio for the year improved by 4.9 points due to positive pricing as well as favorable incidence and recovery trends. The group life loss ratio was very solid but up 1 point versus prior year due to favorable changes in reserve estimates in 2016.

Looking at the top line. 2017 fully insured ongoing premium increased 14%. Excluding the 2 months of results from the Aetna acquisition, growth was 3%. Overall, book persistency on our employer group block of business, including the business acquired from Aetna, was approximately 90% for the year, and fully insured ongoing sales of $449 million were flat with 2016.

Fourth quarter sales of $103 million were up $60 million over last year, largely due to one national account sale.

Integration of Aetna's group benefits business is on track. Our organizational structure is complete, and all aspects of the integration are moving forward with urgency. I'll share more details on this in a moment when I cover our 2018 outlook.

In Personal Lines, core earnings for 2017 were $13 million, including catastrophe losses of $453 million before tax or 12.3 points versus our 2017 outlook of 5.8 points. The full year underlying combined ratio, which excludes catastrophes and prior year development, was 93, improving 2.4 points from last year due to improved auto performance. The Personal Lines auto underlying combined ratio improved by 4.2 points to 99.7 for the full year, driven by the combination of earned rate change, underwriting and agency management actions. These have clearly taken hold in our book of business, and we are confident that our auto profitability improvement plan is on track. Keep in mind, when looking at our quarterly results, that fourth quarter has the highest underlying loss ratio of the year.

In Commercial Lines, we delivered $825 million of core earnings for the year on a combined ratio of 97.3. Catastrophe losses for the year were $383 million or 5.6 points versus our outlook of 2.3. The underlying combined ratio for Commercial Lines was 92 for the year, up 2.6 points compared to 2016. Overall, this is consistent with our expectations at the outset of 2017 and very strong absolute performance when compared to the industry and our peers. Approximately half of the increase is due to margin compression in workers' compensation and general liability, and the other half due to higher variable compensation and technology costs.

Renewal written pricing in Standard Commercial Lines was 3.2% for the full year, up a full point from 2016. This is a positive sign, and I'm encouraged by the recent price firming in property. In Middle Market property, price change this quarter was up 1.5 points compared to third quarter. Pricing across all other lines for the quarter was generally consistent with third quarter, with continued strong trends in auto.

Our workers' compensation rates are down sequentially in the fourth quarter by about 0.5 point, driving our overall quarterly pricing change down slightly. Loss trends in workers' compensation continue to be favorable relative to historical norms.

Written premium of $7 billion for the year was up 3% from 2016, driven primarily by growth in Small Commercial, including the acquisition of Maxum. Small Commercial had another outstanding year. The underlying combined ratio was 87.8, and written premium grew by over 5%, driven by strong retentions and $596 million of new business. Our competitive advantage in this business has been achieved over many years through strategic innovation, consistent investment and rigorous execution, and 2017 was no exception. We began rolling out new capabilities in ICON that allow our agents to submit excess and surplus lines business through a national wholesaler to Maxum and other underwriters as part of our Small Commercial package. Behind the scenes, we continue to simplify our quoting process to make more quotes bindable with fewer underwriting questions by using advanced data and analytics. And we expanded the functionality of our digital service platform, allowing over 30% of all of our service transactions during the year to be completed online. The momentum of this business builds by the day.

In Middle Market, we posted an underlying combined ratio of 96.2 for the year, up 4.7 points from 2016. This was slightly higher than our expectations due to non-CAT property losses and margin compression in general liability and workers' compensation, including an increase to policyholder dividends on certain participating workers' compensation contracts, where loss performance has been superior. We also had higher variable compensation and technology costs.

Written premium increased 1% for the year based on solid retentions and new business production of $484 million, up 5% versus prior year. During 2017, we introduced a new multinational capability, allowing us to win more accounts with exposures outside the U.S. This has brought growth in domestic premium on accounts for which we might not have been able to compete in prior years.

We also stood up an energy vertical, achieving solid new business premium and a growing pipeline of opportunities. And our construction practice has matured into a strong business, delivering double-digit written premium growth in 2017.

In Specialty Commercial, the underlying combined ratio of 97.8 for the year was 3.3 points higher than 2016. Nearly 3 points of this increase was driven by higher expenses, similar to our other commercial business units.

