S&P Capital IQ

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The Hartford Financial Services Group, Inc. NYSE:HIG

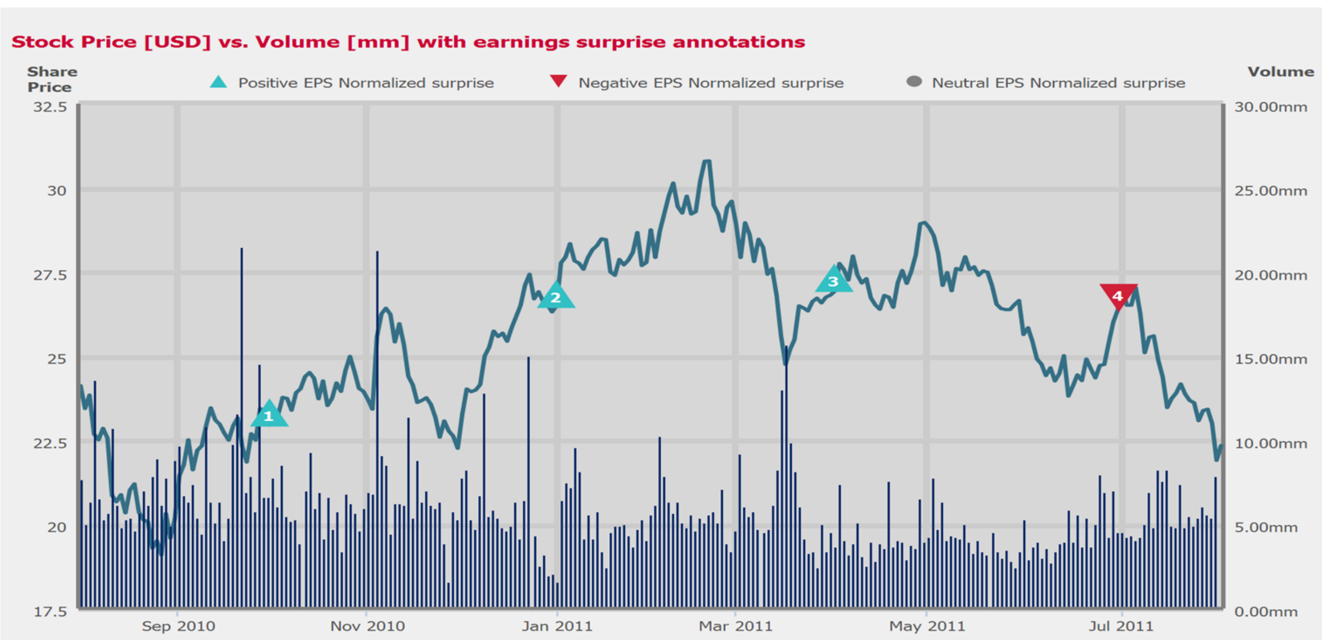
FQ3 2011 Earnings Call Transcripts

Thursday, November 03, 2011 1:00 PM GMT

S&P Capital IQ Estimates

	-FQ3 2011-			-FQ4 2011-	-FY 2011-	-FY 2012-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.25	0.05	▼(80.00 %)	0.85	2.21	3.59
Revenue (mm)	5791.88	4520.00	▼(21.96 %)	5928.71	22769.43	23890.26

Currency: USD
Consensus as of Nov-03-2011 12:11 PM GMT



- EPS NORMALIZED -	CONSENSUS	ACTUAL	SURPRISE
FQ3 2010	0.93	1.43	▲1 53.76 %
FQ4 2010	0.95	1.06	▲2 11.58 %
FQ1 2011	0.95	1.16	▲3 22.11 %

FQ2 2011	0.01	0.00	(100.00 %)

Call Participants

EXECUTIVES

Andre A. Napoli
Former Executive Vice President and President of Consumer Markets & Enterprise Business Services

Christopher John Swift
Chairman & CEO

David N. Levenson
Former Executive Vice President and President of Wealth Management

Douglas G. Elliot
President

Liam E. McGee
Former Chairman

Sabra R. Purtill
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Presentation

Operator

Good morning. My name is Ashley, and I will be your conference operator today. At this time, I would like to welcome everyone to the Hartford Third Quarter 2011 Earnings Conference Call. [Operator Instructions] Ms. Sabra Purtill, you may begin your conference.

Sabra R. Purtill
Senior Vice President of Investor Relations

Good morning, and thank you all for joining us for The Hartford's Third Quarter 2011 Conference Call. The press release, financial supplement and slide presentation are on our web site, along with our 10-Q which was filed last night. On today's call, The Hartford's Chairman, President and CEO, Liam McGee; and Chief Financial Officer, Chris Swift, will provide an overview of our results and accomplishments this quarter. After their prepared remarks, we will open the call for questions. We know that there are many calls this morning, so we will conclude our presentation at 10 a.m. Today we are also joined by other members of our senior management team, including Doug Elliot, Alan Kreczko, Dave Levenson, Andy Napoli, Bob Rupp, Hugh Whelan and Graham Bird. Please note that as discussed on Page 2 of the presentation, any statements made today concerning The Hartford's future results or actions should be considered forward-looking statements as defined in the Private Securities Litigation Reform Act of 1995. These forward-looking statements are not guarantees of future performance, and actual results may differ materially. We assume no obligation to update these statements. You should also consider the important risks and uncertainties that may cause actual results to differ, including those discussed in our press release, our third quarter 10-Q, 2010 10-K and other filings we make with the SEC. In our presentation, we will use some financial measures that are not derived from Generally Accepted Accounting Principles or GAAP. Definitions and reconciliations of these measures to the most directly comparable GAAP measures are provided in our financial supplement, press release and 10-Q.

