S&P Capital IQ

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The Hartford Financial Services Group, Inc. NYSE:HIG

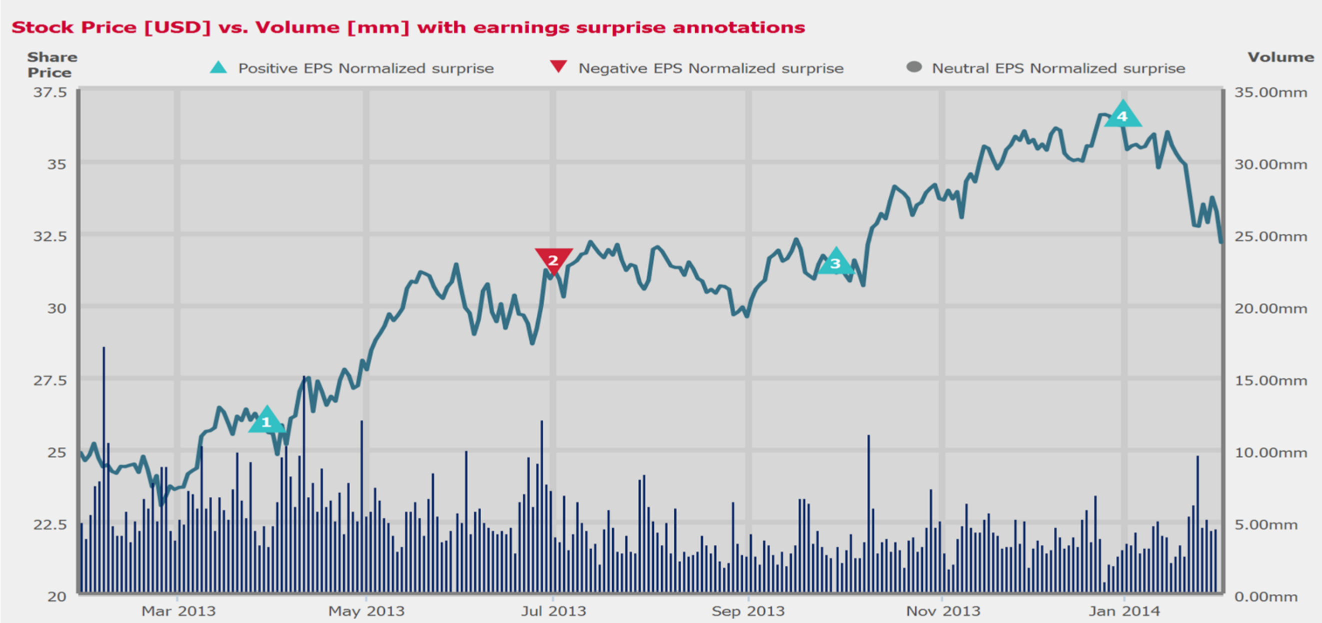
FQ1 2014 Earnings Call Transcripts

Tuesday, April 29, 2014 1:00 PM GMT

S&P Capital IQ Estimates

	-FQ1 2014-			-FQ2 2014-	-FY 2014-	-FY 2015-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.93	1.18	26.88	0.80	3.59	3.80
Revenue (mm)	5309.63	4461.00	(15.98 %)	4880.36	20832.75	16535.35

Currency: USD
Consensus as of Apr-29-2014 1:19 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ1 2013	0.83	0.92	10.84 %
FQ2 2013	0.71	0.66	(7.04 %)
FQ3 2013	0.83	1.03	24.10 %

FQ4 2013	0.90	0.94	▲4.44 %

Call Participants

EXECUTIVES

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

Beth A. Bombara
Chief Financial Officer and Executive Vice President

Christopher John Swift
Chairman & CEO

Douglas G. Elliot
President

Liam E. McGee
Former Chairman

Sabra R. Purtill
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Presentation

Operator

Good morning. My name is Lisa, and I will be your conference operator today. At this time, I would like to welcome everyone to The Hartford First Quarter 2014 Financial Results Conference Call. [Operator Instructions]

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

Sabra R. Purtill
Senior Vice President of Investor Relations

Thank you, Lisa. Good morning, everyone, and welcome to The Hartford first quarter 2014 conference call. Our speakers today include Liam McGee, Chairman, President and CEO; Douglas Elliot, President of Commercial Markets; Andy Napoli, President of Consumer Markets; and Chris Swift, CFO. Other members of our executive management team are also present and available for Q&A, including Beth Bombara, President of Talcott Resolution.

As described on Page 2 of the slides, today's presentation includes forward-looking statements as defined under Private Securities Litigation Reform Act of 1995. These statements are not guarantees of future performance, and actual results could be materially different. We do not assume any obligation to update forward-looking statements, and investors should consider the risks and uncertainties that could cause actual results to differ from these statements. A detailed description of those risks and uncertainties can be found in our SEC filings, which are available on our website.

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

Finally, please note that our 10-Q will be filed by the end of this week.

I'll now turn the call over to Liam.

Liam E. McGee
Former Chairman

Thank you, Sabra. Good morning, everyone, and thanks for joining our call. Just over 2 years ago, we launched The Hartford strategy to enhance shareholder value. Profitably [ph] grow the P&C, Group Benefits and Mutual Funds businesses, reduced the size and risk of Talcott Resolution, and increased the company's operating effectiveness and efficiency.

Our focus on executing that strategy has been unrelenting, and I am very proud of this -- of the substantial progress we've made in transforming The Hartford.

Building a successful 2013, The Hartford outstanding first quarter results further demonstrate that our businesses are profitably growing through margin expansion and top line growth.

In addition, the Japan sale, announced yesterday, is an important milestone in the company's transformation. This is an excellent transaction for shareholders, generating an estimated $1.4 billion capital benefit and sharply reducing The Hartford's risk profile by permanently eliminating the Japan variable annuity risk. Our policyholders in Japan will also benefit from a financially strong, strategic Japanese buyer.