Our Bond business posted another strong year, delivering excellent underwriting results and strong growth, the result of new and expanding projects among our policyholders as economic conditions improve.

And in Financial Products, we have successfully shifted to a Middle Market-centric platform where pricing and loss trends have been more stable.

Looking back on our financial results and accomplishments for 2017. We are very pleased with our execution across our businesses. Market conditions vary by business and line but have been competitive across the board. We are more confident than ever in our ability to navigate such challenges.

But before I turn the call over to Beth, let me offer a few comments on our goals for 2018. In Group Benefits, continuing the successful integration of the Aetna business is a top priority. Now 3 months post-acquisition, we are even more enthusiastic about the team, the business and the claims technology we have acquired. Integration milestones for 2018 are in place, including actions necessary to achieve our cost synergy target of $100 million. We are underway with plans to bring the newly acquired claims management application Workability into our technology platform. Once combined with our existing case management system and newly developed billing and digital engagement tools, we will have a market-leading technology suite for our customers, both individuals and employers.

Overall, we're off to a great start in Group Benefits for 2018, with continuing strong core business results. January 2018 renewal retention on both our existing Hartford business as well as the acquired block has been strong, in line with prior year. And January sales are favorable to last year.

We expect Group Benefits 2018 core earnings to be between $310 million and $330 million after tax. Our 2017 results included very strong partnership investment returns, which our planning assumptions do not expect to repeat in 2018. We also had better-than-expected prior year loss outcomes in 2017 that we expect to normalize in 2018. Net income, which includes integration costs, is expected to be between $275 million and $295 million after tax.

In Personal Lines, building off our substantial progress in 2017, we will continue to increase our new business marketing in AARP Direct, returning to new business growth in direct auto as momentum builds throughout the year. For 2018, we expect to achieve a Personal Lines combined ratio of 96 to 98, including

5.6 points of catastrophes. This implies an auto combined ratio of 97.5 to 99.5, including 1.1 point of catastrophes, putting us in line with our targets.

In Commercial Lines, industry-wide evidence of margin pressure began to emerge in 2017, triggering an inflection point in the market. And as a result, we are beginning to see improvement in property pricing. I expect this trend to continue and include general liability pricing improvement during '18 as well.

Specifically, for our book of business, we expect our auto rate gains to continue in the high single digits. In property and general liability, we expect to see pricing trends improve to mid-single digits over the next 4 quarters. However, given favorable profitability trends in workers' compensation, rates in this line could range from flat to slightly negative.

We remain committed to underwriting discipline, maintaining strong margins and seeking growth when it meets our profit targets. As is always the case, we have some very well-performing lines of business as well as some pockets of business that need price increases to reach target returns. Our pricing actions will be driven by these profitability indicators, and a key priority will be the improved performance of our Middle Market property and liability book of business. As a result, we expect an overall 2018 Commercial Lines combined ratio between 93 and 95.5, including 2.6 points of catastrophes. This represents a slight improvement from 2017 after normalizing for catastrophe losses. This is driven by our expectation of rate increases in areas of the business that are performing below targets and continuing strength in our workers' compensation results.

In summary, 2017 was a very strong year of execution across our Property & Casualty and Group Benefit businesses, with core earnings of $1.1 billion. Despite the historical level of catastrophe losses, our businesses performed well and achieved progress on many strategic priorities. This work continues in 2018, and our momentum is building. Our core priorities remain unchanged: profitable product and underwriting expansion, deep partnerships with our distributors and outstanding value to our customers.

Let me now turn the call over to Beth.

Beth Ann Bombara
Executive VP & CFO

Thank you, Doug. I'm going to briefly cover fourth quarter and full year results from the other segments and investment performance before taking your questions.

Turning to Mutual Funds. Fourth quarter core earnings were $37 million, up 76% after excluding a state tax benefit recognized this quarter. Full year 2017 core earnings were $110 million, up 41% over the prior year due to higher investment management fees as market appreciation and over $3 billion in net inflows drove an 18% increase in total segment AUM to $115 billion. Investment performance remains strong, with 68% of Hartford Funds beating their peers on a 5-year basis, which contributed to the robust sales.

Corporate, which has been restated to include Talcott as a discontinued operation for all periods presented, had a net loss of $4.1 billion in the fourth quarter due to the $3.1 billion loss on discontinued operations and an $867 million charge resulting from U.S. corporate tax reform, reflecting a reduction in the value of net deferred tax assets.

