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The Hartford Financial Services Group, Inc. NYSE:HIG

FQ3 2014 Earnings Call Transcripts

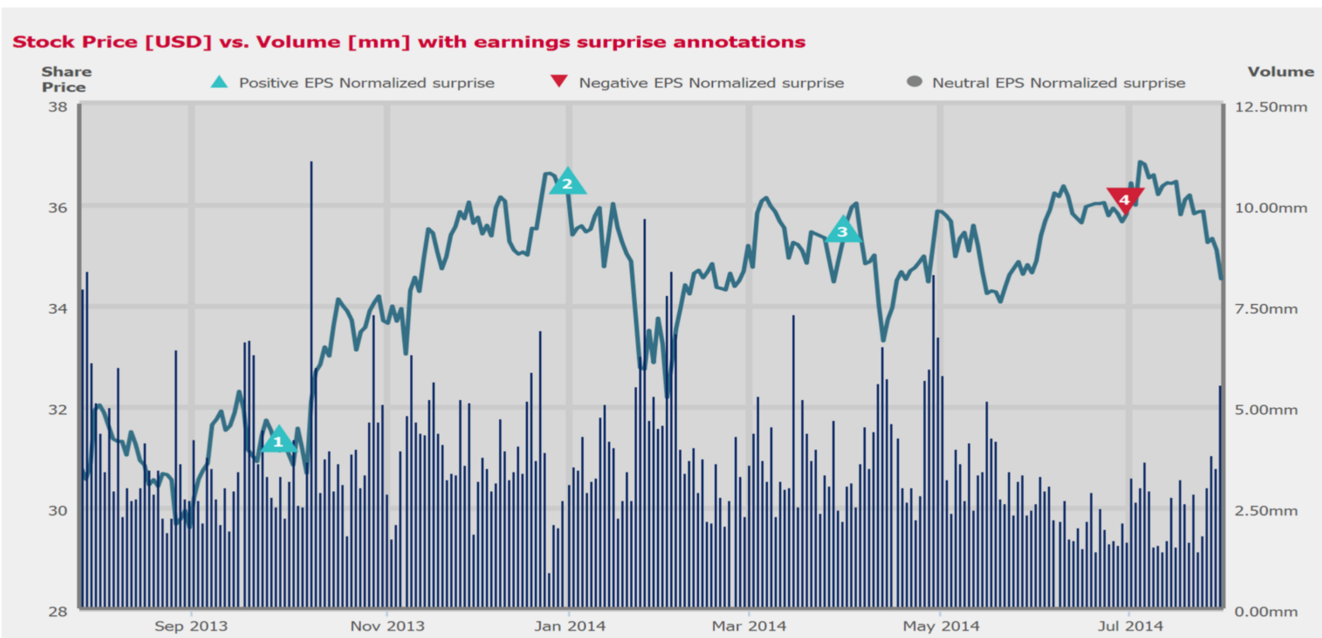
Tuesday, October 28, 2014 1:00 PM GMT

S&P Capital IQ Estimates

	-FQ3 2014-			-FQ4 2014-	-FY 2014-	-FY 2015-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.84	1.06	▲26.19	0.93	3.34	3.75
Revenue (mm)	4701.13	4769.00	▲1.44	4800.00	18449.40	19018.47

Currency: USD

Consensus as of Oct-28-2014 12:15 PM GMT



- EPS NORMALIZED -	CONSENSUS	ACTUAL	SURPRISE
FQ3 2013	0.83	1.03	▲1 24.10 %
FQ4 2013	0.90	0.94	▲2 4.44 %
FQ1 2014	0.93	1.18	▲3 26.88 %

FQ2 2014	0.67	0.31	(53.73 %)

Call Participants

EXECUTIVES

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Chief Financial Officer and Executive Vice President

Christopher John Swift
Chairman & CEO

Douglas G. Elliot
President

Sabra R. Purtill
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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 Third Quarter 2014 Financial Results Conference Call. [Operator Instructions] Thank you.

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, and welcome to The Hartford's third quarter financial results webcast. Our results, the investor financial supplement, 10-Q and financial results presentation, which includes our fourth quarter 2014 outlook, were all filed yesterday afternoon and are available on our website. 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 financial results 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 also 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.

I'll now turn the call over to Chris.

Christopher John Swift
Chairman & CEO

Thank you, Sabra. Good morning, and thanks for joining us today. Yesterday afternoon, The Hartford reported outstanding third quarter results. Core earnings were $477 million or $1.06 per diluted share, up 25% year-over-year on a per share basis. We delivered earnings growth in every business and saw the benefits of the capital management program. Catastrophe losses and limited partnership returns were both favorable in the quarter.

The third quarter results reflect the progress we are making across the company. Profit margins expanded in every business. In total P&C, the combined ratio excluding CATs and prior year development, improved 2.6 points to 90.2, reflecting our sustained focus on pricing improvements. We are also growing the top line in P&C. In Small Commercial, written premiums were up 7%, fueled by positive pricing in new business premium growth. In both Consumer Markets and Middle Market, the top line was up 3%, reflecting pricing and disciplined underwriting. Doug and Beth will provide additional detail and insights about the quarter.

When I reflect on the numbers, the most important takeaway for me is that the results demonstrate that The Hartford is on the right track. Investments we have made to drive profitable growth have taken hold and we are starting to see the positive results.