In evaluating the transaction, we examined a capital benefit compared to the economics of running the block off. We consider the permanent risk transfer and the likelihood of regulatory approval. After a comprehensive process, we concluded that the sale to Orix was clearly the right decision for the company. The transaction will accelerate the return of capital from Japan so we can be redeploy it for accretive activities were quickly. We will provide details about our plans for the capital benefit after the deal closes, which we expect to occur in July.

The transaction also accelerates the transformation of The Hartford, putting greater emphasis on our successful efforts to profitably grow the P&C, Group Benefits and Mutual Funds businesses. This is an important transaction for The Hartford. With the return of capital from Japan and the permanent elimination of the VA risk there, The Hartford is much closer to achieving the strategic objectives we set out in 2012.

The Hartford had an outstanding first quarter. Core earnings increased 23% to $564 million, or $1.18 per diluted share. Core earnings in the P&C, Group Benefits and Mutual Funds businesses also increased 23% year-over-year. Disciplined underwriting and pricing continued to drive margin expansion in P&C and Group Benefits. Excluding a onetime expense benefit, CATs and prior year development, the total P&C combined ratio improved to 89.9 in the first quarter, a 1.9 point improvement over the prior year quarter.

In Group Benefits, we continued to grow margins, recording a 50% jump in core earnings and an increase in the core earnings margin to 5.1%.

As Doug will discuss later, renewal written price increases were strong in P&C Standard Commercial at 7%. Pricing increases remain well ahead of loss cost trends, which will drive future margin expansion.

In addition to increasing profitability, we're beginning to generate improving top line growth across the P&C lines. New business premiums were up year-over-year in Middle Market and Consumer Markets and retentions are higher across the board even as pricing remains strong. In Group Benefits, sales increased 7% over the first quarter of 2013 for the fourth consecutive quarter of year-over-year growth.

In Mutual Funds, growth in assets under management drove core earnings up 5%. We were pleased to see positive net flows in Mutual Funds in the first quarter, a sign of growing momentum in the business.

As Chris will elaborate, we continue to manage the balance sheet prudently. The aim of continued financial strength and flexibility while returning capital to shareholders and paying down debt. During the quarter, we repurchased $300 million of common stock and repaid $200 million of maturing debt.

Across the company, we are driving improvements in operating effectiveness and efficiency, which you can begin to see in declining enterprise insurance and other operating expense levels. We are instilling a continuous improvement mindset to ensure that we operate more effectively and efficiently going forward.

The first 4 months of 2014 represent an important turning point for the Hartford. With the sale of Japan, The Hartford is transforming into an insurance underwriting company with a smaller, less volatile, U.S. run off block in Talcott Resolution. The P&C Group Benefits and Mutual Funds team are delivering profitable growth. Outstanding first quarter results further demonstrate that the fundamental changes we made to how the company operates are working. We are creating a culture of execution of The Hartford and are well-equipped to compete effectively in our markets. We are focused on the work ahead as we continue to execute in The Hartford strategy.

Thanks again for your interest in The Hartford, we look forward to sharing our continued progress with you.

And I'll now turn the call over to Doug. Doug?

Douglas G. Elliot
President

Thank you, Liam, and good morning, everyone.

Commercial Markets is off to a strong start in 2014, and clearly building on the growing momentum established over the past several years. With an improving earnings profile, particularly in Middle Market, P&C and Group Benefits, our attitude towards growth has turned more positive across all our businesses.

Let's begin on Slide 5. For the first quarter of 2014, P&C Commercial delivered $264 million of core earnings and a combined ratio of 91.2. Compared to the first quarter of 2013, this is an increase of $40 million in core earnings and a decrease of 2.8 points in the combined ratio.

Current accident year CATs for the first quarter of 2014 were approximately $60 million. Significantly above the very light CAT quarter 1 year ago. Partially offsetting the increase in CAT losses was a onetime expense benefit resulting from changes in New York Workers' Compensation Board assessments. The underlying combined ratio excluding CATs and prior development was 87.7 for the first quarter of 2014, a decrease of 5.4 points versus the prior year. Excluding the favorable effects of the New York Assessments changes, the underlying combined ratio improved 2.2 points, reflecting our strong execution across all market segments.

CAT losses for our Property & Casualty businesses this quarter were more heavily skewed to Standard Commercial lines. This is largely a function of our extensive Small Commercial business and low temperatures across the Midwest and Northeast, that resulted in a much higher frequency of burst water pipes that we normally see from winter storms.

Turning to the top line on Slide 6. Our total written premium was up 1%. However, underneath this overall modest change, a very important story is unfolding for our P&C Commercial businesses. Adjusting for the $43 million written premium decline in our Programs business, which is a result of re-underwriting actions, P&C Commercial grew over 4%, the strongest quarterly growth we've seen in several years. Furthermore, we continued our relentless execution on written pricing gains, achieving a 7% increase in the quarter. Although down from 8% in quarter 4, we are nonetheless pleased with the general strength of pricing achieved. Importantly, pricing continues to outpace lost cost trends.

New business momentum also continued, and in particular, I would note, our Middle Market new business premium was up 14% in the quarter. With this as a backdrop, let me share a few additional thoughts on each of our 4 business segments starting with Small Commercial beginning on Slide 7.

Performance in Small Commercial continues to be excellent, with an all-in combined ratio of 85.7. Top line momentum is building, with policy retention improving to 83% and new business of $131 million for the quarter. Quotes for our business owners' package policy spectrum were up 12% in the quarter. Recall that we are introducing our commercial auto product on our new quote-to-issue platform in the coming months, completing our small product suite. This cutting-edge technology, with our market-leading products and outstanding distribution partnerships, has us poised for further PIF growth as we look out over the next several quarters.

Moving to Middle Market on Slide 8. I continue to be pleased with our progress. Margin improvement has been our consistent focus over the last several years, and our first quarter underlying combined ratio of 90.1 paints a completely different picture than what we saw a few years back. After adjusting for the benefit from changes in New York Assessments, we're down 3.2 points from prior year. Renewal written pricing at 6% remain well ahead of loss cost trends and our account performance analytics continued to guide our pricing discipline.

As I mentioned in our fourth quarter call, the environment has become more competitive over the last 6 months, but I would continue to describe the overall market as rational.