The Corporate net loss for the year was $4.5 billion. In the quarter, Corporate had core losses of $51 million, slightly better than prior year, primarily due to a state tax benefit of $5 million. For the full year, Corporate core losses totaled $229 million.

Regarding Talcott, the sale and separation process is on schedule, and we expect to close by June 30. Since the transaction economics were locked in at signing, our results for the most part are not impacted by Talcott earnings going forward.

The investment portfolio continues to perform well. For the quarter, net investment income, which now excludes Talcott, declined about -- by about 4% to $394 million, primarily due to lower income from limited partnerships compared to the prior year. For the full year, net investment income was $1.6 billion, up 2% due to higher limited partnership returns, which were 12% before tax in 2017, well ahead of expectations.

The portfolio yield for full year 2017, excluding LPs, was 3.7%, down 10 basis points from 2016 due in part to lower reinvestment rates and lower nonroutine items such as make-whole payments on fixed maturities and prepayment penalties on mortgage loans.

To summarize, fourth quarter core earnings were $293 million, basically flat with fourth quarter 2016, and full year 2017 core earnings were up 11% to $1 billion. For the quarter and the year, the major factors were a change to favorable prior year development, better underlying personal auto results and higher Group Benefits and Mutual Fund earnings, offset by significantly higher catastrophe losses and some deterioration in underlying Commercial Line margins, driven in part by higher expenses.

Turning to the balance sheet. Our rating agency adjusted debt-to-capital ratio increased to 28.8%, up about 4 points sequentially as a result of the net loss in the quarter. We maintain our long-term goal of reducing our rating agency debt ratio to the low to mid-20s and expect debt leverage to improve over the next 12 to 18 months due to future net income and net reduction of nearly $1 billion, as we have previously stated.

Our overall reserve position remains strong. I'd note that the annual asbestos and environmental ground-up review conducted during the fourth quarter of 2017 did not impact earnings as the $285 million in net loss development was covered by the reinsurance agreement with National Indemnity Company that we put in place at the end of 2016. As a reminder, that agreement covers unfavorable development of up to $1.5 billion, so there is $1.215 billion remaining under the cover.

Core earnings ROE for the last 12 months was 6.7%, up 1.5 points from a year ago. This ratio is depressed somewhat because it is calculated using average equity. If you normalize beginning equity for the loss on discontinued operations, pension transfer and tax charges, it would be closer to 8%. We expect our ROE to improve in 2018 due to earnings growth, including the impact of lower federal income taxes. Based on the metrics we provided for 2018, we would expect our core earnings ROE to be in the 11% to 12% range.

In addition, over time, we will deploy the cash flows generated from the Talcott sale and from the monetization of our tax net operating losses and AMT credits into higher-return opportunities.

Regarding capital management. During 2017, we repurchased about $1 billion of our common shares and increased the quarterly dividend by 9%, marking the fifth consecutive year we raised our quarterly dividend.

Before taking your questions, I'd like to briefly summarize the impact of a lower U.S. corporate tax rate in 2018. Our only major preference item going forward is municipal bond income as the dividend received deduction was in Talcott. So aside from the 5.25% tax rate on muni bond income, almost everything else will be taxed at 21%. Our effective tax rate will be the direct result of muni bond income as a percentage of pretax income. In other words, if muni bond income is about 23% of our total pretax earnings, which is approximately where we would expect it to be in 2018, then the effective tax rate would be about 17%.

I'd also note that the reduction in the corporate tax rate reduces the carrying value of the tax benefits we retained in the sale of Talcott. The tax assets we retained are now carried at approximately $700 million, down from the $950 million we discussed in December. However, the net present value of the retained tax benefit has increased as the reduction in value of the NOLs is more than offset by the accelerated monetization of the AMT credits we retained.

I'd also like to point out there is one aspect of the accounting for tax reform which could result in a subsequent change to the 2017 loss on the sale of Talcott. We've provided a summary of this in the appendix to the slide deck. This change would be the result of accounting guidance that the FASB may issue later this month. That guidance is expected to either require or permit us to retrospectively reclassify certain equity amounts from retained earnings to AOCI as of December 31, 2017, or may allow prospective adoption of that change in 2018 or 2019. The amounts that would be reclassified represent the stranded tax rate differential that has already been reflected in earnings. The knock-on impact of this would be an approximate $193 million reduction in the loss on sale reported for 2017, but there would be no impact on the underlying economics of the transaction.

