The Hartford Financial Services Group, Inc. NYSE:HIG

FQ4 2014 Earnings Call Transcripts

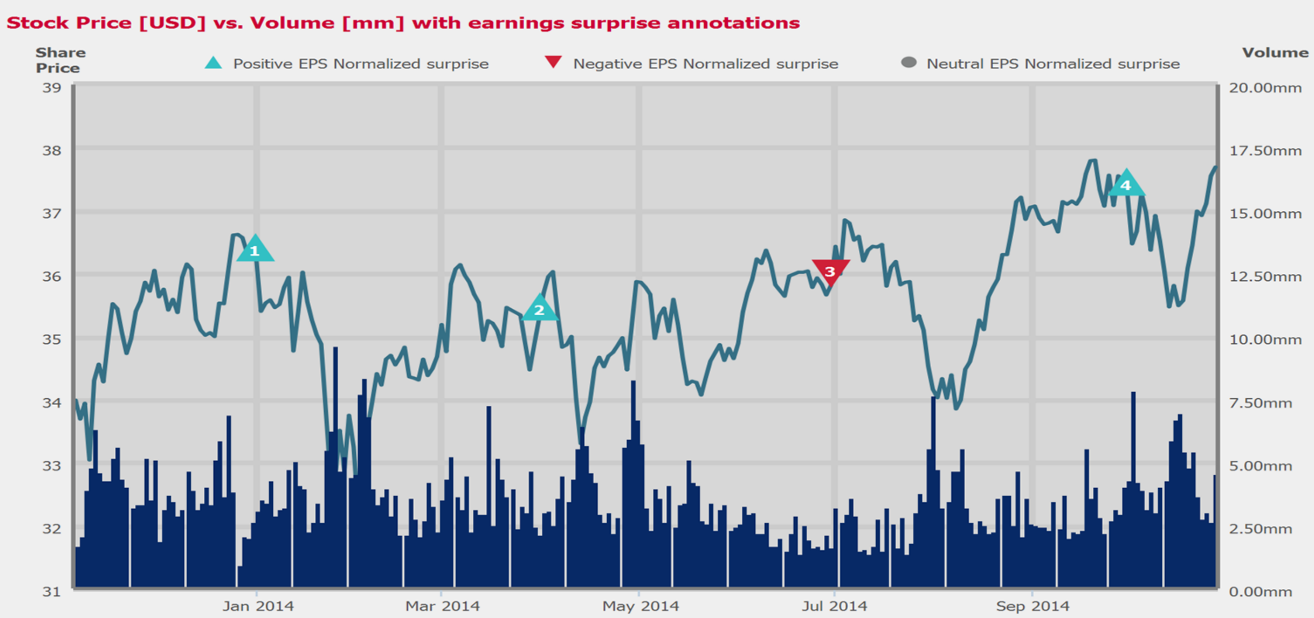
Tuesday, February 03, 2015 2:00 PM GMT

S&P Capital IQ Estimates

	-FQ4 2014-			-FQ1 2015-	-FY 2014-	
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	ACTUAL
EPS Normalized	0.93	0.96	3.23	1.01	3.38	3.36
Revenue (mm)	4688.48	4617.00	(1.52 %)	4712.17	18625.15	18614.00

Currency: USD

Consensus as of Feb-03-2015 11:43 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ4 2013	0.90	0.94	1 4.44 %
FQ1 2014	0.93	1.18	2 26.88 %
FQ2 2014	0.67	0.31	3 (53.73 %)

FQ3 2014	0.84	1.06	▲26.19 %

Call Participants

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Chairman & CEO

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Presentation

Operator

Good morning. My name is Tiffany, and I will be your conference operator today. At this time, I would like to welcome everyone to The Hartford Fourth Quarter 2014 Financial Results Conference Call. [Operator Instructions] Sabra Purtill, Head of Investor Relations, you may begin your conference.

Sabra R. Purtill
Senior Vice President of Investor Relations

Thank you, Tiffany. Good morning, everyone, and welcome to The Hartford's Full Year 2014 Financial Results and 2015 Outlook Webcast and Conference Call. Our news release, the investor financial supplement and the fourth quarter financial results presentation, which includes our 2015 outlook, were all filed yesterday afternoon and are available on our website. At about 8:30 this morning, we posted the slides for today's webcast, which are also available on the Investor Relations section of the website and which will also accompany the webcast today.

Our speakers today include Chris Swift, CEO of The Hartford; Doug Elliot, President; and Beth Bombara, CFO. Following their prepared remarks, we will have about 30 minutes for Q&A.

As described on Page 2 of the presentation, today's call includes forward-looking statements as defined in 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 those 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 comparable GAAP measure are included in our SEC filings, as well as in the earnings release and financial supplement. I'll now turn the call over to Chris.

Christopher John Swift
Chairman & CEO

Thank you, Sabra. Good morning, everyone, and thanks for joining us today. 2014 was an outstanding year for The Hartford. We continued the execution of our strategy and created value for shareholders. We accelerated the transformation of the company by expanding profit margins and increasing ROEs and P&C and Group Benefits and Mutual Funds, by selling the Japan annuity business and reducing risk in Talcott, returning over $2 billion of capital to The Hartford shareholders and executing a seamless leadership transition. I want to thank Liam, the board, the management team and all our employees for contributing to a great year.

Last night, we reported outstanding fourth quarter and full year 2014 results. Full year core earnings increased 9% to $1.55 billion. On a fully diluted per share basis, core earnings grew 16%, reflecting profitable growth and effective capital management. The core ROE increased to 8.4% in 2014, a full 1 point increase over prior year.

Core earnings growth was driven by margin expansion in P&C, Group Benefits and Mutual Funds and solid top line growth in P&C. We achieved an almost 3-point year-over-year improvement in the underlying combined ratio in P&C.

The Hartford's pricing discipline and investments in new products and capabilities are producing strong results. Strong profitability recovery continued in Group Benefits with the core earnings margin rising almost 1 point in 2014 to 5.2%. I'm very pleased with how our businesses are balancing margins and top line growth in this market environment.

The Japan sale was another critical accomplishment in 2014. The transaction significantly improved the company's risk profile, and enabled us to increase our capital management program. During the year, we returned more than $2 billion of capital to shareholders in the form of equity repurchases and dividends. We also reduced holding company debt by $200 million.