Looking ahead, our primary objectives are improving return on equity and growing book value per share to drive top-quartile shareholder returns. To do this, you can expect to see continued progress in 4 major areas: first, expanding product in underwriting capabilities; second, increasing distribution effectiveness; third, improving the customer experience and operating efficiency; and fourth, effective capital management, including the ongoing runoff of Talcott. Let me address each of these briefly.

Since 2011, we have been expanding the P&C product suite and underwriting tools to diversify our business mix and meet changing customer needs. As you know, the initial focus in P&C Commercial was expanding our property and liability expertise to complement the existing workers' compensation capabilities and we are pleased with the progress in these areas. We continue to add new capabilities to allow us to meet more of the insurance needs for a broader range of customers. Over the last year, we have updated our commercial auto underwriting tools, addressing changing trends in that market. We also recently signed a new property reinsurance program that enables us to underwrite accounts with up to $500 million of covered property per location. Finally, we remain focused on expanding the voluntary product suite in Group Benefits, preparing for a more employee-centric model as the market adjust to the new health care environment. Employee Choice Benefits is an expanded group benefit voluntary offering, which is being rolled out with customized educational materials to help employees make informed decisions about their benefits.

On the distribution side, with the ongoing consolidation of the broker and agent channel, it's more important than ever that we offer intermediaries, products and services that position us as a go-to provider for their customer needs. More than 11,000 agents and brokers are licensed to do business with The Hartford. Our objective is to continue to effectively serve larger brokers and agents by anticipating and meeting the needs of their evolving business models, while also continuing to serve and support the thousands of agents who are the lifeblood of Small Commercial and Consumer Markets businesses.

For example, the market-leading ICON platform in Small Commercial helps agents of all sizes get customer quotes in a timely and efficient manner. In addition, our award-winning operations centers effectively handle customer service for many distribution partners, freeing them to spend more of their time on business generation.

Our third area of focus is improving the customer experience and increasing operating efficiency. While The Hartford has strong capabilities in claims and policyholder servicing, we have the opportunity to significantly improve the back-office efficiency and the customer experience with the previously announced investment commitment to improve our technology infrastructure. The objective is to increase The Hartford's ease of doing business and put the ultimate customer at the center of our activity.

One example is the ongoing rollout of a new P&C claims system, which will improve claims efficiency, enhanced by new data and predictive analytic capabilities. We are also working to upgrade digital and customer self-service functionality across the P&C operations. These enhanced capabilities will help continue to differentiate The Hartford.

Finally, capital management will be a critical element as we redeploy excess capital from 2 sources: the go-forward businesses and Talcott Resolution. With improving fundamentals, the P&C companies are positioned to continue to generate significant amounts of excess capital. In addition, with the recent corporate reorganization, both the Group Benefits and the Mutual Fund companies now represent independent sources of dividends to the holding company. As we have discussed previously, we also intend to return capital to the holding company from Talcott over time, both through the generation of statutory earnings and the runoff of the legacy annuity liabilities. In combination, capital generation from the businesses and from Talcott will continue to provide The Hartford flexibility to pursue a broad range of capital management actions, while we invest in new capabilities to drive future profitable growth.

In closing, I am confident that The Hartford is on the right track to achieve our goals of a higher ROE and growing book value per share. During the third quarter, we made progress in each of the 4 areas I discussed today, and we are committed to continue that progress in the quarters and years ahead.

Now I'd like to turn the call over to Doug.

Douglas G. Elliot
President

Thank you, Chris, and good morning. We posted an outstanding quarter across our Property & Casualty and Group Benefit businesses. We're very focused on execution in our front-line teams where we work closely with our distribution partners and make critical risk-selection decisions. We believe that our energy here is paying off as we optimize pricing and retention to drive franchise value over the long term.

Let me share some highlights by business beginning with P&C Commercial, Consumer and then Group Benefits. Our results in P&C Commercial remain very consistent with recent quarters: strong underlying margins driven by written pricing gains, sound underwriting management and growth in our target business lines. We feel very good about our performance as the market showed signs of increased price competition.

For the quarter, we delivered core earnings of $268 million, up $92 million versus prior year on an all-in combined ratio of $90.4 million. Very low current accident year catastrophe losses in the quarter contributed $26 million to the improvement. The balance of core earnings increase is largely due to improved margins and slightly favorable prior year development. The underlying combined ratio, excluding CATs and prior year development was 90.2, an improvement of 3.1 points versus prior year. These financial results reflect our operating focus and discipline and give us confidence that we're making sound, strategic and tactical decisions.

On the top line, total written premium was up 1%. Excluding our Programs business, P&C Commercial grew 4% for the third quarter. We also achieved written pricing gains of 5% for Standard Commercial, outpacing current loss cost trends. While the measurement of written pricing and lost cost is essential to our business, our management of profitability is far more sophisticated than these 2 overall metrics convey. Detailed insights drive our risk decisions, especially as written pricing and loss cost trends are converging. In every book of business, there are cohorts that are performing below targets. These might be defined by geography, industry class or underwriting profile, just to name a few. Culling this business and taking corrective action is essential to achieving and maintaining target margins. That's why I always say there is more work to be done. Whether it's in certain lines of business or specific risk classes, we need to remain keenly focused on our operating risk decisions on an account-by-account basis.