To conclude, full year 2017 core earnings demonstrated good improvement from 2016 despite high levels of catastrophes in each quarter of the year. As we begin 2018, our priorities include continued profitable growth, integration of the Aetna business, closing the sale of Talcott, reducing debt leverage and ultimately redeploying the proceeds of the Talcott sale into higher-return opportunities. We will continue to focus on maintaining strong margins and underwriting discipline while growing where it makes sense in a market showing early signs of improving pricing dynamics.

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

Sabra Rose Purtill
SVP, Head of Investor Relations & Treasurer

Thank you, Beth. Before beginning Q&A, I wanted to mention that Bank of America will be hosting Chris and Beth on February 14 for a fireside chat at the annual Insurance Conference. Their discussion will be webcast, and there is a link to the webcast on our -- on the Investor Relations section of our website so you can listen to it live or in replay.
Jack, could you please repeat the Q&A instructions?

Question and Answer

Operator

[Operator Instructions] Your first question comes from Brian Meredith with UBS.

Brian Robert Meredith
UBS Investment Bank, Research Division

Chris and Doug, I was wondering if you could comment on your thoughts of the impact of tax reform on pricing potentially going forward with respect to Personal Lines but also workers' compensation insurance.

Christopher Jerome Swift
Chairman & CEO

Sure, Brian. I'd -- happy to provide some color, and Doug, I'm sure, will provide his views also, which are similar. I think the dialogue and debate here on tax rate is you got to put it in the context that it's just one component of pricing. I mean, there's other components: loss trends, underwriting classifications, acquisition costs, operating costs. I mean, so it's -- you need to manage all of them together. I would also say it depends on the starting point from a pricing indication side of what may or may not change at the price level to a customer. As we said in our comments, we're going to try and expect to hold on to a significant portion of the tax benefits in the near term, but we are going to put in our models for pricing purposes that are filed ultimately with regulators the new effective tax rate. I think ultimately, this will come down to then as far as, ultimately, a game theory of just what happens at the market level, what do competitive forces in the market do. But I would also state that not all lines of business are price adequate. And as I said in my prepared comments, we're going to try to improve those lines where we need price action. I think the other thing, too, I alluded to, and I'm going to give you the dollar amount, but we are going to accelerate some IT investments, digital investments in product development and data and analytic investments over the next 2 years. I would say that incrementally is about $50 million pretax that's in our plan. It's in the guidance that we provided you. So that's how we're thinking about tax reform from more of a macro level. But Doug, what's your point of view?

Douglas Graham Elliot
President

I guess I would just add, Chris, that I continue to think about our line profitability and our segment profitability, so feel very good about our auto progress but still more work to be done. We posted a 99.7 point of progress this year, but that doesn't leave a lot of underwriting profit, and we still have more work to do in that line. So we will see how this plays out. A lot of our pricing actions are already determined for '18, and we're determined to improve our profitability, particularly in Middle Market and Personal Lines auto. So we will continue to talk about this and share as we go forward. I think it's still early.

Brian Robert Meredith
UBS Investment Bank, Research Division

Got you. And then one for Beth. Beth, just thinking about taxes and tax reform and the elimination of the AMT, what is the kind of cash benefit that you expect kind of on an annual basis from just the reduction in cash taxes paid?

Beth Ann Bombara
Executive VP & CFO

I'm sorry, how much is the benefit or where is it going?

Brian Robert Meredith
UBS Investment Bank, Research Division

Yes. With the benefit, you gave us the present value number, but I'm just kind of thinking, are you going to pay any cash taxes in 2018 now? What is it going to look like from a cash flow perspective for you guys?

Beth Ann Bombara
Executive VP & CFO

Right. So looking at 2018, we'd expect to pay little to no tax in '18. As it relates to the AMT credits that we'll be able to monetize over time, that will really start when we file our '18 tax return in '19. So we'll start to see those cash flows coming through as well. So when we look at both our NOLs and AMT credits and based on our current projections for taxable income, we'd expect to monetize those over the next 3 to 4 years.

Operator

Your next question comes from the line of Kai Pan with Morgan Stanley.