I'll now turn the phone over to our Chairman, President and CEO, Liam McGee.

Liam E. McGee
Former Chairman

Thank you, Sabra. Good morning, everyone. Before we get started, I want to introduce 2 new members of the leadership team who are here with us today, Bob Rupp and Hugh Whelan. We announced Bob Rupp's appointment as the company's new Chief Risk Officer last week. As you know, Bob joins The Hartford from BNY Mellon, where he was Head of Enterprise-wide Market Risk. He has 30 years of financial service experience across a broad range of disciplines, including risk management, investments, law and treasury, as well as some time spent with the SEC. Hugh Whelan, as you know, is the acting Head of Hartford Investment Management and the Chief Investment Officer of The Hartford. He has been with The Hartford since 2005, and he has been an integral part of the team and has improved and positively repositioned the investment portfolio. Welcome to Hugh and Bob.

The macro environment in the third quarter was the most challenging since I joined The Hartford. The economic recovery has been very weak, and we experienced 9 different catastrophes during the quarter. Capital and credit markets were volatile, the S&P 500 dropped 14%, 10-year treasury yields were as low as 1.7%, and the yen strengthened by 4.6% in the quarter. However with these challenges, the quarter was a good test for the improvements we've made throughout the organization. Despite these events, the underlying performance of the businesses was good. The capital position remains strong, and the investment portfolio held up well. Results for the quarter were pretty much in line with what we provided in early October, with a combination of factors collectively impacting results. The third quarter was breakeven on a net income basis. Core earnings were $33 million and included several items we preannounced, including catastrophe losses of $134 million and $227 million of DAC unlock charges. While I'm disappointed with this quarter's bottom line results, I am proud of what the team has accomplished. If we had faced similar economic and market challenges when I joined the company 2 years ago, The Hartford's results would have been significantly worse.

We told you last month that we are confident that we are positioned to maintain strong capitalization even in adverse market scenarios and after the third quarter, I remain confident of that today. The Hartford has a much stronger balance sheet and investment portfolio. Enterprise risk management is significantly enhanced, and our hedging programs provide us with strong protection against the strengthening yen and lower equity markets. I'm also pleased with the progress, discipline and focus we are seeing in our businesses. In particular, we are getting meaningful rate increases in several of our business lines that we expect will drive improved profitability going forward.

In P&C Commercial Markets our priority is profitability, not volume. We are ensuring we get the right price for the risks we are taking. In February, we began pushing for better pricing in the Group Benefits line. We continued this effort in P&C Commercial, where we are getting better pricing to keep pace with loss trends in the interest rate environment. We believe Commercial P&C pricing will continue to increase, and we will continue to drive for price increases in the fourth quarter of 2011 and into 2012. On the top line, P&C Commercial written premium was up 7% in the third quarter, while renewal written pricing has increased to 4% and we've seen a sequential increase in renewal rates each quarter this year.

In Group Benefits, we remain diligent on pricing as well as on improving loss trends. We continue to actively seek rate increases on accounts that are performing below our profitability targets, and this discipline is driving a 4% quarterly drop in ongoing premiums and a 9% reduction in new business volume.

In Consumer Markets, we continued our strategy to address profitability and reposition the business to targeted segments. We achieved renewal-pricing increases of 4% in auto and 8% in homeowners. Weather losses had an impact on bottom line results, and we are adjusting pricing to reflect higher cat and non-cat weather losses. New business in AARP was up 9% over prior year as we saw improved advertising response and conversion rates. In addition, we signed an agreement with the National Wildlife Federation this quarter to market to their $4 million members. This brings our new affinity-marketing base to 10 million members.

In Wealth Management, deposits were up 31% over the prior year with Life Insurance, Retirement Plans and Mutual Funds all showing significant year-over-year growth. These are good results for the business, and I'm pleased with the progress. We continue to focus on innovation, product diversification and multichannel distribution to drive profitable growth in Wealth Management.

In Retirement Plans, we've recently launched a new patented solution, Hartford Lifetime Income, which gives employers the ability to offer a defined benefit pension-like income within a traditional 401(k) program. While only in the market for a few weeks, we received an enthusiastic response from distributors, as well as plan sponsors that has exceeded our expectations. Third quarter sales for the new VA product are still modest, but are gradually increasing. We're bringing a couple of our largest distributors online in the fourth quarter and expect sales to improve in the coming quarters. We have several annuity product introductions for the fourth quarter, including improvements to Personal Retirement Manager and the company's first fixed indexed annuity. These launches are critical to building out an all-weather suite of annuity products.

Now even with the tougher environment, Mutual Funds sales were up 46%. Mutual Funds will continue to be an important part of The Hartford. We like this business, and we plan to make a number of enhancements over the coming months. You'll be hearing more about our plans for Mutual Funds at the Investor Day in December.

In Life Insurance, sales of Life Access Rider continue to grow. In the third quarter, the take rate on the rider was about 40%, up from 30% for the first half of the year. And the Longevity Access Rider launched in June continues to gain traction.

Finally on the distribution front, Woodbury Financial, our independent broker/dealer received a 2011 Broker/Dealer of the Year award from Investment Advisor magazine. Given the substantial uncertainty about economic and fiscal policy, as well as prospects both here and in Europe, The Hartford is prepared to face a potentially challenging environment through the balance of the year and into 2012. We are managing the company's businesses and capital resources with discipline, with the goal of improving our return on equity over time. We are challenging each business to manage the levers that are within its control, including being more efficient, pushing for price increases and targeting profitable growth opportunities. We are allocating capital to those businesses that can generate the most meaningful returns over the long term. And as we've said before, we continuously evaluate ROE and new business profitability at the line of business and product levels, identifying sources of underperformance and we will take actions as necessary.