Middle Market written premium was up 4% in the quarter, reflecting our improved go-to-market capabilities. Retention remains solid and new business of $111 million was up from $97 million in the first quarter of 2013.

Our new business product balance is now consistently performing within our target range. With property, casualty and auto representing 2/3 of our new written premium. Most importantly, based on our aggressive pricing and underwriting actions over the past 30 months, the rate adequacy of our Middle Market growth has improved significantly, including worker's compensation.

Turning to Specialty Commercial on Slide 9. National Accounts continue this top line momentum up 24%. Specific circumstances related to several individual accounts help drive this result. However, even adjusting for these, the underlying run rate is in the low-double digits. Our credit and underwriting standards remain rigorous. We estimate that available new business in the market was down slightly, but I was pleased with the new accounts we wrote in the quarter. As in prior quarters, with exceptional retention above 90%, our new accounts exceeded those either lost or non-renewed, a great organic result.

Financial Products also had a solid quarter with 4% growth. Pricing remains positive in most sectors with the outlier large, commercial excess players where we see pricing declines. I remain positive on our progress here, and I'm pleased with another good 90 days.

Re-underwriting efforts in our Program business remain a priority. We're making difficult yet appropriate financial trade-off decisions here, and I'm not concerned with the top line decline. Our financial outlook for the go-forward programs supported by revised underwriting and claims controls has significantly improved over the past 2 years.

Now let's move to Group Benefits on Slide 10, where excellent momentum from 2013 continues. Core earnings in the quarter of $45 million, were up 50% from last year. Favorable long-term disability incident trends, continued strong recoveries and improved pricing, were all drivers in the quarter. In the February year-end call, I noted our strong persistency on January 2014 renewals. In fact, for the quarter, persistency in accounts renewing in our Employer Group Life and Disability business came in at 80%, up approximately 18 points from 2013. This strong performance produced a book consistency -- persistency of over 90%, which is 10 points improved from 2013.

Looking at the top line. Fully insured ongoing premium declined 4% compared to prior year. The decrease is primarily attributed to a decision we made last year to exit an agreement with a third-party targeting sales through financial institutions. The impact on core earnings is immaterial, but we will continue to see premium decline throughout December 2014 when our exit is complete. Excluding the premium from this arrangement, our top line is down about 1% to prior year.

Turning to New Business. Fully insured ongoing sales of $180 million, were 7% ahead of first quarter 2013. This is now the fourth consecutive quarter of increasing year-over-year sales.

These financial results reflect our improved financial profile and market competitiveness. And critical to our strategy, this improved financial performance has also been recognized by A.M. Best, Standard & Poor's and Fitch, all of which have recently reviewed the Group Benefits writing company and upgraded our ratings. We've been working aggressively to transition all Group Benefits business to Hartford Life and Accident, and these upgrades are important step as we work to grow this business.

In closing, this was a very good quarter for us with strong top line and bottom line performance. I'd highlight that we continued to invest inside each of our business for 2014 and beyond. Technology is at the core of this agenda, but underwriting, product development and data analytics are equally critical. Our markets are continuing to evolve and these operating initiatives will strengthen our value proposition with customers and distributors. Coupled with the improving financial performance we delivered over recent quarters, we are optimistic about our strategic position as we move forward.

Now let me turn the call over to Andy Napoli.

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

Thanks, Doug, and good morning. Consumer Markets delivered strong first quarter results that continued the positive momentum created in 2013. During the quarter, consumer generated written premium growth of 6% year-over-year. Sequential policy growth in both auto and home, while simultaneously improving underlying margins.

Let's start with margins. Overall, despite the winter activity that drove elevated non-CAT frequency across all lines, we produced 1.2 points of underlying margin improvement. In homeowners, winter storms and the unseasonably cold weather that hit the Eastern half of the country unfavorably impacted our non-CAT home loss ratio by 4 points. During the quarter, we experienced large increases in non-CAT weather claim frequency, particularly from frozen pipes.

In auto, the weather also contributed to increased physical damage frequency. On the other hand, auto liability frequency and severity trends remained modestly positive.

Finally, our expense ratio improved over a point compared to last year due to direct marketing efficiencies, coupled with the benefit of increased scale.

Now let's move to the top line. Written premium growth for the quarter was driven equally by new business production and improving retention. Auto new business grew 20% with production coming from all channels. Agent ease of doing business is critically important to us and we spent a large part of 2013 working on new business throughput in this channel. Our team thoughtfully reviewed agency back and implemented numerous workflow improvements, resulting in a 7% increase in quotes and a 32% increase in issues over last year. These improvements helped drive auto new business production in AARP Agency and other agency, which grew 46% and 31%, respectively.

Now let's shift to AARP direct top line, where new business grew 10%. This growth was largely enabled by a 29% increase in response, as we continue to optimize our direct marketing by driving leads for more cost effective, online sources. During the quarter, 78% of our responses came from online shoppers, up 7 points from a year ago. Our AARP direct marketing has improved significantly over the past couple of years, while leveraging better analytics and quicker test and learn capabilities to more efficiently target shoppers who will respond to our Hartford AARP offerings.

Strong premium retention is also driving growth. Targeted renewal pricing and increased policy retention contributed to a 1 point increase in auto premium retention, including a 2 point improvement in agency auto. Home premium retention is also up 1 point.

Overall, we are very pleased with our growth and we we're mindful of balancing that growth with a strong underwriting focus, managing both on a very dynamic basis from state to state to optimize our total return.

Focusing on Auto. We're very happy with AARP growth in states like Florida, Illinois and Arizona, and agency growth in Texas, Connecticut and Pennsylvania. We also have some states who are actively managing like California, where we're taking both rate and non-rate actions to combat loss cost pressure and to decelerate growth a bit.

In New York, where the rate we've taken combined with non-rate actions, for example, restricting new business flow through filters and comparative raters, our actions are working and new business growth has slowed.

Consistent with our results this quarter, where the auto current accident year loss ratio was essentially flat with prior year, we're confident the actions we've taken and will take during the remainder of 2014, will continue to keep earned pricing ahead of lost costs.