Kai Pan
Morgan Stanley, Research Division

My first question is on personal auto. If you look at your rate increases, still in the double digits, I assume your loss cost trend probably in the mid to single digits. So there should be 5-point improvements in the core underlying margin going forward. So I just wonder why the guidance is only sort of showing 150 basis points to the midpoint. Are there more to come?

Douglas Graham Elliot
President

Yes. Kai, this is Doug. I would start by suggesting that over the next couple of quarters, you'll see the written pricing come down a little bit. So our earned trends now that we're achieving improved profitability are going to be slightly less than we've had in the past. The other thing is we had very good trends across our frequency and severity in 2017. Hard to suggest they're going to repeat next year, so I -- we try to be thoughtful and conservative in our selections going forward. I think those 2 combinations still imply that we will see improvement in the auto line underlying going forward. We'd love to see the same rate of change in '18 that we saw in '17. But we'll have to see how that plays out.

Kai Pan
Morgan Stanley, Research Division

Okay. Then my second question on Commercial Line, could you talk a little bit more about the loss cost trend in workers' compensation and general liability? And what gave you confidence to achieve the improvements, given that the 2017 results was -- fell sort of the original guidance?

Douglas Graham Elliot
President

Sure. Our overall workers' comp performance has been very strong, and that goes back a number of years. And although we tweaked it a bit in 2017, I still look at the overall performance and feel very good about it, particularly in our Small Commercial world. So that's just as a starter. As we move forward, I think our sophistication in underwriting and the work we're doing in claim to work and combat, if you will, trends that we expect to see in medical and in wage, give me confidence that we will be able to continue to produce very solid returns, right? And I -- every time I think about my answer on a workers' comp question, I do ask you to think about Small versus National Accounts versus Middle Market. They compete very differently. The results vary. But in general, we look across our segments. We feel good about the line. Our trends have been very solid. The frequency has been in very good shape for a number of years. We're watching severity around medical. It's still better than historical norms, but we are watching the hospitalization end of those costs. And as we go forward, we'll kind of compete month-by-month and quarter-by-quarter and make sure we're reflecting that in the pricing accordingly. Kai, let me add one other -- as I was answering that question, I was thinking also about your Personal Lines question. I think we've shared in the past that we are going to ramp up our marketing spend in Personal Lines. So when you think about the overall combined ratio, expect to see a little bit more cost in the Personal Lines expense component of combined. That's also adding to a part of the answer that I shared with you.

Operator

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

Elyse Beth Greenspan
Wells Fargo Securities, LLC, Research Division

I guess this is following up on some of the earlier questions. As we think about the underlying margin guidance, and this is both a Personal and Commercial Lines question, it seems like your commentary points to some improvement on the loss ratio and potentially higher expense ratios, given investments in both of the businesses. Is that how you see it when you think about 2018 with the spread between the loss and the expense ratios?

Christopher Jerome Swift
Chairman & CEO

Elyse, it's Chris. I would say, from a higher level, yes, generally the case. I mean, we think we could obviously get some rate in the book. We're going to try to manage frequencies and severities to a good outcome, but we are going to continue to invest in the organization, both IT, digital product. I would say that our expenses issue were probably a little elevated, primarily compensation related from our goals in performance side. So I would say that there is going to be a reversion to the mean going forward on compensation costs. But as far as investments in those areas that I described, that'll continue at a healthy pace.

Douglas Graham Elliot
President

Elyse, I would add as well that we're working mix of lines of business as well underneath the broad scenario. So as an example, I did talk about surety. Surety has been a growing -- with a solid performance in 2017. Our top line in surety was up 10%. It's one of our outstanding return areas. We're going to do more in surety. And so we're also mixing the book underneath. Auto is showing signs of improvement in Commercial Lines as well as Personal Lines, so that's an improvement story. So we're battling hard to, number one, maintain the strong margins we've achieved, but to see if we can do a little bit better in 2018.

Elyse Beth Greenspan
Wells Fargo Securities, LLC, Research Division

Okay, great. And then another question. In terms of auto, in your guide for this year, you get to about that 96.5, which has been your target for that business. And you did point to, still taking rate in the high single digits. So maybe this is more when we think out beyond '18, but do you think you can run that business better than a 96.5? Because meaning, if you keep taking high single-digit rates, essentially, you could get the margin lower or then where we just see greater expenses as well in that business.