At the December Investor Day, we will share with you an update on the company's strategy and we'll focus on The Hartford's businesses and goals for 2012 and beyond. Most importantly, we will demonstrate to you that we are effective stewards of capital and are allocating resources to deliver shareholder value. We're looking forward to this meeting, and I hope you'll be able to attend.

I will now turn the call over to Chris to talk about the quarter. Chris?

Christopher John Swift
Chairman & CEO

Thank you, Liam. Good morning, everyone. I'll begin on Slide 5. As Liam said, this was a challenging quarter. Catastrophes were elevated for the second consecutive quarter, equity markets declined 14% and interest rates hit historic lows. Despite these challenges, business fundamentals remain good. We're pleased with the growth in certain businesses that we believe will increase future earnings power.

The investment portfolio continued to perform well. In challenging market environment, our hedging programs worked as designed. Third quarter 2011 core earnings were $33 million before preferred dividends and $0.05 on diluted share basis. These include $134 million of catastrophe losses and $227 million DAC unlock charge. The DAC charge in core earnings reflected lower equity markets and updated policyholder assumptions. In addition, we detailed a few other items on Slide 5. Excluding these items, the quarter's run rate earnings were about $0.73 per share. This assumes a budgeted cat level of $100 million pretax, alternative investment returns of 8% annualized and $494 million fully diluted shares outstanding. Looking to the fourth quarter and knowing the seasonality in our third quarter run rate, we expect a more normalized run rate earnings in the range of $0.80 to $0.85 per share in the fourth quarter. This assumes more normal cats and other seasonality factors.

Turning to Slide 6, book value per diluted share rose 11% over the last 12 months to $46.72. Excluding AOCI, our book value per diluted share rose by 7% to $44.54.

Slide 7 shows the summary of results for Commercial Markets. Core earnings were $106 million compared with $338 million in the prior year. P&C Commercial reported core earnings of $86 million, which includes $60 million of cat losses. The underlying fundamentals of the business are improving. P&C Commercial posted 7% written premium growth, continuing the strong trend we saw in the first half. This growth was fueled by renewal price increases, good retention and exposure growth. For the first 9 months of 2011, small commercial written premium was up 10%. Our combined ratio remains solid, and we are pleased with our performance. We continue to be encouraged by our ability to take rate and maintain strong retention that is consistent with historic levels.

Middle market pricing improved in the quarter marking our third consecutive quarter of positive rate gains, but we still have work to do. Our efforts to drive price are targeted. We are using a state-by-state and an account-specific strategy. The combined ratio of 99.4% ex cats and prior-year development reflects 3 points for the re-estimation of current accident year losses. We are seeing higher frequency in our workers' compensation book, consistent with the broader industry in recent NCCI data. As a result, we've increased our full year 2011 combined ratio guidance to a range of 95.5% to 96.5%. Third quarter P&C Commercial results ex cat were solid for this market. The yield environment will be a headwind for the industry, and we are already incorporating the impacts of a lower interest rate environment into our pricing. Group Benefits reported core earnings of $20 million, which reflects the 3Q loss ratio of 80.1%, 3 points higher than prior year. Life mortality returned to a more normalized level this quarter, unfavorable to 2010's low levels. Disability incidence remains persistently high but consistent with prior year.

The results for Consumer Markets are summarized on Slide 8. Core earnings were a loss of $10 million, which includes $73 million of catastrophe losses. We are pleased with how the underlying business is trending. Auto profitability continued to benefit from price increases that outpaced liability loss cost. Renewal pricing continued to be strong, with a 4% increase in auto and 8% in homeowners. We remain focused on improving the profitability of the agency channel and in particular, homeowners. The pricing increases we've taken are now earning in, which is offsetting some of the impact of the quarter's higher non-cat weather. The disciplined, targeted actions we took earlier this year to increase new business are paying off. Direct marketing response rates have steadily increased throughout the year across all media channels. In addition, phone and Internet conversion rates have improved significantly over the prior year. As a result, AARP new business is up 9% and we are seeing good traction in the AARP through agents channel.

Turning to Slide 9, Wealth Management's core earnings ex-DAC unlock were 238 million, 2% higher than prior year. Given lower markets and surrenders, results were in line with our expectations. Life Insurance core earnings ex-DAC unlock were $56 million, consistent with prior year. Total premiums and fees continue to rise; however, this growth was largely offset by higher mortality. With increased policy size and retention levels, we would expect to see fluctuations in mortality quarter-to-quarter, but this also comes with higher fee income for us, which is a positive for the business. Individual Life strategy of providing a base product with consumer-driven riders is a winning strategy from a customer perspective while increasing profitability for The Hartford. In Retirement Plans, sales momentum in our 401(k) business is strong. We are seeing increased excess in middle market space while maintaining our strong sales position with smaller businesses. We now are the #1 insurance provider of 401(k) plans in the under-100 employee market. We expect our innovative new product, Hartford Lifetime Income, to generate additional interest. Retirement Plans core earnings ex-DAC unlock were $12 million, a $2 million improvement compared with prior year reflecting higher average AUM. Mutual Fund core earnings of $24 million were $4 million better than prior year. Consistent with the overall industry, fund flows were negative, reflecting investor preference away from equity funds. Building on the launch of 3 global funds last quarter, we launched the floating-rate, high income-fund last month. This one is similar to our popular floating rate-fund, which has about $6 billion in AUM. Global Annuity core earnings ex-DAC unlock were was $146 million, in line with expectations and unchanged from prior year. Third quarter sales of our new VA offering were modest at about $90 million and do reflect a gradual increase in sales. We expect sales to ramp up in the coming quarters, but have reduced our full year 2011 deposit guidance to reflect slower sales to date.