In closing, we're proud of our first quarter results continuing the momentum from 2013, improving margins, expanding top line growth and growing policies in-force. As we look ahead to the remainder of 2014, we'll actively monitor growth, we'll take rate to stay ahead of loss trends and implement other non-rate actions where appropriate. We are confident in our ability to achieve our 2014 objectives and that our core strategy remains strong and on track.

I'll now turn the call over to Chris.

Christopher John Swift
Chairman & CEO

Thank you, Andy. This morning, I'll cover several topics. First, I'll review first quarter 2014 results; second, I will cover the HLIKK transaction and its financial impacts; third, I'll provide updates on our legal entity realignment work; and finally, I'll cover our second quarter 2014 outlook.

Let's begin on Slide 14. Last evening, we reported first quarter 2014 core earnings of $564 million, or $1.18 per share, up 23% from the first quarter of 2013. First quarter results included about $58 million after-tax, or $0.12 per diluted share of favorable items. These items included $26 million in after-tax, favorable prior year development, mostly from prior year catastrophes and $32 million after-tax for a reduction in assessments for the New York State Worker's Compensation Board.

Current year catastrophes were in line with our outlook of $57 million after-tax. The addition to these items, limited partnerships returns were 13% annualized, or about $0.07 per diluted share higher than our 6% yield we are using for outlooking purposes.

Turning to Slide 15. Consolidated net income for the quarter was $495 million or, $1.03 per diluted share, compared with a net loss of $241 million, or $0.58 per diluted share in the first quarter of 2013. Hedging losses and credit impairments were modest, reflecting relatively stable capital markets and a favorable credit environment this quarter. Combined, our P&C group Benefits and Mutual Funds businesses, generated core earnings of $452 million, up 23% from the first quarter of 2013.

Doug and Andy covered their businesses, so I'll cover the rest. Mutual Funds core earnings rose 5% over prior year due to higher fees resulting from increased assets under management. Fund performance remains solid and we were ranked as a Top 10 Mutual Fund Family in the Barron’s/Lipper survey for the second year in a row. With strong sales and improving redemptions, net flows were positive for the first time since 2011.

Looking ahead to the second quarter, we anticipate a slight increase in redemptions due to the liquidation of our series of target date funds. These funds have approximately $700 million in assets under management, which reflects our decision to focus resources in areas where we can grow market share.

Talcott's core earnings were $175 million, basically in line with our outlook after adjusting for limited partnership returns. U.S. VA surrender activity remained relatively consistent with policy accounts declining 3% sequentially, and an annualized surrender rate of 12.3% in the first quarter. This is slightly lower than the last few quarters, primarily because of the ESV program.

We continue to explore policyholder initiatives for our annuity blocks. In mid-March, we launched a program that will ultimately be offered to about 84,000 contract holders with $5.5 billion of U.S. fixed annuity account values.

The corporate segment had core losses of $63 million, compared with core losses of $73 million in the first quarter of 2013. The difference was principally due to a reduction in interest expense of about $12 million before tax, due to debt repayments in 2013. During the quarter, we repaid $200 million in maturing debt, consistent with the capital management plan we announced in February of this year.

Turning to Slide 16. At March 31, 2014, The Hartford's book value per diluted share excluding AOCI was $40.17, up 2% from year end 2013, and up 3% from March 31, 2013. The growth in book value per share reflects first quarter net income and the accretive impact of share repurchase during the quarter, which was modestly offset by dividends paid to shareholders.

During the quarter, we repurchased $8.8 million common shares for $300 million at an average price of $34.03 per share, or about 85% of book value excluding AOCI.

Our core earnings ROE for the 12 months ended March 31, 2014 was 9.6%, which is above our expected run rate for full year 2014 of 8.7% to 9.2%. This increase was due to favorable limited partnership income and catastrophe losses over the past year.

Yesterday, we announced the agreement to sell HLIKK, our Japanese annuity subsidiary for $895 million, or $860 million net of expenses and taxes. This is a good transaction at a good price that will eliminate our exposure to the Japan VA business. The transaction, which is subject to regulatory approvals is expected to close in July and has a pro forma estimated capital benefit of $1.4 billion. The benefit is comprised of net proceeds from the sale of HLIKK, and an estimated net statutory capital benefit of $540 million in the U.S. resulting from the recapture of the Japan annuity risk to HLIKK.

On a March 31, 2014, pro forma basis, the transaction would result in an after-tax GAAP net loss of approximately $675 million, and a U.S. Life Insurance company net statutory surplus loss of approximately $275 million. The deal is subject to a purchase price adjustment. The company's hedging program is designed to largely offset the effect of the purchase price adjustment and the expected capital benefit and we intend to continue the hedging program until closing.

As a result of this transaction, effective in the second quarter, the Japan business will be classified as discontinued operations and will not be included in core earnings. Core earnings for Japan were $64 million this quarter, and were outlooked at $215 million for the full year.

Going forward, Japan results will also include the results of hedging and changes in the purchase price adjustment and will be included in net income through discontinued operations until closing, which is expected in July of 2014. The estimated GAAP loss on the sale will be booked in the second quarter.

After closing, The Hartford will have greater financial flexibility and a significantly reduced risk profile. We are evaluating how we will deploy the capital benefit from this transaction, including incremental capital management opportunities, and will update you on our plans after the transaction closes.

Consistent with prior programs, we will evaluate both equity and debt options under any program. As Liam discussed, this sale is a major milestone for The Hartford, accelerating our transformation to a more focused insurance underwriting company and significantly reducing the company's risk profile. In addition, it will reduce future net income volatility as GAAP accounting did not fair value most of the Japan liabilities.

Turning in to Slide 18. We have also made progress on our corporate structure realignment. During the quarter, we completed the Group Benefits legal entity separation project. Today, Hartford Life and Accident, or HLA, largely represents just the Group Benefits business. As part of this separation this quarter, HLA subsidiaries upstreamed an $800 million dividend to HLA in March. This capitalized the Group Benefits company in an RBC [ph] of approximately 400% as of March 31, 2014. After the realignment, HLA's former subsidiaries, Hartford Life Insurance Company and Hartford Life and Annuity became subsidiaries of the Life Holding company.