Christopher Jerome Swift
Chairman & CEO

Yes. Elyse, it's Chris. I would say, again, as I pivoted, and Doug has been talking about, too, I mean, we're trying to return to growth, right? I mean, we've had to take some aggressive actions with the book in shrinking it. So I would say that the growth aspect of it will contribute to obviously an expanding combined ratio while we continue to manage loss cost in trends. And I would say, again, it's going to be a dynamic marketplace out there, too. I mean, there is a lot of strong competition in this area. We're focused in on the more of the mature market segment with a value proposition that is somewhat different. So we remain confident that we can grow and return to the higher levels of premium volumes, which should also generate some relief on the expense ratio. But make no mistake, I mean, it's still going to be very, very competitive.

Douglas Graham Elliot
President

Elyse, just -- I certainly echo all of Chris' focus comments on growth. The other thing I would just point out, I think I mentioned returning to mid-single digits as opposed to higher single digits. So I expect pricing over the next several quarters to be more in that 5 range than the higher single digits.

Operator

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

Jay H. Gelb
Barclays Bank PLC, Research Division

Beth, can you talk about the potential for share buybacks to restart and the timing on that and what we should think about in terms of magnitude of buybacks in 2018?

Beth Ann Bombara
Executive VP & CFO

Yes. So Jay, I'll go back to the comments that we made in the fourth quarter when we stopped our share buyback due to the Aetna acquisition. We'll be back to you when we have a new capital management plan. But right now, we're focused on closing Talcott, and then we'll evaluate what the best use of that capital is and the timing, but not prepared to talk today about expectations for 2018.

Jay H. Gelb
Barclays Bank PLC, Research Division

Okay. And then my follow-up, and this is -- I remember sort of asking this question on the Talcott call. I believe now that the expectation is for an 11% to 12% return on equity in 2018, I believe back when Talcott was announced, the expectation was for that to improve in 2019 as the full benefit of the Aetna transaction comes into play. Is that still the case for 2019?

Christopher Jerome Swift
Chairman & CEO

Jay, it's Chris. I think the -- I probably led that charge on the improvement. And I would say, generally, directionally, we still see it, but I mean, there's going to be some competing forces, right? So we always try to stay focused on hand on what we need to do in '18 that sets up a good '19. So now our focus is on executing, particularly as it relates to standing up Talcott as a separate company, integrating Aetna and making sure we're getting all the expense saves out of there, which obviously from an earnings side, will contribute in '19. But on the other hand, we are -- with that 11% to 12% guide, that does reflect a significant tax benefit in '18 that we'll have to see how that plays out in '19 and '20 and beyond. So that would be the only caveat that I would share with you. There could be some competing forces that impact that trend going forward.

Operator

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

Joshua David Shanker
Deutsche Bank AG, Research Division

The first question, it looks like there are some competitors in the auto market who will be stepping up to make customer growth a priority for 2018. Can you talk a little about the sales proposition at the AARP business and how you retain those customers and how those customers might be less risky to be picked off by a more aggressive competitor in the market?

Douglas Graham Elliot
President

Let me try to tackle, Josh, that in a few pieces. Number one, we're certainly ramping up marketing, as I mentioned, so that we get more client contact, we get more inbound activity. And based on our marketing evidence in the last 90 days, that's happening. So we're feeling more flow. Second part is our ability to close, offer competitive prices and then close. And so we're focused on our skills on the phone. We're focused on our fine-tuning of our auto class plan. Again, this is a state-by-state mix dynamic. So there are a lot of dynamics that we are working on, all trying to improve our close ratio on those inbound calls. And again, we're going to continue to move our marketing spend up as we move throughout 2018. So I expect this to be a growing positive story, but we'll have to work our way through the first 90 days, and then we'll share progress as we move throughout the year.

Joshua David Shanker
Deutsche Bank AG, Research Division

All right. I'll take one more stab at the $25,000 question that Jay asked. In -- your preference is obviously to do transaction, I think, overdo buybacks if the right transaction came along. But what is your appetite for letting a war chest build or the priority about returning capital as it builds to shareholders? Is there a philosophy internally about what to do with money as it comes in?