On Slide 10, we provided updated key driver guidance for full year 2011. The updates include the results for the first 9 months as well as fourth quarter projections. We were pleased with the performance in our investment portfolio this quarter.

As you can see on Slide 11, impairments were $60 million pretax and continued the trend at the lower end of expectations. Our net unrealized position improved to $2.4 billion pretax largely due to declining interest rates. Pretax annualized portfolio yield was 4.3%. Fixed income new money yields in the quarter were 3.6%, reflecting a lower interest rate environment. This quarter's investment results include strong alternative performance of 3.25% for the quarter and 13% on an annualized basis. As we said on October 6, we are implementing strategies to increase long-term portfolio yield in this low rate environment. We funded over $400 million of new hedge fund investments as part of our alpha strategy. These hedge fund investments provide a return that is generally uncorrelated to other asset classes in the portfolio. Our long-term goal is to have approximately 4% of general account investments in this asset class, and we plan to fund another $100 million in the fourth quarter. Over the long term, we expect to earn a high single-digit rate of return on these assets. In addition, we are adding a modest amount of high-yield exposure in a way that balances economics, income and capital. As we told you, we have minimal exposure, about $700 million to GIIPS in our general account. We continue to have minimal exposure to Italy, Spain, Ireland and Portugal with no sovereign exposure and only $20 million of financial services exposure. We have no exposure to Greece.

On expenses, we are making progress toward our goal of reducing run rate expenses by $200 million at the end of 2012. To date, our efforts have reduced the run rate by $130 million. We expect the bottom line impacts to emerge over time as we are making some investments to achieve this longer-term savings.

We continue to re-examine processes in systems across the company to see where we can streamline operations, rationalize the number of management layers and invest in technology to improve speed and efficiency. Since 2010, we have reduced our workforce by more than 1,700 or about 6%. This does not include reductions due to divestitures. In addition, we consolidated our real estate footprint by closing 13 locations. These actions are critical in our transformation to become more operationally efficient within a business model that is in line with our peer group. These efforts will not end in 2012. We are committed to a culture of continuous improvement and are constantly driving efficiencies to improve the profitability of our business.

I want to address some questions I've heard many of you ask about our Life company's statutory surplus generation. We do expect some constraints in 2012 with recovery in 2013 and beyond due to a number of factors. First, global variable annuities. In rising markets, the increase in hedging activities to manage risk reduces statutory earnings in surplus. Second, you're seeing spread compression in our fixed-rate products, which is magnified by the fact that our institutional investment product business is in runoff. Third, year-to-date Individual Life sales have been strong, which creates a new business surplus strength. And finally, a reminder that Group Benefits remains part of the Life Insurance entities on a statutory basis, and Group Benefits earnings have decreased from prior years due to higher disability loss ratios.

Turning to Slide 12. As you recall, the VA hedging program is focused on managing the economics, but we are not fully hedged for the economics. Therefore, the hedges will not entirely offset statutory reserve increases during the period. The program will protect statutory surplus and severe market declines, but will not eliminate point-to-point variability in earnings in surplus. This quarter's results also illustrate the difference between reserve increases, net of hedge gains, on a statutory and on a GAAP basis. As you may recall, the GAAP variable annuity reserves are accounted for under FAS 157 or SOP 03-1. For statutory, all variable annuity reserves are accounted for using VACARVM. In general, VACARVM is a more rigorous, stochastic modeling technique that results in higher required reserves. You can see that the hedge program worked as designed in the third quarter. A mark-to-market gain of $2 billion offset required reserve increases for both GAAP and stat. On a GAAP basis, the net VA impact was a $544 million gain. For statutory, the surplus impact was negative $690 million pretax. From a balance sheet perspective, we ended the quarter with VA reserves of $4.5 billion and $3.7 billion on a statutory and GAAP basis, respectively.

We have provided our statutory roll-forward on Slide 13. As we discussed on October 6, we expected statutory surplus to decline in the third quarter, reflecting implementation of the Japan hedge program, quarterly dividends from the P&C companies, catastrophe losses and lower market levels. I want to comment on a few of the larger drivers. $600 million of the decline was related to net VA impact after-tax, which we just discussed. This includes $250 million pretax for the implementation of the Japan hedge. We also increased reserves to reflect lower interest rates for a block of market value-adjusted fixed annuities, which resulted in $100 million decline. We contributed about $200 million of holding company capital to our 2 life reinsurance captives, White River Re and Champlain. Looking to year end, there may be additional capital contributions depending on market levels, including an expected contribution of $100 million to Champlain which you'll recall manages redundant reserves for Life Insurance products.

On Slide 14, you can see that we ended the quarter with total capital resources of $18.2 billion. Of that amount, $14.8 billion is U.S.

[Audio Gap]

In addition, we have $1.3 billion of capital in Japan and $2.1 billion of holding company resources after taking into account all the capital contributions in the quarter. We are managing our balance sheet to ensure sufficient capital and financial resources in a stress scenario. We've learned from the past and confidence in our capital position is paramount, particularly in times of stress. The capital margin scenarios we provided on October 6 had already factored in most of the items that resulted in the quarter's surplus decline including elevated catastrophes, increased reserving and capital margin requirements for the lower rate environment, Japan hedge program implementation, any scenario that included equity market declines more severe than the 14% we experienced in the third quarter. Certain of these items can be recaptured, like equity market movements and the impact of lower interest rates. Others are more permanent, like cat losses and hedge implementation costs. From where we stand today, there are no items that would significantly change our estimates of capital margins at the end of 2012 for the scenarios we presented. Our balance sheet remains strong and well capitalized. We remain committed to deploying the $500 million of capital earmarked for equity repurchases in early 2012.