As Doug mentioned, after we completed the realignment, 3 rating agencies upgraded HLA, our market-facing Group Benefits company.

Our second project involves White River Re. In the second quarter of 2014, we plan to dissolve White River, our Vermont annuity captive, and Hartford Life and Annuity recaptured the risk previously ceded to White River. This transaction has no impact on net holding company resources or consolidated U.S. life statutory surplus. In addition, this transaction simplifies our regulatory and reporting structure and improved our ability to manage Talcott's resources. Including the impact of HLA and White River realignments, pro forma March 31, 2014 RBC for Hartford Life Insurance Company and subsidiaries would be approximately 430%.

Before turning to your questions, let me provide a brief summary of our second quarter outlook, which is on Slide 19. Bottom line, adjusting for certain items, we forecast the core earnings increase of 8% in the second quarter of 2014 as compared to the second quarter of 2013. In total, our core earnings outlook for the second quarter of 2014 is $295 million to $320 million, or $0.63 to $0.68 per diluted share, assuming 469 million shares outstanding. This outlook does not include Japan annuity core earnings of approximately $55 million dollars or $0.12 per diluted share, which will be reported in discontinued operations.

Talcott's earnings, excluding Japan, are outlooked at $80 million to $85 million for the quarter and include about $15 million after-tax for expenses associated with policyholder initiatives on the U.S. annuity book. This outlook assumes catastrophe losses of $120 million after-tax, which is about equal to our actual experience in the second quarter of 2013. The second quarter is generally our highest CAT quarter, and May and June are 2 of our most active CAT months, particularly for tornadoes and thunderstorms that are still to come. We extend our sympathies to all those affected by Sunday's tornadoes and yesterday's storms in the Midwest and Midsouth.

As usual, the outlook does not include any estimates for prior year development, except for the accretion of discount on workers comp. We complete our annual ground-up asbestos environmental reserve studies in the second quarter.

To wrap up, let me just reiterate that we are off to an outstanding start in 2014 with strong financial results from our P&C, Group Benefits and Mutual Fund businesses and a transaction milestone with the Japan announcement. Our capital position is very strong, with a $600 million improvement in statutory surplus this quarter, reflecting positive statutory earnings in both Life and P&C. I'll 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. We have about 30 minutes for Q&A. [Operator Instructions] Lisa, could you please give the instructions for Q&A.

Question and Answer

Operator

[Operator Instructions] And your first question comes from Mark Finkelstein from Evercore.

A. Mark Finkelstein
Evercore ISI, Research Division

I guess my first question is on the transaction and kind of the earnings outlook that you talked about. I guess, how much in stranded costs get -- or shared services cost get reallocated? And is it too early to start talking about an expense plan in terms of kind of dealing with those?

Liam E. McGee
Former Chairman

I'll let Chris and/or Beth take the details of that question. But Mark, I think as we demonstrated with our sales of the Life and Retirement Plans businesses as well as our broker-dealer, we are always determined to eliminate costs that are associated with businesses we sold. And I think our success to date in those businesses are supportive of that concept. With that, I'll have Chris and Beth give you the details that you asked for.

Christopher John Swift
Chairman & CEO

Thank you, Liam. I think your point is right on. I think, Mark, if you put into context that HLIKK was really a standalone business unit in Japan, reallocated a small amount of holding company expenses to Japan. When I mean small, you think in terms of $20 million, $25 million after-tax -- or excuse me, pretax. And we'll put that part of our efficiency objectives and we'll get out as quickly as we can, but it's relatively small.

A. Mark Finkelstein
Evercore ISI, Research Division

Okay. And then Chris, just what happens to the hedging cost? I mean I know that 70 basis points likely goes away, but is there an opportunity to take down the macro hedge as well? And if so, how much of that save the strain in the -- below the line?

Christopher John Swift
Chairman & CEO

Mark, from the hedging side, I will just reiterate, we are going to continue to hedge from now until closing. That's important as we try to lock in our capital benefit. I think as you forward, in U.S. block, we still spend at 30 to 40 basis points of hedging cost. The macro program cost is approximately $75 million. So I do think we'll have the opportunity, with Bob Rupp's leadership, to recalibrate our U.S. hedging programs. And that's on the list, and we'll update you as we modify it going forward.

A. Mark Finkelstein
Evercore ISI, Research Division

Okay. And then just finally, Andy, is the expense ratio improvement in Consumer sustainable?

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

Mark, this is Andy. Yes, we believe that we should sustain 1.4 point improvement throughout the year.

Operator

And our next question comes from John Nadel from Sterne Agee.

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

I have a question. I know you don't want to address sort of the deployment of the capital until the deal actually closes. But I guess my question is this, should we think -- how should we think about those proceeds in the capital freed up from the sale? And by that, I mean, is it fair for us to look upon those proceeds as completely unencumbered and available to the holding company, either directly as it relates to the sale price or, over time, as it relates to getting the dividends out of the life co?

Christopher John Swift
Chairman & CEO

John, it's Chris. How about if I frame it that the $1.4 billion capital benefit is obviously the gross impact of that combination. I think when you think about it, what we announced our capital management plan for 2014 and '15, you would say as our thinking, this transaction overlaid with that plan. We would say that there's an incremental $1 billion of capital that will be available to supplement that plan. And as you know, we're going to work on it with -- we're going to work on closing the transaction first and then, simultaneously, that will work on our plans. And again, consistent with our past actions, I think we demonstrated the ability to be balanced to achieve our deleveraging goals while returning excess capital to shareholders.

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

Yes, that's fair. I just wanted sort of an affirmation, if you will, that the net proceeds here over what you had already assumed in your $2 billion outlook was indeed unencumbered. And I guess it's fair for us to assume that, right, given the 400% RBC at the group company and the 430% at Talcott on a pro forma basis. Correct?

Christopher John Swift
Chairman & CEO

Yes. I mean, the way we think about it is the capital that's in the U.S. entity, we'll work with our regulators to do an extraordinary dividend to get it out. The cash that's going to come from the sale of the legal entity in Japan will go directly to the holding company. But all that totals in incremental billion dollars compared to our announced plan.