Let's now take a more in-depth look at the results of our P&C Commercial businesses. Our performance in Small Commercial demonstrates the ongoing strength and momentum we've developed in this business. The third quarter underlying combined ratio was 85.6, 1.5 points better than 2013. The all-in combined ratio was 86.4. Written premium grew 7%, driven by new business premium growth of 11% and policy retention at 84%. Both the new business growth rate and the policy retention rate are consistent with trends in the second quarter of this year, reinforcing our strong momentum as we head for year end. As Chris noted, we're very excited to see our investments in this business coming together to deliver exceptional financial performance. In addition to our excellent technology and customer service platforms, we have robust analytics running behind the scenes on every facet of this business. We are successfully balancing growth and profit because we know where the business opportunities exist, we understand loss trends at the most granular levels and we're partnering with our agents to manage pricing, appetite and growth.

Moving to Middle Market. We continue to make steady progress with an underlying combined ratio of 92, down 3.9 points versus prior year. Renewal written pricing remained ahead of loss cost trends, building on our margin improvement from recent years. I'm especially pleased to note that our underlying combined ratio in Middle Market workers' compensation is down over 8 points for the quarter versus last year. After several years of disciplined pricing and underwriting actions on this book of business, it's gratifying to see the combined ratio within our target range.

Written premium growth in Middle Market was 3%, driven in part by solid results in property and general liability, as we continue to have success building our new business mix. Over the last 12 months, we've made several important changes to strengthen leadership in a number of geographies and to better align our field organization with key distribution partners. These actions help to deliver new business of $112 million, up $5 million from a year ago and consistent with second quarter 2014. We view our Middle Market written pricing trends averaging in the mid-single-digit range this quarter as being quite strong given our improved overall profitability since 2012.

Commercial auto continues to lead the way for written pricing increases. I expect us to continue as we, and I suspect many others, are not at our target combined ratios for this line. Increased bodily injury severity is the primary driver, which we will continue to address through rate increases and underwriting actions.

In National Accounts, written premium was down 9% for the quarter, a sizable swing from the growth we posted in recent quarters. The decline is largely attributable to uneven timing of premium flows. When we peel back our operating metrics, we continue to see positive performance indicators within our core book. Our retention rates remain above 90%. We're writing new -- 2 new accounts for every 1 lost, slightly behind our 2013 pace but still very solid. We've been successful in growing this book of business over the last several years. We like our competitive niche and we're confident in our plan for growth and profitability.

In Financial Products, we had a solid quarter, with written premium up 7%. This growth is coming in our E&O business where we've developed some very strong industry-based solutions. In D&O, we're seeing greater competition in the larger segment and we're tightly managing to our pricing standards.

Shifting over to Consumer. We posted an all-in combined ratio of 91.2. Excluding catastrophes and prior year development, the underlying combined ratio was 89.4, improving 1.7 points from a year ago, largely driven by lower expenses. CAT losses, well below our expectations, were above our experience in 2013. Last quarter, we shared that weather and fire losses adversely affected both auto and homeowners results. We have not seen any unusual patterns emerge and the third quarter was back in line with our expectations.

On the top line, written premium was up 3%, driven by continued success with our AARP-through-agents offering, where new business was up 11%. Auto and home renewal written pricing increases were 5% and 7%, respectively. And we remain focused on improving rate adequacy, particularly in the homeowners' line. Our expense ratio decreased this quarter to 23.1, which is essentially flat with the second quarter. We are ramping up spending in the fourth quarter on several technology projects and new business marketing efforts, and we anticipate our full year expense ratio will be approximately 23.7.

And finally, let me shift to Group Benefits, where core earnings of $38 million were up 6% from last year. Recall that the third-party market relationship in our Association-Financial Institutions block will be terminated as of year-end but will still be included in our year-over-year comparisons. I'll base my comments now on the results excluding this business.

We continue to see profit improvement, driven by favorable life and disability results. The life loss ratio was down 2.9 points due to continued pricing discipline and favorable mortality. Disability trends also remain favorable to prior year, with the loss ratio improving 2.2 points that we're beginning to see the rate of that improvement decelerate. Long-term disability incident trends continue to be favorable while claim recoveries were lower than prior year, although still in line with historical norms.

Looking at the top line. Fully insured ongoing premium declined 2% compared to prior year. Overall book persistency on our employer group block of business exceeded 90% year-to-date through September and we're very pleased with our renewal pricing adequacy. Fully insured ongoing sales of $57 million for the quarter was essentially flat with last year.

Given the lead times on large account business, we can see that 2015 is shaping up positively. Sales activity has increased and we're encouraged that our recent investments, particularly those to enhance our product, service and claim capabilities, are resonating with customers. In fact, we will welcome back several large-case customers in the first quarter.

As Chris noted in his opening, our overall suite of capabilities is allowing us to compete more effectively to win cases and then achieve greater employee participation through effective marketing and enrollment tools. These are positive signs for us. We, like everyone else, are adapting to the changing benefits landscape and we're very pleased with our progress.

Let me now wrap up by noting again, this is a very strong quarter for us across P&C and Group Benefits. We remain disciplined, thoughtfully managing our renewals and finding spots to compete aggressively for new business. We have a franchise that is getting stronger every quarter and we're focused on bringing shareholder value over the long term.

Now let me turn the call over to Beth.

Beth A. Bombara
Chief Financial Officer and Executive Vice President

Thank you, Doug. Last evening, we reported third quarter core earnings of $477 million or $1.06 per diluted share. The results reflect improved profitability in our P&C, Group Benefits and Mutual Funds businesses as well as favorable catastrophes and prior year development. The impact of better-than-budgeted catastrophe losses and favorable prior year development totaled $68 million after tax or $0.15 per diluted share. In addition to these items, we also benefited from strong limited partnership returns of $100 million before tax for an annualized yield of 14%.