Before we move into 2015's outlook, I want to touch upon an important event that we originally expected in 2014, the passage of TRIA. The TRIA legislation has been and continues to be critically important to policyholders that rely on the availability of terrorism insurance. We appreciate the efforts of Congress and the administration to enable its passage.

Now let's turn to 2015. We expect to generate core earnings between $1.55 billion and $1.65 billion. As Beth will cover in more detail, adjusting for 2014's low catastrophe losses, strong limited partnership returns and prior year development, earnings growth from P&C, Group Benefits and Mutual Funds is expected to more than offset the anticipated decline in Talcott's earnings. As Doug will detail, we are striving to expand our margins in 2015, recognizing the pricing and interest rate environment has become more challenging.

In P&C, we are optimistic that targeted pricing actions and enhanced capabilities will allow us to drive modest improvements in the underlying combined ratio.

In Group Benefits, the core margin is expected to be relatively stable. We foresee continued improvement in disability loss trends, but expect that to be offset by a reversion to a more typical life mortality. We expect the key story in Group Benefits to be a top line growth recovery. Recent sales activity suggests The Hartford strengths in claim handling and service are making a difference with the customers.

We are committed to improving The Hartford's ROE and growing book value per share to driving top quartile shareholder returns. As I discussed last quarter, we will focus our activities in 4 major areas: expanding product and underwriting capabilities, increasing distribution effectiveness, improving the customer experience and operating efficiency and effectively managing capital, including the ongoing runoff of Talcott.

We continue to add new product in underwriting capabilities to meet the needs of a broader range of policyholders. In 2015, we intend to introduce new industry verticals in Middle Market and to strengthen our underwriting presence in geographies where we have been underrepresented.

In Group Benefits, we have expanded our voluntary product suites to include disability flex, critical illness and accident coverages. These products and underwriting initiatives strengthen our relationship with brokers and agents by helping them better serve their clients. In addition, we seek to extend our distribution in 2015.

The micro segment of Small Commercial is best served by a multichannel distribution strategy. We are aggressively moving in that direction with an AARP endorsed offering and other initiatives that will bring increased simplicity and speed to small business owners and our distribution partners.

We are also investing in technologies that will improve the customer experience and create operating efficiencies. The early feedback from the rollout of our new P&C claims systems has been very positive. The system promises to improve claims handling, efficiency and consistency, as well as the entire claims experience for the policyholder and the agent.

Finally, effective capital management will continue to be critical in meeting the company's strategic goals. We plan to take $1.5 billion in dividends from the Talcott legal entities by early 2016, $500 million of which was completed in January as we begin to appropriately reduce the amount of excess capital in Talcott to reflect its runoff status. This excess capital will provide the company with significant financial flexibility for future capital actions and investments in new capabilities.

As I reflect on the past 12 months, it is clear that this has been a pivotal year for The Hartford. With the sale of Japan and the significant improvements in P&C and Group Benefits, the company's strategic transformation and restructuring is essentially complete. The Hartford enters 2015 as a strong competitor in each of our markets. We have supplemented existing strengths in underwriting and claims with enhanced capabilities in product, distribution and service.

The company is positioned to create shareholder value going forward on a consistent and sustainable basis.

Now I'll turn the call over to Doug.

Douglas G. Elliot
President

Thank you, Chris, and good morning. Today, I'll cover the 2015 highlights for Commercial Lines, Personal Lines and Group Benefits and then share some thoughts for 2015.

First let me quickly remind you that I'll be discussing our results under the new Commercial Lines business alignment we disclosed several weeks ago. 2014 was another year of strong financial performance across-the-board. Our results were achieved through sound risk selection decisions, outstanding execution across our product and field organizations and our relentless focus on getting right all the small things that go into our market-leading franchise.

Before I cover our results, I want to touch on a few broad themes affecting our businesses, both in 2014 and as we look forward to 2015.

First, while 2014 accident year catastrophes in P&C were slightly higher than 2013, losses were below our expectations for a second year. We'll take the good news, but we won't plan for it to continue. We still follow our rigorous process to manage our CAT exposures over the long term.

Second is net investment income, which trended down for the year, and recent movement in Treasury yields suggests that we aren't likely to see a reversal anytime soon. This demands that we stay vigilant in our pricing and actively monitor competitive forces in 2015. Beth will have some additional perspective on our investment portfolio in her comments.

Turning to our financial results. In Commercial Lines, we delivered $996 million of core earnings for the full year on an all-in combined ratio of 93.4. This was an earnings increase of $169 million from 2013, largely driven by 4.7 points of improvement in the combined ratio. The underlying combined ratio, excluding catastrophes and prior year development, was 91.5 for the year, representing 3.6 points of fundamental margin improvement.

On the top line, our written premium of $6.4 billion was up 3% from 2013. Excluding the written premium declines in our Programs business due to nonrenewal actions taken in 2013, growth was 5%. New business momentum was building in the back half of 2013, particularly in Small Commercial and Middle Market, and that momentum carried into our 2014 results. On balance, we're extremely pleased with our competitive positioning in the market and our prospects for profitable growth.

Let me offer some details on that by looking at each of our commercial business units, starting with Small Commercial. Our Small Commercial business continues to excel with its unique skills in product, distribution and service. Our focus on customers and distributors has propelled us to a very strong market position. Written premium for the year grew 5% aided by strong retentions. And the underlying combined ratio of 87 was 2.5 points better than 2013. New business was up 7% for the full year. We finished 2014 with 3 consecutive quarters of double-digit new business growth, driven by the full implementation of our quoting application, ICON, and other agency engagement initiatives. We continue to make investments in this business to drive competitive advantage. We're adding new online features for services, and we launched the partnership with AARP to extend our small business services to their members.

Moving to Middle Market. I'm pleased with our progress. The underlying combined ratio of 94.5 for the full year improved 4.5 points, much of this resulting from margin improvement in workers' compensation, the combination of years of underwriting and pricing actions.