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

Okay. And then if I can just sneak one more in. I kind of hate asking about the Corporate segment on the conference call, but as you look at that $63 million operating and core operating loss in Corporate this quarter, can you give us some help on where we should expect that to trend given the debt reductions as well as your expectation for incremental expenses from here?

Christopher John Swift
Chairman & CEO

Yes. John, I'm looking at the supplements. So I always think in terms of -- at the Corporate segment, there's about $60 million to $70 million of pretax operating expenses up there in addition to the interest expense -- yes, for the year -- I'm sorry, that's for the year. So that will continue to be there, with the -- just the catchfall from some unallocated expenses to the line. So think about it as $50 million to $60 million for an annualized basis pretax within there going forward.

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

Okay. So most of the expenses that we should see from here then are truly in the operating units?

Christopher John Swift
Chairman & CEO

Clearly. I mean that's where all the action is.

Operator

And our next question comes from Vincent DeAugustino from KBW.

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

I'll just start off with Doug real quick. I'm just curious if you're seeing any shifts in quote submissions that might indicate that your clients and agents are becoming more complacent with, call it, mid-single-digit rate increases since we're also seeing a concurrent modest rise in retentions as well?

Douglas G. Elliot
President

Vince, I would describe the operating environment the last 60 days as relatively consistent. So I don't see any major changes out there. Excited about the progress we made in the quarter, sales achieved across our businesses, as I noted, really positive signs for the franchise. But I still see a very rational environment that is allowing us to compete effectively.

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

All right. Good. And Andy, you've already provided some information on the non-CAT non-weather. But I guess the question would go to both Doug and you. But clearly, the winter weather was a drag on the CAT line, and I'm just curious of any thoughts on weather outside of the catastrophe line. There might be some benefit across the writing [ph] lines like auto and workers comp, or some of these frigid temperatures may have weighted on whether it be discretionary driving or construction activity. I'm just looking at some other things in the economy, and we see it in retail sales, home starts, tons of things that are impacted here. And I'm just wondering if there's some also non-CAT, non-weather accident frequency benefits here in the quarter that's benefiting the quarter [ph] line loss ratio that we should maybe thinking about normalizing out or just breaking that down would be helpful.

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

Okay. Vince, this is Andy. I'll address for Consumer and then hand it off to Doug. So let me talk about homeowners first. So we did see an abnormally large increase or spike in freezing pipe claims, so we got to deal with that. And so, when will that repeat itself towards the end of this next year, into next year. The long-term 3- or 4-year trend for non-CAT weather has been slightly negative. And so I view that, as the year plays out that, that trend should continue despite what happened in the quarter with the frozen pipe claims. What's more interesting, at least to me, is what's happening in auto. So we observed a sharp increase in collision frequency that we attribute largely to ice and snow throughout the Northeast and Midwest. And what's interesting about it is we did not see a corresponding increase in auto liability frequency. But that said, that's something that we're paying really close attention to, as we come out of the cold weather period, to see if the collision frequency drops off and auto liability frequency remains modest. That help?

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

It does.

Douglas G. Elliot
President

Vince, let me add a few points to that. One is we had some pressure on our non-CAT weather inside Commercial Markets in the first quarter. Not big, big numbers, but clearly states that we're borderline, ISO-defined CAT-ers, et cetera, so a couple of points of pressure there inside our property lines. Secondly, we feel we also had some frequency in the auto line just because of weather. So we had commercial drivers out on the roads for extra hours, et cetera. And we know, as we look at geographies, it had some pressure in the quarter. And the last piece I'd throw to you, maybe a contrarian thought to you. In comp, we think we saw a little bit in the frequency area just based on weather. So whether it be employees on the job sites with more challenging temperatures, ice, et cetera. So we actually looked at our first quarter frequency numbers and comp and think we saw a little bit of lift in areas that had those adverse temperatures.

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

Okay. So to your point on being contrarian, we should maybe actually think about this at least being sustainable, if not potentially getting some improvement throughout the rest of the year based on all the rate and non-rate actions as well.

Douglas G. Elliot
President

That's fair.

Operator

And our next question comes from Jay Cohen from Bank of America Merrill Lynch.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Two questions. You had mentioned in the U.S. VA book an offer that you're putting out to contract holders of -- if you can give more detail on that. And then on the Property & Casualty side, I guess really on the Commercial side, this was the first quarter that I can recall, where there was no adverse reserve development in any major line of business. And I'm wondering if you're seeing in some of these liability lines better claims trend, or is it simply that, "Hey, we've gotten the reserves where they need to be," at this point?

Liam E. McGee
Former Chairman

Okay, Jay. We'll have Beth take your first question on U.S. annuity offers -- customer offers.

Beth A. Bombara
Chief Financial Officer and Executive Vice President

Great, thank you. Yes, so in markets, as Chris outlined in his remarks, we did start an offer related to our fixed annuity block. This offer is going to cover about $5.5 billion of account value. These fixed annuities, think of them as offering minimum interest rate guarantees of around 3%. And so, with this offer, we're offering policyholders an enhancement and increase to their surrender value as they would surrender their contract.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

And Beth, what's the expectation as far as what that should produce as far as surrender value -- surrender rate?

Beth A. Bombara
Chief Financial Officer and Executive Vice President

Yes. It's early to tell right now. As I said, we just started the first launch in March. And for the first wave, currently we're experiencing about an 8% take rate. So we modeled that we thought, in total, we'd get somewhere in the 10% to 15% surrender rate.

Jay Adam Cohen

BofA Merrill Lynch, Research Division

Great. And the development?

Christopher John Swift
Chairman & CEO

Jay, it's Chris. Yes, on the adverse development, I'll add my comments and Doug might have a view. I think you're kind to notice that we've worked hard to getting the balance sheet right and we believe it is right. I would also tell you that I think we have better collaboration amongst the financial reserving actuaries and the business actuaries, Doug and myself, so that our current year picks, at least over the last 2 years, I think we are more confident about those picks. There's more real time data that goes into our planning process and quarterly process. So Doug, I think we feel that the process that we go through is just tighter, more realtime and better data and to give comfort out on those picks.