In conclusion, let me summarize a few of the accomplishments this quarter. Our business fundamentals are good, and we are effectively balancing top line growth with bottom line returns. We are making good progress on our expense management initiatives and are on track to become a more efficient organization. Our balance sheet remains strong, and our hedging programs performed well throughout the quarter's market stresses. Lastly, in our Investor Day on December 8, we will provide a strategic discussion of our businesses and provide 2012 driver guidance, and we look forward to seeing you there.

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

Sabra R. Purtill
Senior Vice President of Investor Relations
Thank you, Chris. [Operator Instructions] Ashley, can you please introduce the first question?

Question and Answer

Operator

[Operator Instructions] And your first question comes from the line of Jay Gelb from Barclays Capital.

Jay H. Gelb
Barclays PLC, Research Division

My first question is for Doug Elliot. Doug, you've seen past cycle bottoming and with the workers' compensation issue now becoming more of an issue, should we expect this to be a drag for a while on Commercial Property-Casualty results?

Douglas G. Elliot
President

I'd say a few things. Number one, we're encouraged by third quarter rate improvement overall, including the workers' comp line. In fact, our workers' comp rate improvement outstripped the numbers you see in the supplement, so good improvement over the past 90 days. As you know, this is a line that in the last 15 months, 18 months, has seen some stress on the frequency side that clearly in the past decade had not exhibited itself. So we are watching that carefully, driving rate into our book, mixing that need for rate where they profile against class and state. And I'm optimistic that we have better days in front of us, but I think it's a line we have to be careful with and one that we absolutely are acting that way day to day here at The Hartford.

Jay H. Gelb
Barclays PLC, Research Division

And my follow-up is for Chris. Any additional thoughts on the DAC impact on 2012 earnings, how much of a drag that could be on GAAP earnings?

Christopher John Swift
Chairman & CEO

Thank you, Jay. Actually right now, I don't think it's going to be a drag. Our best estimate is it's breakeven.

Operator

Next question comes from the line of Jay Cohen with Bank of America.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

One more, I guess, Property-Casualty line. And I don't think it's a troubled line, but you've seen some change in the reserve pattern and that's professional lines where you have been releasing reserves. The last couple of quarters, you're adding to prior-year reserves. And I guess are you comfortable this isn't sort of a canary in a coal mine? Could this get a lot worse? What are you seeing that's giving rise to the change in reserving pattern?

Liam E. McGee
Former Chairman

It is a line -- that professional liability line is one that we're watching carefully concerning relative to soft pricing still and plenty of capacity in the line. Our reserve releases over the past couple of years have been primarily in the accident years 5, 6 and 7, and what we did this quarter as we looked through our book and looked through our claims, we've made some strengthening moves across 8 and 9, primarily in the sub-prime arena. I think it's still too early to call, and we're being cautious and thoughtful about that approach.

Operator

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

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

Two quick ones, if I could. Chris, I heard you make the comment that you remain committed to deploying the $500 million into the buyback in early 2012. And maybe this is semantics, but I thought your commentary recently at your balance sheet Investor Day and previously was that you expected to exhaust it by early 2012. Could you just clarify?

Christopher John Swift
Chairman & CEO

Thank you, John. I think the clarification, if one is needed, is that we want to complete the program in early 2012, and early 2012 is early second quarter most likely.

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

Is there any reason why you'd be prevented from beginning to buy back shares now that the quiet period for the third quarter has ended?

Christopher John Swift
Chairman & CEO

There's no, I'll call, legal or regulatory constrictions now that the quiet period has ended.

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

Okay. And then if we just look at the net impact, that $700 million impact on statutory capital on the Life Co., can you give us a sense roughly how much of that net impact was driven by the equity market decline versus the decline in interest rates? Because I assume some portion, maybe a large portion of the piece that was equity market driven has already recovered given October's rally.

Christopher John Swift
Chairman & CEO

Yes. Hopefully that rally will continue, and we could recover more. But that is a good point. There are opportunities to recover. The way I look at it, John, is that roughly the $750 million gross decline in surplus prior to capital contributions coming in from the holding company, I would say $450 million of that is VA-related and the vast majority, 85-plus percent is equity-related. But there has also been the $300-other million. As you know, the $200 million after-tax of the Japan implementation hedge charge, and there was $100 million for our reserve increase for that MVA block of business that we talked about that was interest rate-related.

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

Got it. Okay, great. And then just if I can sneak one last one in, with the additional capital contribution into White River, can you tell us where that capital level is maybe at the end of third quarter relative to CTE 98? Because I think that's what Moody's is looking for you and others to have a captive to hold capital to?

Christopher John Swift
Chairman & CEO

John, what I would say is that from an overall Life Company perspective, whether it be our main writing companies and White River Re because remember the agencies, they look through everything no matter what legal entity holds all the risk. We would say at the end of the third quarter, we are still holding CT 98 reserves and capital for the entire Life group.

Operator

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

Thomas George Gallagher
Crédit Suisse AG, Research Division

Chris, just wanted to come back to a few issues on stock capital and the way we should be thinking about the volatility. If I go back to the balance sheet day, I'd look at the S&P 800 stress scenario, a $1.1 billion impact on a net basis. How does the performance this quarter compare to that estimate? Do you still feel pretty good about the way things trended, and is that still a legitimate number, do you think, in lieu of what we saw this quarter? That's my first question.