Written premium growth was 1%, but this now includes our Programs business, which was still shedding business in 2013 and 2014. Excluding Programs, Middle Market written premium growth was 4%, largely driven by our strategy to expand nonworkers' compensation line and deliver a more balanced book of business. Retentions were solid throughout the year, and new business production of $458 million was up for a second year. Much of our success in Middle Market links directly to improved performance in the field. We have upped our game in underwriting, process effectiveness and agency engagement with new tools, better data and deeper analytics on the front line.

We are strengthening our risk capabilities to be a top partner for our distributors and customers, effectively underwriting and servicing an expanded array of new accounts.

Within Specialty Commercial, results held steady with an underlying combined ratio of 100.2 for the full year, up slightly from 99.6 in 2013. National Accounts posted another solid year with strong performance on both the top and bottom line. New business tapered off from 2013, which was a particularly active year. Nonetheless, written premium were up 11%. And account retention was in the low 90s.

Our Financial Products business also had a strong year. The team has successfully repositioned this business, and I'm confident that by more closely aligning with our Middle Market operation, we can build a competitive advantage across Commercial Lines.

Shifting over to Personal Lines. We delivered $210 million in core earnings, up 2% from prior year. Adjusting for Catalyst 360, which we sold in 2013, core earnings actually grew 12%. The all-in combined ratio was 95.5 for the full year, improving 1.4 points versus 2013.

Excluding catastrophes and prior-year development, the underlying combined ratio was 90.6, improving 1.7 points from last year. The improvement was mainly driven by lower marketing and technology-related expenses.

Written premium grew 4% for the year, with continued strong performance from our AARP through agent's offering. AARP direct also posted modest growth from favorable retention and written pricing actions. During 2014, we rolled out our new auto product, Open Road, in 32 states, increasing our pricing flexibility and improving our responsiveness to market trends. We also achieved greater efficiency in our AARP direct acquisition process, improving our cost per conversion by 10%.

Now let me pivot to Group Benefits. Core earnings for 2014 increased to $180 million, up 14% from 2013. That results in core earnings margin of 5.2%. We continue to see profit improvement driven by favorable group life and disability results. Excluding the effects from terminating an Association-Financial Institutions marketing arrangement, the 2014 group life loss ratio improved 3.4 points due to continued pricing discipline and favorable mortality.

Disability trends also remain favorable compared to prior year, with the loss ratio improving 0.5 point. Long-term disability incident rates improved, but at a slowing pace versus prior year. And claim recovery rates continue to be strong.

Looking at the top line, fully insured ongoing premium, excluding Association-Financial Institutions, declined 2% for the full year. Overall book persistency on our employer group block of business came in at 89% for the year, and we've been very pleased with our renewal pricing adequacy. Fully insured ongoing sales, excluding Association-Financial Institutions, was $326 million for the year, down 12%. However, as we sit here today with considerable insight on the first quarter of 2015 activity, we're seeing a strong rebound in new sales. We're encouraged that our recent investments are enabling us to compete more effectively and close more cases.

So as we wrap up 2014, we're pleased with our continued financial progress and by the growing market strength of each business. Across our enterprise, we're seeing strong and still improving levels of employee engagement and a deep commitment to achieving even greater levels of success as we look to the future. This is what defines The Hartford and why our customers and distribution partners trust us with their most important insurance needs.

Before I turn things over to Beth, let me offer a few comments on 2015. We continue to invest heavily in our capabilities as an enterprise, focused on areas of competitive advantage for each business. We've been on this journey for several years, making extensive progress in product development, business metrics and easy-to-use technology applications for distributors, customers and employees alike. A great example is our new P&C claims management platform that will be completely rolled out by end of this year. It is already delivering value through improved claim rep performance, better customer experience and process efficiency. And the data analytics supported through the platform will be a source of innovation for years to come.

I'm also very encouraged by the initiatives for each of our business units. We're having a strong run in Small Commercial, and we have even greater aspirations. Our formula, based on customer value and innovation, continue to separate us from the pack. This year, we will roll out enhancements to spectrum, our business owners' package policy, introduce new online services and invest in capabilities to better support distribution partners as they pursue new marketing strategies and greater efficiencies for these small accounts. Our technology and service operations make us a go-to carrier, and our investments will keep us on the leading edge of this market.

In Middle Market, we have a number of new initiatives in flight to compete more broadly in the market. First, we're introducing a new underwriting cockpit that improves speed, support and data-driven insights for our team of professionals. Underwriters will be better equipped than ever to smartly compete for business.

Second, we'll begin deploying additional underwriting resources in targeted regions where we see new business upside. Working closely with our agents and brokers is critical to success and this demand's local presence.

And the third example of our focus is to build out of additional risk management professionals, specifically in engineering and loss control. We see this skill set is crucial for enabling our progress in new market sectors. These types of investments give us the opportunity to grow our Middle Market business, not by competing solely on price, but by bringing our strong value proposition to a larger share of the marketplace.

Within Specialty Commercial, a major initiative will be leveraging the expertise of our Financial Products business. We now have aligned the strategy and management of Financial Products more closely with our Small Commercial and Middle Market businesses. In addition, to continue and to compete in the public D&O market, these teams will partner on product development and automation to create differentiated offerings across Commercial Lines.

We expect our overall Commercial Lines margin to remain generally stable, with an underlying combined ratio between 89.5 and 91.5. We will continue to seek improvement from a few pockets of lagging results, such as commercial auto, where we will be aggressive with price increases and underwriting actions.

In other well-performing lines, we will manage our pricing strategy to address long-term loss cost trends in individual account performance. We believe that our leadership in Small Commercial and investments in Middle Market provide the opportunity for profitable growth as we better deploy the capabilities we've developed.

In Personal Lines, we will bring even greater focus to our AARP direct business, with new product analytics and improved marketing, test and learning capabilities, we're systematically improving response and conversion.

We're also continuing to refine our AARP through agents' offering, resulting in somewhat slower top line growth. We continue to be very excited about the quality of this business and believe that we can develop deeper partnerships with high quality agents appointed for this program. Excluding catastrophes and prior-year development, we expect the underlying combined ratio to be between 89 and 91, a modest improvement in margins as we continue to focus on rate adequacy.

In Group Benefit, we're very pleased to be positioned for top line growth with our book of business performing well. Renewal rates on business in the first quarter of 2015 are very strong as is new sales activity. New sales with 1/1/'15 effective dates are up over 60% versus a year ago.