Net income for the quarter was $388 million or $0.86 per diluted share, compared with a net income of $293 million or $0.60 per diluted share in the third quarter of 2013. The largest noncore earnings item this quarter was a DAC unlock charge of $102 million after tax, about equal to last year. This year's DAC unlock included a charge of $84 million after tax for our annual policyholder assumptions review, reflecting modest changes in elapsed benefit utilization expense and rate assumptions.

This quarter did not have any impact from discontinued operations, given the sale of our Japan business in the second quarter. However, third quarter 2013 included a loss on discontinued operations of $72 million from the Japan business.

P&C, Group Benefits and Mutual Funds generated core earnings of $413 million, up 30% compared with $317 million in the third quarter of 2013 due to improved underwriting margins in P&C, including lower catastrophe losses, improved results from Group Benefits and Mutual Funds and higher limited partnership income.

Doug covered the results from P&C and Group Benefits so I'll briefly cover the other segments. Mutual Funds core earnings rose 22% over the prior year, primarily due to an increase in average retail and retirement mutual fund assets under management compared with the third quarter of 2013. Performance remains solid, with 76% of funds outperforming their peers over the last 5 years. Mutual Fund sales remain strong at $3.8 billion and equity fund sales rose 11%. Redemptions continued to decline resulting in positive net flows for the third quarter in a row after adjusting for the liquidation of our target-date funds at the second quarter. Excluding that liquidation, year-to-date net flows were positive by nearly $400 million.

Note that in October, we moved the management of some VA and retirement funds from the Mutual Funds segment to our investment operations. For reporting purposes, this internal move will result in an outflow of approximately $2 billion from annuity mutual funds and about $700 million from retirement mutual funds in the fourth quarter. There'll be no significant impact on Mutual Funds earnings as a result of this move.

Talcott's core earnings for the quarter were $122 million, which was above our outlook for several reasons, including lower-than-expected ESV and ISV program costs and higher investment income, including limited partnership income. We continue to see a steady run off of our U.S. VA business where contracts have declined more than 13% since September 30, 2013. Fixed annuity contracts decreased by 5% during the quarter and are down 19% since a year ago. Although expenses for the ISV and ESV annuity programs were lower than expected this quarter, the surrender activity for both of these program was in line with our overall expectations.

In the Corporate segment, core losses totaled $58 million, up from $16 million in the third quarter of 2013. Both quarters had favorable items. The third quarter of 2013 include a total of $55 million of benefits related to recoveries for past legal expenses on closed litigation and a favorable settlement on liabilities with the company's former parent. The third quarter of this year included $7 million of legal expense recoveries. Keep in mind that the principal driver of the lawsuit in the Corporate segment is interest expense, which we expect to decline in the future because of our debt capital management plan. We intend to repay two 2015 maturities that total $456 million and also to spend up to $500 million to call or tender for debt under the current capital management plan. However, with the recent change in market conditions, we expect to execute the $500 million call or tender in 2015 rather than by year-end 2014.

Our investment portfolio continue to generate solid investment returns with modest impairments. Portfolio yields have held up well despite the low-interest-rate environment without any material change in our credit risk or portfolio duration. Excluding limited partnerships, the average pretax portfolio yield was 4.1%, consistent with the second quarter and down slightly from 4.2% in third quarter 2013. Total investment income increased 3% from the prior year quarter, which is principally due to higher limited partnership income, partially offset by the effect of lower assets.

The Hartford's book value per diluted share, excluding AOCI, at September 30, 2014, was $39.82, up 1% from year end and 2% from September 30, 2013. The growth in book value per share over the last year was due to the positive impact of net income and share repurchases, partially offset by shareholder dividends. During the third quarter, we used $845 million to repurchase common shares. We repurchased $320 million or 8.9 million shares through open-market purchases at an average price of $35.78 per share. Under the accelerated share repurchase program we began in July, we paid $525 million and took delivery of 11.2 million shares during the quarter. This program has not yet been completed. Based on the volume-weighted average stock price through September 30, 2014, there were approximately 3.5 million shares yet to be delivered under the ASR. In total, through September 30, we have used about $1.5 million to repurchase common shares under our 2014-2015 program, which leaves a little less than $1.3 billion to be repurchased through 2015.

As you know, one of our key goals is to drive our core ROE to a level that exceeds our cost of equity capital. For the 12 months ended September 30, 2014, our core earnings ROE rose to 8.2% compared with 6.4% at September 30, 2013, reflecting the growth in core earnings as well as the impact of our capital management program. And our cost of equity capital has come down, reflecting our restructuring action. We expect it to continue to decline as Talcott runs off and the company's earnings volatility and risk profile become more in line with our P&C peers.

Finally, before turning to your questions, let me provide a brief summary of our fourth quarter outlook. Our core earnings outlook for the fourth quarter is a range of $375 million to $400 million or $0.85 to $0.91 per diluted share, assuming about 440 million shares outstanding. This outlook assumes catastrophe losses of about 2.5 points on the combined ratio or $42 million after tax and about $5 million after tax of prior year development for workers' compensation accretion.

Talcott core earnings are projected at $95 million, and Group Benefits is expected to be in the low to mid-40s, down from $55 million last year, which had included some favorable items. In addition, keep in mind that limited partnership returns were strong last year, averaging 11% annualized, while our outlook for the fourth quarter assumes 6% annualized yield for limited partnership.