Christopher John Swift
Chairman & CEO

Yes, thank you, Tom. I would say yes. As I said in my prepared remarks, there is nothing that surprised us. Our scenarios that we ran through that balance sheet day continue to be the ones that we think are most realistic.

Thomas George Gallagher
Crédit Suisse AG, Research Division

Got it, okay. I guess the fact that there was a sizable hit to Life Insurance capital, but your point being that if you strip out, if you just isolate the equity market impacts and take away the hedge implementation cost, that wouldn't appear to be too far off the mark. That would be sort of the way I backed into it anyway.

Christopher John Swift
Chairman & CEO

Correct. I think that's the way I answered John's question of -- I would isolate that the quarter really had $450 million-ish of VA-related impacts, mostly market, a little bit of interest rates and then everything else in the quarter was the items that we've talked about previously.

Thomas George Gallagher
Crédit Suisse AG, Research Division

Got it. And then just one follow-up on your comment on Life Insurance statutory capital generation. Your comment on 2012 and 2013, the fact that there's not going to be -- I just want to get a sense directionally, 2012, are you thinking no Life Insurance statutory earnings? Are you thinking a couple of hundred million? And then 2013, can you just give us some -- and I'm not looking for any level of specificity, but just general direction. Are we talking about $500 million of statutory earnings by 2013? Can you provide any clarity on that?

Christopher John Swift
Chairman & CEO

Thank you, Tom. You know I want to and I will. I'm going to ask you to be patient until December 8. We will talk a little bit more about the forward-look there on, I'll call it statutory capital formation and the impacts on ROEs but for right now, just think of '12 as just breakeven as we have it right now and growing from there in '13.

Operator

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

Randolph Binner
FBR Capital Markets & Co., Research Division

I just wanted to touch on annuity sales. They're kind of below our expectation again, and I think the $5 billion in annuity sales goal was still out there as of when we last spoke. So I just wanted to get a sense if that's still achievable and what the components would be that would drive you towards that goal?

Liam E. McGee
Former Chairman

I'm going to ask Dave Levenson to take that, Randy.

David N. Levenson
Former Executive Vice President and President of Wealth Management

So Randy, thanks for the question. I think I'd start by just saying that I think being out of the Living Benefits space for a couple of years has hurt us more than I think we'd expected. So the rebound, I think, as a result has been slower than we expected. But let me give you some points as to why I'm bullish about where sales are going to go from here. First, the product is only 4 months old. As you know, we launched the new product in June with the Living Benefits, so the wholesalers are really only on their second or third meetings with brokers. Two of our largest distributors are going to come onboard in the next couple of months. We've made some significant personnel changes. Six months ago, we took a Senior Product Executive from Jackson and 6 weeks ago, we changed our National Sales Manager, and I think those impacts are already being realized, which result to what we're seeing out there from a sales perspective. Also, we've made some adjustments to the product, as Liam mentioned in his opening remarks. We are actually out of the market by 75 to 100 basis points on commissions. We have corrected for that, so we are now much more in line. We also mentioned that we will be launching FIA products later this month, and we did last quarter talk about reentering structured settlements lines to build this all-weather portfolio. So the $5 billion I can't pinpoint a number for you, but I can tell you that with all these good things going on, I feel a lot more confident we're going to get closer to $5 billion in our current run rate.

Liam E. McGee
Former Chairman

Randy, this is Liam. Just a couple of things I'd add to Dave's description there. The annuity business is in the DNA of The Hartford. We have really good distribution. I think Dave has made some management enhancements to it that will bear fruit. The $5 billion number, as we've always said, Randy, was more meant to be a proportional sense of our appetite. We were a $15 billion-plus company at the peak. We want to be about 1/3 of that at our peak. As Dave said, I think $5 billion is a goal we believe we can achieve. Thirdly, unlike The Hartford of the past and others today, we're not going to ride 1 or 2 products to that type of volume. I think Dave's leadership and vision has been to have what he calls an all-weather portfolio, and he's adding products to it. And we want to be a company that has a balance of what's good for policyholders and what's good for The Hartford, so we can be in the business on a sustained level without the kind of volatility that we and others have experienced episodically in the past. So we're going to be patient here. We think it needs to be an important part of our Wealth Management business and Dave and his team I think are doing all the right things.

Randolph Binner
FBR Capital Markets & Co., Research Division

That's helpful. Just 2 very quick follow-ups. What is the distribution channel going to be for indexed annuities, and are you going into any new channels or doing any channel shifts with VA?

David N. Levenson
Former Executive Vice President and President of Wealth Management

So Randy, I'll talk a little bit more about that on December 8. But one of the things that we will be doing is bringing the FIA to our core channel, and I think that's going to be a big differentiator for us.

Operator

Next question comes from the line of Andrew Kligerman with UBS Securities.

Andrew Kligerman
UBS Investment Bank, Research Division

Real disappointed in the results around the Commercial, Consumer and Group Benefits businesses as the loss ratios kind of blew out of the guided band. So a general question; how confident in each of those major segments are you that you'll be able to stay within the band? I know you can't give exact guidance, but I'd like to get a sense of confidence in each area.

Liam E. McGee
Former Chairman

Doug and Andy will take that.

Douglas G. Elliot
President

Andrew, this is Doug. I would say we're getting more confident by the day that we're nearing this inflection point relative to written rate achieving and intercepting with loss trend. It's a line-by-line conversation, but I'm much more positive about that today seeing that out front than I would have answered 60 days ago. So that's a work in progress. We do think we are working hard to understand our trends underneath and as we go forward, we're absolutely focused on this margin compression that's been sitting amidst our lines during 2011, trying to turn that into margin improvement arena, which we expect and hope we'll see in 2012.