And our win backs, cases that left several years ago have now decided to come back to us, continue to be impressive and especially gratifying. Our service in claim capabilities are the reason. We truly have a differentiated experience, and we're continuing to build on those capabilities.

First as we expand in the voluntary market, we're making additional investments in our products and capabilities to provide an even better experience in an increasingly consumer-driven market. Second, we're investing in enhanced producer analytics and increase field resources aligned with targeted growth markets. We expect our Group Benefits core earnings margin to be relatively stable between 5 and 5.5, with underwriting performance helping to offset declines in investment income.

Overall, across all of our businesses, we're focused on competing in an aggressive and disciplined manner. We believe that we have an opportunity to grow our business through smart product expansion and deeper local partnerships with our distributors. We have great skills and talent that can be deployed more widely without pushing beyond the boundaries of sound underwriting and risk selection.

In summary, we're very pleased with our progress in 2014 and excited to extend our reach in 2015. 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 the other businesses and key 2015 business metrics before turning to the capital outlook for Talcott and the holding company.

Mutual Funds' core earnings rose 17% in 2014, primarily due to an increase in fees from higher average assets under management, excluding Talcott-related funds.

As noted on Slide 19, long-term fund performance remain solid with 64% of Mutual Funds outperforming their peers over the last 5 years. For the year, Mutual Fund sales were stable at $15.2 billion, as growth in equity fund sales was offset by reduced fixed income sale.

During the year, we exited certain types of funds and transferred some funds to our investment operation, which resulted in negative Mutual Fund net flows of $1.4 billion. Adjusted for these items, net flows were about breakeven for the year. In 2015, we expect modest growth in core earnings as growth in Mutual Funds AUM will be partially offset by the continued runoff of funds included in Talcott's VA products.

Talcott's core earnings, summarized on Slide 20, rose 5% for the year, much better than originally expected due to higher limited partnership income and lower contract holder initiative cost. Contract counts continue to decline, down year-over-year by 13% for variable annuities and 18% for fixed annuities. There's only been a modest decline in institutional covered lives as the majority of the block consist of longer duration structured settlements and pension-related terminal funding liabilities.

In 2015, we expect Talcott's core earnings to decline about 15% to 20% to a range of $340 million to $370 million. Almost half of this decline is due to lower projected limited partnership return, which were 10% in 2014 versus 6% projected in 2015.

Excluding the excess 2014 return in limited partnership income, core earnings are projected to be down around 10% in 2015, consistent with the runoff of the annuity blocks, somewhat offset by lower expenses.

Turning to the Corporate segment on Slide 21. 2014 core losses were about flat to the prior year. The 2015 core loss outlook of $235 million to $245 million is slightly better than 2014 due to lower interest expense from planned debt repayments in 2015. During 2015, we expect to spend up to $1 billion for debt management, which will help us move towards our long-term target of debt-to-total cap in the low 20s. Rating agency adjusted debt-to-total cap was 28.4% at December 31, 2014, or 26% pro forma for the projected 2015 repayments.

Turning to investments on Slide 22. We remained pleased with the credit performance of our portfolio, with only $59 million of impairment in 2014 compared to $73 million in 2013.

Investment yields, however, remain a challenge due to market conditions. Our portfolio yield has held up reasonably well in the low interest rate environment, averaging 4.1% this year, excluding limited partnerships, were down about 10 basis points.

Our 2015 outlook, which is based on market yield curve, projects a modest decline in the portfolio yield due to lower reinvestment rate. Our outlook for annualized P&C-only pretax portfolio yield is 3.9%, including limited partnerships.

Turning to our capital management plan. Through January 30, 2015, we have repurchased approximately $1.9 billion, totaling 52 million shares for an average purchase price of $36.46 under the $2.775 billion shares repurchase program, and repaid $200 million of debt maturities from the $1.2 billion debt management program.

Our core earnings outlook includes the impact of the completion of both programs in 2015. Although the precise number of repurchased shares will depend on market prices.

To summarize, as detailed on Slide 24, core earnings in 2014 rose 9% to $1.5 billion, which was the high end of the 2014 outlook. Core earnings per diluted share rose 16% to $3.36 due to the increase in core earnings and the impact of the capital management program.

The core ROE rose to 8.4%. Book value per diluted share, excluding AOCI, at December 31, 2014, rose 4% to $40.71 from year end 2013, largely due to the capital management program.

Shareholders' equity, excluding AOCI, declined 6% to $17.8 billion as the contribution of net income was more than offset by share repurchases and dividends.

Our consolidated 2015 outlook, which you can see on Slide 25, is for core earnings of $1.55 billion to $1.65 billion, which at the midpoint is 7% above 2014 results once you exclude favorable items in 2014, such as CAT and unlimited partnership returns, both better than outlook, as well as unfavorable prior accident year development.

On a per share basis, including an estimate of the impact of share repurchases during 2015, core earnings per diluted share would be approximately $3.65 to $3.85.

Slide 25 lists several of the key business metrics for 2015, most of which we have already covered. Based on our 2015 outlook, we estimate an increase in core ROE to about 8.7% to 9.2% compared with 8.4% in 2014.

As you know, one of our principal financial goals is to increase our ROE. We are frequently asked about our target ROE and how much we can improve ROE each year. As you can see, we have made a lot of progress over the last few years, and we expect an additional 30 to 80 basis points of improvement in 2015. Our goal is to generate an ROE above our cost of equity capital, which based on the current data and market factors is about 10.6% today.

As you can see on Slide 26, our P&C, Group Benefits and Mutual Funds ROE have been improving nicely. Note that the business ROEs on the slide are unlevered. They do not include any debt allocation or interest expense. The unlevered P&C, Group Benefits and Mutual Funds ROE has risen from 10.6% in 2013 to 11.2% in 2014, and we project additional improvement in 2015. These levels exceed our current cost of capital of 8.4% including debt, indicating that we are creating shareholder value in those businesses.

The Talcott ROE, however, is much lower and reduces our consolidated ROE to below our cost of capital. However, as you can see on this slide, our 1 year beta has declined from almost 2 at the beginning of 2013 to about 1.25 today. The reduction in the size and risk of Talcott is the principal reason that the beta has declined, and is an important contributor to our progress in reducing our cost of capital. Nevertheless, our beta remains higher than other P&C companies, which range from 0.6 to 1.15.