Douglas G. Elliot
President

Jay, I would totally agree with Chris' comments. We just feel very good about the process and we jumped on issues early. Just we're solid about where we are.

Operator

And our next question comes from Erik Bass from Citigroup.

Erik James Bass
Citigroup Inc, Research Division

I guess now that the legal entity restructuring is complete, can you just provide an update on the statutory capital levels for the different blocks remaining within Talcott?

Christopher John Swift
Chairman & CEO

Erik, what I would say, if you look at our printed results in the supplement for U.S. Life statutory surplus of $7 billion, $1.4 billion of that is HLA. So the remainder $5 billion, $6 billion then would be the 2 Life legal entities that support Talcott. That $5 billion, $6 billion then is before the approximate $275 million loss. So you could think of it on a pro forma basis for that loss, we have $5.3 billion of surplus supporting Talcott runoff and that we have approximately $600 million of that -- on that surplus, that capital is allocated to VA Japan risk that, over time, will -- again an extraordinary dividend and extract, and return to the holding company. So I think, in total, we ought to think about what we have for Talcott runoff is about $4.7 billion of surplus on a pro forma basis, and our Group Benefits company has $1.4 billion of surplus.

Erik James Bass
Citigroup Inc, Research Division

Okay. That's helpful. And can you talk a little bit about the different options you have for additional deleveraging going forward? I believe you've already committed to retiring the maturities in 2014 and 2015, so would you be looking to potentially tender for additional debt, or do you have any securities that become callable?

Christopher John Swift
Chairman & CEO

Yes. I would say, Erik, that our thinking is very early and preliminary, so I wouldn't want to comment beyond that, that we do need to continue to delever. Our goals are geared towards the go-forward businesses and sort of where we need to be to support those businesses going forward and that will continue to require some deleveraging. How we do that, just give us a little bit more time and we'll come back to you.

Operator

And our next question comes from Brian Meredith from UBS.

Brian Robert Meredith
UBS Investment Bank, Research Division

Just a couple of quick ones here. The first one, could I get, in the P&C insurance business, what the new money yield is versus the current book yield in the investment portfolio? Do you have that?

Christopher John Swift
Chairman & CEO

For the P&C business, I don't have it. I think in total that most of the cash flows relate to the new P&C business, Brian, because we put new money to work at about 3.9% and what was rolling off was about 4%.

Brian Robert Meredith
UBS Investment Bank, Research Division

Okay, so not much deterioration in that here going forward.

Christopher John Swift
Chairman & CEO

Correct.

Brian Robert Meredith
UBS Investment Bank, Research Division

Okay, great. And then, Andy, just quickly, you gave us what the non-CAT weather was for the home owners. Do you have that number just for the whole consumer unit? And how does that compare to last year's first quarter?

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

Yes. So all-in personal line, 2.7 points of non-CAT weather, all auto and home combined relative to last year.

Brian Robert Meredith
UBS Investment Bank, Research Division

Relative to last year. That's the increased relative to last year.

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

That's the increased relative to last year, yes.

Brian Robert Meredith
UBS Investment Bank, Research Division

Perfect, that's helpful. And then last one, Doug. I'm just curious, Doug, could you talk about progress being made in the Group Benefits business with respect to voluntary products for the public exchanges that you guys have been working on or just exchanges?

Douglas G. Elliot
President

Absolutely. Good progress to report. We now are out in the market with our critical illness product, feel good about that, and working on that product with several customers as we speak. And I expect as we move toward the latter half of 2014, we'll be also in the market with accident for a 1/1/15 launch as well. So excited that revamped our FLEX disability, out with critical illness and accident to come shortly.

Operator

And our next question comes from Jimmy Bhullar from JPMorgan.

Sabra R. Purtill
Senior Vice President of Investor Relations

Operator? If you can go to the next question and then Jimmy can re-queue if he needs to.

Operator

Our next question comes from Christopher Giovanni from Goldman Sachs.

Christopher Giovanni
Goldman Sachs Group Inc., Research Division

I guess one of the big surprises is also just kind of the pace of buybacks, particularly so far in April. So I wanted to see if you could talk some about how tactical and aggressive you look to be with the current authorization, recognizing you're almost 1/3 of the way through this $2 billion program that doesn't expire until the end of 2015.

Liam E. McGee
Former Chairman

I'll let Chris give some perspective and then I may answer as well. So Chris, go ahead.

Christopher John Swift
Chairman & CEO

Yes. Chris, yes, we're pleased that we're able to do 2 tranches. I think we've said before that we've been operating under a 10b5-1 plan that we put in place for the first and second quarter of late 2013. So we were very opportunistic, our agent was very opportunistic. But our current philosophy really hasn't changed as it relates to the program over the next 6 quarters. We want to be stable, consistent, generally ratable. But we do have opportunities to be opportunistic here in the second quarter remaining in the next 2 months. So generally, we're pleased with what we've done to date and we're going to continue and execute ratably over the next 6 quarters.

Christopher Giovanni
Goldman Sachs Group Inc., Research Division

Okay. And then, for Doug, just a question kind of on the broader markets. So you continue to show significant improvement across really all your commercial businesses as you stayed disciplined on the underwriting. The rate of price change seems to be pretty consistent with what we've seen from your peers, but I wanted to see if you could comment on any maybe incremental changes in terms of carriers looking to get either more aggressive around pricing or terms and conditions?

Douglas G. Elliot
President

Chris, I'm not sure I would add any to what I shared to my opening comments. Again, recently balanced marketplace, from own perspective, very much improved profile of our businesses, small and middle, and we talked about Group Benefits as well. Like the product balance in the marketplace, we'd still be driven by our product analytics. And '15 is a long way out, but feel very good about the start of '14, and we'll jump into the second quarter as we ended the first.

Operator

And our next question comes from Tom Gallagher from Crédit Suisse.