Christopher Jerome Swift
Chairman & CEO

Yes. I appreciate the question, Josh. Yes, what I would say, again, in the follow-up to Jay's question, I mean, we've got a lot of levers still to continue to expand ROE. So as much as -- and we talked about some competing forces that might be happening. I mean, there are levers that we have to be able to help manage to expand ROE beyond that 11% to 12% that we guided to in '18. And clearly, capital management is one of them. So I think you've seen our history. We're balanced. We're thoughtful. We're, if anything, consistent. So I would expect that philosophy to continue. I don't think there's a calculus I could share with you right now, but as excess capital builds, we know we have to deploy it effectively or return it to shareholders in a timely basis. And that's what I would say right now.

Operator

Your next question comes from the line of Meyer Shields with KBW.

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

Doug, I'm wondering if you could give us a sense as to the auto claim frequency trends that you've embedded in current pricing.

Douglas Graham Elliot
President

Well, certainly, '17, we've talked about them, right, so we feel very good. Our frequency has essentially been flat. We've had low severities, low single-digit severities. We are looking forward at similar frequency trends for '18, and I would say small single-digit severity trends in the 2 to 4 range. So not a lot different in '18 than what we think we're experiencing today, what we are expressing today. And that's as much as I want to give on the guidance front.

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

Okay. No, that's good. It's helpful. And second question, as we anticipate stronger U.S. economic growth, does that have any implications on its own for margins in workers' compensation and in Maxum?

Douglas Graham Elliot
President

Where we have felt that strong economy certainly is in our Bond business with construction start-ups. We've had a number of nice opportunities in our construction unit, in new projects, shovels in the ground, et cetera. And obviously, we continue to fill in Small Commercial. So the start-ups, the new economy, the small employee groups, under 5, where we have a terrific product, and we have a lot of focus in that micro segment of Small. So those areas are clearly signs that we're bullish about. And I think we'll see more of that as we move through '18. Overall, a solid economy is a good indicator of workers' comp and disability. So we understand that our trends relative to employment are good signals for key lines for us. And we have our fingers crossed that we'll see a very solid economy moving forward that we'll be able to grow from moving into '18.

Operator

Your next question comes from the line of Bob Glasspiegel with Janney.

Robert Ray Glasspiegel
Janney Montgomery Scott LLC, Research Division

We've had sort of a turbulent financial market in the first quarter. I wonder if you could just talk about your overall investment strategy going into the market and whether you're in a derisking, rerisking, looking at this as an opportunity to buy. How are you repositioning the portfolio through this?

Christopher Jerome Swift
Chairman & CEO

Yes. Bob, let me start, and then Brion Johnson, our CIO, is with us here, and ask him to give you some additional color. But generally, I think we feel very good. And we've got a high-quality portfolio, well diversified. We've traded out of certain sectors a while ago that we did not think held its potential for returns. So the largest concentration we have is still in munis and in corporate investment-grade bonds. So generally, we feel very good. I mean -- and if you look closely at the tape, I mean, credit spreads are holding in fairly well. We'll see how trading goes today. So to the extent that the equity markets have been rolled over, corrected a little bit, we're not seeing the same pressure to date in the credit environment. But Brion, what would you add?

Brion Scott Johnson
Chief Investment Officer

So thanks for your question, Bob. I would say that Chris articulated it well. We take a sort of a through-the-cycle approach to the investment portfolio. We're very comfortable with the status of the portfolio. It is a high-quality portfolio. And over time, we have been lowering the risk profile of the portfolio just as the cycle got longer and the compensation for risk got lower. So since we've been doing that, we're pretty reasonably well positioned for the environment that we're in. We're nibbling around the edges where we see opportunities, but we're not inclined to change the overall risk profile of the portfolio in response to recent developments.

Robert Ray Glasspiegel
Janney Montgomery Scott LLC, Research Division

Just a quick follow-up. First quarter weather in the Northeast sometimes nails you, cold and frozen roofs. Have you had any issues yet that you'd spike out, Doug? Or...

Christopher Jerome Swift
Chairman & CEO

Bob, again, I'm looking at Doug, too. There's nothing that hits our radar screen. I mean, you're always going to have some frozen pipes. I was in Minneapolis earlier this week, and it was cold, and -- but it's the winter. So -- but nothing's hit our desk as anything outsized right now, Doug, would you say?

Douglas Graham Elliot
President

I agree with that.

Operator

Our final question comes from the line of Jimmy Bhullar with JPMorgan.