We have made a great deal of progress in driving ROE growth and reducing our cost of capital. We are optimistic about continuing to make progress with the goal of generating ROEs above our cost of capital.

Now, I would like to turn to our capital outlook, and specifically, our views of excess capital in Talcott. As we have stated, we have been elevating the appropriate capitalization for Talcott, taking into consideration its improved risk profile with the sale of Japan. Our previous standard was to maintain a minimum of at least 325% RBC in a stress scenario. We have now updated that to a 200% minimum RBC in the stress scenario. Of course, in more favorable markets, the actual RBC levels will be much higher.

Slide 27 displays the allocation of Talcott's $5.6 billion of statutory surplus at December 2014. As you can see, $1.2 billion is allocated to VA, $2.2 billion is allocated to institutional and fixed annuities and $700 million to other, which includes reinsurance credit exposure on divested businesses and our COLI/BOLI book. That leaves $1.5 billion of surplus that we consider today to be excess in a stress scenario and which we intend to take out of Talcott in stages.

Last week, the first dividend of $500 million was paid to the holding company. We expect an additional $500 million in the second half of 2015 and the remaining $500 million in early 2016.

Slide 28 shows the capital margin in Talcott under base, stress and favorable scenarios, the details of which are in the Appendix. All of these scenarios assume we take the $1.5 billion in dividend by early 2016. Assuming the stress scenario occurred in 2015, we estimate a remaining capital margin at the end of 2016 of about $400 million, which roughly equates to a 240% RBC, comfortably above the 200% level.

Slide 29 provides a reconciliation of capital margins in the different scenarios. The VA hedging program helps protect surplus in down market. In fact, the significant portion of the approximately net $800 million negative impact from VA in the stress scenario results from the reduction of fee income that will result from lower asset levels.

Talcott's major source of capital margin impact in a stress scenario comes from institutional and fixed annuities due to investment-related impacts and the impact of interest rates.

Finally, before turning to your questions, I wanted to summarize our holding company cash flow for 2014 and our outlook for 2015. During 2014, the holding company had about $2.9 billion in positive cash flow, including the Japan sales proceeds. During 2015, we expect dividend of about $1.9 billion. I would note that our projection for P&C dividend is lower in 2015. Having accelerated dividends in 2014, we do not have ordinary P&C dividend capacity until the third quarter of 2015.

During 2015, we expect to use approximately $2.6 billion for holding company obligations and the capital management plan, resulting in net holding company cash and short-term investment of approximately $1.8 billion at year end 2015. This is a very strong base that positions us to deploy capital accretively for shareholders into 2016 and beyond.

2014 was an outstanding year for The Hartford, with significant improvement in margins and P&C and Group Benefits, continued net flow improvement in Mutual Funds and a substantial reduction in risk at Talcott. We are focused on growing core earnings in 2015, offsetting the decline in Talcott earnings with growth in the other businesses. In addition, Talcott is generating excess capital, allowing us to deploy capital in more accretive ways to drive ROE improvement. We look forward to updating you on our progress in 2015 to grow both ROE and book value per share to drive shareholder value creation.

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. We have about 30 minutes for Q&A. [Operator Instructions] Tiffany, could you please give the Q&A instructions?

Question and Answer

Operator

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

Brian Robert Meredith
UBS Investment Bank, Research Division

First, for Doug, just curious, with the underlying combined ratio improvement both in Personal and Commercial, how much of that is going to come from expense initiatives versus loss ratio still improving here given where rates are in line with loss trend?

Douglas G. Elliot
President

Let me tackle the Personal Lines first, and then we'll come back to Commercial. We still have a very consistent approach in Personal Lines, and we'll be addressing loss trends through pricing in a very similar manner as we are in 2014. So I look at the strategy and 2015, with Personal Lines, is very consistent with 2014. On the Commercial Lines side, obviously, an evolving environment and as we talk to you on this call and shared our numbers last night, you know the fourth quarter was down a little bit on the pricing side versus the third quarter. So we're being thoughtful about how 2015 will play out. We've got a number of strategies in different places. But much of our improvement is coming, number 1, from the fact that our written prices in 2014 will earn their way into 2015. And I would say that much of the expense work we're doing is being invested back inside the platform. So most of the work and most of what you'll see inside the combined ratio will be pricing and underwriting-driven.

Brian Robert Meredith
UBS Investment Bank, Research Division

Okay. And then the second question, I'm just curious, on Capital Management guidance here. And I make the comment the additional $500 million from Talcott. You're expecting to look to use that for debt paydown. I'm just curious why that decision, particularly given that debt capital is incredibly inexpensive right now. Why would you kind of make the decision to kind of continue to pay down your debt?

Christopher John Swift
Chairman & CEO

Brian, it's Chris. I'll let Bob comment, too. But I think what we've said all along is that this 2-year plan is a balanced plan of equity and debt. If you look closely at our language, I mean we have allocated up to $1 billion of debt repayment this year. Half of that is just maturing debt; the other half is what I call, optionality, to really look at our debt stack to continue to drive down. Basically, our debt-to-cap ratio is as Beth described. Beth, would you add anything else?

Beth A. Bombara
Chief Financial Officer and Executive Vice President

Yes, I just have a couple of things. First of all, I think you refer to the $500 million dividend from Talcott being the same thing as the $500 million of debt reduction, and they're not related, so I would separate the two. As Chris said, we announced our debt management plan last year, and you may recall that in the fourth quarter, we had anticipated using up to the $500 million to reduce debt, and we decided to take a pause because interest rates had decreased at that time and they're still low. And so we'll continue over the course of '15 to look at opportunistically what makes sense for us to use that $500 million in a way that we think is the most benefit to our shareholders.

Operator

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

Randolph Binner
FBR Capital Markets & Co., Research Division

I wanted to touch on trying to understand the pace of the runoff and particularly through the trend that we're seeing in VA's surrender. So that came in, I think, at 11% in the fourth quarter and trended down throughout the year. But the contract count for VA was down about 13% for the year. And so I'm just trying to think about what's the right way for us to think of how these liabilities runoff? Is it more of that full year result? Or is it something that could trend down as a single digit as we look to 2015?