To wrap up, the third quarter was another quarter of significant progress. P&C, Group Benefits and Mutual Funds results were outstanding and we repurchased a substantial amount of equity under our capital management plan. We are pleased with our progress this year and remain optimistic about the future. We look forward to sharing our 2015 outlook with you in February, when we report fourth quarter financial results.

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, Beth. Before opening up the call for the Q&A period, I wanted to note upcoming dates for The Hartford. First, please note that Chris, Doug and Beth will be at the Goldman Sachs insurance conference in New York City on December 9 and we hope to see many of you there. In addition, as Beth mentioned, we expect to announce our fourth quarter results and our 2015 outlook on February 2, with the call the morning of February 3. Please note that consistent with prior years, our call the morning of February 3 will be a little bit longer than our normal quarterly call, and we will note that and hopefully can plan accordingly.

Tiffany, could you please repeat the Q&A instructions at this time?

Question and Answer

Operator

[Operator Instructions] Your first question comes from the line of Jay Gelb with Barclays.

Jay H. Gelb
Barclays PLC, Research Division

Two things. First, the Small Commercial Property & Casualty insurance premium growth of 7%, it looks like that's the fastest since the second quarter of 2012. Policy-enforced growth was modestly positive so I'm trying to get a sense of what contributions were delivering that strong growth. Is it more new business or pricing?

Douglas G. Elliot
President

Jay, this is Doug. I think it's a combination of all, right? So we had steady progress across the pricing front. Our new business numbers that we lay out in the sup, were also very strong in the quarter. And the combination that now we have the entire platform, our ICON platform with all the products in it, is being very well received by the marketplace. So we're hitting nicely across the board and I expect that momentum to continue.

Jay H. Gelb
Barclays PLC, Research Division

Okay. And then on a separate issue, I believe for Beth, for the Talcott earnings, we understand the guidance for 4Q. I believe previously, it might have been either you or Chris, did give an expectation for Talcott earnings growth for 2015 in terms of how -- what order magnitude that would decline? And if you could update us there, that would be helpful just so we can square our models.

Beth A. Bombara
Chief Financial Officer and Executive Vice President

So we, I don't believe, have given an outlook for 2015 as it relates to GAAP earnings for Talcott. I believe what we've talked about in the past is statutory earnings generation in and around the $250 million to $300 million range. As far as the runoff of the block for your models, I'd suggest just look at our surrender rates and you can now have used that as a proxy as you think about the earnings in that book declining, offset by the fact that we have seen market improvement. So that has a counter effect of improving the fees that we get on the existing block.

Jay H. Gelb
Barclays PLC, Research Division

Okay, any other insight you can provide there? Or it's just -- it's a bit of a moving target?

Beth A. Bombara
Chief Financial Officer and Executive Vice President

Yes, I think we'll provide more insight when we get -- in February when we talk about our outlook for 2015.

Operator

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

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

Just to start out with some 2 comp questions. So one of the things that we've, I guess, heard more from the industries, some of your peers trying to put on as much profitable business right now, particularly in small commercial workers' comp. And so the thought process here that we're hearing is that your peers want to put on as much profitable business on the small commercial side since it's sticky and from that, essentially have a profitable base to work through the next cycle. And so as we kind of look at your results and see the strong and consistent Small Commercial underwriting result and profitable, and then also seeing your retention coming up, I'm curious if you guys are taking a similar approach? And then secondly, if we're hearing a lot of chatter around the strategy, does that imply that we really are, within workers' comp, starting to see that market soften?

Douglas G. Elliot
President

Vince, this is Doug. A few thoughts for you. One is that we're very bullish about what we're doing in the marketplace in Small Commercial, both platform and more importantly, results-wise. And we share those results with you. So as we think about areas we want to grow this franchise, clearly, Small Commercial is right in the top row of that discussion. Secondly, workers' comp is a big product relative to our Small Commercial offering. It's been a profitable product for us. It continues to be profitable and I expect that history to move forward in a very good trajectory. So we've got an aggressive plan moving forward. Pleased with the progress in the third quarter. Expect that to continue and I think we're seen as a market leader in this space.

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

Okay, good color there and then just a little bit more granular. So we've also heard that New York and California from the comp side have been particularly challenging. So I just wanted to see how those states are performing for you guys, since I think they're 2 of your largest. And then more broadly, how loss trends may be playing out between the markets in Small Commercial within workers' comp?

Douglas G. Elliot
President

Good. So a few questions inside your second piece. First, there are some headwinds in a few of the states relative to filings. I would say that those headwinds, really, are correlated to loss experienced and has been improving across the books of business, so not total surprise. As we look at the performance and the adequacies of our book, still feel very, very good about that and we'll continue to monitor closely. And obviously, with the workers' compensation line, as you suggest, it is a state-by-state march, very geographic-centric. Second part of your question, Middle versus Small. As I commented in my earlier remarks, we're very pleased about progress on our workers' compensation book in the Middle, slightly different tendencies in our Small book. We tend to be on the micro end of Small. But again, we see good signs on the frequency end, very, very low to minus frequency across both our books of business. And the severity dynamics, both wage and other, have been very moderate over these past couple of years. So to us, the all-in loss trends are very much in check.

Operator

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

Brian Robert Meredith
UBS Investment Bank, Research Division

A couple of questions here. First, just on the reinsurance program, you talked about the new property reinsurance that lets you write up to $500 million per risk. Number one, was that alternative capacity traditional capacity? And then on the top of the reinsurance, are there any other initiatives that you all are looking at right now, i.e., internal reinsurance-type programs to take advantage of the more competitive reinsurance market? And I have a follow-up.