Thomas George Gallagher
Crédit Suisse AG, Research Division

Just had a more of an overall company enterprise risk management question first, and then a specific question on the statutory. But the -- so Chris, I know you mentioned $1 billion of capital as what's been earmarked from this transaction to be freed up. But also just listening to Liam's comments to open the call about the significant risk reduction, I have to imagine that, from an enterprise risk management standpoint, capital buffers would be significantly reduced as a result of this transaction or the need for capital buffers. So is there any contemplation in terms of how we should consider that and, ultimately, how those capital buffers that exist today may come back to the shareholders?

Christopher John Swift
Chairman & CEO

Yes. Tom, it's Chris. I think one point of clarification, what we're saying about the $1 billion, that's the incremental to the capital management plan we announced for '14 and '15. So that is the incremental amount of capital that we will put to work. I think as far as your question regarding capital buffers, capital levels going forward is valid. And we are thinking, really second half of '14 into '15. Now that the legal entity separation work is done, and then I think you know why that was so important to put that out, it put us in a position to run Talcott's 2 remaining legal entities off over a longer period of time with the right targeted runoff capital levels. And we do have the ability to recalibrate that, with Bob Rupp's help, from the risk side. but our guiding principles will always be for Talcott to be self-sufficient in a stress scenario. So with that backdrop, yes, I do think there is some tolerances that we'll look at more closely and change going forward.

Thomas George Gallagher
Crédit Suisse AG, Research Division

Okay. That's helpful. And then just a specific question on how we should think about not necessarily dividendable earnings generated from Talcott U.S. going forward, but I'm more interested in capital generation. And I realized there are restrictions to getting money out today because of negative earned surplus. But I assume the outlook on statutory earnings, all things equal, now that you've folded in White River, or that you're in the process of folding it in, probably looks a little more clean and clear. Can you update on what kind of earnings stream on a stat basis you think that entity can produce over the next couple of years?

Christopher John Swift
Chairman & CEO

Yes. I think about it just sort of total capital generation no matter if it goes through the P&L or directly to equity. So we still think in terms of -- Talcott has about $300 million to $400 million of annual capital generation. I think we got off to a good start, particularly in '14. So a lot of that was front-ended. But even beyond that, I think it's reasonable to project a steady dividend return from Talcott, that will be our philosophy. And it will be tied to excess capital and generating statutory surplus as these blocks run off.

Operator

And our next question comes from Jay Gelb from Barclays.

Jay H. Gelb
Barclays PLC, Research Division

As we work through all the shifts in the balance sheet and earnings from the Japan VA sale, I just want to get a sense of whether you feel the 10% corroborating ROE by 2016 would still be reasonable?

Christopher John Swift
Chairman & CEO

Jay, it's Chris. How to frame that, I think the way we think about it is that the dilutive impact on core earnings of Japan, we think the go-forward business is their growth with our incremental accretive capital management plans can offset that dilution and gives us a good shot at achieving a 10% ROE in '16.

Jay H. Gelb
Barclays PLC, Research Division

That's what I thought. And then for Andy, the personal lines growth is the fastest in many quarters and you are now generating attractive margins from a combined ratio standpoint. I just want to see if there's anything else going on there, sort of underneath the surface, that you feel is driving those better results.

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

Jay, it's Andy. Thanks for the question. Yes, we feel great about our growth and it's absolutely a reflection of the momentum we created in 2013 across all the channels. So I talked about agency channel ease of doing business, so I won't spend any time on that. But don't underestimate the power that, that can have in that channel for agents and CSRs to place more and more business with us. We've grown our AARP Agency appointments almost 12%. We now have 7,200 agent locations out there that are taking advantage of that terrific program. We've also begun rolling out a new class plan for auto that has the effect of expanding our underwriting sweet spot, if so to speak. We traditionally had a strong focus on more mature, older AARP members, and that very methodical and disciplined expansion of that sweet spot is starting to hit the market. So we've got a lot of things sort of hitting at the same time in the agent channel that are contributing to the growth and then just better execution and marketing in our AARP direct channel and class plan implementation there that also serves to open up our underwriting aperture.

Sabra R. Purtill
Senior Vice President of Investor Relations

Lisa, we have time for one more question please.

Operator

Our final question comes from Randy Binner from FBR.

Randolph Binner
FBR Capital Markets & Co., Research Division

So kind of like an older -- more of a forest rather than all the trees kind of question and it goes back to the Japan VA divestiture here. And so, if I kind of put together the expense saves and the looser capital buffers and the potential for debt paydown and buyback, is that going to -- just from an EPS perspective, not necessarily from an ROE perspective, are all of those initiatives -- can we expect all of those initiatives going forward in our model to kind of make up most of that lost EPS, that's $0.40 or so a year that we lose from the VA earnings in Japan? Should we think about those initiatives as being able to kind of backfill that in our models going forward, or do we kind of lose those EPS the way we seem to be for second quarter here?

Christopher John Swift
Chairman & CEO

Randy, 2 points. One, I think implicit in that question, the way we think about it is that net income is going to become more and more important to us as we focus in growing book value per share and ROE. So net income, as you know, over the last couple of years, has been the de minimis or negative sometimes just given the amount of hedging, so I would also have that as a first thought. The second derivative is your core earnings comment then is -- what I was trying to say before is that, yes, I believe that the growth in our go-forward businesses, our efficiency saves, expense saves, the incremental accretive capital management actions, I think we can offset Talcott's Japan's core earnings decline starting in '16.

Randolph Binner
FBR Capital Markets & Co., Research Division

Okay. And just -- that's very helpful. But when you say starting in '16, I'm sorry, wouldn't it start kicking in before that?

Christopher John Swift
Chairman & CEO

Yes. But sort of the crossover point. What I'm saying is that the dilution, the $0.40 that you're talking about, the dilution in earnings, again, I think we could make that up over the next couple of years.

Randolph Binner
FBR Capital Markets & Co., Research Division

Okay, as we work it through over like the next 18 months is kind of...

Christopher John Swift
Chairman & CEO

Yes.

Sabra R. Purtill
Senior Vice President of Investor Relations

Thank you. And thank you, everyone, for joining us today. We certainly appreciate your interest in The Hartford. And Shannon and I are available after the call for any follow-up questions you might have. Thanks, and goodbye.

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