Jamminder Singh Bhullar
JP Morgan Chase & Co, Research Division

First, I had a question on Personal Lines. As you think about the price hikes that you've been implementing, obviously, those have helped your margins recover. Have you been able to raise prices through all the states? Or are there states that are still pending that haven't fully flown through yet?

Douglas Graham Elliot
President

Jimmy, there are still states that we are working on. So we've achieved rate adequacy in a number of states, the large majority of the states, certainly majority. But there's still a couple of key states that are working. And California is one of those states that made a lot of progress, but we have a little bit more work to do as we move into '18.

Jamminder Singh Bhullar
JP Morgan Chase & Co, Research Division

And I'm assuming that's a material part of your business?

Douglas Graham Elliot
President

It is. It's a significant part of our Personal Lines business.

Jamminder Singh Bhullar
JP Morgan Chase & Co, Research Division

And then on just -- so what's your expectation for lapses on the Aetna group business as you onboard it? And are there any concerns that they sold a lot of business on a bundle or cross-sold business with major medical? And even though you're going to be doing it, it's still a separate company. So what's your expectation for lapses as you onboard the book?

Christopher Jerome Swift
Chairman & CEO

It's Chris. All the -- and Doug made the commentary on it. All the data that we see, we knew going into it. We're not surprised. We are obviously trying to renew as much of that business as possible. We understood their pricing approach and philosophy. We're harmonizing it with ours. We'll be thoughtful. I would still say that, again, the guidance that we provided, I mean, there is a tolerance for shock lapses in '18 that we're going to try to manage to avoid. But I think we have a reasonable to conservative plan on premiums from a lapse side. And Doug, I know we got weekly integration meetings, and we're trying to manage to outperform that, Jimmy, but I don't think there's any surprises. And we've got similar experience with profit improvement on certain accounts in our book over the years, and we'll execute very thoughtfully.

Douglas Graham Elliot
President

And Jimmy, you know how far in advance this book works, right? So we didn't expect to see much shock lapse in '18 because much of that had been renewed over the course of the spring and summer months, certainly, the National Account book. We are right in the throes of working hard on the '19 book. Chris and I are heavily involved in the key account decisions. So literally, I felt like we have information we're not sharing. We are working over the next 90 to 120 days on key '19 renewals. And I think we've built in some shock, but based on what we've seen so far, we feel very good about the way the integration's going, the sales force coming together, the tools and technology road map. So I'm optimistic about how this is coming together, and I think our plans are well-thought-out.

Jamminder Singh Bhullar

JP Morgan Chase & Co, Research Division

Okay. and then just lastly, for Beth, can you quantify stranded overhead from Talcott that might need to be allocated to the other businesses? And how was that accounted for this quarter?

Beth Ann Bombara
Executive VP & CFO

Yes. So we estimate that when we look at the costs that aren't transferring with the transaction, it's probably $35 million to $40 million annually, and we expect to eliminate those stranded costs over the next 18 to 24 months. So I don't see that as being a significant drag for our businesses. You'll see some of those costs in the corporate line until we close. But again, when you think about the size of our expense base, it's a pretty small amount.

Jamminder Singh Bhullar
JP Morgan Chase & Co, Research Division

And that's stranded as well as allocated? Because there's some probably corporate overhead that's allocated to Talcott that'll be -- that'll have to be allocated to the rest of the business.

Beth Ann Bombara
Executive VP & CFO

Yes, that's how I'm defining stranded. I'm looking at all the costs that we previously allocated to Talcott, looking at those things that I know we're transferring, those things that we know will just get eliminated right away. And then this is the -- really the overhead piece that we have to address.

Jamminder Singh Bhullar
JP Morgan Chase & Co, Research Division

And this quarter, that number was still in discontinued operations? Or was that allocated out of that already?

Beth Ann Bombara
Executive VP & CFO

It's already -- it's in the corporate line. It's kind of hard to see for the quarter, but yes, it's in the corporate line.

Operator

There are no further questions at this time. I'd like to turn the call back over to the presenters.

Sabra Rose Purtill
SVP, Head of Investor Relations & Treasurer

Thank you. Thank you for joining us today. And if you have any additional questions, please do not hesitate to follow up with the Investor Relations team. Thank you again, and we look forward to seeing you -- some of you next week in New York. Goodbye.

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