Christopher John Swift

Chairman & CEO

Brian, it's Chris. Thank you for your question and joining us today. The $500 million per location policy was traditional reinsurance, working with our long-time partners. So we feel good about it, gives us the opportunity to expand our property appetite in an appropriate fashion. I think as it relates to, I'll call it the alternative capital in general, I know there's been a lot of discussions and I think fundamental there, our view is that, yes, the market in general is we thinking how to support risk-taking in general. And -- but as it relates specifically to our books of business, I think we've talked about in the past, I mean, we feel good about our reinsurance programs, the cost of it, and I'll call it the more permanent nature of it over longer period, over different cycles. So we're aware and participate in a lot of discussions and explorations of what's feasible from an alternative capital, but we are not heavy users of reinsurance right now. But we'll continue to push ourselves to see if there is something creative that can help benefit our shareholders.

Brian Robert Meredith
UBS Investment Bank, Research Division

Great. And second question, Doug, curious, we've seen a drop in gasoline prices, obviously, with the big drop in oil prices. Have you guys seen any increase in frequency in the auto line? Or should we expect maybe that will start to pick up here as we head into the holiday seasons?

Douglas G. Elliot
President

Our trends really have not changed much in the last quarter or so. We will certainly watch carefully and that may indeed happen with the holidays upon us. But at the moment, I would say pretty much as they've been.

Operator

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

Randolph Binner
FBR Capital Markets & Co., Research Division

I'd like to follow up on what Jay Gelb was asking a little bit on Talcott. And so I think what we're hearing is that when we think about capital that can come out of there going forward as kind of the core layer, that estimate in earnings, is it true that we can take contract count decline and thus, AUM decline as a good proxy for the decline in required capital at Talcott? Is that going to be a pretty linear read for us going forward?

Beth A. Bombara
Chief Financial Officer and Executive Vice President

So Randy, it's Beth. So no, I was talking about earnings. When it relates to required capital, as we've talked about in the past, the reduction in required capital is not going to be a linear path as the book runs off. It obviously will decline over time and obviously impact on our views as to access capital within Talcott, but it's not a linear calculation.

Randolph Binner
FBR Capital Markets & Co., Research Division

Okay, well, if not that, what would be our best kind of tool for estimating the drop in required capital? And where I'm going with this -- the follow-up would be I think the RBC last was 500% there, so if required capital declines, it seems like RBC can be allowed to decline as well. So just trying to get a feel for how we can think about how capital could be freed up there as a result of these good surrender activities you're getting in Talcott.

Beth A. Bombara
Chief Financial Officer and Executive Vice President

Okay, so a couple of things. First, as it relates to our views around required capital in the Talcott entities and what their needs are, as you know, that's something that we continue to evaluate. RBC is one thing that we do look at as it relates to that. I'll remind you that we focus on RBC requirements in a stress scenario, not just the printed RBC in this environment. But we have, as we've talked in the past, we have been working to evaluate what should be the appropriate target going forward, taking into consideration RBC targets as well as other things like absolute levels of surplus and liquidity. And our expectation is that we will be sharing with you in February our views around the excess capital that we see in Talcott as well as what we could see as a reasonable expectation and time table for extracting that capital over time as the book continues to run off. So I'd ask you to wait until February, because I think we'll be able to provide you better information then. That will help you see how we're thinking about the capital generation coming from the Talcott entities.

Randolph Binner
FBR Capital Markets & Co., Research Division

Okay, then just one more, if I could. I mean, what is the printed RBC? If we're not going to change the stress case conversation right now, what is the printed RBC as of right now in Talcott, as of the third quarter?

Beth A. Bombara
Chief Financial Officer and Executive Vice President

As of the third quarter, we're at about 500%.

Randolph Binner
FBR Capital Markets & Co., Research Division

Okay, so 500%.

Operator

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

Erik James Bass
Citigroup Inc, Research Division

If, Doug, can you talk a little bit more about the growth outlook for Group Benefits? Which -- it sounds like you're pretty positive in your prepared remarks. But how much activity are you seeing in the market? And how are pricing trends? And then maybe also, are you starting to see any benefit to premiums from employment growth or higher wages?

Douglas G. Elliot
President

Erik, maybe just a few comments and you know we'll back in 90 days to give you the full 2015 layout. We are encouraged by the early look at some of our January 1 activity, which is why I shared the comments that I did. January is just the beginning of the first quarter but we've had some nice success on both the new business front and feel good about our retention of key existing accounts. So let's leave it at that and we'll be back with a broader look at 2015 in a few months.

Erik James Bass
Citigroup Inc, Research Division

Got it. I guess, are you seeing any benefit though, from just on existing business from either higher enrollments or employment growth?

Douglas G. Elliot
President

We're working hard on our penetration inside existing accounts for sure. I would say that, that work is ongoing. As you know, we're really right in the throes of enrollment season, so I'd have a better sense probably out 45 days and we can share maybe some of that at Goldman Sachs. We are seeing relatively small growth in the employment area so don't think the number of workers in our major cases is driving significantly upwards general, small positive growth.

Erik James Bass
Citigroup Inc, Research Division

Got it. And just one more follow-up on Talcott. On -- I guess your fourth quarter guidance is higher than what you had been guiding for the third quarter initially. Is that just because of lower expenses related to the ESV program? Or is anything else driving that?