Beth A. Bombara
Chief Financial Officer and Executive Vice President

Randy, it's Beth. So a couple of things I'd say on that. As you know, we did have some initiatives in 2014, which impacted that VA count coming down, which is why you see the 13%. And as you point out, as we went in to the fourth quarter, we did see a reduction. And our estimate for 10% for next year, we feel very good about when we look at sort of historical trends and the fact that we don't have a planned significant initiative in '15 at this point. So as the year progresses, if we determine that there is something that we would do, we'd obviously update you. But we think right now, from all that we can see in our analysis that a 10% is a good place for us to plan for '15.

Randolph Binner
FBR Capital Markets & Co., Research Division

Okay. And then this 10% on new initiatives and then on the fixed and institutional blocks, is there anything initiative-wise or transaction-wise that would make sense there? It seems like maybe the window for transferring those kinds of risk to some institutions is not as open as it was in the last couple of years. Any color you can provide on that side?

Beth A. Bombara
Chief Financial Officer and Executive Vice President

Yes, so I think about it in two pieces. So we have our fixed annuity block, and again, the surrender rates or contract decreases that we highlighted for the year were impacted by some of the initiatives that we had in that block. And we'll continue to look to see if that makes sense to do in the future. As it relates to the institutional block as we've discussed before, given where rates are at this time, we don't really see a transaction or for that book to really be economical for us as we'll be basically locking in to these very low levels. If the interest rate environment changes, as we've said in the past, we'll of course look to see if there's something more economical that we could do with that book.

Operator

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

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

A couple of quick questions for you. So if I think about -- and Beth, I'm glad that you sort of commented on the $500 million from Talcott being above what was already embedded in your -- to your capital management plan. So if I could get at the question maybe a little bit differently, I think you're targeting in the holding company cash levels by the end of 2015 at around $1.8 billion. I guess, my question is what's your target longer term in terms of how much cash you want to keep at the parent on an ongoing basis?

Beth A. Bombara
Chief Financial Officer and Executive Vice President

Sure. So when we looked at the cash at the holding company, we typically start with looking at what our annual expenditure is for covering holding company obligations so interest in shareholder dividend, which again you can see on our slide is about $600 million for '15. So we typically talk about a target in sort of the 1.5x range for that. And then of course, you'd always want to have, I think, a little bit of cushion. But that's kind of how we look at that.

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

Okay. So it's a fair to say you've got a pretty sizable cushion versus that level?

Beth A. Bombara
Chief Financial Officer and Executive Vice President

Yes, as I said in my comments, I think ending at $1.8 billion is a very strong position. Again, that doesn't include the $500 million that we anticipate to take out of Talcott in 2016. So I think that positions us very well as we head into '16.

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

Okay, and then just a bigger picture question. Given where rates are and you guys, I think, are obviously taking that into a new account in some of your outlook here, investment income-related and other. But with all the mix shift in the company, particularly the reduction in the risk and size of Talcott, can you give us an update on how we should think about the longer term earnings pressure and maybe balance sheet risk from a sustained sort of 2% or sub-2% tenure environment?

Beth A. Bombara
Chief Financial Officer and Executive Vice President

Yes, so if you think about the projections that we have for [indiscernible] , and maybe what I'll do is I'll just talk more about our P&C book. If we looked at our outlook right now for '15 and if rates sort of remained at current levels and didn't follow the forward curve, for '15, we'd probably see a very modest impact, kind of in the $7 million to $10 million range. Obviously, if they stay there longer and if you go into '16, you start to see a compounding effect of that. I think the counterpoint to that though is what would happen on P&C pricing. So there's obviously the NII impact. But then there's also just what does that mean for the broader environment if we were to remain in a low interest rate environment. But that kind of gives you a sense for the P&C portfolio.

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

And then related to Talcott or group, maybe is anything we should be thinking about? I mean discount rate on the group disability side or spread pressures within Talcott?

Beth A. Bombara
Chief Financial Officer and Executive Vice President

Yes, so again, if I look at that same measure sort of putting in all in HIG, which would include the group and Talcott piece. And again, if rates remained flat from kind of where they are now, that $7 million to $10 million impact rises to $16 million-ish. So again, there's obviously some impact on that. I don't have a breakout between Talcott and group. And obviously, group, I would say, they're again, there's a pricing dynamic that would also have to be taken into consideration.

Christopher John Swift
Chairman & CEO

John, I'll just offer from a Group Benefits side, I mean, we've been discounting reserves for '14 and we plan in '15 in the 3.5% range. So I think our liability structures there are already reflecting that low interest rate environment.

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

Really helpful. So we're looking at maybe 1% earnings pressure from sustaining low rates, at least for 1 year?

Operator

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

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Just I guess more of a business question. I was interested to hear that you are through the AARP relationship going to be selling Small Commercial business. I'm wondering, do you have any sense of what percentage of the AARP members own small businesses? How big a population are we talking about here?

Douglas G. Elliot
President

Jay, it's Doug. We are aware that there are more than 1 million members that have small businesses. These, I would characterize them largely as micro small businesses, Jay, employees less than 5. But there is a sizable and component. I think it will take us time to work at that, but we're excited about the opportunity and look forward to partnering with AARP in broader ways going forward.

Operator

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

Jay H. Gelb
Barclays PLC, Research Division

First, I just want to clarify on a previous statement from Beth. That $500 million of flexibility to repurchase additional debt, did you say that could also go into share buybacks?

Beth A. Bombara
Chief Financial Officer and Executive Vice President

No, I did not say that. What I said was that we had earmarked $500 million and that we would look at through the course of '15 when the appropriate time is for us to use that for debt management.

Jay H. Gelb
Barclays PLC, Research Division

Okay. The other point I want to come back to is, I believe, after second quarter there was some outlook with regard to ROE potential. And previously, it was low 9% in 2015, and I believe, 30 to 50 basis points expansion in both 2016 and '17. So that prior guidance would have gotten you right to around 10% in 2016. Is that still a reasonable expectation?