Andre A. Napoli
Former Executive Vice President and President of Consumer Markets & Enterprise Business Services

Andrew, this is Andy speaking to Consumer. So I'd start up by saying we're very confident in our ability to achieve our guidance, but there's been an obvious sharp increase in non-cat weather, so I guess I'd just expect us to be at the high end of that range of guidance. For auto, we're experiencing flat to slightly negative loss cost trends and we've got some nice pricing earning in that's outpacing that loss cost trend. For homeowners, there's big non-cat weather trend that's driving up loss cost and we've been pricing that line very aggressively, so I expect margin expansion to continue there. So I guess I'll conclude with confidence in our ability to hit or achieve our guidance probably at the high end.

Liam E. McGee
Former Chairman

Andrew, this is Liam. That's a very fair question on your part. I think what you should take from Doug and Andy is that we do think we're very close to the inflection point, particularly in Commercial, of pricing coming on top and overlapping loss cost trends. And I can tell you that our team is literally working case by case, customer by customer on that and that's why I was very intentional in my remarks that we see pricing increasing in P&C Commercial. And I think Andy's confidence speaks for itself in the Consumer book.

Andrew Kligerman
UBS Investment Bank, Research Division

And just a follow-up with the -- back to John Nadel -- Chris, you said you were committed to deploying capital in early '12, but there's a distinction between in early '12 and by early '12. If you're saying in early '12, that means you're probably not going to buy back any stock in 2011. If you're saying by 2012, then there's a good chance that you will be buying back stock in 2011. So the question for you is, is it in 2012 or is it by 2012?

Christopher John Swift
Chairman & CEO

I guess I'm going to have to look at the dictionary going forward, Andrew, so thank you for the clarification point. The intention is we will complete the program by early second quarter. Again, I think we've talked about it at the balance sheet day. We're being prudent. We're being a little cautious. We're watching Europe pretty closely, and we like to just get a little bit more clarity and when that happens, we have the deployable capital at the holding company.

Andrew Kligerman
UBS Investment Bank, Research Division

So you could get clarity tomorrow and potentially buy back this year?

Christopher John Swift
Chairman & CEO

That very well could be, yes.

Operator

The next question comes from the line of Bob Glasspiegel with Langen McAlenney.

Robert Ray Glasspiegel
Langen McAlenney

Well Andrew and I are on the same wavelength, and I had the same confusion on buyback. And also I wanted to just push Doug just a little bit further on your comments on feeling more confident we're at the inflection point. Given that you had your current accident year development in comp, that suggests maybe you're more behind the 8 ball and where you need to be and that line that's troubling for everyone, not just you. And given that the interest rates are lower, having rates catch up with loss cost growth still implies a lower ROE than you thought you'd be. So I guess are we further behind the 8 ball than we thought with respect to those 2 items, or is your level of confidence means in spite of that, we're going to be reporting improving ROE before too long?

Douglas G. Elliot
President

I'd start up by saying I essentially agree with all of what you said, right, the accelerant and the pressure point relative to yield over the top in the third quarter absolutely is there, exhibiting itself across all our tail lines. So the targets did move a bit further out in the front. What I was referring to in terms of nearing this inflection point is we're rapidly focused on trying to cross the line between margin compression and margin opportunity. And once there, then it's a matter of the movement toward our targets across these lines, including workers' comp. So we're working as hard as we can. We're mixing our book. We're looking at levels state by state. I am encouraged by some of the recent filing activity across the country in workers' compensation. But it is a work in process and in the middle market today, these are books of business that I think needs significant amounts of rate, and our activities are driven in that direction.

Robert Ray Glasspiegel
Langen McAlenney

Then your own comp, where you are relative to where you thought you were relative to current accident year, is that you just coming onboard and cleaning up things or is there something in the pricing that loss cost -- that maybe the company missed?

Douglas G. Elliot
President

I think there's a very disciplined process in place. Clearly over the course of the summer as yields have come down, we all need to reset expectations and targets relative to where we need to be across that line, I would say GL and some of the others as well. So this is a complicated time. Liam started out his remarks with a difficult quarter, a difficult time in the cycle. I've been through a few of these major cycles in the last 25 years, and this is the first one I can remember at this point relative to insurance pressures where the yields are where they are, so that's just another factor over the top. But I'm pleased with the progress in the third quarter, but there's much more work to be done.

Operator

The next question comes from the line of Mark Finkelstein with Evercore Partners.

A. Mark Finkelstein
Evercore ISI, Research Division

I just want to go back to, I guess some of the capital dialogue. I guess at year-end 2012, you kind of use a starting point for your sensitivities of $3.9 billion capital margin. On a comparable basis, what is that number at the end of the third quarter?

Christopher John Swift
Chairman & CEO

Mark, it's Chris. Just a couple of things on capital margin. I want to be helpful as possible, but I really don't plan on talking about capital margin on a quarterly basis. So as much as I understand your question, the facts will speak for themselves. I mean our capital margins declined from second quarter to third quarter given what happened with statutory surplus levels. But as we look forward, again, the scenarios that we presented on balance sheet day and the market conditions that we just experienced, there wasn't anything out of the normal. There wasn't anything that wasn't contemplated in those scenarios, particularly the downside scenario. And as you know, we ran those at the end of August and things have recovered since then. So I don't necessarily want to just get into a discussion on capital margin every quarter because that's how -- we're really running the business from what is sufficient and required capital at the Life Company and the P&C levels, our view of what's deployable at any point in time. So it's a language that I think I'm trying real hard to not confuse people going forward, and that's just the language that might confuse people.