Beth A. Bombara
Chief Financial Officer and Executive Vice President

Yes, so it's lower expenses for both ESV and ISV. There were 2 programs. And then also, as we've seen markets improve, a little bit of uptick because of that as well.

Christopher John Swift
Chairman & CEO

Erik, it's Chris. In addition to what Doug said, I guess what -- I'm particularly pleased with the team's performance there. As I'll share with you more in early '15. But a number of clients, I would say large ones that we lost maybe 3 years ago during our repricing -- some of our activities, are going to come back to the firm and I think that just speaks to, one, our reputation; our claim-handling capabilities; and just the power of the Group Benefits franchise. So more to come, as Doug said, but I'm particularly pleased with our new sales activities and old clients returning back to us.

Operator

[Operator Instructions] Your next question comes from the line of John Nadel with Sterne Agee.

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

A question for Doug on the P&C Commercial side. So we're seeing pricing begin to decline a bit but it's still above your estimated loss cost trends. I'm just wondering if there's any change in your outlook. Yes, I know it's maybe a little bit premature. You want to talk about 2015 in a few months. But are you still expecting that you can generate improvement in the -- in your combined ratio moving forward, maybe recognizing that some of the non-CAT impacts have been probably a little bit below what you've been pricing for?

Douglas G. Elliot
President

Yes, good question, tough question and a critical one. We have seen the market become increasingly competitive over the last several months, and I commented on that in my script. On one front, it's not surprising, given the overall improvement and actuary the results across both our book and also in the industry. However, I'd suggest there's still more work to be done in pockets. Returns in the aggregate are not what I would consider to be long -- at long-term targets for all lines, especially with kind of the NII yield curve where it is and also CAT risk. I mean, it's generally been a quiet couple of quarters on the CAT site. So putting all this in one basket, I'd continue to describe the overall marketplace as generally rational, especially in the sectors we compete in, which largely are small, commercial and middle. And that's important to us and our franchise and I share those results in terms of stability. It's hard for us to predict these competitive dynamics going out. What I can tell you is that in the fourth quarter, we intend to execute much in the way we had these last several quarters, which is, we're working hard to renew our best performing accounts and driving pricing in terms of those accounts that need improvement. And I think you know our history, we're not afraid to walk away from accounts that we believe we can't get to price adequacy. So our price is going to be very consistent. We're going to watch the marketplace. We're still on top of loss trends, expect that to continue in the fourth quarter. And then we'll talk more as we get out to January about 2015.

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

Okay, really helpful. And then maybe a question for either Chris or Beth. Just coming back to Talcott and sort of the historical look at a stress scenario and maintaining that 325% risk-based capital ratio. I know that's not the only metric, but it's one that we've talked about pretty consistently now for a couple of years. Given so much change and so much reduction in risk in that segment -- and I noticed you also mentioned a very high proportion of the remaining variable annuities are outside of surrender charge at this point, so potentially we could see that surrender rate continue to stay very elevated here. I'm just wondering whether you've actually finalized yet a view on whether the 325 stress target can come down. And if so, by how much?

Christopher John Swift
Chairman & CEO

John, it's Chris. Let me just -- so thanks for joining us. Let me just philosophically, right, remind you. I know you know this and others but we really want to run Talcott to be capital self-sufficient, particularly in a stress scenario. So that philosophy is unchanged. You're referencing the 325% and all I would tell you is again, as Beth said, we'll cover more in early '15. But we know that could come down, so it is going to be different going forward. We're working our process with our various constituencies but particularly our regulators. So I believe we'll have an acceptable outcome that we'll talk through in early '15.

Beth, I don't know if you'd add anything more?

Beth A. Bombara
Chief Financial Officer and Executive Vice President

No, I think you said it very well.

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

I've got 2 questions. The first is you had mentioned, that the underlying portfolio yield and your investment portfolio held up pretty well without taking much more risk and seems to defy gravity, given what we know about the interest rate of environment. Can you talk about how that occurred? Why it occurred?

Christopher John Swift
Chairman & CEO

Jay, it's Chris. If you really look at the numbers this quarter that, I think, Beth talked to, our reinvestment rate was about 3.6%. The maturity, of, I'll call it; securities rolling off this quarter were 3.7%. So I think, again, our HIMCO professionals continue to look for the right opportunities. I don't think we're stretching from a risk side. But we do have also, I'll call it, some core capabilities in real estate, mortgage loans, I'll call it, private placements that offer us the opportunity to be pretty selective and try to get the best yield for the risk of return trade-off.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Got it. Second question, on the -- in the Commercial business, the expense ratio is kind of -- the last couple of quarters, it's really been at the higher end of where it's been for the past 3 years. I know you're making investments in that business. Do you think this is sort of a peak-ish number? Or could we see that number rise a bit further as you continue to invest in the business?

Douglas G. Elliot
President

Jay, this is Doug. When we think about that expense piece, we really are balancing 2 parts of the equation. One part is that we are investing back inside this business, particularly on the technology side. So obviously, that's working against us relative to absolutes here. But we have a number of initiatives inside our businesses where we're looking at expense opportunities in general. We're harvesting ideas that are going to make us a more efficient, productive place over time. Where that is particularly relevant is clearly in Middle Market. As you know in the last couple of years, our Middle Market top line has come a little bit between '11 and '13 and so we've got some expense pressures there that we are coming to grips with and making adjustments for. But albeit, looking out, I'm pretty comfortable with where we are today and very pleased with the trade-off we're making between invest and overall outcome relative to combined ratio and margins.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

So this is not -- isn't sort of a peak-ish number. We wouldn't expect that to rise further from here unless, obviously, the top line changes noticeably.