Christopher John Swift
Chairman & CEO

Jay, it's Chris. I'll ask Beth also to comment. I think some of those comments you're attributing to me. So I still stand by them. But I would say that I think that the headwinds were just, are a little bit more than 6, 7 months ago honestly. Lower rates, P&C pricing cycle's gotten a little more challenging as Doug and I have been saying. So it's not beyond the realm of possibility, but it is a higher degree of difficulty as we sit here today. And then if you really think about it, once we get beyond '15, which again, I think have been fairly tight guidance as far as ROE, I think then we're in that 20 to 40 basis point annual improvement from there. So Beth, would you add any other color?

Beth A. Bombara
Chief Financial Officer and Executive Vice President

No, I think you said it very well. As we talked about before, we do expect to see in '15 a larger increase than that 20 to 40 that Chris just mentioned because of the capital management actions that are working in from the sale of Japan. But I think that, that is a reasonable expectation.

Jay H. Gelb

Barclays PLC, Research Division

Beyond 2015, would you expect the capital management mix to be more weighted towards buybacks as opposed to evenly split in '15 between share repurchase and debt paydown?

Christopher John Swift
Chairman & CEO

Jay, if you give us a little time, we'll talk about that in due course. But right now, we're focused on obviously executing the plan here in '15. And when we get to really developing the '16 plan, we'll give you views. But we've always said balance, so balance could mean within a range. But also keep in mind sort of debt-to-equity ratios, we want to keep them balanced too.

Operator

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

Erik James Bass
Citigroup Inc, Research Division

Thank you for providing the updated Talcott stat capital breakdown. Just an addition to the stat capital, do you believe there's a level of redundant reserves at Talcott that could be freed over time?

Beth A. Bombara
Chief Financial Officer and Executive Vice President

Yes. So obviously there are reserves that we hold, especially in our institutional and fixed book for things that impact interest rates. And so when you look at our margins in favorable scenarios and baseline, you could expect to see some decline in there. But nothing that we're expecting sort of in any significant manner in the near term.

Erik James Bass
Citigroup Inc, Research Division

Okay. And could you provide an update of the present value of the expected earnings from Talcott that I think you had given probably most recently at the end of last year?

Beth A. Bombara
Chief Financial Officer and Executive Vice President

I think you're talking about our MCV analysis? Yes. So again, where we stand today with the VA book, we would estimate that the MCV is still very positive and about $1.1 billion at the end of December.

Operator

Your next question comes from the line of Thomas Gallagher with Credit Suisse.

Thomas George Gallagher
Crédit Suisse AG, Research Division

Just, Beth, just a few points of clarification. So the new news we're getting here today on the whole capital management plan is the extra funds coming out at Talcott. And just remind me though, the '14 and '15 estimates for buybacks and debt repayment, that hasn't changed at all, right? Like so the '14, '15 total capital return plan is the same as it was. But you're taking more money out of Talcott. And so my question really is, if I'm right on that, what are those funds being used for? Is it just more money sitting at the holding company?

Christopher John Swift
Chairman & CEO

Tom, it's Chris. Let me start and then Beth could share. I think you've got the fact pattern right. So the only new news here is we've defined the amount of excess capital in Talcott at the end of 2014, and we plan to take that out basically over the next 12 to 14 months. As we really head into the second half of '15, we'll work on, call it, what's next related to our capital management program. But I think what we're trying to convey, and hopefully, you'll see it is we will have additional flexibility particularly as the cash comes out of Talcott to think about what is the most accretive use of that capital going forward. But we really haven't pinpointed saying exactly what we're going to do, but that's what we're going to work on and communicate it in the second half of '15.

Beth A. Bombara
Chief Financial Officer and Executive Vice President

Yes, and then the only thing I would just add just to be perfectly clear is you're correct. We are not making any changes to the plan that we announced in July that we're currently executing on.

Thomas George Gallagher
Crédit Suisse AG, Research Division

Okay, that's...

Christopher John Swift
Chairman & CEO

Tom, do you mind? Again, just philosophically, I just want to be crystal clear that there really hasn't been any change in our philosophy in how we think about excess capital. You've heard us say it before, and we'll reiterate it here. I mean we're going to continue to be balanced with debt and equity, paydowns and repurchases. We still think it's a good use of our capital to buy in shares. We'll always have an appropriate dividend policy, geared towards growing our operating earnings in P&C Group Benefits. And then we've said repeatedly and we are investing in our capabilities, investing for growth and expansion as we go forward, really with the eye of creating additional revenue streams that create recurring value for shareholders. So that's how philosophically we're approaching our excess capital.

Thomas George Gallagher
Crédit Suisse AG, Research Division

That makes sense to me, Chris. I guess, my follow-up is simply, of the $1.5 billion planned dividends out of Talcott, it sounds like you're describing that as the excess capital that you believe exists in that block. But then it also generates earnings of, I guess, roughly $300 million a year. What about the 3 -- what about the extra $600 million or so of capital that you should get from retained earnings in that block? Should we also expect that? So it would be $2.1 billion all in? Or is the $1.5 billion also contemplate the money that's being earned there?

Beth A. Bombara
Chief Financial Officer and Executive Vice President

Yes, Tom, so it's Beth. I would think about it this way. So again, the $1.5 billion, we defined by evaluating actual statutory surplus at 12/31/'14, and again, ensuring that we would have adequate resources in a stress. So that $1.5 billion at 12/31/2014, would obviously have taken into consideration any previous earnings that we generated on the book. But you're right, as we think about it going forward to the extent a stress doesn't happen, and each year, we generate statutory surplus as we evaluate our statutory position at the end of any given year, we could anticipate that there could be upside to that if we generate the earnings. I would say sitting here today and looking at just a lot of the pluses and minuses that happened with statutory surplus, I would guide you to think about a range of $200 million to $300 million because it does sometimes bounce around a little bit for a variety of items. But again, that would be something we'd evaluate at the end of '15 because obviously, if the stress doesn't happen, you have one more year of earnings, one more year of the book running off and then you kind of evaluate it from there.

Operator

Your next question comes from line of Bob Glasspiegel from Janney Capital.

Robert Ray Glasspiegel

Janney Montgomery Scott LLC, Research Division

Doug, I've got a PC question for you. Commercial auto, you said you're raising rates, that's a source of sort of margin improvement in 2015. Where is this sort of underwriting base that you're operating from in that line? And how much are you raising rates?