A. Mark Finkelstein
Evercore ISI, Research Division

Okay. Well, let me try to ask you a couple of questions and maybe just clarify 1 or 2 things. So is it fair to say then that whatever that capital margin is today -- I think you said that statutory capital generation would be essentially flat in 2012. Is that a true statement from this point forward that within the Life Company, capital generation should be essentially flat and aside from maybe the $100 million that you might push down from the holding company in the fourth quarter, there's no other plans to -- based on a steady-state market performance in line with your EGP assumptions that it's flattish, no additional contribution above the $100 million?

Christopher John Swift
Chairman & CEO

Again, you had a lot there, so let me just try to pick at a couple of points from surplus generation. I think we've always talked through that the P&C company remains our statutory surplus generation engine. We take about $800 million out annually. We continue to plan for that in '12 and beyond. What we're talking about then specifically in the Life Company, we do see it sort of breakeven on a '12 basis, improving in '13 and beyond, being able to generate and get access the capital out of the Life Company at that point in time. Obviously that depends on ultimate market levels, but our best view right now, given everything we know about where we see Group Benefits, disability incidence continue to be elevated. We see persistently low rate environment in '12, and we do see some choppiness in the equity markets but generally stable. So yes, in that state for '12, I think we're breakeven, and we don't see the need to put any additional capital into the Life Company.

A. Mark Finkelstein
Evercore ISI, Research Division

Okay. And then just one follow-up. I mean you talk about '13, and I know you don't want to get too far ahead of ourselves, but you talk about '13 as being better. And I guess I'm trying to understand exactly what is it that's in -- that's causing the better statutory capital generation. Is there a difference in how the variable annuity hedges work that maybe has more of a dramatic impact on '12 on the downside whereas that eases in '13? Or is it more other factors like Group Benefits improving or what have you?

Christopher John Swift
Chairman & CEO

Yes it's a combination of everything, so it's just not one, right? So higher -- market levels will increase. Fee income, hopefully a little bit of a reversion of the 10-year -- back to a normal or higher-rate Group Benefits. We see unemployment. Obviously it'll be linked to employment, but we do see some improvement in '13 and beyond. But those are a lot of things, Mark, that -- let's really get into a good discussion on December 8, and we'll tell you what we see from a capital formation side and the impacts on ROEs going forward.

Operator

And your next question comes from Eric Berg with RBC Capital Markets.

Eric Noel Berg
RBC Capital Markets, LLC, Research Division

Chris, I'm hoping to understand the following with respect to the Life capital. Because your hedging programs have been over the years, more than ever now, increasingly devoted towards the protection of statutory surplus or the avoidance of statutory surplus volatility and understanding the accounting differences that you mentioned, why did you nonetheless have, despite more hedges and more effective hedges than ever, the effect that you did from VA on the stat capital?

Christopher John Swift
Chairman & CEO

Thank you, Eric. I think between myself and Graham here, we'll try to explain that the best way we can. I think it’s simple, at least my mind in that we are hedging for economics, first and foremost. Some of the hedging programs maybe in the past were more geared towards GAAP results and not necessarily economics. We are not 100% hedged for the economics. I think we've been pretty consistent in saying that we're not -- we haven't gone market-neutral over this period of time, so we still have risk on. I would characterize sort of from a risk-on perspective that we have approximately 65% effective risk coverage for the entire portfolio, but that's just our estimates that we see. So again, the variability in markets and not being 100% hedged in the economics and with VACARVM, we consider that to be more fair value-light. There is going to be a little point-to-point breakage in statutory earnings and statutory surplus will happen. And I think the key point, though, on all this as you put it back together, Eric, is the way we're running the firm at the 800 stress scenario, 800 S&P stress scenario and the outcomes that we showed you in October ought to give you greater confidence that the programs that we designed, the 3 different programs we're managing, work collectively together to protect statutory surplus in that severe market decline.

Eric Noel Berg
RBC Capital Markets, LLC, Research Division

The other question I had related to Group Insurance, and I'll make it quick because I know we're at the top of the hour. If you have been purposely steering clear of underperforming business, basically not doing business with customers whom you feel you cannot price adequately, I would think that you would see an improving loss ratio, but we saw actually an uptick. How do I reconcile the uptick in your loss ratio with your statement that you have been sort of editing the customer lineup to include increasingly profitable customers?

Douglas G. Elliot
President

Eric, just a few points. This is Doug Elliot. Number one, when you look quarter-to-quarter, 3-to-3, we had a very favorable mortality quarter in the third quarter of '10, which under today's circumstances, was much more normalized level in third quarter '11. So it looks like there's some unfavorable change q-to-q. Second piece is although we're driving rate into our book, the rate we're driving is a written rate change. And so there's still some slight margin compression [indiscernible] '11 that will reverse itself as we get out in front of these trends. So there's a lot happening underneath. We are feeling better about directionally where we're headed now. We are absolutely committed to this marketplace, no question about it. But at this point, our book needs rate. We need the discipline that we're exhibiting, which is why you see both our top line and our new business levels at levels that are down slightly from a year ago. We think we're doing the right thing.

Sabra R. Purtill
Senior Vice President of Investor Relations

Thank you. And thank you all for joining us today. As always, we appreciate your interest and support of The Hartford. And we also look forward to seeing you all in New York on December 8 at the Waldorf-Astoria for our 2011 Investor Day. For additional information about that meeting, please feel free to contact me. Thanks, and have a good day.

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