Douglas G. Elliot
President

Certainly true. Correct.

Operator

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

Thomas George Gallagher
Crédit Suisse AG, Research Division

Just a quick one for Doug and then one for Chris or Beth. To Doug, just, I guess given on what you mentioned on workers' comp now hitting return hurdles, I presume that's an overall comment. And I guess Commercial auto is the other business where you have been getting rate. Any -- fair to say the heavy lifting's behind you from a rate standpoint? Or any other businesses where you expect to get significant rate?

Douglas G. Elliot
President

Tom, I would say that our comp strategy now is fine-tuning and working the edges, both in Middle Market and also in Small. I did comment that we are still re-underwriting and working aggressively on the pricing front with auto, and that's a comment, again, both across Middle and Small Commercial as well. The Property and liability and our Specialty books all have different strategies, and I would suggest to you that our pricing lean is probably not as aggressive there as we are approaching the marketplace in auto. So somewhere in the mid-single digits, 3 to 6 range probably for the other lines.

Thomas George Gallagher
Crédit Suisse AG, Research Division

Okay, and just shifting gears to Beth or Chris. So if I look at the initial '14 and '15 capital plan was split 80% buybacks, 20% debt reduction. And then if I look at the Japan sale, got a bit more conservative split 60% buybacks, 40% debt reduction. So my question is, as we think about Talcott capital drawdown in the future, how should we think about that split?

Beth A. Bombara
Chief Financial Officer and Executive Vice President

So Tom, it's Beth. I'll take that. So what we said in the past is that our -- any capital management actions that we would take in the future will continue to be balanced. We're very mindful of looking at what our leverage and coverage ratios are. And as we said, our goal is over time, to be in the low 20s and so any actions we take will continue to balance that. So it's not as if I can say it's an exact percentage. It will really be based on the amount and looking at a lot of those factors as we think about the balance sheet going forward.

Thomas George Gallagher
Crédit Suisse AG, Research Division

So Beth, as a follow-up then, since you're still above low 20s right now, fair to say that if you had extraordinary capital return actions on Talcott, you'd probably lean more toward the conservative end of it until you hit the low-20s threshold?

Beth A. Bombara
Chief Financial Officer and Executive Vice President

So the low 20s is a target. We haven't set necessarily a timetable for -- to when we want to achieve that. We'll just continue to be balanced. So what I would say to you is I'd expect there to be a continuation of both, but not necessarily that we're trying to be overly conservative.

Thomas George Gallagher
Crédit Suisse AG, Research Division

And then, sorry, just one last one, if I could sneak it in. From a tactical standpoint, why bother with tendering for debt? Why not just sit on the cash, earn some yield and pay it off as you go? I guess you have some fairly big maturities in '17. I don't know if that's too long to wait or what the view of tendering versus sitting on the cash and waiting to pay maturities.

Beth A. Bombara
Chief Financial Officer and Executive Vice President

So again, our view has been that we do want to reduce the leverage on the balance sheet when we look at the cost of a -- or tender a call. We obviously take that into consideration because, to some extent, what you pay and the PV calculation on that kind of takes into consideration the fact that you wouldn't be paying that interest in the future. So for us, it's really a way to get us to our targets and we'll continue to look for the best way to execute that at the best price.

Operator

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

Robert Ray Glasspiegel
Janney Montgomery Scott LLC, Research Division

Question on hedging costs, which I don't think you break out any more with the Japan. Outage come down and clearly, your assets are coming down against that. Dollars is up and interest rates are down. Any guidance just on sort of the rough run rate of hedging costs that are below the line?

Beth A. Bombara
Chief Financial Officer and Executive Vice President

So Bob, it's Beth. So as it relates to our U.S. VA book and the way that we've thought about the spend for both the WB program and the macro program, we really haven't changed those targets. I would say the macro program has probably cost us a little bit less. We used to talk about it in the sort of $75 million range. We're probably spending a little less than that now. But we really haven't changed our views on hedging. But you can see in our results, because we still do break out the VA hedging results, that they were very modest for the quarter, which is what we'd expect going forward with Japan no longer in our results.

Robert Ray Glasspiegel
Janney Montgomery Scott LLC, Research Division

I'm sorry, the $75 million refers to what?

Beth A. Bombara

Chief Financial Officer and Executive Vice President

Our -- what we refer to as the macro hedge program.

Robert Ray Glasspiegel
Janney Montgomery Scott LLC, Research Division

Okay, that's continuing or that's not continuing?

Beth A. Bombara
Chief Financial Officer and Executive Vice President

So we are continuing the macro hedge program. It's just that the cost of that program has come down a bit just given market conditions.

Robert Ray Glasspiegel
Janney Montgomery Scott LLC, Research Division

And that's below the line or is that in core earnings?

Beth A. Bombara
Chief Financial Officer and Executive Vice President

All of the hedging costs are below the line.

Operator

There are no further questions in queue at this time. I'd turn the conference back over to our presenters.

Sabra R. Purtill
Senior Vice President of Investor Relations

Thank you, Tiffany. And thank you, all, for joining us today and your interest in The Hartford. Certainly, if you have any follow-up questions about the quarter or other items, please contact either Sean or myself by phone or e-mail and we'll get back to you as quickly as we can today. Thank you, and have a great day.

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