Douglas G. Elliot
President

We've been disappointed in our commercial auto performance, primarily in the Middle Market, but also in Small Commercial as well. This year, back half of the year, our pricing has been in a mid-single to a higher-single digit range, and I expect that to continue maybe even strengthen a bit as we move into the early half of 2015. So disappointed. I feel like we have some very strong initiatives both on the pricing side and also in the underwriting side to address it. Looking for progress in '15 for sure.

Robert Ray Glasspiegel
Janney Montgomery Scott LLC, Research Division

Okay. And Beth, just a clarification on your answer to John, sensitivity of Talcott to interest rates. You talked a little bit about earnings in general terms. But how different of a presentation on capital would you have been given if 10 year was 50 basis points higher where it was in the beginning of the year?

Beth A. Bombara
Chief Financial Officer and Executive Vice President

Yes, so, obviously, in the scenarios that we show for a stress we are stressing interest rates in that scenario. And you can see kind of the impact that we see from capital that comes from that. So I think that as we evaluated the $1.5 billion of excess today, I think we appropriately took into consideration additional stress and interest rates.

Robert Ray Glasspiegel
Janney Montgomery Scott LLC, Research Division

So, I'm sorry, I didn't quite follow. The stress is the current environment is stressing it? Or it's 50 basis points from here would stress it?

Beth A. Bombara
Chief Financial Officer and Executive Vice President

So the stress scenario as we outlined in our appendix would have the 10-year at the end of 2016, I believe, in like the $1.6 billion range. So again, that would have been lower in '15 as you go through '16, I don't know if there's exactly the same sensitivity that you're highlighting, but that's how we looked the stress.

Operator

Your next question comes from the line of Ian Gutterman with Balyasny.

Ian Gutterman
Balyasny Asset Management L.P.

I guess, I wanted to clarify a couple of things. First, on the P&C dividend, if you said you don't have ordinary capacity till Q3, what stops you in Q3 from taking a full year's worth of ordinary dividend? Why does it have to be much less in earnings?

Beth A. Bombara
Chief Financial Officer and Executive Vice President

Yes, so the way I would think about it, if you look at the dividend over '14 and '15, we typically take out about $800 million a year, and so what we did in '14 is we just front-loaded that dividend that we normally would have taken out in '15. So over the 2 years, we kind of get back to our normal level.

Ian Gutterman
Balyasny Asset Management L.P.

Okay. But P&C [indiscernible] was capital at the end of 2014, right? So why couldn't they take a full year of earnings in '15?

Beth A. Bombara
Chief Financial Officer and Executive Vice President

Typically, the way we manage the P&C balance sheet and making -- ensuring that we're providing enough capital for the P&C business to continue to invest in its operations. We target annual dividend of $800 million each year. And so that's again how we look at it.

Ian Gutterman
Balyasny Asset Management L.P.

Okay. And then just quickly on Talcott or sort of the stress scenario. And I remembering correctly in the past, I think you've talked about the holdco cushion being for the stress scenario. Now that Talcott, on its own, can handle its own stress scenario, do we need to think of any holdco capital being held for a stress? Or is that really held for something other than a Talcott stress?

Beth A. Bombara
Chief Financial Officer and Executive Vice President

Yes, so as we have said going all the way back to April of 2013, we see that the capital within the Talcott entities is sufficient to handle a stress. So we are not looking to fund any deficit with holding company cash. And so when we think about the holding company requirements, we tend to focus on the actual obligations for interest and dividends. And then as I said, to have some buffer, but obviously, much less than what would have been needed in the past.

Operator

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

Scott Frost

Thanks for clarification on the debt management program. This is the same as you've announced in mid last year. So $0.5 billion is potentially available for tenders and over market repurchases, that's -- just to clarify, that's correct, right?

Beth A. Bombara
Chief Financial Officer and Executive Vice President

Yes, that is correct.

Scott Frost

Okay. Could you tell us how you think about junior sub, also the Glen Meadow in terms of attracting business to your capital structure? Does it factor into considerations in terms of ratings. Also, agencies have talked about improvement, I think, in P&C operations as one catalyst. Is that all -- is it your sense that they also are -- have already taken into account this planned capital management that you've talked about?

Beth A. Bombara
Chief Financial Officer and Executive Vice President

Yes, I'll handle the second part first. So obviously, our plans that we have for capital management we share with rating agencies. So they're very aware of what our intentions are and expectations for this plan. As it relates to other resources that we have, like Glen Meadow, we obviously look at that as additional capital that we would have available to us. And as we get -- go through '15 and into '16, we'll take a look at what that means for us and how we might use that capital.

Scott Frost

Okay. So just to clarify, I mean your capital management plan, is it something the agencies would have to see you execute before they would act in your sense? And again, with your capital position being the way it is, do you need those capital securities? Or are they just attractive from a rate perspective? And are you sensitive to some sort of loss on debt extinguishment? Or is it more of an interest coverage issue that you're working towards?

Beth A. Bombara
Chief Financial Officer and Executive Vice President

It's kind of probably, a little bit of all of the above of what you said. First of all, as it relates to rating agencies, we have had a record, a track record now for a couple of years of laying out a plan and executing on that. And we continue to share with them our expectations, and all of that is considered as they look at evaluating the ratings of the various entities. And then as it relates to just overall debt management, we're very sensitive to balancing all of those needs. So we are looking at reducing our debt-to-capital ratios as Chris and I have talked about. But we're also very sensitive to looking at interest coverage. And we want to make sure that we're making the right tradeoff there. So part of the reason why we held off a bit on using that $500 million that we've been talking about is we felt the charge that we'd have to take, given the current interest environment, wasn't a good tradeoff. So we'll continue to evaluate that as we move forward and as rates change.

Operator

There are no further questions in queue at this time. I would like to turn the conference back over to Sabra Purtill.

Sabra R. Purtill
Senior Vice President of Investor Relations

Thank you, Tiffany. We'd like to thank you, all, for joining us today and your interest in The Hartford. I'm pleased to note that Chris and Beth will be at the Bank of America Merrill Lynch Insurance Conference in New York City on February 11 at 8:00 a.m. We look forward to seeing you there, hopefully, with no snowstorm. And in the meantime, please feel free to contact either Sean or myself by phone or email if you have any follow-up questions on our financial results and outlook. Thank you, and have a good day.

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